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Authors’

Dr. Craig Dalzell is an MSci and PhD in Laser Physics and Photonics. He is an activist and researcher and runs a politics and economics blog at thecommongreen.wordpress.com
Preface

One of the key issues of the 2014 independence referendum was the discussion of division of assets and liabilities should Scotland and the rest of the UK become independent countries. Unfortunately, it was an issue that was discussed in shallow terms despite many historical precedents from which to draw.

The 2014 discussion simply assumed that Scotland would be assigned a population share of the UK's debt in return for a population share of assets from the UK (and that if the latter was refused by rUK, then the former would be refused by Scotland).

This paper seeks to re-open this discussion, taking as its starting point the historical precedents, as they shall show that not only is this simple model one which has rarely been used in practice, it is not necessarily one which would work to Scotland's benefit.

Key Points

- The manner in which states separate is crucial for determining asset division. In particular, the rUK's likely desire to maintain “successor” or “continuing” status to the former UK will likely be largely determined by its willingness to guarantee the debts of the former state.

- The assumption that the baseline for division should be on population can and should be challenged. Many state separations have negotiated settlements which place weight on territoriality as well as the historical contributions and beneficiaries of the former unions. It may be that Scotland has been a historical net contributor to the UK thus may have already more than paid its “share” of the national debt.

- The previous independence campaign discussed the possibility of a subtractive model of asset separation whereby the value of any assets withheld from Scotland by rUK (for example, currency and foreign reserves) would be subtracted from debt liabilities accepted. This report suggests instead an additive model whereby Scotland begins with the assumption of accepting no debt but will accept debt up to the value of assets transferred. It may be that Scotland actually requires less from this transfer than the subtractive model would suggest.

- For the additive model to be actionable, an up-to-date register of assets will be essential. With the last UK Government register of assets in 2007, the Scottish Government must press the UK Government to commission a new register or conduct a Scottish audit in the near future.

- Additionally, the prospect of Scotland issuing its own bonds and buying what is required is explored ('the zero option'). This model may have significant advantages with regard to being able to denote the debt in Scotland's own independent currency thus maintaining full control over debt management and significantly reducing the chances of a default.

- The precedents and models outlined would likely all accrue varying levels of financial benefit to Scotland if utilised properly. A lack of up to date data makes precise figures impossible, but a conservative illustration of each model in the Scottish context would suggest a £800m per year financial gain from the subtractive model with refinancing; a £1.7 billion reduction in debt interest payments from the additive model without refinancing; a saving of over £2 billion per year from the zero option; and, in the case of historical net contribution, a possible financial contribution from rUK to Scotland.
Introduction

In the event of a yes vote for Scottish independence, the separation negotiations are likely to begin as soon as possible. Unlike the situation caused by the Brexit vote in June 2016, Scotland has the luxury of some time for forward planning and can afford to examine the various precedents set by other countries when they have become independent and attempt to apply those precedents to the Scottish situation.

Another difference with the Brexit situation is that there can be no excuse to avoid negotiations, particularly as the terms of Union within the UK do not include a comparable “Article 50” trigger with a hard time limit for exit: the pressure to begin negotiations as soon as possible will therefore be that much stronger (the Scottish Government’s stated aim post a yes vote in 2014 was to begin negotiations from the week following the vote). There may not be time therefore to begin that vital planning only after a mandate for independence is achieved. This report shall attempt to begin discussion of some of the applicable precedents and to lay out some plausible roadmaps and negotiating positions that the Scottish Government could take with regard to claiming Scotland’s assets and apportioning a fair share of the UK’s debts.

Dividing Assets: Principles

Before discussing the situation of Scotland’s assets and what it may end up owning post-independence there must first be a recognition of the different classes of assets a country may find itself holding during the independence process.

Physical assets, such as natural resources, government buildings and military bases, may be considered “immovable” whereas military equipment, some publicly owned artworks* or cultural artefacts, vehicles and, possibly, personnel may be considered “moveable” assets. Aside from the movability of assets, they can be separately designated as “national” (i.e. owned collectively by the prior state and hence shared between subsequent states) or “territorial” (owned entirely by one or other state post-separation). Even liabilities may be considered territorial if, for instance, the prior state borrowed money to pay for an immovable infrastructure project located entirely in one subsequent state.

