The Sustainable Growth Commission has published its report into the economic options open to an independent Scotland.

In 2014, all sides agreed that Scotland 'could' be an independent country. Of course, where opinion differed – and continues to diverge – is over the costs and benefits of independence.

The economy was seen as a key area of challenge for the 'yes' side in 2014. To counter this, the Scottish Government sought to strengthen its position by offering a vision of relative economic continuity post-independence.

Today's report offers a different proposition.

In this – slightly longer than usual – blog we provide an overview and offer some thoughts on where the debate should go next.

Summary of the report

The report by the Growth Commission is a substantial body of work.

It covers the public finances and the currency options for an independent Scotland.

It also offers insights from a select group of countries of similar size to Scotland and puts forward ideas to best grow our economy.

But it is the independence proposition that will attract the most interest.

In particular, the Commission recommends that Scotland retain the pound for an extended period after any vote for independence. But they also firmly open the door for a new Scottish currency to be established in the medium to long-term.

They also conclude that Scotland would face a challenging fiscal settlement on day 1. The report sets out a plan for deficit reduction over a 10 year period. Oil revenues aren't to be used to fund public spending or reduce the deficit, instead they should be invested for the long-term.

Raising the potential & performance of the Scottish economy

There is no doubt that today's report will spark considerable debate.

But irrespective of your views on independence, there is much to be taken – by all political parties – from the report's discussion of ideas for growth.

Many of these are possible with the existing suite of devolved powers.

Of course, one of the challenges – as with any such report – is moving from a high-level vision and well-intentioned strategies, to specific practical policy measures.

If the experiences of the countries reviewed in the report offer one clear conclusion, it is the importance of clarity of purpose in economic policy: internationalisation in the case of Ireland, low regulation and competitive taxation in Singapore, high value-high innovation-high public investment in Sweden.

The report opens up some important questions about the 'type' of Scotland we wish to see in the future.

Overall, the Sustainable Growth Commission report intends to move the public debate forward from 2014 in a rigorous way. Reports in yesterday's media predicting households being better off by £4,100 – figures which should be taken with a large pinch of salt – unfortunately only undermine this aim.

Scotland's Public Finances

The report's assessment of Scotland's public finances makes sober reading.

In a welcome move, which hopefully dispels any remaining myths around GERS, the authors take the GERS numbers as the appropriate assessment of Scotland's *current* fiscal position.

Unlike in 2014, the analysis that follows revolves around a plan to balance the public finances rather than documenting a list of spending priorities.

By 2021-22, after adjusting for the Commission's recommended savings to current UK commitments, their projected Scottish deficit is around 6% (the current UK deficit is 2.2%). The Commission acknowledge that this is unsustainable and will require further action to reduce the deficit to the Commission's target of 3% of GDP within 5-10 years. Such a commitment will limit the wider policy options open to government.

Based on the assumptions and methodologies in the report, the Commission estimate that Scottish Government issued debt will – over a 10 year period from 2021-22 – rise to just over 35% of GDP. This may sound low, but remember that Scotland will also have to cover an agreed share of outstanding UK public sector debt. This is currently around 85% of GDP. The total *effective* stock of debt Scotland would have – i.e. new Scottish Government debt plus the inherited share of UK debt – we can't see published in the report (but it would be interesting to know).

There are clearly upside and downside risks to this. Economic growth *might* surge ahead post-independence and this will help boost Scotland's fiscal position. But the reverse is also possible.

Market sentiment will be crucial. As the report highlights, independent countries of Scotland's size tend to run prudent fiscal positions. No small country listed in the report is currently running a fiscal deficit of 6%. How markets react to this, and their view of the credibility of the proposed deficit reduction plans, will have important implications for the interest charges that Scotland will pay and the speed and scale of the repair job needed.

