European and External Relations Committee
The EU referendum and its implications for Scotland
Written submission from Shetland Island’s Council

BREXIT

General Points

Shetland’s economy and society is well integrated into the EU and as a consequence the Council is generally alarmed by the prospect of Brexit, and all the changes that will occur in the short and medium term. At a high policy level we think that the UK needs to be a member of the European Economic Area (EEA) to maximise the trading opportunities with the EU counties as the UK relinquishes full EU status. Membership of the EEA would help maintain the current trading arrangements and would enable free movement of people which would help address skills and labour gaps in the remotest part of the UK just as in the rest of the Country.

On the management of the withdrawal process from the EU, the Council’s opinion is that the UK should identify the time that it needs to leave the EU in a fully structured manner even if this is longer than the two year period that is often mentioned. If the process of leaving is haphazard then economic confidence will suffer with serious implications for the whole of UK society. Associated with the need for structured withdrawal is an almost equally important need for the UK to emphasise Regional Policy development to help mitigate the impacts on the more vulnerable parts of the UK as EU funding for economic activities and project development ends.

Taking the question of policy development a step further, given that so much of UK legislation has EU legal content along with the increasingly regional nature of the UK political landscape, is the time not right to suggest that a new UK constitution is drawn up to act as the framework for all legislation? This new constitution could influence the federal status of Scotland, Wales, Northern Ireland and all the emerging regional interests in England and could be layered right down to Local Government areas. For example, from Shetland’s perspective, the particular needs of island administrations could be built into the new constitutional framework.

Specific Information

EU Funding – Shetland’s current level of prosperity has been achieved with the support of EU funding sources. We have benefitted from ERDF and ESF funding and though specific schemes such as LEADER, EMFF and agricultural support measures etc. It is essential that the alternatives to these funds are identified as soon as possible so that continuing sustainable economic growth can be stimulated throughout the UK, including the remoter parts such as Shetland.
**Fisheries** – While it is recognised that the Fisheries Industry is generally openly supportive of Brexit, largely because of the blunt application of the Common Fisheries Policy, the transition to full UK control of fisheries is full of uncertainties at a political and practical level. Our top concern continues to be the application of the Landing Obligation in an area of mixed fisheries where vessels could be tied up early in the year if they land their maximum quota of certain species. These vessels would not be allowed to use their remaining quotas to catch the other species in the area. Having vessels tied up for lengthy periods of the year will have devastating consequences for the businesses, staff, families and all the ancillary trades that depend on the industry. It will also impact on exports from Scotland. The achievement of a practical local management solution in the next six months is our absolute priority. Beyond this narrow timeframe, as Brexit proceeds, Shetland has a number of concerns around how the UK will manage fisheries, the allocation of fishing rights to other countries, and the support to encourage development of the sector. Overall, though we are optimistic that the UK can achieve a more prosperous fishing industry in the post Brexit era, assuming that the Landing Obligation is managed better and all the points raised here and detailed further in appendix one are resolved.

**Agriculture** – There is an increasing concern in Shetland that support for active agriculture in the more vulnerable farming areas will be more restricted under the UK and Scottish Governments. Shetland agriculture derives about £9M a year from support measures, much of which is EU funded. There is growing evidence in Shetland, as in the rest of the Highlands and Islands, of land abandonment where no stewardship is now practiced and the economic and social potential is lost. Any loss of financial support will significantly reduce productive agriculture and would accelerate land abandonment. A more detailed analysis is provided in appendix two.

**Aquaculture** – Salmon farming and mussel production are two of Shetland’s main industries, employing around 500 people. The salmon industry is an international one with two large Norwegian companies and one Canadian company involved in Shetland. By contrast, the mussel farming sector is largely locally owned. Neither sector is currently particularly worried about Brexit because both consider reasonable UK trade deals with the EU as being likely. Exporting to the EU is much more important for the Salmon Industry as 40% of Scottish exports are to the EU. The main worry in the sector, particularly among ancillary businesses and the smaller mussel farms is uncertainty over the future financial support for development projects. Read appendix three for more detail.

**Renewable Energy** – The development of the Renewable Energy trade in the post Brexit era will depend on a number of factors. These include: the extent of interconnection of electricity grids across Europe; the availability of UK funding for research and development projects; and, the impact of adverse exchange rates on capital costs and favourable exchange rates on exported sales. Appendix four explores these points in more detail.
Tourism - The main impact of Brexit on tourism will be the rate of exchange, which could be very positive if the pound remains low against other international currencies. Should that change and the UK economy achieves a relatively strong currency then tourism may be become more restricted.