When states separate there is a general consensus that a territorial principle is applied to immovable assets and the subsequent state takes sole control of those military bases, public factories, government buildings and suchlike as is located within their border after the split, whereas moveable assets are subject to some kind of negotiation.

That said, an “efficiency” principle is sometimes also applied (at least when negotiations are comparatively amicable). If a state-owned factory cannot function effectively without the moveable equipment it depends on, such as vehicles and portable plant, then they will remain with the fixed assets.

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How the split of moveable assets is calculated can itself be the subject of intense negotiation (particularly in reference to liabilities such as debt) and can range from some form of proportional share (measured by population, % of GDP or suchlike), through some measure of “contribution” (a new state which was a significant net financial contributor to the prior state may not wish to take on a substantial share of debt) or by some measure of “need” (a new state may not wish to take on a rightful share of certain assets it neither wants nor requires, this will be discussed later).

Dividing Assets: Precedents

Entire books can and have been written on the history of the discussion of the division of assets between states which become independent1,2 so it is necessary here to only outline a few examples (although it has been observed3) that most cases of the creation of a new state either involve contentious circumstances, an outright war, unplanned and sudden shocks to the political landscape or the complete dissolution of the previous state. Scotland’s route to independence will almost certainly set its own distinct precedent so the parallels with previous examples may apply only partially.

The Soviet Union

The 1991 dissolution of the Soviet Union resulted in efforts by the largest member state, the Russian Federation, to be considered by the international community as the “successor state” of the former Union, not least because successful adoption of this status would greatly ease questions arising such as the Soviet Union’s permanent membership of the United Nations Security Council. All Soviet foreign debt was claimed by Russia, as was ownership of Soviet military assets (USSR successor status, including ownership of all debt, has also been claimed by Ukraine4 although this claim has been met with far less international recognition). The 1992 Lisbon Protocol

*Public art, moveable and immovable, can be a source of great contention in ownership disputes especially when they depict or represent some aspect of cultural significance to one or both parties.
between Russia, Belarus, Ukraine and Kazakhstan also led to the agreement that all states other than Russia would relinquish ownership of the nuclear weapons located in their territories and arrange to have them either transported to Russia or destroyed. Ownership of other mobile military assets (i.e. conventional equipment) were transferred on a territorial basis which resulted in Ukraine inheriting far more materiel than it could feasibly use. Additionally, the equipment was distributed such that most of the more modern of the USSR’s materiel positioned in Ukraine (Russia’s territory containing a greater proportion of reserve and obsolete equipment) but positioned in a manner which reflected the overall strategic concerns of the USSR but not, necessarily, the territorial defence requirements of Ukraine⁶. This fact may well have played into some of the security concerns which have arisen in more recent years including the 2014 conflict resulting in Russia’s re-integration of Crimea and Sevastopol.

“One prominent issue which came up during the separation negotiations was the situation in Kazakhstan where the ownership of the Baikonur Cosmodrome (Earth’s first and largest space launch facility) was intensely disputed.”

One prominent issue which came up during the separation negotiations was the situation in Kazakhstan where the ownership of the Baikonur Cosmodrome (Earth’s first and largest space launch facility) was intensely disputed. Kazakhstan sought to apply the territorial principle on what was obviously an immovable asset (some nationalist elements wanted the facility shut down entirely for environmental reasons) whereas Russia, not wanting to lose control of its principle space port, sought to apply a contributory principle seeing as Russian funds had largely supported the facility since inception. A deal was eventually struck between the two nations whereby Kazakhstan would lose control of its principle space port, sought to apply a contributory principle seeing as Russian funds had largely supported the facility since inception. A deal was eventually struck between the two nations whereby Kazakhstan would retain sovereignty and legal jurisdiction over the port but operational control would be leased to Russia for the sum of $115 million per year⁶.

Yugoslavia

It goes absolutely without saying that the dissolution of Yugoslavia is a model of state separation to be avoided at almost any cost. It is estimated that more than 140,000 people lost their lives over the course of the resultant wars and more than 4,000,000 people were displaced, many permanently⁷.

