Undermining Economic Resilience: The Economic Impact of Adopting the European Union's Stability and Growth Pact in an Independent Scotland

DISCUSSION PAPER

SUMMARY
What Our Paper Means for Scotland's Economy

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Undermining economic resilience.

It is essential to note that this is not an anti-European Union document. It was co-authored by a German economist currently working at the European Parliament* and a Scot who lived in Barcelona for more than a decade, with a son born in the Catalan capital. We both agree that, in time, EU membership may well prove the best decision for Scotland — socially, politically, and economically. But the opposite may also be true.

Our concern is that aligning Scotland's economic journey too closely with the European Union immediately upon independence risks undermining the very purpose of independence itself: the ability to design institutions tailored to Scotland's own needs.

Assuming Scotland becomes independent within the next few years, it would likely take at least a decade before it could formally join the EU. Aligning institutions too readily with EU frameworks from the outset would mean forfeiting the flexibility to create institutions that serve Scotland's best interests in the early years of independence. An independent Scotland requires fiscal flexibility, not self-imposed rules from a bloc it does not yet belong to.

The paper is also not anti-independence. The Scottish Government argues that independence will allow Scotland to "tailor policy to Scotland's needs; build greater equality and wellbeing; and become more resilient" (Scottish Government 2022 p. 6) . We fully agree—this is the fundamental case for independence. An independent Scotland has all of the necessary resources, skills, and institutional capacity to enable its citizens to prosper.

This paper demonstrates the value of rigorous, independent research into how economic choices, especially those made in the early years of independence, will influence Scotland's long-term prosperity. We urge the Scottish Government to support similar independent studies. The Currency Options for an Independent Wales (Laurentjoye 2024), commissioned by the Senedd Cymru, is a good example of how this kind of work can inform national policy in a meaningful way.

We argue throughout the paper that, as part of the United Kingdom, Scotland's economy is poorly served, but our principal concern is the current economic vision for independence as outlined by the Scottish Government.

We use the macroeconomic framework of sectoral balances developed by English economist Wynne Godley (1926-2010), which has long been a well-established tool in macroeconomic analysis. Sectoral balances provide a vital framework for understanding the interconnected dynamics of modern economies.

The paper is written with a specific period in mind: the decade after a vote for Scotland to become independent. We believe this transition period has been overlooked in Scottish government papers, including the most recent 'A fresh start with independence', which was published in October 2025, a month after this paper was released.

*The views expressed in the paper while hence be his private views and not those of the European Parliament or any of its members.

Constraining or enabling future economic choices.

The initial frameworks Scotland adopts — particularly fiscal rules, regulatory regimes, and monetary arrangements — will shape our long-term resilience and constrain or enable future choices.

Our paper is one of the few academic attempts to examine a specific institutional decision proposed for when Scotland becomes independent again — the plan to align with the EU's fiscal rules under the Stability and Growth Pact, which limits government deficits to 3% of GDP and total debt to 60% of GDP.

The main takeaway from the paper.

ALIGNING WITH THE EUROPEAN UNION'S STABILITY AND GROWTH PACT (SGP) WOULD LIKELY RESULT IN AT LEAST A DECADE AND A HALF OF AUSTERITY IN SCOTLAND, UNDERMINING THE SCOTTISH GOVERNMENT'S GOAL OF ACHIEVING EU MEMBERSHIP. FISCAL RULES OF THIS SORT ARE NOT APPROPRIATE FOR AN INDEPENDENT SCOTLAND.

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An independent Scotland on a pathway to comply with the EU's Stability and Growth Pact would be forced to cut its net spending path because of "excessive deficits". This would result in cuts to government spending and, at most, modest increases in tax rates.

As a result, economic growth would slow, unemployment would increase, and the availability of public goods and services would decrease. It would also likely increase household debt stress, disproportionately affecting the lowest earners, women, children, and minority groups. The extent of those cuts would depend on the speed at which the Scottish Government aligned with the SGP.

Using our most optimistic scenario (1.4% GDP growth), we calculate the impact of different pathways for the Scottish economy to comply with the SGP. In other words, how much pain would the economy have to take to achieve the 3% deficit rule in a specific period of time?

