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# If the UK votes to leave The seven alternatives to EU membership

By Jean-Claude Piris

# If the UK votes to leave: The seven alternatives to EU membership

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- ★ The United Kingdom might vote to leave the EU in the forthcoming referendum. But the British people may be voting without any clear sense of the alternatives to EU membership. This policy brief considers the various options. An overarching theme is that, if the UK wants access to the single market when it has left the EU, it will have to accept three things: continued budget contributions, continued free movement of labour, and continued supremacy of EU law over British law in the single market.
- ★ Some British eurosceptics believe that Britain could negotiate a special status of ‘half-membership’, whereby the UK would remain a full, voting member of the single market, but ditch most other EU policies. However, this would require the existing treaties – which allow no such special status – to be revised, which is not a viable possibility at the moment. In any case, most member-states and the EU institutions believe that allowing such a status for Britain could provoke similar requests from others, possibly leading the entire Union to unravel. So half-membership is not an option.
- ★ After a vote to leave, the UK must invoke Article 50 of the Treaty on European Union, which could lead to several alternatives to membership. One simple option would be for Britain to join the European Economic Area (EEA) – the ‘Norwegian’ option. Britain would then be outside the common agricultural and fisheries policies. But its economic relationship with the EU would not change significantly: it would pay nearly as much into the budget as it does today, free movement of labour would continue, and the UK would have to apply the single market’s rules and regulations without having a vote on them.
- ★ Most other options would involve the negotiation of a withdrawal treaty between the UK and the EU. One possibility would be a withdrawal treaty leading to a customised relationship. The best possible outcome for the British, under this option, would be something akin to the Norwegian option but without EEA membership. Britain would gain as much access to the single market as it was prepared to accept EU rules, without having a vote on them; to make payments into the EU budget; and to tolerate free movement of labour.
- ★ The Swiss option is unlikely to be on offer from the EU. Switzerland has negotiated a series of bilateral agreements with the EU. The country is part of the single market for goods, but not services. A similar status for Britain would be highly costly for the City of London. But the EU is very unhappy with the relationship, because it has to negotiate constantly with the Swiss to make sure that their rules are equivalent to the EU’s evolving *acquis communautaire*. And since the Swiss voted to impose quotas on immigration from the EU in 2014, the EU has demanded a new agreement which would make Switzerland automatically update its rules to match those of the EU, as well as accept the jurisdiction of the European Court of Justice.
- ★ Britain could join the EU’s customs union, like Turkey – accepting the EU’s external tariffs without having a say on the setting of those tariffs. The UK would then not face tariffs in exporting to the EU, and it would have access to the single market in goods, in exchange for signing up to all the relevant EU rules. But it would not have access to services markets and Turkey, like Switzerland and Norway, does not benefit from the free trade agreements (FTAs) that the EU negotiates with other parts of the world.

- ★ A free trade agreement is one of the more likely options, but the main benefit of most FTAs is merely tariffs that are lower than those prescribed by World Trade Organisation (WTO) rules. Most FTAs do not cover services, regulatory convergence or public procurement. If Britain sought to negotiate a more substantive FTA than any existing template – giving it good access to the EU’s single market – the other member-states would insist on mechanisms for ensuring that it automatically adopted new EU rules, and for policing the agreement. They would also demand payments into the EU budget and free movement of labour.
- ★ Britain could simply trade with the EU under WTO rules. The WTO sets upper limits on the tariffs that countries can impose. So British exports to the EU would be subject to the EU’s common external tariff. And the WTO has made little progress in freeing up services, which would restrict the City of London’s access to the EU market. British exporters to the EU would also face the same non-tariff barriers that most non-EU countries, like Russia and China, have to put up with. As for trading with the rest of the world, the UK would no longer enjoy the benefits of the 60-odd FTAs that the EU has negotiated with other countries. The British would have to negotiate new agreements from scratch; but in doing so – as with any other FTA that the UK pursued – they would have much less clout than the EU as a whole.
- ★ Withdrawal would create enormous legal headaches for EU companies and individuals currently in Britain, and for British ones elsewhere in the EU. After the repeal of the European Communities Act of 1972, the British government would have to hurry to draft new laws covering farming, fishing, competition policy, regional aid, environmental standards and much else, to avoid a regulatory vacuum. To the extent that the UK retained any access to the single market, the government would also need a mechanism for adopting new EU regulations and directives as they emerged. British citizens and companies in other member-states would lose rights derived from EU law. The British government would need to negotiate an accord with the rest of the EU on reciprocal rights. If, as is likely, a post-Brexit government made it harder for EU citizens to live, work or study in the UK, Britons wishing to remain in or move to the continent would face similar problems.

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David Cameron, the British prime minister, has promised a referendum on the United Kingdom’s EU membership before the end of 2017. His government is currently negotiating a series of EU reforms with the other member-states together with, perhaps, special provisions for the UK. Cameron will probably recommend that the British people vote to stay in the European Union. However, if the British reject membership, what would the alternatives be? What kind of political and economic links could be re-established between the UK and the continent after a ‘Brexit’?

The purpose of this policy brief is to sketch out the various legal options that the UK could follow after a decision to quit the EU.<sup>1</sup> Some people believe that Brexit would put an end to the UK’s relations with the EU. This policy brief argues the contrary. As the UK would want to maintain access to some or all of the EU’s market, it would have to negotiate a new settlement with the EU. Unfortunately, none of the options that would allow the UK to achieve that objective look palatable.

The most attractive option would be for the UK, instead of withdrawing, to remain an EU member, but with a special status: in a kind of ‘half-way house’, the UK would take part only in certain EU policies. But a half-way house is not a viable option, as will be demonstrated below.

