

POLICY PAPER

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# Scotland's Brexit Choices

Kirsty Hughes

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The Article 50 clock is ticking, but talks are not likely to start until the end of May or early June. The two year deadline to conclude exit talks means, barring a change of heart, the UK will be out of the EU by March 2019 but with most of its future EU-UK trade deal still to negotiate.

First Minister, Nicola Sturgeon has asked for a second independence referendum, and a Section 30 order, so that Scottish voters can have a choice on independence or not before the UK finally leaves the EU. Theresa May has said, for now, she won't go along with that. However this political stand-off develops or is resolved, Scotland will have to make its Brexit choices amidst considerable uncertainty – unless it gets no choice, with May turning 'no, not now' into 'no, never'.

If Sturgeon and May resolved their disagreement so that a second independence referendum could be held by March 2019, what might Scottish voters know by then, and what will still be uncertain?

## Section One: What will we know on the UK-EU27 deal?

### **(1) No Deal and a WTO Cliff**

We will know by March 2019 if EU27-UK exit talks have broken down. If the European Parliament or Westminster failed to ratify the deal – or no deal was struck – there would surely be a major political crisis and debate across the UK about what to do next. Article 50 is clear that if there is no deal, the departing member state simply leaves. World Trade Organisation (WTO) tariffs would come in overnight at the end of March 2019 and there would be legal and economic uncertainty, if not chaos, alongside the political crisis.

Of course, there might then be some sort of political fudge to deal with the immediate fall-out of the crisis, perhaps the UK would make a dash for temporary European Economic Area (EEA) membership alongside Norway but it would still be outside the EU's customs union.

If they were voting in March 2019, Scottish voters would know whether the WTO cliff had been avoided or was upon us. Of course, if the UK and EU27 strike an exit deal but eventually fail to strike a trade and security deal, the WTO cliff could return some years later, so that would remain a future uncertainty.

Amidst a 'WTO cliff' economic and political crisis, there would surely be demands by some to postpone the independence referendum while the crisis was resolved (possibly even resolved by the UK staying in the EU after all –unlikely though that prospect looks for now). Others, on the pro-independence side, would equally be likely to argue that the 'WTO cliff' crisis was all the more reason to continue with the referendum and vote 'yes'.

### **(2) An Exit Deal Successfully Ratified – UK out of the EU**

If, as is most likely, the UK and EU27 agree and ratify a divorce deal within the two year timetable, then the details of that will be clear by March 2019. Indeed, it is anticipated that the exit deal will be done by October/November 2018 to allow time for ratification. It is likely to cover three main areas:

***(i) The immediate exit deal***

An exit deal will include an agreement on the future rights of EU citizens already resident in the UK, and UK citizens in the EU. There will be a deal on the UK paying to cover its budget liabilities. There will be a first deal on the Ireland/Northern Ireland border which is likely to respect the existing Common Travel Area and not impede or require checks on people crossing the border but that will be more complex in how goods traffic is dealt with. This is likely to be a first rather than final deal since it is likely to need revisiting once a future UK-EU27 trade deal is finalised in terms of how goods and services are dealt with.

***(ii) Outline of future trade deal goals***

There will be an outline of, or a set of agreed goals for, a future UK-EU27 trade and security deal. This will doubtless set out the aim of tariff-free trade on goods (and possibly agriculture). It will set out some broad aims on how to deal with regulatory divergence across different sectors (from banking to cars to medical services to drugs and more) and broader agreements on employment, social and environmental standards to avoid the UK going down a 'Singapore' route while having good access to EU markets. It is also likely to set out in broad terms how the EU27 and UK anticipate dealing with disputes and supervision of the deal, especially on differences in regulation.

The outline of the future trade deal will probably also set out how future customs procedures between the two should operate. Outside the EU's customs union, the UK will certainly, like Norway, have to complete 'rules of origin' certification for third country goods going to the EU via the UK (which may have paid different tariffs). And there will need to be other certification and bureaucratic processes (that Norway in the EU single market doesn't face) to cover and check product standards and other regulatory specifications. Services, in particular, may face new barriers that they don't face now – with the loss of 'passporting' in financial services widely anticipated, though just one example of the likely additional frictions there will be in services trade.