Looking at the state of the division of assets and liabilities provides some instruction on what may occur during Scotland’s negotiations. In contrast to the dissolution of the USSR, the attempt by what was then known as the Federal Republic of Yugoslavia (which comprised the states now known as Serbia, and Montenegro) to be considered the legal successor to the former state was denied. The Socialist Federal Republic of Yugoslavia was declared dissolved in entirety in September 1992. This posed a problem for creditors of the former state which, due to the fractious nature of the dissolution, could not be solved by negotiations between the new states themselves. It was instead left to the creditors to try to apportion what they could to whom. This led to the concepts mentioned earlier of “territorial” liabilities, which could be assigned to specific states due to their paying for geographically identifiable infrastructure or something similar and “national” debts which could not⁸. Many assets, including military assets, were subject to separate negotiations but of those that were not, the IMF devised a complex ‘key’⁹ which apportioned what remained on a basis weighted depending on each successor state’s population, territorial size, contribution to the federal budget as well as export earnings and benefit from federal expenditure. As a side-note, when the Federal Republic of Yugoslavia itself broke up in 2006 following the Montenegrin independence referendum the previous year, the new Republic of Serbia was accepted as sole successor state to the former federal republic although assets and liabilities were split on a beneficiary principle with Serbia taking on 90% of the former state’s debts and Montenegro taking on 10%¹⁰.

Czechoslovakia

The peaceful dissolution of Czechoslovakia in 1992, often called the “Velvet Divorce”, would provide for Scotland a far more desirable situation in terms of outcome, if not an exact parallel in terms of process, than previously mentioned examples. The emergence of democracy and party politics did show a pattern which would be familiar to Scottish voters in 2016 whereby parties dominant on the Czech side of the federation had little or no presence on the Slovak side of the border and vice versa, whilst Slovak parties had little influence in the Czech dominated parliament¹¹. Despite a poll placing popular support for dissolution at less than 40% on both sides of the border, the discussions over whether the Federal should either fully centralise into a unitary state or further decentralise into a confederal model ultimately resulted in Slovakia declaring independence and an agreement reached that Czechoslovakia should dissolve entirely.

The division of assets and debts between the two new states was also considered reasonably amicable with immovable assets being transferred territorially and moveable assets being split on a straight population share of 2.29:1 allocated to the Czech and Slovak republics respectively (with some further details and exceptional circumstances being worked out on a territorial or other relevant basis)¹². That said, the negotiations did take a lot longer than is often supposed with the final agreements and transfers taking place some nine years after independence¹³. One issue of particular relevance to Scotland would be the issue of currency. Separation talks were agreed on the basis of a currency union but it was widely acknowledged that due to the divergent economic situations in the two new states that such an arrangement would be a short term one, perhaps lasting only a year or two. However, the lack of effective capital controls during the transition period as well as a lack of confidence in the arrangement led to capital flight and a run on the
CLAIMING SCOTLAND’S ASSETS — A discussion paper on the division of assets and debts to an Independent Scotland

bonds (with funds generally flowing from Slovakia to Czech Republic) which forced the abandonment of the union in only 38 days\(^6\). The lesson is that proper implementation must be adhered to if any separation negotiations are to be successful.

Québec

Québec is not, as of 2016, an independent state but the intense debate surrounding the constitutional status of the province, particularly in the run up to the second referendum in 1995, led to much discussion over how assets and debts could be split should independence occur. In addition to the population, GDP and beneficiary splits assets and debts could be split should independence occur. As of 2016, the UK is responsible for approximately £1.6 trillion worth of debt\(^8\) held in a variety of bonds or gilts (which are interest bearing and may or may not be index linked) or treasury bills (which are not interest bearing but are sold at a discount on their reimbursement value – you may buy a bill for £950 which is later reimbursed for £1000, for instance). In terms of who actually owns these debts, the UK Government Debt Management Office produces quarterly reports outlining the structure of the UK’s liabilities\(^9\) and shows that roughly a quarter of the UK’s debt is owned overseas, roughly a quarter by insurance and pension funds, another quarter by the Bank of England (which, somewhat strangely, means that this portion of the debt is recorded as both liability and an asset on the public records) and the balance by financial institutions, private investors, local authorities and others.

