



SCOTLAND'S PLACE IN EUROPE:

People, Jobs
and Investment



Scottish Government
Riaghaltas na h-Alba
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and Investment

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Foreword from First Minister



In the next few weeks talks will start on the future relationship between the EU and UK.

The outcome of those talks will have a major impact on economic and job prospects for current and future generations.

People in Scotland voted decisively to remain in the European Union and we continue to believe that

this is the best option for Scotland and the UK as a whole. However, short of EU membership, the Scottish Government believes the UK and Scotland must stay inside the Single Market and Customs Union.

The European Single Market is the largest and most lucrative in the world.

Securing our position in that market is the number one priority for the Scottish Government when phase two of the negotiations begin.

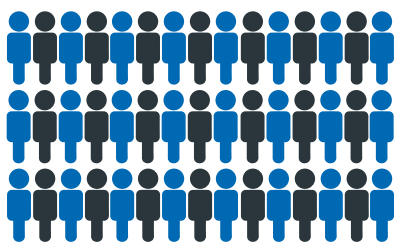
That means the Prime Minister must drop her “red lines” over free movement of people and the role of the Court of Justice of the European Union and prioritise, instead, the interests of the economy and of future generations.

It is time for the UK Government to stop deluding itself, and misleading others, about what will happen if it maintains those red lines.

The EU has made it clear that in those circumstances the only possibilities are a basic free trade deal (often called a “Canada” type deal with perhaps some limited add-ons) or reverting to trade on World Trade Organization (WTO) terms. The EU has set out these options as illustrated by the graphic below.

This paper therefore:

- ★ explains what these terms – “a Canadian type deal” and WTO - mean and assesses the damaging consequences they will have for the Scottish economy. The UK Government has been reluctant to publish an assessment of the impacts of a hard Brexit on the economy. The analysis presented here shows the impact on income, growth, productivity, trade, immigration and foreign direct investment;
- ★ details the significant economic benefit for Scotland if we instead retain our place in the European Single Market and Customs Union, compared with the options outside these arrangements;
- ★ shows the future economic opportunities available to Scotland and the UK from completion of the Single Market in the digital economy, energy, services and other key economic sectors; and
- ★ demonstrates why maintaining the free movement of people is in itself a considerable benefit to Scotland – not a trade-off for access to the Single Market – and shows the substantial tax contribution our fellow EU citizens make to our NHS and other public services.



MEMBERSHIP OF THE EUROPEAN SINGLE MARKET PROVIDES SCOTLAND'S BUSINESSES WITH UNRESTRICTED ACCESS TO A MARKET OF OVER 510 MILLION PEOPLE.

All of Scotland's future population increase over the next decade and beyond is projected to come from people choosing to come to Scotland to make this country their home.

A very real risk from the UK Government's hard Brexit approach is that Scotland's working population will fall. That means the number of people working and paying taxes to support the NHS and other public services that we all rely on will also fall.

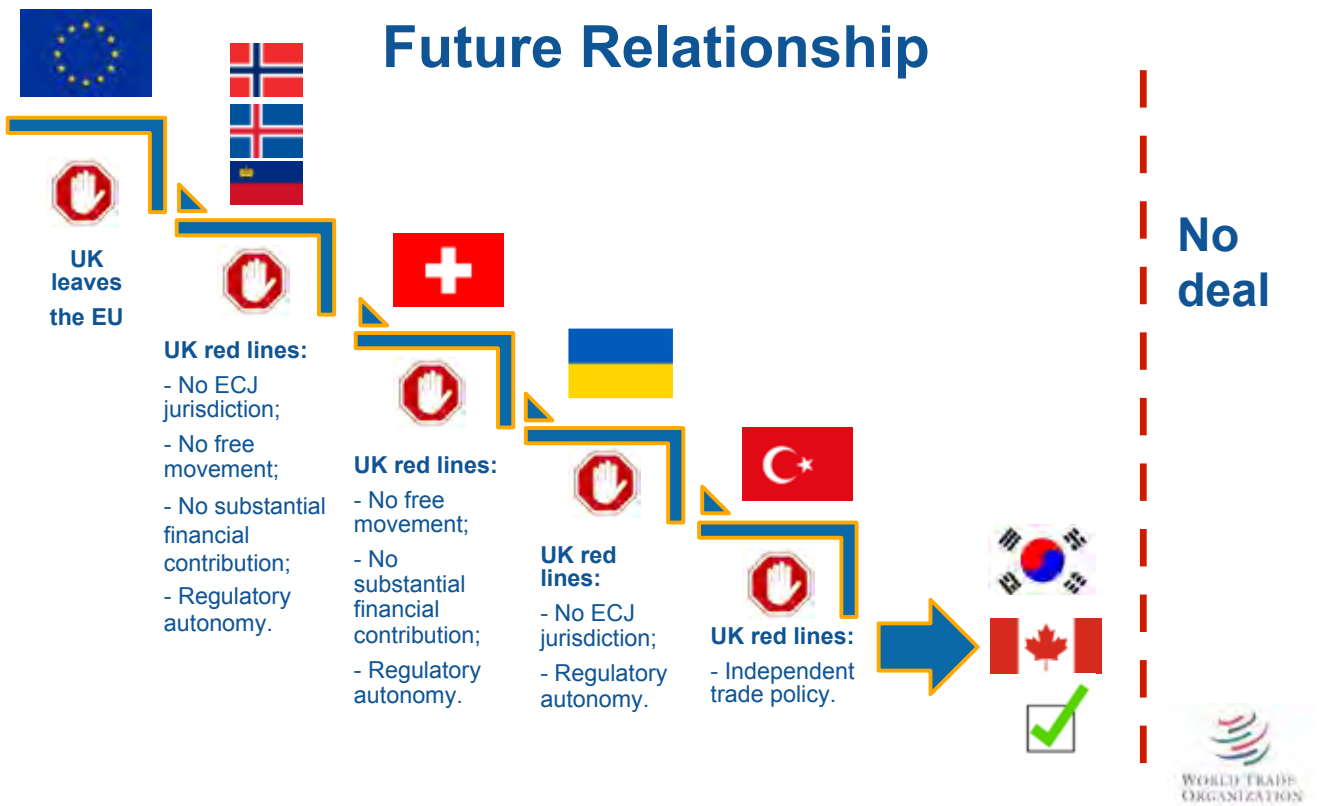
That, in turn, will mean an increased burden on young people and fewer opportunities for this and future generations.

The damage will not only be economic, serious as this is, but will also compromise current safeguards in a range of vital policy areas currently driven at the EU level such as rights and protections in areas like the environment, workers' rights and justice and home affairs co-operation where we derive considerable benefit.

From the perspective of the Scottish Government, the commitment the Prime Minister made in her Lancaster House speech to ensure that "...Ministers from each of the UK's devolved administrations can contribute to the process of planning for our departure from the European Union" needs to be honoured, in a way that it has not been to date.

That means accepting the Scottish Government's call to re-visit the "red lines" and re-open the case for staying in the Single Market and Customs Union.

I look forward to discussing these proposals with all those seeking to avoid an extreme Brexit in favour of a better future for Scotland, the UK and the EU.



European Commission, 2017

Introduction

1. As we demonstrated in *Scotland's Place in Europe*, published in December 2016, Brexit represents a significant threat to the UK's and, in particular, to Scotland's future economic and social prosperity. In the intervening 12 months since the publication of that paper, the scale and specific nature of this threat has become even more evident. It is now even more clear that any kind of future relationship short of EU membership will be damaging to Scotland's future economic and social prosperity. The extent of this damage, will be more significant the further away the future relationship is from membership of the European Union (EU).
2. As a government it falls to us to ensure our voice - representing as it does the interests of our people, our society, our environment and our economy is heard and acted upon by the UK Government as it takes forward the most crucial set of negotiations in our recent history.
3. The Scottish Government has been clear that we have a hierarchy of preferred outcomes following the referendum. We continue to believe that Scotland's future is best served by continued EU membership. If this is not possible, within the context of the outcome of the EU referendum, then we have been clear that the UK should remain within both the European Single Market and a Customs Union.¹ We also put forward options to allow Scotland to maintain this status in the event that the rest of the UK should choose a different outcome. These differentiated options remain valid within the current context and, if the UK opts to leave the Single Market, we believe they should form part of the considerations within negotiations on our future relationship now that phase is getting underway.
4. As the Brexit negotiations enter the second stage from January 2018, it is essential that the UK Government places at the forefront of its strategy the fundamental economic, environmental and social interests of the country as a whole. We are disappointed that it has taken almost nine months to make progress in the first phase of the Brexit negotiations which, as the EU has made clear, has delayed the beginning of vital negotiations on the framework for the UK's future relationship with the EU. The pressure on the negotiations has been exacerbated by the time it has taken the UK Government to get to a position to begin detailed negotiation with the EU, some nine months after Article 50 was triggered. It is now of critical importance that a credible position on transition is reached within the first few months of 2018, ahead of talks on the future relationship which will be significantly more complex than the first phase of negotiations.
5. At present, considerable, and damaging, uncertainty continues to characterise the negotiations and the UK Government's ultimate objectives with regard to the future relationship with the EU. We welcomed the commitment the Prime Minister offered in her speech in Florence that the UK would seek to continue to trade on current terms, implying that we will remain within the European Single Market and a Customs Union for a transition period beyond March 2019. However, inconsistencies and a lack of clarity in what form that transition will take - and most critically what will follow it once the transition period expires - remain. While the EU has been clear that a so called 'steady state' transition could be agreed, the UK Government has defined the parameters of this increasingly selectively, risking an incoherent sectoral approach which will not meet the needs of businesses and individuals.

¹ Whilst the UK could not remain within the EU Customs Union as this it would require to be a member state, we would advocate the creation of a UK/EU Customs Union which replicates the terms we currently enjoy as a member of the EU Customs Union. Throughout the remainder of this paper the term 'a Customs Union' refers to this approach.

6. Notwithstanding this, it is vital that agreement on transition is reached early in 2018 and that it is credible. While recognising the UK will not be a member of the EU during this transition, nonetheless pragmatic arrangements must be found to ensure Scotland's continued participation in specific EU decisions, such as annual fishing quotas, during this period. However, complete certainty on what the UK Government will secure will only be clear once the withdrawal treaty is agreed.
7. As a government, we firmly believe that Scotland's future economic, environmental and social prospects will best be served as a member of the European Union as an independent state. The First Minister has made clear that we will scrutinise the detail of any final Brexit deal negotiated by the UK Government before deciding any further steps in terms of giving people a choice on Scotland's future. However, that position does not interfere with our duty, or compromise our responsibility, to vigorously protect Scotland's interests under the current constitutional arrangement. Accordingly, it is essential that Scotland's position is fully represented as the UK Government negotiates on issues that will determine the UK's future relationship with the EU.
8. In the period since the publication of *Scotland's Place in Europe*, we have sought to engage with the UK Government on the approach it is taking to the Brexit negotiations. To date we have been disappointed with the results of these endeavors. As we begin on the second and most crucial part of the Brexit negotiations, it is essential that the UK Government fully involves the Scottish Government – and the Welsh and Northern Irish devolved administrations – in these negotiations. Discussions about how that will take place are now underway, though have yet to reach any meaningful conclusion.
9. We have also continued to consider the implications of the differentiated approach which we set out in *Scotland's Place in Europe* should the UK as a whole not remain part of the European Single Market and Customs Union. These proposals are particularly relevant given the nature of the commitments that the UK Government has made regarding the island of Ireland. Here, in the absence of a comprehensive trade deal between the UK and EU, Northern Ireland could have a different relationship with the EU from Scotland, England and Wales. This is set out in paragraph 49 of the joint report as follows – “*The United Kingdom remains committed to protecting North-South cooperation and to its guarantee of avoiding a hard border. Any future arrangements must be compatible with these overarching requirements. The United Kingdom's intention is to achieve these objectives through the overall EU-UK relationship. Should this not be possible, the United Kingdom will propose specific solutions to address the unique circumstances of the island of Ireland. In the absence of agreed solutions, the United Kingdom will maintain full alignment with those rules of the Internal Market and the Customs Union which, now or in the future, support North-South cooperation, the all-island economy and the protection of the 1998 Agreement.*”²
- This raises profound questions about the validity of the UK Government's summary dismissal of the elements of the Scottish Government's proposals for a differentiated relationship as unworkable. It also has implications for the relative competitive positions of the Northern Irish and Scottish economies in the event of each having a different level of access to the European Single Market.
10. In this period we have also engaged with Scotland's businesses, workforces and citizens to understand their concerns about Brexit, and how these concerns might be allayed. We reported some of the key concerns raised by businesses in our recent publication, *Brexit: what's at stake for businesses*.³

2 https://ec.europa.eu/commission/sites/beta-political/files/joint_report.pdf

3 [Brexit: What's at stake for Business](#)

11. We have also been undertaking further analytical work examining the broader implications of the different scenarios that will define our future relationship with the EU on our economy and society. The conclusions are stark and unambiguous: in the context of Brexit, Scotland's future economic prospects are best protected by the UK remaining within the European Single Market⁴ and a Customs Union which replicates the terms of the current EU Customs Union.⁵ This outcome is achievable and should be coupled with a transitional period beyond March 2019 during which the UK remains dynamically compliant with all EU law and policy under the current terms of membership.
12. This paper sets out, in detail, the evidence and arguments that underpin our objective of remaining within the European Single Market and a Customs Union – the enhanced European Economic Area (EEA) option. In doing so we build upon the analysis presented in *Scotland's Place in Europe*.⁶ In particular, here we extend the work reported in *Scotland's Place in Europe* by:
- demonstrating the costs to Scotland of exiting the EU by a comparative analysis of the macro-economic impact under the only realistic three alternative scenarios – (i) continued European Single Market membership, (ii) a preferential UK-EU (free) trade agreement (the UK Government's apparent preferred option), and (iii) non-preferential access to the European Single Market under WTO provisions;
 - considering the future economic opportunities that will accrue to Scotland if we remain inside the European Single Market, and therefore able to share in the economic gains that will come from the further consolidation of that Single Market, notably in trade in services and completion of the digital Single Market;
 - examining the consequences of a hard Brexit for a range of policy objectives and aspirations we share with our EU partners, and which we have contributed to, and benefited from, for many years. This includes EU environmental policy, social policy, research and innovation and policies in the area of consumer protection and safety;
 - assessing the substantial benefits to our economy and society that have been secured through the freedom of movement of persons, one of the four 'freedoms' at the heart of the European Single Market; and
 - proposing a solution for the UK's long term relationship with the EU which mitigates – though does not offset – the costs of Brexit, and ensures our economy and society remain within the European Single Market and a Customs Union from which we derive considerable economic and social benefits.
13. Although our primary aim in this paper is to highlight likely impacts of a hard Brexit that will result in Scotland being outside the European Single Market and a Customs Union, we also hope the propositions set out in this paper will find broad support across the political spectrum in Scotland, and beyond and help ensure that the UK Government position can be fully representative. We will seek to build the necessary consensus to ensure the UK negotiating position reflects Scotland's interests, and we will seek to ensure the legislative competences of the Scottish Parliament are protected as the negotiations proceed.

