Scottish Affairs Committee

Oral evidence: The Referendum on Separation for Scotland, HC 140-xxiv

Wednesday 14 May 2014

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Written evidence from witnesses:

Watch the meeting

Members present: Mr Ian Davidson (Chair); Mike Crockart; Jim McGovern; Graeme Morrice; Pamela Nash; Sir James Paice; Mr Alan Reid; Lindsay Roy

Questions 5679 - 5738

Witnesses: **The Rt Hon. George Osborne**, MP, Chancellor of the Exchequer, and **Sir Nicholas Macpherson**, Permanent Secretary to the Treasury, gave evidence.

Q5679 Chair: Welcome to this meeting of the Scottish Affairs Committee. As you are aware, we are having a series of meetings about various aspects of the impact of a possible separation on Scotland. It would be helpful if you started by introducing yourself for the record and then, Chancellor, I understand, you want to make a brief statement.

Mr Osborne: Yes. First, thank you very much for inviting me along. I have Nicholas Macpherson, the permanent secretary at the Treasury, alongside me. Could I just make a brief opening statement and then take all your questions?

The decision about whether Scotland leaves the UK is for the people of Scotland. My responsibility is to make sure the Scottish people have all the facts before them as they make that momentous decision. The currency is one of the most important issues in the independence debate. All the evidence suggests that people in Scotland value highly the stability and security of the UK pound, backed by the strength of the Bank of England and taxpayers from across the whole of the UK.

I want the best of both worlds for Scotland and its devolved Parliament. That's why I want Scotland to be able to keep the pound, underpinned by the Bank of England and 30 million UK taxpayers, but the only way this will happen is if we stay together. Those who advocate independence want to break apart the currency arrangements we have now. The nationalists' preferred plan is to replace our UK pound with something very different from what we have now—an unstable, eurozone-style currency union, which wouldn't work at all for Scotland or the UK. It's a plan where Scotland leaves the UK, but the Scottish nationalists still expect taxpayers in the rest of the UK to continue to provide a safety net.

It’s a plan where the nationalists want to be independent but make Scotland’s economic policy dependent on another country, in which it has no longer any say or representation. That’s why it’s a plan that simply doesn’t make sense; and don’t just take my word for it. The Governor of the Bank of England has explained the difficulty of currency unions. Numerous academics, including Alex Salmond’s former adviser, don’t think a currency union would be agreed, and the recent survey by the British Chambers of Commerce showed business opinion is firmly in favour of keeping the UK and not in favour of a currency union.

So to conclude this opening statement, as Chancellor of the Exchequer, it is my obligation to explain that no currency arrangement under independence will be the same as the strength and stability of one UK, with one UK pound. The people of Scotland deserve straight answers to straight questions, and you’ve had straight answers from the Labour shadow Chancellor, from the Liberal Democrat Chief Secretary and from me, the Conservative Chancellor. We have all made it clear that there will not be a currency union if Scotland becomes independent. No ifs, no buts: an independent Scotland would not share the pound with the rest of the UK. We want Scotland to remain in the UK and to keep the pound, and the common-sense position is clear: if it ain’t broke, don’t break it.

Q5680 Chair: Thank you. Could I start by asking about your visit to Edinburgh, when you announced that you and your colleagues would not be willing to share the pound? Do you accept that that was a presentational disaster and that it diverted attention away from the matter of substance and on to the question of process, because it looked as if it was some English Tory coming up to tell us what we could and couldn’t do?

Mr Osborne: No, I don’t accept that. My obligation in this job is to provide people with the facts. This is for the people of Scotland to decide. The people of Scotland have a referendum; they must decide the future for their country. But as Chancellor of the Exchequer, I have an obligation to explain to the people of the whole of the United Kingdom what the consequences would be if the people of Scotland voted for independence and, particularly, given my responsibilities, what the consequences would be for the currency. This was not just a single visit to Scotland; it was on the back of a huge amount of work that had been conducted by the Treasury—by the civil servants in the Treasury—and of course followed on from a whole range of conversations that we had had both in Scotland and across the UK.

The counterfactual is: can you imagine a situation where I was not prepared to say what the situation would be post independence—not prepared to put the facts in front of the Scottish people, wanted to keep that all secret in the Treasury and not go to Scotland and explain those facts? I think that would be totally unacceptable.

Q5681 Chair: Could I ask, then, about the question of negotiations? The Government have said that they are not willing to enter into negotiations or pre-negotiations before the result of the referendum, yet by ruling something out, you have effectively pre-empted what might happen after the referendum. Do you think that’s a reasonable way of approaching this particular issue?

Mr Osborne: I think it is, because it is such a fundamental issue. It's about the currency. It's about the pound; it's about the currency you're paid in, the currency you pay your mortgage in, the currency you have your savings in. It's fundamental to the people of Scotland, and I think they're entitled to know, as they make this hugely important decision, what the consequence is of voting yes to independence.

Having looked at all the evidence, I came to the conclusion—as, indeed, did the senior civil servant in the Treasury—that there were no circumstances in which we could recommend a currency union to the people of the rest of the United Kingdom post independence. That was a view that other political parties—the Labour party and the Liberal Democrats—also came to. It would have been bizarre to pretend to the Scottish people that the question was open when it wasn't. I think that would have been misleading people in advance of a very important decision that they have to make.

Q5682 Chair: You said there that there would be no circumstances in which you would be willing to entertain the question of a joint currency. If the Scottish Government handed you control of everything—tax, spend, tax levels; virtually their entire economy—would you still not be prepared, under any circumstances, to consider a joint currency?

Mr Osborne: Even under that case, which, of course, would be purely hypothetical—and Alex Salmond said the complete reverse: he has said, and John Swinney has said, "We would go on" controlling taxes and the like—even under that hypothetical situation it would clearly not be sustainable. It is not a sustainable state of affairs for two sovereign nations—for one nation to hand over to the other control of all the things you listed. For that reason it would not work either.

These are reasons rooted in the political economy and in the economics of currency unions. It is not just politicians saying this; it is not even independent senior civil servants saying it; it is also the view of the Governor of the Bank of England when he talks about the challenges around creating currency unions. It is the view of a whole range of academics, in Scotland and elsewhere, who have looked at this issue. Alex Salmond's assertion that there can be a currency union is not backed up, really, by any significant number of credible voices. I think that is rather telling, many months into this debate.

Chair: On the question of credible voices—Graeme.

Q5683 Graeme Morrice: Before I ask the question I was going to ask, may I pick up on a point with the Chancellor? You obviously said that if there was an independent Scotland, it would not be able to share the pound with the rest of the UK as part of a formal currency union. How would you respond to the obvious fact that it is Scotland's pound, too?

Mr Osborne: A currency is much more than the pieces of paper that bank notes are printed on or the metal that is stamped to create a coin. What stands behind it is not a building, like the Bank of England; it is an arrangement. It is 30 million UK taxpayers; it is the monetary framework of the UK. That is what makes for a currency. That is what means that the piece of paper in your pocket is worth something and that you can exchange it for goods at the shop. It is because something stands behind it, and that is a set of arrangements. What is very clear from all of the legal advice and the like is that if Scotland chooses to be independent, the rest of the UK—England, Wales and Northern Ireland—are the continuing state of the UK, retaining the central bank and the like. It is not like in a divorce, where you are dividing up the CD collection; this is something very different. This is a fundamental set of arrangements intrinsic to the UK. It is not just a physical asset that would be shared.