So there will be a broad, but not detailed, view of the likely non-tariff barriers, customs procedures and bureaucracy that could result from the future trade deal. There will be much dispute over the likely economic impacts of the outline trade deal – both in the context of a Scottish independence referendum but also more widely across the UK. These arguments will run and run – even in a decade or two, with hindsight, how UK trade and foreign direct investment would have evolved inside the EU compared to its Brexit path will be hotly debated.

***(iii) A transition phase***

The exit deal should, if successful, also set out a transition phase to run as soon as the UK leaves in March 2019. It will set out the basis on which the EU27 and UK will trade while they negotiate their final trade deal. It will set out interim customs arrangements and the time period over which these will be phased in. It will set out arrangements on migration policy and whether free movement of people will continue at all (at the start of the transition) or not.

The transition phase may also show which of the EU's 34 regulatory agencies the UK will remain part of – whether during the transition or permanently (with some sort of

associate status, if the EU agrees). It is also likely to indicate which EU programmes the UK is going to stay in temporarily and permanently (such as the research and education programmes, Horizon 2020 and Erasmus).

The transition phase will be time-limited. The EU27 and the European Parliament have been very clear that transition must not be open-ended not least as it may allow the UK an interim set-up that is more favourable than a final deal (though the EU27 will surely guard against that). There will be some sort of deal on the role of the European Court of Justice (ECJ) during the transition phase. If the UK retains access to the single market in the first year or two of transition, or to the EU's customs union, then the EU27 will insist on full jurisdiction for the ECJ.

Overall, the details on the transition phase should make clear the extent to which, and how quickly, the UK will lose its current full access to the EU's single market.

### **Debate on the Exit Deal in the Context of an Independence Referendum**

For Scottish voters, making their choice on independence, they will be faced with competing claims from politicians and experts as to how good or bad the exit deal is, and what the implications of the final trade deal may be, given its agreed outline goals – and how damaging or not to trade and foreign direct investment compared to being inside the EU. There will also be arguments about how long it will take to negotiate the future trade deal (anything from 3-7 years plus two years for ratification looks likely) and the degree of risk there is that the future trade deal will fail to be agreed or to be ratified.

Whether there will be much debate over the crucial question of the UK's likely weaker foreign and security policy relationships with the EU, its loss of influence over EU decisions, and its retreat from solidarity is an open question. The focus so far in most of the Brexit debate, in Scotland and the UK, on trade and economic implications suggests possibly not. This will also surely depend, though, on whether Nicola Sturgeon goes for an EEA or EU offer when she sets out her independence plan.

The details of the transition phase will also feed in significant ways into independence debates. If Scotland were to vote 'yes' in March 2019 to independence, it would take at least 18 months or longer to become independent. Arguments about whether and how fast an independent Scotland could re-join the EU or join the EEA would be strongly linked to the nature of the UK's transition phase out of the EU and how quickly or slowly the UK was about to diverge from the EU and its single market.

If the UK is set to disengage from the EU quickly during its transition phase, that will add hurdles and time to Scotland re-joining the EEA compared to a less disruptive transition phase. Even though the Great Repeal Bill is intended to bring EU laws into UK law, this will be a very complex process, and if the UK establishes its own regulatory agencies and starts to change EU laws before Scotland were to go independent, any return to EU rules by Scotland would take longer.

The European Parliament's Brexit resolution states that the UK's transition phase should be no longer than three years in total. But it may turn out to be longer than this (perhaps four to five years) although it seems politically infeasible from both sides (UK and EU27) that the UK would stay in the single market and customs union for more than

the first couple of years of transition, even if there are other policies and arrangements phased in for a longer period after that.