4 European Single Market – Has its basis in article 26 of the Treaty on the Functioning of the European Union which provides in article 26(2) that "[t]he internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties". The European Commission describes the European Single Market as "the EU as one territory without any internal borders or other regulatory obstacles to the free movement of goods and services". The European Single Market is in effect extended to include the EFTA State parties to the EEA Agreement (Norway, Iceland and Liechtenstein) by the EEA Agreement: the EFTA State parties participate in the European Single Market under and in terms of that Agreement

5 EU Customs Union – The effect of a Customs Union is to ensure that no customs tariffs are levied on goods travelling within the area of the Customs Union with a common external tariff imposed on all goods entering the Customs Union – effectively prohibiting members of a Customs Union negotiating independently of other members bilateral trade deals with other countries. The members of the EU Customs Union are all the EU member states, Monaco, Isle of Man, Jersey and Guernsey, Akrotiri and Dhekelia. (The EU also has partial Customs Unions with Turkey, Andorra and San Marino where some goods and most services are excluded.)

6 Published by Scottish Government in December 2016 and available at <https://beta.gov.scot/publications/scotlands-place-europe/>

Chapter 1

Economic Implications of Leaving the Single Market and Customs Union



CTMX	0.45	▲	+0.45%
FTR	-0.23	▼	-2.3%
CSCO	-1.01	▼	-1.89%
CHK	0.02	▲	+0.21%
AAPL	+2.58	▲	+3.05%
PRTO	-0.12	▼	-1.42%
AMZN	-0.15	▼	-0.15%
TSLA	-0.15	▼	-0.15%

14. The UK Government has made clear that it intends for the UK to leave the European Single Market and Customs Union⁷ but has yet to set out its assessment of the economic consequences of its decision, including the costs of being excluded from the raft of preferential trade agreements which the EU has concluded with third countries, and from which our exporters currently benefit. Despite the UK Government undertaking some analysis of a number of industrial sectors, there has been no public estimate from the UK Government of the (sectoral or overall) impact on the UK economy of a being outside the European Single Market and a Customs Union.
15. Pre-referendum calculations published by the Treasury indicated that the UK would become 'permanently poorer' as a result of leaving the European Single Market – estimates that have since been confirmed by a number of independent studies.⁸ Most recently the National Institute for Social and Economic Research suggested that the effects of the Brexit-related economic slowdown and in particular the depreciation of sterling following the referendum (while the UK was still a member of the EU) has already made UK households worse off by around £600 per annum.⁹ Beyond this, analyses of individual elements of the post-Brexit UK, such as the imposition of customs checks, or loss of access to EU negotiated free trade agreements have produced a range of estimated costs to our future economic prosperity. For example, the Institute for Government has estimated that the costs to business – arising solely from customs declarations – could be in the region of £4bn to £9bn annually.¹⁰
16. The first two chapters of this paper bring this analysis together for the first time. Initially focusing on the economic costs of leaving the Single Market and Customs Union across a range of sectors, as well as some of the practical issues this will create for future trade with the EU. This is followed by the presentation of new macro-economic modelling bringing together these issues and presenting the cumulative effect on the economy in Scotland, in three scenarios –
 - a. trading on WTO terms;
 - b. a comprehensive Free Trade Agreement (FTA); and
 - c. EEA membership for the whole of the UK
17. While a so called 'no deal' scenario has not been modeled explicitly, we are clear that this would be even more economically damaging than a planned shift to WTO terms as modeled. In the event of a no deal the UK could find itself out-with the legal framework of the WTO and the legal protections which this affords our traders.

Economic Costs of Brexit

18. Scotland is home to a strong and productive economy. Our economy is characterised by a diverse business base with international successes across a wide range of sectors including life sciences, food and drink, tourism, financial services, energy and creative industries. Our labour market is performing strongly, with unemployment falling over the year and employment rising. Our productivity performance has also improved, with Scottish growth in productivity between 2007 and 2015 higher than any other country or region of the UK, including London.
19. Brexit puts this at risk. The economic consequences of leaving the EU, and in particular no longer being a member of the European Single Market and Customs Union, will be significant across all sectors and regions of Scotland's economy. We have undertaken further research to estimate the likely costs of Brexit to Scotland's economy under different post-Brexit scenarios.

7 PM's Florence speech: a new era of cooperation and partnership between the UK and the EU

8 World Bank (2017) 'Deep Integration and UK-EU Trade Relations'

9 <https://www.niesr.ac.uk/publications/commentary-monetary-and-fiscal-policy-normalisation-brexit-negotiated#Wfmj-rs5M3E>

10 The Institute for Government (2017) Implementing Brexit: Customs

20. Continued EU membership has consistently been shown to be the best outcome for our businesses, our consumers, our workers, and for the economy as a whole. These benefits primarily come from the four key channels summarised below.

- ★ **Trade** – EU membership allows Scottish companies to trade on an almost unrestricted basis within the world’s largest Single Market, allowing them to grow their operations and create new jobs in Scotland.
- ★ **Investment** – Unimpeded access to EU markets ensures Scotland remains an open economy that is attractive to inward investors.
- ★ **Migration and Labour Mobility** – Free movement of people allows Scotland to attract the workers that our economy needs in order to fill skills gaps and help address the challenges of an ageing population. It also allows Scottish citizens to travel and work freely in the EU, helping them gain new skills and business contacts.
- ★ **Productivity** – Having an open, internationally focused economy inside the European Single Market results in increased competition, specialisation, innovation and investment and in turn boosts Scotland’s competitiveness and productivity.

21. Each of these channels has implications for the drivers of economic growth set out in Scotland’s Economic Strategy¹¹ and as highlighted in the Programme for Government. The Scottish Government is committed to ensuring that Scotland continues to develop a sustainable and innovative economy.

22. All of these channels are also supported by the UK’s current participation in the so-called four freedoms, notably the free movement of people, goods, capital and services. While we will deal separately with the free movement of people in chapter 5, the interlinked issues of the free movement of goods, services and capital are considered in this chapter. In essence, they allow for goods to be moved freely within the European Single Market and for companies to establish themselves in another member state, or to operate

in that member state from a base elsewhere in the EU. With the addition of the free movement of people, this allows for labour, or in the case of services, the people delivering the service, to move freely throughout the European Single Market to undertake economic activity. This has underpinned the development of the European Single Market into the most integrated market in the world.

23. All options short of full EU membership will impose a cost on our economy and reduce the effectiveness of these channels as a source of economic growth. However, the costs would be considerably less under some alternative agreements. In particular, continued membership of the European Single Market via the European Economic Area Agreement, would offer a range of significant economic advantages compared to the type of hard Brexit sought by the UK Government.

Trade in Goods and Services

24. The EU is Scotland’s most important international export market. In 2015, Scottish companies’ exports to countries within the EU were estimated at £12.3 billion, which is 43%¹² of Scotland’s total international exports and supports, directly and indirectly, hundreds of thousands of jobs across Scotland.¹³

25. Evidence suggests that bilateral trade among EU members has grown by between 40% and 90% as a direct result of further development of the European Single Market.¹⁴ For the Scottish economy, membership of the Single Market has resulted in the removal of formal and informal barriers to trade thereby ensuring our businesses have unfettered access to a market of 510 million consumers and the largest single market in the world.¹⁵

26. In considering the best option for Scotland’s future, it should be remembered that after Brexit, the European Single Market will still be around seven times the size of the UK market in terms of population.

¹² Scottish Government (2017) Exports Statistics Scotland

¹³ HMT (2016) – HM Treasury analysis: the long-term economic impact of EU membership and the alternatives

¹⁴ See for example Baier et al (2008), Eicher et al (2012), Fournier et al (2015).

¹⁵ http://ec.europa.eu/trade/policy/eu-position-in-world-trade/index_en.html

¹¹ These drivers are Investment, Innovation, Internationalisation and Inclusive Growth

27. The progress made by the European Single Market in dismantling the obstacles to trade in goods and services has therefore been a key driver of growth and employment in Scotland, and across the EU in general. The project to complete the European Single Market has resulted in the elimination of the vast majority of tariffs and so-called technical barriers to trade in goods in the form of divergent national rules and regulations governing the production, distribution, marketing and sale of the products which businesses buy from each other as part of international supply chains and which we buy in the shops. It is these complex non-tariff barriers to trade, rather than straightforward tariffs, that represent the main obstacle to trade between the EU and (third) countries outside the Single Market. The Single Market is also dynamic, and so is able to address and mitigate any new non-tariff barriers as and when they arise.
28. If the UK Government opts to exit the European Single Market then the UK would become a third country from the perspective of the EU, and trade is likely to diminish as UK exporters (and importers) become subject to a much more restrictive UK-EU free trade agreement. Even the most sophisticated and liberal EU free trade agreement, such as the EU-Canada model, largely excludes provisions for eliminating non-tariff trade barriers and does not provide the unfettered access to the European Single Market that we presently enjoy as members of that market. These types of agreement also provide limited – if any – provision for services, or financial services, which are a key part of the UK economy.
29. The impact of complex regulatory barriers would be felt not only in our trade in goods but also on our exports of services to the EU. This would be highly significant and damaging. Services account for around three quarters of Scotland's economic output. Presently there are relatively limited regulatory barriers to UK service providers selling their services across the EU – either directly across borders, or by traveling to other EU countries, or by establishing a branch in another member state. No free trade agreement in the world provides for this degree of freedom of movement of services within the European Single Market.

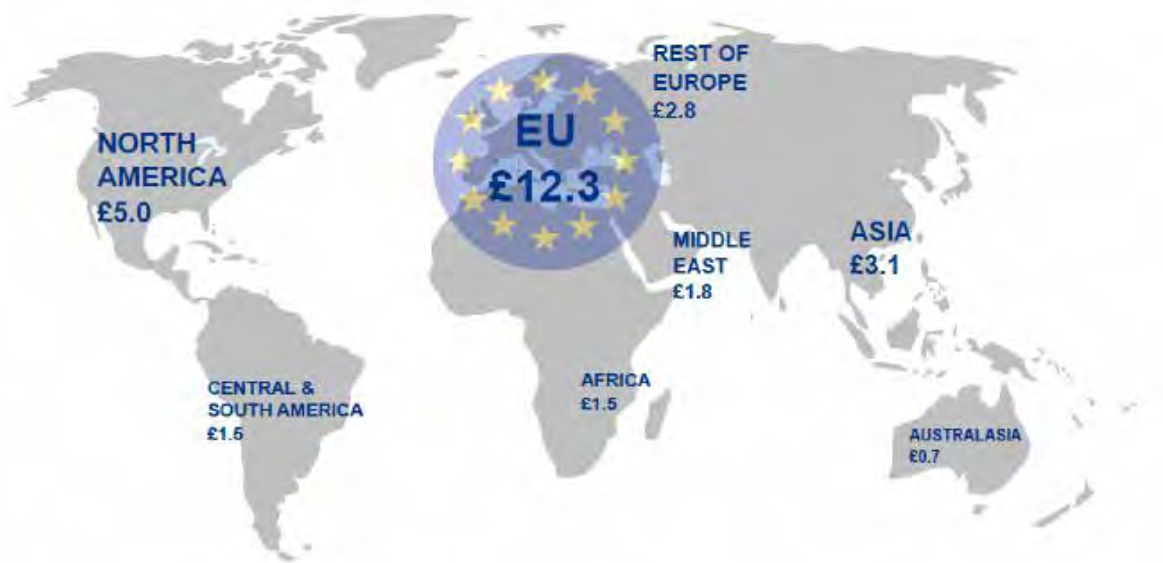


LEAVING THE EU AND THE SINGLE MARKET COULD REDUCE SCOTLAND'S ECONOMIC OUTPUT BY 8.5% BY 2030, EQUIVALENT TO A LOSS OF £2,300 A YEAR FOR EACH PERSON IN SCOTLAND.

30. The UK Government suggests that these non-tariff (or regulatory) barriers need not obstruct our trade – in goods or in services – with the EU on the basis that UK rules and regulations will continue to mirror our EU counterparts post-Brexit. As a result, the EU would recognise the UK rules and regulations as 'equivalent' to their own and permit UK goods and services to be sold in the European Single Market. However, the EU are under no obligation to accept future UK regulations as equivalent to those governing the European Single Market. This proposition ignores the on-going dynamics of regulatory changes, which can quickly outpace any existing equivalence agreements, on which stable trading arrangements ultimately would depend. In any event, under the rubric of "taking back control" which lay at the core of the Brexit argument, there can simply be no certainty that UK product rules and regulations, or any other policies on which Single Market access relies, will remain convergent with European Single Market legislation over time. This inevitably creates a highly uncertain and potentially volatile environment for our businesses to operate in, even if there is an agreed dispute resolution mechanism.
31. An approach which puts the UK outside the European Single Market will also jeopardise the wider conditions which underpin trade. These include data transfer agreements, aviation, transport and the ability for people to move and provide services. These conditions and the lack of non-tariff barriers are particularly important for small and medium enterprises in reducing risk and uncertainty that is otherwise a significant barrier to international trade.

32. These market access complexities would inevitably arise across a vast swathe of the traded goods and service sectors. Financial services which is one sector that may be particularly adversely affected by Brexit. Presently UK (and Scottish) financial service providers are able to supply a range of products directly across the European Single Market under a regime called 'passporting', which applies only to firms located within the European Single Market (including non-EU EEA countries). If the UK is outside the European Single Market then our financial services providers would no longer enjoy passporting rights and significant regulatory barriers are likely, at best, to significantly compromise the present level of UK exports of financial services to the EU.
33. However, financial services is only one example where current levels of trade (and so employment and growth) would be jeopardised by a hard Brexit. There are many other sectors where regulatory obstacles to trade are likely to emerge if the UK is outside the Single Market and which would compromise our trade with the EU – pharmaceutical products, food and drink, road haulage, energy, business services and aerospace are just a few other examples.
34. The vulnerability of our economy to a hard Brexit cannot be adequately mitigated through a UK-EU FTA. While the EU FTA with Canada does include limited provisions for some degree of third country validation, they are aligned with EU regulations in order to facilitate trade in goods, this falls substantially short of securing the access to the European Single Market the UK – or any EEA member country – presently enjoys. Continued membership of the European Single Market on the other hand will ensure the UK economy continues to benefit from the trading arrangements we presently have. Recent analysis by National Institute of Economic and Social Research (NIESR)¹⁶ demonstrates that retaining Single Market membership could avoid seeing a 60% decline in both goods and services exports to the EEA in comparison to an arrangement based on WTO rules.

