European and External Relations Committee

The EU referendum and its implications for Scotland

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1. This evidence looks at the most likely scenarios for the UK’s future EU relations in the context of the 23rd June Brexit vote. It considers timing issues and the choices for Scotland given the likely scenarios for the UK.

Possible Brexit outcomes for the UK

2. Given the uncertainty over the UK government’s Brexit intentions including the apparent continuing debate within government over their preferred approach, the uncertainty too around the political impact of the upcoming Supreme Court judgement, and uncertainty around how the EU27 will respond to any UK negotiating pitch, it is necessary to consider a range of outcomes and scenarios.

3. There are four main outcomes to consider: an ultra-hard Brexit where the UK falls back onto World Trade Organisation (WTO) rules; a bespoke, Canadian-style trade deal; a Norway-style European Economic Area (EEA) deal or no Brexit at all.

WTO Outcome

4. Despite some pro-Brexit voices arguing for a rapid break with the EU and a move to WTO rules, this scenario looks unlikely as one that the UK government or the EU27 would aim for. However, it is one that could become relevant if the two years of talks once Article 50 is triggered go badly. If there is no UK-EU27 deal then the UK will leave automatically after two years, unless the EU27 and the UK agree to extend this period (this is unlikely but not impossible). In this situation – exit with no deal – WTO rules would then apply. The UK would also need to agreed its own WTO schedule of commitments which may or not prove tricky.

5. A WTO scenario, especially one that happened with little time for planning, would risk being chaotic for businesses who would not have systems ready for handling, applying and trading according to appropriate tariffs. Those businesses with cross-European supply chains and just-in-time production would be particularly badly hit. Services, losing access to the EU’s single market, would also be badly hit in this scenario.

A bespoke, Canada-style deal

6. A bespoke UK-EU27 deal is what the Prime Minister is apparently aiming for, though without any detail it is hard to know exactly what this might entail. A Canada-style deal would not be a good outcome for the UK as the Canada-EU trade agreement has little coverage of services. Moreover, tariff-free trade for goods does not resolve all issues of regulation and associated non-tariff barriers. However, a ‘Canada-plus’ deal that also made substantial provision for services access might be less damaging.
7. It is possible, in theory, to envisage a Canada-plus deal that gave the UK very good access to the EU’s single market in goods and services. However, even with a relatively good services deal, with some procedures for ensuring regulatory equivalence, many sectors, not least financial services, would find they did not have the same level of guaranteed access as when the UK was in the EU. There would need to be some sort of judicial mechanism to oversee compliance with the deal and resolve any disputes. If this was a Canada-style deal, the UK would also be outside the EU’s customs union – enabling it to strike its own trade deals around the world, but adding bureaucratic and customs barriers (particularly rules of origin certification) to trading processes.

8. The EU27 is highly unlikely to agree a strong, favourable to the UK, ‘Canada-plus’ bespoke deal. The UK would at that point have its own migration policy, which would not allow free movement of people between the UK and EU27 any longer. In that context, the EU27 would not agree a deal that mimicked closely the advantages of full single market membership. Consequently, a Canada-style deal can be envisaged, perhaps even one with some better access for services, but it will fall some way short of being close to, or equivalent to, being in the EU’s single market. Consequently, there will be substantial costs to such a deal.

A Norway-style, EEA outcome

9. The option of joining the EEA is one that the UK could go for. This has been called a ‘soft’ Brexit. The UK would then be in the EU’s single market, have to respect all four freedoms (of movement of people, goods, services and capital) and these processes would be overseen judicially by the EFTA court. It would not be in the EU’s agricultural, fisheries, justice and home affairs, neighbourhood and foreign policies.

10. The Norway option has the benefit of keeping the UK in the EU’s single market. Beyond that it does not look desirable. It is unclear why a state like the UK, with substantial influence as an EU member state, would choose an option that removed most influence and gave it no vote on rules, regulations and laws. It may, even so, be preferable to the harder Brexit scenarios described above. It may too, arguably, be said to respect the referendum vote to leave the EU.

11. The UK government is not likely to accept this route – both as it wants a bespoke deal, for the UK to set its own laws and regulations, to control its own migration policy, and not to come under the European Court of Justice. The government would probably also argue it does not respect the spirit of the referendum vote. The House of Commons is currently unlikely to vote for the Norway option (if it gets such a vote) since Labour is, like the Conservatives, looking for the fullest possible access to the single market, not membership of it.

Staying in the EU

12. This option would require either (i) a second EU referendum, with the Remain side this time winning the vote or (ii) a referendum on the terms of the final UK-EU deal – with the deal being rejected in favour of staying in the EU, or (iii) for the House of Commons to reject the referendum result and vote to stay in the EU. At present, none of these possibilities look likely. There is a lack of political leadership in any of
the UK-wide political parties currently arguing to change minds on staying in the EU (option (i)). Consequently, few politicians are continuing to present arguments as to the deeply damaging impacts of Brexit, with staying in the EU as the best way to avoid these. Yet if public opinion changed substantially (which it has not so far done), there could be a case for a second referendum. Current positions of the UK parties suggest that a vote (if there is one) to trigger Article 50 will pass in the House of Commons (at which point the Lords may be likely to delay but not to block).