A secondary impact may come as a consequence of how the UK is perceived politically by the remaining EU states. Should the UK attain a poor reputation in Europe in its relations with the EU, visitors may be put off from holiday making in the UK. In these circumstances promoting distinctive UK locations will be essential to help potential visitors to see over political perceptions and adverse exchange rates.

Textiles – Shetland’s knitwear and woollen cloth sectors consist of around 40 small and micro-sized businesses, which sell an estimated £6M annually. Around £4M of sales are exported mainly to the EU, USA and Japan. Japan is the largest export market. While textiles are not a particularly large sector, the businesses still employ around 100 people and make a significant contribution to the rural economy in Shetland. In terms of Brexit, exporting may improve if the strength of the pound continues to be relatively weak over and beyond the Brexit period. That stated, there is a great deal of concern about what the future trading deals will be between the UK and the EU, USA and Japan. From a support perspective, currently there is a growing interest among younger people to develop textiles as part of the drive to develop the creative sector. Their interest would be stimulated still further if there was to be easy access to UK development funds in the post Brexit period, particularly in replacement of LEADER and other EU support measures for developing small businesses.

Further and Tertiary Education (including research) – This is an area where there is growing concern about the general impact on the sector if EU students have restricted access to UK universities and colleges. This is likely to have a domino impact throughout the industry as the competition for Government funding will increase, leaving the UHI in a vulnerable position. With regard to research, there is uncertainty regarding continuity of EU funding for existing projects. Also, UK universities are now regarded as unattractive partners within EU consortium bids.

Concluding Remarks

These are the main areas of concern, and opportunities, relating to Brexit that have been identified in Shetland so far. There is little doubt that more issues will emerge as we make our way forward. In general, once the transition period of Brexit is over and, assuming that a reasonable trading deal is negotiated with the EU, and the UK has identified mitigating regional policy and sectoral support measures, there is a good prospect of economic and social adjustment to Brexit in Shetland.
Appendix 1 – Fishing Appraisal for Brexit

General

Fishing is one of Shetland’s main industries, worth over £100M a year in landings and £157M a year taking supply chain and value adding activities into account. Around 275 people are employed in the fish catching sector. The Common Fisheries Policy is set to end with Brexit and this will involve a major change in how UK fisheries will be managed within an independent 220 mile UK fisheries zone.

Landing Obligation

There are, of course, threats and opportunities for fisheries as the UK moves forward with Brexit and these are summarised below. However, the main and overwhelming Common Fisheries Policy threat to Shetland’s fishing industry at present is the Landing Obligation, which is likely to cause substantial damage in a white fish sector that operates in rich mixed species fishing grounds. The main issue is that there are abundant numbers of certain species which the fleet has limited catching quota for because the theoretical scientific limits for catching do not reflect the actual numbers of fish there. The term for such species is “choke species”. Without a practical intervention to identify how the Landing Obligation can work in a mixed fishing zone, vessels will have to tie up early in the year once these “choke species” quota levels have been achieved. This will have potentially serious consequences for fishing businesses, staff and ancillary trades through loss of earnings. Unfortunately, time is getting very short to effect a change in this EU legislation before 1 January 2017.

Brexit Implications

The areas of uncertainty in fisheries are:

- Continued access to EU markets for exported fisheries produce from the UK
- How the UK is going to manage and control fisheries in the greater area of sea that it will have?
- To what extent will be UK be able to exclude non-UK vessels?
- Making sure that Scotland benefits to the full as the UK renegotiates a share of fish quotas
- How vulnerable are our fishing rights to a trade-off when the UK is renegotiating wider trade deals with the EU?
- Having access to the necessary levels of UK financial support to develop the industry
Appendix 2 - Brexit Scenario Planning – Agriculture

1.0 Introduction

This note considers the current state of Shetland agriculture and its position in a national Scottish and British context, and explores possible consequences of the recent national EU membership referendum upon the industry locally and nationally.

2.0 Shetland Agricultural Industry

2.1 Overview

Agriculture in Shetland comprises a mixture of crofts and farms in 1,876 holdings, over 60% of which comprise less than 20 hectares. In the period 2001-2009 numbers involved in the industry fell by 18%.

As Shetland agriculture is largely a grass-based industry the main production outputs are livestock (sheep and, to a lesser extent, cattle). Numbers of sheep fell by 28% in the decade up to 2012, and have subsequently remained static at around 280-285,000. Cattle numbers in the same period have declined by around 10% to 4,700 in 2013. The vast majority of sheep and cattle are exported as store animals. Shetland’s ground is, in a national context, rather poor and unfertile – and the general unsuitability of the islands for agriculture is compounded by a short growing season and poor climate.

The number of dairy units has reduced from 6 in the first decade of the current century to just 4 in 2016. Shetland Farm Dairies, the farmer-owned cooperative that markets their produce, has enjoyed a period of high demand in recent years during the intense oil industry related building works in the Shetland, but this enhanced demand has now all but evaporated.