Figure 1.0 Destination of Scottish International Exports 2015 (£ Billions)



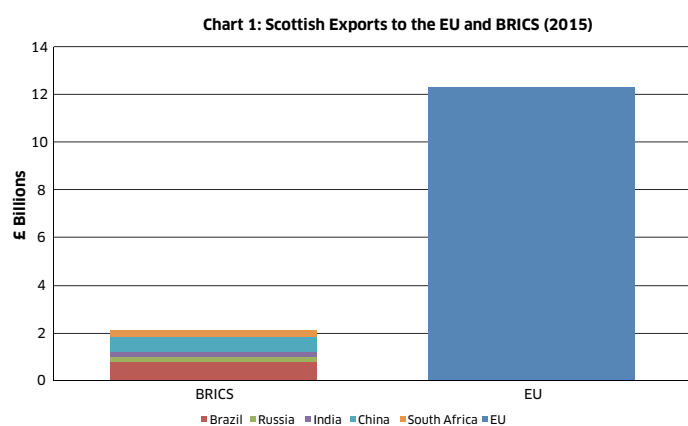
16 Ebell (2016) – Assessing the Impact of Trade Agreements on Trade

35. Membership of the EU has also enabled Scotland to benefit from the EU's FTAs with more than 50 international trading partners. In 2015, Scotland exported around £3.6 billion to countries with which the EU has a FTA. This trade accounted for a further 13% of Scotland's international exports.¹⁷
36. In addition, although hard to quantify, many of the products from Scotland "exported" to the rest of the UK will form parts of finished goods destined for the rest of the Single Market.

EXPORTS TO THE EU AND OTHER COUNTRIES THE EU HAS TRADE AGREEMENTS WITH, ARE WORTH £15.9 BILLION. THAT'S 56 PER CENT OF TOTAL INTERNATIONAL EXPORTS.



37. It has been argued by the UK Government's Global Britain Strategy¹⁸ that the UK would offset any decline in trade with the EU from being outside of the Single Market by exporting more to other countries. However, fully replacing the value of EU trade will be challenging, as illustrated by trade flows with emerging economies such as Brazil, Russia, India, China and South Africa (known as the BRICS countries). These nations account for around £2.1bn (7%) of Scotland's exports (chart 1). In comparison, the EU accounts for £12.3bn (43%) of Scotland's exports. Even small proportionate losses in trade (or lost growth in trade) with the EU would require dramatic increases in trade with such countries.



38. To replace a 5% reduction in Scotland's EU exports with increased trade from the BRICS economies would require a 30% increase in exports to those economies. Even if the UK signed agreements with the 10 biggest non-EEA single country trading partners (including USA, China, and Canada), a process which would take many years, this would only cover 37% of Scotland's current exports compared to 43% of current exports that go to the EU.
39. With most of the alternative markets to the EU, such as Australia and the USA, being a significant distance from the UK, it is difficult to see how the impact of reduced trade with the EU can be fully mitigated by forming new trading relationships with other countries. For example, for goods which are perishable or have low profit margins, the additional time and cost involved in selling to a country such as Australia rather than into the EU will be prohibitive.
40. As an EU member state, our businesses also benefit from being part of the EU Customs Union under which all member states adopt a common trade policy with respect to third countries. This means that once goods from outside the EU have entered, they can move freely within the EU.
41. Our current membership of both the European Single Market and the EU Customs Union, has enabled firms in Scotland to greatly expand their participation in global supply (or 'value') chains. These are networks of producers across the world which each contribute inputs, in the form of goods and services, to a production process. For instance, the production of an aircraft wing involves multiple parts crossing many European borders before the finished wing, never mind the aircraft, is complete. Any additional administration in this process at each border crossing would have a significant impact on the continuation of these processes. There are no models which allow the full impact of participation in global value chains to be quantified. As a consequence the impact presented of the FTA and WTO models will not fully capture the negative impact of companies changing their production chains and potentially even the location of elements of their business.

17 Scottish Government (2017) Exports Statistics Scotland and SG Calculations

18 <https://www.gov.uk/government/speeches/beyond-brexit-a-global-britain>

Box One – Global Value Chains

International trade is frequently presented as the buying and selling of final goods and services. However, international trade is increasingly carried out through global value chains (GVCs) where services, raw materials, parts and components are exchanged between countries. Around three quarters of international trade is businesses buying intermediate inputs (OECD, 2015), and many jobs are dependent on feeding into the production chains of final goods which are produced in other countries. For example, 715,000 jobs in the UK are dependent on UK exports which feed into products produced in other EU member states which are subsequently exported.¹⁹

GVCs have profound implications for trade policy. Even small increases in tariffs become cumulative, and additional customs requirements become increasingly burdensome when intermediate inputs are traded across borders multiple times. Therefore, tariff-free access, elimination of non-tariff barriers and quick and efficient customs procedures are indispensable to the functioning of supply chains. To compete, businesses need to maintain lean inventories and still respond quickly to demand.

Traditional trade statistics are not well equipped to measure GVCs because they assign the value of all intermediate products to the company, and country, where the product is finished and shipped to its final destination. Value-added statistics are necessary to understand where economic activity and jobs are generated along supply chains. Data from the publically available World Input Output Database (WIOD), are widely used across academia and in policy development and provide an illustrative example.

Manufacturing of machinery and equipment

Manufacturing of machinery and equipment is an important export sector for Scotland representing around 9% of all manufacturing exports. It encompasses a range of goods, such as engineering systems and subsea and drilling equipment. Using the latest WIOD data release, we calculate estimates of the share of value-added in the production process of UK machinery and equipment that are attributable to international trading partners (see table). For example, in 2014 over a quarter of the value in UK production of machinery and equipment originated from outside the UK.

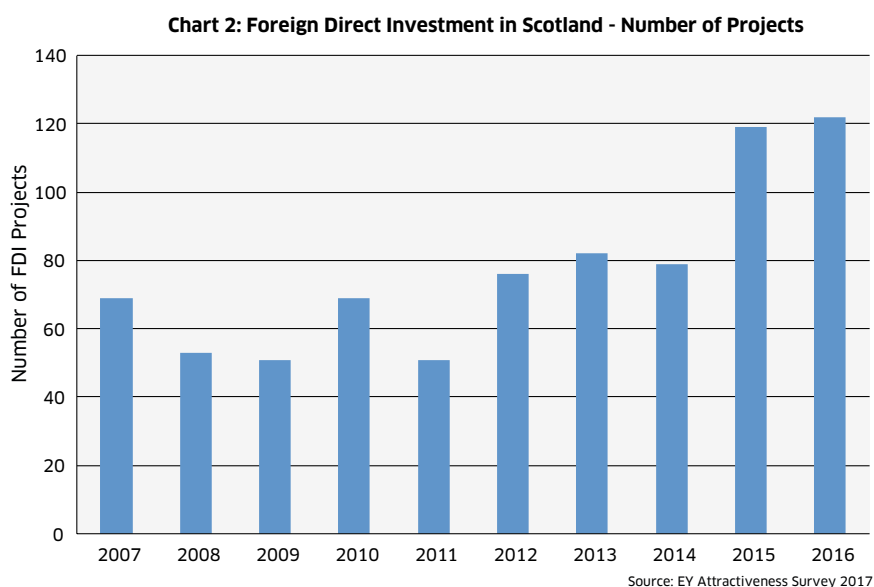
Share of value-added generated in	2000	2006	2014
UK	79%	76%	73%
EU	10%	11%	13%
USA	3%	3%	2%
China	0.4%	1%	2%
Japan	1%	1%	1%
Others	6%	8%	9%

The analysis shows that UK manufacturing has become more integrated with the EU and the rest of the world over time. The EU remains the main international source of value-added for this industry. This shows that to remain competitive, UK manufacturers have become more integrated with international partners in GVCs, benefiting from access to inputs from outside the UK and providing inputs to firms in other countries.

¹⁹ European Commission (2016).

42. A recent report from Oxera²⁰ noted that the added costs to business as a result of leaving the Customs Union will depend, in part, on the new relationship between the UK and EU. However, they estimated – conservatively – that the UK economy-wide costs would be in excess of £1 billion per year, excluding the additional economic costs of uncertainty that would fall on companies reliant on UK-EU trade.
43. Foreign Direct Investment (FDI) is a key feature of the contemporary global economy, and one from which the UK, and especially Scotland, has derived considerable benefits (see Chart 2 and 3). Rather than simply exporting to other countries, companies are increasingly investing in foreign enterprises or setting up their own operations overseas. In addition to creating jobs, and economic activity, this supports the transfer of knowledge, skills, technology and innovation between countries and in turn boosts productivity. There are 2,350 foreign-owned firms in Scotland employing around 318,000 people. Of these foreign firms 1,040 (44%) are EU owned and employ around 122,000 people in Scotland.²¹
44. The key drivers for inward FDI decisions include access to markets, access to supply chains and intermediate inputs, access to consumers, or a combination of these factors. Scotland has been a major recipient of FDI and this inward investment has been an important source of job creation. EY estimate that since 2002, FDI into Scotland has supported around 43,000 jobs.²² Current uncertainty, and a changed future relationship with the EU, creates the risk that potential new investors will re-evaluate their investment projects and future flows of FDI will move elsewhere.

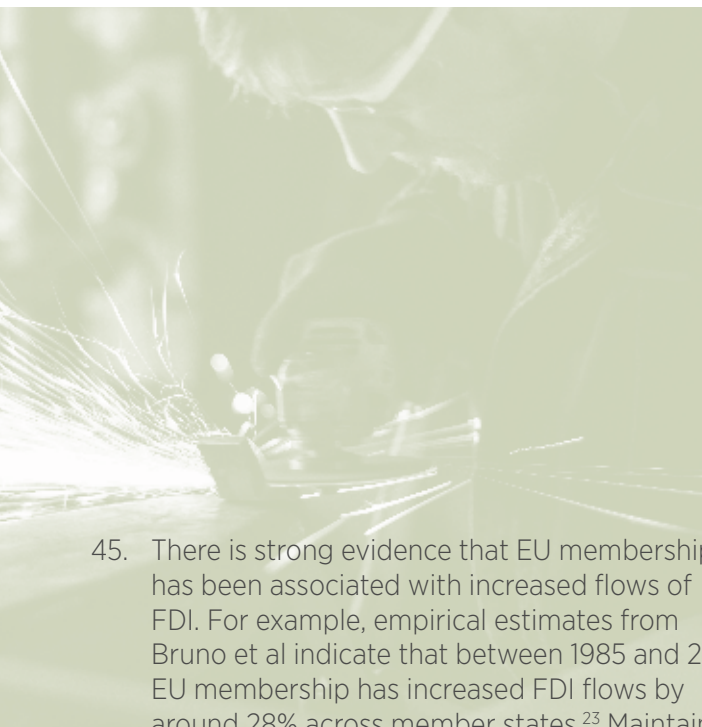
Investment



²⁰ <https://www.oxera.com/Latest-Thinking/Publications/Reports/2017/Brexit-ports.aspx>

²¹ Scottish Government – Businesses in Scotland (2017)

²² EY Attractiveness Survey Scotland (2017)

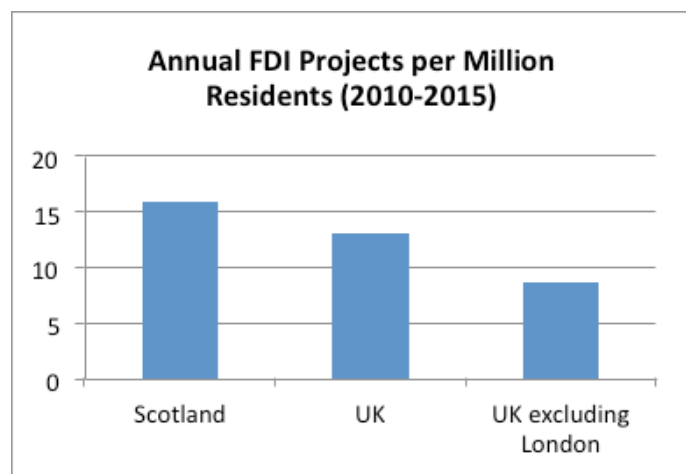


45. There is strong evidence that EU membership has been associated with increased flows of FDI. For example, empirical estimates from Bruno et al indicate that between 1985 and 2013, EU membership has increased FDI flows by around 28% across member states.²³ Maintained membership of the European Single Market will ensure Scotland continues to attract international investment to Scotland. In contrast, any future relationship short of Single Market membership is likely to result in a reduction in attractiveness to investors and therefore ultimately in lower investment in Scotland and the rest of the UK. Work by the London School of Economics finds that striking a Swiss-style trade deal would not significantly reduce or offset the negative effects of Brexit on FDI.²⁴ We consider this can only be achieved through continued European Single Market membership.

²³ Bruno et al (2017) The FDI Premium from EU Membership

²⁴ LSE (2016) - The impact of Brexit on foreign investment in the UK

Chart 3



Productivity

46. Improving productivity (output per hour worked), is the key driver to overall economic success in the long-term and has a direct impact on real wages and living standards. OECD analysis, supported by UK and Scotland specific studies, shows that as businesses become increasingly international they become more competitive and productive.²⁵ Membership of the EU and European Single Market has increased openness to trade and thereby increased the movement of goods, services, capital and labour. This in turn helps boost productivity through a number of channels including;

