

The Brexit Shambles – Charting a Path Through the Rubble: *A view from a Scottish perspective*

By Jim Gallagher

The Brexit Shambles – Charting a Path Through the Rubble: A view from a Scottish perspective

A few weeks after the shock of the Brexit vote, the time for stunned silence or hysterical overreaction is past. Governments – in London, Edinburgh and elsewhere – need to find a way through the mess which an ill-considered referendum and a notably mendacious campaign have created. In so doing they must pursue the national interest, not partisan advantage. This paper offers advice to both the UK and Scottish governments, and focuses particularly on the challenge the vote has produced to the territorial integrity of the United Kingdom.

What the vote means, and what it doesn't mean

The Leave vote is more protest than proposition, like the campaign which promoted it. The vote cannot be ignored, but it must also be understood. Support for leaving the EU was strongest among economically disadvantaged communities and poorer people. There is a striking resemblance to the Scottish independence referendum. There, long-standing nationalist support, ideologically committed to leaving the UK, was supplemented by the votes of those who thought the present economic and constitutional setup did not serve their interests and had left them behind; they thought change could make things no worse for them and were told it would make them better. Similarly, in the European referendum those with a long-standing ideological opposition to Europe were bolstered by a group of voters whose alienation from the political process and dissatisfaction with their economic situation made them receptive to a message that with one bound they would be free. Voters who think things can't get worse are not persuaded by warnings of risk. The relative proportions of voters in each case is the subject of reasonable argument, but in both a substantial share of the vote for change was a negative, dissatisfaction with the status quo - and that's what delivered the narrow Brexit majority, not endorsement of a particular plan for the UK's international status.

Not least because, as we all now know, there was no plan. The Leave camp had no specific proposition to put before the electorate. Voters did not know whether they were opting to become Norway, Canada or Australia with respect to the EU. Indeed (in echoes of the Scottish campaign) they were promised mutually inconsistent things: like retaining free trade but abandoning free movement of people. It is no accident that the two most prominent front men of the Leave campaign have walked away since the vote.

Governments must nevertheless be guided by the result. If you hold a referendum, you must expect many voters to answer the question at the front of their minds, not the one on the ballot paper. (Voters are like students who answer the question they would like to have been asked, rather than the one on the exam paper. But it's the question-setters who have failed this exam.) But still, understanding the vote has implications for how governments should proceed. First, it means Mrs May is required to adopt neither the premises or the promises

of the Leave campaign. She is under no obligation to adopt the beliefs of the Leave campaign – about, say, the economic effects of change, or how other European governments will react to the vote. Nor is she under any obligation to deliver the different promises of the various Leave actors about how leaving the EU should be pursued, what the future UK-EU relationship should be, notably in relation to freedom of movement, or the effects on public spending. The Leave vote was not the endorsement of a manifesto.

The UK government is mandated to pursue Brexit, but does not have to wear Mr. Farage's spectacles or keep Mr. Johnson's promises. Rather it has lost none of its obligations to view the world rationally and pursue the national interest. The same applies to the Scottish government, as discussed further below.

What the UK government should do

By announcing his resignation as Prime Minister, David Cameron has at least prevented immediate triggering of the formal legal process for the United Kingdom to leave the EU, the so-called Article 50 notification. Just as well. The process of Article 50, with a two year drop dead date, is designed to make it difficult for departing countries to secure their interest as against those of continuing member states. Mrs May should not be bounced either. Instead before triggering Article 50 – though it will infuriate other EU states – the UK should formulate its position and ascertain whether that position is achievable in negotiation.

In formulating its position, the government must have regard to two key aspects of the UK national interest. First and manifestly, the economic effect, notably on trade with what is Britain's largest market. The second, which has received insufficient attention at UK level as yet, is the implications of the *terms* of exit, as well as the fact of exit, for the territorial integrity of the United Kingdom. The two are closely connected, and must be considered together. By getting both wrong, the government could turn the UK into a group of impoverished, isolated statelets on the fringe of Western Europe.

The argument for the EEA

We begin with trade. Economists since David Ricardo and Adam Smith have been clear about the economic benefits of free trade. Leaving aside, perhaps, the position of developing countries entering a globalised market, it is clear that free trade brings economic benefits all who participate in it. That is why governments worldwide continually seek to negotiate free trade agreements, though concerns about the effects on individual sectors, domestic pressure groups and so on, make such negotiations extremely slow and problematic. After many decades, the European Union has achieved a functioning single market, with free trade in goods, and at least some free trade in relation to services. This is more than just the absence of tariffs, though they matter; it the absence of non-tariff barriers which can be critical.

The economic benefits the single market brings to the UK, and the risks from losing it, were clearly set out in thorough and highly respectable economic analysis by HM Treasury during the referendum campaign. The overwhelming majority of economists agreed with them. Even if the way in which the work was used in the campaign was unwise, the underlying analysis remains valid. No responsible UK government – however mandated by a referendum vote – can disregard it.