Overall, by early 2019, there will be substantial information available on the UK's exit deal (if there is one) including the transition phase and the outline of the proposed future UK-EU27 trade deal. There will be much to debate over the implications of that exit deal and outline trade and security deal in an independence referendum campaign held in early 2019. The debate is likely to focus in particular on the transition phase and the outline future trade deal and how both could impact on Scotland if it did decide to become independent.

## Section Two: Scotland in the EU or EEA – or in neither?

If a referendum campaign was running in early 2019, then the 'yes' side would surely have clarified whether it was aiming for Scotland, as an independent state, to re-join the EU as swiftly as possible, or to re-join the EEA (as a transition to, or instead of, the EU). While some on the pro-independence side reject both options, the challenges of negotiating a Scotland-EU trade deal as a third country would be considerable and are not likely to form part of the SNP independence programme. The risks of ending up outside both, and so of having to negotiate such a deal, would though be likely to be emphasised on the pro-UK side and so would form part of the debate.

What would we know about these options – EU, EEA or a separate Scotland-EU trade deal – for an independent Scotland in early 2019?

### (1) Scotland in the European Economic Area

If the SNP were arguing for Scotland to join the EEA on independence, then there would be substantial debate on the implications of this during an independence referendum.

There would be issues around how quickly Scotland could join the EEA as an independent state. And there would, surely, be discussion of how much the EEA option differed from the outline aims of the future UK-EU27 trade deal, whether it offered better access to the EU than that trade deal (which is very likely) and what its impact would be on the Scotland/England border if Scotland were independent (where the first deal done on the Ireland/Northern Ireland border would certainly be very relevant).

The pro-independence side would doubtless emphasise the benefits of remaining within the EU's single market while the pro-UK side would emphasise the differences in regulatory structures that could impede Scotland's trade with the rest of the UK (rUK) and create non-tariff barriers in trade between rUK and Scotland.

The pro-independence side would, presumably, have made clear whether the EEA was an end goal or a transition to future EU membership. There are a number of issues, and potential challenges, that could come up here.

If the EEA is a transition to EU membership, and that goal is set out clearly and raised with the European Commission and EU27, then the EU will have their own views on how Scotland, as a candidate country for membership could best transition to the EU. This may well not be via the EEA – the normal route is for accession countries to have a specific Association Agreement with the EU.

Timing issues would also be relevant here and surely the subject of some debate. To join the EEA, a European state must first be in either the EU or EFTA (the European Free Trade Association – whose members are Norway, Iceland, Liechtenstein and Switzerland). So Scotland would first need to get agreement of the EFTA Council<sup>1</sup> to join EFTA and then it would need agreement of all the states in the EEA Council<sup>2</sup> – the three EEA/EFTA states (since Switzerland is not in the EEA) and the 27 EU states – to join the EEA. These states would then need to ratify the agreement.

This process could take one or more years depending both on how long ratification processes take, and on the time Scotland would need to meet all single market laws again if it had in the meantime diverged from those. Given these issues, whether the EEA option therefore makes sense as a transition to the EU is clearly debatable – and these issues would be likely to be aired in an independence referendum debate.

The EEA route would also mean Scotland leaving many EU regulatory agencies, and unwinding a number of laws (especially in the justice and home affairs area). Norway is in only about a dozen of the EU's 34 regulatory agencies so Scotland would be moving away from the EU only to re-join agencies and regulatory systems later, if the EEA is only a transition route. It would also have to consider how to develop its own regulatory system where it is not part still of EU regulatory agencies despite being in the EEA.

The EEA has other pluses and minuses which would doubtless be much debated. EU member states like Ireland and Sweden are part of the decision-making and law-making process in the EU. Norway, Iceland and Liechtenstein essentially are rule-takers – a less than democratic position to be in. But they are not in the EU's agriculture and fisheries policies (which would have potential costs and benefits for Scotland), nor in the euro.

In the EEA, Scotland would be part of the EU's four freedoms including free movement of people. There would be arguments over whether Scotland would remain part of the Common Travel Area and how that would fit with rUK having its own migration policy – as well as debate over whatever deal had been struck to avoid a hard border between Ireland and Northern Ireland and its applicability to Scotland.

