

Viewpoint: It's Scotland's pound, and we're keeping it

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John Warren was recently asked by a commentator on this blog to explain his opinion on what he sees as the deeply embedded Scottish attachment to sterling as a currency. The note reproduced below is John's response.

As John has told me:

I support a Scottish currency, but I am confident I understand the culture in Scotland (and the latent small-c conservatism, which runs deep); and that the case is not adequately being made. Currency never played the part it should in 2014, because Sterling was assumed, and scarcely debated; and it has not been adequately addressed since. It has been fudged. A very hot potato. Having the right theoretical case is not enough, if you do not persuade people to change their behaviour.

I don't agree with all that John says, but his opinion is important, and certainly indicates that there is a lot more political thinking as well as work to be done on this issue.

One word of warning: this post is nearly 4,000 words long. You might want to make a brew before you start.

It's Scotland's pound, and we're keeping it

The words of the title were Alex Salmond's; SNP leader, First Minister for seven years, the only man to win an overall majority for his Party in Holyrood, under an electoral system designed to prevent it; economist, banker and probably the shrewdest, most effective political operator in Scotland (or probably Britain) in the 21st century, with the arguable exception of his younger peer, Nicola Sturgeon. Salmond lost the referendum, but polled 45% on an unprecedented 84% turnout, when Conservative Unionists under Cameron only offered the vote because they were confident Salmond's support would scarcely rise above 25%-30%, under the pressure of a real choice. The 45% assumed the pound sterling, and the EU membership were safe. Not everyone did.

Salmond's commitment to independence is scarcely contestable but he had no doubt about his position on the issue of the currency, because he clearly believed keeping Sterling was by far the wisest political course to follow for Scotland. John Swinney, then Finance Secretary made this all embracing claim: "Our framework is one of monetary union with the rest of the UK. Retaining the pound under independence is something that I believe is in the interests of Scotland, the rest of the UK and the stability of Sterling itself." (11th June, 2012); and Swinney further claimed, in language echoing Salmond, that the Bank of England was, "as much Scotland's as anybody else's" (BBC News, 11th December 2012).

Alex Salmond didn't hold this strong position on Sterling entirely for technical, economic reasons; but because of the fundamental nature of the politics Sterling invoked in Scotland. Salmond confidently underscored his position on the currency in a Holyrood debate, during the charged political atmosphere in the run-up to the referendum, declaiming: "We are keeping the pound in a currency union [because] we are appealing to the greatest authority of all - that is, the sovereign will of the people of Scotland." (Holyrood, Tuesday, 5th August, 2014).

Salmond was quite wrong about the inviolate destiny of the pound (Sterling) and independence, but clearly not about his own belief that it represented the sovereign will of the Scottish people. Wrapping the florid language of the 'sovereign will' in the destiny of a currency may seem to suggest an unusual, emotive commitment to hard cash; but it is scarcely surprising. This is Scotland. Salmond believed he represented the orthodox, and politically safe approach to currency, without him, or almost anyone else of influence, needing to justify his case. He did so because his argument was conventional wisdom in his Party (and of course for the Unionists he hoped to persuade); and was generally accepted, as both fairly obvious, and uncontroversial in the country (save for a minority of acute, but largely ignored critics).

Survation carried out a poll published, 19th February, 2014, which addressed the issue. Here is an excerpt from the conclusions on currency: "The preferences of what both 'Yes' and 'No' voters wanted were broadly similar, with both having a strong preference for a currency union that would enable them to keep the pound (41% for 'Yes' voters and even more, 52%, for 'No' voters). But when asked what they expected to actually happen, only 23% of 'No' voters expected a currency union to come about, less than half of those who had wanted that as their preferred option. In contrast, fully 45% of 'Yes' voters were confident that a currency union would come about". But the currency union didn't happen.

The transformation in SNP/independence currency policy since 2014 is total, but the evidence that the public has yet been persuaded is much thinner than proponents wish to believe. They are complacent. They are looking for easier to deal with excuses for the inability to move the 'dial' on independence support than for currency. I do not claim it is the only problem: but it is a factor, it hasn't been fixed, and so far has been poorly, and unconvincingly addressed as a matter of critical public persuasion.