Q5684 Graeme Morrice: I am sure that we will touch on sterlingisation later on. How would you respond to the First Minister's accusation—I hope that you will be aware of this—when he referred to you as espousing "bluff, bluster and bullying" in your rejection of a currency union with the rest of the UK in the event of separation?

Mr Osborne: I always think that it is telling when your political opponent— I dare say it occasionally happens here at Westminster—just hurls words and abuse at you and does not actually have a serious argument. You know there is a telling argument when your opponent engages with it, finds holes in it and finds supporting evidence to undermine the case you have made, but there has been absolutely nothing from the nationalists since the speech I gave and since the comments from the Labour shadow Chancellor; there is just the assertion that it is bluff and bluster. I would suggest that Alex Salmond should look in the mirror when he makes those accusations because he is not being straight with the people of Scotland.

We are very clear. Here I am, sitting before a parliamentary Committee, respecting the oath of telling the truth to this Committee, and I am absolutely clear that there will not be a currency union if Scotland votes to become independent—no ifs, no buts. That is not just my position; it is the position of the Labour party and the Liberal Democrats, therefore any combination you can imagine of a British Government in the foreseeable future has ruled this option out. I think it is important that the people of Scotland have that information as they make this incredibly important decision about their country's future.

Q5685 Graeme Morrice: So you would view the First Minister's comments as negative and scaremongering?

Mr Osborne: I will let others make their own interpretation of them. I just think people should examine whether those claims that Alex Salmond makes stand up to any kind of scrutiny, given everything that people have heard from me, from the Labour party, from the Governor of the Bank of England and from a host of independent academics and the like. I think it is important that if you are asking Scotland to make this enormously risky economic leap into independence, you are straight with people about the consequences of that and do not pretend to people that arrangements they currently have, such as the pound, with all the stability and security that provides, are going to remain, because they are not.

Q5686 Graeme Morrice: Chancellor, is it not the case that Alex Salmond is right and everybody else is wrong?

Mr Osborne: Not on this occasion, and not on plenty of other occasions either.

Q5687 Graeme Morrice: You do not think it is important that we have a mature and grown-up conversation on this whole question of Scottish independence?

Mr Osborne: I do. My interpretation of the debate—of course, this is for the Scottish people—is that what the people of Scotland want are facts. They want to know more about the case for independence and the risks associated with independence and they want to know about the benefits of staying in the United Kingdom. I should stress that there are enormous economic benefits for Scotland within the United Kingdom, as evidenced by today's unemployment numbers—unemployment down again in Scotland and jobs up in Scotland. I think people want information and I see that as our task and the task of the Government. Of course we are advocating that Scotland remains in the UK, but the case we have sought to make is one that has been examined by numerous independent people and has not been found wanting.

The thing that has somewhat surprised me—after all, we have been talking about this for a couple of years now—is that you have not really had a credible plan on the currency from Alex Salmond or John Swinney or the nationalists. They have had plenty of time to develop one—after all, they have been planning independence for decades—but they do not have a proposal that stands up to scrutiny. They do not have a plan. He is a man without a plan.

Q5688 Lindsay Roy: Chancellor, talking about scrutiny, John Swinney has said, "A shared currency will mean an independent Scotland having control of tax policy, employment policy, social security policy, oil and gas revenues, immigration policy and a range of other levers to suit our own circumstances." What do you make of that?

Mr Osborne: That is not credible. That is not consistent with any kind of concept of a currency union. I thought, again, Mark Carney did a very good job for us all. He is a Canadian who, if you like, doesn't have a dog in this fight. He has set out for us and made it very clear that the decision is for politicians and elected representatives, but the condition of any kind of successful currency union would be a fiscal union—in other words, that the partner in the fiscal union, particularly the partner that has a very much larger economy, would want a lot of say and control over taxation, spending, borrowing and the like. Again, in his assertion, John Swinney is not being straight with the people of Scotland about the consequences of independence for the people of Scotland.

Q5689 Lindsay Roy: Would you consider this to be bluff and bluster?

Mr Osborne: Again, they have to answer for themselves, but it does not stand up to any kind of credible scrutiny. That is not just my view or that of the Labour shadow Chancellor; it is a view held by the various independent academics who have looked at this. Increasingly, of course, around the world you are also starting to get comments from participants in financial markets, rating agencies and so on, and they are all lining up at the moment to say that this assertion from Messrs Swinney and Salmond does not stand up to scrutiny.

Q5690 Chair: Your answers have certainly had the merit of clarity so far. Do you accept that you have pretty much painted yourself into a corner now, and that in the event that Scotland votes for separation, with a general election only eight months thereafter, you would be pretty well destroyed if you did a somersault on this question? Have you knowingly and deliberately put yourself in that position?

Mr Osborne: Let me be clear: there is no way that we could agree a currency union after independence. I want to make that absolutely clear in advance of the referendum. I want people know that as they go to cast their vote. It will not be possible for us to change our position after the vote.

That all said, I am not the one asking Scotland to take the big risky move to independence. I am not the one who has to explain what would happen afterwards as much as Alex Salmond is, because he and the nationalists are the people who are asking Scotland to take this big, risky decision about their economic future, the prosperity of people in Scotland, the mortgage rates that people pay and the like and the prospects for their jobs. Ultimately it is for him to explain what he has not explained so far: how he could provide economic security and stability and a working currency for this new independent state.

Chair: We have focused on questions of presentation, because, as I am sure you appreciate, that has been running high in Scotland. We want to turn now to the questions of substance that have been masked by the all the spin doctoring and so on.

Q5691 Pamela Nash: Chancellor, in your opening statement you described the Scottish Government's proposal for a currency union as "unstable, eurozone-style". Will you expand on that? It would be helpful if you could explain why, in the event of separation, this settlement would be not only unsuitable and unwanted by the rest of the UK, but unacceptable and not beneficial to an independent Scotland.

Mr Osborne: One of the features of having been Chancellor in recent years is that I have been to a lot of European Finance Ministers meetings, where they have been trying to put together arrangements that will make the euro work better. They have come to a conclusion and are now implementing a banking union, so that, to a degree, they stand behind each other's banks, and a fiscal union, so that they stand behind each other's countries. This is in a currency union with many countries and in which the largest economy—the German economy—is only 30% of the total European economy.

If you had a currency union in the United Kingdom between the remaining UK, which would be about 90% of the economy, and Scotland, which would be about 10%, the remaining part of the UK would demand, as we were discussing earlier, all this control over taxation, interest rates and the like. The country that had just become independent would have to cede all that control and that is just not realistic and will not happen.

Currency unions work only when you have countries coming closer together, but we are talking about a country splitting apart in this case. So why is it not in the interests of the rest of the United Kingdom? Because ultimately you would be asking UK taxpayers to provide a safety net to a separate country, which, by the way, has a very large banking system and a much smaller economy. It would be like sharing the bank account and credit card after a divorce.

I do not think that it would be in the interests of the people of Scotland either, because they would be tying themselves to the economic decisions of another country; the interest rate decisions of a Bank of England that they were not involved with anymore; and the tax and spend decisions of this Parliament, where there would not be Scottish Members of Parliament representing their interests. So I do not think that it is in either the UK's or Scotland's interests.

It is important in this debate to remember that the current arrangements work well for the United Kingdom, including Scotland. Scotland has the opportunity of the best of both worlds: a devolved Parliament and at the same time the security and stability of the UK pound and economic arrangements.