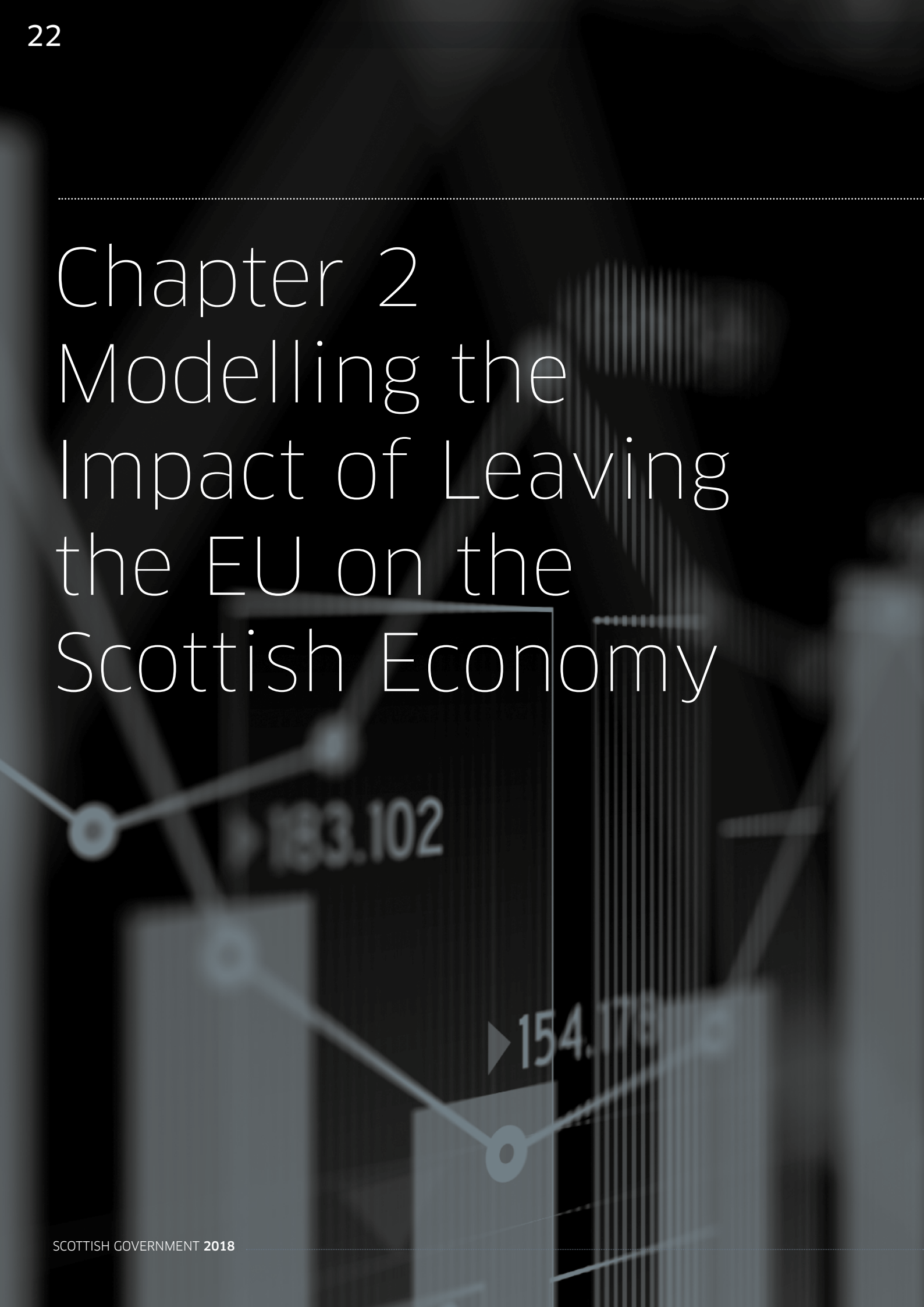
- ★ **Scale and Specialisation** – Access to a larger market allows the most productive and successful firms to expand, taking advantage of economies of scale in production. There is evidence that greater openness to trade also improves productivity by encouraging firms to specialise in the things they do best;

²⁵ OECD (2008) Trade and Innovation Project: A Synthesis Paper. Trade Policy Working Paper No.72, Harris and Li (2007). Firm Level Empirical Study of the Contribution of Exporting to UK Productivity Growth Harris (2010) SDI Policy Evaluation

- ★ **Foreign Direct Investment** – FDI improves access to investment, new technologies and management practices, all of which help to boost the productivity of firms. Many investors have highlighted that membership of the European Single Market is an important factor in determining the location of their investments;
 - ★ **Increased Competition** – Having fewer trade barriers increases the level of competition in the market, and provides greater incentives for companies to invest and increase the efficiency of their production processes; and
 - ★ **Innovation and Adoption** – Having fewer barriers to trade has been shown to increase the incentives for domestic firms to implement and adopt new approaches and technologies into their business by exposing them to new business practices and competition.
47. Continued European Single Market membership has supported all of these channels and is a significant driver in existing UK productivity, although this is not growing at the same rate as our EU partners. Continued Single Market Membership will result in better outcomes across each of these channels, maintaining economic openness, and retaining and enhancing the competitiveness and dynamism of the economy. For example, analysis by the Treasury finds that productivity would be permanently lower under a WTO scenario, compared to an EEA scenario.

Chapter 2

Modelling the Impact of Leaving the EU on the Scottish Economy



48. The economic consequences of the UK leaving the EU have been analysed by several organisations and think tanks.²⁶ There is widespread agreement in the economic literature that Brexit will have a detrimental effect on the UK economy.
49. The Fraser of Allander Institute (FAI) has produced economic analysis on behalf of the Scottish Parliament, which models the potential impact of Brexit on Scotland.²⁷ The analysis incorporates the economies of both Scotland and the rest of the UK, helping to capture spill-over effects arising from the high levels of economic integration between the Scottish and UK economies. The FAI have also presented the impact on jobs, suggesting Brexit could cost up to 80,000 jobs.²⁸
50. In common with other studies, the FAI analysis examines the long-term impacts of Brexit by comparing a range of potential future trade scenarios (all characterised by less economic integration with the EU) to the status quo as a member of the EU. These scenarios are: participating in the European Economic Area, securing some form of Free Trade Agreement with the EU or a WTO relationship.
51. Their analysis concludes that the further removed Scotland is in future from EU membership, the more significant the negative impact would be to the Scottish economy. In short, membership of the EEA is not as economically beneficial as full EU membership, but is the least damaging of the three options by a significant margin.
52. The FAI modelling of the WTO scenario suggests that after 10 years:
- ★ GDP is expected to be over 5% (£8bn in 2015-16 terms) lower than would otherwise be the case;
 - ★ real wages are expected to be 7% lower, equivalent to a reduction of around £2,000 per year; and
 - ★ the number of people employed in Scotland is 3% lower (around 80,000 jobs).
53. To further illustrate the costs of leaving the European Single Market, the remainder of this chapter presents new Scottish Government analysis using the Scottish Government's Global Econometric Model (SGGEM).²⁹ The analysis focuses on six economic areas that are impacted by the type of relationship the UK has with the EU:
- ★ total volume of trade in goods and services with the EU;
 - ★ levels of trade tariffs with the EU;
 - ★ Foreign Direct Investment (FDI) flows;
 - ★ productivity growth which is tied to the level of trade openness;
 - ★ levels of net migration; and
 - ★ the UK/Scotland's net contributions to the EU budget.
54. In common with the majority of the literature on the economics of Brexit (including studies by the OECD, NIESR, Fraser of Allander, and the Treasury), the analysis looks at the impact on the Scottish economy under a range of possible established or "off the shelf" scenarios,³⁰ based on the EU's existing trade relationships.³¹ Further information is provided in the technical annex. The three alternative scenarios to EU membership examined are:
- a. a World Trade Organisation style relationship;

26 Examples include Ebell, M., Hurst, I., & Warren, J. (2016). *Modelling the Long-Run Economic Impact of leaving the European Union*. National Institute of Economic and Social Research & OECD. (2016).

27 FAI (2016) – Long-term Economic Implications of Brexit. A report for the Scottish Parliament.

28 <https://www.sbs.strath.ac.uk/economics/fraser/20161006/Long-term-Economic-Implications-of-Brexit.pdf>

29 SGGEM is a large scale structural global econometric model, created by the National Institute of Economic and Social Research (NIESR) and is based on an adaptation of their own National Institute Global Econometric Model (NiGEM).

30 At a high level, the difference between each scenario reflects changes in the impact on the six areas outlined above: with negative impacts on the UK's export market share in the EU; an increase in export prices to the EU as a result of tariffs; a negative impact of productivity and a fall in FDI. The EEA scenario assumes continuation of free movement of labour which is reflected in using the Office of National Statistics' "High Migration" population projection for Scotland while the "Principal Migration" projection is used for the FTA and WTO scenarios to reflect lower immigration. Under the EEA scenario there is an assumption of some form of payment into the EU budget and there is no repatriation of the UK or Scotland's net contribution.

31 Full details of the assumptions behind each scenario can be found in the technical annex along with the source in the economic literature each assumption has been drawn from.

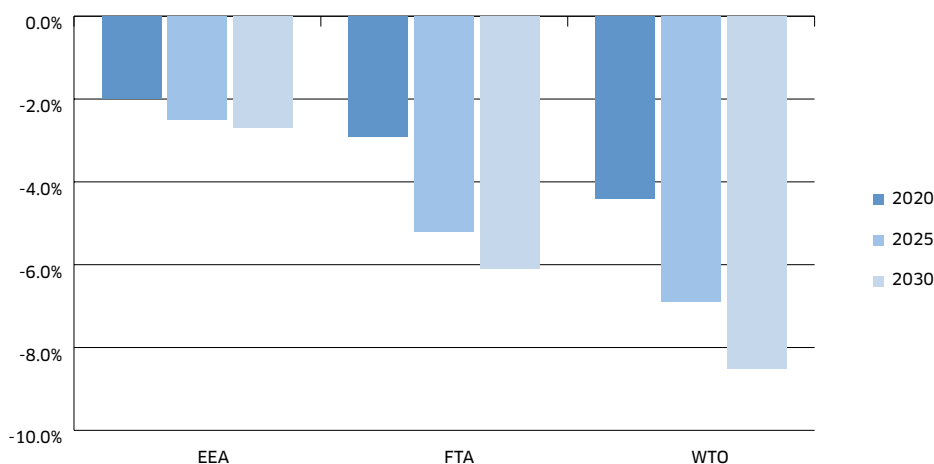
- b. a form of Free Trade Agreement: outside the Single Market and Customs Union; or
- c. participating in the European Economic Area (EEA).
55. The available evidence also indicates that a chaotic exit from the EU, including an unplanned reversion to WTO rules would be more damaging than a planned transition to WTO terms.³² Notwithstanding this, it is also important to note that there is no longer any such thing as completely free trade. All trade is managed trade with benefits for both partners in any deal. A complete absence of any trade rules creates significant uncertainty and consequent economic damage.
56. Consistent with the literature, the modelling finds that each scenario examined results in a permanent decrease in GDP relative to continued full EU membership. The magnitude increases the looser the relationship with the EU becomes. In particular there is a notable difference in the impact of the FTA and WTO scenarios relative to that of the EEA scenario, as shown in Chart 4.
57. For example, should the UK pursue a WTO-style relationship, Scotland's GDP would be around 8.5%, or £12.7 billion (in 2016 cash terms), lower by 2030, compared to continued full EU membership. This is equivalent to a loss of around £2,300 per year for each person in Scotland. A Free Trade Agreement relationship would mean Scotland's GDP would be 6.1% (£9bn in 2016 cash terms) lower by 2030. Should the UK remain in the Single Market by participating in the EEA this impact could be significantly mitigated, with Scottish GDP estimated to be around 2.7% (or £4 billion in 2016 cash terms) lower.
58. Table 1 summarises the long term impacts on GDP and some other macroeconomic indicators by scenario.

Table 1 - Headline Macroeconomic Indicators by 2030 relative to a baseline of Full EU Membership

	GDP (%)	GDP Per Capita (£) in 2016 Cash Prices	Real Disposable Income(%)	Business Investment (%)
EEA	-2.70%	-£688	-1.40%	-2.90%
FTA	-6.10%	-£1,610	-7.40%	-7.70%
WTO	-8.50%	-£2,263	-9.60%	-10.20%

Source: Scottish Government Global Econometric Model (SGGEM)

Chart 4 - Change in Scottish GDP (%) by 2030 - Relative to a baseline of a Full EU Membership

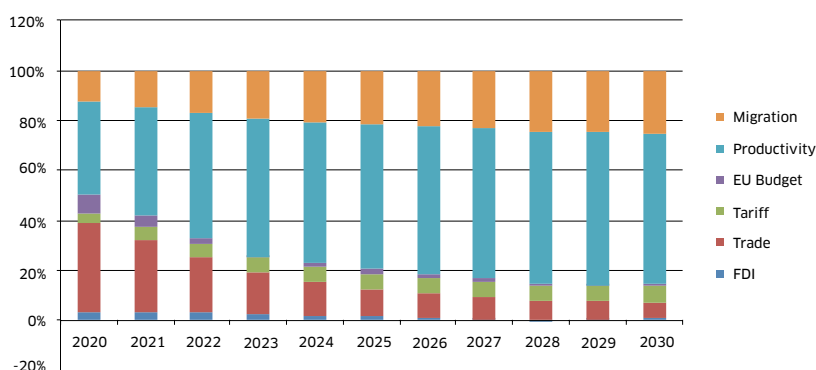


Source: Scottish Government Global Econometric Model (SGGEM)

³² See for example <http://ukandeu.ac.uk/research-papers/cost-of-no-deal/>

59. Table 1 shows that should the UK remain in the Single Market by participating in the EEA, Scotland's GDP could be 5.8 percentage points (or around £8.7bn) higher by 2030, compared to the WTO scenario. It is difficult to identify the benefits of the Customs Union in isolation. Much of the economic literature on which the estimate of the benefits of EEA membership is based implicitly captures some aspects of the Customs Union, but not the full benefit. It is therefore reasonable to assume that were EEA membership to be attained alongside a Customs Union the economic benefits will fall between the EU and EEA estimates.
60. The results indicate that business sector investment is projected to be lower in all scenarios. For example, under a WTO scenario business investment is projected to have fallen by 10.2% by 2030. Lower levels of investment in the economy in turn leads to lower levels of capital stock which negatively impacts output per worker and the average real wage.
61. The impact of lower investment can be observed in lower real disposable income – a measure of consumer spending power after changes in the price level. This is also projected to be 9.6% lower in a WTO scenario, although again membership of the EEA mitigates this impact significantly.
62. Chart 5 shows the contribution to the difference in GDP between the Full EU membership and the WTO scenarios disaggregated by the impact of changes in migration, productivity, EU budget contributions, tariffs, volume of trade and FDI.
63. In the short to medium term, the impact of different levels of trade and tariff barriers explains a sizeable amount of the difference between a WTO scenario, and the full EU membership scenario. Over time however, the impact on productivity and net migration overtakes the trade effect as the main contributors to the difference between these scenarios.
64. For example, by 2030, productivity would account for 60% and migration 26% of the difference in GDP between the two scenarios. This is primarily due to the importance of both channels on the overall productive capacity on the economy. Over time these supply-side channels have a much greater and more permanent impact on the size of the economy and are where the greatest gains from a closer relationship with the EU can be found.
65. As chapter three explains, the Single Market is an evolving framework. As such, future improvements in the economic relationship with the EU such as the further deepening of the Single Market (particularly the future development of the Single Market in services) will result in further economic benefits for its members.

Chart 5: Contribution (%) to the difference in GDP between the WTO and full EU membership scenario over time



Source: Scottish Government Global Econometric Model (SGGEM)

Chapter 3

The case for the European Single Market, Now and in Future

66. As we have demonstrated in the preceding chapter, exiting the EU will have significant, unavoidable and adverse consequences for our economy, our society and, indeed, our way of life. However the costs of Brexit are not just the immediate costs to the economy. Consideration also has to be given to the wider range of benefits EU membership has provided us with and the future opportunities that will be lost to our economy, our environment, our workers and citizens as a result of the UK's withdrawal from the EU. These opportunities will arise not only from the continual evolution and deepening of the Single Market, but also from the further development of common EU policies to which we currently contribute and from which we benefit. These are the long term consequences of Brexit – the opportunity costs – that we do not believe can be offset as the UK seeks new trading relationships outside the EU.
67. In this chapter we highlight some of the key Single Market and associated policy areas where the evidence indicates significant opportunities will continue to arise and from which Scotland could benefit. These are a mixture of the so-called 'flanking' and 'horizontal' policies in which the UK could continue to participate through both the European Single Market or in associated bi-lateral agreements, such as in justice and security. It should also be noted, that the modelling presented in the previous chapter is based on the Single Market as it stands, and does not reflect any future economic benefits from the developments set out in this chapter, although we present some estimates in this chapter of the potential future economic benefits.
68. Alongside the development of the European Single Market this chapter also presents, at a high-level, some of the opportunities for collaboration on key areas of security, environmental and social policy. It does not provide a comprehensive analysis of all of these areas, but the Scottish Government will publish further material in due course on individual policy areas.