The only practicable way of retaining the present level of free trade with the countries of the European Union is by joining the European Economic Area, like Norway or Iceland. It is a fantasy to imagine that the UK could negotiate its own, bespoke, free trade agreement with the EU in any reasonable timeframe; it would be the grossest of irresponsibility to assert that in any but the very longest of terms – during which, as Keynes reminded us, we are all dead – leaving the EU single market would be economically beneficial to the UK. Achieving Norwegian status, therefore, has to be the only sensible negotiating objective of the UK government. So their first responsibility is to assess whether this can be achieved in negotiation. It may not be achievable but, if it is, it is highly likely that it would be only on the terms in which Norway already enjoys: free movement of labour, alongside the movement of goods, services and capital. That is the nature of the EU single market and the European Economic Area today. Leave campaigners claimed that single market access could be secured without accepting freedom of movement but that does not make it true. Mrs May perhaps now says that she will not accept that in negotiation: but that does not oblige the government to reject free trade when becomes clear that freedom of movement is an ineluctable concomitant. You don't get all your opening bids in a negotiation.

The EEA and the territorial integrity of the UK

This is closely connected to the territorial implications of change. It matters most of all for Northern Ireland, and the government must consider this point most carefully. If EEA freedom of movement remains, it is possible to retain the Common Travel Area between Britain and Ireland, and so avoid having a hard border between the Republic of Ireland and Northern Ireland, or a hard border between Northern Ireland and the rest of the UK. Failure to secure both free trade and freedom of movement has significant economic risks for Northern Ireland and the Republic. It also puts the border back into Irish politics in the way in which it has not been present since 1972, with unpredictable consequences. Pursuing this option also has implications for the position of Scotland. In one sense, it makes the possibility of an independent Scotland inside the EU with rest of the UK outside more plausible: Hadrian's Wall, the original hard border between England and Scotland, would not have to be reconstructed along the Cheviots. It is far from certain that an independent Scotland in the EU is an achievable aim (whether desirable or not) and the EEA option secures for Scotland many of the advantages of EU membership. It might also open up further, more imaginative, options which are discussed below.

There might be those in England who would claim arguing for EEA membership to secure the position of Northern Ireland, and to offer a degree of optionality to Scotland, is the tail wagging the dog. But the economic arguments point in exactly the same direction. Others will point out that this result, which meets the referendum mandate, greatly reduces Britain's power in Europe while retaining many of its obligations, but a responsible government will be making the best of a bad job. Whether the government then ask the people again if they are quite sure about leaving now they know what it really means is a question beyond the scope of this paper.

What the Scottish government should do

The formal position of Scotland is quite clear. It is part of the United Kingdom, a decision confirmed by the Scottish people 18 months ago. The UK is the EU member state, and if it ceases to belong to the EU, so does Scotland. That is the central expectation, but the politics are more complex. The SNP administration wavered on the issue, but now say that another independence referendum is highly likely. Holyrood has no legal power to hold such a referendum without UK sanction, but could seek a political denouement by trying to do so. It may be that all that is holding them back is that there is no certainty of winning. Opinion polling suggests Scottish sentiment has shifted a bit in the last couple of weeks, but hardly decisively, and obviously not on a sustained basis. Indeed independence is some respects a harder sell in 2016 than 2014: Scotland's fiscal position is notably weaker, and its EU status even less certain now than then. In any event a responsible Scottish government would be seeking to draw lessons from the EU referendum campaign and analysing as objectively as possible where Scotland's national interest lay, in a radically changed environment.

More the same than different

One immediate reaction – that the vote suggests Scotland and England are radically different places – can immediately be put to rest. If a significant proportion of the anti-European majority is an expression of dissatisfaction with the economic and political state of the country, then there is little difference between Scotland and England. Nearly half of Scots voted to reject the UK, and just over half the English population felt the same way about the EU. It would be a mistake to draw too much from the wording of the exam paper, when in both countries many voters answered a different question. And it should not be forgotten that 40% of Scots agree with the majority in England, many of them in the poorest and most disadvantaged communities – and many of them SNP voters. So when prominent actors and politicians reach the conclusion that England and Scotland are different, they are ignoring the evidence that they are in many respects just the same. Both are hurting, and looking for someone to blame for it.

