Report
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Open Europe

What if...?
The Consequences, challenges & opportunities facing Britain outside EU

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FREE TRADE

PROTECTIONISM

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- **Boost jobs and growth.** Enable and encourage free trade – internally and globally. Regulate business less, but better.
- **Embrace democracy.** Be transparent and accountable to citizens, recognising the crucial role of national parliaments. Cut the cost of Brussels.
- **Focus on the big questions.** Do not interfere in areas that could be equally well handled at the national or local level.
- **Be flexible.** Allow powers to flow back to the member states, and let some countries integrate more than others.

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Foreword

One way or another, it looks likely we will be given a referendum on Europe. Brace yourself for a barrage of misleading economic propaganda from both sides. Those who want to stay will characterise a British exit, or Brexit, as nothing short of economic suicide. Those who want to leave will overstate the EU's costs and present prosperity as the inevitable result of new found liberation.

In this report, Open Europe sets out the economic options facing Britain should we decide to leave the EU. It is a remarkably balanced document. To that extent, it will disappoint the headline grabbers on both sides of the European debate. The report unearths one profoundly important truth: if we decide to leave the EU, whether we flourish or fail will depend on the political and economic decisions we take in the wake of departure. Of itself, leaving the EU will guarantee neither success nor failure.

If we leave and follow the path of protection, xenophobia and isolation we will indeed face the economic decline so feared by Europhiles. Open Europe estimates that, under the protectionist scenario, leaving the EU would cost 2.2% of GDP by 2030. Alternatively, if we embrace free trade, roll back damaging regulation, and take a balanced approach to economic migration, then we could be more successful outside the EU than within. In such a scenario, we could add at least 1.6% to GDP by 2030.

I love the things the EU does to foster liberty – free movement of goods, services, people and capital; but I intensely dislike that which it increasingly does to restrain, regulate and tax us. Without bold EU reform, I would opt to leave, but there are significant risks associated with Brexit. Before we take that step, Eurosceptics and Europhiles should unite behind endeavours to get the bold reforms Europe so badly needs.

Lord Wolfson of Aspley Guise
Chief Executive, Next Plc
Open Europe Advisory Council Member

Foreword

The Brexit debate is dominated by opposing exaggerations. To read some assertions, you would think that leaving the EU would bring a wasteland, with three million jobs lost and businesses fleeing the country overnight. To read others, you would expect with one bound to be free to exclude immigrants, slash EU costs and trade with the world, adding billions to the national wealth

Both these propositions are deluded. The mere act of leaving would not bring European trade to a halt or stimulate trade with China and the US. Nor would it be followed automatically by deregulation. We calculate that the GDP impact would be around plus or minus 1%, depending mainly on the UK's policy response.

If we struck a beneficial trade agreement with the EU, concluded similar agreements with Asian and American countries, and pursued free market policies domestically, we could be financially better off out. But if we maintained most of our existing regulations (e.g. on climate change and banks) blocked immigration and protected industries threatened by global competition, then we would be worse off. In reality, we would no doubt do a bit of both, narrowing the gap between advantage and disadvantage.

For many readers, non-financial considerations will be uppermost. How highly do we value pure self-government as against our current partly compromised democracy? How important is European solidarity, with Putin and Islamic militancy at the gate? If we leave the EU, will Scotland leave us? This study makes no attempt to answer such questions. Its more modest aim is to strip the debate of adversarial claptrap and substitute solid factual ground on which a less emotionally charged decision can be taken.

Lord Leach of Fairford
Director, Jardine Matheson Holdings Ltd
Open Europe Chairman

Executive Summary

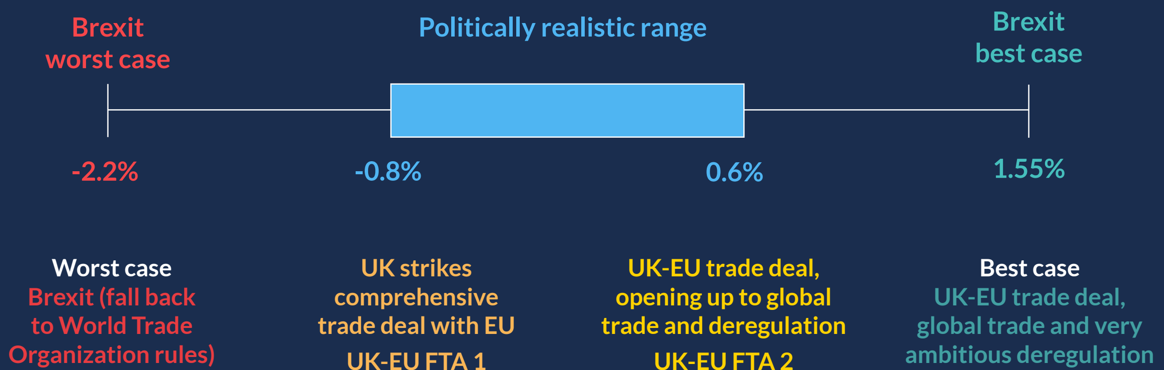
In this study, we look primarily at the economic impact of Britain leaving the EU. However, given that Brexit comes down to a finely balanced calculation, unquantifiable considerations such as lost sovereignty and democratic accountability may be what in the end determines whether Britain remains a member.