This leaves seven alternatives that the UK and its partners would have to choose between: a customised relationship with the EU; membership of the European Economic Area (EEA), like Norway; membership of the European Free Trade Area (EFTA) – which the UK left in 1973 when it joined what is now the EU; the Swiss model of bilateral agreements with the EU; the Turkish model of a customs union with the EU; a free trade agreement with the EU; or, finally, the UK would become ‘just another partner’ of the EU, relying on World Trade Organisation (WTO) rules to govern trade.

One common theme runs through these options: in exchange for access to the EU single market, the UK would have to apply corresponding EU rules. But once the UK

<sup>1</sup>: The author is grateful to the CER’s John Springford and Charles Grant for their advice on this paper.

had left the EU, it would have little influence on shaping those rules. Neither a Norwegian, Swiss nor Turkish model would be well-tailored to the UK's political and economic interests and aspirations. Before examining these options,

this policy brief looks at whether a half-way house could be negotiated; and, if the answer is negative, how Brexit could work in terms of EU and international law.

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## Could the UK negotiate a special status as a 'half-member' of the EU?

Some people in London still seem to think that a half-way house is a viable option. The influential mayor of London, the Conservative Boris Johnson, appears to believe so. The idea is that the UK could remain a member of the EU, but one with a special status, through a revision of the EU treaties. Such a special status would, the thinking goes, allow the UK to continue participating both in the internal market and in the corresponding EU decision-making process, while obtaining the right to opt out of most of the rest of what the Union does.

But those who believe in the plausibility of the 'half-member' option are mistaken. The current EU treaties do not authorise such a possibility so they would have to be modified. In accordance with article 48 of the Treaty on European Union (TEU), this would require a common agreement and a ratification of the changes "by all the member-states in accordance with their respective constitutional requirements", which may mean a referendum in member-states such as Ireland. The subject of negotiation would not be the exit of a member-state, but the renegotiation of the treaties among all 28 members, in order to create a new status for one of them.

It would not be clear who should first ratify the necessary amendments to the EU treaties. Should that be the UK, which might well feel the need to organise another referendum, to bless the fruit of the negotiations with the 27? In that case, it would be difficult for the British government to convince the British people to vote in favour of a text which any of the other 27 might reject later. Therefore, the British authorities would probably ask their EU partners to be the first to ratify the revision of the treaties, in order for the British people to be sure of what they would be called upon to approve in the referendum. But one wonders how it would be possible to convince the 27 other states to organise the politically sensitive procedure of ratifying a new EU treaty. This would be particularly difficult in the current political climate, given the increase in euroscepticism on the continent, and without knowing if the British people would later accept the results. Moreover, the ratification process might take several years. In Belgium, for example, the ratification would not only need the approval of the federal parliament; the parliaments of the three regions and of the three communities would also have to give their consent.

One can see why the British might wish to obtain such a special status within the EU. However, the EU institutions and the other member-states would have important reasons to reject this type of arrangement. First, it would give a member-state which refuses to take part in joint decision-making in most policy areas the right to participate in EU decision-making in the single market; this grates against the EU's principle that its decision making should be autonomous. Second, it would be accepting a 'pick and choose' approach to membership, which, despite some member-states' opt-outs, is still considered by many EU leaders to be a single package of benefits and duties. Third, such a privilege could prove attractive for other EU-sceptical countries. For example it could open the door to similar requests from the likes of Switzerland, Norway, Iceland, Liechtenstein and the three 'states of a small dimension', Andorra, Monaco and San Marino. It could also create political tensions in certain EU member-states, such as Sweden, Denmark and others, where eurosceptic political parties could be tempted to push for half-member status, thereby opening up existential issues for the EU.

*“The current EU treaties do not authorise the 'half-member' option.”*

Some British eurosceptics think that the idea of a special status could be achievable because they are over-optimistic about the UK's leverage. The point is often made that the UK has a trade deficit in manufactured goods with the rest of the EU, and that the EU would have a vital interest in maintaining open trade with the UK. But while 45 per cent of its exports in goods and services go to the EU,<sup>2</sup> other EU countries only sell about 10 per cent of their exports to the UK, on average.<sup>3</sup> The UK's power of negotiation is therefore much weaker than some people think. Moreover, half of the EU's trade surplus with the UK is accounted for by just two states – Germany and the Netherlands – while a revision of the EU treaties would also require a positive vote of the other 25, including some which have trade deficits with the UK.

In any case, the idea that the EU could make an exception by conferring a special status upon the UK, conceding advantages which have consistently been refused to

2: UK Office of National Statistics, 2014 data.

3: See the excellent final report from the CER commission on the UK and the EU single market, 'The economic consequences of leaving the EU', June 2014.

Norway, Switzerland and others, would be unacceptable to most member-states and to the EU institutions. A half-way house is therefore not an option. David

Cameron has recognised this point by not asking for it in his negotiations with his EU partners.

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## The legal route to withdrawal

If the UK decided to withdraw from the EU, article 50 of the TEU – introduced by the Lisbon treaty – provides a legal basis and the procedure to be followed.

The article states:

1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.
2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.
3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.
4. For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it. A qualified majority shall be defined in accordance with Article 238(3)(b) of the Treaty on the Functioning of the European Union.
5. If a State which has withdrawn from the Union asks to rejoin, its request shall be subject to the procedure referred to in Article 49.

From paragraph 1 of that article, it is clear that, if the UK decides to leave the EU, the other member-states cannot prevent it from doing so, or even delay its exit beyond two years. Paragraph 2 provides for a procedure which allows the negotiation of a withdrawal treaty (WT)

between the withdrawing member-state and the rest of the EU. If such a negotiation between the UK and the EU were successful, the date of the UK's withdrawal from the EU would then be the date of the entry into force of the WT that they had agreed upon together. Otherwise, if no WT is concluded, the withdrawal would automatically happen two years after the notification of the UK's decision to the European Council.

