

## **Breaking Up is Hard – and expensive - to Do**

### **The Scottish Referendum**

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Divorces are unpleasant and expensive affairs. Both sides underestimate the costs and exaggerate the benefits. Scotland goes to the polls this week to decide whether or not to end a Union that has lasted over three centuries. One that has held together through Enlightenment, the rise and fall of the first Industrial Empire, the cataclysm of two global war and the end of Communism.

In my view, voting “yes” would be a mistake both politically and economically.

The existence of the United Kingdom symbolises the possibility of multiple identities. We can be Scottish and British; English and European; to be like my father – an immigrant and still to belong to London. The rise of nationalism in Scotland, England and throughout Europe is a scourge on this tolerance.

Scotland and the rest of the UK will be weaker in the world because of breakup. But let me focus on the economics. Here’s the bottom line: the Scottish people will be poorer as divorcees. A lot poorer.

Everyone can see the enormous short-term costs. There will be financial instability, duplication of state functions, a long struggle to re-enter the EU and a God-awful row about division of the assets and the debts, especially those of RBS.

Scotland will not be in monetary union with the rest of the UK – all the main political parties and the Bank of England have ruled it out. And even if they agreed it would be a crazy thing for Scotland to do. The inability to devalue the currency in the face of different economic shocks is the major reason for the ongoing Euro crisis. Scotland risks becoming like the depressed “[Spain without the sunshine](#)”. Scotland will have to introduce its own currency and will be forced to pay higher interest charges to bondholders. The currency will be backed by a smaller state and reliant on an economy more skewed towards natural resources and finance than the rest of the UK. Hence, it will be a much more volatile and risky place.

Isn’t the business cycle in Scotland and the rest of the UK much more closely aligned than in the Eurozone? It is true that Scotland has a similar per capita GDP to the rest of the UK. This by itself gives the lie to those who say union is an inescapable financial impoverishment. More importantly, the alignment of the business cycle is the result of a high level of economic integration. As the countries diverge in policies and regulations this will inevitably chill trade and commerce between Scotland and its largest export market. Perhaps the main thing learned from international economics is that these non-tariff barriers are a major impediment to trade. As they get erected higher this will reduce commerce and be a drag on productivity.

It is often said that whatever the short-run economic costs, things will be better in the long-run for the new country. But the loss of trade dynamism is ignored by conventional assessments and are likely to magnify the costs of separation. The same is true if the UK left the EU – an extraordinarily foolish act which would be made more likely if Scotland votes “Yes”. My

calculations with CEP's Professor Gianmarco Ottaviano, who advised the government on Scottish independence, are that income losses are [twice](#) as large once dynamic effects are factored in.

Will independence unleash a wave of dynamism and initiative as the SNP's breezy forecasts assume? No. Decentralization can spur innovation and I endorse the recommendations of the [City Growth Commission](#) to give greater autonomy to English city-regions and to give greater powers to other countries within the UK. But "Devo-Max" would follow a vote to keep the kingdom united and achieve this. Innovation will be harmed by excess fragmentation. For example, the great Scottish universities will be hurt as they will find it harder to attract and retain international stars in their faculty. The attractions of small countries are weaker than of the large.

Finally, there's a lot of nonsense talked about the need of independence to "save the NHS". Scotland already controls health spending, so this is not really an issue. The truth on public finances is that Scotland will have [much less room](#) for additional spending if it's independent because of its fast ageing population. So it is much more likely that NHS spending will be lower in an independent Scotland.

So let's be clear. If the UK breaks up Scotland will have lower wages and higher taxes. Maybe this is a price worth paying for having her own army, embassies, trade representatives, and some more pomp of state.

To me, the attractions of this divorce are illusory and a very bad bargain.

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