Inquiry into EU reform and the EU referendum: implications for Scotland

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Submission regarding the following issues:

- What does EU membership mean for Scotland's economy and its people? What are the implications for Scotland of the UK leaving the European Union?
- What would be the process for leaving the EU, including: the legal process with the EU and within the UK; withdrawal from the single market and EU trade agreements; the ending of free movement of persons; and transition arrangements?

1. This submission will focus on explaining what withdrawal from the EU would entail for Scotland, especially with regard to the single market and its four "fundamental freedoms". The latter consist of the free movement of goods, services, capital, and labour. It is by virtue of these four basic components of the single market that Scotland and its people derive the principal benefits of EU membership. Brexit jeopardises these benefits, a fact that serves to illustrate the many advantages of remaining in the EU.

2. A complete break with the EU is unimaginable since the single market is the location for half of UK trade and acts as a magnet for foreign investment. Complete withdrawal from this market would be self-destructive as the United Kingdom, and hence Scotland, would lose access to privileged trading terms beyond the "most-favoured nation" terms protected by the WTO,[1] significantly hurting the UK economy. As a non-member state, 90% of UK exports by value would become subject to EU tariffs (House of Commons, 2013: 27).

3. Different degrees of association with the EU are nevertheless possible as a non-member. Switzerland negotiates access to the single market bilaterally; Norway and Iceland are part of the European Economic Area (EEA), which entails full single market participation in return for domestic implementation of EU rules. It would be extremely incongruous to withdraw from the EU only to remain committed to enacting single market rules on a non-voting basis. The most plausible model for the UK if outside the EU is thus a bilateral one, even if in the Swiss case it has taken years of negotiations (and a number of issue-specific referendums) to put into practice.

[1] Under Article XXIV of the WTO Treaty, regional free trade areas, such as the EU, can offer favourable terms of trade that do not extend to third countries.

4. The bilateral model is highly imperfect for Scottish interests. Mobility of capital is vital with regards to Scotland's financial services industry, which accounts for roughly 7% of Scottish GDP. But adhering to EU regulatory authority over banking is unlikely to be sufficient in itself to protect Scotland's banks. Swiss financial institutions, for instance, are not entitled to do business directly in the EU (Centre for European Reform, 2014: 62-64). They are required by EU regulators to establish subsidiaries within a member state; most chose to locate in London. In the absence of a change to existing regulations then, Brexit would compel the relocation of bank operations, as Goldman Sachs have confirmed.[2]

5. The other three fundamental freedoms pose more serious difficulties still for bilateral negotiation. Free circulation of goods and services is the product of removing non-tariff barriers, which often depends on EU-wide standardisation of procedures regarding production and sale in the single market. Similarly, there are common minimum standards for health and safety at work, covering issues such as working time, break periods, contract rules for temporary workers, and maternity rights. These are one-size-fits-all policies that impose costs on British businesses. However, the possibility of negotiating access for British firms to the single market without following such rules is hard to imagine. It is not an attractive proposition for EU countries to allow their firms to compete on uneven terms. In this case Scottish firms are likely to have to continue to implement EU single market regulation even after a Brexit.

6. The free movement of individual citizens – often at the heart of the most virulent Eurosceptic critiques of EU integration – currently affords enormous reciprocal gains for Scotland. The obligation to treat Britons and EU/EEA citizens equally is the ground for unrestricted EU migration access to education and welfare on the same terms as British nationals. In return, Britons have the right to study, work, or retire across these countries. Repudiating this arrangement wholesale will hurt Scottish businesses, which benefit from a much bigger pool of skilled workers (there are over 120,000 EU citizens over the age of 16 in Scotland).

7. Brexit negotiations would thus involve a highly delicate balancing act: one of deciding how far to participate in single market areas while meeting EU obligations, now and in the future. All this would take time and sap business confidence as future terms of trade would be shrouded in uncertainty.

[2] http://www.politico.eu/article/brexit-city-london-financial/

8. Uncertainty would permanently surround a British withdrawal as any bilateral UK-EU market arrangement would be vulnerable to future changes. Within the EU judicial space, member states are not entitled to resort to tit-for-tat retaliatory measures if they feel another government is fudging common rules e.g. banning French wine in protest at restrictions on British beef imports during the BSE epidemic. It is the job of the Commission to investigate and for the CJEU to arbitrate if such evidence is found. Outside the EU, matters are different. Should the UK government, as a non-EU member, unilaterally change the terms of trade through new, discriminatory regulations the EU would respond in kind. This logic was demonstrated after the Swiss referendum to restrict EU immigration was passed in 2014, which broke the terms of the EU-Swiss agreement on free movement of labour. In response, the European Commission swiftly retaliated by excluding Switzerland from participation in the Erasmus university exchange and the €80 billion research funding programme Horizon 2020, which the Swiss help finance.[3]

9. Consequently, the risk is that a Brexit deal concerning single market access would have to be revisited periodically in response to domestic legislative developments. In Scotland's case, the abrogation or amendment of an EU agreement by Westminster would leave business and people in Scotland vulnerable to retaliatory action by Brussels. The Scottish government should thus expect to monitor closely UK legislation for any potential impact on the status of the terms of access to the single market.

10. Finally, the end of the UK's membership would also have significant financial repercussions for Scotland. Both Norway and Switzerland pay into the EU's coffers in return for their market access, meaning the UK would have to do the same. The costs involved, however, are much lower than those for the UK as an EU member state because these non-members do not participate in the expensive Common Agricultural Policy. The absence of CAP support for farmers and rural communities would be particularly disruptive to the Scottish economy as total income from farming is estimated at £688 million for 2014. At the moment, CAP monies are not part of Holyrood's Departmental Expenditure Limits. The British government and the devolved legislatures would thus need to examine how to finance grants and subsidies in agriculture, fisheries, and food as expenditure in these areas is not present in the Barnett Formula. Hence nothing less than an overhaul of the budgetary system of devolution across the

[3] In September 2014 a compromise was reached allowing Swiss universities to participate in some EU-funded research until 2016, after which continued participation is dependent upon Switzerland accepting the extension of free movement to Croatian citizens.

UK would be required. This process is bound to be politically fraught and time-consuming.

REFERENCES

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