European and External Relations Committee
The EU referendum and its implications for Scotland
Written submission from CBI Scotland

We welcome the opportunity to respond to the Committee’s inquiry on Scotland’s relationship with the EU. As the source of economic growth, jobs and opportunity in our communities and regions, business has an important role in maintaining stability and helping to plot Scotland’s future in the wake of the EU referendum result.

In the weeks since June 23rd, the CBI has consulted with over 500 of its members of all sizes and sectors across the UK to gauge their reactions to the vote to leave the EU. Opinions vary between businesses but there are some clear areas where policymakers and businesses can work together to secure the best settlement possible.

This submission by CBI Scotland to the European and External Relations Committee will argue that:

1. The immediate economic impacts of the vote to leave the EU are mixed but the business community is showing impressive resilience
2. Scottish businesses are working hard to maintain positive relationships with their international partners
3. The Scottish government and Scottish businesses must both be involved in the withdrawal process, which must be clarified as quickly as possible
4. No other country has an alternative relationship with the EU that would be a perfect model for the UK’s future arrangement, which should be characterised by a commitment to openness and the preservation of a deep economic relationship between the UK and the EU
5. Policy-makers and business will have to work together at a domestic level to manage changes to funding systems and the new trading and regulatory relationship between Scotland and the EU
6. The UK’s immigration system will need to allow companies to access the people and skills they need, while recognising public concerns

1. The immediate economic impacts of the vote to leave the EU are mixed but the business community is showing impressive resilience

It is difficult to fully assess the immediate economic impact of the vote to leave the EU as there is still only a limited amount of data, but the consequences so far have been mixed. The CBI’s growth indicator (which covers around 75% of the private sector economy) showed only a modest slowing in growth in the three months to July, with variation between sectors. Manufacturing output recovered and, while retail sales fell on a year ago, retailers suggest this was more affected by bad weather than the referendum.

Some Scottish businesses have suffered as a result of the fall in the pound, and some have benefited. There has been a significant improvement in the
competitiveness of exports – helping externally-facing industries, but the price of imported goods and raw materials is increasing. This rise in the cost of imports is affecting Scottish businesses as diverse as printing presses faced with higher paper costs and logistics companies forced to renegotiate prices on bulk orders of vans. The increase will offset some – if not all - of the gain in export competitiveness, and will put upwards pressure on inflation.

Many businesses are reassessing their investment intentions as a result of pressure on pension deficits and uncertainty. Evidence from Purchasing Managers’ Indices, the CBI’s survey data and conversations with members show serious deterioration in business sentiment and a sharp fall in activity in July as a result of the uncertainty caused by the vote to leave. This uncertainty, combined with additional pressure on pension deficits from lower government bond yields, has led many – though by no means all – Scottish businesses to pause their investment plans.

The Scottish government has the power to tackle some of this uncertainty by taking domestic action to drive a strong and prosperous Scotland that succeeds beyond an exit from the EU. Business can deliver vital infrastructure for Scotland, but it needs political commitment across priority areas like transport – including the A82, A9, A96 and the Glasgow terminal and airport link. The rollout of digital connectivity needs to continue, and a boost to housing supply necessary. The quality of education is the most significant determinant of the long-term health of our economy, and aligning education and skills pathways with the needs of the economy will deliver opportunities for all. Use of the Scottish government’s existing and new tax powers – including the ability to immediately cut APD on Band B by 50%, and a review of business rates to reverse the burden on business - would send a clear signal that Scotland is open to the world. Building on Scotland’s core strengths and addressing the practical issues affecting the economy will send a signal that Scotland is the place business can thrive.

2. Scottish businesses are working hard to maintain positive relationships with their international partners

Of greatest immediate concern to many Scottish businesses is the impact of the vote to leave on their employees. EU citizens in particular, but foreign-born workers in general, have experienced a rise in racially-motivated hate crime and discriminatory sentiment. The Scottish government’s rapid reassurance for EU workers was welcome, and many Scottish businesses have communicated what support they can to EU citizens in their workforces, but the perception of the UK as a place to live, work and do business has been altered.

