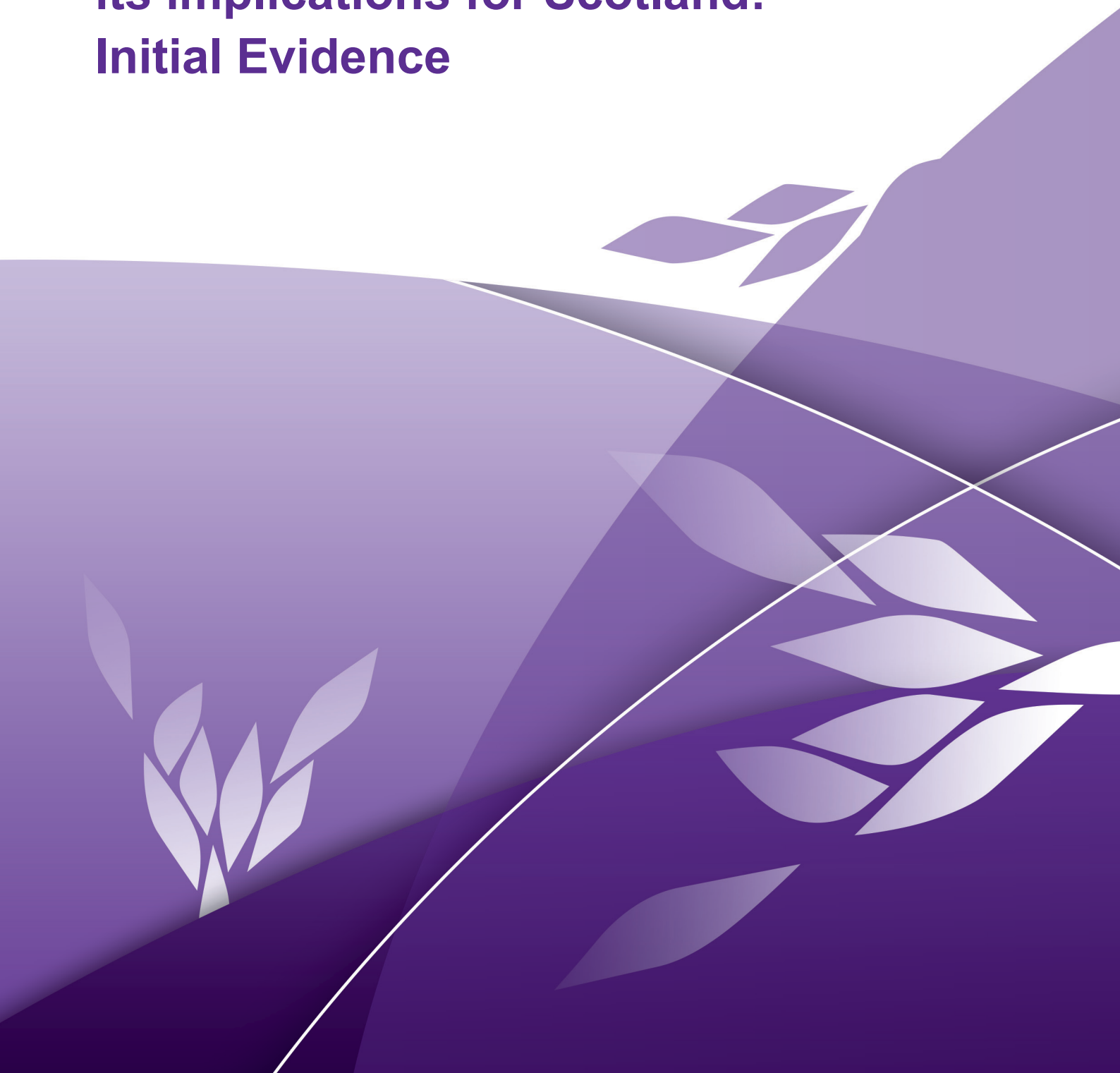
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European and External Relations Committee

The EU referendum result and its implications for Scotland: Initial Evidence



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Contents

Convener's Foreword **1**

Introduction **2**

Background 2

This report 3

Evidence heard and key issues **4**

Introduction and our work to date 4

Constitutional and legal matters 5

Leaving the EU 5

Economic, business, financial and labour market issues 12

Evidence received 17

Conclusions 32

Conclusions and recommendations **34**

Annexe A **40**

European and External Relations Committee

The remit of the European and External Relations Committee is to consider and report on—

a. proposals for European Union legislation;

b. the implementation of European Communities and European Union legislation;

c. any European Communities or European Union issue;

d. the development and implementation of the Scottish Administration's links with countries and territories outside Scotland, the European Union (and its institutions) and other international organisations; and

e. co-ordination of the international activities of the Scottish Administration.

2. The Committee may refer matters to the Parliamentary Bureau or other committees where it considers it appropriate to do so.

3. The convener of the Committee shall not be the convener of any other committee whose remit is, in the opinion of the Parliamentary Bureau, relevant to that of the Committee.

4. The Parliamentary Bureau shall normally propose a person to be a member of the Committee only if that person is a member of another committee whose remit is, in the opinion of the Parliamentary Bureau, relevant to that of the Committee.

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Convener's Foreword

Ten weeks ago, 51.9% of those who voted in the EU referendum voted to leave the EU. In Scotland, 62% of voters cast their vote to remain in the EU.

The European and External Relations Committee immediately embarked on a programme of work to examine the implications of the vote for Scotland. This decision was made against the background of a vote in Parliament giving the First Minister authority to explore means of maintaining the benefits Scotland receives from its relationship with the EU.

The period during which we carried out our deliberations has been characterised by uncertainty. The new Prime Minister has confirmed the binding nature of the result of the referendum, emphasising that "Brexit means Brexit". She has indicated that the UK Government will not trigger the withdrawal process until 2017. It is unclear exactly what role the Scottish Government will have in shaping any deal. However, the UK Government has said it wants to hear views from Scotland and that the deal has to work for the UK as a whole. Our Committee can act as a useful forum so we have taken the decision to publish this, initial report based on the evidence gathered this summer. We will send it to both the UK and the Scottish Governments.

The evidence we have taken from economists, constitutional exports, diplomats, businesses and trade unions overwhelming suggests deep concern about loss of access to the single market in terms of inward investment, free movement of capital, labour and goods. However, the Scottish Fishermen's Federation said Brexit provided an opportunity to manage our marine resources more effectively. During our time in Brussels we discussed the EFTA/EEA option, which, while it would leave the UK outside the customs union, does give access to the single market. We believe that this and other options, either a bespoke free trade agreement or a reversion to WTO rules, require further investigation to see what arrangement would be least damaging to Scotland's interests. We will also investigate how or if Scotland might enjoy a different relationship that better reflects its interests.

It is unclear where Scotland will stand in negotiations. This is another area that requires investigation, along with the article 50 process, the position of EU citizens and the long term impact on our economy. We also need to speak to a wide range of sectors and explore more fully those concerns raised already. I would like to thank the many organisations and individuals who have recently responded to the Committee's call for evidence on the implications of the EU referendum for Scotland. We will draw on this wide-ranging evidence in our inquiry work over the coming months.

This report is the first chapter in what we see as rolling scrutiny of the Brexit process in the Scottish context. We hope that it helps people to better understand some of the issues at stake, and help hold to account those whose decisions are so crucial to our future.

Joan McAlpine MSP
Convener, European and External Relations Committee

Introduction

Background

1. On Thursday 23 June 2016, the UK voted by an overall margin of 51.9% to 48.1% to leave the European Union (EU), commonly referred to as 'Brexit'. The question on the referendum ballot paper was as follows – "Should the United Kingdom remain a member of the European Union or leave the European Union?" Total turnout was 72.2% across the UK. Scotland and Northern Ireland voted to remain by of 62% to 38% (on a turnout of 67.2%) and 55.8% to 44.2% (on a turnout of 62.7%) respectively, whilst voters in England voted 53.5% to 46.5% (on a turnout of 73%) and those in Wales voted 52.5% to 47.5% to leave (on a turnout of 71.7%). Additionally, voters in Gibraltar voted to remain by 96% to 4% (on a turnout of 83.5%).[1] In Scotland, electorates in all 32 Local Authorities voted to remain in the European Union.

2. The formal process for any Member State choosing to leave the EU (the process defined by Article 50 of the Treaty of the EU) has not been triggered and the UK Government has indicated that it will not formally notify the EU of its intention to leave before 2017.

3. The vote to leave the EU in the referendum resulted in significant political changes in the UK Government. The United Kingdom now has a new Prime Minister following the resignation of Rt Hon David Cameron MP and the appointment of Rt Hon Theresa May MP as his replacement. In appointing her cabinet, the new Prime Minister created two new ministerial positions to manage the process of leaving the EU. The Rt Hon David Davis MP is the Secretary of State for Exiting the EU and the Rt Hon Dr Liam Fox is Secretary of State for International Trade and President of the Board of Trade. The new Secretary of State for Foreign and Commonwealth Affairs is the Rt Hon Boris Johnson MP.

4. In Scotland, the Scottish Parliament held a debate on Tuesday 28 June as part of its first business following the Referendum.[2] At the close of the debate, the Parliament resolved by 92 votes for, none against, and 31 abstentions that—

> "the Parliament welcomes the overwhelming vote of the people of Scotland to remain in the European Union; affirms to citizens of other EU countries living here that they remain welcome and that their contribution is valued; mandates the Scottish Government to have discussions with the UK Government, other devolved administrations, the EU institutions and member states to explore options for protecting Scotland's relationship with the EU, Scotland's place in the single market and the social, employment and economic benefits that come from that, and instructs the Scottish Government to report back regularly to parliamentarians, to the European and External Relations Committee and

> the Parliament on the progress of those discussions and to seek Parliament's approval of the outcome of that process."