The damascene conversion of the SNP to a Scottish currency subsequently to 2014 had nothing to do with choices made from conviction. There was little choice (this too has been 'glossed'). The conversion from the Sterling commitment was based on the fact that it was Scotland's pound, only as long as Scotland was in the Union. There, was the inconvenient fact. The British government laid out its position, bluntly; choice played little part in it.

Essentially, one party in the Union, rUK (remain UK - England, Wales, NI), had to ensure a "continuator" state existed; and that there was no final dissolution of the rump UK state. Critical factors were the 2,000+ global diplomatic, economic and monetary treaties of the UK; and the National Debt, to select only some obvious critical continuities. rUK was incontestably the only viable candidate as continuator state (for the detail, see 'Scotland analysis: Devolution and the implications of Scottish independence'; HMG, February, 2013, Cm8554). It became clear that without rUK voluntarily agreeing to a currency union, Scotland could not assert legal rights over Sterling; and rUK, in the event made clear it was not going to offer a currency union (for the detail see 'Scotland analysis: Assessment of a sterling currency union'; HMG, February, 2014, Cm8815; and for outright rejection of a currency union, speech by George Osborne, Chancellor, 13th February, 2014 "If Scotland walks away from the UK, it walks away from the UK pound"; see also, letter from the Chief Secretary to the Treasury, Nick McPherson to the Chancellor, 11th February, 2014, attached to Cm8815).

Salmond may have been wrong on the currency issue for a number of reasons, and although a man not easy to write-off, he is out of power and favour: but Scottish independence has moved the dial from around Salmond's extraordinary 45%, to a scarcely earth shaking 48% in the nine years following the referendum; in the most calamitous period of abject, despised, failed, and ridiculed British mis-Government, since at least the 1930s; a farce enriched in the theatre of ever changing, forgettably risible, short-lived Prime Ministers - five Conservative PMs since 2016; every one a disaster. Even with the promises of Unionists still ringing in their ears, that EU membership was only safe in Unionist hands, as the Scots voted vainly to try to keep Britain in the EU in 2016; and Scotland voting 62% to Remain, it all counted for precisely nothing, and the support for independence has scarcely moved. It remains unmoved today, when we can all see the appalling result of Brexit; with no way out of the Brexit mire politically possible. I submit the latent currency problem, never satisfactorily resolved in the public arena at least, since 2014 is a factor; and a greater factor than some of the mishaps of the Scottish Government, however vigorously exploited by the Unionist media.

Offered so many easy political targets by the British Government and Parliament's serious failures over thirteen years, independence in Scotland sits in a state of cataleptic inertia; increasingly beset instead by the foreseeable (tax) traps set within the Westminster devolution settlement. Two matters are confused by those

independence supporters who insist there is no problem with public acceptance of the independent currency issue. The claim is asserted, but neither adequately made, still less proved. Independence always required a separate Scottish currency. Salmond was always wrong about the currency policy. Depending on Sterling for currency, in or out of a currency union effectively defeats any real independent policy or action attempted by a Scottish Treasury. That truth does not fix the problem of the enduring place of Sterling in Scotland. Salmond was not wrong in his understanding of the general Scottish political opinion on the currency; and the Scottish commitment to Sterling, which has deep historical roots in the economic transformation of Scotland It has traction. It was not an issue for the public in 2014, until rUK made its position clear.

Those who argue for a Scottish currency, too often gratuitously assume that this fact alone is somehow virtually sufficient to persuade the Scottish electorate to support a Scottish currency. I do not believe they have made the case, both with the general Scots voter and especially the ones with real practical leverage on this issue; and the problem is an implicit, repressed (even, perhaps unconscious) reason in the public's mind that the SNP have failed to move the independence dial forward from 2014. The case for a Scottish currency is sound, but has not been made. The currency issue is the elephant in the room. It has not been fixed.