The area of ground in cultivation for crops in Shetland fell by 90% between 1971 and 2008, with much of that decline happening pre 2001.

Wool has traditionally been a valuable resource that supported the development of knitwear and textiles on the island. While there is a small renaissance in the production of the latter, the former remains a relatively low value product compared to its heyday.

In terms of value, sheep account for 53% of sales, cattle 16% and milk 21%. The value of production in the past 10+ years has fallen in both actual and real terms – between 1986 and 2008, by 46% in real terms. As a result the viability of the sector has become poorer – this follows the general trends in other parts of Scotland, particularly upland/hill sheep production areas.
This lack of viability and fall in production value has been completely obscured by very high subsidy levels that bring money into the local economy. Subsidy levels now account for nearly 50% of total income when in the early 1980s it only contributed 23% of income. The level of support is similar to the rest of Scottish agriculture.

The following statistics show the value of the industry to Shetland in 2014 and the percentage change on the previous year in brackets (Source: Shetland in Statistics):

Production Value £9.23m (-0.5%)

Subsidy Value £9.04m (+4.1%)

In the same year it is calculated that agriculture accounted for 272 F/T and P/T employees in Shetland.

Coinciding with the rise of subsidy as a major contributor to farm income in Shetland, and the change of agricultural practice towards, in general, a sheep monoculture supported by silage as a winter feedstuff, has been a long-term decline in Shetland’s biodiversity. This is largely driven by the use of in-by land for silage production and grazing rather than for hay and crop production, but also the rise in use of chemical fertilisers and the application of lime to artificially boost yields of grass. These changes to farming methods and the landscape has meant that many species have been lost to or restricted in Shetland.

2.2 Opportunities, Threats and Issues

The National Farmers Union Scotland (NFU Scotland) have committed to work together with the English and Welsh NFUs on a shared ambition for a progressive future for farming post-Brexit. Representing 76,000 farm businesses across the UK, the national unions have agreed that their organisations “must be the focal point for cross-border cooperation in the wake of the UK’s decision to leave the EU”. They have identified “the trade and investment climate as a critical focus for the Unions to collaborate on, as well as ensuring simple access to labour, domestic farm policies that work for farmers across the UK, and clarity over the UK’s exit from the EU”.

In their own right, the message lately from NFU Scotland has been more focused on the importance subsidy plays in the economic model of farming in Scotland. At a recent meeting of the Scottish Government’s European & External Affairs Committee the NFU Scotland parliamentary officer stressed the need to maintain current levels of subsidy, and identified Brexit as an opportunity for Scottish ministers to introduce their own agricultural policies which could be far more beneficial (i.e. lucrative) to Scottish farmers than the current Common Agricultural Policy (CAP).
Some reassurance has been provided to the industry in the short term with the announcement by HM Treasury that it will guarantee current levels of agricultural funding until 2020. Thereafter, HM Treasury says there will be “a transition to new domestic arrangements” (source: HM treasury letter, date 12th August 2016).

2.2.1 Trade Agreements

The UK’s agriculture industry does have the potential to suffer from EU exit, as import tariffs could be imposed from key markets – both in and outwith the EU. The current status quo, as we know it, will need to be entirely rewritten in the coming years.

From a local perspective most, if not all of Shetland’s exported agricultural produce goes into the UK domestic market. Our main export is store lambs and, while 38% of lamb produced in the UK as a whole is exported into the EU, we understand that Shetland store lambs are finished primarily in Scotland and Wales.

Providing Scotland remains part of the UK, there is no reason to suppose that the current scenario will change markedly. Matters would be more complicated were Scotland to succeed in realising the Scottish National Party’s ambition of independence from the UK (and with it, membership of the EU) as then any Shetland-produced livestock bound for south of the Scottish border would be bound by whatever trade agreement Scotland negotiated with what remained of the UK - producers would be subject not only to possible import tariffs but also to the vagaries of the fluctuating exchange rate between the Scottish Euro and UK Sterling.

Opportunities:

Capitalise upon our disease-free status as a supplier of high quality livestock for the UK market.

Attempt to focus more on producing for our local Shetland market.

Threats:

2.2.2 Inward Investment - Private

n/a where Shetland agriculture is concerned, as it exists on the cusp of viability and has not attracted private inward investment to date.