*“The Council would approve the withdrawal treaty by qualified majority, after obtaining the consent of the European Parliament.”*

A WT could lead to several of the options covered in this paper, such as a customised relationship with the EU, the Swiss model, the Turkish model, a free trade agreement (FTA) or trade governed by WTO rules. But if the UK wanted to join the EEA or EFTA, a WT would not suffice: another treaty would have to be concluded by the UK with the member-states of those organisations.

During the negotiation of a WT, the UK would remain a member-state and continue to participate in EU activities. Its nationals would, in principle, continue to exercise their tasks and rights in all EU institutions and bodies. It is likely, however, that the capacity of the UK to influence the functioning of the EU and the decisions taken by the institutions would be seriously affected, including on matters unconnected with its withdrawal. The only legal exception provided for in article 50(4) is that the UK's representative in the European Council (the prime minister) and the Council (ministers) would not participate on the EU side in negotiations on the future WT. This would also apply to officials in the preparatory bodies of these two institutions, such as the Committee of Permanent Representatives to the EU (the ambassadors).

A WT would require neither unanimity in the Council,<sup>4</sup> nor a ratification by all member-states: it would have to be concluded only by the UK and the EU's institutions. The Council would approve it on behalf of the Union, “acting by a qualified majority, after obtaining the consent of the European Parliament”. Alongside the negotiation of a WT, a withdrawal would necessarily trigger a revision of the EU treaties. For example, the

<sup>4</sup>: However, the negotiation would take place within the framework of ‘guidelines’ adopted by consensus by the European Council.

articles listing the names of the member-states would have to be amended. This would have to be done in parallel, on the basis of article 48 TEU<sup>5</sup>, because article 50 does not allow a WT to amend the EU treaties. "Contrary to the WT itself, it would be primary law and would therefore not be subject to the jurisdiction of the European Court of Justice". (That change of the treaties would require the agreement of all the 28 and ratification by each of them; furthermore, the Court would not have competence over the change.)

Given the complexities of withdrawal, it is very likely that the two years allowed for the WT's entry into force would not be sufficient. In such a case, article 50(3) allows for an extension of that period, subject to the agreement of the UK and to a unanimous decision of the European Council. A longer period might also be needed for the UK to prepare the national legislation which would be necessary to substitute for EU acts.<sup>6</sup> Some parts of the WT could, if both parties agreed, be applied provisionally at the date the treaty is signed, but before the official date of withdrawal from the EU.

If the UK and the EU could not conclude a WT before Brexit, London would probably try to negotiate and conclude an agreement with the EU shortly afterwards. However, the ordinary rules of the EU negotiating treaties with third parties would then apply, and probably make

the conclusion of the agreement subject to unanimity in the Council (article 218(8) of the Treaty on the Functioning of the European Union, or TFEU), which would make it much more difficult to adopt.

One of the British priorities would probably be to obtain as much access as possible to the EU's internal market (actually, for the most part the EEA's market).<sup>7</sup> In other areas of EU policy, some transitional measures would be appropriate. This is because the economies of the UK and of the rest of the EU, after more than 40 years of membership, have become closely intertwined and interdependent. This is also because, as EU citizens, about two million British people live, work or are retired in other EU member-states, while some two and a half million other EU citizens live in the UK.

*"About two million British people live, work or are retired in other EU member-states."*

All this makes clear that the UK would have no interest in waiting to negotiate an agreement until after it had formally withdrawn from the EU. It would have a strong interest in negotiating speedily while still a member, and thus being able to benefit from article 50 TEU special procedure.

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## The seven options after 'Brexit'

Since a 'half-member' solution is not possible, if the British people vote to leave the EU, it really will mean leaving. The issue then becomes how Britain can build a new relationship with the EU, especially one covering trade. And this, contrary to the thinking of some, would be neither a quick nor an easy process. The British government could pursue any one of the seven following options. Unfortunately, all of them would have major drawbacks for the UK.

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### 1. The UK negotiates a withdrawal treaty that provides a customised relationship with the EU

After a vote to leave, the UK would notify the EU of its intent to withdraw, following article 50(2) TEU procedure. The negotiations would hopefully start as soon as possible after the notification. The government would presumably try to 'pick and choose' among EU policies, following a sectoral approach. The aim would be to keep the benefits that some key EU policies bring to the UK, while ditching commitments which are contrary to the

UK's interests or unpopular among British voters. For example, the UK might request continued access to the internal market in all areas except for the free movement of workers. It might also seek to be free of certain EU policies, such as the Common Agricultural Policy, the Common Fisheries Policy, the economic, social and territorial cohesion policy, or the social policy (although this policy is largely national).

5: That 'revision treaty' would have to be ratified by all the remaining member-states of the EU, in accordance with their respective constitutional requirements.

6: For example, it would not be possible to withdraw from the Common Agriculture Policy overnight, without causing disruption for farmers. House of Commons Library, 'Leaving the EU', July 2013.

7: The European Economic Area (EEA) was established by several agreements signed in 1992. It comprises the 28 EU member-states and three of the four member-states of the European Free Trade Association (EFTA) – Iceland, Liechtenstein and Norway. The EEA allows for a large participation of these three states in the EU's internal market. Switzerland, which is an EFTA member, is not a member of the EEA: it has chosen, instead, to negotiate a number of bilateral specific agreements with the EU.

The UK's leverage in the negotiations for maximising its access to the EU's internal market would be, as already explained, weaker than some people believe. It should also be remembered that the European Council has to agree on the guidelines for an agreement with the UK by consensus, meaning that each head of state or government has a veto on those guidelines.