SNP and independence supporters now appeal to the confidence the Scottish people would have in a Scottish currency - that doesn't exist. They point to opinion polls. Here is the problem. Opinion polls represent potential voters. Each person counts for one vote. It is called democracy. Currency, however doesn't count votes. Each person in Scotland does not possess just one pound. Some have more money than others; some have less; a lot more, and a lot less. Some currency is institutionalised and a few people are able to move vast sums of money at discretion. It isn't democratic. Some of them, perhaps unfairly and disproportionately, may also be Unionist; or simply trust what they and their forebears have trusted for three hundred years, through thick and thin, and trust Sterling a lot more than a theoretical currency; more than you may think. In addition, it is a very dangerous assumption to deduce that because people claim to believe something; they will act consistently with the stated belief in big decisions, and under pressure. They don't (ever since Akerlof and Dickens, 'The Economic Consequences of Cognitive Dissonance', 1982; the issue of irrationality and decision making in economics and finance has rightly received much more attention). Think of it as a Dacia moment. Forget the car. You do the maths.

There is the added Scottish dimension: the history that formed the Union, and the enduring impact of Sterling. I have added this section because it seemed to be implied in the request for an explanatory blog of my comment on another thread, and the history is important in establishing the importance of Sterling in Scotland. The history is quite distinct from England's currency history, and played a larger part in Scotland's modern transformation, probably than any other 'British' factor arising from Union. Dynasty and 'established' religion do not play as decisive a role in modern Britain or

Scotland as once they did; but Sterling does play a role, that is now, even more central to everyone's life. Faced with fundamental constitutional change, Sterling's significance in Scotland represents the most obvious and powerful feature of the change every Scot will face, every single day. It is not remote, or abstract.

The decisive constitutional moment, etched in religious crisis and dynastic upheaval was for British constitutional and intellectual historians, the Glorious Revolution, 1689-90. Another, far more prescient revolution was happening, unfortunately largely quite unnoticed by historians in Scotland over broadly the same period: a monetary revolution in Scotland. The transformation of Sterling.

Scotland in the 1690s was an economic wasteland. Two extraordinary men emerged, quite likely as the unexpected representatives of a deep, long repressed desire for economic transformation in Scotland; long suppressed by the land-owning Scottish aristocracy's vice-like grip over Scottish society in every vestige of life. They owned most of Scotland outside the major townships and in a pre-industrial society they were Princes in their domains; ruling through 'heritable jurisdictions' with quasi-judicial powers. The maintenance of their power depended on the feudal principles that had guaranteed their predominance. There was, therefore no incentive for the aristocracy to change. They already owned everything; already wrapped in aged aspic. They provide the key to understanding the significance of the monetary revolution in Scotland.

The most critical economic problem of Scotland at the end of the 17th century was lack of credit. Everybody knew it. There was no money. Nobody, least of all in the Scottish Parliament (packed with the great aristocrats and those they patronised) knew how to fix the problem; or were prepared to take any risks with their quasi-feudal hegemony to take radical action. The two men who began to describe a modern world designed on radically different terms, that entailed a money transformation were visionaries; of an unlikely kind, a very, very modern kind that few then, or perhaps even now, adequately understood. The men were John Law (1671-1729), and William Paterson (1658-1719). Law was the son of an Edinburgh Goldsmith, brought up in the money business, and with a natural gift for mathematics. He was an adventurer, a successful gambler, a duellist with, by all accounts a 'charismatic' personality, with international appeal. He presented a paper to the Scottish Parliament, which was desperate to find answers to Scotland's deep economic predicament in 1705 : 'Money and Trade Considered, with a Proposal for Supplying the Nation with Money'; a radical proposal to reform banking in Scotland and realise the potential of credit to release economic growth. It was rejected.

Law nevertheless succeeded in implementing his exotic proposal on the biggest stage of all; France. He became the most powerful economic force in France, transformed banking there and with the 'Mississippi Scheme' led the country into the biggest financial crash in its history. Ironically, England looked on in envy at the growing crisis, and faultlessly followed the example; with the 'South Sea Bubble' (1720), the biggest financial crash in British history, at least until 2007. Law failed, but he transformed understanding of the nature of credit, debt and money; albeit historically as

international monetary economics 'bête noire'. He was much more.