5. Following its establishment, the European and External Relations Committee has met formally on two occasions, including during the summer recess, to discuss the implications for Scotland of the UK's decision to leave the EU. Initial decisions on the Committee's work programme were taken on 30 June[3], including agreement to take some initial evidence in this area, arrange discussions with various bodies in Brussels and commission research and briefing material on a variety of subjects. The Committee also met on the same day with a number of Consuls, Consuls General and Honorary Consuls from EU/EFTA countries that are based in Scotland. The Committee has held discussions with David Lidington MP, the then Minister for Europe on 6 July. Subsequently, on 28 July,[4] the Committee agreed to appoint two **advisers** to assist members in their work – Professor Sionaidh Douglas-Scott and Professor Michael Keating – and to launch an inquiry and open call for evidence.[5]

6. To date, the Committee has heard the views of the Scottish Government's Cabinet Secretary for Culture, Tourism and External Affairs and has also taken evidence from a range of constitutional law and EU policy specialists, as well as economic commentators, business groups, fisheries and farming interests and the trades unions.

This report

7. This report summarise the evidence the Committee has heard to date and the key issues that are emerging. **We are publishing this report now in advance of the next stage of our inquiry to inform both the UK Government and the Scottish Government of the views expressed to us so far. In addition, we hope that the report will inform the public at large in Scotland of some the principal issues relating to withdrawal from the European Union that the Scottish Parliament will need to consider in the months ahead**.

8. This debate is only just beginning and the formal process of triggering withdrawal via a notification from the UK Government under Article 50 has not yet commenced. **The Committee urges all organisations and individuals who have an interest in this matter to engage with our inquiry work over the coming months in order that the implications of the referendum vote to leave the EU for Scotland are fully understood and articulated.**

Evidence heard and key issues

Introduction and our work to date

9. In addition to the evidence taken at its formal meetings on 30 June and 28 July,[6] on 19 July, a cross-party delegation from the Committee visited Brussels to meet with the British Chambers of Commerce and the ambassadors to the European Union of Iceland, Norway and Ireland.[7]

10. Some of the main themes that were explored during this visit and the issues that emerged from those we met were the immediate economic concerns of UK and Scottish businesses, the possible decrease in inward foreign investment to and the various challenges facing the UK economy in the immediate aftermath of the referendum. We were also able to assess the various views towards Scotland's position given it voted to remain part of the European Union. Members were also able to explore how negotiations were likely to progress following the triggering of Article 50 and the pros and cons of other potential economic models available to the UK following its departure from the EU. One very clear conclusion was that European partners would be open to a distinctive Scottish approach to maintaining our relationships in Europe, as long as that approach had been agreed with the UK Government first. The importance of the Single Market was also highlighted.

11. The Committee has also commissioned research from the Parliament's research service (SPICe) and externally in the following subjects:

    - The Fraser of Allander Institute has been commissioned to conduct research on the implications of leaving the EU for the Scottish Economy. This research will be prepared in conjunction with SPICe and should be available in September.

    - Professor Alan Page of Dundee University has been commissioned to conduct research on the implications of leaving the EU for the Scottish Parliament's legislative competence.

    - SPICe is preparing research briefings on the implications of leaving the EU for key sectors in Scotland.

    - SPICe is preparing a number of research briefings which will be published in September and October 2016. This includes briefings on WTO rules, EU funding, and EU migration in Scotland and the contribution of EU citizens to the Scottish economy.

12. The work conducted to date has helped us to identify a number of constitutional and legal issues, and economic, financial and labour market issues, which are set out below.

Constitutional and legal matters

13. To date, the Committee has explored a number of issues relating to the constitutional and legal process for leaving the EU. These have included the process to be followed within the UK, when and how Article 50 is triggered, what form the negotiation process is likely to take and what constitutional or legal scope there is for a potentially different form of relationship between Scotland and the EU compared to that of the rest of the UK.

Leaving the EU

14. It is important to note at the outset that no Member State has ever withdrawn from the EU and Article 50 of the Treaty on European Union (TEU), which was introduced by the Treaty of Lisbon, has therefore never been tested. The full text of Article 50 (TEU) is as follows—

> 1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.
>
> 2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.
>
> 3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.
>
> 4. For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it.
>
> A qualified majority shall be defined in accordance with Article 238(3)(b) of the Treaty on the Functioning of the European Union.
>
> 5. If a State which has withdrawn from the Union asks to re-join, its request shall be subject to the procedure referred to in Article 49.[8]

15. This Committee's predecessor in Session 4 set out the withdrawal process in detail in its 2nd Report of 2016. It noted that the first step, under Article 50(2) would be for the UK to notify the European Council of its intention to withdraw

from the Union. In effect, this notification would set the clock ticking for the two-year period identified in Article 50(3). The European Council then would agree and provide negotiating guidelines.

16. A **'withdrawal agreement'** in the form of a treaty would then be negotiated and concluded between the EU and the UK. This would set out the arrangements for the UK's withdrawal, and would *take into account* the framework for the UK's future relationship with the Union. **While various options for the agreements and treaties that could be negotiated have been identified, the details of the UK's new relationship with the EU could be set out in a separate agreement**.

17. Under Article 50(4), as the departing Member State, the UK would not be able to participate in the European Council or Council discussions or decisions concerning its departure. This would mean that only the remaining 27 Member States would be party to these discussions. Significantly, this would cover all decisions concerning the framework for the UK's future relations with the EU.

18. If the withdrawal negotiations were successfully concluded within two years, then the date of the UK's withdrawal would be the date of the entry into force of the agreement. At that point, the Treaties would cease to apply to the UK. If the negotiations were not successfully concluded within two years, Article 50(3) effectively provides a guillotine clause whereby withdrawal would happen automatically two years after the date on which the UK had notified the European Council of its intention to withdraw. However, the European Council – acting by unanimity – could agree with the UK to extend this period. It should be noted that the next elections to the European Parliament take place in June 2019 and that, additionally, this period also sees the next cycle of discussions on the EU's budget. The current European Commission's term of office runs until 31 October 2019.

19. The agreement will be concluded by the Council of Ministers, having secured the consent of the European Parliament, acting by a Qualified Majority Vote and would not, therefore, require unanimity. However, if it was a mixed agreement, that is if it was an agreement between the EU and the Member States as it covered areas of Member State competence as well as EU competence, it would need to be ratified by other Member States in accordance with their own constitutional arrangements. This ratification process could add a number of months to the time required before an agreement is formally in place.

20. The withdrawal agreement would instigate the need for a revision of the EU treaties in accordance with Article 48, at a minimum to amend them where they referred to the United Kingdom and to remove the protocols specific to the UK.

21. Finally, Article 50(5) includes a disincentive to a potentially equivocating Member State by introducing a requirement that re-joining the EU would take place through the various steps outlined in Article 49 TEU.

22. In addition to the withdrawal agreement required for the UK to leave the EU and establish a new relationship between the UK and the EU, the UK would need to address its domestic situation in regard to EU law. The evidence collected by the previous committee, and echoed in the evidence we have heard to date indicated that the scale of this could be extremely significant, although it would depend on the extent to which the UK Government, and the devolved administrations, decided to maintain EU law domestically.

Evidence heard

23. The Committee sought to clarify with witnesses whether the result of the referendum constituted a decision in accordance with the constitutional requirements of the UK, as required by Article 50.1. Sir David Edward, a former Judge at the European Court of Justice, set out three different positions on this question—

> The first is that the decision has been taken by the referendum, although the European Union Referendum Act 2015 does not provide that that is to constitute a decision.
>
> The second position is that, because the decision relates to treaties and international relations, it is a matter for the royal prerogative, which can be exercised without the consent of Parliament.
>
> The third position, which is illustrated to some extent by the question, is that precisely because the treaties go into personal and commercial relationships, and rights and obligations are thereby created for both UK nationals and the nationals of other member states, and that is a matter of statute—the will of Parliament—which stands for the time being, it could only be Parliament that authorises the United Kingdom to take the position of commencing a process that is intended to create a situation in which, in accordance with article 50, the treaties shall cease to apply.[9]

24. Sir David's view was that, "…if there is parliamentary sovereignty and we continue to believe that we are a parliamentary democracy, the third course is necessary."[10]

25. Professor Sionaidh Douglas-Scott – giving evidence before her appointment as an adviser to the Committee – agreed with the premise that these three positions represented the various interpretations that were available. She expressed the view that "the UK constitution is not very explicit at all on any of those aspects, and it is not helped by the fact that we have no precedents under article 50". In addition, she observed that "the EU itself has not been giving out clear messages."[11] With regard to whether the result of the referendum constituted a trigger, she expressed the view that, "I think that we are all clear that the referendum is advisory, and that if Parliament chose not to act on it, it would not have to."[12]

26. Professor Douglas-Scott recognised the arguments that there was a need for the UK Parliament to agree to a withdrawal from the EU under Article 50 but concluded that they were unlikely to "win the day".[13] She concluded—

> When it comes down to it, the withdrawal from the union will have to be agreed by [the UK] Parliament when it repeals the European Communities Act 1972, if that is what it does. I suspect that enough people will say that Parliament will have its say then, given that there will have to be some sort of withdrawal agreement and that Parliament will have to ratify that in a European communities withdrawal act.[14]

27. The role for the Scottish Government in the process for triggering Article 50, as well as the process for reaching the decision itself, were covered in the evidence that the Committee heard from the Cabinet Secretary for Culture, Tourism and External Affairs. In the immediate aftermath of the Referendum, and before the appointment of a new Prime Minister, the Cabinet Secretary stated—

> UK ministers have not told me what their plans are because I do not think that they have plans yet. That is to be resolved. Some of this is party political and concerns what can or should be done before a new Prime Minister is in place, but I have made it clear that they should think carefully about when and how they trigger article 50 and that it is important that we be involved in the negotiations or discussions and the process prior to article 50 being triggered.[15]

28. In the Cabinet Secretary's view, "the legal competence for the negotiation is with the UK Government, so we need to be part of the UK Government's negotiations and at the table in the discussions." [16] She also indicated that there needed to be a role for the civil service in Scotland in addition to the Scottish Ministers—

> I said earlier that, particularly during a time of change in personnel in Government, we need to make sure that Scotland is operating not just minister to minister and Prime Minister to First Minister but also at a senior civil service level. The UK civil service set-up means that Scotland has an opportunity to make sure that we have a key position and voice. That is important.[17]

29. Speaking subsequently, the First Minister stated that it was her view that the Scottish Parliament as well as the Scottish Government has a role in the Article 50 process and decision. She said—

> My government is now working with the UK government to establish exactly what these commitments mean in practice.
>
> We need now to set out in detail the manner in which the Scottish Government will be involved in the development of the UK position ahead of Article 50 being triggered and the mechanism for ensuring meaningful assessment of the options we bring forward.