If Scotland were independent in the EEA, it would relate to the EU as Norway does today. It would not be in the EU's customs union, and so there would be customs procedures around 'rules of origin' for exports to the EU but it would otherwise be fully in the EU single market (but not in agriculture and fisheries policy).

But there is another issue here. Once the UK is a third country outside the EU, then Norway, Iceland and Liechtenstein will need to do separate, new trade deals with the UK (probably bilateral ones rather than an EFTA deal including Switzerland) since they will not be covered by the UK-EU27 deal. And these deals couldn't be done until after March 2019 when the UK is a third country (and perhaps not finalised until after the UK-EU27 deal is done). Scotland in the EEA would also need to strike a new trade deal with rUK and that would also come up in the referendum debate. That new trade deal would have to be consistent with Scotland meeting, and protecting, the EU's single market rules in Scotland as part of the EEA.

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<sup>1</sup> As set out in Article 56 of the EFTA Convention

<sup>2</sup> Article 128 of the EEA Agreement

Overall, there would be many similarities in the independence debate whether the pro-independence side offered the EEA or EU route – on timing issues and on the political and economic impacts on relations with rUK, given its exit deal with the EU27 – but also some significant differences as discussed next.

### **(2) Scotland in the EU**

If the SNP made clear that their goal was independence in the EU, then there would be debate during the referendum campaign about how easy or difficult that would be, how fast or slow it could be, and the impacts on rUK-Scotland relations.

The issues would in part depend on the nature of the UK's transition phase out of the UK and how fast it diverged from EU rules (while Scotland was still within the UK). There would also be debate around whether Scotland would have to commit to eventually joining the euro, be a full part of justice and home affairs, and make a budget contribution without the UK rebate. Scotland's future macroeconomic position, including its likely deficit, would come up more widely in the independence debate but also in terms of EU rules on deficits.

There would be debate about the advantages of having a seat at the EU's top table and a say in decisions (economic, political and foreign policy) – and how much say a small country really gets in the EU.

With a much more positive attitude to Scotland amongst the EU27 than in 2014, the arguments for Scotland re-joining the EU fairly swiftly would be fairly strong<sup>3</sup> but would certainly be contested<sup>4</sup>. Spain has recently indicated it would not veto Scotland joining the EU if it voted for independence. But politics can change, and Spain's position, or how fast the EU27 would move may change as EU politics moves on in the coming years. Even so, Scotland re-joining the EU would be likely to look feasible still in early 2019. The big issues would surely be the likely terms of that accession and its impact on Scotland's political and economic future and its future relationship with the rest of the UK.

With the UK's transition phase out of the EU clear, Scotland's future relations with the UK, if it was in the EU, would be determined by the future UK-EU27 trade deal – of which the outline/goals would be known (but not whether it was going to definitely succeed). Given the expectation that any future UK-EU27 trade deal will introduce some new barriers to trade – though probably new non-tariff barriers rather than tariff barriers – then the anti-independence side will surely emphasise how independence in the EU would introduce non-tariff barriers to rUK-Scotland trade (whether literally dealt with at the Scotland/England border or, more likely, dealt with in customs and bureaucratic processes elsewhere).

But there are likely to be various ironies and contradictions here since the Conservative government in March 2019 would be hailing the exit deal and the goals for the future UK-EU27 trade deal, and saying how smooth that will make trade between the UK and EU, while at the same time arguing that Scottish independence in the EU will create rUK-

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<sup>3</sup> Kirsty Hughes and Tobias Lock (2017) "An Independent Scotland and the EU: What Route to Membership?" *European Futures* 20<sup>th</sup> February

<sup>4</sup> Ian Duncan (2017) "It does not stack up that Scotland could easily join EU after a Yes vote" *The Herald* 21<sup>st</sup> February

Scotland barriers. Meanwhile the pro-independence side will present arguments as to how such barriers could be avoided (the Scottish government paper 'Scotland's Place in Europe' suggested drawing on the Liechtenstein-Switzerland example for instance<sup>5</sup>) – while nonetheless criticising the UK-EU27 deal.