William Paterson was the son of a Dumfriesshire farmer. He was a 'projector', with some of the characteristic brilliant financial insight of Law, a man who understood Exchange Alley, but with an acute and original understanding and instinct for the principles of (yet unknown) central banking; that Law unfortunately lacked. William Paterson was the principal creative genius behind the formation of the Bank of England (1694). He soon left; a 'projector' whose attention turned to Darien; the adventure that broke Scotland. It was however a much better idea in conception than the disastrous project that was actually undertaken.

The Scottish Parliament, desperate for economic answers that did not disturb the land-owning hegemony operating within Scotland, latched on to the idea of Empire provided by the conception of the new trading scheme offered, using methods that England had already exploited so effectively. The whole Scottish project, however was undertaken principally in response to Downing's notorious Navigation Acts (turning older English wartime measures into mercantilist era trade protectionism); which treated Scotland as a foreign power and blocked access to Scottish trade with English colonies. In response the Scottish Parliament finally passed the Act creating a new Chartered Company: 'The Company of Scotland Trading to Africa and the Indies' (1695).

The critical point that is too often missed is that the idea was not originally Darien at all. The Company was a deliberate intent to compete with the English monopoly, The East India Company (EIC) directly (as, in fact is effectively declared 'on the tin'). The money was to be raised, not principally in Edinburgh (where capital was scarce); but in London. The idea had indeed been encouraged in London by financial interests there that were seriously and determinedly opposed to the EIC monopoly, and that desired competition with it. Only Scotland could offer a chartered monopoly to allow that competition. This was the idea that was to provide an outlet for Scottish economic and imperial ambition.

It never happened. The Presbyterians had supported King William unwaveringly, into power and possession of the Crown; had always supplied significant numbers of Scots for his Dutch Army, and even the Chaplain who blessed the cause when he landed on the beach at Brixham; but this Protestant king now stepped into the fray; and killed the public offer in London stone dead. The Scots were thrown back on their own devices, and money; which did not run to competing with the leading monolith that was the EIC. Darien was a last, desperate throw of the independence dice in a new world of trading empires in which they simply refused to give up this last opportunity to participate independently.

Paterson's new, mad idea was a trading dream that spanned Pacific and Atlantic, at its narrowest point; Darien. A jungle that still remains a problematic jungle today. A global vision that was only executed in 1914, with the opening of the Panama Canal. Darien was a complete disaster. The colonists quickly succumbed to diseases they didn't understand, including members of Paterson's family. Many died. England (almost

unbelievably), called on Spanish support to stifle the attempt to form the colony. It collapsed.

The most remarkable point of Darien is the list of members who subscribed, unwavering in the national commitment of huge sums of personal money, in a country short of credit. The subscribers are dominated by the landed elite by investment size. But everyone who could scrape some 'siller' together is to be found in the list of the permanently obscure. The commitment was national. Many were ruined. Everybody lost, badly. Scotland was broken. In worse desperation than ever, John Law's ideas were rejected by the Scottish Parliament in 1705. Union with England now beckoned; from England's perspective the final solution to religious and dynastic uncertainty and weakness, and now credible in Scotland's perilous state. For the Scots Union was the only way to access Empire, and serve its frustrated ambition, provided they could protect the status quo for the elite in Scotland; their domestic hegemony. Outside the elite, in Scotland the Union was hated. Outside the elite didn't count. Even the elite were wary; less about the Parliament's ignominious sacrifice, than their social status and economic hegemony. How to fix it? The Scottish Parliament was to be sacrificed for two opportunities; not religion, not dynasty; but Empire - and Sterling.

Why sterling? William Paterson was a genius, and a Whig. The Darien disaster he recovered from and applied himself to solve the problem of how Union and Empire could be achieved. Paterson had realised that from a Scottish perspective, the failure of Darien was due to a betrayal of Scotland and its independent Parliament, in England's interests, and Scotland's bitter cost, by King William (now dead). The cost of that betrayal had been heavy for the Scots, and was not forgotten. What it proved to Scots was that with a British monarch serving English Parliamentary interests first, Scotland's Parliament was now in an untenable position. The latent threat of Jacobitism in Scotland however remained sufficiently potent that it suppressed the scale of outrage, and for good reason. Confronted with the prospect of a Union negotiation with England, a price may now be exacted, for the betrayal. What price, and how was it to be exacted?