The numbers

Based on economic modelling of the trade impacts of Brexit and analysis of the most significant pieces of EU regulation, if Britain left the EU on 1 January 2018, we estimate that in 2030:

- In a worst case scenario, where the UK fails to strike a trade deal with the rest of the EU (thereby having to fall back on World Trade Organization rules) and does not pursue a free trade agenda, Gross Domestic Product (GDP) would be 2.2% lower than if the UK had remained inside the EU.
- In a best case scenario, where the UK strikes a Free Trade Agreement (FTA) with the EU, pursues very ambitious deregulation of its economy and opens up almost fully to trade with the rest of the world, UK GDP would be 1.6% higher than if it had stayed within the EU.
- However, these are outliers. The more realistic range is between a 0.8% permanent loss to GDP in 2030 – where the UK strikes a comprehensive trade deal with the EU but does nothing else; and a 0.6% permanent gain in GDP in 2030 – where it pursues free trade with the rest of the world and deregulation, in addition to an EU FTA.

Impact of various Brexit scenarios on UK GDP (2030)



Worst case
Brexit (fall back to World Trade Organization rules)

UK strikes comprehensive trade deal with EU
UK-EU FTA 1

UK-EU trade deal, opening up to global trade and deregulation
UK-EU FTA 2

Best case
UK-EU trade deal, global trade and very ambitious deregulation

%GDP	Worst Case	UK-EU FTA 1	UK-EU FTA 2	Best Case
Initial Cost	-2.76	-1.03	-1.03	-1.03
EU budget saving	0.53	0.22	0.22	0.53
Unilateral free trade	-	-	0.75	0.75
Deregulation	-	-	0.7	1.3
Total welfare gain/loss	**-2.23**	**-0.81**	**0.64**	**1.55**

Source: Open Europe and Ciuriak Consulting

The tough choices facing Britain outside

In none of our scenarios would the cost of leaving the single market and the EU customs union be off-set by merely striking a new trade deal with the EU. Britain will only prosper outside the EU if it is prepared to use its new found freedom to undertake active steps towards trade liberalisation and deregulation. It faces a series of difficult choices:

- *Beyond the border:* Opening up the UK economy to trade with the rest of the world – including the USA, India, China and Indonesia – is essential to economic growth post-Brexit. However, this would mean exposing UK firms and workers to whole new levels of competition from low-cost countries, and would therefore be politically very sensitive.

- *On the border:* In order to be competitive outside the EU, Britain would need to keep a liberal policy for labour migration. However, of those voters who want to leave the EU, a majority rank limiting free movement and immigration as their main motivation, meaning the UK may move in the opposite direction.

- *Behind the border:* EU rules have largely been incorporated into UK law, and would remain in force until the UK Parliament decided to amend or scrap them. Outside the EU, we estimate that a very liberally inclined UK government could in theory cut the cost of the most burdensome EU regulations by an amount equivalent to between 0.7% and 1.3% of GDP. However, on current evidence, Britain is likely to keep many of these EU rules, for example on climate change where it has gone further than the EU standard.

The choices for Europe

- The economic advantages and disadvantages of Brexit will depend to a large extent on the future relative economic dynamism of the EU. If it manages to overcome its current economic problems, and liberalises internal and external trade, then the cost of Brexit relative to remaining within the EU will be higher.

The process of leaving

- Article 50 – the only established legal way to leave the EU – is a major liability. Once triggered, there is no turning back, it excludes the UK from key decisions as well as the final vote and it leaves the EU in charge of the timetable during two years of negotiations, following which the UK could be presented with a 'take it or leave it' deal. Our results show that leaving without a preferential trading agreement would dent UK GDP significantly.

Sector analysis

- After initial disruption, there is a high likelihood that the UK and the EU could conclude preferential trade deals covering goods sectors, but with new border and administrative costs due to rules governing foreign content in their products. For many sectors, a deal may involve adhering to the EU's high regulatory standards.

