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Memorandum by Iain Wright¹ and David Heald² to the Finance and Constitution Committee

THE IMPACT OF UK COMMON FRAMEWORKS ON THE DEVOLUTION SETTLEMENT³

Introduction

1. The opportunity is welcomed to submit written evidence to the Finance and Constitution Committee Inquiry into the impact of post-Brexit common frameworks on the devolution settlement.
2. Under the *European Union (Withdrawal) Act 2018*, EU law will apply to the United Kingdom until 29 March 2019, at which point it will be frozen. There are various circumstances in which changes to this body of law will be required:
 - a) The European Union passes new regulations and directives which apply or must be implemented during the transition period
 - b) The European Union passes new regulations and directives after the transition period with which the United Kingdom must comply in order to maintain whatever market access arrangements have been negotiated
 - c) The UK Government wishes to change the frozen body of EU law applicable to the United Kingdom.

The Finance and Constitution Committee's (2018) Call for Evidence notes that there are 111 areas of EU law that intersect with the devolved competence of the Scottish Parliament.

3. Before the Brexit Referendum, there were almost no references to the internal UK market, protection of which largely came from all parts of the United Kingdom being subject to EU law. Post-Brexit, UK common frameworks are intended to perform that role. Although not always explicit, there are two issues:

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- a) whether, in particular cases, protection of the internal UK market requires harmonisation across the United Kingdom, meaning either uniformity or equivalent outcome
- b) whether the UK Government unilaterally determines those common frameworks or whether the Devolved Administrations have rights of consultation or veto.

To avoid unnecessary complications in the drafting, this memorandum is written on the assumption that there will be a Withdrawal Treaty, that the United Kingdom leaves the European Union on 29 March 2019, and that the transition period ends on 31 December 2020. However, most points could be developed in relation to other scenarios.

4. The authors of this memorandum are not lawyers but public policy specialists: Wright on the energy sector and Heald on public finances. Accordingly, observations are restricted to areas of expertise and knowledge. The next section provides responses to the four questions posed by the Call for Evidence, then two sections discuss the specific areas of energy and public finances.

Responses to Questions posed by the Call for Evidence

Question 1: What should replace the current EU policy-making processes across the UK?

5. The political difficulties stem from the lack of trust between the UK Government and the Devolved Administrations, as noted by the report by the Public Administration and Constitutional Affairs Committee (2018). Obstacles to consensual policy-making will continue: the constitutional status of Scotland and Brexit remain contested issues; there is divergent political control of the UK Parliament, the Scottish Parliament and National Assembly for Wales; and there has been *de facto* suspension of the Northern Ireland Assembly since 9 January 2017. All events and developments are interpreted through the lens of political calculation in relation to constitutional futures. Viewed from the devolved capitals, 1999 was a critical juncture in the governance of the United Kingdom. Viewed from London, it was marginally inconvenient (the relatively clean separation of functions limited spillovers) but not a fundamental challenge to Westminster

authority. The notion of ‘partners in the Union’ does not travel well beyond the borders of the devolved nations. Moreover, Brexit, which was not anticipated in 1999, has brought unprecedented conflict between the UK Government and the Scottish and Welsh Governments, with the UK Government reasserting its primacy.

6. Moreover, the Brexit decision followed massive cutbacks in Whitehall capacity due to post-2010 austerity policy (Freeguard et al., 2018, p. 26). The effects on institutional memory have been exacerbated by extensive reconfigurations of Whitehall departments and by the unprecedented workload generated by Brexit preparations. Brexit negotiations have been further complicated by UK Cabinet divisions on ‘type of Brexit’ and by the EU tradition of late-night deals. Seeking agreement with politically hostile Devolved Administrations has unsurprisingly been a low priority for the UK Government (Public Administration and Constitutional Affairs Committee, 2018).
7. In terms of institutional structures, common frameworks should be developed by a process similar to that for creating an EU directive. Although the establishment of Non-Departmental Public Bodies (NDPB) attracts criticism for adding to the so-called ‘quango state’, a specific-purpose arm’s length body would be appropriate, bringing a standardisation of approach across all UK departments. This should be staffed by personnel from across the United Kingdom, some on secondment. The detailed drafting of particular elements of the common frameworks could be delegated by this body to the functional departments of the four governments. This NDPB should lay reports to all four legislatures. It would be worthwhile considering the experiences of federal countries such as Australia and Canada, though the asymmetric UK devolution might make arrangements more difficult to replicate.