Scotland's Debts

How Government's Borrow - The UK's debt

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Scotland's Assets

Beginning under the 1997 Labour government, the UK produced a National Register of Assets which catalogued and estimated the value of all of the UK’s publicly owned assets. On the grounds of bureaucratic complexity this program was cancelled in 2010 when David Cameron’s Coalition government came to power, leaving the 2007 edition of the Register the most recently publicly available audit.\(^{10}\) As it stands, the 2007 register is now almost a decade out of date and pre-dates the beginning of the 2007/08 recession, the bank bailouts and nationalisations as well as two Conservative led governments pushing an “Austerity” agenda based on public asset sell-offs. “As it stands, the 2007 register of assets is now almost a decade out of date and pre-dates the beginning of the 2007/08 recession, the bank bailouts and nationalisations as well as two Conservative led governments pushing an “Austerity” agenda based on public asset sell-offs. ”

Scottish Government is serious about considering a second independence referendum it should therefore examine the a newly independent Scotland would find desirable but is currently lacking (such as a Central Banking\(^7\) or foreign embassy infrastructure for instance). “As it stands, the 2007 register of assets is now almost a decade out of date and pre-dates the beginning of the 2007/08 recession, the bank bailouts and nationalisations as well as two Conservative led governments pushing an “Austerity” agenda based on public asset sell-offs. ”

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With around 95% of the UK’s debt portfolio being interest bearing, there is a strong dependence of the cost of servicing this debt on the interest rate being paid. In recent years, indeed recent decades, there has been a general downwards trend in the yield of national government bonds and the UK has been no exception. Where a UK 10 year bond would have yielded 10% per annum in 1986, 7% in 1996 and 5% in 2006, the UK’s 10 year bond yield stands, in mid-August 2016, at just 0.5% and a weighted average yield across all bonds of roughly 0.7%. This goes a long way to explaining why the annual cost of the UK’s total debt interest peaked at £44 billion per year in 2011-12 and has dropped to £36 billion in 2015-16\(^{20}\) despite the total debt accrued increasing from £1.2 trillion to over £1.6 trillion over that period\(^{21}\). There have even been cases recently in countries such as Germany where bond yields have dropped below zero and have led to the situation where investors have, in effect, been paying the government to hold their money. This can occur if losing a small, certain amount of money on an investment balances favourably against the risk of losing a larger, uncertain amount by investing elsewhere, such as the stock market.

\(^{10}\) The next scheduled date would have been 2013, less than a year from the first Scottish independence referendum and at a time when such a register would have been both deeply instructive and deeply controversial.
It can also occur if the negative bonds are being sold at a discount on their face value such that over the life of the bond a gain can still be realised by the investor. In any case, it is clear that there has rarely been a better time for governments to borrow money and whilst this situation will and is having serious repercussions for pension and savings funds reliant on bonds any government that wished to embark on a substantial capital investment project would find little obstacle in the way of being able to pay for it.

Credit Ratings

Linked to the concept of interest rate is the concept of credit rating. Specialised credit rating agencies will examine the finances and economics of a nation and render a judgement on how likely it is that the country will be to either continue to be able to pay back creditors or default on that debt. In popular consciousness, the credit rating of a nation is strongly linked to the interest rate demanded by those who lend money to that country. In practice many other factors play into the calculation of bond yields experienced by a country and whilst a correlation does exist the credit rating becomes the dominant correlative factor only once a country’s credit rating drops into “junk” status. For example, the UK infamously was downgraded from AAA to AA status by ratings agency Standard & Poor’s in the wake of the Brexit vote in June 2016 but bond yields have continued to fall since then.

With reference to the 2014 Scottish independence campaign, there was a substantial debate over the prospective credit rating and the interest rates that may be paid by a newly independent Scotland (a debate which would itself be influenced by the potential amount of debt taken on by Scotland on independence). In February 2014, Standard & Poors attempted to informally outline the considerations required for Scotland to be issued a credit rating and concluded that, subject to a reasonable and consensual asset and liability separation negotiation, Scotland’s outlook would be consistent with an “investment grade” rating 22. Whilst much of this judgement was based on Scotland achieving agreement of a currency union with the rest of the UK, the report also noted that there was “no fundamental reason why Scotland could not successfully float a[n independent] currency”.