> And we must also be clear what our involvement, and that of the other UK administrations and parliaments, will be in the political decision to invoke Article 50 - not just in the evidence gathering and consultation to inform that decision, but in the actual decision itself. I know other administrations are equally anxious about that and indeed at the British-Irish Council meeting in Cardiff on Friday Carwyn Jones, First Minister of Wales, put forward the suggestion about the involvement of all four parliaments across the UK being involved in that. This is the work we are doing to turn the commitments that have been given into practical reality.[18]

30. More recently, in a letter to the Committee, the First Minister welcomed the "commitment from the Prime Minister that the Scottish Government will be fully involved" in the process of developing a UK position in advance of Article 50 being triggered, and that "Article 50 will not be triggered until there is a UK approach and objectives for negotiations."[19] On 25 August, the First Minister also indicated that it was her intention to appoint Michael Russell MSP to act as a new Minister for UK Negotiations on Scotland's Place in Europe; an appointment approved by the Parliament on 6 September.

31. The question of when Article 50 should be triggered was also been part of the evidence we have taken to date, as well as an integral part of wider discussions in the UK. In her evidence at the time, the Cabinet Secretary for Culture, Tourism and External Affairs recognised that in the immediate aftermath there had been calls for an immediate trigger but that now, some time is being allowed to elapse.[20]

32. From the discussions the Scottish Government had had to date with representatives of other EU states, she felt that—

> Politicians in many other countries will face elections in the next year to 18 months, and they will want their interests to be reflected. Therefore, it would be wrong to say that there is one view. There will be different views for different reasons. The whole point of the European Council of Ministers is to bring that collection of views together to identify what is in the common interest of all the member states.[21]

33. At the time of publication of this report, the latest position is that the UK will not trigger Article 50 before the end of this calendar year. Speaking on 28 July, the new Prime Minister stated that she wished to maintain "the closest possible economic relationship once the UK has left the European Union" and that it would "take time to define the nature of that relationship, which is why I have said that we will not trigger Article 50 before the end of the year".[22]

34. Once triggered, Article 50 provides for a two-year period for the completion of the withdrawal negotiations whereupon if there is no agreement, and where there has been no decision to extend the discussions, the Treaties cease to apply in the UK - in effect, the UK is no longer a member state of the EU.

35. The Committee heard evidence on the process that was likely to be followed for the negotiations. Dr Kirsty Hughes of the Friends of Europe think-tank told the Committee that "it is possible that there will be two sets of negotiations".[23] She explained further—

> One set could negotiate a basic withdrawal agreement within two years, so that the UK is not—as the committee discussed with the cabinet secretary—sitting in the Council of Ministers when it has said that it will leave and is therefore a rather unwelcome and potentially obstructive presence. That would ensure that the UK could leave within two years. If a trade or association agreement had not been agreed by then, negotiations on that could carry on over the five or 10 years that might be needed. However, the basic deal would be agreed on ending budget contributions, MEPs coming to the end of their terms and European civil servants.[24]

36. This view was shared by Professor Douglas-Scott who also believed that there would have to be two agreements[25] - the Article 50 withdrawal agreement to govern the end of the UK's membership of the EU and a separate agreement to set the terms of the future relationship.

37. Commenting on this, Sir David Edward pointed out that there was difference in the texts of Article 50 in the English and German language versions of the TEU which resulted in a lack of clarity on the timing of the agreement on the future relationship between the EU and the departing member state.[26] He noted that the English version uses the wording that "the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of [*our emphasis*] the framework for its future relationship with the Union" while "the German text seems to say that the withdrawal agreement will have taken account of [*our emphasis*] the future relationship; in other words, you have to negotiate the future relationship as well and before withdrawal."[27]

38. Leaving this issue to one side, the Cabinet Secretary made the Scottish Government's view clear in her evidence on her preferred position at the end of the two-year period. She said—

> … we need to make sure that we maximise the options. I think that the intention is that the UK Government will trigger the article 50 process, but it might not do so—that is also a possibility. If we have not maximised our position by the end of the two years and the guillotine falls and we are out, we could be in the extreme position that I talked about. That is the one thing that we cannot allow.
>
> People will make a judgment, but if we have not managed to get a position that maintains Scotland's membership by the end of that two years, Scotland will be, as part of the United Kingdom, out of the European Union.[28]

39. Additionally, within the two-year period itself, the Cabinet Secretary stressed the importance of continuing to engage with EU issues in the Council of Ministers and other groupings whilst recognising the potential for a declining influence. She said—

> We were Europeans last week, we are Europeans today, and we will be Europeans tomorrow. We are members of the European Union until such time as we are not, and our intention is to ensure that Scotland remains. That is a clear position. …
>
> It is important that the EU hears from people who want to remain so that we can maximise our position over the next two years. We do not want to lose ground in those two years, and there is a real risk of that.[29]

40. Finally, the Committee has heard a suggestion that there is a potential for a different relationship for Scotland with the EU than that that may be taken by the rest of the UK.

41. Professor Andrew Scott of the University of Edinburgh told the Committee that it was important to consider this question alongside the scope for a different constitutional arrangement in the UK. In response to a question from a Committee member, he said that—

> Any arrangement in which Scotland has an exceptional position, with the UK in its present structure, is difficult to conjure up, as you said. Any option would have a constitutional dimension. You asked how Scotland would be represented, and the Greenland option is somewhere in there.[30]

42. Professor Scott also pointed out that—

> A difficulty is that there would have to be a rules of origin agreement between RUK and Scotland. If Scotland had more privileged access to EU markets than the rest of the UK but it was still part of the UK, a whole bunch of arrangements would have to be set up to ensure that English goods—if I can describe them in that geographical sense—did not enter the EU via a free-trade corridor that Scotland enjoyed with the EU.[31]

43. Dr Hughes agreed with the comments from Professor Scott, noting that the issue of how "complex the situation is depends on what the rest of the UK is doing, if we are talking about a scenario in which Scotland stays in the European Economic Area or in the single market with all four freedoms."[32]

44. Professor Douglas-Scott observed that—

> … it depends on the solutions and permutations, both within the UK and in the EU relationships. Take free movement, for example. If England and Wales were to adopt some sort of Norway-plus EEA arrangement, there would be free movement of persons, and if Scotland and the rest of the UK

> had some other sort of differentiated relationship with the EU, that would be more workable.[33]

45. Sir David Edward also gave his view, stating—

> It does not seem to me to be possible to envisage a position in which Scotland remains part of the UK but has a separate relationship with the single market. All sorts of complications, such as customs, would arise.[34]

46. Speaking at an Institute for Public Policy Research (IPPR) Scotland conference, the First Minister also commented on this matter. She stated that—

> When Article 50 of the Lisbon Treaty was drafted, it would have been considered inconceivable that any country would ever vote to exercise it. In fact, you only have to read it to know it was never drafted in a way to be actually executed. But that has now happened and, beyond a few lines of text, there are no rules for what happens next. The territory is uncharted, the page is blank. That gives us an opportunity to be innovative and creative - an opportunity to shape the future.
>
> Already, ideas are being floated. Terms like "reverse Greenland" and the "Norway model" have entered our lexicon and a number of academics and experts have started to sketch out other possibilities. Some may prove impractical or undesirable. But in a union where the relationships between our nations are constantly evolving, there's no black and white. Let's consider all the options with an open mind and work to develop the right outcome for Scotland.[35]

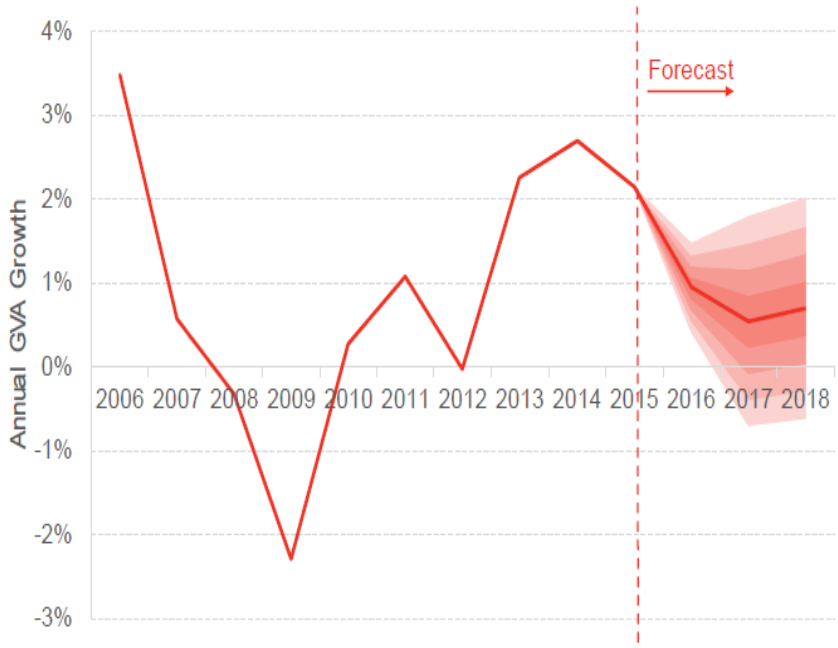
Economic, business, financial and labour market issues

Economic analysis of Brexit

47. In advance of the Committee's evidence session on 28 July, the Fraser of Allander Institute at the University of Strathclyde published a summary of its work up until that date on the economic implications of leaving the EU, providing it to the Committee as part of their formal evidence.[36]

48. The key finding of the Institute is a forecast that the rate of growth in the Scottish economy will experience a sharp slowdown over the next three years as a result of the decision to leave the EU (see Figure 1). This is partly due to uncertainty and volatility posing a risk to investment, growth and incomes, and partly to damaged trade and investment prospects.[37]

Figure 1: Gross Value Added - actual in Scotland (to 2015) and forecast error range for 2016 to 2018



Source: Fraser of Allander Institute

49. This analysis makes a distinction between the short-term, where there may be economic uncertainty during the negotiation period, and the longer-term (beyond 2018) when there is more clarity on the UK's future trading relationships.[38] The sectoral impact will vary according to the Fraser of Allander Institute, with some sectors such as construction and retail hit hard because of their reliance on imports.