Sir Nicholas Macpherson: Can I just give a small example to back that up? Unlike the Chancellor, I had either the privilege or bad fortune to be in the room when both HBOS and RBS were collapsing in the autumn of 2008. In those circumstances, Governments have to take decisions really quickly. It involves putting at risk huge amounts of taxpayers' money. I simply do not think it would have been possible for Alistair Darling—as it then was—to make the necessary decisions, if he had had to have a side negotiation with the Government of a different country.

I think it was Mervyn King who said that banks are international in life and national in death. If you look at some of the banks in the Benelux areas that did collapse at that time, resolution was very difficult indeed, and almost certainly sub-optimal.

Pamela Nash: The examples you gave are Scottish banks, so the remainder of the UK would not be responsible but, as the Chancellor said, could end up underwriting it.

Q5692 Chair: Before we move on, the UK was prepared to back banks in Ireland and the Irish Government. Why would the UK, without Scotland, not be prepared to bail out Scotland if necessary, when you were prepared to bail out Ireland?

Sir Nicholas Macpherson: I think that is a very different issue. With Ireland, when those Irish banks were collapsing, it was very much an issue for the Irish Government and taxpayer. It ultimately became an issue for European taxpayers. The Chancellor took the decision to lend money to Ireland. That was the right thing to do; Ireland has an important relationship with the UK. But that was very different from dealing with fundamental issues around currency and the banking system.

Mr Osborne: And, of course, the context in Ireland was precisely because they had a very large banking system and a relatively small economy. That caused a huge amount of economic pain for Ireland. They ultimately had to turn to the IMF and the European Union, and to Britain to offer a bilateral loan alongside that, approved by the House of Commons. That is what happens if you have a very large financial sector in a small economy and things go badly wrong. Of course, Ireland was in the euro and was able to call on the eurozone arrangement. That is not something that Alex Salmond—at least publicly—claims as an option.

Q5693 Mike Crockart: But surely if you have a currency union, banking union, monetary union, fiscal union, you would have to stand behind those banks. The banking sector would be a UK-wide—as in UK and separate Scotland—sector, so you would have to stand behind it, surely.

Mr Osborne: Well that, of course, is what a banking union involves. It is hugely controversial on the continent of Europe. There is a very good reason why Britain has not wanted to get involved in a European banking union, so British taxpayers, in Scotland and England and elsewhere, are not standing behind Spanish or Italian banks or anyone else's. That is precisely what a banking union involves.

You would have to be saying to the rest of the United Kingdom, "This country has just become independent. We are now going to form a banking union with this country. It has a very large financial sector relative to its economy. We are now going to stand behind that. You English, Welsh and Northern Irish taxpayers are going to stand behind these Scottish banks." That is one reason why this is not a credible proposition.

Q5694 Mike Crockart: Therefore, the argument is not that there would be complexity involved in making the decision to back those banks; it is that you would not agree to get into that position in the first place.

Mr Osborne: I will ask Sir Nicholas to speak, but the complexity is twofold. One is that you would have to organise in effect an international bail-out. There is no evidence that that is very straightforward or easy to do. Secondly, there is the broader point, which may not be the subject for today's hearing, of the integration of the financial services industry. Let's remember that financial services, as you all well know, are not just about investment bankers in the City of London or even well-paid asset managers in the middle of Edinburgh. It is about hundreds of thousands of people across the UK and many tens of thousands of people across Scotland whose jobs depend on it. They benefit from being part of a UK financial services system and if you create two countries, they are no longer part of that larger UK financial services system. I think that would lead to substantial job losses and relocations out of Scotland.

Let me stress again that I do not want to see any of this. I want to see jobs created in Scotland. I want to see businesses created in Scotland. I want businesses to grow in Scotland and I want people to do well in Scotland. I think that can be achieved within the United Kingdom under the arrangements we have—the best of both worlds.

Q5695 Pamela Nash: Chancellor, I want to return to the speech you made regarding the currency union and there not being one in the future. I have to say that when I was speaking to some constituents, they felt bullied by that. They felt they were getting told by the British Government that they were not getting the pound. I want to give you the chance to be absolutely clear to my constituents and all the people of Scotland who are making this choice. You have been very clear on why it would not be good for the remainder of the UK, but let us just concentrate on why it would not be good for Scotland.

It is clear that the independence campaign, by its very nature, is about giving more powers to Scotland. From what you said earlier, my impression is that Scotland would actually be giving up powers in that scenario, if they were to be an independent country with a currency union. Am I right in that analysis?

Mr Osborne: For your constituents and for the people of Scotland, what they seek is security, stability, and better economic prospects for their family and for their country. Under independence, they would lose a lot of that security and stability. They would lose the pound. The reason that it would not be in Scotland's interest, let alone the rest of the United Kingdom's, to join in sharing the pound is that, having just voted for independence, they then have to give up control of fundamental things like taxation, spending and interest rates to this other country where they do not have you representing them as their local MP in Westminster during the week. Their voice would not be heard here in the place where those decisions would be made.

At the same time, the Scottish economy—which has been a great success over many decades and it is fantastic that it is growing and creating jobs at the moment—has two very large industries. One is financial services and the other is oil. Sitting within a bigger country like the United Kingdom, we can insulate against increases in the oil price or, more to the point, reductions in the oil price. We can absorb banking crises, even one as big as the near failure of the Royal Bank of Scotland. Scotland alone, even in a currency union, would be hugely exposed to one of those things going wrong in the future and have had enough experience in recent years to know that these things are not remote possibilities. They can happen.

The trouble is that the people who would pay the price when this all went wrong would not be Alex Salmond sitting in Edinburgh or us here in Westminster; it would be the people in your constituency who lost their job, saw their mortgage go up, saw their standard of living fall and the prospects for their children blighted. That is not something you want to see and is not something I want to see.

Q5696 Pamela Nash: My last question on this: the response from the Scottish Government—in particular the Deputy First Minister—has been that it is unforeseeable that a continuing UK Government would not allow a currency union, because of the damage it would do to businesses and trade. Would the benefits to businesses on both sides, in Scotland and the rest of the UK, in terms of reducing their costs and uncertainty about a change of currency, override any of the major concerns we have spoken about today?

Mr Osborne: There has been a very interesting survey from the British Chambers of Commerce in the last couple of weeks. The survey, which was conducted among businesses across the UK, showed a strong desire among businesses in England, Wales and Northern Ireland for Scotland to remain in the United Kingdom, but it was equally clear that, if Scotland chose to be independent, those businesses did not want to share the pound. The assertion from Nicola Sturgeon and others that, overall, businesses want a currency union is not backed up even by the most recent survey of businesses in the rest of the UK. They understand that this is about much more than the cost of changing currency when people cross an international border. After all, if we wanted to get rid of those costs, we would have joined the euro or the dollar—we do a huge amount of trade with America. We do not do that because we want to keep control of our own economic policy. Businesses understand that, and I think people across the country understand it, too. That is why sharing the pound is not going to happen.

Q5697 Mike Crockart: You have made your position very clear here today, and you made it very clear in your recent speech, but the First Minister's response was to say that his fiscal commission working group's detailed analysis addressed your criticisms of the proposed sterling zone. How would you respond to that?