The EU's institutions, including the Commission, which would negotiate on the EU's behalf, would oppose a 'pick and choose' approach. They would try to preserve the EU's decision-making autonomy, as well as control over how the UK would implement its future obligations. They would stress that the free movement of goods, persons, services and capital comes as an indivisible package.

Should the EU allow the UK access to the single market, in full or in part, it would insist on rules to stop discrimination against EU companies (and workers, if the free movement of labour is included in the agreement). It follows from that basic requirement that the UK would have to accept pertinent EU legislation, and as a non-EU member it would not have a right to vote on the adoption of new laws and modification of old ones. On top of that, the UK would also have to pay a significant financial contribution, as is currently the case for both Norway and Switzerland. Finally, the UK would no longer benefit from the many Free Trade Agreements (FTAs) which the EU has concluded with other parts of the world (the same applies to the other options: see section below on trade).

During the negotiation, each member of the Council of Ministers would naturally act according to the interests of the state which he or she represents, as well as the interests of the EU. The Council would take a decision to conclude a WT by qualified majority voting, and the European Parliament would be able to veto the WT. The member-states would not have to ratify the agreement,

because it should not cover areas where they have competence. However, the EU would later have to negotiate and sign another treaty with the three EEA EFTA members (which would need to be ratified by the EU, the UK, the 27 remaining EU member-states and the three EEA EFTA states), in order to take account of the new relationship to be established between the EEA and the UK.

*“Should the EU allow the UK access to the single market, it would insist on rules to stop discrimination against EU companies and workers.”*

Finally, a member-state, the European Parliament, the Council or the Commission would have the right to ask the Court of Justice whether the negotiated WT was compatible with the EU treaties. Should the Court's opinion be adverse, the agreement would not enter into force, unless it were revised or the EU treaties amended. This would of course heavily delay the process of negotiating a new relationship between the UK and the EU.

If the UK managed to negotiate a customised relationship with the EU, its substance would probably be similar either to that of Norway's with the EU, though the UK would not be within the EEA; or similar to the possible future (and more demanding) institutional agreement currently being negotiated by the EU with Switzerland (see section below on Switzerland).

In either case, the British government would find it difficult to accept the loss of sovereignty that such a withdrawal treaty entails.

## 2. The UK joins the European Economic Area (EEA)

The UK could try to join the EEA. In order to do so, it would also be legally required to join EFTA, of which the three non-EU members of the EEA are also members. The EEA option would have the advantage of simplicity: the legal framework has existed since 1994. The EEA agreement allows Iceland, Liechtenstein and Norway to participate in a large part of the EU's internal market and to enjoy the four freedoms, without being obliged to participate in other EU policies, such as agriculture, fisheries, judicial affairs, foreign policy and so on. These three countries have to apply the EU legislation concerning the internal market, as well as changes to that legislation, and to follow EU rules on competition, state aid, and so on, without having the

chance to influence their content significantly. They are given the opportunity to express their views on legislation, but cannot vote on what is decided. None of their representatives or nationals may participate in the meetings and work of the European Parliament, the Council of Ministers or the Commission.

The UK should also be aware that the EU is unhappy about the way the EEA is currently working. In a 2012 review, the Commission and the European External Action Service complained about the increasing backlog in the implementation of new EU laws by the three EEA EFTA states.<sup>8</sup> By the beginning of 2014, they still had not integrated around 580 pertinent EU acts into EEA law.

<sup>8</sup>: European Commission and European External Action Service, 'A review of the functioning of the EEA', December 2012.

By comparison, about 7,000 EU acts have been integrated into EEA law since the EEA agreement went into force in 1994. In its conclusions of a meeting on December 16<sup>th</sup> 2014, the Council noted:

...with concern the recurrent backlog and delays incurred during the entire process of incorporation of EU legislation into the EEA Agreement, as well as in the implementation and enforcement of relevant legislation in the EEA EFTA states. In this context, the Council strongly emphasises the need for renewed efforts in order to ensure homogeneity and legal certainty in the European Economic Area. The Council notes in particular that the questioning of the EEA relevance of EU legislation by the EEA EFTA states, the extensive use made of the possibility under the Agreement to request adaptations and exceptions, as well as delays in the clearance of constitutional requirements and in the implementation and enforcement of already adopted EEA legislation in the EEA EFTA states contribute to a fragmentation of the internal market and to asymmetric rights and obligations for economic operators.

To be clear, the EEA EFTA states are complaining too: according to them, the EU does not sufficiently take their interests and their constitutional problems into account.<sup>9</sup>

The UK could see advantages in choosing the EEA option: it would avoid the complex bilateral negotiations that a withdrawal treaty would entail. But the EU has demonstrated, in its current negotiations both with Switzerland and with the three 'states of a small dimension', that it wants non-EU states to adopt EU laws speedily and in full, as the price of single market access. The EU is also unhappy with the latitude that even the EEA agreement provides.

In any case, in the framework of the EEA, the UK would have to transpose into British law new EU acts governing the internal market, without having the right to shape their substance. It would also have to accept the rule that

all EEA EFTA countries speak with one voice in the joint committee which manages the EEA agreement, while that committee takes decisions on the incorporation of EU laws into the EEA legal order by consensus.

*“The loss of sovereignty associated with membership of the EEA might be difficult to accept.”*

Furthermore, EEA membership gives its members less freedom over their trade policy than some might imagine. Norway, Iceland and Liechtenstein (like Switzerland) are outside the EU's customs union. This means that the EU applies 'rules of origin' to its trade with Norway: if a Norwegian firm exports goods to the EU with a significant content from non-EU countries, EU tariffs are applied. This is to prevent exporters from outside Europe getting into the EU market without paying its tariffs, via a Norwegian 'back door'.