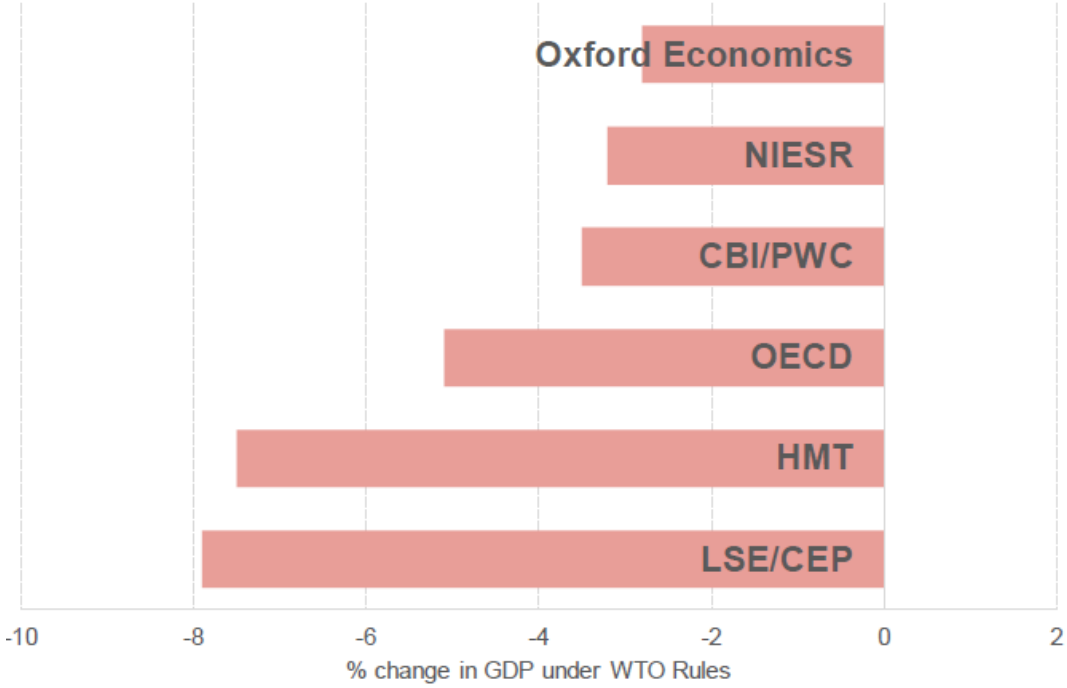
50. For the Fraser of Allander Institute—

> The degree of impact will depend upon the nature of the revised trading agreement. Remaining in the Single Market is clearly a top priority as it will minimise the degree of dislocation, but even then, Brexit will have a detrimental effect on growth.[39]

51. The Institute notes, however, that "securing a deal on access to the Single Market without freedom of movement is highly improbable."[40]

52. The Institute's analysis also summarises the forecasts of a number of other think tanks, industry bodies and the HM Treasury on the long-term impacts on GDP under a "WTO rules" scenario. This is shown in Figure 2.

Figure 2: Some Forecasts of the Longer Term Impact of Brexit (% change in GDP under WTO rules)



Source: Fraser of Allander Institute

NIESR: National Institute for Economic and Social Research
CBI/PWC: Confederation of British Industry/PriceWaterhouseCoopers
OECD: Organisation for Economic Co-operation and Development
HMT: HM Treasury
LSE/CEP: London School of Economics/Centre for Economic Performance

53. These figures are similar to those from a recently published study by the Institute of Fiscal Studies, which concluded that—

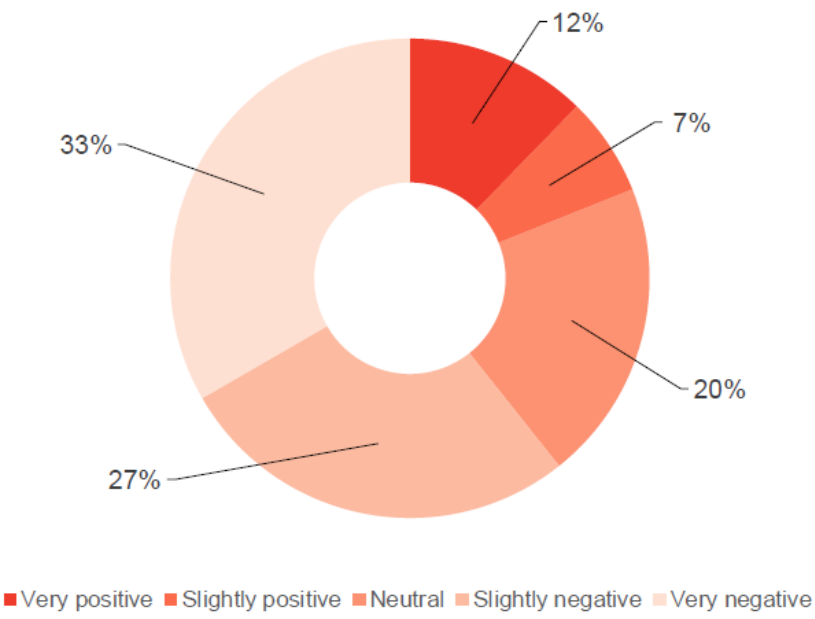
> In the short-term, indicators on the strength of the economy since the EU referendum are still emerging but the Bank of England has revised down its forecasts for growth throughout the next three years, with the largest revision to its GDP forecasts since the introduction of the Monetary Policy Committee in 1997.
>
> However, in the medium to long-term, the model the UK chooses will matter significantly to the economy and living standards. Maintaining membership of the Single Market as part of the EEA could be worth potentially 4% on GDP – adding almost two years of trend GDP growth – relative to World Trade Organisation (WTO) membership alone. This would, on average, mean higher living standards and likely be distributed across income levels. Both theory and the available modelling suggest EEA membership would be likely to mean stronger UK economic performance than an FTA with the EU.[41]

54. In analysis published by the Scottish Government in August 2016, it indicated that—

> …applying the results of a range of UK level studies to Scotland, suggests that if the UK adopted an alternative trading relationship with the EU, it could potentially reduce Scottish GDP by up to £11.2 billion per year by 2030, compared to what it could be if Brexit does not take place.[42]

55. In the accompanying survey of Scottish businesses published in July 2016 by the Fraser of Allander Institute, 40% believed that Brexit would either have a 'slightly negative' or 'very negative' impact on their future investment plans (Figure 3).[43]

Figure 3: Fraser of Allander's business survey: Do you think that the result of the referendum will be positive or negative for your business?

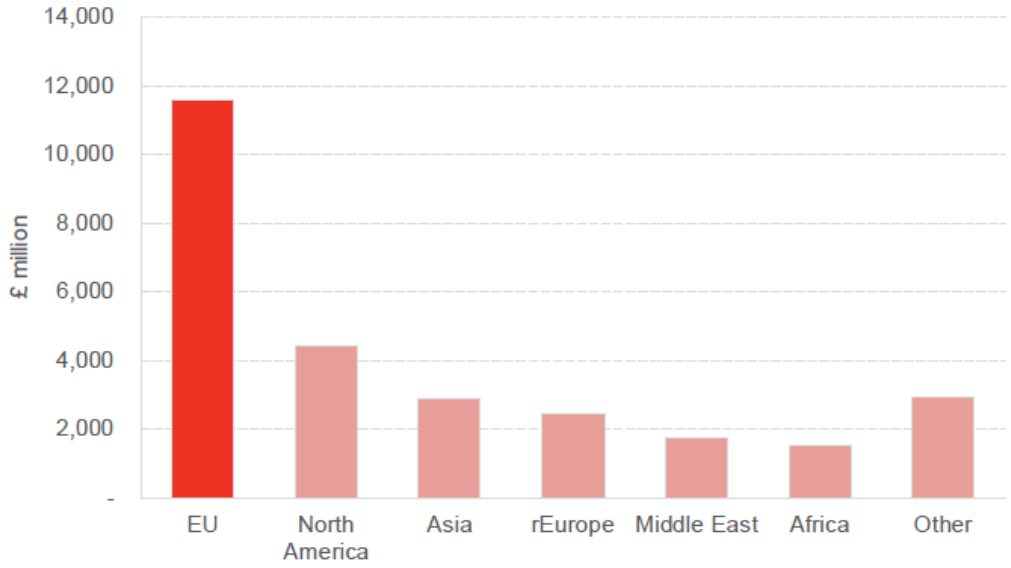


Source: Fraser of Allander post-Brexit Survey (July 4-12th, 2016)

56. The Institute states that the currently lower exchange rate will help dampen some of the effects of the short-term impacts, noting that since the referendum the sterling effective exchange rate has fallen nearly 10%. In its view, a fall in sterling boosts the competitiveness of Scottish exporters and the tourism sector, although as costs rise this 'advantage' will disappear over time. Sectors, including retail, which rely on imports will fair less well.[44]

57. The total nominal value of Scotland's International Exports (excluding Oil and Gas) was around £27.5 billion in 2014.[45] Figure 4 sets out the importance of the EU within this in terms of a destination for Scottish exports.

Figure 4: The importance of EU exports: Scottish international exports, by destination (2014)



Source: Fraser of Allander Institute

58. If we consider the service sector alone, the Scottish Government's Export Statistics report that exports from the service sector have had increasing importance in recent years, accounting for 38% of all exports in 2014 compared with 24% in 2002, with those on professional services (legal, accounting, management, architecture, engineering, technical testing and analysis activities) worth around £2.3 billion per year and those in financial services worth £1.2 billion per year. Total service exports equated to around £10.5 billion per year in 2014, with around 40% of trade going to the EU.[46] Services also contribute to the UK's overall balance of trade as service exports are higher than service imports[47]. Not all of the potential 'models' for a future relationship between the UK and the EU extend to the free trade of services.