Mr Osborne: That is not my interpretation of what they did. Indeed, some of the people who advised Alex Salmond, such as John Kay, have pointed out all the problems with trying to deliver the currency union that the nationalists talk about. He came to the conclusion that, in practice, it is almost impossible to see how it could be concluded. I do not see any convincing evidence from the commission on that, or indeed on other issues.

The one revealing thing from the commission, and indeed from the White Paper—this is fundamental; it is a key part of Sir Nicholas' published advice—is that the nationalists go out of their way to say that the proposed sharing of the pound does not have to be a permanent arrangement and that, in future, Scotland could choose to have a different arrangement. As we know from our difficult experience as a country during ERM, the moment that people sense that you could come out of a currency arrangement they force you to do so. Imagine if, in 2012—Sir Nicholas alluded to this—the Greek Government had said, "We might, if push comes to shove, readopt the drachma." That would have happened within hours because the markets would have forced it to happen.

Another compelling reason why this currency union that the First Minister proposes is not a credible proposition is because he himself says that it is not necessarily a permanent arrangement. Why, then, would another country, a larger neighbouring country, want to enter into this arrangement, which by their own admission is not necessarily permanent?

Q5698 Mike Crockart: I accept your point, but it is slightly to one side of the main argument, which is about what is the best choice for Scotland and the rest of the UK. Speaking just days after your speech, Alex Salmond said: "the Chancellor seemed totally unaware of the amount of work and analysis that has been devoted to this question and the strength of the commission who carried it out." He is effectively saying, "I have independent experts, too. Perhaps my independent experts are better than your independent experts." How do we get to a point where we can actually look at the facts and say what is best for the UK and best for Scotland?

Mr Osborne: Maybe I'll ask Sir Nicholas to say something about that.

Sir Nicholas Macpherson: For very good reasons, the Treasury has acquired very deep and serious skills and knowledge on currency unions. We went through this massive exercise in 2003 with the five tests on the euro. As it happens, our analysis has been completely vindicated. The eurozone did enter serious difficulties as a result of the banking crisis. We did not spot all of the precise transmission mechanisms, but there is deep expertise. We brought the same sort of approach to bear on this issue. We published two very lengthy, quite technical papers on the subject. What is interesting, and I was surprised by this myself, is that the more we looked at this, the greater became our conviction that the risks were very great indeed. I know there have been impressive people on the fiscal commission, and so on, but the analysis that they have published I do not find terribly convincing or reassuring.

Q5699 Mike Crockart: So are there any plans to do analysis of what they have proposed line by line and point out what they have missed? That is basically what you are saying. They have not picked up on everything that you have picked up on.

Sir Nicholas Macpherson: We did try very hard. We published this document called "Assessment of a sterling currency union", which was, in effect, an assessment of their plan A, and we concluded that this had very grave risks for the UK as a whole but most importantly for Scotland.

Q5700 Sir James Paice: Chancellor, you were very specific in your opening remarks that this debate has been about a "currency union". In order to put this into language that the ordinary person will understand—to put it into something that means something to them—can we be a little clearer about the definition of a currency union? There has also been talk about a fiscal pact from Scotland to go alongside a currency union. You referred earlier in the European context to banking unions, and then there are fiscal unions. Could you put into language that people will understand what the distinction is between all those, and what the different options would therefore actually mean for the people on the ground, and thus why you believe that all of those are wrong?

Mr Osborne: A currency union is the agreement to share a currency. We might come on to talk about what happens if there is no agreement to share a currency, but it is a formal agreement to share a currency. As the Governor of the Bank of England pointed out in his speech in Scotland, that only works—it is only a durable currency union—if other conditions are met. The two he particularly identified were the banking union and a fiscal union. What do they mean more plainly? The first thing, the banking union, means that you stand behind each other's banks when they get into trouble, and you also stand behind each other's depositors, so that if a bank fails, you have got your money in your bank account and you can get that money back. We offer a guarantee that people can get a portion of their money back from that situation. So you would have to find yourself in a situation where, again, English or Welsh taxpayers would be promising to give Scottish taxpayers—this is in a separate country, in this scenario—their money out of their bank account from the local bank down the high street in Edinburgh, Aberdeen or wherever, and that is the nature of a banking union. That is why, as I explained, I do not really understand why any English, Welsh or Northern Irish taxpayer would want to agree to that; I do not think that they would.

The second thing you need is a fiscal union. You need to make sure that this other country that you are sharing a currency with is not spending wildly out of control, borrowing too much, running up all the risks and the like. Again, that is why you would have control over the budgets that they set, the taxes that they set and the spending that they set. It is very interesting to see this with the euro. I sit around the table with other Finance Ministers, and when I present a Budget to you in Parliament, that has been agreed by the Cabinet and then I present it to Parliament. In these euro nations now, they have to send their Budget in advance to Brussels and get it ticked off before they can present it in the French National Assembly or the German Bundestag or wherever. That is what is required. In a currency union between Scotland and the rest of the UK, there would have to be very tight control over taxation and spending in Scotland. That would be the fiscal union. Inevitably, and this is not an arrangement I support, it would be quite one-sided as well, because the rest of the UK—England, Wales and Northern Ireland—would be 90% of this joint economy and Scotland would be only 10%, so one side would have a lot more say than the other side. I do not think the people of Scotland would regard that as fair. So that is what a fiscal union means. It means that some other country decides how much tax you pay and how much gets spent on your local hospitals, police and schools, and it also decides whether to pay you out if the bank that you have your life savings in collapses. That is the reality of it.

Q5701 Sir James Paice: In pursuing their idea of a currency union, the Scottish Government have referred on occasion to the prospect of having a fiscal pact alongside it, by which we understand they mean an agreement about setting certain fiscal criteria, which would stabilise the currency and address some of those issues. What is your view on that?

Mr Osborne: The first thing I would say is that—you are rightly asking me all these questions about the nationalists' plan and what happens if there is independence—we have good arrangements. It is the best of both worlds where the Scottish people make devolved decisions about their health service, the police and the like, but they do so within a UK economic framework and they have the security and stability of the pound. A fiscal pact is a sort of treaty between two countries that they are going to keep their deficit and their debt under control. Of course, it did not work very well in the euro. This was what fell apart, actually, over the years leading up to the financial crisis.

At the moment, there is absolutely no evidence of fiscal responsibility from the nationalists. They have a whole set of uncosted spending pledges and independent views, including independent views from think-tanks in Scotland, such as the Centre for Public Policy for Regions, which pointed out that we would have very different deficits in the rest of the UK compared to Scotland in the year in which independence will be due to take place. Far from doing what they can to reassure the rest of the UK that they would have a grip on their public finances and be tough and responsible with people's money, they are actually heading in a completely different direction.

Within the next few weeks, as part of the analysis programme, the Treasury is going to publish further evidence on some of the fiscal implications of independence, and, above all, the fiscal benefits of being part of the United Kingdom—the real benefits that that brings to people in Scotland, like in the rest of the UK.

Sir Nicholas Macpherson: Can I just add a point there? The really important point that Mark Carney made, drawing on his experience of the Canadian federation, is that it is not enough just to have a pact. You also have to have very big cross-border transfers effectively to stabilise the wider economy. Carney was talking in terms of 25% of GDP as the sort of cross-border public spending you need, and there is absolutely no—

Q5702 Sir James Paice: Sorry, can you put that into language that—God help us—our readers who follow these proceedings might recognise?

