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Scotland and the UK Internal Market: Challenges of Brexit

1. This written evidence considers the evolution of the UK internal market as a consequence of Brexit and its implications for Scotland. The following sections examine (1) the definition of the UK internal market; (2) Brexit's impact on the UK internal market; (3) international agreements and the UK internal market; (4) Scotland's political institutions and the UK internal market; and (5) the post-Brexit outlook for Scotland. This evidence reflects the state of affairs as of February 2020.

Section 1: Defining the UK Internal Market

2. The UK internal market can be defined as the economic space of the United Kingdom. In that regard, it has existed for as long as the modern UK. It is the essence of a sovereign state to have its own economy. Beyond overall global forces, the governance of the UK's market economy has been shaped by two significant factors over recent decades. The first is the UK's participation in the European Union from 1973 to 2020. The second is the development of devolution in Scotland, Wales and Northern Ireland (and to a very modest extent within England). At a general level, the UK's EU membership resulted in degrees of unification – between the UK and the rest of the EU and European Economic Area, and within the UK. By contrast, devolution has resulted in degrees of differentiation between the constituent parts of the UK. These meta trends are intentional. They are the logical consequences of constitutional decisions (accession to the EEC and establishment of devolution), and such eventualities were fully evident at the time of those decisions.
3. EU membership involves combinations of rights and responsibilities which significantly influenced the governance of the UK internal market. The primary purpose of the EU is to enable the progressive integration of its Member States to pursue common objectives for mutual benefit. The EU internal market is one of the centrepieces of European integration, alongside the eurozone. As a Member State, the UK was a constituent of the EU internal market. It applied the *acquis communautaire*, the body of laws, policies and practice which sustains the EU. Much of the *acquis* relates directly to the internal market or indirectly to flanking policies. Given the primacy of EU law in the Member States, the *acquis* came to define the regulation of the UK internal market to a substantial degree. Many measures related to implementing the *acquis* were undertaken by institutions in the UK, while others were directly applicable from the European level. While the EU internal market is founded on uniform rules and harmonisation of laws, mutual recognition of national standards is an equally fundamental component. The UK market was therefore highly integrated into the EU market yet remained distinct in some measure.
4. Scotland's political institutions have, through the exercise of their powers resulting from progressive devolution from the UK level, also shaped the governance of the UK internal market. The foundational aim of devolution is to enable decision-

making which is closer to the people of Scotland. The Scottish Parliament and Government pursue public policy objectives which to some extent create differentiation between Scotland and the wider UK in areas directly and indirectly related to the market economy. Two decades of devolution have generated a substantial corpus of distinctive Scottish laws and policies, resulting in degrees of regulatory divergence with the wider UK. In that regard, we can indeed speak of a Scottish internal market. At the same time, Scotland's policy differentiation has been bounded by two delimiters. First, during the period of the UK's EU membership, Scotland's institutions were responsible for implementing the EU acquis in their areas of competence. Second, the powers reserved to the UK level have ensured some coherence in the overall structure of the UK market. While a UK internal market and Scottish internal market both exist, they have to date been significantly shaped by participation in the EU.

Section 2: Brexit's Impact on the UK Internal Market

5. The EU internal market and its governance are grounded in the EU treaties and supported by secondary legislation. This degree of codification is essential, since the Union operates on the basis of the conferral of powers by the Member States. The Union's laws, policies and actions must derive from a clear legal base. In that regard, the EU internal market is well defined because it is dependent on such definition to operate. By contrast, the UK internal market is less defined because its existence is inherent to the UK state. It is the baseline economic space in the UK to which adaptations are made based on European and international obligations on one level, and devolution of power on another level. Withdrawal from the EU will ostensibly result in the removal of the European level from the governance of the UK internal market. During the post-withdrawal transition period, the UK will functionally remain in the EU internal market without political representation. Its relationship with the EU internal market after the transition will be determined through the current EU-UK negotiations.
6. Those negotiations are currently at an early stage and the final outcome remains unclear. While seemingly unlikely to be pursued, it is still possible for the UK to forge a close relationship with the EU internal market through an EEA/EFTA model or equivalent. The stated intention of the UK Government is instead to seek a free trade agreement and other wider cooperation with the EU. Under that outcome, the UK will no longer be a constituent of the EU internal market. We move therefore from speaking of participation in that market to access to it as a third country. The degree of access which the UK is granted to the EU internal market will depend on the extent to which it continues to align with EU laws, policies and standards. Such alignment would have to include rules directly related to the internal market and also those connected with flanking policies on social, labour and environmental standards, among others. This so-called level playing field would have to be maintained consistently and in perpetuity for the UK to retain whatever access to the EU internal market is agreed. Ultimately, the EU controls external access its own market.
7. The future governance of the UK internal market will therefore be determined in large part by the degree of extrication from the EU internal market which is pursued and the policies within the UK which are developed in replacement. Given the