Scotland’s Debt Liabilities

Even under the expanded devolution settlement due to come into force by April 2017, the Scottish Government will have only very limited ability to borrow money on its own account, only £600 million per year on the current budget and £450 million per year on the capital budget with total outstanding deficit and debt caps of £1.75 billion and £3 billion respectively 23. These combined deficit and debt caps are equivalent to 0.7% and 3.0% of GDP.

Whilst the UK government also does not readily publish an audit of debts split on a contribution or territorial basis, the Scottish annual accounts, GERS, allocates Scotland’s “share” of the UK’s debt and debt interest on a straight population basis (8.24% in 2015, with £2.8 billion allocated as Scotland’s “share” of interest paid in 2014-15 24). On this basis Scotland has been allocated a share of the UK’s total national debt of around £136 billion. However, without any detailed audit of debt spent on a territorial basis then Scotland’s actual contribution towards the total UK debt becomes difficult and highly contentious to estimate. One study by the Scottish Government, published in 2013 25, made the claim that since 1980 Scotland had, in fact, proportionately overpaid into the UK national accounts with an accumulated “comparative surplus” of £222 billion. If these figures are accepted then the difference between a population and contribution share of the UK’s debt could be the difference between an independent Scotland paying money to the rest of the UK and the reverse. It can therefore be seen that the finances of a newly independent Scotland will be highly dependent on the separation agreement reached.

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Splitting the Debt

Once such an agreement has been reached the next question is precisely how the transfer of ownership of the debt takes place. This is not a trivial question as the portfolio of debt is made up of individual bonds with individual owners. If the rUK achieved its goal of being considered the formal successor or continuing state to the UK (as Russia did with regards to the USSR) then responsibility for the UK’s debts falls entirely to it 26. To transfer ownership of a bond to another state (i.e. Scotland) may not meet with the approval of the owner of the bond and may constitute a default.

Instead it may be arranged that a transfer agreement is established whereby the transferring state pays the transfeeree state an amount agreed based on the nominal outstanding debt at the time of separation. This may be a set amount or may be a set annual fee (fixed or as a percentage of revenue, as a percentage of GDP or some similar agreement) paid for a fixed amount of time and may include arrangements such as the currency that payments would be denominated in. If an interest rate is attached to the payments then this would need to be agreed ahead of time as well, as if Scotland were to be making transfer payments to rUK it could not reasonably be penalised if the latter’s bond yields were to rise due to economic mismanagement.
Negotiating Positions

It is clear that the method by which a state becomes independent can have substantial bearing on the method by which it takes possession of its share of the former state’s assets and liabilities. The precedent of the 2014 independence referendum, being a democratic vote following a consensually arranged referendum, provides the model least likely to cause overwhelming ill-feeling between Scotland and the rest of the UK although the lesson from that referendum and, indeed, from Brexit is that this does not preclude either or both sides attempting to achieve maximum advantage or minimum disadvantage from the negotiations. Several negotiating positions can be considered based on previous examples as well as the known facts about Scotland’s assets and liabilities.

The Subtractive Model

This position is the one which most closely matches the stated position of the Scottish Government during the 2014 independence campaign. It posits that Scotland and rUK will take possession of all fixed, territorial assets within respective boundaries and will take possession of a proportional share of mobile and national assets. The precise percentage used to calculate proportionality will depend on the method by which the baseline is calculated. Table 1 below lays out Scotland’s percentage share or contribution to several appropriate metrics which may be used as a measure in a single year, in this case the financial year 2015-16 (it should be noted though that percentages for individual years are volatile and some measure averaged over several years may also be appropriate).