This is also reflected in the sentiment of European businesses towards the UK. Many Scottish universities involved in collaborative research projects have reported a “cooling” in relations between themselves and EU partners, particularly when it comes to participating in consortia making new applications for funding. Similarly, many Scottish companies which do business in the EU have found it necessary to dedicate substantial levels of time and effort to protecting previously solid relationships with their customers and suppliers, who are concerned and uncertain about what the vote to leave means for their partnerships.
3. The Scottish government and Scottish businesses must be involved in the withdrawal process, which must be clarified as quickly as possible

Governments and businesses must work closely together to make the most of the vote to leave - identifying opportunities while safeguarding the benefits of a close relationship with the EU. The Scottish business community has welcomed the Scottish government’s quick efforts to involve business in this process, and would like to see this dialogue continue. The business community is willing to help, and the CBI is ready to assist policy-makers in working with representatives from across the economy on this issue.

Ensuring that the needs of Scotland and other devolved nation governments are represented in the discussions on the UK’s future is critical. The implications for all regions and nations of the UK must be understood by all who have a role in negotiations with the EU. All devolved nation governments should be able to nominate senior civil servants to work in the Department for Exiting the European Union and provide a liaison point for those business with operations in the devolved nations.

For businesses to continue to have confidence to invest in Scotland, the UK government must outline its intentions as soon as possible. Business understands that it will take time for the UK government to set out the detail of its plan, and it is important that the plan it eventually presents meets the needs of the diverse array of stakeholders affected by this decision. However, the level of uncertainty in the business community means that some clarification is necessary early. This is an urgent priority. A decision over the timetable for the invocation of Article 50 is a key part of the outline business needs, as is the process for developing and communicating the principles that will underpin the negotiation of a new relationship with the EU.

If uncertainty around Scotland’s relationship with the EU is prolonged, it will have long-term impacts on the economic health of the nation. Many Scottish businesses currently form a part of pan-European or international supply chains, providing a small component or specialised service as part of a process that produces a larger product. The complex nature of these supply chains means that planning can take place 3-5 years before the product comes to market. Similarly, international companies with subsidiaries Scotland will make investment decisions a decade or more in advance. Scotland competes with other countries to attract that international investment. Extended uncertainty about the UK’s EU membership could make it less attractive to include Scottish companies in these long-term plans, with the effects being felt for many years.
4. No other country has an alternative relationship with the EU that would be a perfect model for the UK’s future arrangement, which must be characterised by a commitment to openness and the preservation of a deep economic relationship between the UK and the EU.

The UK’s situation is very different to that of other countries with alternative preferential relationships with the EU. Association and Free Trade Agreements are almost universally negotiated with the intention of bringing countries closer together, but the UK and the EU are already more deeply integrated than countries in any other economic relationship. For this reason, alongside the size and complexity of the UK economy, the agreement that the UK seeks to secure is unlikely to strictly adhere to any of the established models. However, the alternative models can provide a basis of comparison that is helpful.

It will be important to approach the UK-EU negotiations in a way that champions principles of openness and the preservation of a deep economic relationship between the UK and the EU, rather than limiting negotiations to the current alternative models. The UK’s new relationship with the EU must retain the ease of UK-EU trade that businesses get from the single market, and balance regulatory equivalence with the EU with flexibility and influence over the domestic environment. It must also ensure that the UK’s migration system allows companies to access the people and skills that they need, while recognising public concerns. The economic and social benefits of EU funded projects must be protected, and the UK must develop a clear strategy for international trade and other economic agreements which are currently managed through the EU.

Within the European Economic Area, Scottish businesses would experience many – but not all - of the benefits of full access to the EU single market in goods and services, providing the UK implements all relevant EU regulation. Without any formal influence over these regulations, this could prove challenging. Additionally, outside the EU customs union, non-tariff barriers to trade would create delays and increase costs. There would, however, potentially be opportunities from being outside the customs union, as it would allow the UK to control its external tariff and strike deals with new countries across the world. Free movement of people would continue.