Inside the EEA, the UK would have to accept the powers of the EFTA Surveillance Authority, which would monitor whether the UK complied with the EEA agreement, as well as the jurisdiction of the EFTA Court, which would deal with violations of the EEA agreement by the UK. The UK would also have to pay the EU a financial contribution of a comparable magnitude to that of an EU member.<sup>10</sup> It would also have to accept free movement of people with the EU, as do the EEA EFTA countries. Finally, should the UK decide to join the EEA, it would need to sign an accession treaty which would have to be concluded and ratified, not only by the EU and the UK, as is the case for a withdrawal treaty, but also by each of the 30 EEA member-states (27 from the EU and three from EFTA).

In short, the loss of sovereignty associated with membership of the EEA might be difficult to accept. Which may be why David Cameron spoke disparagingly of this option in Reykjavik on October 28<sup>th</sup> 2015.

### 3. The UK rejoins the European Free Trade Agreement (EFTA)

The UK could also try and become a member of the EFTA, while staying out of the EEA. Harold Macmillan's Conservative government played a leading role in establishing EFTA in the early 1960s, as an alternative

to EU membership. But the UK left EFTA when it joined the EU in 1973. Switzerland is in EFTA but not the EEA, though, as the next section describes, it has negotiated a series of bilateral agreements with the EU.

<sup>9</sup>: Norwegian Ministry of Foreign Affairs, 'The EEA Agreement and Norway's other agreements with the EU', 2012-13. See also Jacques Pelkmans, 'The EEA Review and Liechtenstein's Integration Strategy', Centre for European Policy Studies, Brussels, March 2013.

<sup>10</sup>: Centre for European Reform, 'The economic consequences of leaving the EU', June 2014. This report points out that the financial contribution of the three EEA EFTA States to the EU was €1.79 billion for the period 2009-14. The Norwegian contribution per head to the EU during that period was comparable to the British net contribution during the same period – just 9 per cent less. The House of Commons Research Library's figures are comparable: for the year 2011, Norway's per head contribution was 17 per cent less than the UK's. In fact Norway is currently the 10<sup>th</sup> largest per capita contributor to the EU budget, just behind the UK which is 9<sup>th</sup>. House of Commons Library, 'Leaving the EU', July 2013.



If the UK were merely to rejoin EFTA, it would achieve very few economic benefits. Given the development both of the EEA and of bilateral relations between Switzerland and the EU, the FTA between the EU and EFTA has become almost an empty shell, containing little of substance. The FTA covers only trade for some fish and agricultural products, and no services at all. It is not linked to either the EEA, or to the 1972 trade agreement (modified several times) between

Switzerland and the EU. EFTA membership would not give the UK access to the many FTAs concluded between the EFTA states and third countries; the EFTA itself does not broker FTAs.<sup>11</sup>

Thus, joining EFTA would do very little to provide British firms with preferential access to key European or other export markets.

## 4. The UK follows the Swiss model

The UK could use a withdrawal treaty to try to follow the Swiss model of relations with the EU: Switzerland has concluded more than 120 sectoral agreements with the EU, a few of them being substantial.

One of the problems that the UK would have with this model is that Switzerland has no agreement on services with the EU, and in particular on financial services (apart from one accord on life assurance). The Swiss and the EU are unlikely to negotiate a financial services agreement in the short or medium term. A substantial part of British trade is in services, because of the City of London's role as an international financial centre.

Nevertheless, enthusiasts for this model underline that the framework of the arrangements between Switzerland and the EU is based on classic international law. This means that, unlike EU member-states, Switzerland is not bound by judgments of the European Court of Justice (ECJ) and, unlike the EEA EFTA states, it is not bound by judgments of the EFTA Court. But that legal analysis does not fully reflect reality: in order to be able to export to the EU, Switzerland often finds itself in the same *de facto* situation as the EEA EFTA states. It has to incorporate EU regulations and directives into its legal order and follow their interpretation by the ECJ, although it does not participate in the decisions that lead to their adoption. Switzerland must also contribute financially to the EU budget: its contribution per head is about 55 per cent that of the UK.<sup>12</sup>

But the major problem for the UK in trying to pursue the Swiss model is that it would be entering uncharted waters. This is because the EU is unhappy with the state of its relationship with Switzerland and wants to change it. In December 2010, the EU's Council of Ministers described these relations as "not ensuring the necessary homogeneity", and causing "legal uncertainty". It added that this system "has become complex and unwieldy to manage and has clearly reached its limits". In December 2012, the Council reaffirmed that "further steps are necessary in order to ensure the homogeneous

interpretation and application of the Internal Market rules", and that it would seek a "legally binding mechanism" to make Switzerland sign up to revised laws, as well as "international mechanisms for surveillance and judicial control".

*"The EU said that, unless Switzerland rethinks the migration issue, it will start to lose access to the single market."*

Then, in February 2014, the Swiss people decided in a referendum to oppose unlimited immigration from the EU. So the Swiss government announced that it would not allow free movement of persons with Croatia, which joined the EU in 2013, although this would breach treaties between Switzerland and the EU. The EU rejected that move. It also rejected a subsequent proposal that Switzerland should be able to impose quantitative limits on a surge of immigrants from EU countries. The EU has already 'punished' Switzerland by excluding its people and universities from the Erasmus educational exchanges and from some of its research programmes. It is unclear how and when this stand-off will be resolved, but the EU has said that, unless Switzerland rethinks the migration issue, it will start to lose access to the single market.

The dispute over free movement of persons confirmed the EU in its view that the current legal framework was failing. Driven by the desire to try and solve all problems in a single comprehensive 'package deal', the Council of Ministers decided, in May 2014, to mandate the Commission to launch negotiations with Switzerland on "an international agreement on an institutional framework governing bilateral relations with the Swiss Confederation". These negotiations are continuing.