The domestic hegemony of the Scottish elite was not the major problem; England did not consider Scotland a sufficiently enticing prospect to overcome the potential problems or hostilities consequent of close, direct government, given the history between them. The Treaty of Union is largely an exercise in protecting the Scottish elite with what really mattered to them; not a Parliament, plagued with insurmountable economic problems, but their domestic hegemony; protecting Scots Law in the treaty (effectively to prevent English carpetbagging); and among other important areas of effective independence - even the heritable jurisdictions survived. The price of all that was the implicit expectation that the elite would not allow Jacobitism to become a military threat. When the Jacobites rose, not once but twice, 1715 and 1745, Parliament finally decided the Scots elite had failed; heritable jurisdictions were terminated with brusque immediacy. Ironically, Scottish enterprise began to benefit from the Union, only in the second half of the 18th century, after the lifting of heritable jurisdictions; but

economic historians find little uplift from the immediate effects of Union in the domestic Scottish economy following 1707. Otherwise, Scotland, sans Parliament was largely left in the hands of the old, long established Scottish elite.

The price of the Darien betrayal was paid in Sterling; by another remarkable innovation conjured by William Paterson, this time with the help of the mathematician David Gregory (1658-1708), Savillian Professor of Astronomy, Oxford University; an Episcopalian Tory driven out of Edinburgh University by the Glorious Revolution in 1690. Paterson addressed the betrayal indirectly; rather as a problem for Scotland taking a share of responsibility for England's very large existing National Debt, which required compensation to the Scots.

Scotland was broke in 1706; but it was not 'bankrupt' in any significant sense, as a debtor. Scotland was mostly potential long-term upside; credit was so short in Scotland, the State came with few debts to burden the new British Treasury. The same could not be said for England, which came loaded with debt. Paterson set the problem as a negotiation over the price to be paid by England, in return for Scotland accepting a share of England's debt (which as a founder of the BoE, he possessed significant knowledge).

In the event, this was a price England was prepared to pay. It was termed 'The Equivalent'. It was worked out by Paterson and Gregory and a Committee, using Gregory's mathematical techniques, and Paterson's desire to mathematicise and rationalise the application of government, and banking; effectively the introduction and general application of present values to international and central banking finance; and therefore a revolution in the valuation of future cash flows (for the detail see William Derringer 'Calculated Values' (2018); Ch.2, pp.79-114). There is a glimpse of Gregory's cumbersome algebra, but then a cutting-edge formula for financial present values: $\frac{1}{(r-1)} - \frac{1}{(r^2 \times r - 1)}$ in the corner of a page in the Equivalent MS. The final sum, effectively was not the most relevant part of the process but rather the method of valuation; except first to Scotland, and second that it was agreed by both parties. The specie arrived in chests, carried up to Scotland, heavily guarded by soldiers and delivered in Edinburgh. A substantial part was paid not in specie, but bonds: more Debt. But then Paterson understood, in a way few understand now, that debt was not a weakness of England's, but the key to its power and strength; and it was transformative in Scotland, the recipient of the Equivalent in a new Currency, Sterling and more credit; but more important for the future of Scotland, it brought a new world of expansive commercial, mercantilist Empire; all driven on Sterling debt.

The Scottish elite took control of the specie and bonds; and here was the brilliance of the two-edged Paterson plan. A substantial part of the Equivalent was carefully set aside and paid directly as compensation for the Darien betrayal to its subscribers, whom had lost heavily from the disaster. Bribery, as many thought, then and since? Not in the politics of an age in which the elite self-defined 'political Scotland'. Not in the politics of a nation betrayed by its own ruler, and its Parliament damaged beyond the

contemplated repair of its majority electorate.

Some of the Equivalent, through a circuitous route ended as capital of the new Royal Bank of Scotland (1727); set up as competition for the original Bank of Scotland (1695). For many years both Sterling and the old Scottish currency were both used without difficulty in Scotland. The adjustment was made remarkably effectively. Sterling embedded itself in the fabric of Scottish life more than anything else in the Union that has survived to the present day.