<table>
<thead>
<tr>
<th>Measure (2015-16)</th>
<th>Percentage of the UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population</td>
<td>8.24</td>
</tr>
<tr>
<td>GDP</td>
<td>8.34</td>
</tr>
<tr>
<td>Revenue</td>
<td>7.93</td>
</tr>
<tr>
<td>Expenditure</td>
<td>911</td>
</tr>
<tr>
<td>Land Area</td>
<td>32.14</td>
</tr>
<tr>
<td>Total Area (Including EEZ)</td>
<td>54.76</td>
</tr>
</tbody>
</table>

Obviously, as with Québec, each side of the negotiating table will naturally attempt to negotiate the metric which most benefits them and it may be that some compromise or multi-metric solution ends up being promoted similar to the post-Yugoslavian “IMF Key” or the Belanger-Campeau formula suggested for Quebec. For simplicity, this proposal will simply assume that a population share is proposed and that the debt liabilities taken on by Scotland look similar to the figures used in GERS (i.e. a debt share of approximately £136 billion as of 2014-15).

From this initial point the negotiations may look at some of the imbalances that a straight population share might bring. For a start, as population is mobile then a date would need to be fixed from which it is calculated. If a person decides to move across the border (in either direction) due to the independence decision, should their “per capita share” of assets and liabilities travel with them?

The rUK Government may stick to its pre-2014 campaign position that Scotland would indeed be liable to accept a full proportional share of UK debts but would not expect to receive a share of assets in return. If that is the case, under the subtractive model, the value of any assets that Scotland could claim but is refused should be deducted from the debt that Scotland takes on. Currency would be a good example to illustrate this. Scotland may seek its share of the UK’s foreign currency reserves – around £10 billion at a minimum – with which to underpin its own independent currency. If refused these reserves, £10 billion could be written off the debt that Scotland would be considered to owe rUK.

Where asset transfers do occur, it may also turn out that a straight percentile share is inappropriate. As common with the case of Ukraine and Czechoslovakia (albeit for generally different reasons) a straight population share of military equipment may not be well suited to Scotland’s defence needs. Scotland could not take a straight 8.24% share of the UK’s two aircraft carriers, nor would it be particularly diplomatically or legally appropriate for a newly independent Scotland to attempt to lay claim to an 8.24% share of the UK’s nuclear arsenal (which may amount to approximately 14 warheads). In these and other similar cases the “cash value” of these assets may be either written off the assumed debt total or assigned to an increased proportionate share of assets that Scotland may actually need (an independent Scotland’s defence force would likely be more reliant on aircraft and surface vessels than are currently deployed here). This exact process occurred when Slovakia turned down its “share” of Czechoslovakian MiG-23 jets in exchange for half of the fleet of MiG-29’s. Of course, all of this assumes that Scotland’s defence spending remains at roughly the same percentage as it is currently. If it is intended to be much more or less then the calculations once again must change to reflect that policy.

The Additive Model

Rather than accepting some agreed percentage of assets and liabilities and then subtracting from it according to circumstances, Scotland could take the opposite approach. It could accept the UK’s claim to ownership of mobile assets and start from a position of claiming zero UK debt. From this position, Scotland could agree to take on a level of liabilities matching the value of any assets it is granted, effectively “mortgaging” them against UK debt. It may well be that the rUK has comparatively little in the way of mobile assets that Scotland actually requires and that taking on a population share in return for those limited assets would be disproportionate. This model is obviously significantly more proactive on the part of the Scottish Government or Scottish separation negotiation team as each asset required or desired must be identified and costed. Lacking a recent official Register of Assets, this process may be difficult or even impossible, therefore a Scottish Government serious
about campaigning for another independence referendum should ensure that one is available before that campaign. If the UK Government will not commission a UK wide audit then the Scottish Government should commission a Scottish one itself or make as detailed estimates as it can. This should be commissioned alongside an audit of assets that an independent Scotland would require but currently lacks, as well as assets currently owned but which may be superfluous.

“Lacking a recent official Register of Assets, this process may be difficult or even impossible, therefore a Scottish Government serious about campaigning for another independence referendum should ensure that one is available before that campaign.”

Whilst more proactive than the subtractive model, the additive model is substantially less aggressive in its pitch. There is less scope for the net debt transfer state to be accused of threatening to withhold share of debt according to whim or some real or perceived infraction. There may also be less justification for states to renege on any debt obligations at a future date, as occurred in the 1930’s during the Anglo-Irish Economic War.

