European and External Relations Committee

The EU referendum and its implications for Scotland

Written submission from Ben Thomson

Proposal

If Scotland is to establish a strong, separate relationship with the European Union (EU) post a Brexit that best suits Scotland’s economic and social requirements, then it will require a different relationship with the UK. This paper sets out the case for “Home Rule” the principles of which were advocated by the CSHR, that would allow Scotland the flexibility to establish its own relationship with the EU, particularly for devolved matters, whilst still remaining a part of the UK and within the sterling monetary system. It also sets out that following Brexit certain EU restrictions fall away, such as varying the rate of VAT within a member state, that will allow further devolved powers for Scotland to be considered.

The paper assumes Brexit will go ahead on some basis and does not speculate on whether there will be a reversal of the decision reached in the referendum. It also assumes that the UK will impose some restrictions on migration of EU citizens, given that this was such a key political issue in the referendum campaign.

Rationale for a strong relationship between Scotland and the EU

The world is becoming increasingly global, not just in terms of financial trade but also in areas such as the movement of people, communication, tackling poverty, agreements on the environment and defence against terrorism. In such an increasingly global world, it is important that Scotland maintains a strong presence in external affairs.

It is likely over the next generation that global politics will change. For instance, it is unsustainable that all 193 nation states in the United Nations can have a direct voice or that the security council of 5 permanent members is democratic when 2 members, France and UK, have together less than 2% of world population. It is almost inevitable over time that global representation will be organised into continental regions with Europe, with just over 10% of the world’s population, being one region. Representation on other global bodies whether global corporates, charities or government organisations are also likely to move to a continental regional basis. Therefore, it is vitally important that Scotland has a strong role within Europe as a conduit for global representation, particularly as Scotland’s largest export industries; whisky, oil and gas and financial services are all global in nature.

The EU is our most important overseas trading zone, representing some 42%\(^1\) of overseas exports from Scotland. It is therefore important that Scotland maintains a strong trading relationship with the EU. This is not the same as the rest of the UK

Scottish Government 2014 Export Statistics Scotland
where the 4 largest industries are financial services, aerospace, pharmaceuticals and automotive\(^2\) and have different requirements to Scotland.

Part of the reason for the vote for Brexit in the referendum in general was fear over immigration. This may be a problem for parts of the UK where there has been a large influx of migrant workers from the EU. The UK’s population has increased by 8.4\(^3\) over the last 5 years with 85\(^4\)% from EU migrants. Scotland’s population has only increased by 5.1\(^5\)% over the same period and with the potential time bomb of an ageing population needs a controlled increase in its migrant workforce to achieve a demographic balance.

Lastly, although the referendum was a UK vote, Scotland clearly voted to remain within the EU. Scotland has long historical ties with Europe and the nature of the relationship between Scotland and Europe is different to England. Circumstantial evidence from a number of friends travelling around Europe this summer would suggest a different response to travellers who say they are Scottish rather than English.

In summary, Scotland needs a strong relationship with Europe if it is to have global representation; to benefit from trading with its largest overseas partner in the industries which define the Scottish economy, to ensure the right balance of its skilled workforce and because culturally Scots feel European and voted overwhelmingly to stay in the EU.

**Rationale for relationship between Scotland and the UK**

The benefits of being part of the UK are both financial, social and cultural.

The UK is Scotland’s largest trading partner with some 66\(^6\)% of all exports to the rest of the UK. It therefore makes sense for Scotland to be part of the UK’s single currency system as transactions would be more costly if there were currency exchanges between Scotland and rUK and monetary union provides all parts of the UK with financial security which in turn lowers the cost of borrowing. For a stable currency system there needs to be stable monetary policy controlled by a central bank and enough political union that there is minimal resentment that one region subsidises another region and accepts that the national debt is the responsibility of all. Therefore, the sterling zone is a strong rationale for the UK and sufficient political integration is needed for such a single currency zone to operate.

In addition, there are some public sector services such as defence and counter terrorism that arguably are better done at a UK level.

On a social level, a good relationship between Scotland and the rUK is vital in some form of Union. It is after all what was voted for in the Scottish referendum. However,


\(^3\) [http://www.tradingeconomics.com/united-kingdom/population](http://www.tradingeconomics.com/united-kingdom/population) 60,070,000 2010 / 65,100,000 2015

\(^4\) [https://fullfact.org/immigration/eu-migration-and-uk/](https://fullfact.org/immigration/eu-migration-and-uk/) 100,000 EU net migration 2010 / 185,000 2015


it may be possible to structure the Union in a better way that would allow Scotland to have a different relationship with the EU.