Figure 1 SGP Paathways with 1.4% GDP Growth

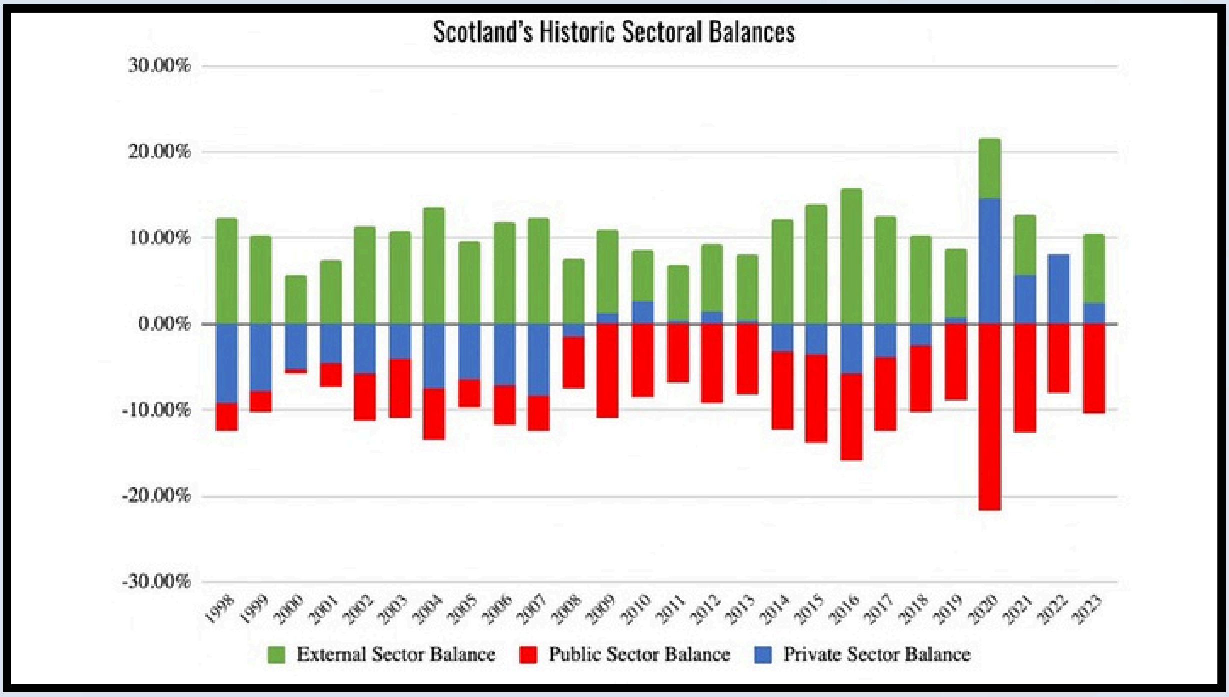
Pathway	Timeframe to Deficit < 3%	Annual Government Spending Reduction
One	3 years (by 2028)	12.5%
Two	5 years (by 2030)	7.5%
Three	10 years (by 2035)	3.2%
Four	15 years by (2040)	1.7%

Pathway two: roughly equiviant to Greece between 2008 - 2012
Pathway four: roughly equivant to Osborne's austerity 2010 - 2015

Scotland's Sectoral Balances.

Sectoral balances reflect a simple but fundamental principle: one sector's surplus must necessarily be matched by a deficit in another, as all financial transactions balance across the economy.

Figure 2, Scotland's Historic Sectoral Balances



Source, Ehnts & Thomson, 2025

The economy is divided into three sectors: the private sector (households and businesses), the government sector (in Scotland's case, Westminster, Holyrood, and Local Authorities), and the foreign sector (trade and financial transactions with the rest of the world).

By examining financial flows between sectors, sectoral balances provide a comprehensive view of how economic activity is distributed and sustained. Insights from sectoral balances underscore the crucial interplay between government deficits and private sector balances, providing a powerful lens to assess the impact of fiscal policy decisions and trade dynamics on a nation's economy. This approach shifts the focus from balancing government budgets to balancing the economy.

Modern economies are socially constructed to rely on robust sales and production to sustain growth; imbalances in any one sector can lead to broader economic instability. For example, if the private sector decides to save more out of their income, the resulting decline in demand must be offset by either increased government spending or net exports to prevent economic contraction.

The public sector balance, also known as the government budget deficit/surplus, is shown in red. Since the Global Financial Crisis (GFC) of 2007/08, the Scottish economy has normally run with a budget deficit of around 10% of GDP. The sectoral balances show that the corresponding surpluses were recorded in the private or external sectors.

The private sector balance, also known as private saving, is shown in blue. In Scotland, the private sector is often in deficit.

The external sector balance, also known as the trade deficit/surplus, is in green. The external sector is in surplus because the rest of the world (including rUK) sells more goods and services to Scotland than it buys from Scotland and extracts net financial wealth.

Without higher exports, lower foreign income outflows, or reduced private savings, the public deficit must rise to match the demand for Scottish financial wealth from the foreign and private sectors. Taken together, this strongly suggests that the Scottish Government would continue with a significant public deficit beyond the SGP limit of 3%.

In reality, it is politically unthinkable that a newly independent nation would start off by following policies that would reduce GDP in such an unplanned manner as to shrink net private wealth, either by reducing government expenditure or increasing taxes. This would result in significant fiscal austerity, with direct consequences for poverty and inequality in Scotland. If this is the economic strategy, it is unlikely to win independence.

Concerns with the current direction for an independent Scotland.