The European Single Market: the untapped potential

69. Creating an environment where businesses are encouraged to develop, compete and grow nationally and internationally is a central priority for the Scottish Government. We believe remaining within the European Single Market is an essential component of maintaining that growth-friendly environment. Moreover, it is clear that the benefits we have derived from almost 45 years of membership of the Single Market are far from exhausted. Although substantial progress has been achieved in the years since the European Single Market programme was launched in 1992, it remains incomplete in key areas. Removing the remaining barriers to trade in goods and services will unlock further gains for commerce, consumers and workers across the EU. This is particularly true as the EU moves to complete an Energy Union, a Capital Markets Union, a Banking Union and a Digital Single Market. Furthermore, considerable potential remains untapped due to remaining barriers to cross-border trade in goods and services.
70. A study conducted by the European Parliamentary Research Service estimated the untapped potential from completing the existing Single Market to be in the order of €651 billion to €1.1 trillion per year, equivalent to an additional 5% to 8.6% of EU GDP, that could be realised from the phasing in of reforms designed to further ease the cross-border movement of goods and services, completing the EU digital Single Market and increasing cross-border public procurement.³³

³³ European Parliament (2014) The Cost of Non-Europe in the Single Market. Published here: http://www.europarl.europa.eu/RegData/etudes/STUD/2014/536356/EPRS_STU%282014%29536356_REV1_EN.pdf

Completing the internal market for goods and services

71. The largest part of the untapped potential of the Single Market are expected to flow from completing the Single Market in services – an area of particular significance to the UK, and Scottish, economy. This would result from both the consistent implementation of the 2006 Services Directive and new initiatives aimed at increasing cross-border competition in network services, professional services and the retail sector.
72. Today services contribute approximately three quarters of Scotland's GDP compared to less than half when we joined the EU. Over the same period the contribution of manufacturing has fallen from 36% to around 10% of GDP. The increasing importance of non-manufactured sectors to our economic wellbeing is also evident in the pattern of international trade. Exports from the service sector have increased as a share of total international exports in recent years, accounting for 38% of all exports in 2015 compared with 24% in 2002 and now also account for around 32% of Scotland's EU exports, compared to only 22% in 2002.³⁴
73. The long-term potential gain from completing the Single Market in services, where Scotland and the UK have a comparative advantage, is estimated to be of the order of 2.4% of EU GDP.³⁵ To put this into context, a 2.4% boost to Scottish GDP in 2016 would be equivalent to £3.6 billion, or £668 per person.
74. If, post-Brexit, the UK is not in the European Single Market through membership of the EEA, it is highly unlikely that Scotland's economy, including in the key services sector, will be able fully to share in these additional benefits as the European Single Market is completed. Even the most sophisticated international trade agreements the EU has concluded with third countries does not provide for comprehensive access for third country producers and (in particular) service providers – including those providing financial services – to the Single Market. The EU's chief negotiator Michel Barnier has been clear, that if the UK chooses a model outside of the European Single Market, financial services companies cannot expect to trade freely on the same terms as they currently do.³⁶
75. However, it is not only in further liberalisation of intra-EEA trade in goods and services that significant economic opportunities will arise in the European Single Market in the future. Further benefits will flow from on-going developments in key economic sectors, and from participation in the policies through which the Single Market is regulated.

³⁴ Scottish Government (2017) – Exports Statistics Scotland

³⁵ European Parliament (2015). Mapping the Cost of non-Europe 2014-19. Published here: [http://www.europarl.europa.eu/RegData/etudes/STUD/2015/536364/EPRS_STU\(2015\)536364_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2015/536364/EPRS_STU(2015)536364_EN.pdf)

³⁶ <http://www.telegraph.co.uk/news/2017/12/19/michel-barnier-rules-special-deal-city-london-theresa-may-plans/>

The Digital Single Market

76. The digital Single Market allows EU citizens and companies to more easily, and more securely, access and sell online goods and services across national boundaries. The potential gains of a digital Single Market could be in the range of €415 to €500 billion per year (3.0 to 3.6% of EU GDP)³⁷ as a result of higher productivity due to faster flow of information, greater efficiency in traditional economic sectors and higher levels of e-commerce. The European Commission estimates the benefits of reinforcing the integration of the digital Single Market to be 1.9% of EU GDP.³⁸ For Scotland, a 1.9% boost to GDP in 2016 would be equivalent to £2.9 billion, or £529 per person.
77. The UK digital economy will face increasing trade costs if UK and EU legislation diverge. EU legislation regulating the free movement of personal data and data localisation facilitates cross-border data flows within the EU. Outside the Single Market, UK businesses and particularly data intensive service industries such as accounting, banking, telecommunication or gambling, will lose competitiveness.

Integrated Energy Markets

78. Integrating electricity energy markets across the EU would save money for consumers. EU policies such as the Clean Energy Package³⁹ rationalise reserves and procurement activities, incentivising investment and the common management of cross-border energy infrastructure. This will bring tangible benefits to citizens through lower energy bills, with a study for the European Commission estimating that integrating electricity energy markets could bring benefits of at least €12.5 billion per year.⁴⁰ This energy market is of particular importance for the Scottish renewables sector.

37 European Parliament (2015). Mapping the Cost of non-Europe 2014-19. Published here: [http://www.europarl.europa.eu/RegData/etudes/STUD/2015/536364/EPRS_STU\(2015\)536364_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2015/536364/EPRS_STU(2015)536364_EN.pdf)

38 European Commission (2014). The Economic Impact of Digital Structural Reforms. Published here: http://ec.europa.eu/economy_finance/publications/economic_paper/2014/pdf/ecp529_en.pdf

39 <https://ec.europa.eu/energy/en/news/clean-energy-package-top-agenda-eu-energy-council>

40 Booz&Company (2013). Benefits of an Integrated European Energy Market. Prepared for DG ENER European Commission. Published here: https://ec.europa.eu/energy/sites/ener/files/documents/20130902_energy_integration_benefits.pdf

Commercial, Environmental and Labour Policies

79. The European Single Market also seeks to safeguard the broader public interest through a range of common policies that underpin a shared approach to the regulation of markets and market participants. These common, Single Market policies are driven by a number of factors – namely changes in technology, advances in scientific knowledge, the emergence of new types of company and new patterns of working, the intensification of globalisation, the emergence of new societal challenges to name a few. In the face of these developments the public rightly expects adaptation of public policies to ensure that the public interest continues to be protected. It is these developments and these concerns that underpin many of the common policies that have been implemented at EU level.
80. At the same time EU public policy must continue to safeguard a competitive business environment that stimulates investment, jobs and growth, and in which businesses across the Single Market compete, nationally and internationally, on a level playing field. These are the aims of EU competition policy, research and development policies – policies geared to support the development of small and medium sized enterprises and the drive to encourage EU businesses to innovate.
81. Consumer and environmental protections are also key aspects of Single Market policy. The interests of our businesses, and our citizens, are also supported by the setting of high environmental standards and robust environmental regulations to which goods and services must conform in order to be sold within the Single Market. As well as removing non-tariff barriers to trade, environmental standards and regulations help protect and enhance our stock of natural capital, including our air, land, water, soil and biodiversity and geological resources, which are fundamental to a healthy and resilient economy.

82. Similarly, barriers to trade are avoided and healthy environments for business supported by progressive EU employment laws, rights of citizens who settle in other member states, and to the development of a broader social agenda that seeks to improve the quality of jobs and working conditions, combat discrimination, promote equal opportunities, and tackle poverty and social exclusion.
83. And while further progress in all of these policy areas is required, we believe that the rights and interests of consumers and workers, and their families, are best protected within the framework of EU policies and legal entitlements. Therefore while we agree the EU's social and environmental agenda is far from complete, we believe it offers the appropriate framework to continue to develop programmes and policies that deliver the form of inclusive growth the Scottish Government regards as a vital component of our future prosperity.
84. In leaving the European Single Market, the UK would lose any ability to influence the further development of these policies and standards. However, as they are increasingly being adopted as global standards in the context of international trade, the UK would nonetheless still remain subject to them.
85. Remaining part of that European Single Market will ensure Scotland's producers – of goods and services – continue to adhere to the highest standards, and that our consumers and workers will continue to enjoy the protection these standards afford us. It will also ensure we retain some opportunity to influence the future development of these policies to meet our needs, albeit with greatly reduced leverage than that which comes with being a member state.

Beyond the Single Market: Social, Environmental, Justice and Security Co-operation

86. As the European Single Market develops, in particular as the EU signs new comprehensive trade deals, Single Market members will also be increasingly affected by a range of policies of the EU, including those sometimes referred to as flanking policies as well as those covering areas such as state aid, regional policy, structural funds and fair work. Participation in the development and implementation of these policies as a member state has helped to support Scotland's economic and social development over the last 40 years, something which will be jeopardised by Brexit.
87. The flanking policies straddle a range of objectives that have enhanced the collective well-being of our citizens: policies which protect our environment, increase our security, and boost the competitiveness of our businesses and our industries. These policies reflect a shared approach to managing the common challenges and the resources we share with our partners in the EU.
88. We have seen the benefits of collective action through the establishment of common environmental ambitions building on the standards and regulations that underpin the Single Market. These ambitions are increasingly reflected in the standards we expect of products entering our markets under the most recent generation of EU trade deals. Developing and enforcing a common approach to environmental policies and using the Single Market as a key tool for delivering those policies, ensures that shared challenges such as addressing pollution or ensuring the protection of natural habitats are collectively managed and ensuring that no single nation can escape their share of responsibility and action. Scotland has developed an expertise in environmental management and regulation that is valued across Europe.

89. As we continue to face growing, complex environmental and climate challenges, with serious implications for economic and social wellbeing, we believe we must continue to actively participate with our EU partners in finding common solutions. The continued ability to collaborate, innovate and bring this expertise to bear across the Single Market must be retained.
90. Similarly, in relation to the agriculture and forestry sectors, Brexit represents a hugely significant challenge. Food and drink alone accounts for Scotland's biggest non-energy export, with over two-thirds of exports worth £1.2 billion in the first three quarters of 2017 going to EU countries. By food category, fish and seafood accounted for the majority (58%) of Scotland's overseas food exports and was valued at approximately £694 million, up 32% on the same period in 2016.⁴¹ Forestry comprises 18% of Scotland's land area, contributing almost £1 billion per year to the Scottish economy and supporting more than 25,000 full-time equivalent jobs. Brexit will create challenges in trade, labour, plant health and environmental standards.
91. Withdrawal from the EU will result in the departure from the Common Agriculture Policy (CAP) impacting significantly not only on farming and food production, but also forestry, environmental protection and wider rural sustainability. Membership of CAP results in nearly half a billion pounds annually of EU and Scottish funds being invested all across rural communities. Subsidies underpin our farming sector – in 2015-16, farm business income (FBI) was £12,600; without support grants, FBI would have been a loss of £25,500^[2]. Currently Scotland receives 16% of the UK's CAP funding, indicating the greater importance of agriculture to our land use and economy – loss of this funding is therefore a significantly greater issue for Scotland than for other parts of the UK.
92. External analysis on a range of post-Brexit trade scenarios, co-funded by the four UK administrations, has shown the potential for widespread negative impacts and disruption to markets in the UK agricultural sector.⁴² The report shows that failure to reach a deal with the EU, combined with taking a complete free trade approach, would disrupt every single sector of agriculture, with beef production in Scotland particularly adversely affected. The study confirms what the Scottish Government has been saying all along: rural communities' interests are served best by Scotland remaining within the EU as has been made clear by a recent interim report by the National Council of Rural Advisors.⁴³
93. Scotland's fisheries zone is the fourth largest of core European waters and makes up over 60% of the UK's total European waters. There is significant abundance of fish in Scottish waters and numerous EU and third countries currently have access to fish quota allocations in our waters. At present the management of our waters is through the EU's Common Fisheries Policy (CFP). As we set out clearly in *Scotland's Place in Europe*, if Scotland is not part of the EU then we will not be a part of the CFP. Nor would we seek to become a part of it, the CFP is excluded from the EEA agreement and we would not wish to change that arrangement.

42 <https://www.afbini.gov.uk/sites/afbini.gov.uk/files/publications/FAPRI-UK%20Brexit%20Report%20-%20FINAL%20Clean.pdf>

43 National Council of Rural Advisers: Interim report on the Potential Implications for Rural Scotland of the UK leaving the EU – (Published 29th November 2017). <http://www.gov.scot/Publications/2017/11/6792>

41 HMRC Food and Drink Export Statistics: Q1 – Q3 2017

94. Aquaculture plays a significant role in Scotland's economy as well as supporting fragile rural communities. Farmed salmon is Scotland's and indeed the UK's largest food export, with fish and seafood overall accounting for 60% of Scotland's food exports. In the first nine months of 2017, 45% of Scotland's salmon exports went to the EU. Scotland supplies by far the majority of the EU's farmed salmon and we continue to see growth in EU, as well as world, markets. As well as the risk of tariffs, non-tariff barriers such as animal health requirements and delays at ports due to customs controls could have a significant impact on seafood exports.
95. Under the EU's European Maritime and Fisheries Fund (EMFF), between 2014 and 2020, Scottish seafood and marine sectors will receive £95m⁴⁴ in direct assistance supporting research, development and structural reform. This programme will also release further assistance from the Scottish Government and in total could be worth up to £150m support to the marine sector. EMFF, has played a key role in supporting compliance and ensuring the protection of our marine assets. In 2017-18 Marine Scotland will receive up to £3m in EMFF funding to support compliance activity.
96. Given that most agricultural and seafood products traded from EFTA EEA countries to the EU are subject to tariffs, the UK Government needs to negotiate for tariff-free access to the Single Market for these products and we will press for this.
97. Around £4m a year of European funding supports the science, data and compliance cost which is necessary to manage and support the industry, in addition to the project funding that is paid in direct support to the sector.
98. In the wider social sphere too there are real benefits to be reaped from remaining within the EU policy framework. The European Commission, in pursuing the creation of a digital Single Market, has called on EU governments to focus on finding innovative ways to offer life-long and personalised support to help people in relation to employment, skills and welfare. In parallel to this, in January 2017 the European Parliament approved recommendations for a European Pillar of Social Rights which would guarantee basic rights for workers, regardless of the form of employment and contract, and specifically including work intermediated by digital platforms. In leaving the EU policy framework Scotland would lose both the opportunity to influence this key element of the fair work and inclusive growth agenda, and also run the risk of diverging significantly from future norms in a complex and rapidly expanding area.⁴⁵
99. The progressive development of the European Research Area (ERA) is a key area in which we make a substantial contribution to the development and application of research and knowledge, and from which we derive significant benefits. Successive EU research framework programs have been highly effective in intensifying research collaborations between universities, research institutions and business across the EU.
100. Scotland's universities have been at the forefront of developing these collaborations and have been highly successful in winning research funding and engaging with researchers from across the EU in pioneering collaborations. As a government we believe our universities, research institutions and businesses must continue to work within this common, and expanding, European-wide collaborative framework. The recently concluded review of the Horizon 2020 Programme recommended a doubling – to €160 billion⁴⁶ – of the total resources to be allocated to the successor EU research and innovation programme. It is not just the money: our opportunity to influence will be severely limited from outside. It is widely acknowledged that research and innovation

