THE CONVERSATION
Academic rigour, journalistic flair

The best currency for an independent Scotland would be Norway's krone

June 18, 2014 6.01am BST

Scotland may become more like Norway than you think. Thomas Berg, CC BY-SA

Author

Piotr Marek Jaworski
Lecturer in Economics, Strategy and Operations, School of Management, Edinburgh Napier University

Scotland's referendum debate has so far centred mainly on practical issues and medium-term choices like currency, new entities' share of public debt, and membership of the EU.

Far less has been said about how the different players influenced by the outcome will be affected in the longer term. It is well worth considering how independence would eventually affect the Scottish and UK economies, particularly in relation to North Sea oil. The reality is that this constitutional change could alter the macroeconomic foundations of the political map of Europe.

Aside from the UK, Norway and Denmark are the two other countries which now explore the North Sea. In 2013 the total proportions of North Sea oil produced by these three countries were 27%, 66% and 7% of the total respectively. By my estimates, Denmark's oil sector provided around 5% of the country's GDP, once you include petroleum production and dependent industries such as petroleum services, pipelines, refineries and so forth. For the UK it was somewhere approaching 20%, while for Norway it was 23%.

Oil and European integration

There is a strong correlation between these oil sector figures and each country's economic and political choices. Norway stays out of both the EU and European monetary union. It has its own independent currency, whose rate of exchange is determined by the market.

At the other end of the spectrum Denmark is a member of the EU and is part of European Exchange Mechanism II (ERM II). The Danish krone's exchange rate is tied to the euro, making it practically another form of euro. The UK is in the middle: a member of the EU but not in ERM II or the euro.

If Scotland votes for independence, it will create a completely different economic context for the two new countries that emerge. This new macroeconomic framework will work against the currently declared goals of both countries' governments.

The economy of an independent Scotland would of course be much smaller than the economy of the new UK. This means that with the same absolute oil extraction, you can estimate that the sector would contribute more than one-third of Scotland's GDP. In the new smaller UK, on the other hand, it would only contribute something like 1% (coming from the mainly gas fields off east England).

Future choices for Scotland and the UK

This suggests that it would suit the two countries to make completely different economic and political choices. If North Sea oil dominates the Scottish economy to an even greater degree than in the case of Norway, it would suggest that it would be even less inclined towards the EU and euro than the latter country.

The logic behind this point is that oil changes the economic cycle of a country. The easiest way to think about this is to reflect on the effect of the oil price. If the oil price is high, a country that heavily relies on oil production does well and non-producers tend to do less well, because they are paying higher prices for their fuel. When oil prices are low, this reverses.

Anyone who had a passing interest in the eurozone crisis will know that the problems between the Mediterranean periphery countries and their northern neighbours were partly caused by the fact that they needed different levels of interest rates to suit their economies. An independent Scotland would suffer a similar fate, albeit for different reasons. The more that oil dominates an economy, the less well suited it is to European integration.

For the same reason, the rest of the UK would be inclined much more towards these European institutions than beforehand. The Danish experience suggests that it might lead not only to membership of ERM II but also even to adoption of the euro.

In turn, this would also lead to changes in the EU. The sheer size of the new UK would enhance the core of EU international member states, greatly increasing GDP for example. At the same time, the relative strength of socialist-inclined France would be reduced, raising the prospect of a more Atlanticist free-market approach to European unification.

Iceland and Sweden could get pulled into the same orbit. Bodvar Egertsson, CC BY-SA

On the other hand, Scotland and Norway would be naturally pushed closer to each other. They might be joined by Sweden and Iceland – Iceland and Norway share fishing interests, while Sweden and Norway's economies are closely aligned. This could lead to much closer political co-operation between these countries, plus a kind of monetary co-ordination, if not monetary union.

Some might dismiss these arguments, pointing out that Scotland has aspirations towards the EU and that England is increasingly eurosceptic. But such people should remember the example of the UK's brief membership in the first European Exchange Mechanism in 1990-91. The lesson was that no matter the political will, the economics will be fundamental in determining how situation evolves.

In view of these observations, it is hard not to reach several final conclusions. The Scots are not making a choice in September that is fully informed in economic terms. And the UK and EU do not seem to be fully aware of the possible long-term consequences either.

UK Norway EU Denmark Scotland Oil and gas currency union North Sea scottish referendum