

## THE LEGAL BASIS OF SCOTTISH BANKNOTES

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This briefing paper addresses the question of whether Scottish banknotes are legal tender in the rest of the UK.

The briefing looks at the meaning of the term legal tender and the effect this has on Scottish banknotes. It briefly addresses the history of the printing of Scottish banknotes and details the legal, legislative and financial basis for their existence. It concludes that, although they are not legal tender, even in Scotland, they remain a valid form of monetary exchange as promissory notes backed by the issuing banks holdings.

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Throughout this note the term Scottish banknote has been used to refer to banknotes printed by Scottish banks under the Bank Charter Act 1844. Currently the only Scottish banks able to print money are the Bank of Scotland, the Royal Bank of Scotland and the Clydesdale bank. However there were more in the past and this briefing is still relevant to these banknotes.

## **LEGAL TENDER**

“The concept of legal tender is often misunderstood. Contrary to popular opinion, legal tender is not a means of payment that must be accepted by the parties to a transaction, but rather a legally defined means of payment that should not be refused by a creditor in satisfaction of a debt. This makes legal tender a rather narrow legal concept that has little to do with the way in which most payments are made. In practice, people are often willing to accept payment by cheque, standing order, debit or credit card – in fact by any instrument that they are confident will deliver value.”  
(Bank of England, March 2003)

Under this narrow legal definition Scottish banknotes have never, even in Scotland, except for two very short periods during the two World Wars, been legal tender. Bank of England banknotes are also not legal tender in Scotland under this definition. Only coins from the Royal Mint are legal tender in Scotland and even these are subject to limitations, e.g. £1 worth of 1p coins is legal tender but £1.01 is not. £1 and £2 coins are legal tender in Scotland to unlimited amounts.

However, this does not detract from the value of Scottish banknotes as money. They carry a promise to pay which means that, should a note be presented at the headquarters of the issuing bank, the bank promises to exchange it for an equal amount of legal tender, hence cancelling the debt. This is backed up by the holdings of the issuing bank, which cannot issue more banknotes than it has holdings to cover. In the case of Scottish banks these holdings are expressed mostly in terms of Bank of England banknotes. These Bank of England banknotes are, in turn, backed by the holdings of the Bank of England. In the past these would have been in gold bullion but with the withdrawal of Britain from the Gold Standard in 1931 these are now expressed purely in terms of financial securities. Financial securities are stocks, shares, bonds and other financial market instruments that have a monetary value but are not expressly cash holdings

## **HISTORY OF BANKNOTES**

The situation that exists today, with the Bank of England having a monopoly on banknote printing in England and Wales and only three banks in Scotland issuing banknotes, arises directly from the Bank Charter Act 1844. This Act provided that any bank formed after 6 May 1844 would not be allowed to issue its own banknotes. Further, should a bank cease to issue notes, cease to exist or fall bankrupt it would lose its right to issue notes. In 1844 there were 15 banks in Scotland that were eligible to issue banknotes, but over the years mergers, bankruptcies and closures have reduced this number to three, the Bank of Scotland, the Royal Bank of Scotland and the Clydesdale Bank. This is also the case in England and Wales. Up until 1921, when the bank of Fox, Fowler and Co. in Somerset issued the last private bank note in England and Wales, the Bank of England was not the sole issuer of banknotes. Hence the production of Scottish banknotes is not because of a special derogation or allowance for Scotland; rather it is because of the enhanced longevity of banking institutions in Scotland.

Under the Banknote (Scotland) Act 1845, Scottish banks retain a right to print banknotes backed by their own holdings up to a limit that is based on the circulation in 1845. This amounts

to approximately £3m. However, the current circulation of Scottish banknotes amounts to approximately £1,500m. This excess can only be printed if it is backed by an equal holding by the bank of Bank of England notes.

Under Schedule 5, Part II, A1 of the Scotland Act 1998 the issue and circulation of money is a reserved matter, hence the Scottish Parliament has no powers to alter the legal position of Scottish banknotes.

## SUMMARY

To conclude, Scottish banknotes are not, strictly speaking, legal tender in either Scotland or the rest of the UK. However, this does not diminish their value as currency. Scottish banknotes are printed in accordance with UK wide laws laid down by Acts of the UK Parliament at Westminster. Approximately 99.8% of Scottish banknotes are backed up by equivalent holdings of Bank of England banknotes and all Scottish banknotes carry a promise to pay an equivalent amount of legal tender should they be presented to the issuing bank.

Further, since the issue and circulation of money are reserved matters, any alterations to the legal standing of Scottish banknotes would have to be made by the UK Parliament in Westminster so there can be no suggestion that devolution has altered the value of Scottish banknotes in England.

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