2.2.3 Inward Investment – EU Funds

In terms of what amounts of State aid the UK and Scottish governments can actually afford in their own right to provide to British farmers, we cannot at this stage predict with any certainty whatsoever what will happen post-Brexit.
Approximately £3bn per annum is currently received by the UK for CAP Basic Payment. Shetland alone receives around £9m per annum in agricultural subsidy. On August 12th 2016 HM Treasury moved to reassure the agricultural industry by committing to ensure this level of national funding would be received until the end of the Multiannual Financial Framework in 2020. Thereafter, HM Treasury stated, “The government will work closely with stakeholders to ensure that funding in the period immediately after exit is used to help the agricultural sector transition effectively to a new domestic policy framework. These funds will be allocated using the principle of CAP Pillar 1, and we will of course consider the opportunities post exit for making any short-term improvements to the way the system operates once we cease to be bound by EU rules.”

We should assume that some form of subsidy structure will supplant the monies that formerly came via the EU. The alternative is that farmers will pass on the increased costs of production to consumers. Were this to happen, we might expect to see household expenditure on food and drink return to pre-CAP levels (30-35% of household income) as opposed to the current expenditure: 10-15% of household income, a figure that reveals the extent to which UK consumers enjoy cheap food thanks to high levels of agricultural subsidy. This is highly unlikely to be allowed to happen, as the economy requires active consumer spending across the board and not only on one aspect of the ‘shopping basket’. Sudden constrained consumer ability to spend will not be an outcome any domestic government desires.

Having said that, nor can it be assumed that subsidy levels will continue at the same or indeed higher levels than hitherto. Faced with competing pressures for spending (healthcare, education, etc) it seems probable that some sort of middle ground may be achieved where levels of agricultural subsidy are concerned post-Brexit.

What might this mean for Shetland’s producers? Much depends where the focus of the subsidy is concentrated. If it is on production, our limited and constrained agricultural systems (essentially, store lamb production) may do well – our current sheep headage is almost half what it was in the 1980s during the Sheep Annual Premium subsidy regime – but inevitably at the expense of the environment. Shetland’s denuded biodiversity and damaged uplands still show the damage done by agriculture in the past.

If subsidy is focused on the delivery of public goods, such as environmental outcomes and measures designed to conserve and develop biodiversity, this return to / consolidation of local agriculture damaging the environment will not happen – but requires Shetland’s farmers and crofters to emphasise stewardship of the land as the priority activity rather than production driven agriculture and that might not rest easily with a significant proportion of our farmers and crofters.
Once again, the likely outcome is somewhere in between those polar extremes – but at this stage we cannot predict which way the pendulum will swing. Andrea Leadsom, the recently appointed UK Secretary of State for Environment, Food and Rural Affairs, is understood to be kindly disposed towards intensive agricultural systems and less favourably inclined towards environmental outcomes. We may then expect in the first instance the NFU to press hard for subsidies that suit their position – namely intensive food production at the expense of the environment – and possibly with some cause for optimism that they will be successful. In Scottish terms this may well favour the lowland beef farming industry and might not be good for Shetland’s agricultural industry and environment as a whole, nor specifically for the wildlife aspects of our tourism industry.

Now could be the time for both the agricultural industry in the vulnerable farming areas of Scotland and active environmental bodies to come together to impress upon the Government at an early stage the need to think and plan how to support Shetland agriculture in the vulnerable farming areas to achieve an economically and environmentally sustainable future.

**Opportunities:**

Chance to fundamentally change local agricultural paradigm towards a more environmentally friendly and sustainable future

Chance for agricultural industry to lobby for more subsidy (whether production or public good outcome-based is up to them)

**Threats:**

Possibility of reduction in (subsidy) income for Shetland’s agricultural industry

Possibility of further damage to Shetland’s natural heritage if agricultural industry nationally / locally is successful in lobbying for subsidy linked to production. Hence damage to tourism here.

2.2.4 Immigration

Nationally, immigration and the freedom of movement of migrant workers is of concern to agricultural producers, namely those involved in production of seasonal crops. From a Shetland perspective, this is not considered to be an issue as there is no reliance on seasonal migrant workers.

2.2.5 Currency Exchange Rate

The Shetland agricultural industry imports a certain amount of bulky inputs (animal feed, fertiliser, and lime) – if any of these are sourced from Europe there may be additional cost associated with them due to currency fluctuation and the weakness of Sterling.
2.2.6 Legislation/Regulation

Agriculture generates, and is subject to, more legislation than most industries given that it involves not only the production of food for human consumption but also animal welfare issues, environmental considerations, the use of myriad chemicals, the application of considerable amounts of State aid, etc. There are 2,715 legal acts that cover the CAP and the implementation of the single market for agricultural products; and a further 1,918 environmental and food safety chapters.

Although much of the legislation governing the agricultural industry has its roots in EU law it is unlikely that the UK will look to re-write the rule books immediately on exit, if only to ease the process of transition in the short-term. Depending on the outcome of trade deal negotiations to replace the former single market situation, it may be that in many instances EU rules and regulations continue to apply in practice.