- For the remaining services sectors, and financial services in particular, guaranteeing seamless access to EU markets for UK businesses will be more difficult, not least because the UK has a deficit with the EU in goods, but a surplus in services.

Hurdles to overcome to prosper outside the EU

Brexit to trade deal with EU

- Needs approval of all EU members & MEPs.
- No existing model suitable – UK would need to negotiate specific deal.
- Lengthy to negotiate, Article 50 puts power in EU's hands.
- May involve commitment to keep EU free movement.

Trade deal plus ambitious deregulation

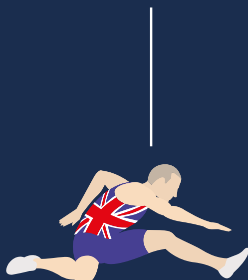
- Tough political choices, including scrapping EU social and employment law regulations.
- Governments talk big on deregulation but rarely deliver – could not be afforded in this instance.

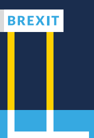
Open up to global trade

- Radical measure – would expose UK firms to low cost competition from abroad.
- Benefits economy as a whole but some firms may be forced to close.

Further deregulation

- Even tougher choices including scrapping climate change commitments.
- Would face resistance from Trade Unions, NGOs and even voters.





Worst case Brexit
-2.2% GDP

Figures show GDP gain/loss in 2030 relative to baseline inside EU

UK strikes comprehensive trade deal with EU
-0.8% GDP

Trade deal and deregulation
-0.1% GDP

UK opens up to global trade
0.6% GDP

UK embarks on unprecedented further deregulation push
1.55% GDP

Say over the rules

- Though some standards are set globally, most sectors would suffer from the UK's loss of voting rights in the EU - the financial services sector in particular.

Alternative models

- We judge alternatives to full EU membership on four tests – EU market access, say over the rules, gains in independence and negotiability – concluding that none of the existing models are suitable for the UK.
- Instead, the UK would likely have to negotiate a tailored deal for itself. Based on our tests, a "Single Market-Lite" arrangement – staying inside a very tightly defined EU single market – would be the most beneficial for the UK. Unlike the EEA, this must also involve voting rights over the rules governing the single market, which would be very difficult to negotiate.
- A politically more realistic alternative is a comprehensive Free Trade Agreement, differing from the "Swiss model" by including better access for financial services and a fair say over how rules and standards are implemented.
- The UK could also pursue unilateral liberalisation, which would involve minimum negotiations with the EU but difficult domestic political decisions. However, our modelling suggests that a strategy of agreeing FTAs with the EU and other states, followed by unilateral free trade with the rest of the world would produce the greatest benefit.

Given the difficulty in leaving the EU and the extent of the political and economic challenges the UK would need to overcome to make Brexit work in its long-term interests, it would be foolhardy to leave without first testing the limits of EU reform. Limiting the areas of EU interference and further market liberalisation would be the most beneficial option for both the UK and the EU.

If the UK puts as much effort into reforming the EU as it would have to in order to make a success of Brexit, the UK and the EU would both be far better off.

1.

Introduction

1.1. The outline of this report

With a significant chance of a referendum on the UK's EU membership following the next General Election, the chances of the UK leaving the EU are non-negligible. Therefore, no matter where one stands in the debate, the potential implications of Brexit must be examined. Just as any good businessman must plan for different economic scenarios, those involved in the EU debate (on both sides of the Channel) should prepare for all potential outcomes.

We acknowledge that there are a whole range of intangible aspects to the debate about whether Britain should remain a member of the EU, from political and geopolitical to ideological and outright emotional. Many would argue that it is not possible to put a number on democratic accountability, for example. In this study, however, we look primarily at the economic impact of Britain leaving the EU. It is, if you will, the cool-headed balance sheet analysis of what might actually happen if Britain leaves.

Section 2 looks at the legal and political route to EU withdrawal. **Section 3** sets the scene by outlining the importance of EU and global trade to the UK economy and **Section 4** looks at the potential impact of Brexit on the UK's key exporting sectors. **Section 5** looks at the existing alternatives to EU membership and how they might be better tailored to the UK. **Section 6** assesses the overall economic impact of the UK leaving the EU under different scenarios and the choices facing the UK outside the EU, with respect to trade with the rest of the world and the domestic regulatory environment.