59. In addition to the export sector, leaving the EU may have an impact on Foreign Direct Investment by overseas companies investing in Scotland. In its recent analysis, the Scottish Government states that "EU membership is also important for attracting inward investment into Scotland as it allows companies easy access to European markets" and estimates that "there are nearly 1,000 EU-owned companies in Scotland employing over 115,000 people".[48]

60. In terms of policy responses, the Fraser of Allander Institute has called on the Bank of England and HM Treasury to step forward with an immediate fiscal stimulus and for the UK Government to move away from its deficit reduction plans in the short-term with a programme of new infrastructure investment and support

for exporters. It also calls on the Scottish Government to do the same and to clarify its own plans for the constitution to avoid uncertainty.[49]

61. On 10 August 2016, the Scottish Government announced the acceleration of capital spending on projects to support and create employment. An additional £100 million of funding has been allocated in the current financial year to speed up delivery of health and other infrastructure projects. In addition, a new dedicated service to provide information and support to businesses affected by the EU referendum will be established, and a new Post-Referendum Business Network will be set up to work closely with the main business bodies, the STUC and the Scotland Office.[50]

Evidence received

62. In addition to the analysis presented above, the Committee has received initial written and oral evidence from a range of business organisations and trades union representatives, summarised below under four broad headings: alternative models for relations with the EU; views from various sectors of the economy; labour market and migration issues; and EU funds, funding and new fiscal arrangements.

Alternative models for relations with the EU

63. For most organisations we have spoken to, it was too early in the process of leaving to be definitive about their preferred alternative to EU membership. Nevertheless, many were prepared to outline what would be important in the new relationship to be formed with the EU and identified their key priorities.

64. As indicated above, the Fraser of Allander Institute has stated in its evidence that remaining in the Single Market was a "top priority"[51]. Giving evidence to the Committee, its Director (Designate), Dr Graeme Roy, elaborated on further options and challenges that these would bring. He said—

> There are quite significant and important differences between the single market and a free trade area. In essence, a free trade area removes tariffs between two trading partners, particularly for goods. Largely, however, it does not give access through services. For example, although Switzerland has a special, bilateral relationship with the EU, that does not exist in services and Swiss financial services companies have to incorporate separate bodies within the European Union in order to trade as entities within the EU.
>
> All that the free trade area does is remove tariffs, but it largely does not remove tariffs on services and it does not remove non-tariff barriers.[52]

65. He also noted the difference between a Single Market and a free trade area, stating—

> The EEA requires proof-of-origin rules to ensure that a good that is produced in the EEA is actually produced in that area and has not been

> passed from another country into somewhere such as Norway to be traded into the EU. All goods that come from outside the single market must go through a process of proving the country that they were produced in before they can be traded into the single market, which adds a small cost of 1 to 2 per cent to trading. When margins are tight, adding in proof-of-origin rules, non-tariff costs and other compliance issues before we even get to tariffs makes a significant difference between a free trade area and a single market.[53]

66. Colin Borland, Senior Head of External Affairs at the Federation of Small Business in Scotland, stated that "there are some immediate priorities, the top one being simple access to the European single market"[54] He added that "from a business point of view, we are clear that the priority is access to European and other markets, but I do not think that we are yet in a position to say how that should be achieved." [55]

67. For James Withers, Chief Executive of trade body – Scotland Food and Drink – some sense of the UK Government's preferences at this stage would be helpful. He told the Committee—

> … we are still talking about extremely broad principles such as the benefits of being in the European economic area as opposed to being in a free trade agreement or being hostage to World Trade Organization rules. Some sense of what plan A or option 1 is would be helpful in narrowing down the discussions so that we can deal with the detail. I appreciate that we are engaged in negotiations and that there will be a limit to how much the UK Government will want to show its hand, but it would be helpful to have at least some sense of what an ideal option would be in terms of our future relationship with Europe. That would enable my industry to start dealing with more of the detail.[56]

68. Stephen Boyd, Assistant Secretary of the STUC, cautioned against making assumptions that the UK could be selective in approaching a negotiation, "At this moment, it is very difficult to envisage any circumstances in which the EU would give the UK full access to the single market without the UK retaining both free movement and a very significant financial contribution to the EU."[57]

69. Stephen Boyd articulated the view that "we are looking at least-bad scenarios" and that "whatever we end up with is likely to be significantly worse than what we had before as full members of the EU."[58] He noted that "EEA status would offer a degree of protection that would not be there under other scenarios."[59]

70. A note of caution on the feasibility of EEA membership was highlighted by Dr Roy. He said—

> People have talked about immediately joining the EEA, as if that would be easy to do. However, one reason why the EEA has worked is that it involves a small number of countries that happen to be small. Throwing the

> UK into that mix would fundamentally change its make-up. Goodness knows whether it would want that to happen and whether the EU would want the UK to be in the EEA and still have access to the single market.[60]

71. An alternative to the EEA or EFTA route would be for the UK to negotiate a bilateral free trade agreement with the EU. The ability of the UK to negotiate free trade agreements more generally with other countries such as the USA or the Peoples Republic of China was also covered in the evidence we heard, with mixed views expressed.

72. Stephen Boyd raised the issue of capacity, stating that, in his view, there was a much wider point, namely "the huge glaring lack of capacity at all levels across the UK to deal with complex trade issues."[61] He elaborated further—

> … across all institutions in the UK that have an interest in economic matters, trade has been underdiscussed for an awful long time and it is only now that people are really beginning to think about the deeper issues involved. Up until now, we have been discussing what our relationship with the EU will be like, but we have relied on the EU to negotiate free trade agreements with more than 50 other countries. We have to recognise that the UK's lack of capacity for negotiating such agreements and Scotland's capacity to monitor them in our interest is a real problem.[62]

73. He also warned that—

> There is also probably a lack of understanding of the importance of the scale of the EU in negotiations and its ability to introduce issues of global importance such as climate change, anti-trust—on which the EU has been very active although that has been poorly recognised—and tax avoidance. The EU can introduce such issues into its bilateral discussions in a way that the UK simply would not be able to do because it would be outgunned by partners that are more economically powerful and have much more experience in negotiating these complex agreements.[63]

74. This was not a view shared by David Frost, Chief Executive of the Scotch Whisky Association and former Director of Trade Policy at the Department for Business Innovation and Skills. He drew a distinction between staff that had experience of negotiations and staff who had experience of supervising these negotiations. Speaking in a personal capacity, he said—

> …it was news to me that the UK Government does not have capacity in that area. What it does not have are people who have spent a long time sitting in trade negotiations as opposed to supervising them; it also lacks some technical expertise in areas such as WTO rules and translating deals into text and so on. Therefore, capacity will definitely have to go up a bit, and the UK Government will definitely have to buy in some of that, but the idea that there is no capacity to do or think about trade negotiations is simply wrong. It exists; the negotiations can be kicked off straight away.[64]

75. A suggestion was also made by Stephen Boyd that Scottish Development International (SDI) – Scottish Enterprise's international trade arm – would also need strengthening. He said that SDI did "a very good job" but questioned whether it was "properly resourced" to advise companies on issues such as proof of origin which is has not had to do in the past. He described this as "potentially an area for additional investment."[65]

Views from various sectors of the economy

76. The Committee also heard important views on economic and financial matters from a range of individual business sectors and parts of the Scottish economy which set out their own sectoral priorities. Some of the issues raised that are common to many sectors – such as EU funding and labour market access – are dealt with in subsequent sections of this Report.

Food and drink

77. The Scottish food and drink industry's turnover has grown to £14.3bn (2013) from £10bn in 2007 according to Scotland Food and Drink, based on a strong home market and a growing export presence. For the trade body, the provision of further detail on future trade agreements was a key issue.[66] It told the Committee that it was important to secure ongoing access to the EU's single market and prioritise Free Trade Agreements (FTAs) with third country markets. In its view, work must be undertaken to explore access to the existing Free Trade Agreements applicable to the EU and to provide for smooth operational and paperwork requirements for the import and export of goods to and from the EU.

78. Scotland Food and Drink also highlighted the importance of considering the legislation in the UK and in Scotland that would replace existing EU law when the UK leaves the EU. It called for clarity on how the complex web of EU food, farming and health-based regulations would be superseded by national arrangements.[67]

79. Finally, James Withers of Scotland Food and Drink highlighted the particular importance of geographical indications for the food and drink industry. He said—

> Interestingly, one of the restrictions of being part of the single market is on the ability to promote regional foods. Within state-aid rules, we cannot promote Scottish foods, as that is seen as skewing one particular part of the single market. What we can do is promote geographical indications. There are about 70 products across the UK that have protected geographical indication status—the same thing that covers champagne and Parma ham—and we have 13 products in Scotland with that status.
>
> Whisky has a fairly unique level of geographical indication protection through UK legislation, which provides greater certainty of the protection of that industry than is provided for Scottish salmon, which is Scotland's biggest export and the UK's number 2 export. As we go forward, it will be

> critical to understand the future protection of that status in Europe, in the UK and in third countries.[68]

Whisky

80. More than 90% of the Scotch Whisky produced is currently sold outside of the UK, and it is the biggest single net contributor to the UK's balance of trade in goods according to the Scotch Whisky Association (SWA). Of the £3.8bn worth of Scotch exported in 2015, £1.2bn was shipped to the EU.[69]

81. The SWA concurred with of the points made by the food and drink industry representatives such as the importance of geographical indications. It also highlighted the importance of beginning work on regulatory issues such as definition of whisky, food labelling, bottle sizes etc. which were often set at EU level and would need to be replaced by domestic law.[70]

82. In terms of its priorities for the UK's following withdrawal from the EU, the SWA called for UK trade policy to be as open and free-trading as possible and for existing provisions in FTAs to be subject to transitional arrangements or be 'grandfathered' (i.e. continue to apply after withdrawal). Over the medium-term, the SWA wanted to see the UK Government develop its own network of trade agreements with non-EU countries.[71]

83. David Frost of the SWA provided a specific example of 'grandfathered' rights in FTAs, indicating this was an area of uncertainty and concern at present and noting that EU free trade agreements already provided the industry with—

> …so-called tariff preference for perhaps 10 or 15 per cent of our exports to countries such as South Africa, Colombia and South Korea. Is there going to be continuity with those? Can they be grandfathered? Can we continue to benefit from that situation after Brexit? I do not know about that.[72]

84. Mr Frost also highlighted an issue relating to negotiating teams during the UK's transition period to Brexit. He said—

> One thing that is really important to us is what happens now and not just the big free-trade agreements. If there is a barrier in market X now, who talks to the Government there to get rid of that barrier? At the moment, we turn to the [European] Commission and the UK Government, but it is realistic to think that the Commission might at some point show less enthusiasm for doing that on the UK's behalf than it does at the moment, so the UK Government will have to step up soon on that. That is the more immediate problem.[73]

Agriculture

85. For the National Farmers Union in Scotland (NFU Scotland), "Scottish farming must not be used as a bargaining chip as we negotiate our exit from the European Union and establish new trade arrangements."[74] In her evidence to the Committee, NFU Scotland's Parliamentary Officer Clare Slipper highlighted the industry's concerns relating to the funding regime that will need to be negotiated to replace the Common Agricultural Policy (CAP), the importance of the current EU funding for research and innovation. These issues are covered in separate sections below.