By focusing on the decision to align with the EU's SGP, we can highlight specific and more general concerns with the current direction for an independent Scottish economy:

- Principally, on the decision to align with the EU's Stability and Growth Pact, but also
- The more general institutional alignment with the EU
- The grandfathering of regulation from the UK
- The delayed implementation of a Scottish currency and the weakening economic resilience this will create
- The 'sound finance' neoliberal orthodoxy that underpins the current plan
- The lack of academic rigour and the deep inconsistencies in the current prospectus for independence
- The lack of understanding of the significant difference in sovereign power for Scotland between remaining a currency user and issuing its own sovereign fiat currency, and
- The lack of acknowledgement that financial instability and crisis are predominantly caused by a weakness in private finances, rather than in public finances.

A private-sector surplus of circa 10% of GDP would be essential to rebuild public services to a normal European level. A sustained double-figure government deficit would be manageable for a nation with high monetary sovereignty that pursued policies to enhance its economic resilience and would not pose an inflationary risk or downward pressure on a new currency. In fact, this level of private sector surplus would be essential for Scotland to chart a different economic path from the United Kingdom.

Scotland’s economy today.

The paper supports the need for alternative strategies across multiple sectors of Scotland’s economy that can be addressed today. The report lends significant weight to the argument that Scots are poorly served by the current devolved settlement.

It reframes the dominant narrative that Westminster spends “too much” on Scotland, explaining that, owing to the large foreign income outflows, Westminster's deficit spending is in fact too small to enable the private sector in Scotland to net save.

In only seven out of the last twenty-five years has it been possible for Scotland’s private sector to net save. Across the same time period, the wider UK private sector has been able to net save on fourteen occasions (Modern Money Lab, 2025), which is still low compared to other similar nations. Enabling Scots to spend less than their total income must be an essential goal for any government. We highlight that:

- The financial fragility of Scotland's private sector net wealth is of utmost concern
- The over-reliance and the ultimately negative impact of foreign direct investment will not significantly increase the private sector’s net wealth
- A realistic increase in exports will not significantly increase the private sector's net wealth
- Realistic levels of GDP growth will not significantly increase the private sector’s net wealth
- There is a need for larger public sector deficits now from Westminster, and in the future from Holyrood, and
- The Scottish Government needs to make community wealth building a genuine priority.

An alternative approach.

Economic rules should support macroeconomic stability, which benefits the overall economy. Sustainable use of resources, full employment, price stability, and a framework that concentrates on resilience are the foundations of a modern society. Without them, there is social, political, and economic instability, which creates a breeding ground for fascism.

While there is no one-size-fits-all solution, as the SGP has clearly shown, a set of rules tailored to each country's needs is beneficial for the social welfare of citizens today and in the future. Under the SGP, “fiscal sustainability” would constrain rather than enable public investment and services. Far from rejecting austerity, adopting the SGP would entrench it, undermining the progressive ambitions of independence itself.

A guide to macroeconomic stability

Sustainability: The Scottish Government should not spend money in a way that compromises the sustainability of the Scottish economy in terms of resources. Nor should it spend in a way that conflicts with international agreements such as the Paris Agreement.

Full employment: The Scottish Government should budget for full employment. It should set its net spending path to plausibly lead to zero involuntary unemployment. All those unable to find work in the public or private sectors should be able to secure employment through a government job guarantee.

Price stability: The Scottish Government should budget for price stability. It should use its available resources to buy and contract at prices that rise in line with the inflation target. If there is a shortage of resources, the government should, where possible, use supply-side policies to increase the quantity of the resource. If this is not politically feasible, it should use regulation, subsidies, and taxation to ensure an appropriate demand for the resource or source from other countries.

Resilience: The Scottish Government should budget to improve Scotland's economic resilience by increasing technological, food, and energy resilience and by ensuring wealth, income, and ownership are more broadly spread across Scotland.

Given Europe's economic history of developing before fiscal rules, it would seem that there is no economic benefit in applying the SGP to Scotland. On the contrary, the damage in terms of unemployment imposed on the Scottish people would be severe, with long-term effects including lower pensions and a permanent reduction in the workforce's skills and knowledge due to prolonged unemployment.

Reducing government spending will also lead to a decrease in the quantity and quality of public services, public goods, and public infrastructure. This will lead to a loss of productivity and competitiveness in the Scottish economy.

These problems would be intensified the longer the Scottish Government remains a currency user.

Our extended paper has demonstrated that progressive goals are incompatible with the EU's fiscal rules.

Should Scotland become independent in the next decade or so, we cannot rely on neoliberal fiscal rules from the 1990s. An alternative policy framework, based on functional finance and briefly outlined above, is both technically feasible and practically viable.

References

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Discussion Paper. Undermining Economic Resilience: The Economic Impact of Adopting the European Union's Stability and Growth Pact in an Independent Scotland, and the simple macroeconomic model of the Scottish Economy used in our growth models, are available from www.scotonomics.org/the-sgp-in-an-independent-scotland

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