

Scottish Government – Written evidence (FTS0057)

Introduction

I am writing to formally respond for the Scottish Government to the Committee's call for evidence on "the future of UK-EU relations on trade in services". As you will recall, I previously wrote to provide the Scottish Government Response to the House of Lords EU Services Sub-Committee Enquiry into "The future UK-EU relationship on professional and business services".

The people of Scotland voted decisively to remain within the European Union (EU) in 2016. Scottish Ministers continue to believe that EU membership is the best option for Scotland.

On 24 December 2020, the UK Government and the EU announced agreement on core elements of the future relationship.

Compared to a starting point of trading on purely WTO terms, there are many aspects of the overall agreement that might have been positive for trade between the UK and EU. But, the UK and EU **were not** trading on WTO terms.

The Scottish Government has conducted initial analysis of the agreements and their implications for Scotland. This assessment confirms the Scottish Government's long-standing view that Scotland will be worse off outside the EU.

From the loss of free movement of people to having to navigate 27 different regulatory regimes to the complete closure of some sectoral markets, there is very little to welcome in the TCA for services. The agreement is weak and threatens real harm to our economy in the medium and long term.

On the 26th of January I published [Scotland's Vision for Trade](#). The Vision sets out the principles and values for the trading relationships we want our country to have, now and in the future.

We want Scotland to be a successful trading nation but we also want to be known as much for how we trade as what we trade.

What it does seek to do is set out a coherent approach to our trade relationships. An approach that better reflects the country we want to be and the trading relationships we want to have with other nations.

Ivan McKee MSP
Minister for Trade, Innovation and Public Finance

Cross-cutting issues:

1. What is the impact for trade in services of the UK and EU reaching a free trade agreement?

Negative. As a general principle, UK service suppliers will have to comply with host-country rules in each EU Member State, in particular with regard to the recognition of professional qualifications but also in terms of licensing.

Overall, therefore, considering the substantive changes in trading conditions as well as the fact that crucial decisions have been postponed in important areas such as financial services, cross-border data flows and recognition of professional qualifications, the TCA represents a major setback for services sectors, for some more so than for others. The increase in trade frictions may also hit smaller firms harder than large enterprises, which may have foreign affiliates and could therefore more easily adapt by relocating activities across borders.

2. What effect may national reservations to the UK-EU Trade and Cooperation Agreement have on trade in services with the EU?

Negative. As with all modern services FTAs, the broad commitments outlined above are caveated by 'reservations'. Reservations are exclusions from the terms of the agreement, and for the EU, demonstrate that the single market for services only operates for EU member states.

The EU reservations include economic needs tests, discrimination between EU and non-EU service providers, local presence requirements and nationality restrictions on senior personnel.

These restrictions are not consistent across member states or sectors. The most highly regulated services (e.g. legal services) are the most likely to face restrictions but many less regulated services also face restrictions. There is also a sometimes complex relationship between mobility and service provision.

France is Scotland's largest EU export market for services, and has more reservations than any other of Scotland's five largest export markets. These five markets (France, Germany, Republic of Ireland, Netherlands, Spain) account for 64% of Scotland's EU services exports.

3. What effect will arrangements on the mobility of professionals have on trade in services between the UK and EU?

Negative. In contrast to the arrangements that Scotland enjoyed when the UK was a Member State, there is no automatic right to freedom of movement of people or visa / work permit free travel or mutual recognition of professional qualifications. Therefore individuals seeking to travel to the EU to deliver services will face increased barriers.

The temporary stay of personnel for business purposes is categorized into five types: business visitors for establishment purposes, intra-corporate transferees, short-term business visitors, contractual services suppliers and independent professionals. The permissible length of stay may differ across these five categories. There are also additional requirements such as visas, work permits and potentially economic needs tests. These requirements, which again may differ depending on the type of business personnel and the sector, need to be met and will depend on the reservations which exclude or restrict rights guaranteed under the Agreement. The reservations vary across Member States and will need to be met for every jurisdiction in which the worker hoped to discharge the service.

The impact on touring musicians is well known, but the same customs complexities are likely to be faced by other services providers who carry specialist equipment (e.g. testing equipment) to discharge their duties.

Financial services:

4. How will the arrangements in the UK-EU Trade and Cooperation Agreement shape UK-EU trade in financial services?

Negatively.

The financial services sector is a significant employer in Scotland, employing over 87,000 people across a broad range of activities including banking, insurance and asset management. Financial services is also a significant export strength for Scotland. In 2018, financial and related professional service exports were valued at £8.6bn, a figure second only to London in terms of overall financial service export performance in Great Britain.

The scale and type of financial services traded into and out of the EU by UK institutions will have to change.

The previous system of passporting rights (i.e. an authorisation issued by one Member State must be recognised by all other Member States) which facilitated trade across the full range of financial services for Scottish financial services providers while the UK was a Member State has been lost. This is likely to affect the flow of capital through the UK.