Under a Swiss relationship model, business’ access to the single market would be nuanced and complex, particularly in services. The Swiss agreement does not cover financial services, a significant downside – as Scottish banks would be required to establish subsidiaries inside EU countries in order to access passporting and the EU single market in financial services. As under the EEA model, the UK would be required to implement EU law in the areas covered by the agreement but would not have influence over its direction. The UK would also be able to sign its own trade deals with countries across the world and free movement of people would continue.

A customs union relationship like Turkey’s would provide a loose relationship with the EU with the benefit of removing tariffs. It is also currently the only way to remove non-tariff barriers at customs on trade in goods between the UK and the EU. However, the Customs Union’s scope is limited and services are not considered. For
Scotland, the most difficult element would be that it would not have access to the markets that the EU has agreed free trade deals with, but those countries would have access to the Scottish market. For example, goods that entered the EU through an FTA to which the UK was not a party could flood the UK market. While the UK could seek its own trade deals, the EU would have to give approval first.

If the UK’s relationship with the EU was governed by WTO rules only, Scotland would not benefit from tariff- and barrier-free access to the EU single market in goods and services. Scottish businesses would be subject to tariffs and certain sectors would face a significant impact, with tariffs as high as 20% on food, drink and tobacco exports or 10% on clothing exports. The UK would be able to focus efforts on securing comprehensive trade deals with countries around the world to mitigate some of the impact of tariffs and barriers to trade with the EU. The WTO model provides the loosest relationship with the EU, with the least access to the EU market but no obligations regarding free movement of people, implementation of EU rules or budgetary contributions.

Under a Free Trade Agreement similar to the EU-Canada Comprehensive Economic and Trade Agreement, Scottish businesses would be able to undertake tariff-free trade in goods with the EU, but would experience non-tariff barriers to both goods and services trade. This model would exclude participation in free movement of people. Over time, companies would be likely to find divergence between the UK and EU’s regulatory environments, as Free Trade Agreements are not updated over time. However, this relationship also provides significantly more flexibility to determine the domestic regulatory environment. It would allow the UK to negotiate its own trade deals, as it would be outside the customs union and the common external tariff.

5. Policy-makers and business will have to work together at a domestic level to manage changes to funding systems and the new trading and regulatory relationship between Scotland and the EU

Continued easy access to the EU market, with minimal barriers, is the Scottish business community’s primary concern in relation to the UK-EU negotiations. Scotland’s importing and exporting businesses need trade with the EU to be tariff-free and as uncomplicated as possible. Extra paperwork, multiple sets of standards and multiple sets of regulation all cause delays, costs and complications, which most significantly affect small businesses and those who form parts of supply chains. The right of UK services companies to establish and provide services in other EU countries must also be maintained.

While there may be opportunities for more domestic flexibility outside the EU, this must be balanced with the need for regulatory equivalence that allows Scottish businesses access to the EU market. Governments and business will have to work very closely together to look at the legal frameworks currently in place. There are particularly integrated arrangements in areas like financial services regulation, the Common Aviation Area, the digital single market – from data flows to intellectual property – and the internal energy market. Clarification is particularly needed for areas which are regulated by pan-European authorities – such as the European Medicines Agency which licenses pharmaceuticals across Europe.
there may be areas for domestic flexibility going forwards, a careful balance must be maintained between opportunities for new approaches and the regulatory equivalence required for access to the single market in highly tradable sectors.

**New strategies will be required for domestic investment in the areas currently covered by European funds.** Scottish business welcomed the announcement of some protections for EU-funded projects agreed up to the UK Government’s Autumn Statement. However, clarification is urgently needed for funds that have not yet been allocated, the future of the UK’s involvement in collaborative projects and the European Investment Bank. In the medium-term, work will have to take place at the domestic level to establish priorities for investment in the areas currently covered by EU funding. The future of agriculture, infrastructure, innovation, research and development will need to be explored. To avoid pauses in vital areas of the Scotland’s growth, the Scottish government must work closely with the UK government to complete the majority of this work before departure from the EU, when the new economic landscape is clear.