Sir Nicholas Macpherson: The point of the Governor was that supposing—I don't know—Vancouver went into a deep recession, you needed payments coming out of Ottawa, primarily social security or other interventions, that would help stabilise the economy. That happens in the United Kingdom at present. If there is a downturn in the oil industry that affects the Aberdeen economy, there would be quite big transfer payments through the Department for Work and Pensions to that local economy. In the case of independence, those transfer payments simply would not happen unless you constructed an extraordinary central fund, but that is just not in anybody's proposals, and I am quite certain the rest of the UK would not agree to it.

Q5703 Sir James Paice: So really, none of that could happen without political union, which of course is what we have got already, in a nutshell.

Mr Osborne: Of course, the irony of this whole proposal for the nationalists is that they are saying Scotland can be independent while giving up some of the devolved control that they currently have in Holyrood. That is why it is not a credible proposition. Vote for independence and then hand over control of all your tax and spending decisions and interest rates to England, Wales and Northern Ireland and don't send any MPs to Westminster and don't have any representation in the Government. That is another reason why it is not a credible proposition.

Q5704 Sir James Paice: May I put one final point to you really just for confirmation, but I think it needs to be made clear publicly? In the event that Scotland chooses to go for separation, the Bank of England, which is effectively the central bank of the UK, would remain purely the central bank of the remaining UK and therefore accountable, through you, effectively to the UK Parliament. Whatever sort of union there could be, setting aside your strong views, whatever sort of currency or monetary-type union or even fiscal union that is conceivable, you would still have Scotland economically answering to a central bank that was the bank of another country.

Mr Osborne: If this arrangement were to come about—

Sir James Paice: Yes.

Mr Osborne: An important factor was established quite early in the debate. In the event of independence there are not two completely new states. There is one new state—Scotland—and then there is the remaining United Kingdom. That is the legal position. That is what has happened all over the world when you have seen states break up. Often it has not been a happy occurrence. Based on international law, the rest of the UK is the continuing United Kingdom. It retains its membership of the European Union, its membership of NATO and the like. It also has its central bank. The central bank is the UK central bank and the UK remains, albeit without Scotland and, by the way, I personally feel is very diminished as a result because it would not have Scotland as part of it. This comes back to the point that there is a very positive story to tell here about Scotland benefiting not just this month or next month but over many decades from being part of a much larger economy actually doing better in that economy than some parts of England. Scottish companies and the investment that Scotland attracts is all evidence that the arrangements can work well for Scotland. As I say, they have the best of both worlds.

Q5705 Jim McGovern: I want to refer to something Mr Macpherson said when he ironically used Aberdeen as an example. If some sort of financial crisis happened the UK could bail out Aberdeen. The separatists' argument usually is that Aberdeen is bailing out the UK in terms of the oil industry. Does that argument stand scrutiny?

Sir Nicholas Macpherson: I don't think it does. Don't get me wrong. I think Aberdeen is an extraordinarily successful part of the UK and makes a big contribution. The point I would make is that when it comes to fiscal matters, one of the issues that informed my advice to the Chancellor is that Scotland on its own would face bigger fiscal risks. It would be more dependent on both the oil and financial sectors, compared to the UK average. That would expose it to greater risk. As it happens, in the recent period oil revenues have been substantially lower than have been forecast. That has happened year after year after year. It has been a great disappointment to the Treasury. I would have loved those revenues to be coming in. One of my worries is that the Scottish Government are relying on very optimistic projections, which allow them to make this argument that somehow Scotland's fiscal position is stronger than that of the rest of the UK, but they are wrong.

Another good reform introduced by the Chancellor, incidentally, is the fact that the Treasury no longer forecasts our revenues; an independent Office for Budget Responsibility does. Those independent projections have resulted in substantial downward revisions. Now, as part of the UK, none of this matters too much—it all washes through—and because there is an economic and political union, life goes on. It is very striking this morning that both Scottish employment and unemployment data are very good, and that reflects how you would expect a successful economy to work, and Scotland is a very successful economy. But if you go it alone, you expose yourself to greater risk, and that is compatible with our analysis. As the Chancellor says, we are going to publish more analysis in the near future.

Q5706 Jim McGovern: So in a nutshell, basing a national economy on something as volatile as the price of oil is not really feasible.

Sir Nicholas Macpherson: Personally, I would not recommend it, because oil prices go down as well as up. It has been a huge asset and has been of great benefit to the Scottish and the British economy, but especially at the point where production is on a different trajectory, you are taking a risk.

Q5707 Lindsay Roy: Sir Nicholas, can you tell us why your advice to the Chancellor about the common currency agreement was publicly released, and by whom?

Sir Nicholas Macpherson: It was released by me. I mean, I discussed it with the Chancellor, but it was my decision to publish it. I recognise, in doing that, that these were very exceptional circumstances. I thought that it was the right thing to do; I still think it was the right thing to do. Why was that? Because it was really important that the position of the British Government was absolutely crystal clear. It was no point this coming out after the referendum; it had to come out before the referendum.

Others on the Committee referred to bluster and bluff. It seemed to me of critical importance that no one was in any doubt of the Treasury's position, by which I mean the political and the official Treasury, and the fact that there was complete alignment. I am happy to make it absolutely clear that no pressure was put on me by the Chancellor of the Exchequer to publish anything—

Q5708 Lindsay Roy: You would say that anyway.

Sir Nicholas Macpherson: No, I would not say that anyway actually. I have worked with a number of Chancellors of the Exchequer, and—

Mr Osborne: He outlasts us all.

Sir Nicholas Macpherson: I have free and frank discussions with them on a range of issues—fortunately, I am still there—but if I thought it was the wrong thing to do, to publish it, I simply would not have done so. I think that we have a relationship that works, I am pleased to say, and this was very much my idea and the right thing to do.

Q5709 Lindsay Roy: Some people have argued that this was a contravention of the civil service code, but you are saying that there are exceptional circumstances—

Sir Nicholas Macpherson: I think there are exceptional circumstances—

Lindsay Roy: Can you tell us, for the record, what the exceptional circumstances are? What was the substance of the advice you gave?

Sir Nicholas Macpherson: The special circumstances relate to the Treasury's special responsibility for the currency. If any institution ultimately has to defend or explain what the plan for the pound sterling is, it is the Treasury.

I also have wider responsibilities as accounting officer, whereby one of my responsibilities is to ensure that the UK state can borrow as cheaply as possible. If I sat there and said nothing, in my view there was a risk that the cost of borrowing would increase, because of the lack of clarity on what the Treasury and the British Government intended. Under those circumstances, my responsibilities as an accounting officer are clear. Similarly, if the Chancellor asked me to do something that was flagrantly bad value for money, which I am sure he would not, I would ask for an accounting officer direction from him. The convention is that the exchange of letters would then be published. This is not without precedent and those who are arguing that I have somehow grossly abused my position are wrong.

Q5710 Lindsay Roy: There was also mention in your statement of debt. Why was that important to highlight?

Sir Nicholas Macpherson: Like it or not—I do not particularly like it—this country still has a lot of debt. We are trying to do something about it. We have got something like £1,000 billion of debt out there. It does not require very big changes in interest rates for the costs of servicing that debt to really start eating into the available resources for other public spending programmes. I have a huge interest in trying to do everything I can and in the British state doing everything it can to keep the cost of servicing that debt as low as possible.

Q5711 Lindsay Roy: Was there not some mention of the possibility of Scotland defaulting on national debt in your statement?