Fisheries

86. One of Scotland's leading representatives of the fishing industry – the Scottish Fishermen's Federation (SFF) – struck a more optimistic and supportive note on the prospect of leaving the EU than others who have provided evidence to the Committee to date. Its chief executive, Bertie Armstrong, told the Committee that—

> The Scottish fishing industry has a very different take on the matter. We regard Brexit as a once-in-a-lifetime opportunity, as it involves a systemic change in the restoration of our exclusive economic zone with regard to fisheries, which amounts to half of the northern continental shelf—a really big patch of prime maritime real estate.[75]

87. The SFF challenged both governments "north and south of the border ... to have the backbone to enact that and not trade it away again."[76] The SFF was critical of the current fisheries regime in the EU – defined by the Common Fisheries Policy (CFP) - describing the current set-up as a "distant, centralised and monumentally complex process, which produces exactly what might be expected from such a structure – of a continuous stream of largely dysfunctional rules and regulations."[77] Of central importance to the SFF was the possibility for Scotland to be the managing authority for "fisheries management and exploitation in our own Exclusive Economic Zone."[78]

88. In relation to the fisheries regime that would replace the CFP, the SFF said—

> …we are conscious that Parliament may be unwilling to revert to a blank slate in all cases where EU regulations cease to have direct effect (environmental regulations, for example). In such situations the UK fishing industry would seek to avoid any aspects of transposed EU law that threaten its viability. As a matter of principle, we insist that fisheries regulations incorporate a commitment to sustainable harvesting whilst allowing the fleets to operate in an economically coherent manner. Scottish fishermen have a proven track record of rebuilding fish stocks and protecting the wider ecosystem; many of our stocks are now certified under the gold standard of the Marine Stewardship Council (MSC).[79]

Aviation

89. A significant proportion of the users of Scotland's airports are tourists visiting Scotland and leaving Scotland for other destinations. One risk of withdrawing from the EU identified by Edinburgh Airport Ltd in its evidence to us is that of the impact on tourist numbers, as well as on other types of visitor—

> A further dimension that is less discussed is the 'sentiment' risk where it is possible that the UK's decision to leave gives the message that we wish to be isolationist and inward looking and less welcoming to others. This is a particular risk for tourism demand where this is an entirely discretionary market in terms of location choice but other sectors such as education will also be impacted where decisions are made for relatively short periods of time (a holiday or a 2 year post-graduate course) and where there are good alternatives on offer in Europe and the US in particular.[80]

90. Edinburgh Airport Ltd also highlighted what it perceived to be some of the early impacts on its operations of the UK's decision to leave the EU in terms of the response of a number of carriers—

> In terms of low cost carriers, easyJet is talking about relocating and therefore less focussed on UK market for future growth and Ryanair focussing its growth in mainland Europe at expense of UK markets.
>
> We're seeing long haul carriers (e.g. Delta) trimming winter operations where the currency/demand implications are greatest.
>
> We're also finding that potential long-haul carriers (e.g. China) are more likely to wait until there is more clarity on European access and the impact on UK economy and border controls.
>
> For certain, UK domestic carriers will now have higher fuel costs that are in dollars and face uncertainty about longer term economic impacts.[81]

91. In his evidence to us, Gordon Dewar, Chief Executive of Edinburgh Airport Ltd, set out his immediate priorities in terms of responding to the prospect of withdrawal from the EU. In addition to calling for the Scottish Government to take forward its plans for a cut to Air Passenger Duty, he also called for preservation of the UK's involvement in the Open Skies arrangement—

> It is critically important that we preserve our access to the open skies agreement. It would be deeply ironic if we lost it, given that the UK was behind the founding concept of that policy and pushed it for years. Further, we are an island nation on the north-west periphery of Europe, so air access is more important to us than it is to any other European country, as we simply do not have the land-based options.[82]

Colleges and universities

92. In written evidence provided to the Committee, Colleges Scotland set out some of the sector's concerns in relation to Brexit and how it may affect colleges. Colleges Scotland noted that colleges were in receipt of around £15m of EU funds, which were matched by a further £11m from the Scottish Funding Council.[83]

93. Colleges Scotland also commented that one of the other major areas impacted – as with the universities – is that of EU students attending, or planning to attend, Scotland's colleges. In 2014-15, there were just over 130 such students in the college sector. For Colleges Scotland, an immediate impact is the uncertainty about the status of students such as these from other European countries who are due to commence their studies in the autumn. In its view, "since the formal process for the UK to leave the UK has not yet commenced, it is thought likely that they will be able to start their courses as planned. However, this situation needs to be clarified urgently."[84]

94. Colleges Scotland also noted that—

> In relation to students currently in the system, until the UK leaves the EU, EU students can rely on current arrangements. Therefore, undergraduate students entering their third or later years in 2016/17 should be able to complete their studies with their current fee status. It may also be the case that all current students could rely on rights 'acquired' before the termination of the treaty. Also, when taking account of the framework for the UK's future relationship with the EU, the EU/European Parliament may seek to specify that any EU-students already enrolled at the time of the UK's departure from the EU would be covered by some form of transitional arrangements that would mean they could complete their course on the same basis in terms of fees as when they first enrolled. Furthermore, a new relationship between the UK and the EU might include membership of the EEA with a requirement for free movement and therefore fee status could be protected.[85]

95. Similar issues were reported by Universities Scotland, the representative body for Scotland's university sector. Speaking at the Committee, its Director, Alastair Sim, commented—

> To illustrate the scale of the European-ness, among other factors, of that ecosystem, 16 per cent of our academic staff are from the EU. In the past year, £75 million of research project funding came from EU sources, principally horizon 2020. We have 24,000 EU students in Scotland who contribute to the economy by spending about £156 million off campus, and about 1,700 students go out each year on Erasmus to European partners.[86]

96. He also highlighted the issue about EU students, both those currently at Scottish universities as well as those who may apply to attend Scotland's universities—

> There are other issues that we need to address quite urgently. The Scottish Government moved urgently to say that European students currently in the system or joining in 2016 would continue to benefit from Scottish Further and Higher Education Funding Council places. That was very helpful, but we need a similar assurance quickly on 2017 students because prospectuses are already out, having been published prior to the Brexit vote, that say that students can come here and benefit from Scottish funding council funding. We want to maintain that funding for 2017 entrants. There is a contractual element, in that the offer has already been made and applications will be arriving in the next few weeks. Further assurance in that regard is needed urgently.[87]

Banking and financial services

97. The Scottish banking and financial services sector currently employs almost 100,000 people directly and around the same again indirectly, generating about £8bn for the Scottish economy or more than eight per cent of Scottish onshore economic activity. It manages over £800bn of funds and accounts for 24 per cent of all UK employment in life assurance, and 13 per cent of all banking employment.[88]

98. Commenting in the immediate aftermath of the referendum, Scottish Financial Enterprise – the leading representative body for this sector – set out a number of priorities including securing "access to the European Union markets, currently worth over £11 billion to Scottish businesses", and "access to a talented, skilled workforce, including the clear protection of EU nationals currently studying, living and working in Scotland, because their skills are crucial to the success of our businesses."[89]

99. Appearing before the Committee, Hugh Chater, Director of Banking at Virgin Money, set out a wider set of issues his bank was focussed upon in light of the prospect of the UK withdrawing from the EU—

> The first of the three areas that are particularly pertinent to our business is the future of the housing market in terms of both new build and existing stock, which is driven by consumer confidence as much as by any hard economic facts and indicators. The second area is what happens to the Bank of England's base rate. Although many banks have various business levers that we can move in response to a change in the base rate, that would put pressure on the economic performance of banks and other financial institutions. The third area is employment—more specifically, unemployment.[90]

100. He also commented on the issue of the Financial Passport that enables financial firms to offer services across the whole of the EU without requiring further authorisations or meeting local regulations (for example, requirements on capital or liquidity). It also avoids the need to set up a subsidiary as a separate legal entity, which would require its own governance and risk management to trade within the EU.[91] Mr Chater indicated that this may not prove to be as significant an issue as originally highlighted by some—

> Whether the passporting issue—which has been talked about quite a lot particularly in relation to financial institutions and which got a lot of publicity and column inches immediately following the vote—will turn out to be a key issue is unclear. In reality, it is questionable whether, if passporting were not available, financial institutions would choose to relocate to Europe or North America.[92]

101. Mr Chater suggested that the potential for a differentiated regime north and south of the border could lead to opportunities for financial services in Scotland—

> There may be an opportunity, but, as this is a political area, I will tread with care. In Scotland, particularly in Edinburgh, we have a thriving financial services sector that employs close to 100,000 people. Depending on where Scotland's relationships with the EU land, there may well be the opportunity to offer the country as a relocation safe harbour for institutions that are worried about the removal of passporting from the rest of the UK.[93]

Labour market and migration issues

102. As indicated previously, the Committee requested further research into migration issues and the potential impact on Scotland's economy and public services of withdrawing from the EU from SPICe.