If concluded, such a new agreement would impose on Switzerland much stricter legal obligations than those of the EEA EFTA members. Crucially, it would not

11: Contrary to what seems to be implied by Research Paper 13/42 of the House of Commons Library.

12: House of Commons Library, 'Leaving the EU', July 2013.

only apply to the future agreements between the EU and Switzerland, but also to all existing agreements, including all those “related to the internal market”.<sup>13</sup>

The Council mandate proposes that the European Commission should monitor Switzerland’s application of the bilateral agreements. It also says that the Commission should be given “investigatory and decision-making powers” which should “reflect” the Commission’s powers over member-states when policing the single market.

As for enforcement, the mandate proposes that the ECJ should have jurisdiction, and that either the EU or Switzerland should be able to take cases to the court “without the other party’s prior consent”. The decisions of the Court should be “legally binding on both parties”. And the Council wants a procedure that would allow the EU to terminate agreements if Switzerland violates them.

The mandate also proposes a maximum time limit for Switzerland to implement EU laws, when they are updated

by the EU. The mandate says that there should be no more agreements with the Swiss on further access to the single market, before “the conclusion of the agreement on an institutional framework”.

*“The current Swiss model is broken and will never be accepted again by the EU.”*

In other words, the EU wants the Swiss-EU relationship to become much stricter than the EEA-EU model, with agreements enforceable by the institutions of the EU itself. However, the negotiations are far from complete. It is by no means a given that Switzerland, which might need to organise a referendum for the ratification of a new agreement, will accept all the EU’s requests.

In any case, the current Swiss model is broken and will never be accepted again by the EU. And any revamped version that the EU and Switzerland may one day agree upon is unlikely to be an appealing model to the sovereignty-conscious UK.<sup>14</sup>

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## 5. The UK negotiates a free trade agreement with the EU

This is perhaps the most likely option to be adopted, and could happen via a withdrawal treaty. Many British analysts believe that the size of the British economy (the fifth largest in the world), and its importance to the rest of the EU (the source of 53 per cent of British imports) would ensure that the UK could obtain an FTA on very good terms.

No existing EU free trade or association agreement could serve as a template for the new relationship between the EU and the UK, for none of them are as ambitious in scope as the one that the British would seek.

The term ‘free trade agreement’ is misleading. Most FTAs do not provide for free trade, but rather for better market access than that provided by WTO rules. FTAs usually say very little about trade in services. They do not necessarily eliminate tariffs or quotas and almost never deal with non-tariff barriers to trade. And while tariffs matter to some industries, such as car-makers, non-tariff barriers are nowadays the most important barriers to trade. For example, many governments use national regulations and standards, consumer protection laws, procurement rules, administrative obstacles or blatant national favouritism to keep out foreign competition. Some of the recent FTAs negotiated by the EU, such as those with Canada and

Singapore, not yet in force at the date of writing, move a little way towards the harmonisation of norms and standards. So will the Transatlantic Trade and Investment Partnership (TTIP), currently under negotiation between the EU and the US, if it is concluded.

Consider the EU’s trade agreement with Canada, the Comprehensive Economic and Trade Agreement (CETA), which was agreed by negotiators in 2014 but has not yet been ratified. It is the most comprehensive trade agreement the EU has ever negotiated. It will eliminate tariffs on all industrial products, although tariffs on cars and ships will be reduced only slowly. Most agricultural and fisheries tariffs and quotas will go, apart from those on meat and eggs. But differences in regulations and standards will remain, and these constitute some of the larger barriers to trade. The agreement says there will be more co-operation on future regulations to try to make them more compatible. But, for example, cars and chemicals made to meet Canadian standards may not be sold in the EU. Financial services are excluded from the agreement, so Canadian retail and investment banks, insurance and pension companies, as well as investment funds, may not provide many services in the EU without establishing a subsidiary in Europe. And government procurement is also excluded, which will allow EU

<sup>13</sup>: Agreements on: free trade, free movement of persons, air transport, carriage of goods and passengers by rail and road, trade in agricultural products, mutual recognition in relation to conformity assessment, certain aspects of government procurement, simplification of inspections and formalities in respect of the carriage of goods and on customs security measures, and co-operation in the field of statistics.

<sup>14</sup>: David Buchan, ‘Outsiders on the inside: Swiss and Norwegian lessons for the UK’, CER policy brief, September 2012.

governments to turn down Canadian companies' bids for government contracts, and vice-versa.<sup>15</sup>

Compare this to the more comprehensive nature of the EU's single market. In the single market, goods standards are harmonised, restrictions on the provision of cross-border services are lower, and governments must accept bids for contracts from companies based in other member-states. All these rules are enforced by the EU's institutions, which have authority over national governments. By contrast, even the most advanced FTAs do not provide for the kind of surveillance and judicial instruments that the EU would insist on in any agreement negotiated with a post-Brexit UK. This is shown by the current EU's negotiating position with Switzerland. It would probably be the same with the UK,

if the EU were to concede the substantive access to its internal market that the UK would like to enjoy.

In that case, the EU would require that the UK continues to adopt future EU laws concerning the internal market, in order to preserve a level playing field for all economic operators. The UK would have to apply a number of rules on health and safety, competition policy, product standards, consumer protection and technical specifications, as well as rules in other areas. It is unlikely that the European Parliament and the Council would accept an agreement that did not set such obligations for the UK.

Therefore the UK would probably find the FTA model unsatisfactory.