Sir Nicholas Macpherson: There was. I mentioned it because the Scottish Government made it clear, in setting out this vision of tit for tat, that if the British Government did not agree to currency union, they would renege on the debt. I think that that would be incredibly damaging for a newly independent state, were that to happen. I am British and I serve the British Government. If Scotland left the Union, I would be left serving the rest of the UK. In those circumstances, I would have a duty to try to ensure that the cost of borrowing remains as cheap as possible and is, in a sense, insulated from the wider turbulence that would be created by a country defaulting on its debt. An investment bank—I think it was Jefferies—suggested that were Scotland to default on its debt, that could add anything up to 5% on to the interest rate, which is 500 basis points on to the cost of borrowing in Scotland. This is big stuff and has huge implications. It is not just some sort of game that we play in the Treasury. It affects every citizen in this country.

Q5712 Lindsay Roy: Are there any other exceptional circumstances in relation to the economy that you feel you might have to advise the Chancellor on in the near future?

Sir Nicholas Macpherson: I am a traditionalist as a civil servant. I do not court publicity. I have been doing my job for nine years, and unlike some of my colleagues, I do not go and give interviews with the media. I have no media profile and I have no interest in going out and getting attention, which would be a recipe for disaster for a civil servant. In those nine years, I have not encountered any issue other than this where I want to go out and publish my advice. In my view, this issue is exceptional and goes right to the heart of the credibility of the pound, so I felt I had to do it.

Q5713 Lindsay Roy: So there is nothing at the core of the currency economy argument that gives you further concern and on which you would give the Chancellor further advice. That is what I am asking.

Sir Nicholas Macpherson: As I say, I have worked for Gordon Brown, Alistair Darling and George Osborne. I have not encountered any other issue—

Q5714 Lindsay Roy: I am asking in relation to the referendum and the next three or four months. Are there things that are causing you concern?

Sir Nicholas Macpherson: I would hope not, because I do not particularly like having to go out and become—I am a faceless bureaucrat. My comfort zone is not having my name appear in newspapers. You never know, but the currency thing was the fundamental issue.

Q5715 Lindsay Roy: Do you think you have strengthened the credibility of the Government's position?

Sir Nicholas Macpherson: I think I have. By publishing my advice, I demonstrated that this was not just some political whim or political manoeuvring. The Treasury, which is a thousand-year-old institution, stood fully behind the Chancellor of the Exchequer in saying that you couldn't put the proverbial cigarette paper between the official machine and the politicians.

Q5716 Pamela Nash: You just touched on the Scottish Government's promise of reneging on their debt if their expectations in negotiations were not met. Can you be absolutely clear to Scottish people what impact that would have on their individual lives if a newly independent Scotland were to renege on the debt?

Sir Nicholas Macpherson: The experience of countries that renege on their debt—Argentina always comes to mind in these circumstances—is not a happy one. If you renege, then the markets don't trust you, and if they don't trust you, they basically demand a higher interest rate on the debt you sell.

As I mentioned, Jeffries investment bank has said that this could result in anything up to a 500-basis point increase in interest rates. To give an example, if that fed fully through into mortgage rates and, say, you were paying a 3% mortgage rate, you would be paying an 8% mortgage rate. That is quite a big step to take, and it is quite a big risk.

Q5717 Chair: Can I just be clear, again for the people in Scotland? If they have their mortgages with companies, say, based in England, in the event of separation, surely their mortgages would not go up, because the mortgage would have been arranged through someone based in, say, London?

Sir Nicholas Macpherson: Generally, you don't get cross-border mortgages. This is all speculation about something that has not happened. Just as if I borrow from Santander, which is a Spanish bank, the interest rate I pay is not determined in Spain, but by the markets in London. There could be transitional issues, but once the system settled down, if you were based in an independent Scotland and you had a mortgage, the rate you would pay would be determined by Scottish conditions. The thing that determines interest rates more than anything else—even more than the Bank of England's base rate—is the rate at which the sovereign borrows that; that tends to underpin the markets. I would say that that is what would happen.

Q5718 Chair: People in Scotland who wanted to minimise risk would be well advised then to borrow for their mortgages from enterprises based in England, Wales or Northern Ireland. My mortgage used to be from the departed Halifax, which presumably was based in Halifax. In those circumstances, presumably, if the Scottish interest rate for mortgages went up, my mortgage would have been based on the rate in Halifax.

Sir Nicholas Macpherson: That works because you are within a fully integrated country with economic, monetary and political union. If Scotland were to become independent, a whole lot of risks would arise immediately. The first is a currency risk: on day one, you would have a large sterling liability—assuming your mortgage is large—and that would have to be serviced. We simply do not know where Scotland's monetary arrangements are going to end up, because the one thing we know is not going to happen is that there is going to be a monetary union with the rest of the UK. That carries risks.

Mr Osborne: The way to minimise the risk is, as you put it, Mr Davidson, to make sure that Scotland remains in the United Kingdom.

Q5719 Pamela Nash: The mortgages are a big enough risk on their own. Are there any other risks that would come out of a country reneging on its debts, for individuals?

Mr Osborne: For individuals, the calculations that have been done are that, for the average mortgage in Scotland, there would be £5,400 more in mortgage payments a year. That would mean some people could not afford those mortgage payments. It would squeeze the incomes of Scottish families. Scottish businesses would have to pay more to borrow money, so the extension that a business wanted to make to take on some more people would not be affordable; or, indeed, the loan they need to stay in business would not be affordable.

So having much higher interest rates costs you jobs and costs you higher mortgage fees, if that is driven by not the Bank of England taking a decision about the appropriate rate of interest for the current demand in the economy, but rather driven by the fact that you have not got any credibility out there in the international community. If Scotland's first act as an independent state were to have a huge credit default I think the rest of the world, which anyway would be asking some questions of this independent state, and probably asking it to pay more to borrow, would ask it to pay a lot more to borrow. What that means in practice is Scottish families, Scottish businesses, paying a lot more to borrow. That potentially means homes being lost, businesses closing and jobs being lost.

Q5720 Mr Reid: For this particular debt, the Scottish Government would not be defaulting on a debt that it had itself taken out. My understanding is that the UK Government has assured people who are lending it money that the UK Government will be responsible for paying all this money back. The debt would be that the Scottish Government would then owe money to the continuing UK Government. Do you think that the fact that this was not a debt that the Scottish Government itself had undertaken would make any difference to the view of the money markets on paying back future debt?

Mr Osborne: Maybe I will say something, and then Nicholas. The first thing is we stepped in earlier this year because people around the world were asking us, "What's going to happen to this debt you are writing at the moment, what is going to happen to these gilts you are issuing, should Scotland become independent?" We made it clear that, as we always have done in this country over centuries and in some of the most stressful situations of war, we stand behind our debt. We have an almost unparalleled record in the history of the world of honouring our debts as a nation, and we all benefit from that. It is one of the great advantages of being in the UK's economic arrangements. We said that. Actually, it was reassuring to the market. I think it proves, by the way, the strength of the UK's credibility—that we can make an assertion that we could do this and it is believed, and rightly so.

What everyone would see in the situation where Scotland voted to become independent and Scotland was refusing to take any of its share of the national debt is that this would be a hostile separation by Scotland, that the amicable discussions would not take place and Scotland would pay a very heavy price. I think most of the rest of the world would see that Scotland had defaulted on its obligations to this other country, the United Kingdom, and it would pay a price for that.