13. The Liberal Democrats are arguing for a new referendum on the terms of the UK-EU deal once it is negotiated. At present, Labour’s deputy leader has said that their support for this is unlikely. The LibDems have said that the choice in such a referendum should be between the deal and staying in the EU. There is a major timing problem here as discussed further below as the final UK-EU deal is likely to be agreed some years after the UK has left the EU.

14. At present, the most likely outcome of the Brexit process would appear to be some form of comprehensive trade deal between the UK and EU. How good or bad a deal this will be for the UK remains to be seen. But given the EU27 insistence that, without respect for the four freedoms, the UK cannot have the same participation in the single market as it has today, then we can anticipate increased barriers between the UK and UK and some substantial, negative economic impacts of any likely deal.

**Timing**

15. Timing of the Brexit talks will depend on various factors. It is possible that the Supreme Court judgement, if it confirms a role for Westminster, and possibly too for the devolved administrations, will mean that the time taken to trigger Article 50 will go beyond the end of March 2017, the declared goal of the Prime Minister. However, as Labour have said they will not oppose or delay the triggering of Article 50, any delay may not be substantial, though this will depend too on the House of Lords.

16. If Article 50 is triggered by the end of March, then the two year time limit for the talks will expire by the end of March 2019. It is unlikely, though not impossible, that that deadline will be extended.

17. The Article 50 talks are expected to focus, firstly, on an agreed exit package that will cover issues including: UK budget liabilities (including concerning infrastructure projects, pension liabilities etc), rights of EU citizens and businesses already in the UK, and UK citizens and businesses already in other EU member states; EU agencies currently located in the UK; security issues around border changes with the UK becoming a third country not an EU member state. The Prime Minister of Malta has also indicated that the question of the border between the Republic of Ireland and Northern Ireland may be dealt with at this first stage of talks.

**Transition Period**

18. The initial two years of talks may only allow time for substantive talks for around 18 months or so, since the European Parliament will have to consider and vote on any deal. Article 50 indicates that the talks may set out a framework for future relations between the leaving state and the EU. It is not anticipated that a complete UK-EU27 deal will be concluded in that time. Consequently, the UK and EU27 will be
likely to see if they can agree some form of transitional deal, that will avoid too much disruption (and avoid a WTO scenario).

19. The EU27 will be cautious in agreeing a transition deal. They will not want any interim deal to become a final deal and so it is likely to be a time-limited deal (possibly three to four years). Any agreement on such a deal is also likely to come later on in the two year Article 50 talks, since an early deal on transition may reduce pressure on the UK to agree an acceptable exit deal (from the EU27 point of view). Nor is a transition deal likely to be one that allows the UK to be fully in the single market, unless the UK agreed, in effect, to be in (or stay in) the EEA and so respect all four freedoms, come under the ECJ and make a budget payment. Even then, at that point in early 2019 when the UK left the EU (and moved into its transitional status) it would already be outside EU agriculture, fisheries, justice and home affairs and foreign policies.

20. Unless there is a fairly clear framework for the aims of the ultimate UK-EU27 deal during the Article 50 talks, a referendum on the proposed deal (before it is agreed) would look difficult. There may also be limited time in which to hold such a referendum. However, if Article 50 is revocable, which looks likely though this remains controversial, then the UK could if necessary withdraw its notification of leaving the EU, in order to allow sufficient time to hold a second referendum on the deal.

**Choices for Scotland**

21. Scotland has three main choices given the above scenarios. It can attempt to influence the overall UK Brexit deal; it can hold a second independence referendum with the aim of staying in the EU as an independent member state; or it can argue for a differentiated deal for Scotland within the overall Brexit deal (as the Scottish government currently is).

**Scotland as part of a hard Brexit**

22. At present, the UK looks likely to be aiming for a bespoke, Canada-style deal that will, given likely EU27 reactions, not be close to its current single market membership. It might in such a deal have reasonable, tariff-free access for goods but face more barriers in a number of service sectors. This relatively hard Brexit would be one, at the moment, that Scotland would be part of – with all the associated economic, social, political and security costs that it would engender.

**A special deal for Scotland, staying in the single market**

23. Given this outlook, it seems appropriate to explore, as the government is, whether Scotland could somehow get a differentiated deal and stay in the EU’s single market. This looks technically tricky but could possibly be feasible. It looks politically difficult.

24. If Scotland stayed in the single market, while the UK had a bespoke deal as described in para 22, then there is a question of what sorts of barriers that might set up between some parts of Scotland’s trade with the rest of the UK (rUK) and whether there might need to be a hard, physical border between England and Scotland. If the
UK-EU27 deal allowed tariff-free trade in goods, and regulatory equivalence, then the frictions that could arise would lie mostly in services.