profound depth of the UK's current integration into the EU internal market, substantial divergence from EU rules and standards would be challenging and costly. Moreover, the economic and social rationales for such a course are largely unclear or unconvincing. The UK Government's proposals for the EU-UK relationship imply major divergence. Although the EU has concluded free trade agreements with a number of states and territories, they are distant from the EU in some respect and the agreements seek to provide degrees of convergence. The UK is by contrast extremely politically, economically and geographically close to the EU already. Brexit will only lead to the creation of distance which did not exist before, and a free trade agreement would be insufficient to sustain a comparably close EU-UK relationship. Even if the European level were to be formally completely removed from the UK internal market, EU laws, policies and standards would still have an impact, given the EU's regulatory heft.

Section 3: International Agreements and the UK Internal Market

8. Throughout its period of EU membership, the UK continued to conclude and implement international agreements in areas not conferred on the EU. While as an EU Member State the UK did not conduct EU trade negotiations, it was nevertheless involved in the process through the EU Council. International agreements, where enacted in the UK's legal order, will facilitate rights and obligations which will in part shape the UK internal market. In order to create a national trade policy, the UK will need to demonstrate to potential partners that it has the capacity to (1) negotiate, conclude and implement trade agreements; (2) define and manage its own trade and customs territory; and (3) ensure consistency and relative uniformity in the governance of its economic space. Since the UK internal market will be shaped in part by the EU-UK relationship, it will be difficult to conduct trade policy without clarity on the UK's access to the EU internal market and the associated obligations. Only if the UK were to assume a distant and disconnected future relationship with the EU could it proceed now to undertake full trade negotiations.
9. The UK will enter the international trade negotiation arena as a modest actor compared to the EU. While the UK is a comparatively large economy in the world in GDP terms, it is significantly smaller than the EU and will more be susceptible to global forces. The UK's most important trade partner will undoubtedly remain the EU, given the substantial volume of EU-UK trade, the UK's trade dependence on the EU and the persistent importance of proximity in global trade. These factors among others underline the imperative for the UK internal market of maintaining closeness to the EU internal market for goods and services, and relatedly on rules and standards. In negotiations with other trade partners, the UK will not be placed to make trade agreements as favourable as those concluded by the EU, in view of its much smaller economic, policy and regulatory weight. It is perfectly possible that the UK will have to provide greater market access and accept less favourable sectoral trade-offs in order to secure trade deals. The UK will have to respond to the expansive nature of new trade agreements, given the limits of reducing or eliminating tariff barriers, the importance of non-tariff barriers and the increasing spillover into wider policy areas, driven in large measure in fact by the EU.

10. Thorough consideration should be given to the process under which the UK will negotiate, conclude, approve and implement future trade agreements. The continuation of the UK's current procedure for making international agreements, which affords a limited role to the UK Parliament and no formal role to Scotland's political institutions, would be unsuitable given modern expectations of greater political participation in trade negotiations and the multi-level character of government in the UK. A new internal trade agreement process should therefore be established in the UK which moves away from the Royal Prerogative to a codified system founded on incorporating the UK Parliament and political institutions of Scotland, Wales and Northern Ireland. This system should include internal approval mechanisms for negotiation mandates and major decisions throughout trade negotiations, and a positive treaty ratification procedure. Such an evolution in UK practice would require significant change and political investment at the UK level.