The Zero-Option: Borrow on Scotland’s Terms

In the heat of the 2014 independence campaign it was common to hear each side of the debate make promises or claims about asset ownership which many commentators claimed would not have been maintained after the vote went against them. This view was further backed in the wake of Brexit when several promises made by the former chancellor George Osborne – such as to hold an emergency budget with punitive spending cuts – were not upheld. From this experience any claim made by the UK Government regarding withholding Scotland’s proportionate “share” of assets (particularly assets such as foreign reserves or reserves underpinning the value existing Scottish banknotes) must be balanced against the likelihood of that threat being carried out. That said, should the UK stand firm by its claim of ownership over all mobile assets then the Scottish Government would and should naturally insist that this includes claim over all debt and that no transfer arrangements would be required. Of course, Scotland would then need to issue its own bonds in order to raise the funds to buy whatever assets would be required.

As Scotland has not yet exercised existing powers to issue bonds under its own name, it does not yet have an established credit rating nor a track record of bond yields. There are, however, some considerations which can be offered. At time of writing, UK bond yields currently range between 0.2% for 5 year bonds to around 1.3% for long term 30 and 50 year bonds. This means that the UK is paying higher rates of interest on bonds priced prior to the current levels. When one examines accounts such as GERS, it shows that the average interest paid by the UK on its debt in 2015-16 was around 2.2%. This implies that if Scotland were to become independent at a point when the current bond yield rate was lower than the average rate paid (even if it were higher than the UK’s current rate) then it could be to considerable financial benefit to take on that debt on Scotland’s own terms.

As an illustration, Scotland’s accounts currently denote £2.8 billion per year paid to service £136 billion worth of debt. To take an arbitrary example, if Scotland were to become independent at a point where its weighted yield across all bonds was lower than the rate paid on GERS (even if individual bonds were slightly higher yielding than equivalent rUK bonds at the point of independence) such that Scotland paid 1.5% on average then this would represent a saving of over £750 million per year.

Obviously a plan based on this proposal would be highly sensitive to market pricing and especially the willingness of the market to buy enough bonds to finance Scotland’s initial needs. However, beyond the economics, the prospect of an independent Scotland starting life with no debt owed to the rest of the UK may be politically attractive and should an independent Scotland issue its own currency then having its outstanding debt denominated in a currency it controls could be extremely important.

History provides several examples of countries which were forced to default on debts denominated in currencies it could not control (examples include 1920’s Germany owed bonds to be paid in coal, Argentina in 2005 in US dollars and the near-miss of Greece in 2015 with bonds to be paid in euros). In extremis, a country which controls the volume of the currency in which its debts are denominated can almost always increase that volume (by printing more money) to service them. Argentina and Greece could not print more dollars or euros nor could Germany arbitrarily increase coal production to meet targets. It must be recognised that printing money to pay debts may have severe ramifications for the greater economy of a country and should not be considered a substitute for sound fiscal management, but it does make it far harder for such a country to undergo a default.

Separation Negotiations: Examples applied to Scotland

With the various precedents and models outlined, it is now possible to apply them to the case of Scottish independence to illustrate them in practice. However due to the lack of definitive information regarding the level of moveable assets which may be transferable, as well as the uncertainty in the actual level of interest which will be accrued on any outstanding debt, these illustrations should be taken as fairly conservative estimates.

(2) Prior to WWII, the bulk of the UK’s bonds were, in fact, undated and lasted indefinitely until the owner either cashed them in or the government ordered a reimbursement. The last of these perpetual bonds, including one issued in 1853, was reimbursed in 2015.
The Subtractive Case with Refinancing

In this example, the separation negotiations are based on the subtractive model with Scotland taking a population share of the UK’s debt. In the subtractive model as outlined, this debt would be reduced by the value of any assets “withheld” from Scotland by the UK. In this particular case it is posited that negotiations are smooth, amicable and all applicable assets are transferred as required. In this case, the full debt share of £136 billion is taken on by Scotland.