This is, again, not an assertion by me as the Chancellor. It is not an assertion by the permanent secretary to the Treasury. This is a view taken by the people around the world who lend the UK money and assess the credibility of the UK. In the end those are the people who would have to be convinced to lend Scotland money in this situation.

Q5721 Mr Reid: But have you done any analysis, or are there any forecasts out there that would suggest what Scotland's annual budget deficit would be if it did not have interest payments to make? If those figures are available, would it be a better deal for Scotland to pay higher interest rates for future borrowing? Would it save money by doing that because it would not have to pay back existing debt?

Mr Osborne: We are happy to look at doing that analysis. I think it is something we could undertake. We have tended to point to third-party endorsements, such as that of Jefferies bank. I am certainly happy to look at that. I think it is pretty clear from almost everyone who has looked at this and commented on it that Scotland would be in a very much worse position if it had defaulted on its debts with its neighbour. That is why I do not think Alex Salmond is really making a credible threat. He knows this, and although he says that, I think in this case it is bluff and bluster. If it is not bluff and bluster, it is very dangerous for the Scottish economy.

Q5722 Lindsay Roy: What would you say to the First Minister, who might say to us, “The Scottish Affairs Committee has let the Chancellor scaremonger and talk Scotland down”?

Mr Osborne: I would reject that. As I understand it, there is always an opportunity for a nationalist to sit on this Committee and ask me questions, but they have chosen not to do so today. As I said, this is for the people of Scotland to decide, and I hugely respect that. I am part of the Government that have offered this referendum, and part of a Parliament that voted, as you said, to make it happen. I am not Scottish; it is for the people of Scotland to make this decision, but as the Chancellor of the Exchequer, I have an obligation to put the facts in front of the people of Scotland as they make this decision, and the fact is—no ifs, no buts—that Scotland will not be able to share the pound if it votes to become independent. It is therefore incumbent on those who want Scotland to become independent and who want to take this great economic risk to spell out what their plan is. I have heard no plan.

Q5723 Jim McGovern: Sterlingisation is a term we have heard comparatively recently; originally, it was dollarisation, referring, I think, to Panama. Alex Salmond and the Scottish Government have said that Scotland could go ahead and use the pound after independence without any currency union. I know that you have touched on that, but is it feasible?

Mr Osborne: I don’t think it is feasible. Frankly, I think it is a bit of a red herring—

Q5724 Jim McGovern: But legally, are they right?

Mr Osborne: Well, there is nothing to stop people in, say, France using the pound if they wanted to—if they managed to get hold of the notes and the coins—but it is not a sustainable arrangement; it is not something that could last for any period of time. A couple of countries in the world have tried it, including Panama, which has had more IMF bailouts than virtually any other country in the world, and even Panama has to issue its own coins because it runs out of US coins—it uses the dollar and runs out of US coins, so it has to issue its own Panama coins to make good the physical absence of the coins. Montenegro is another example, and it has had bouts of hyperinflation.

With the greatest of respect to Panama and Montenegro, Scotland is not Panama or Montenegro. Scotland is a much bigger economy, a much richer economy and a much more sophisticated economy; there are many great businesses in Scotland. The idea that Scotland could adopt the Panama or Montenegro approach is just not credible. It would not last, it would be pretty disastrous for Scotland even to try that, and frankly I do not think that it would. As I said at the beginning of my answer, it is a bit of a red herring, and I think it is the nationalists trying to muddy the water by saying, “Oh, don’t worry, you’d still have the pound under whatever arrangement.” I do not think they are being straight with people. They could not share the pound—that has been made abundantly clear by all the British parties that could form the British Government. Using the pound without the consent of the rest of the UK would not work; it is not sustainable. It is the Panama option and Scotland is much better than that.

It is for Alex Salmond, John Swinney and others to explain their plan for the currency. What are the people of Scotland going to be paid in? What is their mortgage going to be in? What are their savings going to be in? What is the currency that this newly independent country is going to use if they listen to them and vote for independence? As a citizen of the United Kingdom, as someone born in England, I passionately hope that Scotland does not choose that. We are all better together. I think that England benefits enormously from having Scotland in the UK and Scotland benefits from being in the UK, but this is a decision for the people of Scotland, and I have a huge amount of respect for that.

Q5725 Jim McGovern: Perhaps I should make it crystal clear that I am not comparing Scotland to Montenegro or Panama; I am just making a comparison in relation to the principle of the currency situation. If Scotland decided to use the pound outside of a currency union, have you any idea what the implications might be for the rest of the UK?

Mr Osborne: We would have some of the challenges that the US Treasury has of people using dollars, but I think the real challenges would be for Scotland, frankly. It is interesting. We were talking about the nationalists' Fiscal Commission, and Nicholas has reminded me what the Fiscal Commission said about this: "International evidence suggests that informal monetary unions tend to be adopted by transition economies or small territories with a special relationship with a larger trading partner—like the Isle of Man. Advanced economies of a significant scale tend not to operate such a monetary framework. Though an option in the short-term, it is not likely to be a long-term solution." Even the nationalists' Fiscal Commission, no doubt trying to choose their words in a way that might be more helpful than not, has said it is not a long-term option, so I think it is a bit of red herring in this debate.

The proposal from the nationalists is to share the pound. I hope I have made it clear today—Ed Balls, the shadow Chancellor, has made it clear, as has Danny Alexander, the Liberal Democrat Chief Secretary—that that is not an option. That is also the view of the official Treasury and it is the view of the international observers of the UK economy. Therefore, it is up to Alex Salmond to propose something else. What is his other currency that he is going to use in Scotland, because it will not be the pound?

Q5726 Jim McGovern: Would there be implications, detrimental or otherwise, for the rest of the UK if Scotland said, "We will continue to use the pound"?

Sir Nicholas Macpherson: It is a matter for Scotland—they would be a sovereign state under those circumstances—just as it is a matter for Panama. I do not think it would have direct implications for the rest of the UK. Obviously, under those circumstances, you want the system to work, but what is striking about countries such as those is that it is a unilateral decision, which is then implemented unilaterally, and it has very big constraints. It has quite big implications for the Scottish banks in terms of holding—

Mr Osborne: Sorry to interrupt, but it is inconceivable that you could have a financial sector that is anything like the size and sophistications of Scotland's, employing tens of thousands of people, when you are literally having to grab pound notes and pound coins as they come across the border and try and hold on to them. It is not a sustainable situation. I honestly do not think it is actually a serious option. I think it is put into this debate, in a way, to try and muddy the waters by saying, "Well, even if they do not agree to a currency union, we could still use the pound." Although there are these examples like Montenegro and Panama, it is just not remotely practical and it would mean a very different Scottish economy and a Scotland that is very much poorer than it is today.

Q5727 Sir James Paice: This is a very brief question, Chancellor, and in light of everything that you have said, it is, of course, entirely academic, but in the event that some Chancellor was prepared to agree to a monetary union, do you think that is a matter that should be put before the people of the rest of the United Kingdom—to share a currency with Scotland?

Mr Osborne: That really is a hypothetical question, because this is not just my position; it is the position of the British Government and the position of the three principal parties here at Westminster—the Labour party, the Liberal Democrats and the Conservatives—and you would only ever put something to the British people in a referendum like this if you were recommending it. I made a point of saying in my speech, and it has been echoed by comments from people who have done my job before me, both Labour and Conservative, that no Chancellor could recommend this. So I do not think the question really arises, because as I say, I cannot imagine those circumstances. I do not think there could be any circumstances where, on the evidence you have heard today, a Chancellor would recommend it to the Cabinet and the Cabinet would agree that we would enter a monetary union and share the pound with Scotland.