Question 2: Addressing the governance gap in relation to the monitoring, implementation and enforcement of frameworks

8. Scotland, Northern Ireland, Wales and England have each had (varying degrees of) legislative divergence, established over a range of timescales. This has allowed Scotland to pass legislation on smoking in public places and alcohol

limits for drivers that differ from those elsewhere in the United Kingdom. The Scottish Government has also chosen not to follow England & Wales on privatisation of the water industry and has rolled back commercialisation in the Scottish Health Service, while that process has advanced in England.

9. It is perfectly possible to implement market arrangements that span jurisdictional boundaries provided there is political will, even where substantial differences in legal frameworks exist. These differences are not likely to be an issue if they govern personal behaviour (e.g. drink-driving limits), but they might be contentious if they are perceived to constrain government discretion at a UK level (e.g. in making third-country trade agreements involving water, health services or fisheries).
10. Sensitive issues relate to the balancing of powers of devolved and central governments. The European Union is constrained by only being able to legislate in areas where competence has been conferred by the EU Treaties. Moreover, EU legislative action is also constrained by the principles of proportionality and subsidiarity; “EU action cannot exceed what is necessary to achieve the objectives of the treaties”, and “in areas where either the EU or national governments can act, the EU may intervene only if it can act more effectively” (European Commission, undated). In contrast, the constraints on UK Government action post-Brexit will be political rather than constitutional. Although much attention has been paid to devolution gains in the three smaller nations of the United Kingdom, the diminished status and functions of local government, particularly in England, have been just as significant.
11. In the context of creating common frameworks for the post-Brexit world, applying the principles of proportionality and subsidiarity would address some of the issues identified in the Scottish Government’s (2016) *Scotland’s Place in Europe*, where issues were identified around powers being defined differently for Scotland compared with Northern Ireland, with questions being asked as to the underlying principles being used to determine which powers should be available to each Administration. The need for a proper governance framework has been identified

by the Public Administration and Constitutional Affairs Committee (2018) and Paun (2018).

12. The Communique from the fifth Joint Ministerial Committee (EU Negotiations) (2017), issued on 16 October 2017, stated that:

A framework will set out a common UK, or GB, approach and how it will be operated and governed. This may consist of common goals, minimum or maximum standards, harmonisation, limits on action, or mutual recognition, depending on the policy area and the objectives being pursued. Frameworks may be implemented by legislation, by executive action, by memorandums of understanding, or by other means depending on the context in which the framework is intended to operate.

It is therefore clear that there is already a significant degree of consensus as to what a common framework should look like.

13. However, the principles described in the Communique do not address fundamental issues, such as the basis on which it will be decided that an approach will address UK or GB issues (and by inference, NI-only frameworks). Other omissions from the document are a definition of how the final content of common frameworks will be decided, or why it is envisaged that operation and governance arrangements might be expected to differ from one framework to another. It is not enough to say that “It will be the aim of all parties to agree where there is a need for common frameworks and the content of them”, without providing some definition of agreement and a mechanism to ensure that agreement is forthcoming where it has been agreed to be necessary.
14. Although the Communique states that common frameworks may be implemented by legislation, it is silent on how this should be done; whether there should be a single UK Act, or whether each jurisdiction should enact compliant legislation, in line with its own legislative competence and taking account of particular local factors, to deliver a co-ordinated legislative framework across the United Kingdom. For example, agricultural markets and challenges are materially different across the UK jurisdictions. It has been argued that a one-size-fits-all common framework would reflect the needs of the largest population and ignore

the needs of the more marginal markets overseen by the Devolved Administrations.⁴

15. Both the UK Government and the Devolved Administrations have many years' experience of interaction with EU legislative processes and outputs that must be incorporated into domestic legislation. Whether or not you agree with the legislation itself, it is a fact that the process is effective in defining a common legal framework that Member States can appropriately transpose into their own domestic law. In the case of frameworks addressing UK-wide issues, it would make sense to adopt a modified EU legislative approach to defining legislation that must (or may) be enacted by the Devolved Administrations, in line with their own legislative framework. Expert legal opinion might provide insight as to whether this approach might also address constitutional aspects of the debate but, in a commercial context, adopting a minimum change approach is generally the least risky approach for effective delivery of change.