The type of relationship between the UK and Europe

There are many types of relationship between European countries. Even within the EU different nation states have different status; the UK is one of 8 countries out of the 28 member states that are not in the Euro. Being in the euro zone requires closer political integration with the greater monetary policy homogenisation. In addition, not all EU states are in Schengen border arrangements but some nations outside the EU are, such as Switzerland.

There are also the 3 additional countries in the EEA: Norway, Switzerland and Lichtenstein and principalities such as Monaco, Vatican City, Malta, San Marino and Andorra that have their own relationship with the EU. Overriding all of these different arrangements within Europe is the European Free Trade Zone.

The loosest possible basis that holds all of these arrangements together in the European Free Trade Zone is the 4 freedoms; movement of capital, goods, services and people. The UK government should welcome the first 3 of these freedoms as they are viewed as positive to economic growth. However, free movement of people is more problematic given the issue surrounding immigration. This is probably the key debate between the UK and EU. Its results will also make a huge difference to the relationship between Scotland and the UK as well as Scotland and the EU.

Consequences of a UK immigration control on EU members

In the event the UK leaves the EU with restrictions on EU members then it is likely the UK would not be able to join the current European Free Trading Zone given it would not have adhered to 1 of the 4 key principles. This would have severe consequences in two ways. Firstly, the movement of capital, goods and services could be restricted with potential for tariffs, quotas and border checks. This would not benefit either the UK or Europe and have a likely impact on economic activity.

In addition, restrictions on movement of people could also impact growth through limiting parts of the country that need skilled labour,

It could even cause political and civil instability most particularly in the border controls between Eire and Northern Ireland.

Northern Ireland has argued, and will continue to argue, that restrictions on its borders with Eire should be free not just for trade but also to secure peace. Not only is there the free movement of goods, services, capital and people but also people on either side of the border may hold both nationalities. This was a key part of the peace accord in 1998. Therefore, as the Prime Minister has already stated, there will need to be special arrangements on the Eire/Northern Ireland border. If this is so it raises two questions.

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[^7]: http://ec.europa.eu/economy_finance/euro/index_en.htm
[^8]: https://www.gov.uk/eu-eea
[^9]: https://en.wikipedia.org/wiki/Good_Friday_Agreement
Firstly, will there then be border controls between Northern Ireland and the rest of the UK to avoid an obvious route into the UK and change the nature of citizenship in Northern Ireland? Second, once one part of the UK has special arrangements does this set a precedent for other areas of the UK.

**Why is home rule a potential solution?**

Given the positive rationales for Scotland having a strong relationship with both the UK and Europe given above, and given the scenario that the UK Brexit will happen and with some sort of migration controls, then Home Rule provides a potential solution for Scotland to have a different relationship with the EU (though perhaps not as a member) that is more suited to its needs and reflects the voting of Scots in the referendum.

It is feasible that under Home Rule Scotland could join the EU (“the reverse Greenland situation”). In 1985 Greenland left the EU after it got Home Rule from Denmark. However, the reverse situation is England and Wales getting Home Rule and leaving. It is possible, but seems unlikely. More likely is that Scotland and rUK can create different relationships with the EU and are able to negotiate separately with the EU on devolved matters. This is much more feasible if the UK had Home Rule as proposed by the CSHR.

Home Rule as set out in the CSHR had 3 core principles as set out below:

1. **Raise what you spend**

   Ensuring that both Holyrood and Westminster have responsibility over the tax and borrowing powers required to make each of them responsible for raising the money that they spend. At the heart of this principle both governments should have the powers to change, create or abolish taxes for which they are responsible. It would be the responsibility of future Scottish Parliaments and the parties that control them to determine how the powers are used, making them properly accountable to the electorate. It would be easier for Westminster to reserve certain tax powers in the same way it currently reserves the rest of the devolved powers. The UK government would remain responsible for the overall UK wide monetary and fiscal regime and to ensure that areas of the UK with economic or social difficulties should have access to support through redistribution and that Scotland continues to contribute its fair share to fund that support. This would be on a needs basis such as advocated by the Holtham Commission.

   The majority of Scotland’s spending is still reliant on funding from fiscal transfer from Westminster which reduces responsibility and blurs lines of accountability. Home Rule will enable Scotland to take such responsibility, which should enable it to be in a better position to benefit from any relationship it develops directly with Europe.

2. **Devolved responsibilities**

   A presumption in favour of devolving responsibility to Holyrood. Schedule 5 of the Scotland Act 1998 should be reviewed and the burden of proof for
reserving a power rest with Westminster should it wish to retain that responsibility. At the very least, Holyrood should have control over the reserved powers which are linked to devolved responsibilities.