Q5728 Chair: That was pretty explicit. Am I right in thinking that you have left yourself absolutely no wriggle room whatsoever on this question?

Mr Osborne: I have left myself no wriggle room, but that is because I passionately believe this to be in the interests of the United Kingdom. I fervently hope that I am not a Chancellor having to make decisions for just England, Wales and Northern Ireland. I want this country to stay together; I think we are better together and as I say, all the risks we have talked about today—all the risks to people's mortgages and jobs, to Scottish business and the like—do not exist if we stay together. That is something that I—

Chair: We expect a vote at 3, so let's try to pull things together before then.

Q5729 Pamela Nash: On sterlingisation, I know you gave quite a lengthy answer there, but I still think the man in the street might be a bit confused as to why exactly it is not feasible and what sterlingisation would look like in an independent Scotland, which would mean it would crash. Is there any way you could put that into layperson's terms?

Mr Osborne: What it means is you do not have your own currency; you have another country's currency. You are not printing or distributing bank notes, or making coins—

Q5730 Pamela Nash: And that would be the case even though Scotland, as we all know, prints its own notes?

Mr Osborne: But they wouldn't exist any more.

Q5731 Chair: Sorry—can I just be clear? Under sterlingisation, Scottish banks would not be able to print their own notes any more?

Mr Osborne: Because Scottish banks print their notes with the support and the authority of the Bank of England and Parliament, which has passed legislation during our time in Parliament to support this and will continue to support this. So you would wait for coins and notes to come across the border, either people bringing them or through transfers of money electronically, because there has been a business deal or something like that, and then you want to try to hold that money in the country, or at least make sure you have not run out of it, which means you always have to run a balance of payments surplus with your neighbour.

While it was perfectly right for us to do a huge amount of work on the Scottish Government's proposal of a currency union—obviously we have currency unions such as the euro, and we should interrogate that and we have done—I do think the sterlingisation option is not actually credible in any sense of the word.

Sir Nicholas Macpherson: Just to be clear, what would happen with sterlingisation is that the banks would have to have—I think they could actually publish if they had the backing—

Mr Osborne: They would actually have to have the money in the bank—

Sir Nicholas Macpherson: It is a bit like the gold standard. In principle, under the gold standard you could go along to the Bank of England and ask for some gold. Under sterlingisation, it would be very important to demonstrate that the banks had—

Mr Osborne: For every £1 that the Royal Bank of Scotland issued as a bank note, it would be like a kind of IOU against the pounds that it had kept in its bank vault. That is not how they issue bank notes today; it is a very different arrangement. They issue bank notes backed up by the Bank of England. This would be a bit like issuing IOU notes off the pounds that it would have to keep on its balance sheet.

Sir Nicholas Macpherson: At the risk of muddying the waters, the next step up from sort of pure Panamanian dollarisation is the so-called currency board arrangement, which you have in places such as Hong Kong. The reason why Hong Kong has managed to maintain its link to the US dollar is that it has built up very large surpluses; the banks have very strong reserves. This would require very different economic policies. You would have to be running large surpluses just to underpin the system.

Mr Osborne: But they have their own currency, of course. The way to run a currency board is that you have to issue your own Hong Kong dollars.

Q5732 Lindsay Roy: Sir Nicholas, that leads us to plan C—a separate currency. Have you any information or insight into how long it would take to set up a separate currency and set up a central bank?

Sir Nicholas Macpherson: We have got the experience of the euro, although the euro was planned. Going back to the original Maastricht treaty, which I think was in 1991 or 1992, it took a long time before you got the whole notes and coins. That took until 2001, so it took nine years.

If you are going to do these things properly, it is best to plan them. Countries which have broken up have often had to act very quickly—I think we have occasionally mentioned the union of Czechoslovakia, which tried to maintain a currency union; that lasted 30-odd days. In those circumstances, you are in a very messy period. When the currency union breaks down, people often stamp the notes. In Scotland, although primarily Scottish banknotes circulate, there are a lot of English banknotes, so very early on you would have to take steps. It will be messy, but it can be done, because these things happen.

Q5733 Lindsay Roy: What would be the advantages and disadvantages of setting up a separate currency for Scotland?

Sir Nicholas Macpherson: We covered this at quite a lot of length in the first paper; I think the Chancellor's first speech on the issue covered it. It is perfectly possible to have a separate currency. There are big problems with transition, and costs of introducing a new currency; and then you are totally dependent on your credibility in the markets. There are small countries which can be successful, but to come back to the Hong Kong example, they tend to run very rigorous fiscal policies. You have to have very strong banking systems.

Q5734 Chair: We are in danger of getting into speculation. Before we get into things like currency boards and all the structures, there is a danger that people will lose the will to live. Can we start—

Mr Osborne: Crucially, Mr Davidson, those are not things that the nationalists are proposing.

Q5735 Chair: Absolutely. Unless people have any final questions, I have one very brief one. I particularly want to give you both the opportunity to answer any questions that we have not asked, in case there is anything you feel we have omitted.

Mr Osborne: I think we have covered it, from my point of view.

Chair: Okay. We have time for two final points, then.

Q5736 Pamela Nash: One thing that the Government could do to help the "Better Together" campaign, while we are on the subject, is to ensure that English businesses accept Scottish notes. That is raised with me quite a lot on doorsteps.

You have been very clear why we could not have some of the currency options. What currency options should a separate Scotland have?

Mr Osborne: I am not the person advocating Scottish independence. Alex Salmond, John Swinney and the nationalists are the people advocating Scottish independence. I think it is incumbent on them, not us, to sort out the big issue of what currency Scotland will use if it becomes independent. They have not answered that question. At the moment, they do not have a credible plan, or any plan at all. I hope that I have made clear again today that a currency union and Scotland sharing the pound is not going to be the case. It is not in the interests of the rest of the UK, it is not in the interests of Scotland, and it would not help Scottish families or those in the rest of the UK. It is the nationalists who are asking the country to take a big economic risk, and it is incumbent on them to spell out how they would manage those risks.

Q5737 Mike Crockart: As the representative of a constituency absolutely steeped in financial services, I want to be absolutely clear what the impact would be on financial services in Scotland of a sterlingisation route. It is the fact that there would not be a lender of last resort that would surely have the greatest impact. What would that mean, particularly for headquartering?

Mr Osborne: I do not think it would be remotely possible for all the great companies that locate and headquarter in Scotland to remain there under the sterlingisation plan. I think there would be challenges for some of those companies to remain even under independence with different currency arrangements, but certainly under sterlingisation. It has never been tried in any economy of anything like the size and sophistication of the Scottish economy, or with anything like the established banking and financial services that Scotland has, which brings huge benefits as a result not just to Scotland but to the whole of the UK.

Q5738 Chair: A final question to Sir Nicholas. As the head civil servant, do you think the Chancellor has left himself any wriggle room at all? Do you think there is any way he can possibly change his mind and retain even a shred of credibility? Yes or no is what I am looking for.

Sir Nicholas Macpherson: No.

Mr Osborne: And I agree with Nick.

Chair: You've done that before, haven't you? We have reached the end. Thank you very much.