Question 3: The interaction between frameworks and the negotiation of new international agreements including free trade deals

16. For 45 years EU frameworks have constrained the legislative and executive discretion of UK governments; the design of 1999 devolution did not anticipate that this would ever change. Once outside the European Union, the UK Government wishes to negotiate free trade deals with other third-party countries, more advantageous to the United Kingdom than those that currently apply to the United Kingdom as an EU Member State. Three difficulties arise:
 - a) there is uncertainty about whether the UK Government can retain Westminster approval for, and EU acceptance of, the Chequers Agreement (HM Government, 2018)
 - b) there is a lack of clarity about whether Brexit will be followed by extensive elimination of the 'wasteful regulation' which one strand of Brexiter opinion

⁴ 'Liz Saville-Roberts MP (Plaid Cymru) said that developing common frameworks for the UK as a whole required mature co-operation between the national Governments of the UK. "It should not be a case of one country asset-stripping powers away from the others to impose a once-size-fits-all England-first framework across all the UK's countries." She also noted that Westminster will only be bound by political undertaking in the form of intergovernmental agreement, while the devolved Governments face legal constraints.' (Senedd Research, 2018).

believes to be the great benefit of leaving the European Union: changes that would make free trade deals with certain countries much easier to negotiate but would provoke EU claims of economic and social dumping

- c) it is clear that the UK Government believes that the Devolved Administrations do not share its deregulatory instincts and would attempt to obstruct, because of substantive policy disagreement and for tactical motivations.

Although the positions of the three Devolved Administrations might vary according to the issue, a high level of political tension between them and the UK Government can be expected unless measures are taken to overcome the lack of trust.

Question 4: Funding of obligations and commitments arising from frameworks

17. As noted in the later section on 'Applicability to Scotland's public finances', the effects of Brexit will bring further complexities to the devolved financing system.

There are three reasons for this:

- a) identical policies across the four UK nations do not result in the same levels of per capita expenditure owing to varying characteristics
- b) policies deemed to be equivalent will not necessarily have the same expenditure dynamics as identical policies
- c) historically these issues have been swept up under EU frameworks and financing, with a common UK interest to maximise receipts and thereby reduce the net contribution to the EU budget.

18. The question arises as to how former EU-financed expenditure will be managed and funded in future, though the issue could be wider, depending on what common frameworks contain. Fiscal risks for Scotland and Wales are intensified by the increasing dependence of their budgets on revenues either raised or assigned, bringing greater year-on-year volatility than when most revenue came from the Barnett-controlled block grant within the context of UK Spending Review settlements.

19. There is likely to be a tension between (a) the desire to maximise expenditure by contesting detail, and (b) protection of the block grant character of the funding

settlement. Technical options include (i) transferring exit-year expenditure⁵ into the block and then applying the Barnett formula, and (ii) classifying all ‘common frameworks’ expenditure as Annually Managed Expenditure, while treating such expenditure either as a mini-block with predetermined rules on switching or as a large number of specific grants. An outcome to guard against is giving financial levers to the UK Government, which could result in concealed micro-management of devolved finances, thus negating one of the strengths of the 1999 fiscal settlement. An issue for concern is that such expenditure is likely to attract more political and media attention than its absolute size merits, thereby adding to the widespread public misunderstanding of the devolved fiscal arrangements.

Electricity as an Example of Common Framework Functioning

20. The UK Government wishes to ensure that UK internal commerce will not be impeded by the imposition of different legal standards and/or obligations by the Devolved Administrations. The principle of establishing common frameworks to retain the necessary legal and regulatory alignment is accepted by all, including the Scottish Government. Being able to map the common framework concept to a familiar and proven operational setting will be helpful in defining how the new frameworks should be approached and governed. As these are intended to serve a similar policy-unifying function to EU regulations and directives, it would be logical to use the latter framework as a starting point to the definition and implementation of mandatory/outcome-based common frameworks. Indeed, the proposed Intergovernmental Agreement (Cabinet Office, 2018b)⁶ supports this perspective as it distinguishes between “specific elements of some areas” that will require legislation and other policy areas where other forms of agreement will suffice.

⁵ The transfer could be of expenditure averaged over a number of years in those cases where there is significant year-on-year variability.

⁶ “As of 24 April 2018, the UK Government and the Welsh Government have agreed to the terms of this IGA and Memorandum. The IGA and Memorandum remain open to the Scottish Government and a future Northern Ireland Executive” (Cabinet Office, 2018b, p. 1).