It is possible that the EU will grant 'equivalence' status in a number of areas, which would enable financial businesses to continue their current activities in many parts of the sector. However, to date the EU has only granted two temporary equivalence decisions in respect of derivatives clearing and the settlement of Irish securities. Equivalence is not as good as passporting as it is normally granted for a limited duration and can be revoked at 30 days' notice. As such, equivalence provides firms with much less certainty. The EU is currently in the process of reviewing equivalence decisions in 28 areas but, has publicly expressed concerns about the possibility of UK deregulation and the need to bolster the strength and

independence of the EU's own financial services sector meaning there is no guarantee that the EU will consider it within its interests to grant further decisions. It will be important in the context of MoU negotiations that UKG is able to provide reassurance to the EU about its intentions concerning regulatory divergence.

Many financial services providers have shifted substantial parts of their business to affiliates established inside the Single Market. Scottish Widows transferred its European portfolio to a new legal entity in Luxembourg in March 2019, while Standard Life Aberdeen has opened portfolio management and distribution services in Dublin to service EU clients. Similarly, Royal Bank of Scotland began operating a banking entity in Amsterdam in March 2019 from where it will serve non-UK EEA customers. Advocates in Germany who promote Frankfurt as a financial centre claim that under the terms of the TCA, around 40% of the business that banks transact out of London with EU partners will need to relocate, and the fate of another 20% will depend on the outcomes of the pending equivalence decisions.

5. The Joint Declaration on Financial Services Regulatory Cooperation sets out that both sides seek to establish structured regulatory cooperation on financial services. What form should this dialogue take?

Scottish Government would encourage the UK Government to approach the MoU negotiations with a high level of ambition. While recognising that time constraints are likely to result in a reliance on precedent, we would like existing precedents such as the regulatory cooperation arrangements in the EU-Japan EPA or the EU-US cooperation to be seen as a floor not a ceiling.

In light of the range of financial services interests within Scotland, we favour a model of regulatory cooperation which will cover as wide a range of regulatory issues as possible to include in particular key Scottish interests in asset management and emerging technologies such as fintech and cybersecurity. We should also seek a high level of ambition for international cooperation in the field of green and sustainable finance reflecting our interest in impact investment and the potential importance of ESG finance in our ability to maintain our position as a leading destination for inward investment and the role impact investment may play in ensuring a successful outcome for COP26.

6. Given the plans to delegate more powers to financial regulators, what form of Parliamentary oversight of these regulators would be appropriate?

We do not consider it within our remit to comment on the specific arrangements for Parliamentary oversight at Westminster. However, we would note that the strength of oversight and supervision applied by UK Government and the Parliament is likely to be a relevant factor for the UK's ability to obtain and retain equivalence decisions from other jurisdictions and also to the UK's relative influence and credibility in mechanisms for

State to State dialogue such the proposed MoU for regulatory cooperation in financial services.

7. How might the financial services sector be affected by the changes in other, interrelated sectors?

There are a number of inter-dependencies in the professional business services sector as impacted by the EU-UK TCA which will need to be assessed collectively in terms of impacts on trade in financial services. In particular the loss of mutual recognition on professional qualifications as may affect regulated professions such as accountants, auditors and the legal profession; the scope of permitted activities for Mode 4 provision and the ongoing uncertainty concerning the prospect of further EU decisions on data adequacy and equivalence in respect of specific regulated financial service activity. Further, the existence of exemptions and reservations at Member State level adds an additional layer of complexity for financial service providers to navigate.

More positively and of interest to the Scottish Fintech sector, the TCA provides for trade in emerging technologies for financial services where such services would be permitted in like situations from its own economic operators without adopting or modifying a law, this may present an opportunity through regulatory cooperation to be able to maintain opportunities in new and emerging markets.

Professional and business services:

8. How will the new UK-EU framework for the mutual recognition of professional qualifications affect professionals and service sector businesses?

Negatively. The MRPQ provisions fall far short of the single market, with the loss of both the automatic and general systems. Of importance to occasional exporters, there is no temporary or short term MRPQ arrangement. Until such time as a MRA for a particular profession is agreed, professionals will be reliant on third country routes, where they exist.

An MRA can be proposed by any UK and EU counterpart regulators for consideration on a profession-by-profession basis by the Partnership Council (a new body set up by the TCA which has responsibilities for implementation, interpretation, and application of the TCA). All MRAs must "take account" of all 27 EU states, but the form and depth of the agreement with each state would not need to be identical. MRAs can have different arrangements for each of the 27 states, or the same for all of them, but it must take each into consideration.

Previous precedents for such arrangements under, for example, the CETA agreement between the EU and Canada have yet to deliver any agreements between regulators. The lack of mutual recognition of professional qualifications may have a significant impact on the ability of both manufacturing and services firms to offer their services in the EU

market. It may also affect the ability of UK firms to source professional services from the EU or EU residents.

Changes to the MRPQ regime may also introduce risks in terms of talent retention, making it harder to attract and retain high quality and skilled professionals in key disciplines. If such roles were to be moved to the EU, there will be a direct impact on jobs and livelihoods as well as the potential to create a 'brain drain'.