It should be noted that countries that are not EU members but are members of the European Economic Area (EEA), i.e. Norway - a potential status for the UK post-Brexit – have to fully comply with all relevant EU environmental, food safety and veterinary legislation.

However, it has long been a contention amongst farmers and crofters that access to their subsidies is “too bureaucratic” and involves “too much paperwork and red-tape” – we can expect, with a high level of confidence, that the NFU will lobby hard for reductions or removal of legislation that is seen to hinder access to subsidy and to complicate how their members operate on a day to day basis.

Such legislation will certainly include those laws currently in place to protect the environment. This poses a significant risk to the UK’s biodiversity as, with checks and balances removed, the agricultural industry would inevitably intensify production at the expense of the environment. It is ‘easier’ to farm without heed to unintended consequence than it is to comply with environmental legislation. For example, NFU Scotland has already stated with regard the use of pesticides and herbicides that “a risk, rather than a hazard or precautionary-based approach, is needed” (source: NFUS Briefing, 22 July 2016).

Similarly, the much-despised electronic sheep tags that the industry felt was imposed upon it “by Europe” are unlikely to be abolished – initial resistance to change was inevitable on their introduction, but the UK and Scottish governments continue to place importance in the traceability of livestock and are unlikely to change the status quo at this point some years after the event.

However, the risk of legislation that currently upholds public goods such as the environment and animal welfare being relaxed, in the face of concerted lobbying from the NFU, must not be discounted.
State aid restrictions currently apply to the agricultural sector, much to the chagrin of farmers and crofters across the nation – with Shetland’s producers no exception. Removal of State aid restrictions, were this to happen, could pose opportunities for Shetland’s agricultural producers – for example, if there was a compelling economic and social case for a large capital item (for example, a new abattoir and processing facility), the current State aid restrictions of 50% public funding could be exceeded, to the benefit of local producers. Similarly, local producers would warmly greet the opportunity to have former, subsidised local improvement schemes (bull purchase, artificial insemination of cattle, heifer payments, re-seeding initiatives, lime and fertiliser grants, etc) reintroduced at high intervention rates.

The reality of State aid intervention post-Brexit is likely to be somewhat different to the utopian view held by some in the agricultural industry, both nationally and locally. It seems highly unlikely that the UK or Scottish government would allow a free for all situation thereafter, where regions of the UK could, according to their individual circumstances, confer competitive advantage on their local businesses over similar businesses elsewhere in the UK.

Therefore it is probably sensible to assume that something similar to the current system of State aid legislation will prevail post-Brexit; but in the meantime, we can expect an industry already used to high levels of subsidy to press hard for even greater application of State aid going forwards.

Were any Shetland producers considering an export situation outwith the UK they would face an increase in bureaucracy, as they would need to produce export certificates. This is not considered a significant issue as most Shetland agricultural produce is bound for the domestic market and, in the event of any store lambs being sold on to Europe, they will probably have been purchased at marts and be the responsibility of a third party at point of export.

**Opportunities:**

Possibility of influencing legislators to relax State aid restrictions in such a way that regional weaknesses (i.e. remoteness) can be compensated for compared with other areas of agricultural production.

**Threats:**

3.0 **What can the Council do to support the agriculture industry?**

- Keep abreast of the political situation, gather information.
- Keep in touch with industry and continue to gather views and concerns. An agriculture working group may be useful to pick out common themes or discuss priorities. Industry priorities may however not always be Council priorities – past experience should inform us of the industry’s
inability to cooperate with one another, and their confrontational approach to the Council where State aid is concerned – there exists an element of the industry that feels they have a right to be subsidised.

- Assist businesses with information requests they may have.
- Encourage eligible organisations to apply for European funding while it is available.
- Identify key Government Officials contacts who are willing to hear Shetland’s views on how Shetland would like to proceed now, or in the near future. Shaping thinking at an early stage may be more beneficial than reacting to changes.
- Consider formal lobbying activity for actions which will protect the future of the industry in Shetland.

Appendix 3 - Brexit Scenario Planning – Aquaculture

1.0 Introduction

This note refers to the two main Shetland aquaculture industry sectors of salmon and mussel farming although it should be recognised that the sector can include many other species.

2.0 Shetland Salmon Industry

2.1 Overview

Scotland is currently the largest salmon producer in the EU and third largest in the world after Norway and Chile. The Shetland salmon industry produced an estimated 46,000 tonnes of salmon in 2015 which represents 25% of the total Scottish production (187,000 tonnes). Salmon is the UK, Scotland, and Shetland’s number one food export and approximately 40% of Scottish salmon exports are to the EU (mainly France). Other key markets are the home market in the UK (the largest market), the USA and China.