Scotland's interests

Today Scotland belongs to two unions, and gets advantages from both. Any Scottish government must try to retain as many of the advantages of both as possible. That is where the interests of Scotland lie, whatever the ideological position of the SNP administration might be (and it is to Nicola Sturgeon's credit that she has not just defaulted to her ideological stance). The challenge for the Scottish government is identifying, in the uncertain position of the UK, how best to safeguard the Scottish interest. They have to consider some very concrete questions: freedom of movement for Scots across borders, most notably with England, but also with the EU; Scotland's trade, today overwhelmingly with England, but significant with the EU; Scotland's fiscal position, currently supported by very large transfers from the rest of the UK; Scotland's currency; Scotland's defence; and softer issues such as its cultural and social ties. Given the vote, it's not easy to see how all of these can be sustained as they are today, but the obligation is to try.

Trade and freedom of movement go together, and UK membership of the EEA is overwhelmingly in Scotland's interest, whether independent or still in the UK. It is the only way to guarantee continued trade with *both* the UK (or rUK) *and* the European Union. Moreover, it is the only way to be sure that people in Scotland will be able to continue to live and work *both* in the British Isles *and* mainland Europe as they can today; and it safeguards the position of EU citizens here and UK citizens elsewhere in the EU. **The Scottish government's single most important priority therefore should be to press the UK as hard as possible to take the Norway option or something very close to it.** If it cannot be achieved, and Scotland faces the choice of a hard border at a European airport (if in the UK) or a hard border at a new Hadrian's Wall (if in the EU). **A new Hadrian's Wall along the Cheviots is just about the worst outcome** for Scottish trade, and for the 400,000 Scots who live in England, and the 200,000 English people living in Scotland.

Scotland's fiscal position was extensively explored during the referendum campaign, and has changed significantly for the worse since then, as North Sea oil revenues are now essentially zero, and unlikely to be significant in future. There are some unpalatable facts here, which cannot be ignored. Scotland's fiscal deficit is huge, proportionately twice the UK's already large deficit, and even if the UK were to manage to get into surplus – now unlikely in the next few years – Scotland would not. Public spending on the services run by the Scottish Parliament is roughly 25% per head higher than in England. This is financed by fiscal transfers of around £7bn per annum from the rest of the UK. During the independence referendum, Yes campaigners tried to obfuscate these realities, but oil revenues were never going to fill the gap, and they certainly won't now. Mr. John Swinney – who must understand the fiscal reality – negotiated hard and successfully to ensure that the rUK fiscal transfers to Scotland did not decline when Holyrood got new tax powers. Breaking the UK union would mean Scotland swallowing reductions in public services, benefits and pensions of at least 10% more than the austerity already imposed by the UK government. **So the Scottish government's second priority should be to safeguard Scotland's public services, pension and benefit payments, and that means securing a continuing fiscal union with the UK.**

The other critical economic choice for Scotland relates to the currency; Brexit is a game-changer here. Nationalists previously argued an independent Scotland could and should continue to use the pound in a formal currency union with the rest of the UK with both in the EU. But with the rest of the UK out, that argument is much harder to make. While it is possible to envisage an independent Scotland using the pound informally, on what is called a "dollarised" basis, this is inconsistent with EU obligations, and likely to create very serious fiscal difficulties indeed: unable to create or print money, a government in those circumstances has to run a surplus in order to accumulate the currency to allow the economy to function. If Scotland loses the pound, the choice is a new Scottish currency, with a promise to use the euro. Just as it is not certain whether and when an independent Scotland could join the EU, so is it not clear when or on what conditions it could join the euro: as it stands, Scotland fails very badly to meet the required fiscal rules. So the most likely option would appear to be a new Scottish currency, which would have to float on the currency markets (Scotland would be in no position to peg it against the pound or the euro). That immediately introduces uncertainty into Scotland's trade with *both* the rest of the UK *and* the rest of the EU. One of the big lesson of the independence referendum was that currency unions do not work without fiscal unions, and that if Scotland wants to keep the pound it must keep the UK fiscal union too. **This analysis suggests the Scottish government's next priority should be to continue to use the pound in a currency union with the rest of the UK, which will be possible if Scotland also remains in a UK fiscal union.**

Scotland gets advantages from the EU as well as the UK, and the Scottish government must aim to keep as many of these as possible. Independence in the EU would do that, but may not be achievable and comes at a significant price in UK relations. The most important advantage is free trade, and it can be retained with both with UK and the EU under the EEA option. In the past Scotland has benefited from European structural funds, though this is very much a declining advantage. It also participates in the Common Agricultural Policy, and probably gets proportionately greater payments from it than does the UK as a whole. By contrast, rightly or wrongly, the Common Fisheries Policy is deeply unpopular among Scottish fishermen. Like the rest of the UK, Scotland also participates in other EU programmes, such as university research funding and scholarships. **A Scottish government's next priority must be to do what it can to clarify *all* the options for Scotland's relationship with EU in future.** Most obviously, if Scotland were independent, could it look forward with certainty to immediate EU membership? If not, the prospects of independence are bleak, as a member of neither union. If so, what conditions would attach? Is there any prospect of a continuing relationship between Scotland and the EU if Scotland remains in a union, perhaps an evolved or amended union, with the rest of the UK?