103. According to the Office of National Statistics (ONS), 5.24 million people born outside of the UK were working in the UK at Q1 2016, of whom 2.21 million were from the EU.[94] According to the National Records of Scotland (NRS), there were 173,000 EU nationals resident in Scotland (primarily from Poland, Ireland, Germany and Spain). Of these, a significant number were in employment both in the private sector as well as the public sector, making up about 5% of Scotland's workforce in 2015. NRS reported that it is estimated that 5% of NHS staff are EU nationals and, based on data from the regulators, perhaps 9% of doctors, 4% of nurses and 2% of dentists in training are from the EU.[95]

104. Many of the organisations and individuals that gave evidence to the Committee to date have commented in the importance of labour market issues and on the issue of freedom of movement of people, labour and establishment.

105. Colin Borland of the Federation of Small Business in Scotland commented—

> Of course, it is possible to hire people from outside the EU, but that involves going through a fairly lengthy and complex process whereas hiring people from the EU is fairly straightforward. In the UK, we would need to put in place something that would allow such movement of goods and labour with the absolute minimum of extra bureaucracy if that is where we end up, depending on whatever deal we finally sign up to.[96]

106. James Withers of Scotland Food and Drink stated that for his sector—

> Around 30 per cent of the workforce in the food and drink industry is from eastern Europe. There is an urgent need to get an assurance that the workers who currently work in the food and drink industry—and in other sectors—in Scotland will have their rights maintained. That issue is causing a great deal of uncertainty for individual workers and for businesses.[97]

107. His views were shared by Alastair Sim of Universities Scotland[98], who also commented that dependents of EU staff are able to accompany any member of staff moving to Scotland for employment in a Scottish university.[99]

108. Bertie Armstrong of the Scottish Fishermen's Federation was more confident of the ability to negotiate an arrangement on labour market migration should the issue of freedom of movement of people become more problematic when negotiating a deal on the UK's new relationship with the EU. He said—

> …we should not overemphasise the importance of the free movement of people. I did not hear anybody in the debate in the run-up to the referendum saying that we will ban everybody from everything. If it is in the country's best interests to import labour—for soft-fruit picking or for the fishing industry—I have no doubt that an arrangement could be reached to achieve that. We are continually fighting for more concessions to bring in labour from elsewhere—it is not immigration as the labour is used at sea—and getting nowhere. There are many aspects to consider, but I do not think that any of it is overwhelming.[100]

109. In his evidence to the Committee, Dr Roy of the Fraser of Allander Institute highlighted an additional issue, namely that of freedom of establishment as well as freedom of movement of labour—

> The single market has four fundamental freedoms, of which freedom of movement is a key one. It is integral to the single market holding, because it is linked to the free movement of labour and the freedom of establishment. This is not usually picked up when we talk about the free movement of people, but the freedom of establishment is the freedom for someone to set up a business in another part of the European Union. In services, it is key that somebody from Germany can come to the UK—or

> vice versa—and set up a service. Freedom of movement is, therefore, integral to the successful operation of the single market.[101]

110. Finally, commenting on the specific issue of employment rights in the labour market, Stephen Boyd of the STUC expressed some concerns that these could be weakened—

> The extent to which labour rights would be protected by EEA status depends on the deal that is negotiated, but they are very unlikely to be strengthened by that process. Given who is likely to do the negotiating on behalf of the UK, there is a risk that those rights could be diminished in some way, shape or form.[102]

EU funds, funding and new fiscal arrangements

111. The final issue explored by the Committee and highlighted in our initial evidence is that of EU funding in Scotland and the process by which any funds formerly spent from EU budgets (such agricultural subsidies, research funds etc.) will now be allocated to Scotland from the UK as the latter no longer makes its contribution to the EU's budgets.

112. There are currently a myriad of different EU funding streams benefiting Scotland. These include—

- Agricultural programmes such as the Common Agricultural Policy and the scheme to support Less Favoured Areas.
- Research funding programmes such as Horizon 2020.
- Regional development funds such as the European Regional Development Fund and the European Social Fund.
- Programmes for the environment and climate action such as the LIFE programme.
- Education support schemes such as bursaries for Scottish students to study in the EU under the Erasmus programme.

113. As an example, for the 2014-2020 programming period, Scotland secured a total investment of €941m split across the European Regional Development Fund (ERDF) and European Social Fund (ESF). A briefing by SPICe produced in October 2015 provides more detail on EU funding in Scotland.[103]

114. Similarly, according to SPICe, Scottish Universities also benefit from access to the Horizon 2020 funding programme for research and development. In the first 18 months of the programme (which began in January 2014), Scottish organisations were awarded over €111 million in funding which is 1.5 per cent of the total awarded Horizon 2020 budget to date. This figure also equates to 10.5 per cent of the funding awarded to the UK (over €1 bn).

115. In terms of agricultural support, SPICe estimates that Scotland will receive €4.1bn between 2014 and 2020 via Pillar 1 of the Common Agricultural Policy and just under €0.5bn under Pillar 2 (both non-adjusted for inflation). These represent 16.3% and 18.5% of the funds allocated to the UK respectively; therefore a higher proportion that if allocated by population share.

116. Now that the UK is set to leave the EU, unless other arrangements are negotiated, the UK will no longer be a beneficiary of EU funds in due course, nor make a contribution from UK funds to the EU's budgets. The exact impact of this over the longer-term after the UK has left the EU is of course dependent on the withdrawal agreement and the shape of the UK's new relationship with the EU.

117. In its commentary on the subject of funding, the NFU in Scotland outlined its view on what needed to happen in the transitional period to Brexit and thereafter. Its Parliamentary Officer, Clare Slipper, said—

> To secure the levels of food being produced from our farms and crofts in the future, ongoing support remains vitally important. The current CAP package, due to run until 2020, is likely to span the UK's expected exit from the European Union.
>
> We want Government to send out a clear message on its commitment to support levels in the future and we believe the next four rounds of payments, from now until 2020, should be delivered as promised and as budgeted for. That would provide a confident platform going forwards.
>
> In the longer term, the real prize will be creating a new system of support in Scotland that fits with our farming and crofting systems. Our initial thoughts are that we would want that to genuinely reward activity as well as considering other elements such as research, innovation, knowledge transfer and advisory services.[104]

118. The importance of replacing the current regime with new support programmes for research and innovation was also highlighted by Bertie Armstrong of the Scottish Fishermen's Federation—

> We have a number of schemes that are indirectly funded by the European maritime and fisheries fund. We are still getting reasonably good news—yesterday, we heard about the continuation of the Government's gear innovation and technology advisory group, so the money is still coming and we have not seen it turned away.[105]

119. Colleges Scotland reported that the £15m that the sector had received from the EU (matched by £11m from the Funding Council) under the Developing Scotland's Workforce and Youth Employment Initiative provides additional student places of around 63,000 credits (4,200 Full-time Equivalent (FTE) students).[106]

120. Colleges Scotland also indicated that the capital programme for colleges in the last 10 years or so invested approximately £500m in the college sector towards a total of about £1bn. Typically European Regional Development Fund funding for a college capital project would be about 20-25%, but considerably higher in more deprived areas such as parts of Lanarkshire and Glasgow. So a conservative estimate would be approximately £200-250m of European funding has been provided towards historic capital projects in the college sector in Scotland.[107]

121. EU funding was also an important component of the debate according to Scottish Environment Link. It said—

> EU funding has both enabled the roll out of important projects in Scotland to increase our understanding of how our environment operates as well as provided incentives for sustainable practices. To ensure that the good progress being made in those areas continues, it will be important to safeguard this level of funding.[108]

122. As part of the fiscal arrangement negotiated between the two governments in the devolution agreement, Scotland receives funding from the UK via either the Barnett formula and block grant arrangement, or via the new tax-raising powers on income tax for example, where there is a block grant reduction to take into account the ability to raise revenue locally.

123. The degree of clarity on the funding streams to replace the monies coming into Scotland from the EU was also a feature of the evidence we took. Speaking on this subject, Clare Slipper of the NFU in Scotland commented that this was an important issue for the agricultural sector. She told the Committee that the NFU in Scotland was consulting its members on this issue and that the industry was keen to engage with both governments on future funding. Asked whether she was clear that an equivalent sum of money will be paid under a new regime to that paid now via the EU, she said—

> That is the concern. We do not know what the nuance will be. Will some agricultural funding come through the block grant? Will that even be spent? Will it be topped up by the Scottish Government? It is all to play for and it is hard to say at the moment exactly where things will lie.[109]

124. She also confirmed that no details had yet been agreed to, or assurances provided, by the UK Government for those programmes – for example Less Favoured Area schemes - where Scotland receives more than its population share of EU funding relative to the UK as a whole. She said—

> Not as yet—nothing has been set in concrete—but that is exactly what we are pushing for. As I said in my opening statement, we are looking for the UK Government to commit the money that has already been dedicated for the next four years, but we need to address the longer-term situation. We are absolutely pushing for that in discussions with ministers, but we have not had anything set in stone yet.[110]

125. Dr Roy of the Fraser of Allander Institute also commented on this matter, noting that the fiscal implications of leaving the EU was one of the main issues that needs resolved—

> During the referendum there was quite a lot of debate about the United Kingdom's net contribution to the European Union and the difference between gross and net contributions. Gross contributions are the total amount that is paid into the EU, but once we take off things such as the rebate and the other revenues that come into the United Kingdom and Scotland through research funding, the common agricultural policy and various other elements, there is a set of issues that needs to be considered around what the potential fiscal implications of leaving the EU would be.[111]

126. It should be noted at this stage that on 13 August 2016, the new Chancellor of the Exchequer, the Rt Hon Phillip Hammond, announced that—

- all structural and investment fund projects, including agri-environment schemes, signed before the Autumn Statement will be fully funded, even when these projects continue beyond the UK's departure from the EU;
- the Treasury will also put in place arrangements for assessing whether to guarantee funding for specific structural and investment fund projects that might be signed after the Autumn Statement, but while we remain a member of the EU. Further details will be provided ahead of the Autumn Statement;
- where UK organisations bid directly to the European Commission on a competitive basis for EU funding projects while we are still a member of the EU, for example universities participating in Horizon 2020, the Treasury will underwrite the payments of such awards, even when specific projects continue beyond the UK's departure from the EU.[112]

127. Mr Hammond also guaranteed that the current level of agricultural funding under CAP Pillar 1 will be upheld until 2020, as part of the transition to new domestic arrangements. The Chief Secretary to the Treasury, David Gauke, has also written to each devolved administration to confirm the same level of assurances offered to UK government departments in relation to programmes they administer but for which they are expected to rely on EU funding.