What is indisputable is that, as with the Ireland/Northern Ireland border, the Scotland/England border would become an external border of the EU in this scenario. And, despite the many contradictions across the arguments for and against staying in the EU and in the UK, the likelihood of some barriers, and their impact on rUK-Scotland trade and border management, will surely be a substantial issue for debate.

Scottish voters would also know, in this option, if the Scottish government was proposing or not a referendum on future EU membership once membership terms had been agreed. This is possibly an attractive route for Nicola Sturgeon (if she does choose the EU not EEA option) since it may provide a way of keeping the support of 'yes' voters who also voted 'leave' in the EU referendum. However, in the face of referendum fatigue, it may not go down well more broadly across Scottish voters.

Overall, the implications of Scotland becoming an independent member state in the EU would be a major issue of debate in a referendum campaign including how it related to the UK's anticipated UK-EU27 trade and wider security deal.

### **(3) Scotland outside the EU and EEA**

A substantial minority of pro-independence supporters voted to leave the EU. Some of those would settle for EEA membership, others would not wish to be part of any organisation linked to the EU (as the EEA clearly is). This latter choice (neither EU nor EEA) is not a route that the SNP is expected to take as part of an independence campaign. But it is a route that some pro-independence supporters might prefer and a route that the pro-UK side may well raise as part of an argument that an independent Scotland's route to the EEA or EU may not be assured.

Voters would know, in an early 2019 referendum campaign, if any groups were suggesting this route and they would know if the pro-UK side were making this outcome a major argument in their campaign.

What sort of trade deal Scotland could negotiate with the EU27 if it rejected the EU and EEA is rather unclear. Having just set out goals for a future EU27-UK trade negotiation, the EU would not be keen to hold new talks with an independent Scotland on an entirely separate deal and might suggest that it either chooses the EU/EEA route or is part of the UK trade deal. The separate deal done with Switzerland is seen as cumbersome by the EU, and still binds Switzerland into EU freedom of movement of people and many EU regulations. It is, anyway, not likely to be on offer to an independent Scotland from the EU27 side.

The risk of ending up outside both the EU and EEA would surely be emphasised by the anti-independence side. However, while the EU would in principle stand back from the Scottish independence debate, there might be some comment (as there was in 2014) on the feasibility of Scotland's EU or EEA options (and from EEA/EFTA states too) which

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<sup>5</sup> "Scotland's Place in Europe" (2016) *Scottish Government*

would also impact on any debate over the risk of Scotland ending up in neither. In autumn 2016, the head of the European Commission's London office suggested an independent Scotland would face a normal accession process<sup>6</sup>, and such a line is likely to still be the Commission position if there is an independence referendum in two years' time.

### Conclusion: Scotland's Choices in 2019

If Scotland did hold an independence referendum in March 2019, then Scottish voters would have more information on Brexit, and on the goals for an independent Scotland vis-a-vis the EU or EEA, than they do now. But there would be some substantial uncertainty still and plenty of room for debate about the implications of the UK's Brexit deal in 2019 and of the potential impacts – positive and negative – if an independent Scotland joined the EU or EEA and the risks it might fail in such an attempt.

A final UK-EU27 trade deal would be clear, in outline, in March 2019, assuming the WTO cliff had been avoided. But a final deal might not be definite until five to ten years later. Some may argue Scotland should wait that long to have a second independence referendum – but that would be a choice for Scotland to go along with Brexit for the medium term.

If a second independence referendum is held in early 2019, then Scottish voters would know the following:

- Whether a WTO cliff has been avoided;
- The details of the exit deal, including the details and nature of the transition phase while a full UK-EU27 trade and security deal is negotiated, including any deal to ensure a soft not hard Ireland/Northern Ireland border;
- The outline goals and structure of the future UK-EU27 trade and security deal, though with no guarantee that a deal would be successfully struck and ratified.