1.2. The role of the EU in British economic and political life

Nearly all aspects of the UK's trade are conducted by the EU, leaving only trade promotion in the hands of member states.[1] EU membership and the trade agreements the UK is party to via its EU membership currently cover around 60% of the UK's trade. This could rise to over 85% if the EU is successful in its current trade negotiations.[2] EU member states are part of a customs union, with no trade tariffs or customs controls on goods moving within the EU, and a common tariff applied to goods entering the EU from the rest of the world. The EU's single market is also meant to ensure the free movement of services, capital and people among the member states – although some of these freedoms are 'freer' than others. The single market in goods remains far more developed than in services, where many legal, administrative and cultural barriers to the provision of services across EU borders remain.[3] Likewise, the proposal to create a 'capital markets union' illustrates the perceived barriers to the movement of capital across the EU.[4]

The EU represents and negotiates on behalf of all 28 members at the World Trade Organisation (WTO) and also negotiates bilateral free trade agreements (FTAs) on their behalf under the EU's Common Commercial Policy. Since the 2009 Lisbon Treaty, EU free trade negotiations and agreements with third countries have included investment, in addition to traditional trade in goods and services.

As a full member of the EU, the UK is represented in the European Commission, which proposes EU legislation, and the EU's Council of Ministers and European Parliament, which together vote on and decide the final shape of EU rules and regulations.

Arguably, membership is contentious in the UK because the EU is much more all-encompassing than the customs union and the so-called 'four freedoms'. The EU has a wide-ranging regulatory impact on the entire UK economy, including the public and private sector, from social and employment law to environmental policies, and fiscal implications for the UK via its net contribution to the EU budget. The Common Agricultural Policy (CAP) increases the cost of food for consumers via tariffs and subsidies[5] and the EU's complex regional policy means that every member state, irrespective of wealth, contributes and receives money from an unnecessarily over-centralised system.[6] The EU also has a growing role in justice, home affairs and human rights.

The EU's role in these many areas of UK life not only restricts national policy making but reduces democratic accountability to the British electorate. On the other hand, this multifaceted nature of the EU means that any economic (and political) arrangement for the UK outside it will involve a trade-off between the level of access to EU markets, freedom from EU regulation and standards, the freedom to conduct an independent trade policy, and influence over the setting of domestic and EU regulation.

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[1] There is also increasing, though not complete, EU competence over foreign investment and related capital flows.

[2] TheCityUK/Analytically Driven, 'Analysing the case for EU membership: how does the economic evidence stack up?', p15, April 2014

[3] For a discussion see Open Europe, 'Trading places: is EU membership still the best option for UK trade?', 2012; www.openeurope.org.uk/intelligence/britain-and-the-eu/eu-membership/; Open Europe, 'Kick-starting growth: how to reignite the EU's services sector and boost growth by €300bn', www.openeurope.org.uk/intelligence/economic-policy-and-trade/single-market-in-services/

[4] See UK Government, Balance of Competences report on the single market; www.gov.uk/government/uploads/system/uploads/attachment_data/file/227069/2901084_SingleMarket_acc.pdf

[5] Open Europe, 'More for less: making the EU's farm policy work for growth and the environment', 2012; www.openeurope.org.uk/intelligence/energy-and-environment/cap/

[6] Open Europe, 'Off target: the case for bringing regional policy back home', 2012; www.openeurope.org.uk/intelligence/economic-policy-and-trade/eu-regional-policy/

1.3. Existing estimates of the costs and benefits of Brexit

It is difficult to put a precise figure on the effect of the UK leaving the EU, not least because no one knows exactly what life outside the EU would be like. Various studies have estimated the net cost/benefit of the UK's EU membership at anywhere between -5% and +6% of GDP, but these studies all differ in their methodologies and assumptions about life after Brexit.[7] Assumptions must also be made about the nature of the EU with or without the UK, such as the degree of future trade liberalisation or protectionism within the single market.

The studies that find a net cost of EU withdrawal tend to look at the longer-run effects of the UK being a member of the EU versus a more restrictive trading relationship. A 2013 study by the Centre for Economic Policy Research (CEPR) for the UK Government's Balance of Competences Review found that withdrawal could result in an annual cost to UK GDP of between 1.77% and 1.24%, depending on whether the UK were to leave and rely simply on World Trade Organisation (WTO) rules or secure an ambitious free trade agreement with the EU.[8] However, this study did not attempt to calculate the knock-on effect these new trade barriers could have on the flow of inward foreign direct investment into the UK or, on the other hand, the cost that EU regulation and EU tariffs currently impose on UK firms and consumers.