128. In response, the Cabinet Secretary for Finance, Derek Mackay, wrote—

> We will study the detail but what is already clear is the Chancellor's approach falls far short of what fishermen, farmers and communities across Scotland need.
>
> A limited guarantee for some schemes for a few short years leaves Scotland hundreds of millions of pounds short of what we would receive as members of the EU.

> Major funding stream such as contracts for EU structural funds and European Maritime Fisheries projects beginning after the Autumn Statement have no guarantee of continuation at all. That simply isn't good enough.[113]

129. The Scottish Government notes that CAP Pillar 1 subsidy schemes will be guaranteed until 2020, but contracts for EU structural funds, CAP Pillar 2 or European Maritime Fisheries projects beginning after the Autumn Statement will receive no such treatment.[114]

Conclusions

130. The evidence heard by the Committee to date indicates that there are a range of issues that are likely to emerge from the decision to leave the European Union. These can be grouped into two key areas: firstly, the agreements necessary to withdraw from the EU and the domestic process that would ensue to adapt law and policy to the UK's new relationship with the EU; and secondly, the formulation of the UK's future relationship with the EU and the implications of that for Scotland.

131. Under the first area – the agreements necessary to withdraw from the EU and the domestic process that would ensue to adapt law and policy to the UK's new relationship with the EU – there are also a further range of issues, including—

- The process and timing for triggering Article 50;
- The involvement of the Scottish Government on the decisions relating to the triggering of Article 50;
- How the negotiations will be managed by the UK Government and the extent to which it involves the Scottish Government to ensure that Scottish interests are represented;
- The transparency of the negotiations and the extent to which the UK Parliament and the devolved legislatures will be able to scrutinise developments;
- The manner in which the EU institutions will manage the negotiations given the lack of precedent and clarity in Article 50;
- The positions of the EU institutions and the other Member States in relations to the UK's withdrawal;
- The likely length and complexity of the negotiations;
- The impact of withdrawal on the Scottish budget.

132. Under the second area – that of the formulation of the UK's future relationship with the EU – there a further range of issues. These include the following—

- How agreement will be reached within the UK on the form of the UK's future relationship with the EU;
- The UK's future trade relationship with the EU and other countries, including customs issues, taxation and tariffs;
- Freedom of movement of people and labour between the EU and the UK;
- The acquired rights of EU nationals in the UK and UK nationals in EU member states;
- Employment, social, consumer and other rights and protections;
- Future co-operation on a range of areas such as policing, security, energy and climate change, asylum policies etc.;
- EU funds and subsidies;
- Implications for relations within the UK and for devolution, including UK-Irish relations and the status of the Common Travel Area;
- The potential for Scotland to seek a differentiated relationship with the EU in the future;
- The relationship of organisations in Scotland with their European counterparts.

Conclusions and recommendations

133. On 23 June 2016, a majority of voters in the referendum on UK membership of the EU voted in favour of withdrawal from EU (the so-called 'Brexit'). Although voting patterns varied across the nations and regions of the UK, the decision in the EU Referendum was ultimately one for voters in the UK as a whole.

134. In the immediate aftermath, the Scottish Parliament met and resolved that the Scottish Government should have discussions with the UK Government, other devolved administrations, the EU institutions and member states to explore options for protecting Scotland's relationship with the EU, Scotland's place in the Single Market and the social, employment and economic benefits that come from that. The Parliament also affirmed to citizens of other EU countries living here that they remain welcome and that their contribution is valued.[115]

135. As the Parliament's lead committee for EU matters, the European and External Relations Committee has set out its initial programme of work responding to the implications of withdrawal from the EU for Scotland. It has also taken evidence from the Scottish Government, constitutional lawyers and EU policy specialists, the business community and the trades unions.



Committee Meeting on Brexit, 28 July 2016.

136. Research has been commissioned to help the Committee and the Parliament better understand a series of complex matters that will be important to the debate on withdrawal from the EU, such as how EU competences will fall within the legislative competence of the Parliament, on the economic impact of withdrawing from the EU, the implications of withdrawal for EU funding, and EU migration patterns.



Members of the Committee meeting H.E. Oda Helen Sletnes, Norway's Ambassador to the EU.

137. The Committee has begun the process of engaging with others in the EU. It made an early visit to Brussels in July 2016 to meet with representatives of the UK's business community and the ambassadors to the EU of Norway, Iceland and the Republic of Ireland; two of the leading EFTA/EEA states and our closest EU neighbour respectively.

138. This report summarises our work to date and the evidence we have heard. We are publishing this report in advance of our next steps, which are to hear from the First Minister of Scotland, the Secretary of State for Exiting the European Union, the Secretary of State for International Trade and the Secretary of State for Scotland, and initiate further inquiry work. We will consider which other organisations and individuals we need to hear more from as the responses to out call for evidence are received. **All organisations and individuals affected by Brexit in Scotland are encouraged to respond to engage with the Committee to set out the implications – whether positive or negative – of leaving the European Union**.

139. The Committee aims to conduct further inquiry work in order to identify Scottish interests in terms of the UK's alternative relationship with the EU. **The Committee will formulate its views on how Scottish interests can best be represented and will inform the Scottish Parliament of its recommendations in due course**.

140. **We note the initial evidence provided to us by the Fraser of Allander Institute and published by others such as the Institute for Fiscal Studies on the potential for damaging short-term impacts on the Scottish economy as a consequence of the decision to leave the EU. We have commissioned research on this subject which will be published in September 2016. We also note the economic analysis set out by the Scottish Government in August 2016.**

141. **A key conclusion from the early evidence that we have heard relates to the importance of access to the single market (both for services and goods), and the lack of tariff and non-tariff barriers (such as licensing). We consider that these are important priorities for the Scottish Government in its discussions with the UK Government on the UK's future relationship with the EU.**

142. **We recognise the evidence that we heard underlining the importance of being able to ensure that the EU-nationals currently working in our public and private sectors and those attending Scotland's Higher Education and Further Education institutions do not have to leave Scotland. In addition, we acknowledge the evidence we heard concerning the need for certain sectors within the Scottish economy to be able to recruit suitable workers and attract students and entrepreneurs to Scotland in the future.**

143. **We also conclude by noting the views we heard on other key issues such as the importance of a fully-funded replacements for the current EU-funded programmes in Scotland in agriculture, fisheries, regional development, and research and technological development funding. We note the recent funding announcements made by the UK Government to provide some financial support in the short-term. Exactly what schemes replace these EU-funded programmes in the longer-term, how they are funded, what they prioritise, Scotland's share of these funds and what scope there is for new, innovative approaches are all key issues for future work.**

144. At the moment, it is not clear what relationship the UK Government would like to have with the EU in the future. Nor is it clear how or if Scotland might enjoy a different relationship that better reflects its interests. The formal process of leaving – the notification by the UK Government under Article 50 of the Treaty of the EU – is not set to start until next year according to the Prime Minister.

145. We note that there are a number of key dates and events in EU's calendar in the coming years that may have an impact on the future timetable. These include elections to the European Parliament in the summer of 2019 and the appointment of a new European Commission in October 2019, national elections in both France (Spring 2017) and Germany (Autumn 2017) and also the start of negotiations in relation to the post 2020 EU budget.

146. **We recognise the uncertainty that all of the above causes but understand the need for careful consideration of the momentous decisions that now have to be taken**.

147. **We agree with our counterparts in other parliamentary committees across the UK that parliaments and assemblies must have a role to play in these discussions and will work closely with them on this. We welcome the First Minister's commitment to keep this Committee informed of progress as highlighted in the Parliament's Resolution of 28 June 2016. We expect the principles of the Scottish Government's** Written Agreement **on Intergovernmental Relations to underpin Government's engagement with the Committee and to be kept informed both before and after formal inter-ministerial meetings on issues relating to Brexit**.

148. **In this respect, we welcome the appointment of Michael Russell MSP as the new Minister for UK Negotiations on Scotland's Place in Europe and look forward to a close engagement with him and other Scottish Ministers during this Committee's work. In line with the Written Agreement, we expect him to keep this Committee fully informed of his work in this new role**.

149. This first Report represents an early assessment of where we are, what views have been expressed to us so far and our next steps. Further reports and work will follow in due course.

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[5] Available at: http://www.parliament.scot/Inquiries/Written_Call_for_Evidence_-_FINAL_VERSION.pdf
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[27] *European and External Relations Committee*, Official Report, 30 June 2016, c37.
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[30] *European and External Relations Committee*, Official Report, 30 June 2016, c32.
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Annexe A

Evidence taken on 30 June 2016

- Fiona Hyslop, Cabinet Secretary for Culture, Tourism and External Affairs
- Karen Watt, Director for Culture, Tourism and External Affairs, Scottish Government
- Professor Sir David Edward, Chair of the Europa Institute, University of Edinburgh, and Former Judge of the European Court of Justice
- Professor Sionaidh Douglas-Scott, Anniversary Chair in Law, co-director, Centre for Law and Society in a Global Context, Queen Mary School of Law, University of London;
- Dr Kirsty Hughes, Associate Fellow, Friends of Europe, Brussels
- Professor Andrew Scott, European Union Studies and Co-Director of Europa Institute, School of Law and Dean International for Europe, University of Edinburgh.

Evidence taken on 28 July 2016

- Graeme Roy, Director (Designate), Fraser of Allander Institute;
- Colin Borland, Senior Head of External Affairs, Federation of Small Business Scotland;
- Kenny Richmond, Senior Director, Economics, Scottish Enterprise;
- Stephen Boyd, Assistant Secretary, STUC;
- Clare Slipper, Parliamentary Officer, National Farmers Union Scotland;
- Bertie Armstrong, Chief Executive, Scottish Fishermen's Federation;
- David Frost, Chief Executive, Scotch Whisky Association;
- Alastair Sim, Director, Universities Scotland;
- Gordon Dewar, Chief Executive, Edinburgh Airport Ltd;
- Hugh Chater, Director of Banking, Virgin Money;
- James Withers, Chief Executive, Scotland Food and Drink.