The **Scottish government must be prepared to take targeted action at a domestic level if leaving the EU impacts certain sectors of the economy disproportionately.** It is too early to tell how evenly any negative effects of leaving the EU may be experienced by the Scottish business community. Where some sectors may experience real opportunity – which must be grasped, others – particularly exporting businesses – may be negatively affected. If the progress of the negotiations begin to indicate that this may be the case, the Scottish government must explore targeted domestic action to protect the health of these sectors before the UK leaves the EU.

Where domestic flexibility may increase outside of the EU, the devolved nation and UK governments must work together to ensure new initiatives do not impede the ease of trade between the nations. Trade with the rest of the UK currently accounts for 65% of all Scottish ‘exports’. Devolved powers should be used to improve the attractiveness of the business environment in Scotland and drive growth in the Scottish economy. It is important that divergence between the nations outside of the EU does not result in regulatory barriers on an intra-UK level.

6. **The UK’s immigration system will need to allow companies to access the people and skills they need, while recognising public concerns**

The UK’s immigration system must be one that has the confidence of the public, and it must be open and outward-looking. The net migration target, introduced by the UK government in 2010, has driven a narrow debate on migration in the UK that is centred on numbers. While measuring net migration is one way to gain an understanding of the levels of inflow and outflow from the UK, it fails to differentiate between different types of migrants and the different values they bring. Neither businesses nor the public consider migrants to the UK to be a homogenous group. The political debate must recognise and reflect this. We need to move away from a debate about a net migration target to one that ensures that those coming to the UK make a positive contribution to our economy and society. A nuanced and informed debate should recognise the benefits of different types of migration.
Businesses recognise the need to strike a balance in our migration system and respond to public concern about the social impacts of immigration. The UK government's efforts to date to demonstrate our migration system is managed have had no impact on the public’s perception of our migration system. This is because the revenue raised from measures like the Immigration Health Surcharge and the forthcoming skills charge is not being effectively directed to relieve the pressures on services in areas of population growth. The funding of public services is not currently responsive enough to changes in population, so a more direct link between the benefits of migration and affected areas is needed. Ring-fencing the revenue raised from employers and properly targeting it at the services in the most affected regions and communities would more effectively manage the impact on public services of migration.

The vote to leave the EU clearly demonstrates that an alternative to free movement is needed. But it is vital to recognise how deeply integrated the UK has become after 40 years of close partnership. There are currently around 3 million EU nationals in the UK and more than a million UK nationals in EU member states. The spike in hate crime following the referendum and the uncertainty faced by many employees is deeply concerning for many businesses. A generous system must be put in place for EU nationals currently in the UK confirming their right to stay – this should be reciprocated by all member states in the European Union. Reassurances should be made for EU migrants already in the UK and UK citizen’s resident in the EU. Clarity should also be given on their future status, once the UK has left the EU.

In an increasingly global environment, where more jobs can be situated in any country, the UK needs a competitive migration system to attract the investment and jobs that create prosperity. A critical element of this is the movement of highly skilled migrants across Europe. While in some sectors and occupations, such as agriculture and hospitality, the UK labour market is facing significant labour shortages. Currently, free movement across the EU supports this labour demand. The UK’s future migration system must maintain both access to European skills and sustain a ready labour supply from our nearest neighbours.

Firms do not choose either to invest in training or to recruit from overseas – they do both. Firms are already investing in the skills of their UK workforces, and young people in particular. Businesses need both in order to gain a competitive edge and ensure global jobs are based here rather than elsewhere. Attracting jobs to the UK brings wider benefits, boosting productivity and living standards. Businesses also benefit from being able to move their employees around the EU to share knowledge and foster innovation. Business and Government should work closely together to build an immigration system that works for the economy and for society.

International students contribute to the local economies in which they are based and provide vital income streams for our world-leading universities. Educating the world’s top talent is a growth opportunity for the UK that we must capitalise on by encouraging international students to study here and fill skill shortage vacancies once they have graduated. The UK’s migration system must maintain access to students and staff to ensure UK universities remain world-leading. Guaranteed protections for students should be considered. European students currently applying to study in the UK, and UK students currently applying to study in the EU, should be encouraged to continue.