In exploring the scope for Scotland to continue to enjoy some relationship, perhaps as an associated region of the EU, even if the UK leaves, the Scottish government should explore whether, for example, Scotland could continue to apply EU law in relation to devolved matters, or even whether Scottish citizens could retain European citizenship. What institutional mechanisms might enable Scotland to retain some voice in the councils of the European Union? Would opting out of the Common Fisheries Policy be to Scotland's

advantage, and are there alternatives to the Common Agricultural Policy which would meet Scottish needs better than the European system presently in place?

Scotland's options

The range of possible options for Scotland's constitutional position post exit is uncomfortably wide, because of the uncertainty about the UK position and Scotland's European status. Independence outside the EU however is an option that can readily be ruled out: Scotland would lose the advantages of both unions, and gain nothing. If it becomes clear that EU membership is not guaranteed in the event of Scottish independence, then the Scottish government must simply put its independence aspirations on hold. Independence with EEA membership offers mostly disadvantages over remaining in the UK with that status. How attractive an independent Scotland with guaranteed EU membership looks depends on the UK's position. If the UK becomes a third country with respect to the EU, the Common Travel Area would have to be abolished, and Scotland would be obliged to create a new border for the movement of people and customs. Scotland would become an offshore island of the EU, with virtually no direct travel links with the rest of the union. If the UK followed the Norwegian option, then independence need not require a hard border with England. The choice is then whether giving up a common UK currency, UK fiscal sharing and the other economic and social links with England, Wales and Northern Ireland are offset by representation in the European Parliament and Commission, and participation in the CAP and CFP.

If Scotland remains part of the UK, it obviously retains the Common Travel Area, the pound sterling, fiscal sharing and the UK single, domestic market. If the UK is not part of the European single market, then Scotland would simply lose access to it. Scotland can retain many of the advantages of EU membership if the UK joins the EEA, though it loses representation in the European Parliament, and Scots would no longer be EU citizens; nor would Scotland participate in the CAP and the CFP. Whether these last two are advantages or disadvantages is a point which might be debated.

It is certainly worth considering whether there are any mechanisms by which Scotland might retain closer links with the European Union while still remaining part of the UK. This makes sense only if the UK is part of the EEA. As part of the UK it is hard to see how Scotland be a member state, represented in the European Parliament and nominating a European Commissioner. But it might seek to become a region outside the EU which was nevertheless associated with it, perhaps with some application of its law, some voice in its councils, and participation in some of its programmes. So for example, the Scottish Parliament could continue to be obliged, or oblige itself, to follow EU law; UK citizens resident in Scotland could continue, perhaps, to be the EU citizens as they are today (after all, Greenlanders remain EU citizens even though Greenland left the EU, because Greenland is still part of the Danish realm); Scotland might retain representation on the European Committee of the Regions; in return for some form of subscription fee, its universities might continue to participate in

research sharing (as Israel does), and student scholarships. It might even voluntarily sign up to the CFP.

These are course speculative possibilities, and imply some degree of weakening of the Scotland-UK relationship. Whether they require a fully, formally, federal UK is perhaps arguable. Such an arrangement might, as has often been pointed out, turn out to be unstable in its own right. Alternatively, one might imagine a relationship which a formally independent Scotland nevertheless entered into a different kind of union or confederation with the rest of the UK for the purposes of defence, currency and macroeconomic management and fiscal sharing. These issues deserve to be explored as fully as possible before Scots can reasonably be obliged to make any choice about their future after the exit vote.

One lesson from the shambles

The European referendum and its result has put the UK, and Scotland, in a difficult and uncertain situation. The people have voted in the absence of a detailed prospectus hoping for something that probably cannot be delivered in practice; indeed they may find that the only practicable solution is one which they would have rejected had it been offered to them clearly beforehand. The UK should not have made that mistake, and Scotland should not make a similar one. The Scottish government have not rushed to another independence referendum, but if there were one it could only be on the basis of a proposition which was guaranteed to be deliverable, which could be put into effect with certainty. So, for example, no responsible Scottish government could promote independence without being sure of Scotland's position in the EU, and without knowing the likely position of the rest of the United Kingdom in relation to free movement and trade and without a practicable economic plan for public spending and the currency. Similarly, if there were to be scope for some more imaginative constitutional resolution which retained Scotland-EU links, the full detail would have to be worked out and guaranteed to be delivered before that choice was placed before the population. One bad and ill-informed decision should not lead to another.

In the spirit of not letting a crisis go to waste, it is worth asking whether this time of uncertainty offer an opportunity for Scotland to unite behind a constitutional solution that puts the divisions of 2014 behind it, goes beyond the false dichotomy of nationalism and unionism and focuses on safeguarding the national interest?