The Shetland salmon industry is an important contributor to the local economy, both in terms of the jobs that it generates and the location of these jobs in rural areas.

In addition to direct production, the industry is supported by an upstream and downstream supply chain. In Shetland this includes egg/smolt production, equipment supply and repair, vessel harvesting and maintenance services, quality control, training, waste disposal, health management and outward transport.

The following statistics show the value of the industry to Shetland in 2014 and the percentage change on the previous year in brackets (Source: Scottish Salmon Farming Economic Report June 2015):
Shetland Employment: 448 (+9%)
Capital Investment: £17.8M (+62%)
Salaries: £12.9M (+29%)
Local Industry Spend: £30M (+231%)

Salmon farming has become a global industry and production in Shetland is now dominated by several large multinational companies:

- Grieg Seafood Hjaltland UK Ltd - owned by Norwegian based Grieg Seafood ASA
- Scottish Sea Farms Ltd owned by Salmar AS and the Leroy Seafood Group of Norway
- Cooke Aquaculture Scotland Ltd owned by Cooke Aquaculture Inc, based in Canada.

2.2 Opportunities, Threats and Issues

The salmon industry body for Scotland, Scottish Salmon Producers’ Organisation, has taken a fairly neutral stance on what Brexit will mean for the industry and commented that there will be no significant impact on the market.

The Scottish salmon market does not rely solely on the EU as a market and even if future trade agreements are less favourable, the demand for salmon within other EU countries is not likely to change significantly. The market, and the price achievable for salmon, is much more influenced by global issues such as what is happening with supplies from Chile or fluctuations in the exchange rate.

2.2.1 Trade Agreements

Scotland’s salmon industry does have the potential to suffer from EU exit, as import tariffs could be imposed from key markets.

Under the most optimistic Brexit scenario for trading, in which the UK leaves but remains a member of the European Economic Area (EEA), Scottish salmon sold to EU countries would be subject to an import tariff of least 2%, the rate for Norwegian salmon imported to the EU. The UK’s membership of the EEA would require agreeing to the EU’s freedom of movement of people and contributions to the EU budget (Source: The Times article, July 2016)

If the UK does not remain an EEA member, import duties on Scottish salmon to the EU could be higher as the EU’s import duty on salmon from outside the EEA is 8%. It is however considered unlikely that the EU would want to hamper trading relations by applying apply duty at this level.
At this time it is not clear if the UK would have to apply to rejoin the World Trade Organisation, as it is currently a member as part of the EU. China, which in 2014 accounted for 14% of Scottish fresh salmon exports, imposes an import duty of 12% on the fish from the EU but 70% if it is from countries without ‘most favoured nation’ status. This is a potential threat to the development of the Far East market.

Perhaps a bigger threat to salmon production than Brexit would be Scottish independence and the border issues which would apply to England as a key market.

On a more positive note, new trade agreements may be made outside the EU. South Africa, for example, imposes a 25% duty on Scottish salmon but none on Norwegian.

2.2.2 Inward Investment - Private

The Shetland salmon production is predominantly owned by foreign based entities and by having a UK base, these companies currently benefit from tariff-free access to the EU. Whilst Brexit could be viewed as a reason for producers to halt investment in Shetland in favour of other growing areas, or at worst retracting from Shetland, this is not considered to be the case. One reason for this is that the UK represents the largest market for Scottish production and therefore foreign owned producers have a strong reason to be based here. A second relevant point is that there are limited areas in the world in which salmon can be farmed and unless there were significant tariffs applied to EU trade, it is unlikely that producers would be influenced to the point of withdrawing operations and investment.

2.2.3 Inward Investment – EU Funds

Impact on Producers:

Currently Scottish SMEs can access development funds through EU funded European Maritime and Fisheries Funds. As Shetland salmon producers are almost all classed as large companies, they have limited ability to access European grant funding streams and so Brexit will not have direct implications.

Impact on Ancillary Services:

There may however be an impact on ancillary suppliers to the industry who currently qualify to apply. Whilst the current EMFF programme was set to run until 2020, there appears to be an immediate impact on the application process with advice from the Scottish Government that development projects set to run beyond March 2018 will be unlikely to be eligible.
Impact on Training and Research:

The NAFC Marine Centre is an important facility in Shetland for the industry in terms of both training and research. EU funding has been, and still is, an important element to the NAFC and UHI in terms of assisting research projects to happen. Whilst EU funding streams are still currently available, there appears to be an immediate impact on research projects undertaken by the NAFC, particularly those running beyond March 2018 and requiring grant support to progress. There is also a worry that uncertainty around what the future holds will delay research which may otherwise have gone ahead.