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## 6. The UK seeks a customs union with the EU, along the lines of the customs union between Turkey and the EU

Turkey and the EU are bound by an association agreement that includes a customs union. A customs union eliminates internal tariffs and requires the participating countries to agree on common external tariffs. If the UK accepted such an arrangement with the EU, it would not be free to adopt its own tariffs, because it would have to follow decisions on tariffs made by the EU. Besides, this option would not give full access to the EU's internal market, unless it was extended to cover services, which is not the case for Turkey. Under such an arrangement, UK-based manufacturers would have to comply with EU product standards, and the UK would have to accept large sections of the EU's *acquis communautaire* and competition policy, and its future evolution. If the UK resisted this, the EU might suspend market access or impose anti-dumping duties, to prevent British firms undercutting continental competitors through subsidies or deregulatory measures.

Moreover, Turkey does not have a say on the FTAs that the EU negotiates with other countries, and does not benefit

from them. For instance, after the recent EU FTA with the Republic of Korea (South Korea), Turkish exporters do not have access to the Korean market, yet Korean exporters have automatic access to the Turkish market. Similarly, Turkey is now concerned that it will not have access to US markets through the TTIP, if that EU-US trade deal is agreed (Switzerland and Norway have the same concerns).

*“Turkey does not have a say on the FTAs that the EU negotiates with other countries, and does not benefit from them.”*

In short, the Turkish model would provide only limited access to the EU's internal market, yet would deprive the UK of sovereignty on trade policy. It is therefore hard to see how it could be attractive to the UK.

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## 7. The UK does not conclude any trade agreement with the EU and relies on WTO rules to manage trade with it

If none of the above six options proved palatable, the UK could simply trade with the EU under WTO rules, which set limits on the maximum tariffs that countries can apply to trade in goods.

The EU and its member-states would become third countries vis-à-vis the UK, and vice-versa. The UK would have to re-establish customs controls at borders with EU member-states. This would include establishing a border

with the Republic of Ireland, unless the EU and the UK managed to conclude a special agreement on that issue before the date of the UK's withdrawal. A new border between the two parts of Ireland could have serious political repercussions.

The WTO rules would give the UK no more access to the EU market than that of countries lacking FTAs with the EU, such as Russia and China. Were the UK's trade with the EU

<sup>15</sup>: European Commission, 'Consolidated CETA text', September 26<sup>th</sup> 2014.

to be governed by WTO rules, the UK's goods and products would also face EU common external tariffs. In some price competitive markets, these tariffs would damage the UK's exporters. The EU's tariff on car engines, for example, is 10 per cent, and several manufacturers ship engines from their UK plants to other EU countries. These supply chains would be disrupted under WTO rules; firms might reduce production in the UK and expand it in the EU.

### Regarding British external trade with the rest of the world:

The UK is, like all EU member-states, a signatory in its own right to those FTAs concluded by the EU that are 'mixed agreements'. These agreements are concluded both by the EU and its member-states, because their content is covered partly by the EU's exclusive competence and partly by member-states' competences. However, commitments concerning trade in these agreements have been taken solely by the EU, because of its exclusive power on trade. Therefore, the commercial part of these agreements would no longer be legally binding for relations between the UK and the non-EU countries that had signed them. The same would apply to any parts of the FTAs that covered services, such as financial services or air transport.

However, as a WTO member, the UK would benefit from its rules on access to markets. What would be the effects of these rules? One must recognize that they would give extremely modest results. The WTO has a poor record of lifting barriers to trade. Since its creation in 1995, it has not concluded a significant multilateral trade agreement on lowering tariffs. Even more important, it has done very little to combat either non-tariff barriers for trade in manufacturing, or trade in services – which compromise a big part of the UK's exports.

A major problem, which would also be the case with the other six options, is that, being outside the EU, the UK would no longer be party to the FTAs negotiated by the EU with about 60 non-EU countries or organisations (together, these FTAs cover about 35 per cent of world trade). The benefits from these FTAs would disappear on the day of withdrawal. The UK would need to negotiate new agreements with all these countries. However, the British government would

face logistical problems in doing so: it has not had any trade negotiators since 1973, having handed over trade deals to the EU, given the EU's exclusive competence in the area of common commercial policy. Whitehall would need to find hundreds of people – from retirement, other countries or consultancies – to do this work.

Besides, and this is of even more concern, it would be difficult for the UK to negotiate FTAs with third countries that would be, in substance, as beneficial for its economy as the existing EU ones.

*“For several years after Brexit, a long period of uncertainty would weigh on Britain's trade and inward foreign investment.”*

The UK alone would have much less bargaining power than the EU. FTAs are trials of strength, in which each side concedes additional market access to the other. The strongest powers get the best deals. Thus, in the China-Switzerland FTA, concluded in 2013, Switzerland has given China more access to its markets than vice versa.<sup>16</sup> The EU is the leading exporter and importer in the world, both for goods and for services. According to the WTO, the UK accounted for 2.7 per cent of world exports of goods and 6.8 per cent of world exports of services (including intra-EU exports in both cases) in 2014; compared with, respectively, 14.9 per cent and 26.2 per cent for the EU (excluding intra-EU exports).<sup>17</sup> An additional problem for the UK in negotiating FTAs by itself is that it already has a relatively open economy. Therefore it has relatively little to offer in a bargain over the removal of barriers to trade.

Thus, for several years after Brexit to say the least, British external trade would be negatively affected. A long period of uncertainty would be weighing on Britain's trade and inward foreign investment, and this would affect economic growth. In the long run, hopefully, when bilateral trade agreements between the UK and all its main partners, including of course the EU, came into force, the situation would improve.