44 using € exchange rate as of January 2018

45 https://ec.europa.eu/commission/priorities/deeper-and-fairer-economic-and-monetary-union/european-pillar-social-rights_en

46 https://ec.europa.eu/research/evaluations/index_en.cfm?pg=h2020evaluation

- policies make a significant difference to increasing productivity and boosting the competitiveness of EU industry.
101. The Scottish culture sector received at least £59 million in funding from the EU over 2007-16, supporting around 650 projects. This provides vital finance for the sector, but at least as important is the cultural collaboration and professional development that the EU's funding programs support. Scottish organisations are keen and prominent participants in the Creative Europe programme which actively promotes and facilitates cultural organisations to work in international partnerships, learning from their peers and sharing knowledge and experience.
 102. Free movement of people within the EU allows artists from around the EU to bring their work to Scotland and Scotland's cultural and creative industries companies are able to recruit the talent and skills that they need from as wide a pool as possible.
 103. EU citizens can travel freely to Scotland to experience our unique culture and world leading festivals. In 2016, spending by tourists in Scotland generated around £11 billion of economic activity in the wider Scottish supply chain and contributed around £6 billion to Scottish GDP (in basic prices). This represents about 5% of total Scottish GDP. Leaving the European Union will pose significant difficulties for Scotland's tourism industry: seven of our top 10 markets are in Europe and around 10% of those employed in the sector are from the EU.
 104. Tourism in particular is a sector that contributes to the rural economy; with the sustainable tourism sector in 2015 being relatively more important for remote rural areas, followed by rural areas and cities. LEADER is a unique scheme which supports the wider rural economy to increase support to local rural community and business networks, including tourism and hospitality, to build knowledge and skills, and encourage innovation and cooperation in order to tackle local development objectives.
 105. In addition to these funding streams, the flanking policies and opportunities to collaborate also have a significant impact on local government, colleges and the third sector in Scotland. Continued access both to structural and framework programme funding is essential. Beyond the financial implications, shared approaches to social policy have allowed for partnerships to be developed across Europe. These approaches range from environmental issues to employability, and from fair work and social inclusion to access to further education. They have enhanced the ability of the third sector, local government and colleges to deliver positive programmes and outcomes to communities throughout Scotland. Good examples of this include work on the skills development agenda and promoting social mobility.
 106. The Erasmus+ programme has played a significant role in broadening the educational experience, developing cultural awareness and increasing employment prospects for Scottish students. Since 2014 more than 15,000 people have been involved in nearly 500 Erasmus+ projects across Scotland. The programme is evolving to include vocational education and training, adult education, schools education and youth work. This significantly increases the number of people who can benefit. This flow of people to and from Scotland supports the development of the skills, experience and global outlook necessary for Scotland's society and economy to thrive.
 107. In addition, some of the issues explored in chapter four in relation to the free movement of people and Scotland's attractiveness as a nation have a very direct bearing on the ability of Universities and research institutions to attract and retain the very best international talent to support research and innovation. A diverse student population is also highly valued for its social, cultural and educational impact. Recognised benefits of EU and international students include an enriched learning experience and international outlook among home students and graduates, and the development of an international network of alumni. Latest UCAS figures show a reduction in applications from EU students to Scottish universities, raising major concerns about the longer term impact of Brexit on the diversity of our student population.

108. Scotland and the UK have also benefited significantly from participation in EU civil judicial and security, law enforcement and criminal justice co-operation. We face threats from new forms of criminal activity, including terrorism and cybercrime, and continued close and direct collaboration with our European partners is vital and helps Scottish law enforcement agencies to act quickly to meet those threats, keep pace with the latest developments and influence policy and operational choices to develop the most efficient practices and tools which help keep people in Scotland safe. In 2014 the UK chose to opt into a suite of justice, security and law enforcement measures, which enable the police and prosecutors of EU Member States to rapidly share information and work closely together to investigate and prosecute serious and organised crime across European borders.
109. Scotland's distinct legal and judicial system, which is separate from other parts of the UK, and the role of the Lord Advocate in overseeing the investigation and prosecution of crime in Scotland, means there is direct co-operation between Scottish law enforcement agencies and their European partners. For example, Police Scotland benefits from the UK's participation in Europol; and Scottish prosecutors benefit from participation in Eurojust. These organisations share intelligence and other data, in accordance with EU standards, which are vital to the investigation and prosecution of crime. That practical co-operation also enables the enforcement of EU legal measures, such as the European Arrest Warrant and the European Investigation Order, which are crucial tools in helping police and prosecutors deal rapidly with serious and organised crime across European borders.
110. EU civil judicial cooperation measures underpin the operation of the Single Market and address the practical legal issues which arise from the free movement of people, goods, services and capital across European borders. Existing EU law measures in civil and commercial matters are embedded in the law in Scotland and regulate areas such as marriage, divorce, child abduction, commercial contracts and disputes. EU law has also established practical arrangements for the mutual recognition of court judgments issued across member states. All these existing cooperation measures benefit individual citizens and businesses in Scotland by providing certainty and stability about what the law is and how these measures operate across EU Member States.
111. The UK Government has published discussion papers⁴⁷ indicating that they will seek to agree with the EU "new close and comprehensive arrangements for civil judicial cooperation" and "new dynamic arrangements" for the future partnership and on security, law enforcement and criminal justice matters. However there is a lack of clarity about the detail of these arrangements or how these will take into account the separate justice system in Scotland. While the UK might be able to continue elements of these direct co-operative arrangements through future agreements, they are unlikely to be as comprehensive and effective as that which the UK currently enjoyed by the UK as a member state – particularly if the UK does not accept the jurisdiction of the Court of Justice of the European Union (CJEU). A failure to accept this jurisdiction, and not having full access to shared databases across the EU, could lead to a reduction in the co-operation between EU member states and the UK; which will have a detrimental impact on the ability of Scottish law enforcement agencies to keep our people safe. There will undoubtedly be an adverse impact on businesses and individuals who will lose certainty on their rights and the stability which flows from that.

47 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/645416/Security_law_enforcement_and_criminal_justice_-_a_future_partnership_paper.PDF
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/639271/Providing_a_cross-border_civil_judicial_cooperation_framework.pdf

112. As we have demonstrated in this chapter, our membership of the Single Market and Customs Unions and participation in wider EU policies from this platform, deliver many current benefits, and support both the development of our society and our economic prosperity. However, more than that, we have shown how these benefits are evolving and increasing all the time, and that both present and future benefits will be at risk if the European Single Market and Customs Union membership is not maintained in the long term.
113. Just as the scope of the European Single Market will continue to expand and offer new opportunities to its member countries, so too will the regulatory framework governing that market continue to evolve and adapt. Therefore, as the EU's policies continue to reflect new science and a better understanding of how to address the challenges we face, new products for sale in the European Single Market will be required to meet new regulations.
114. Anything but the softest of Brexits will detach the UK from the development of these new standards, regulations and policy responses that will characterise and shape the development of the European Single Market over the long-term. Increasingly these regulations and responses are influenced by the work of EU-level specialised agencies – agencies shaping the regulations governing the food we eat, the medicines we prescribe, the chemicals we come into contact with, the quality of our working lives, and our environment to name just a few of the functions EU agencies perform. In order to maintain the same outcomes as those delivered by current EU institutions there will need to be significant growth in capacity within the UK.
115. If the UK falls outside the framework of the European Single Market not only will it be unable to contribute to the work of these important agencies and in so doing lose all influence over their recommendations, it will almost inevitably lead to a divergence between UK standards in products and production processes and those required by the EU before goods or services can be offered for sale in the European Single Market. For that reason the damaging consequences of a hard Brexit are likely to impose on-going losses to Scotland's economy to the extent we are no longer permitted to compete in the European Single Market.
116. The purpose of this chapter has been to set out insofar as possible the longer term implications of a hard Brexit – that is, a Brexit that results in Scotland being outside the European Single Market and Customs Union. These costs are to be measured in the opportunities that could be foregone by this eventuality. It is this consideration of the longer term implications of a hard Brexit as much as our concern of the immediate – or impact – effects this will have, that leads us to conclude that continued, membership of both the European Single Market and a Customs Union is essential. The EEA Agreement provides a framework that would allow the UK to remain an integral part of the European Single Market once the UK exits the EU. It will allow for continued collaboration on a range of policies and it is a framework which dovetails with the Prime Minister's commitment to a post-Brexit transition phase during which "nothing will change" regarding our adherence to EU law and policy.

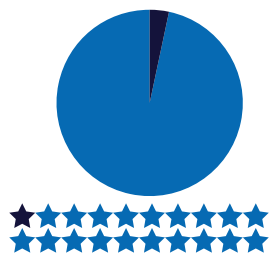


Chapter 4

Free Movement of People

- 117. Membership of the EU has played a central role in the social progress that Scotland has made over the last twenty years of devolution, with perhaps no aspect of EU membership more important than free movement of people. Scotland has always been an open and welcoming nation, and that welcome has extended to the many EU citizens who choose to study, live, work and raise their families here. Their presence in communities across the country has helped make Scotland the modern, dynamic European nation it is today.
- 118. More than that, they have also helped turn around the long-term decline in Scotland's population, and mitigate the effects of an aging society. The demographic challenge Scotland still faces, though, will see more deaths than births every year for the next 25 years. By 2041 there is projected to be as many as 10,000 more deaths than births that year. Migration will account for all of Scotland's population growth over the projection period 2016-2041. Ensuring EU citizens are free to continue to live and work here is essential for maintaining that population growth, which underpins future economic growth and the sustainability of our public services.
- 119. The ability to move freely across Europe has also broadened the horizons of many Scottish people who have been able to study in European centres of learning, take up work anywhere in Europe, and live in and join the many and varied cultures across the continent. As these reciprocal rights have been exercised, ties of family and friendship have been developed and strengthened across Europe. The ease of this valuable exchange, and the opportunities it brings, for citizens of the UK as well as other EU citizens, is now at risk.
- 120. The UK Government's intention to end this freedom seems not only wrong from this perspective, but will also be damaging to our businesses and economy and would appear to be incompatible with their desire for 'frictionless access' to the European Single Market. Moreover, the threat of Brexit, compounding the real and severe damage to the economy and to people's lives and livelihoods, is a lowering of our sights and an unnecessary and unwelcome retreat from the world. Scotland rejected that narrow vision by voting decisively to remain in the EU, and the Scottish Government will do all it can to reaffirm and reinforce that Scotland remains an open, welcoming member of the family of Europe that values the contribution EU citizens make to our society.

**219,000 (NON-UK)
EU NATIONALS
LIVING IN SCOTLAND,
4.1% OF THE TOTAL
POPULATION**



**35.2% OF WORKING AGE
EU NATIONALS HAVE A DEGREE
LEVEL QUALIFICATION OR HIGHER**



**77.6% OF EU NATIONALS
AGED 16 AND OVER ARE
IN EMPLOYMENT**

**30.3% ARE EMPLOYED
IN DISTRIBUTION
HOTELS AND RESTAURANTS**



**17.6% ARE EMPLOYED
IN PUBLIC ADMINISTRATION
EDUCATION AND HEALTH**



**24,000
EU NATIONALS
WORK IN TOURISM
13.0% OF ALL THOSE
EMPLOYED IN THE SECTOR**



**10,000
EU NATIONALS
WORK IN FOOD AND DRINK
12.1% OF ALL THOSE
EMPLOYED IN THE SECTOR**



Source: Annual Population Survey, July 2016 – June 2017

Context for Free Movement

121. It is worth making clear what free movement actually entails. Free movement is the Single Market freedom that most directly affects the day-to-day lives of EU citizens, including UK citizens. Rights under freedom of movement have expanded over time, building on the initial conception of the free movement of workers to support the Single Market: it now incorporates the concept of EU citizenship, and includes rights to study, seek work, reside self-sufficiently, be accompanied by non-EU family members, and access certain benefits and public services. Rights have been further reinforced by judgments of the European Court of Justice, and consolidated in the 2004 Citizenship Directive, also commonly referred to as the Free Movement Directive.⁴⁸
122. For stays of fewer than three months, the only requirement for EEA citizens, including those from the EU, to move and reside in other member states is that they possess a valid identity document or passport.
123. If EU citizens choose to exercise their right to freedom of movement for stays of more than three months, they must be a 'qualified person': which means they must be employed, self-employed, studying, self-sufficient or seeking work. Generally, EU citizens have equal access to benefits and public services as nationals, although there are some restrictions including access to social assistance. In the UK jobseekers have limited access to job seekers allowance, and only after the three month initial period of residence. Many member states also require non-national EU citizens to register their presence in the country, which is permitted after the first 3 months under the relevant EU rules, although the UK has never previously done so.
124. EU member states may refuse entry, or in certain cases remove, EU citizens of other member states on grounds of public policy (such as criminality), public security or public health; or in the event of abuse of rights or fraud, such as 'sham' marriages. Furthermore, member states are able to restrict the free movement of citizens of new EU member states, for a limited period after a new country joins the EU. The UK opted not to exercise these controls for the 2004 accession of eight new member states, mostly from central and eastern Europe. It did exercise transitional controls for the subsequent accessions of Bulgaria and Romania in 2007, whose nationals only gained full free movement rights within the UK from 2014, and of Croatia in 2013. Most other member states also applied transitional restrictions to these accessions.
125. These same limitations and restrictions on the exercise of the right of free movement of people apply equally to UK citizens exercising their valuable rights by seeking to live, work or study in other EU member states.
126. As we will demonstrate in this chapter, and as we set out in the Scottish Government response to the Migration Advisory Committee call for evidence⁴⁹ on the impact of EEA workers, Scotland benefits greatly from the contribution of EU citizens. We want them to stay and we want Scotland and the UK to continue to be able to benefit from free movement of people by remaining in the European Single Market. In supporting ongoing free movement of people, we respect the need for measured and proportionate controls to safeguard against fraud, abuse, security threats and criminality and we support the proper enforcement of those rules. These controls already exist in the framework enabling free movement of people and can ensure that – as we have seen in recent years – the overwhelming majority of EU citizens coming to Scotland are able to make a dynamic and positive contribution to our society.