Whilst equivalent grant support for industry development may be available in the future from Scottish/UK sources, the extent of this support is not known. With no post-EU economic plan yet in place, the Government is unlikely to commit to any long term investment until negotiations with the EU are well advanced.

There could however be an opportunity for industry to impress upon the Government at an early stage the need to think and plan alternatives to allow the sector to remain competitive. If this is left as a secondary priority there could be a long transition to a new support structure.

2.2.4 Immigration

Future immigration policy is a further concern as the salmon packing plants and in Shetland are reliant on foreign national workers to fill posts. Immigration is perhaps more of an issue on mainland Scotland where there is more of an emphasis on processing and added value production which requires more staff resource, but it still applies to local salmon packing. Foreign nationals are also employed locally in farm husbandry positions and as skilled laboratory workers.

2.2.5 Currency Exchange Rate

The current weakness of the pound is beneficial for salmon producers exporting and there may be opportunities to grow the main export markets further.

Salmon feed represents around 50% of the production costs of salmon and is traded in $US. The value of the pound is therefore likely to affect feed prices in the medium term. The weak pound is also likely to affect items such as polystyrene box prices bearing in mind that the raw bead is bought from abroad (Germany predominantly but also Norway). There may be additional cost associated with specialised equipment imports.

2.2.6 Legislation/Regulation

Although most legislation governing the salmon sector has its roots in EU law it is unlikely that the UK will look to re-write the rule books on
exit. Depending on the outcome of the trade deal negotiations it may be that EU rules and regulations continue to apply.

State aid restrictions apply to this sector although if these rules did not apply there may not be much impact or benefit on production since this sector is not dependent on public financial support.

Salmon producers will face an increase in bureaucracy, as firms will have to produce export certificates for shipments to the EU, although this is not considered a significant issue.

3.0 Shetland Mussel Industry

3.1 Overview

Shetland produced 5,565 tonnes of mussels in 2015 which is 77% of the total production of Scottish mussels (7,270 tonnes). The 2015 Scottish Shellfish Production survey shows that 26 businesses were operating in Shetland employing 50 full time and 54 part time members of staff. As with the salmon sector these jobs are predominantly located in rural locations around Shetland.

The shellfish sector in Shetland differs from the salmon sector in that it is more traditionally structured with local ownership. The majority of producers are however members of the cooperative, the Scottish Shellfish Marketing Group which offers unified market access and managed supply.

The supply chain for the mussel industry is much simpler than that of salmon production but the industry is supported by businesses involved in equipment supply, quality control and outward transport.

3.2 Opportunities, Threats and Issues

The general feeling from the mussel industry in Shetland is that Brexit will not have a major impact trading but there may be implications for funding to support further development.

3.2.1 Trade Agreements

At present the principal market for Shetland’s mussels is the UK. There are some sales to EU and some to markets in the Middle East. Currently no tariffs apply to exports to these destinations. Any import tariffs applied through future trade agreements would have some impact on sales but as 95% of production is consumed by the UK market the impact would be minimal.

3.2.2 Inward Investment

The mussel sector has benefitted from EU fisheries financial aid schemes over the years. In particular the producers have utilised EU funds to assist in the development of growing sites to increase tonnage.
The investment supports the Scottish Government targets for increasing production, recognising the potential to increase supply to meet strong and growing demand.

As the future of EU funding is uncertain this represents an issue for the industry, both in terms of current development projects in the pipeline and future proposals.

3.3.3 Currency Exchange Rate

As the sector is not involved in a high level of exports the current weakness of the pound does not have much impact on sales revenues. In terms of imports, and potential negative effects, equipment imports will be more expensive due to currency rates. Unlike the salmon industry, there are no feed imports required for mussels and so no impact.

3.3.4 Legislation/Regulation

The impacts will be dependent on the trade deals negotiated and whether EU regulation continues to apply to the sector.

4.0 What can the Council do to support the aquaculture industry?

- Keep abreast of the political situation, gather information.
- Keep in touch with industry and continue to gather views and concerns. A Fisheries and Aquaculture working group may be useful to pick out common themes or discuss priorities. Industry priorities may however not always be Council priorities.
- Assist businesses with information requests they may have.
- Encourage eligible organisations to apply for European funding while it is available. This includes ancillary service industry and potential research proposals.
- Identify key Government Officials contacts who are willing to hear Shetland’s views on how Shetland would like to proceed now, or in the near future. Shaping thinking at an early stage may be more beneficial than reacting to changes.
- Consider formal lobbying activity for actions which will protect the future of the industry in Shetland.