Section 4: Scotland's Political Institutions and the UK Internal Market

11. Following the UK's withdrawal from the EU, the structure of the UK internal market is now likely to be significantly altered. The implications for Scotland's political settlement, which was founded around EU membership, could be profound. It is logical to consider not only how the powers and roles of Scotland's political institutions should evolve in response to the specific realities of Brexit, but how they should be further enhanced generally in the governance of the UK internal market. Beyond the discussion of common frameworks and related coordination, it is reasonable to explore novel means of enabling effective political participation for Scotland and others in the development and regulation of the UK internal market. New permanent political structures could be established for this purpose. Greater constitutional codification of the rights, powers and existence of Scotland's institutions would also foster better intergovernmental relations. Such evolution would require political will at the UK level and necessitate real change in UK governance.
12. The UK internal market is not a uniform or homogenous economic space. Devolution has fostered policy and regulatory differentiation between Scotland and the other constituents of the UK. However, the UK Government may intend to conduct trade negotiations in such a manner which prefers or assumes a greater uniformity than actually exists. It will remain to be seen to what extent the UK will incorporate the policy decisions and preferences of Scotland's political institutions into its approach to trade policy. Other federal and multi-level states have found means of integrating the perspectives of their component polities. Differentiation within the UK on policy domains likely to be subject to trade negotiations is possible to sustain in the conclusion and implementation of trade agreements. It requires a high degree of internal organisation and coordination, and clear communication with the trade partner on the relevant modalities. The reshaping of the UK internal market will need new structures to uphold existing and future policies and decisions made by Scotland's political institutions, relative to UK level policy decisions and international agreements. In their absence, Scotland's institutions could be often and unpredictably undermined in the exercise of their responsibilities, which would have implications for the functionality of the UK's constitutional order.

13. The Scottish Parliament and Government will be responsible for implementing the rights and obligations arising from UK trade agreements in their areas of competence, whether or not they form part of the relevant decision-making. It would be eminently sensible for Scotland's political institutions to be substantially involved in the various stages of the new UK trade agreement process. It is established in other states that their constituent polities should be consulted by central government on European and international matters related to their responsibilities. Consistent and detailed involvement in negotiations would ensure that Scotland's institutions were best placed to understand the content and outcomes of trade agreements and therefore to implement them more effectively. Trade partners could have greater confidence in the UK's internal application of its agreements with the active participation of Scotland and other UK constituents. Increased democratic legitimacy in trade negotiations would result, which is particularly important with the expansive nature of new trade agreements. Consideration should be given to the structures and processes that should be created to facilitate new roles for the Scottish Parliament and Government. A Treaty Consent Motion (TCM) could be introduced, analogous to a Legislative Consent Motion and focused on the approval of international agreements. The Scottish Parliament might elect to establish a dedicated Trade Committee to scrutinise these matters, or to add a trade portfolio to another committee – such as a Finance and Trade Committee.

Section 5: Post-Brexit Outlook for Scotland

14. The removal of EU membership will transform the UK internal market. Current indications suggest that the UK Government's approach will result in the EU-UK relationship being significantly distant. Were Scotland's political institutions to pursue degrees of continued alignment with EU laws, policies and standards, the Scottish internal market may become uniquely differentiated compared to the wider UK. Depending on the circumstances, such positioning could make Scotland more competitive vis-à-vis England and Wales where it reduces the scope of new UK rules and standards and maintains existing European ones. EU and international trade with Scotland could proceed without the costs associated with adapting to additional and specific UK-only rules. Economic actors would need awareness of these differences in the Scottish internal market and be positioned to respond to them. Alignment with aspects of the EU acquis would also represent Scotland's commitment to the social dimensions of EU environmental, labour and other standards. Such alignment could potentially lead to progressively greater differentiation with the wider UK. Scottish actors will likely seek (1) clarity on the rules and standards, and related market access, to apply in different contexts, (2) consistency on Scotland's approach to EU alignment and (3) interoperability to the extent possible between the governance of the Scottish internal market and the wider UK internal market.

The UK's withdrawal from the EU on 31 January 2020 has brought little certainty beyond the realities that the UK is now a third country to the EU and that its privileged transitional relationship will end on 31 December 2020 unless extended. It will be difficult to envisage the future governance of the UK internal market in the absence of knowing the shape of the new EU-UK relationship. That relationship will depend on a number of related factors. The UK's approach to implementing the

Withdrawal Agreement across its lifetime will hold great importance to the EU and impact wider EU-UK relations. The current negotiations and potential agreements on trade and much wider cooperation will form the core of the new EU-UK partnership. The duration of that process to negotiate, conclude, approve and implement those agreements will be critical, given the impending default to no formal relationship at the end of the transition. Even if both sides successfully create the new partnership, the agreements underpinning it must be maintained. The EU and its laws and policies constantly evolve and, considering the scope of the partnership, the UK will have to adapt its laws and policies accordingly or else face the reduction or suspension of its EU market access or other bilateral cooperation. Depending on the UK level's approach, Scottish actors could face an economic and regulatory environment of relative short-term certainty and permanent long-term uncertainty. The EU, as one of the largest economies and regulatory areas in the world and in immediate vicinity, will influence the UK internal market in perpetuity, whether directly or indirectly. Scotland will have to balance difficult considerations in its alignment with the EU versus its connection to the wider UK.