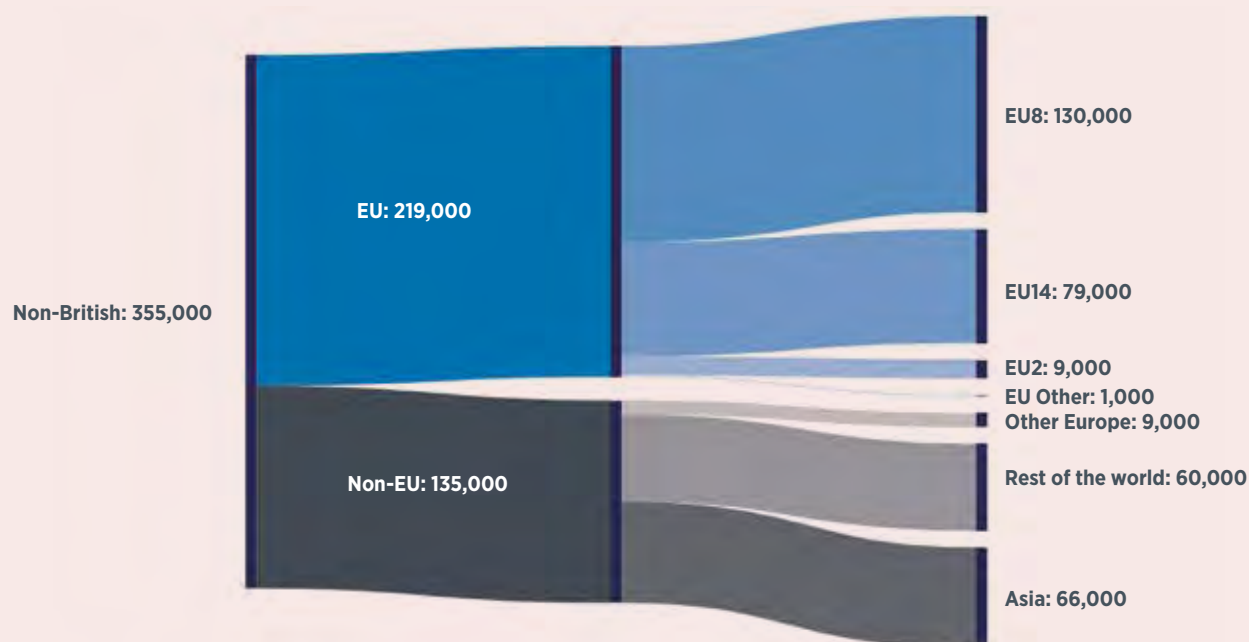
48 Directive 2004/38/EC

49 Scottish Government evidence to Migration Advisory Committee available at <http://www.gov.scot/Publications/2017/11/1376>

Box Two - EU Citizens in Scotland

EU citizens who live and work in Scotland are an important part of our economy and our society. Despite Scotland and the UK's best interests being served by continuing to benefit from freedom of movement, the UK Government has set out its intention to end free movement of people in the spring of 2019. As part of any transition to a new system the UK Government will need to clarify the status of the 219,000 EU citizens who are currently resident in Scotland (and many more elsewhere in the UK), as well as the rights of EU citizens who may be looking to work, live and study here after the spring of 2019.

Population by non-UK nationality, Scotland, July 2016 - June 2017



Source: Annual Population Survey, Office for National Statistics, July 2016 to June 2017

Notes:

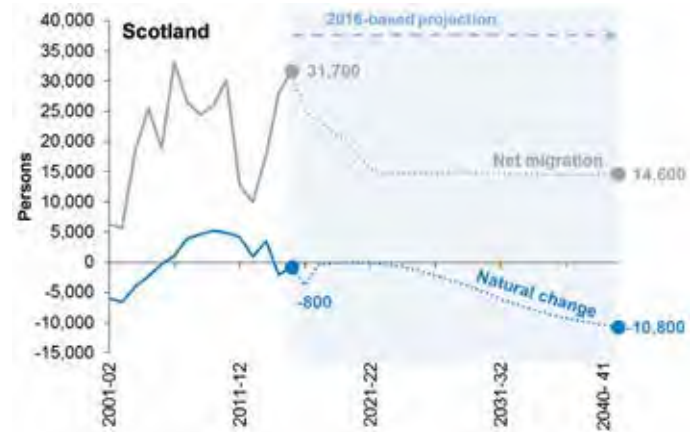
1. Nationality refers to that stated by the respondent during the interview. Where a respondent has dual nationality the first one is recorded.
2. Republic of Ireland nationals are included in the EU14 category.

The UK Government's 'offer' to EU citizens as set out in June 2017 proposes that 'qualifying EU citizens' will have to apply for settled status. If a fee is imposed for settled status, the Scottish Government has committed to look to meet this cost for EU citizens working in the Scottish devolved public services.

Demography and EU Migration

127. Scotland's historical experience of population change, until relatively recently, has been one of out-migration. Throughout the 1950s and 1960s, when England and Wales saw strong immigration, almost 6% of the population left Scotland in each decade. Natural change through births and deaths also continued to decline in Scotland throughout the 1980s and 1990s, when it recovered elsewhere in the UK. A turning point was reached at the start of this century: from 2001 onwards, Scotland became a country of sustained net in-migration for the first time since records began. Most of the net increase in migration came from overseas, rather than from within the UK; and most of the population inflows from overseas came from EU member states. The improvement predates, but was further boosted by, the accession of Eastern European member states in 2004.
128. However, despite the recent turnaround it is important to stress that Scotland is still facing a significant demographic challenge. While Scotland's population is growing, this growth is uneven across our communities. Over a third of Scotland's local authorities will face depopulation before 2039. As previously highlighted, all of Scotland's population growth in each of the next 25 years will come from migration, with natural change forecast to be negative in each of those years: by 2041, there may be as many as 10,000 more deaths than births that year. This demographic challenge is much more pronounced in Scotland than it is for the UK as a whole, where migration accounts for only 54% of forecast population growth.

Chart 6 – Natural change and net migration, Scotland, 2001-02 to 2040-41⁵⁰



129. It is also projected that the population of pensionable age will increase by 25% over the next 25 years. The anticipated increase is highest for the older age groups (e.g. over 75s), with all age groups below 65 projected to decline in population over the next 25 years. At the same time, the projected growth in Scotland's population will slow if levels of EU migration are reduced. In scenarios where future EU migration is constrained, the population is projected to peak in the 2030s and then decline after that point. In contrast, the UK overall continues to see its population increase every year over the next 25 years.
130. These trends will have a significant impact on Scotland's economy. The increase in the number of people of pensionable age will increase demand for health care and other public services. The concurrent fall in the working age population which is projected under reduced EU migration scenarios, will introduce skills shortages across the economy and reduce the tax revenue required to fund public services.

⁵⁰ National Records of Scotland, Mid-year population estimates, National Population Projections (2016-based)

131. Inward migration is therefore key to maintaining Scotland's working age population, and in turn our economic performance. We know that EU citizens in Scotland have a younger age profile than the Scottish population as whole. 61% of EU citizens living in Scotland are under 35 years of age compared to 42% for Scotland as a whole. This further reinforces the importance of EU migration to sustaining the working age population.

Economic contribution of EU citizens

132. Scotland's economy benefits significantly from EU migration. EU citizens are helping to grow our economy, address skills shortages within key sectors and make an essential contribution to our population growth. Over the last decade population growth has been the primary driver of GDP growth and this has been driven chiefly by inward migration. The Scottish Government recently undertook modelling of the economic contribution of EU citizens to the Scottish economy (see Box three) which confirms that workers from other EU countries bring real economic benefits to Scotland.



ALL OF THE INCREASE IN SCOTLAND'S POPULATION OVER THE NEXT DECADE IS EXPECTED TO COME FROM PEOPLE MOVING HERE. WITHOUT IMMIGRATION THE NUMBER OF PEOPLE OF WORKING AGE, WORKING AND PAYING TOWARDS PUBLIC SERVICES IN SCOTLAND IS LIKELY TO FALL.

Box Three – The Economic Contribution of EU Migration to Scotland⁵¹

Introduction

Recent Scottish Government economic modelling shows the economic contribution of EU migration to Scotland.

Approach

In the period from 2007 to 2016, the trend in the number of EU citizens employed in Scotland was equivalent to 7,800 additional people per year. A dynamic computable general equilibrium model (CGE) of the Scottish economy was used to examine the net additional economic impact of a marginal increase in EU migration into Scotland. By marginal increase we mean a one year increase in labour supply equivalent to a one year inflow of EU migration into Scotland. This approach to modelling migration is similar to the one adopted by PWC in their study of the impact of migrants on London, its workforce and its economy.⁵²

The Scottish Government CGE model has previously been used to model a wide range of economic policies and variations of this model have also been used in similar analyses by academic institutions. A general description of the model is available on the Scottish Government website.⁵³

Findings

The key findings are:

- ★ On average each additional EU citizen working in Scotland contributes a further £34,400 in GDP
- ★ The total contribution by EU citizens working in Scotland is approximately £4.42 billion per year
- ★ On average each additional EU citizen working in Scotland contributes £10,400 in government revenue.

Discussion

Our findings are in line with previous research which finds that migration contributes positively to regional economies. The model, however, does not consider complementarities in skills between migrants and native born workers, nor does it account for the positive effects on innovation, productivity and entrepreneurship stemming from migration. Our results, therefore, are likely to understate the full positive impact of EU citizens in the Scottish economy.

51 The Contribution of EEA Citizens to Scotland: the Scottish Government's Response to the Migration Advisory Committee Call for [Evidence](#) on the Role of EEA Workers in the UK Labour Market - Evidence Annex

52 The modelling approach is the same as that adopted by PWC (2017) *Facing the facts: The impact of migrants on London, its workforce and its economy*

53 A brief description of the Scottish Government CGE model can be found here: <http://www.gov.scot/Topics/Economy/Publications/Introduction-to-CGE-modelling>

133. EU citizens are making a positive contribution across Scotland. They are working in our public services; meeting the skills gaps in our industries, and working as seasonal workers in key sectors. We know that 77% of EU citizens are in employment compared with an overall rate for Scotland of 73% and EU citizens account for over 5% of all employment in Scotland. Rural areas are also more reliant on EEA workers.⁵⁴ Free movement has been essential, with skilled and unskilled labour fulfilling diverse needs across our economy. Adopting a sectoral approach which prioritises the needs of certain sectors but ignores the needs of others will not address this issue. In addition, increasing recruitment in one sector will reduce the pool of potential candidates for other sectors. We need to view solutions in relation to the whole workforce.

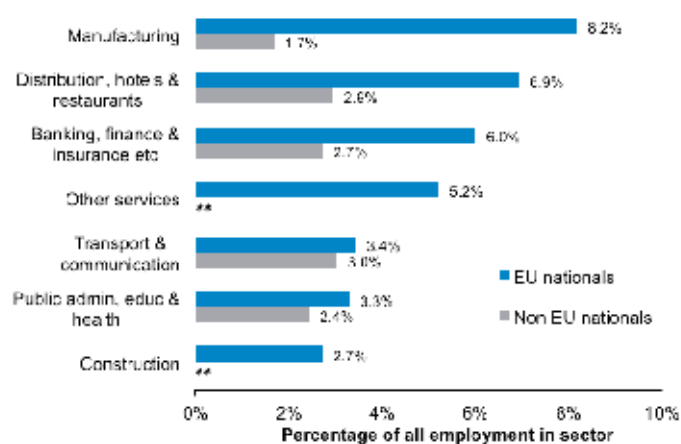
IT IS ESTIMATED THAT ON AVERAGE, EACH ADDITIONAL EU CITIZEN WORKING IN SCOTLAND CONTRIBUTES £10,400 IN TAX TO PAY FOR THE NHS AND OTHER PUBLIC SERVICES.



134. Key sectors of our economy are particularly dependent on the contribution of EU citizens. Distribution, hotels and restaurants and manufacturing are sectors heavily reliant on EU workers: over 30,000 EU citizens are employed in distribution, hotels and restaurants in Scotland, and EU citizens make up over 7% of employees in the manufacturing sector. However, employers in Scotland across all parts of the public and private sector rely on the contribution of EU citizens. EU citizens are also key to our international competitiveness, and make up a significant proportion of employment in sectors which are large exporters within Scotland, such as in the food processing and manufacturing sector as well as in wholesale and retail.

135. EU citizens make a vital contribution to the public sector in Scotland, including in NHSScotland where they fill skilled vacancies in hard-to-recruit specialisms and geographical regions. Many EU citizens work in social care, in roles that may be low-skilled or relatively low paid and so would likely fall below the thresholds in the non-immigration system.

Chart 7 – Non-UK EU and non-EU nationals share of sector employment in Scotland, 2016



Source: Annual Population Survey, Jan – Dec 2016⁵⁵, Office for National Statistics

**Estimates are suppressed as they are not considered reliable estimates for use

136. The Annual Population Survey does not record seasonal workers but these workers play a crucial role in our agricultural sector. Our soft fruit and vegetable sectors as well as the fish processing sectors are highly dependent on seasonal EU labour. These jobs and the people employed within them play an important role in our rural communities. While almost half of all EU citizens are resident in the cities of Aberdeen, Edinburgh and Glasgow, there are people born in the EEA living in every local authority in Scotland (see chart 8).

⁵⁴ Potential Implications for Rural Scotland from the UK leaving the EU. Interim Report by the National Council of Advisers, November 2017

⁵⁵ Note: Agriculture & fishing and Energy & water sectors have been excluded for disclosure reasons.

137. The importance of migration in meeting Scotland's demographic and economic needs is felt in particular in our rural communities, where the positive contribution made by EU workers, and their families, can be especially significant. It is difficult to estimate the number of EU workers in rural Scotland, because many are seasonal workers and highly mobile. However, at the time of the census in March 2011, more than 42,000 migrants were living in rural locations, with up to a further estimated 22,000 seasonal workers in summer and autumn.⁵⁶
138. Approximately one third of Scotland's small and medium-sized enterprises are based in rural areas, with some 51,000 businesses operating in a diverse range of sectors including agriculture and forestry, tourism, the manufacture of high-tech niche products and creative services. Low unemployment in rural areas means workers often need to be sourced from outwith the local area, driving the need for migrant workers. Data from the Federation of Small Businesses found that a quarter of small businesses in Scotland employ EU citizens, with that figure rising significantly in rural areas: 41% of small businesses in the Highlands and Islands, for instance, employ EU citizens. Many rural employers are reliant on unfettered access to workers from Europe in order to meet their current and future labour needs, and would be disproportionately disadvantaged by any restrictions on free movement of people.
139. However, EU citizens should not be seen as just workers. Their contribution to the communities in which they live, and to wider Scottish society and culture is significant and must also be recognised. EU citizens are not just colleagues and co-workers they are also friends and in many cases family – people who have chosen to build a future in Scotland and to bring their families up here and become part of the communities within which they live and work.
140. Freedom of movement within the EU enriches Scotland's culture. Artists from around the EU are able to bring their work to Scotland and EU citizens can travel freely to Scotland to experience our unique culture and world-leading festivals. Creative industries have been the fastest growing sector of the UK economy over the last two decades and it is important that Scotland's cultural and creative industries companies are able to recruit the talent and skills that they need from as wide a pool as possible. This allows our homegrown talent to seize opportunities and gain new skills and perspectives from working across the EU.
141. Within Scotland, there are specific challenges faced by many of our rural and island communities. Population growth is uneven across communities. Many local authority areas, particularly those which include Scotland's islands, are expected to experience population decline over the next 25 years. This pattern of distribution, and the depopulation trends in remote and rural areas means that the value of migrants to these areas is more than the skills they bring to gaps in the labour market; their presence in rural areas makes a contribution to the demographic and economic sustainability of rural and remote areas, which is critical for these communities to survive and thrive.
142. EU citizens are making a positive contribution across the economy in urban and in rural Scotland; as employees and as entrepreneurs they provide employment within our communities. Free movement also allows Scots to easily live and work in Europe allowing people to build the skills, gain experience and develop the networks to support Scottish business. They may choose to settle permanently or to bring those skills and experiences back to Scotland.