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## The impact of Brexit on the UK's legislation and regulations

In the absence of any agreement between the EU and the UK providing for the contrary, from the date of withdrawal the UK would be liberated from its legal obligation to implement EU law. The 1972 British European Communities Act, which has given legal effect to European law, would be repealed. EU law includes regulations, directives, decisions, international treaties

and other EU norms. It governs matters going well beyond the internal market and the four freedoms. It would concern for example Europol, the European Arrest Warrant and other security measures. It would also concern existing EU law for all other EU policies, such as agriculture and fisheries, transport, competition, taxation, social issues, consumer protection, trans-

<sup>16</sup>: Most Chinese tariffs on goods will be reduced or eliminated, but many of them over a lengthy transition period, while almost all of Switzerland's tariffs were eliminated from day one of the treaty entering into force.

<sup>17</sup>: WTO, UK and EU trade profiles, 2014.

European networks, economic and territorial cohesion, research, environment, energy, civil protection, common commercial policy, development co-operation with third countries, humanitarian aid and so on. By the same token, the remaining 27 member-states would of course no longer be bound to respect EU law in their dealings with the UK.

Paradoxically, this situation would entail a lot of legislative and regulatory activity in Britain. In order to plug the legal gaps which would open up when EU law ceased to apply, the British authorities would have to adopt many new national laws. It would be urgent to do so, for example, on competition policy, the protection of consumers and of the environment, agriculture and fisheries, and so on. EU regulations (as opposed to directives) are binding and directly applicable to member-states, so if the UK left the EU and the 1972 British European Communities Act was repealed, they would cease to apply. The British Parliament would have to move swiftly to pass new laws in their place. EU directives, in contrast, set out the objective to be achieved, but leave it to member-states to adopt their own implementing legislation. The UK would have to review the national laws that it had passed in order to implement EU directives and choose, on a case-by-case basis, whether it wanted to abrogate, retain or modify them.

Moreover, the withdrawal would not put an end to the links between the EU and British laws. As explained above, British products and services would still have to comply with some EU standards, in order to be eligible for export to the EU. Thus the UK would have to adopt national laws and regulations in order to enforce those standards.

#### **The impact on individuals:**

Brexit would matter hugely for the roughly two million Britons living in EU countries. It would not be possible for them to retain the advantages of EU citizenship. The treaties say that one must hold the nationality of a member-state in order to be a citizen of the Union. There is nothing in the EU treaties or in the case-law of the ECJ which could be used to establish a theory of 'acquired rights' – the idea that no individual can be deprived of legal rights, once he or she has enjoyed them – for the citizens of a state departing the EU.

Therefore only EU laws that grant nationals of non-EU countries specific rights would benefit UK citizens. This would be the case for the right of residence or the right to work; the EU has adopted, for example, directives on family reunification, on long-term residents and on students.

Therefore, after a Brexit, some public authorities, companies and individuals, from both the UK and other member-states, would no longer benefit from many rights established by Britain's EU membership. Moreover, companies and people from member-states that were established or permanent residents in the UK would no longer benefit from the protection of single market law. They would be in a new legal situation. People who had a right to permanent residence in other EU countries could probably keep it, as this right is derived from the European Convention on Human Rights. Such people could continue exercising their rights, based on their particular contracts, but in conformity with the applicable local law. Those who did not have a right to permanent residence could, in theory, be forced to leave, according to applicable national rules on immigration.

*“Britons wanting to work or study or join their families on the continent would face difficulties.”*

The UK would therefore have an urgent need to conclude an agreement with the EU, in order to protect British citizens living (and companies established) in EU member-states. Any agreement would be based on classic international law and in particular on reciprocity. The UK would not be able to negotiate separate deals with each of the 27 – in a bid, for example, to exclude Central and East Europeans. The UK would have to negotiate with the EU as a whole, which would not allow some of its citizens to be discriminated against by the UK. All rights obtained in favour of British citizens residing in the 27 member-states would have to be granted to their nationals residing in the UK.

Given that, post-Brexit, the British government would be highly likely to impose restrictions on the right of EU citizens to live and work in the UK, Britons wanting to work or study or join their families on the continent would face equivalent difficulties throughout the EU. Depending on what the UK demanded of EU migrants, Britons could need to obtain visas or to satisfy financial and residency requirements. In the absence of an appropriate agreement, the ability of some Britons to remain on the continent could become difficult, especially if they were unemployed.

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## Conclusion

The conclusion should be clear: none of the options available to the UK, in case it were to decide to withdraw from the EU are attractive. Any option would take the UK in one of two directions:

- ★ The UK would become a kind of satellite of the EU, with the obligation to transpose into its domestic law EU regulations and directives for the single market.
- ★ The UK would suffer from higher barriers between its economy and its main market, obliging the government to start trade negotiations from scratch, both with the EU and with the rest of the world, without having much bargaining power.

In short, if the UK chooses to leave the EU, it will be left between a rock and a hard place.

On the one hand, it is unlikely that the UK's European partners would allow the UK to remain in the EU with a special status, which would need a significant revision of the EU's basic treaties. If the UK sought such a deal, the EU would oppose such a 'pick and choose' approach that could lead, in the long run, to the dismantling of the European project.

On the other hand, withdrawing from the EU and negotiating a new agreement with it would not be easy either. None of the available options could satisfy at the same time the UK's political wishes and its economic interests. In exchange for access to the single market, Britain's partners would impose on the UK a requirement to apply corresponding EU laws, without it being able to take part in their drafting.

Nevertheless, the UK could not afford its new relationship with the EU to be free of formal agreements, as this would affect many British and EU citizens. Crucially, it would have substantial negative effects for the UK's external trade and for its economy. For at least five to ten years, considerable uncertainty would weigh on companies operating in Britain. It would also, though to a lesser degree, be harmful for the economy of the rest of the EU.

Finally, Brexit would certainly be damaging politically for the status of the EU – and its liberal values – and, thus, for the future prosperity and security of Europe as a whole. That includes the United Kingdom, of course.

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