25. If Scotland and the UK were both outside the EU’s customs union (as Norway is) then this would reduce the risk of a hard border, though applying rules of origin before exporting to the EU would be necessary – and Scotland would probably have to apply rules of origin to rUK goods. If Scotland were in the customs union (though how this would be achieved as a sub-state is unclear) and rUK was not, then this creates more barriers potentially (depending on the nature of the UK-EU27 deal). Whatever deal is reached to stop there being a hard border between the Republic of Ireland and Northern Ireland may provide a helpful precedent here – but any Irish deal will not be straightforward to achieve.

26. There would need to be substantially more devolution of powers to Scotland if it were to be in the EU’s single market. It would also, like Norway, have no vote or real influence in the rules the EU sets. There would need to be some form of judicial oversight – but since Scotland is not a state, it could not under current treaties join the EEA and so use the EFTA court.

27. Migration policy would need to be partially devolved if Scotland were to be part, in some form, of the EU’s free movement of people. However, the UK would be a third country from the EU27 point of view (and Scotland would not be in a position like Norway to join the border-free Schengen area). This would, then, require all the EU 27 to agree free movement terms with the UK for Scotland as a sub-state. Politically, this would also be very difficult at UK level as, even if free movement only applied to Scotland, EU citizens in Scotland would, over a period of years, then acquire a right of permanent residence or even citizenship which would mean they could then move elsewhere in the UK.

28. Scotland, under this deal, would not be part of EU agricultural or fisheries policies and would lose (as rUK) any EU agricultural support funding. It would also need to pay into EU funding programmes.

29. The overall costs and benefits to Scotland of such a deal will depend on the details of the UK-EU27 deal. If Scotland has full participation in the EU’s single market, while rUK suffers the negative economic impacts in several services sectors of not having full access (while perhaps having a decent deal for goods trade and some other service sectors) then the overall benefits and costs to Scotland will depend on the costs of frictions introduced into rUK-Scotland trade, and the benefits of retaining full participation in the single market. If the main frictions are in certain high value-added services sectors, then these costs will need to be compared to the benefits in these same sectors of full access to the EU’s single market.

30. Beyond the technical and legal complexities, the chances of the UK government agreeing to propose to the EU27 that Scotland stays in the EU’s single market look slight to non-existent. However, if the politics of triggering Article 50 in Westminster (and perhaps too at Holyrood too) changes then the political dynamics of a special deal for Scotland could change.

31. The EU27 will not negotiate any special deal for Scotland if it is not proposed by the UK government. If it was proposed by the UK government, then the EU27 might
have some sympathy towards the proposal but they would also be wary of creating precedents about differentiated treatment for different parts of a state (a state that is no longer an EU member state). The idea of Scotland as a sub-state joining the EEA is highly unlikely for this reason. If there was a way to fold the special deal for Scotland into the overarching UK-EU27 deal then this might be politically easier. However, the EU27 would also want to be sure that any such deal did not provide rUK with a backdoor into the EU’s single market. In the context of what are likely to be very difficult, sometimes acerbic, negotiations, the additional complexity of factoring in a special deal for Scotland may be prohibitive from an EU27 point of view.

**Independence in the EU**

32. The Scottish government could choose to hold a second independence referendum. Whether the UK government would agree to this is an open question, although the Prime Minister’s spokespeople have said repeatedly that the 2014 referendum had resolved the issue.

33. If there were an independence referendum before the UK left the EU in 2019, then Scotland, if it voted ‘yes’ to independence, could aim to stay in the EU rather than leave with rUK. However, there are obviously major timing issues in this. If the earliest a referendum could be held is 2018, then Scotland would have made its choice before the UK left the EU. This would not, though, allow enough time for the UK and Scotland to dissolve their union before the UK was out of the EU.

34. The EU27, in such circumstances, might attempt to find some sort of special status for Scotland so that it did not have to undo EU legislation or come out of EU programmes. There would probably be a period of time where Scotland was still part of the UK but outside the EU. For that period, the UK government would have to agree this.

35. The EU27 could fast-track membership negotiations with Scotland since it would already meet almost all EU requirements. Chapters on budget, the euro, justice and home affairs including Schengen, would need to be negotiated which could be done within months rather than years. However, ratification would still take two to three years. Scotland might have observer status in the EU once negotiations were complete, while waiting for ratification.

36. Scotland-UK relations, if Scotland were independent inside the EU, would then depend on what sort of UK-EU27 deal was negotiated. Scotland-UK relations would be very similar, if not identical, to Ireland-UK relations at that point. Many of the issues that would come up – rules of origin, tariffs (if there is not a full free trade deal), non-tariff barriers and so forth are similar to those that come up if Scotland were to stay in the single market and in the UK. In the EU, though, Scotland would be part of the EU’s customs union and part of its trade policy, so the differences between Scotland and the UK at that point would be greater.