⁵⁶ Annual Census of Agriculture, RESAS, June 2017 <http://www.gov.scot/Topics/Statistics/Browse/Agriculture-Fisheries/PubFinalResultsJuneCensus>

Future Policy

143. Scotland is a progressive outward-looking nation. We recognise that migration strengthens our society and that our nation benefits from the skills, the experience and the expertise of those people from other EU countries who have chosen to live, work and study in Scotland. In some rural areas the presence of EU citizens is a crucial factor in maintaining key services, like schools. We value the contribution of those EU citizens who have chosen to make Scotland their home – people who have brought their families with them or who have chosen to start their families in Scotland; children who have never lived anywhere other than Scotland. These individuals are part of our communities, yet at the moment many of them are feeling uncertain and worried about their future. They need clarity about their future rights and what Brexit will mean for them and for their families. EU citizens who came to the UK with their families, and who have built lives here on the basis of an expectation of ongoing EU law rights, should not find that those rights have been diluted.
144. Attracting skilled migrants is key to Scotland's future economic growth and to mitigating the demographic pressures arising as a result of Scotland's ageing population. Scotland has distinctive needs, and the Scottish Government has set out Scotland's particular needs in response to the Migration Advisory Committee's call for evidence.
145. What is now required is a migration policy that reflects those distinct needs. There is a growing consensus that different parts of the UK should be empowered to develop their own solutions to migration. The House of Lords Committee on the EU, and the All-Party Parliamentary Group on Social Integration, have both published reports recommending that UK Ministers should devolve substantive immigration powers to the constituent nations of the UK.
146. Our Programme for Government⁵⁷ included a commitment to publish a series of evidence-based discussion papers setting out the case for further extending the powers of the Scottish Parliament in a number of key areas including in relation to immigration. The Scottish Government will publish a paper setting out why it is vital to our economy to be able to attract talent from across Europe and the world; why the current UK Government policy is so harmful to Scotland's interests; and how a more flexible and tailored approach to immigration with more autonomy for the Scottish Parliament could operate.
147. Scottish Ministers' position, set out in *Scotland's Place in Europe* and reinforced in this paper, is that Scotland's best interests are served by continued membership of the European Single Market, and continuing to benefit from free movement of people. The case for immigration policy to be devolved to the Scottish Parliament is strong, even with the outcome of continued European Single Market membership. However, it becomes critical for Scotland to have an immigration system that works for our interests in the event that the UK Government chooses to leave the European Single Market against our will.

⁵⁷ <http://www.gov.scot/Publications/2017/09/8468>



Conclusion

148. In *Scotland's Place in Europe* (published over a year ago) we demonstrated the significant, and lasting, economic and social damage Brexit would bring to Scotland. We argued that while the UK-wide result of the EU referendum provided the Prime Minister with a mandate to take the UK out of the EU, it did not provide the authority to take the UK out of the European Single Market. In the intervening 12 months an increasing body of opinion and evidence shows that the UK Government's pursuit of its present negotiating red lines (of which require it to leave the European Single Market and Customs Union), is set to inflict considerable harm on the economy and on the prosperity of Scotland and the United Kingdom.
149. Although there are confusing messages about the type of future relationship the UK Government will seek to conclude with the EU. It is in essence those red lines which will determine the nature of the outcome unless the Prime Minister softens her stance on issues including migration and the future role of the Court of Justice of the European Union (or another equivalent court) the UK's future relationship with the EU is unlikely to be significantly better than the EU-Canada deal.
150. The evidence presented here reinforces the conclusions we reported in December 2016: that Scotland and the UK should remain within the European Single Market and Customs Union. We have provided new evidence of the substantial costs resulting from lower economic growth and lower business investment opportunities in Scotland and the UK that will result from leaving a market in excess of 500 million. Scotland's GDP could be as much as 8.5% (or £12.7 billion) lower by 2030 and business investment in Scotland could fall by up to 10.2% by 2030, compared to continued EU membership. We also explained the range of significant benefits of remaining within the European Single Market and Customs Union that extend well beyond trade, to incorporate wider social, economic and environmental considerations.
151. Despite the UK Government's optimistic rhetoric regarding our future trading relationship with the EU, the evidence presented in this paper demonstrates there is simply no alternative to continued Single Market membership that will secure the economic benefits we presently enjoy as a member of this huge and highly integrated market. The conclusions from our analysis show the clear difference between the model we propose – being part of the EEA – and a free trade agreement such as that concluded with Canada.⁵⁸ There is no other credible outcome able to deliver the guaranteed market access, shared regulation and consumer protection that Scotland and the UK needs, and from which we have increasingly benefitted since joining the EU in 1973.
152. The threats to jobs posed by Brexit are very real. Global investment has come to Scotland and the rest of the UK to take advantage of our membership of the European Single Market and Customs Union to serve integrated EU supply chains. A range of financial services from banking and insurance to legal have flourished with the easy access across that Single Market. Companies from across the globe have set up European headquarters in the UK and are having to re-think their business models if the UK leaves the European Single Market and Customs Union.
153. The risks to our research and development capability are significant. The Annual Attractiveness Survey (May 2017)⁵⁹, reported that during 2016 Scotland attracted more research and development (R&D) inward investment projects than any other UK region, including London. Many of these projects were planned pre-EU referendum. Such long term, high value R&D investment from countries like the USA, Australia and across the countries of Scandinavia, have been attracted by the strengths and capabilities of our universities and their ability to collaborate with and attract research talent from across the EU, underpinned by freedom of movement.

⁵⁸ <http://ec.europa.eu/trade/policy/in-focus/ceta/>

⁵⁹ <http://www.ey.com/uk/en/issues/business-environment/ey-uk-attractiveness-survey-2017-scotland>

154. The imposition of new tariff and crucially non-tariff obstacles to trade with our most important market, will curtail our exports, drive up consumer prices and result in lost opportunities, fewer jobs, lower incomes and weaker growth. We have also shown that these are not one-off costs. As the European Single Market continues to develop, Scotland and the UK will lose out on exciting new opportunities to collaborate as part of a growing European Single Market .
155. Remaining within the Single Market and Customs Union would secure continued involvement in a wide range of common EU policies – including those designed to protect workers’ rights and our environment. These policies would enhance our research and innovation base, promote collective action against climate change, promote wider social justice, and enable much easier EU-wide cooperation under the EU justice and home affairs agenda.
156. We have also shown the benefits of free movement of people to Scotland’s labour market and the buoyant and sustainable growth of our population which is dependent on inward migration. We are seeking to change the narrative around migration and demonstrate the value it has to Scotland and the UK by detailing evidence of the role EU citizens play in the viability of key sectors of our economy, manufacturing, services and, crucially the delivery of vital public services.
157. The evidence also reveals the vital contribution made by these citizens in tackling Scotland’s demographic challenge. Our economy and society, now, and in the future will be much poorer if the UK Government insists on restricting the free movement of people between Scotland and the countries of the EU. This is why the Scottish Government is committed to securing for the Scottish Parliament the ability to design and implement a distinct Scottish immigration policy which meets the needs of our country.
158. The conclusion from our analysis is clear: Membership of the European Single Market and Customs Union have delivered significant benefits to our country for more than 40 years. Remaining within both arrangements is essential if we are to secure Scotland’s future economic prospects and the long term prosperity of our citizens. The UK Government must speedily bring to an end the confusion and uncertainty arising from their lack of any clear strategy for our future relationship with the EU. Time is rapidly running out before we reach the point at which the UK will leave the EU.
159. Membership of the European Single Market must be the foundation of our future relationship with the EU if continued EU membership is not presently possible. That can best be secured through UK membership of the European Economic Area Agreement alongside Norway, Iceland and Liechtenstein.
160. Making our businesses less open to Europe will not make our businesses more successful in global markets. We will lose the same favourable access to the EU’s existing FTAs and will also cut ourselves off from future deals with the likes of Japan, Mercosur (South America’s leading trading bloc) and Switzerland. The size and integration of the European Single Market is a huge attraction for companies wishing to locate in the UK. The time and resource required to negotiate new trading agreements across the globe will be immense. We should not delude ourselves that some of the most prized markets will offer the same or better terms than with the much larger EU.⁶⁰ Recent evidence would suggest a greater level of protectionism taking hold globally – some of the biggest nations will drive a hard bargain and these deals could take many years. Moreover, we will be under constant pressure to lower rights and standards in areas such as employment and environment.

60 See, for example, the following <https://www.theguardian.com/commentisfree/2017/nov/19/wishful-brexith-thinking-will-not-create-jobs-or-fund-public-services>
<https://www.theguardian.com/politics/2017/nov/19/hard-brexith-highly-damaging-says-former-top-civil-servant-martin-donnely>

161. The Scottish Government has welcomed the Prime Minister's commitment to negotiate a transitional, or "implementation", period although we continue to seek greater clarity on what precisely the UK Government will be seeking to agree with our EU partners in terms both of the scope and the duration of such an agreement. We believe a transitional agreement must represent a steady state continuation of the current relationship – that is, an agreement that not only ensures we remain fully compliant with the rules and regulations of the European Single Market – the *acquis* – but that also permits the UK to remain within the framework of the EU Customs Union.
162. The coming 12 months of negotiations between the UK and the EU will be a decisive period in our history. The Scottish Government will continue to represent Scotland's vital economic, environmental and social interests. This report clearly outlines threats to these interests and how they can be protected, and it will be on the basis of this evidence we will continue to engage with the UK Government.
163. Our engagement is currently mediated through the Joint Ministerial Council on European Negotiations – JMC(EN) – which has a remit to ensure there is agreement on UK policy ahead of negotiating positions being finalised. We are clear that the JMC(EN) must play an active role ahead of the negotiations on the future framework, that we must be involved in discussions of the options available to the UK in establishing that framework, and we must be part of the negotiation process as it unfolds.
164. We explained in *Scotland's Place in Europe* in 2016 that participating in the EEA as a means of securing and enhancing benefits to Scotland was neither the ideal scenario nor straightforward to achieve. This remains the case. But an overwhelming bank of evidence now suggests that there is no credible alternative that comes close to protecting our collective interests in view of the situation we are now in.
165. We will continue to reach out and engage with businesses, with organisations, with other administrations and with individuals throughout Scotland, the UK and in Europe to enhance our evidence and to build alliances to influence opinion. We will also continue to work constructively with the Scottish Parliament and its committees. We hope the propositions set out in this paper will find broad support across the political spectrum. Our goal is straightforward – to give Scotland the best chance of limiting the serious damage to jobs and prosperity that will result from a reckless and hard Brexit and to put Scotland in the best possible position to benefit from the continued evolution of the European Single Market, either through continued UK membership, or by Scottish membership.

Technical Annex

Assumptions underpinning the analysis

- ★ **Trade:** Assumptions for all scenarios are drawn from Ebell & Warren, 2016, covering the literature around the impact of leaving the EU. The results are drawn from the gravity model literature reflecting the impact from factors including reduced market access, higher non-tariff barriers, being outside the Customs Union, and other trade frictions.
- ★ **Tariff:** The assumption follows Ebell, Hurst & Warren, 2016 in assuming a 5% tariff on trade with EU countries for the WTO scenario. This is lower than the baseline World Trade Organisation, Most Favoured Nation (MFN) tariff, but reflects the possibility of some potential negotiation with the EU.
- ★ **FDI:** Assumptions draw from the work of (Ramasamy & Yeung, 2010) and (H.M. Treasury, 2016) covering the negative impact on FDI from a range of trade scenarios. This is then modelled as a calibrated reduction in private sector investment in line with the work of Ebell, Hurst & Warren, 2016.
- ★ **Repatriation of EU Budget:** Based on Ebell, Hurst & Warren, 2016. Data from GERS 2016, which details the net contributions both UK and Scotland make to the EU budget. This is equivalent to around 0.3% of GDP.
- ★ **Productivity:** Based on work from (H.M.Treasury 2016) and (OECD, 2016) on the impact of a reduction in trade openness on levels of productivity. This assumes that any impact on Scotland would be equivalent to that seen for the UK as a whole.
- ★ **Migration:** Based on OBR analysis. Assumes that the Scottish and UK populations grow in line with the ONS “High Migration” projections for any scenario involving free movement of labour (e.g. EEA) and the “Principal Migration” projection under an FTA and WTO scenario. The shock applied to an FTA and WTO scenario is then the percentage difference between both projections over time.

Summary of modeling assumptions

Shock	EEA	FTA	WTO
Reduction in export market share in the EU	-23%	-29%	-50%
Increase in tariffs on trade with the EU	0%	0%	5%
Productivity	-2.4%	-3.5%	-5%
Reduction in inward FDI flows and Investment	-10% FDI (-1.5% private investment)	-17.5% FDI (-2.6% private investment)	-24% FDI (-3.5% private investment)
Population	No change	-2% UK / -2.8% Scotland	-2% UK / -2.8% Scotland
EU budget savings, % of GDP	No change	0.30%	0.30%

Comparisons to other studies

The results in this paper are for Scotland. To compare the analysis to other institutions, the table below presents the UK results from the Scottish Government model alongside the results of similar studies.

While there are differences in the results, reflecting different assumptions and models used, the Scottish Government analysis is broadly in line with other studies.

Comparison of modelling results with other studies

	OECD	HM Treasury	WTO NEISR	FAI	Scot Gov
UK GDP, % Change from base	-7.7%	-5.4% to -9.5%	-7.8%	-7.9% to -8.1%	-9.4%
Assumptions					
Reduced Trade with EU	✓	✓	✓	✓	✓
Productivity Losses from Reduction in Trade	✓	✓	✓		✓
Reduction in FDI	✓	✓	✓	✓	✓
Productivity Losses from reduced FDI	✓	✓	✓		✓
Change in Migration	✓			✓	✓
Lower or zero contributions to the EU budget	✓	✓	✓	✓	✓
Model		NiGEM		CGE	SGGEM



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