In particular, responsibility for alleviating poverty is currently a largely devolved area however many of the associated powers such as welfare are set and determined by Westminster. In 2012/13, £16.4bn of identifiable expenditure coming to Scotland was for social protection. Even if pensions, maternity/paternity pay and the free TV licence for over 75s were excluded then some £6.5bn of welfare expenditure could be devolved to the Scottish Government to create welfare structures best suited for managing its responsibilities to alleviate poverty.

3. Mutual respect

Ensuring the Scottish Parliament is made permanent with a written set of arrangements that cannot be altered without the consent of both parliaments. This principle should also be considered between Holyrood and Local Government.

Addressing the democratic deficit and improving the relationship between Scotland and the rest of the UK by strengthening the mutual respect between Parliaments and considering other ways to strengthen the constitutional position of Scotland.

How to adapt home rule if UK left the EU

The principles of Home Rule could be adopted and extended to accommodate Brexit as follows:

Principle 1  Raise what you spend

Under the Scotland 2016 Act, income tax rates and most bands will be devolved and 50% of VAT was assigned. In total Scotland will now be responsible for devolved taxes where it can change the rate for 30%\(^\text{10}\) of Scottish Parliament tax income as a percentage of total tax raised in Scotland and 37%\(^\text{11}\) of Scottish Parliament tax income as a percentage of Scottish Parliament expenditure in 2015/2016.

One of the potential benefits of Brexit will be that VAT will no longer be restricted by the EU from being varied within a nation state. Therefore, VAT can now be devolved to Holyrood rather than assigned. In addition, Holyrood could opt for a straight sales tax similar to the US rather than stick with the more complicated VAT. A devolved tax on sales could make sense as it would allow Holyrood both to benefit from economic upturns as well as influence economic development through taxation. It also gives Holyrood more power to alter and therefore use taxes to create fiscal stimuli. At present the power to alter only one significant tax, income tax, does not create enough fiscal tools to encourage real tax change.

\(^{10}\) https://reformscotland.com/2016/03/constitution-fact-sheet-june-2015/

\(^{11}\) https://reformscotland.com/2016/03/constitution-fact-sheet-june-2015/
The Scotland Act 2012 identified that for the purposes of income tax there would need to be “Scottish Income Tax” payer to identify who paid Scottish income tax. If further taxes are devolved then this would need to be extended to a Scottish Citizen who would be identified both for devolved taxes and welfare payments.

**Principle 2  Devolved responsibility**

The two largest areas of EU expenditure are on economic development and sustainable resources (agriculture), in total making up about 80% of the EU budget. However agriculture, fisheries and economic development are all largely devolved areas to Holyrood. It would therefore seem rational that EU areas of responsibility that have been devolved should return to Holyrood, not Westminster.

In addition, it makes no sense for the Westminster minister of a devolved area such as agriculture negotiating with the EU representing Scotland when the devolved policy may be different from the UK policy. Therefore on devolved matters the responsibility for negotiating directly with the EU should be devolved to Holyrood. On reserved matters such as defence then Westminster would negotiate directly with the EU after Brexit.

As Holyrood is largely responsible for the Scottish Economy, regulation of the labour market including the responsibility for maintaining a skilled labour force should be devolved. Scotland’s demographics are not the same as many other parts of the UK and migration of skilled labour into Scotland is, now and may in future be, different. Therefore, in order for Holyrood to carry out its responsibilities to ensure a skilled labour force it should have control over the migration of workers as a devolved power. With the creation of a Scottish Citizen (required for tax purposes) migration of workers can be controlled by the work force far more easily than with border controls. In addition, greater devolved welfare powers will give Holyrood the tools to create its own environment to develop a fair structure between work force migration and benefits migration.

**Principle 3  Mutual respect**

Two referendums in the last 2 years should have highlighted the difficulties of making constitutional decisions through referendum. A legislative and written arrangement between Westminster and Holyrood would provide a mutually agreed process for subsequent change.

**Conclusion**

Holyrood in its current form is in danger of having little influence in both the current Brexit debate and after Brexit establishing a separate relationship with Europe. This is largely because it does not have enough fiscal and constitutional tools around the area of its devolved responsibilities.

One option to achieve this would be another referendum on Independence. However, this is against a background of statements made before the last referendum about a “once in a generation” event and against a Scottish economy
and public sector economy that has significantly deteriorated with a £15\textsuperscript{12} billion public sector deficit. Therefore, even if there was another referendum there is no clear evidence the public’s position has changed.

Home Rule however could be adopted within the next 2 years without a referendum and give Holyrood a much greater role in both negotiating Brexit and developing different policies for devolved matters. Scotland would remain in the UK and benefit from the sterling zone, borrowing rates, workforce mobility and UK defence.

Therefore, I believe that Home Rule is the best platform to develop Scotland’s position in Europe given the UK vote to exit the EU last June.

\textsuperscript{12}http://www.gov.scot/Publications/2016/08/2132