Appendix 4 - Renewable Energy

Overview of Renewable Energy sector in Shetland

The growth of a renewable energy sector in Shetland has to date been limited by the capacity of the island grid to connect intermittent generation. The Viking Energy Wind farm is driving the development of large scale renewables
in Shetland and a grid connection to the UK National Grid. An announcement from the Government is expected soon that will clarify the ability of island onshore wind generation to bid into the next competitive round of CFD (Contracts for Difference) along with offshore wind, and how much capacity and budget there is going to be available to bid for. If successful in winning a contract to supply renewable power this will provide the business case for the project to reach financial close and proceed to construction. This will also provide the basis on which Ofgem can sanction the construction of the interconnector between Shetland and the North of Scotland.

Decisions regarding the development of large scale renewable energy development in Shetland and connection to the UK National Grid are made at a member state level in London. So it is really UK energy policy and not EU legislation that governs the decision making on the Viking Energy Project, the interconnector and the new electricity solution for Shetland.

**Short Term Impact**

The short term impacts of Brexit on such projects could be from a weakened pound and foreign exchange rates having the potential to increase the capital costs of the interconnector or turbines and major components imported from Europe. The UK imports over 50% of gas so there is likely to be an increase in electricity prices for consumers but also could make renewable energy more competitive in relation to fossil fuels.

**Uncertainty for Long Term Investment**

Large interconnector and generation projects are long term investments, those being developed at the moment to connect the UK to other EU member states may feel an impact from the uncertainty created post Brexit. It is difficult for developers and investors to have clarity on what the UK’s energy system is going to look like and its future relationship in the European electricity market. The impact could lead to delays in the development of projects due to doubts generated in the overall investment climate. Greater interconnection with Europe is seen as a key strategy in decarbonising the electricity market and increasing the use of intermittent generation. The aim is to increase interconnector capacity from 3GW to 10GW. Norway has a number of interconnectors and is trading in the European Electricity market but has to comply with all EU laws, with no seat at the negotiating table. The Swiss have bilateral or sector arrangements but these are not concluded yet over the freedom of workers’ movement. So it is not clear where the UK will end up and what will be the result of negotiations. There are 7 interconnector projects being looked at with the aim to trade within the single European market. Greater interconnection of electricity grids across Europe is seen to be beneficial to the increased use of renewable energy. Countries benefit from the capture of energy from weather systems as they cross Europe and a mix of generation. There is good correlation as peak generation is required across a number of time zones and it is beneficial to have electricity flowing between countries. The UK is significant in this capacity and also has the best wind and marine renewable energy resources in Europe.
A Shetland to UK connection would be in a different position from that of an investment in an interconnector between member states, as it is supplying into the UK grid and financed through use of system charges paid for by the connected wind farm. Viking would be underpinned by a Government backed, index linked CfD contract. Projects seeking finance from the likes of the EIB (European Investment Bank) may meet stiffer competition from EU member States with those UK energy projects not perceived to be sharing benefit with the EU being given lower priority. The UK would also no longer have a seat on the board of the bank and less influence in investment decisions, competing with other European member states for finance and other countries outside the region. To date the EIB has invested heavily in UK energy projects. Many of the large interconnector and generation projects benefit from European funding in the high risk development phases of the project. In the transition towards a low-carbon economy there will be the need for a considerable amount of research and development work and the deployment of innovative new systems. The UK has received 1.6 billion Euros over the last 5 years through the framework programme.

**State Aid**

Outside of EU, the UK could be more flexible in how it gives certain types of support but potentially less free in how it trades electricity with neighbouring member states. Depending on how integrated into the single EU market the UK remains it could still require compliance with State Aid regulations. The government may also come under increased pressure to provide public funding when the State Aid regulation is no longer there, especially if there is less EU funding around for projects. A lot of the large investors in the UK energy market are not just UK businesses but European companies and multi-national companies.

**Climate Change Legislation**

The UK, post Brexit, still has the UK Climate Change Act 2008 that has a target of a 80% reduction in greenhouse gas emissions by 2050 from 1990 levels. To keep this target on track the UK Government aims to have made a 57% reduction in greenhouse gas emissions by 2030. Shortly after the Brexit vote, the UK Government announced the 5th Carbon Budget, showing their continued commitment to a low carbon society. There is still a lot of detail to come out as to how the UK electricity system aims to meet these targets but this target is in line with that for the 2030 Paris agreement which is still to be ratified.

Post Brexit and coming out of the EU does not impact on the UKs climate change legislation but if a future government that looked less favourable on the Climate Change Act they could try to replace it via new legislation. At present the UK has a commitment under an EU created framework to meet climate change targets, this would no longer be in place once outside the EU.
EU Funding in Shetland for Energy projects

In the last 10 years £863,002.75 of European funding has been allocated to Shetland energy related projects the economic development service has worked with. The majority of projects were in rural communities throughout Shetland.

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