What is also important is a recognition of the drivers of long-term fiscal sustainability, notably in relation to demographic change. For example, the report allows for modest real terms spending increase (around ½% pa including debt interest payments). But with health needing to rise by 1% pa just to keep up with an ageing population, other areas of the budget will be squeezed. Population growth can help only to an extent. It should be remembered that these are challenges that all countries face – including the UK – but by inheriting a slightly weaker fiscal position combined with Scotland's demographic profile, the task will be more difficult.

Scotland's currency options

The proposal is that Scotland retains Sterling immediately post-independence, most likely through an informal arrangement akin to 'Sterlingisation'. The aim is to provide continuity and reassurance. Arrangements and infrastructure would then be built up to support a move to an independent currency should certain tests be met. Of course, these tests may never be met, but the tone of the commentary around the report suggests that a new currency should be seen as more than a possibility.

Until the establishment of a new currency an independent Scotland would essentially have no separate monetary policy powers. Under sterlingisation, Scotland would face an interest rate regime set by the Bank of England taking into account conditions in the rest of the UK economy only.

A separate currency comes with opportunities, but also risks. It's not possible to go through all of them in this blog, but here are some to consider.

In the long-run, many economists will argue that the creation of an independent currency can have its advantages as it provides flexibility to set monetary policy in the interests of the Scottish economy. A number of small independent countries successfully run their own currencies, e.g. Denmark, Sweden, Norway, and New Zealand. Some try to peg to other currencies, others don't bother.

But this flexibility comes with a downside. It would mean that Scottish firms would have to change currencies (and face transaction costs and possible exchange rate risks) when selling into the rest of the UK (and internationally). It would also have implications for existing supply chains and household spending.

The 'new' Scottish currency would be exposed to the credibility of international investors. In theory, this can be managed, but as we have seen even relatively recently, global market forces can deliver harsh consequences if sentiment turns against you. Alongside running tight fiscal balances, many countries have assets they can call on. Denmark has reserves of around \$64bn, Singapore \$251bn – well in excess of the £11bn Scotland would expect to inherit. Building up reserves is possible, but not easy if Scotland continues to run a trade deficit.

Perhaps the greatest challenge however, would be the transition from the status quo to a new currency. Here the report offers a roadmap and sets out plans for financial regulation, banking and the creation of a Scottish Central Bank.

A 'sterlingisation' type regime has never been tried in a country of Scotland's size or stage of development.

It would provide continuity in terms of retaining the pound as Scotland's currency. But it would also mean no separate interest rate or exchange rate policy for Scotland and a very limited 'lender of last resort'. rUK banks could lend into households and firms in Scotland, although how the banks themselves – and regulators – would view this will have implications for borrowing costs, lending and the make-up of the sector in Scotland. Scotland's net trade position with the UK would become crucial.

If a decision was taken to move to a new currency, there are practicalities to be worked through. Millions of contracts would have to be looked at, from car loans to mortgages; commercial transactions to Scotland's inherited share of public sector debt. For many, avoiding being tied to making repayments in one currency whilst receiving income in another will be important.

The report sets out stages as per an orderly transition process. But as history has shown, economic plans can change. Markets are likely to 'price-in' the prospects of potential currency switching (good or bad) from day 1. At the same time, the modern economy is full of risk and uncertainty – many outside the control of the Scottish Government – so contingency plans will be crucial.

Conclusions

Today's report is an important contribution to the debate on Scotland's economic future.

It offers one view of the potential options for an independent Scotland. It outlines some of the opportunities for Scotland – particularly over the long-term – but also highlights some tough choices in getting there.

In this regard, whilst offering important insights for the Scottish Government, it also puts forward some significant challenges which Ministers will now have to respond to.

But it also represents a challenge to other political parties. They too need to set out their vision for Scotland and how they seek to deliver economic prosperity in the years ahead.

In this regard, we hope that the debate that follows today's publication focuses upon the substance of the arguments on both sides and discusses the risks and opportunities from all potential constitutional models for Scotland in a transparent and respectful manner.