21. The issue underlying common frameworks is that of delivering desired policy co-ordination while respecting devolved legislative competences. The intersection between the range of policy areas and the different devolved legislative competences has already been identified in the Frameworks Analysis (Cabinet Office 2018a) and the implementation of common frameworks must address this asymmetry in a rational manner, to avoid inconsistencies and uncertainty. However, previous experience in establishment of the Single Electricity Market (SEM) for the island of Ireland shows that a significant cross-jurisdictional market policy can be implemented by a subset of UK legislatures, even though the specific area of energy is not devolved in Scotland.
22. The policy of creating a more efficient and secure electricity system for Ireland required agreement between two governments, with different constitutional and legal frameworks. It also impacted only Northern Ireland rather than the whole United Kingdom. The UK and Irish Governments implemented this policy through a Memorandum of Understanding (MoU) (HM Government, 2006), whereby they agreed to work together on the project and pass legislation to implement the agreed market framework. The MoU recognised the common framework of EU legislation within which the market would operate, ensuring future policy alignment between the two governments. Thus, a range of existing directives covering renewable generation, competition in generation and supply, environmental standards and consumer protection, that already ensured cross-border policy alignment, could be drawn upon as the basis for the new cross-border market. European Union membership provided assurance as to sustainability of the joint market, even in the significant market structural change introduced by the Third Energy Package of legislation (European Commission - Energy, undated).
23. This Third Energy Package differs from requirements in earlier European energy legislation, as it uses EU regulations to obligate changes that must be implemented identically across all Member States, alongside EU directives that allow Member States discretion in implementing internal requirements. In

combination, the regulations and directives ensure alignment of policy and cross-border arrangements that co-ordinate effectively.

24. Experience over many years in both the SEM and the European single market more generally demonstrates that cross-jurisdictional common policy frameworks can operate successfully, without inhibiting trade, even where they have been implemented through different trading structures as a result of different legislative frameworks. There is no reason why a similar approach should not be applied to the implementation of agreed common policy frameworks in the post-Brexit environment with Holyrood retaining all its devolved competences and implementing these frameworks as it would previously have done with EU directives.
25. As with the SEM, common frameworks could apply across all UK internal jurisdictions, but be implemented by the devolved legislatures. These frameworks could also be mobilised for specific purposes to support a wider policy goal across a subset of the Devolved Administrations. For policy areas identified as requiring legislation, these would function in a similar way to European regulations, in that they would have direct effect without ‘transposition’ into devolved legislation. For common frameworks of both types, the key to effectiveness and acceptance will be the process of development and governance of their operation; particularly as there are likely to be financial consequences arising from implementation.

Wider Considerations concerning Scotland’s Public Finances

26. Fiscal frameworks are outside the remit of this Inquiry, yet they are relevant to the issues under consideration. The nearest thing to a common fiscal framework has been successive issues of the Treasury’s (2015) *Statement of Funding Policy*. Although the asymmetry of UK fiscal devolution is a factor in the lack of a statutory basis for devolution finance, this is internationally unusual. Heald (2016) cautioned against assuming the resilience of the February 2016 fiscal framework for the Scottish Parliament, negotiated between the UK and Scottish Governments shortly before the Brexit Referendum (HM Government and

Scottish Government, 2016). The Cameron UK Government's desire to 'clear the decks' worked to the advantage of the Scottish Government which reached an agreement about the Block Grant Adjustment that is more favourable than it might have been. The interim nature of the 2016 Fiscal Framework means that future negotiations are required in time for setting the Block Grant Adjustment from 2022-23 onwards; timing that is unfortunate in the context of Brexit.

27. The post-devolution survival of the Barnett formula system is one of the surprising features of the first two decades of devolution. This has benefited Scotland in two ways: ensuring that there are rules-based procedures for upwards and downwards adjustments; and in providing some protection for the block-grant character of UK devolution finance. Nevertheless, UK devolution finance is deeply embedded in the Treasury's processes for public expenditure management and control (Heald and McLeod, 2005), leading to more internal borders within the block⁷ and making it more difficult to manage and prioritise. Further complexity seems an inevitable consequence of the repatriation of EU-financed expenditure, though the form that this takes will have important effects. Whereas in the past EU state-aid rules set a high threshold, there could be arguments about whether certain devolved taxes distort trade.

Glasgow, 31 August 2018

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⁷ For example, the division of Departmental Expenditure Limits (DEL) into Resource DEL, Capital DEL and Financial Transactions DEL.

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