9. What will be the impact of the Agreement's provisions on the cross-border supply of services and rights of establishment, such as commitments on local presence and economic needs tests?

Negative. The 'host nation' principle means that Scottish businesses will have to navigate up to 27 different sets of rules – bringing together local presence, economic needs tests, nationality requirements, mobility restrictions and changes to MRPQ. It is likely to be more difficult for professionals (such as architects) to pick up contracts in the EU, and for many, impossible to provide services to all member states.

Further, the fact that Scottish lawyers will be unable to provide legal advice on EU and member state law may make contracts more difficult and expensive to negotiate and agree, creating a further barrier to trade.

Research and education:

10. Under the future relationship agreement, the UK will become an associate member of Horizon Europe but will not associate with the Erasmus+ programme. What impact will this have on the UK's research and education sector and students in the UK and EU?

Without association to Erasmus+ we are likely to see the numbers of visiting European students to Scotland decline. Those students who do visit (including those via Turing) are likely to be from wealthy backgrounds and a limited number of wealthy countries.

Scottish participants from colleges and schools are likely to have less opportunities for mobility exchanges. Scottish adult learners and youth groups are likely to see most if not all opportunities for mobility exchanges removed.

11. What is your assessment of the Turing Scheme - the Government proposed domestic alternative to Erasmus+?

This scheme will be deployed in Scotland without the consent of the Scottish Government or Scottish Parliament, via the UK Internal Market Act, and will bypass all funding from Scottish Ministers.

The scheme will be funded for one year at a cost of £105 million, with no guarantee that this funding will continue.

The scheme will not provide any support for the inward mobility of European participants to the UK.

The scheme will provide support for the higher education sector, limited support for the further education, schools, and VET sectors, and no support at all for the adult education and youth work sectors. Additionally, it will not provide support for staff mobilities, or the building of strategic partnerships between institutions such as the eTwinning programme utilised by our schools.

This replacement scheme which cannot match the breadth and scope of the Erasmus programme.

With funding only guaranteed for one year, no provision for inward mobility to the UK, and no support being offered for adult education and youth work, what the UK Government is proposing is a watered-down imitation of the real thing which will see support for our most disadvantaged learners cut, and opportunities for all our students, staff and young people reduced.

Creative industries:

12. How will the provisions in the UK-EU Trade and Cooperation Agreement affect the creative industries sector?

The TCA has raised a new issue around cabotage rights. The deal means that exemptions to specialist road haulage limits under the ECMT will not apply, meaning that the number of cabotage movements within an EU member state will be limited to 2-per week for UK organisations. This could have a major impact on the culture and creative sectors as it could limit and complicate touring where specialist road haulage is required – this is likely to be the case for orchestras and theatrical productions.

ATA Carnets are export licenses required for temporarily moving goods into the EU, eg. musical equipment for touring. These are now required for moving such goods between UK and EU.

There are no specific mobility arrangements in the TCA to support activities vital to the culture and creative sectors. Stakeholders have raised concerns that the UK Government has not provided a comprehensive breakdown of work permit requirements in different EU member states, and the activities that do not require work permits. If musicians, artists etc. are not included on the EU's list of activities that are permitted without a work permit, the ability to tour and work in EU countries – which is central to the operation of much of the creative industries – will depend on policies in different member states. Those working in the sector urgently require clarity for activities such as touring, exhibiting, production work and other short-term business activities.

Data and digital services:

13. The EU has granted the UK a six-month data adequacy 'bridge' to allow the free flow of personal data until the EU determines whether or not to grant a data adequacy decision to the UK. How would the absence of a data adequacy decision at the end of this bridging period affect trade in services?

Only a positive data adequacy decision by the EU will ensure the free flow of personal data from EU to UK. Maintaining the free flow of personal data between UK and EU/EEA organisations is vital for Scotland's economic growth. With the shift to digital delivery of services accelerated during the Covid-19 pandemic, it is more important than ever that a data adequacy decision is in place. A decision is not just important for the digital delivery of services, but it affects the wider trade in services in all sectors. Failing to achieve a positive outcome is likely to disproportionately affect small to medium sized businesses and occasional exporters, less able to put in place alternative transfer mechanisms.

14. What impact will the arrangements agreed have on digital trade and trade in digital services between the UK and EU?

The digital provisions of the TCA fall short of the Digital Single Market, the main consequences for Scotland relate to this.

The minimal access to the Digital Single Market will have implications for cross-border e-commerce and digital delivery of services. Businesses now face additional barriers in accessing the EU market, such as the requirement to comply with regulations for selling goods or services online in each of the 27 EU member states. This will increase transaction costs through the complexity and diversity of regulatory and administrative requirements and the related reduction in legal certainty for business.

Under the agreement, we have shifted from having free roaming mobile services which are vital to many business travellers to being dependent on mobile telecoms providers maintaining a voluntary agreement, creating uncertainty over service availability and costs.

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