If Scotland were to refinance this debt by issuing its own bonds and if the annual yield on those bonds averaged to approximately 1.5% (which is double the current UK average rate and may be due to a combination of a substantial “Scottish premium” on the yields or simply that Scotland has issued long term, 30 or 50 year, bonds for the purposes of financial stability) then the annual cost to Scotland on that £136 billion debt would be £2.04 billion, which represents a saving of £800 million per year on the current situation.

The Additive Case with No Refinancing

In this example the additive case is used and represents a situation where the rUK, in its efforts to be considered the continuing state to the former UK, has claimed the entirety of the UK’s debt and asset portfolio. Scotland would start with a baseline of zero debt liabilities but also no claim to any moveable assets. As stated, without a full National Audit, it is difficult to estimate a value for the assets that Scotland would require but for illustrative purposes the extremely conservative number of £50 billion can be used (The 2007 National Register of Assets placed the value of total fixed assets for Scotland at £23 billion32 but does not estimate moveable assets in a consistent manner).

Claiming £50 billion worth of assets would lead to Scotland taking on £50 billion worth of UK debt in compensation. Under this model, Scotland agrees that this sum will be paid back at the current UK average rate of 2.2% per year over the next 45 years. Scotland’s annual repayments would therefore be £1.1 billion per year which would represent a saving of £1.7 billion per year on the debt interest payments currently assigned to the country in GERS.

The Zero Option Case

It may be that the rUK is either completely unwilling even to sell assets to Scotland or the assets that the UK has are unsuitable for Scotland’s needs (if Scotland wishes to construct a military structure radically different from the one based here now, for instance) or that Scotland wishes to maintain complete control over the debt by ensuring that it is denominated in Scotland’s own independent currency. In this case, the Zero Option may be appropriate which would see Scotland simply buying what it requires from whichever source it needs to.

In this example a portfolio of assets worth the equivalent of £50 billion is bought as in the Subtractive case but this time it is bought at the Scottish bond yield of 1.5%. This would imply an annual cost to Scotland of just £750 million per year which is a saving of over £2 billion per year on the situation at present.

The Historical Net Contribution Case

In all of the above situations, the prospect of Scotland taking a population share of the UK’s debt has been assumed without question, but as has been shown with the historical precedents this is rarely the case. In many cases, notably the former Yugoslavia and Québec, the separating state’s net contributions to or from the former state are also considered.

“If the estimates cited earlier of Scotland’s contributions to the UK of £222 billion since 1980 are taken as valid and the population share of the UK’s debt is subtracted then Scotland’s net contribution to the UK could be £86 billion.”

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Conclusions

The UK Government position that an independent Scotland would automatically be responsible for paying a full proportional share of the UK’s debts whilst expecting nothing in return is a position completely at odds with the historical reality of separation negotiations. Even the concept that Scotland would inherit a population share of the debt, whilst simple to calculate and already in use within records such as GERS, can be challenged within the precedents. It may well be that, depending on the measure used, the historical beneficiary of Scotland’s membership of the Union has not, in fact, been Scotland. If a subtractive model of asset division is to be used in future negotiations then the baseline for the division can and should be discussed and challenged openly.

As a basis for a negotiating stance going into a future independence referendum the Scottish Government would be well placed by advocating an additive system of asset and debt separation with regard to mobile assets, on top of the normal territorial division for fixed assets. Such a strategy would require a comprehensive and detailed register both of the assets Scotland could reasonably expect to acquire as well as a plan in place to cover those assets which would need to be built up outside of this agreement. However, the option of borrowing on Scotland’s own terms should also be considered particularly if
independence is to be based on the principle of Scotland launching and maintaining its own currency as this would remove a significant risk factor involving being liable for a potentially substantial liability denominated in a currency which the country cannot fully control.

“As a basis for a negotiating stance going into a future independence referendum the Scottish Government would be well placed by advocating an additive system of asset and debt separation with regard to mobile assets, on top of the normal territorial division for fixed assets.”

Regardless of the scenario selected it is difficult to hypothesise a scenario under which Scotland is responsible both for more debt and for a greater level of debt interest than is currently assigned to it. In this respect, independence would represent a financial saving on Scottish national accounts, perhaps a saving measured in the equivalent of billions of pounds per year.

ENDS
References


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32. UK Debt Management Office, (2016)