Scottish voters would also know what the pro-independence side, in particular the SNP, was proposing in terms of future relations with the EU. They would know if the aim was:

- EU membership (as fast as possible);
- Independence first in the EEA then the EU (with the EEA as a transition – something the EU27 might not agree to);
- EEA membership for the medium term.

They would know too if the pro-UK side was going to put substantial emphasis on the risk of Scotland ending up outside both the EU and EEA.

There will be three broad areas where the UK's exit deal with the EU – covering the immediate exit deal, the transition phase, and the outline future UK-EU27 trade deal – will impact on debate in a Scottish independence referendum held in early 2019.

***Timing, speed and uncertainty:*** Timing of Scotland becoming independent, and of it joining the EU or EEA, and how that relates to the UK's own transition phase out of the EU will be one area of debate. If the UK's transition phase includes a year or two when

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<sup>6</sup> "‘No reason’ independent Scotland would fail to join EU" (2017) *The Herald* 11<sup>th</sup> February

the UK maintains access to the EU's single market and/or customs union, Scotland's own transition could potentially be smoother than if the UK's transition involves moving more sharply away from the EU. How quickly Scotland could re-join the EU or EEA will depend, in part, on whether it has diverged from EU and single market laws and regulations, and on how quickly Scotland can set up relevant regulatory and institutional structures.

***Economic impacts:*** The impacts of Scotland being independent in the EU or EEA while the UK has a third country trade deal with the EU – the goals of which are known – is likely to be a major focus of debate. This will include debate over border issues and over the economic costs and benefits of Scotland remaining either fully part of the EU, or part of the single market (EEA). The larger scale of rUK-Scotland trade compared to Scotland-EU trade is already part of the debate in Scotland. This will doubtless be compared to the costs and benefits of being part of the EU's free movement of people, part of its trade deals with third countries round the world (and how fast the UK could replicate those), and having unfettered access to the EU's single market compared to unfettered access to the UK's market.

What non-tariff barriers there may be between Scotland and rUK will be contested strongly from both sides. Part of this will be debate over how smooth future UK-EU27 trade will be, with how many and what sort of non-tariff, regulatory and customs barriers. Contradictions may abound in the debate. Those arguing the future UK-EU27 trade deal looks good may also warn even so about future barriers to an independent Scotland's trade with the rest of the UK. Those arguing that an independent Scotland will not face such barriers may nonetheless argue that the UK-EU27 deal looks damaging and does introduce barriers.

***Political impacts:*** The UK's exit deal will include an outline of a future UK-EU27 trade and security deal that will have elements focused on future foreign and security policy cooperation. If the pro-independence side is focused on the EEA route, then there will be debate over whether an independent Scotland would miss out on this foreign and security policy interaction with the EU27. Equally, if the pro-independence side promotes Scotland in the EU as their goal, then this would be likely to lead to a debate about the benefits of being part of EU wider foreign and security policies and whether and how much influence the UK had lost in moving to third country status.

In the end, as long as the UK and EU27 do strike an exit deal, Scottish voters would be choosing between, on the one hand, staying in the UK as part of that deal and, on the other hand, the goal of either being independent in the EU or being independent in the EEA. If the choice is between a UK-EU27 trade deal and the EEA, the debate could become a highly detailed one over the impact of these different sets of trade arrangements.

A choice between the UK-EU27 trade and security deal and independence in the EU would mean potentially a bigger set of political as well as economic arguments about the future UK-EU27 relationship and the future potential Scotland-rUK relationship.

The EU or EEA choice for an independent Scotland versus staying in the UK in the context of its future UK-EU27 deal means European issues will inevitably be of substantial importance in a future independence referendum debate. Scotland will be

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debating, and deciding, how it wants to relate to the EU and the wider world – from inside or outside the EU, independent or not.

[Dr Kirsty Hughes is Director of the Scottish Centre on European Relations](#)