Meanwhile, a 2004 National Institute for Economic and Social Research (NIESR) study found that UK GDP would decline by 2.25% permanently after withdrawal, primarily because of lower Foreign Direct Investment (FDI) leading in turn to lower technical progress.[9] However, determining the link between inward FDI and EU membership is notoriously difficult as decisions to invest are motivated by any number of factors, including the integrity of the UK legal system, the availability of particular skills and services and the status of the English language.

On the other hand, the studies which find a net benefit to withdrawal have tended towards a static approach, calculating the various impacts – fiscal, regulatory, trade-related – and adding them to produce an overall cost. To the extent these studies look forward, they assume further integration will increase these costs. Recent exceptions include the winner of the Institute for Economic Affairs (IEA) 'Brexit prize', *A blueprint for Britain: openness not isolation*, which estimated the long-term economic impact of withdrawal to be between -2.6% and +1.1% of GDP, with a best estimate of +0.1%. In addition, the Mayor of London's report, *The Europe report: a win-win situation*, which tested how London's economy would be affected by four different scenarios based on the UK's relationship with Europe over 20 years, found that London would be best off with the UK remaining in a reformed EU. Withdrawal followed by a pro-growth, reform agenda would however be better than staying in an unreformed EU, with withdrawal followed by a poor post-exit relationship, coupled with internal protectionism, the worst option.[10]

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[7] House of Commons Library, 'Leaving the EU', Research paper 13/42, 1 July 2013, p7 and Open Europe Literature Review

[8] CEPR, 'Trade and investment balance of competence review: a study for the Department of Business, Innovation and Skills', November 2013

[9] See HMT, 'The Economic effects of EU membership for the UK: revised storyboard', August 2005; www.gov.uk/government/uploads/system/uploads/attachment_data/file/220965/foi_eumembership_presentation.pdf

[10] Mayor of London, 'The Europe report: a win-win situation', August 2014; www.london.gov.uk/sites/default/files/europe_report_revised_17_10_14.pdf

However, the EU has always been much more than a trading bloc. There are important political costs and benefits of EU membership – although these are also impossible to quantify: the balance between sovereignty and independent action on the one hand and the value of influence within and as part of a major bloc on the other. It is however clear that withdrawal could have different impacts on certain sectors of the UK economy, depending on the terms of withdrawal and the policies implemented by any UK Government post-withdrawal.

Selected estimates of the cost of UK membership/withdrawal from the EU

Study	Assumptions	Benefit/Cost of membership/ withdrawal
Professor Gianmarco Ottaviano et al, 'The Costs and Benefits of Leaving the EU', May 2014	Pessimistic case assumes that the UK and EU will apply MFN tariffs post-withdrawal. In optimistic scenario tariffs on goods continue to be zero. Varying increases in non-tariff barriers and further intra-EU liberalisation.	Losses from Brexit range between 1.13% and 3.09% of GDP. Including dynamic effects could more than double such losses.
Ian Mansfield, 'A blueprint for Britain: openness not isolation', *IEA*, April 2014	In both best case and most likely scenario benefits from reducing fiscal and regulatory costs outweigh trade and FDI gains of withdrawal.	The total long-term impact of withdrawal is estimated to be between -2.6% and +1.1% of GDP, with a best estimate of +0.1%.
CEPR, 'Trade and investment balance of competence review: a study for the Department of Business, Innovation and Skills', November 2013	UK falling back on to WTO MFN market access to the EU.	Withdrawal would cost 1.77% of GDP (£25.8bn) annually, of which £3.8bn tariffs and £22bn non-tariff barriers (NTBs).
	A UK-EU FTA similar to terms envisioned under EU-US deal.	Withdrawal would cost 1.24% of GDP (£18bn) annually, of which £2.8bn rules of origin and £15.2bn NTBs.
Professor Patrick Minford et al, 'Should Britain leave the EU? An economic analysis of a troubled relationship', *IEA*, 2005	Outside the EU, UK would pursue unilateral free trade and enjoy MFN WTO access to EU markets at world prices.	3.2–3.7% of GDP in ongoing costs from EU membership. Leaving EU would benefit consumers via lower prices, while exposing UK firms to greater competition would increase specialisation and productivity.
NIESR, 'The macroeconomic impact of UK withdrawal from the EU', 2004	Costs of withdrawal primarily because of lower FDI leading in turn to lower technical progress.	GDP would decline by 2.25% permanently after withdrawal.
IoD, 'EU membership – what's the bottom line?', 2000	The aggregate impact of the EU Budget, CAP, Customs Union, Single Market, EU Social Welfare Model and EU related Foreign Direct Investment is negative for the UK economy. Under an alternative scenario, whereby FDI increased because of a lower cost and regulatory burden in the UK, the annual net cost of membership could increase.	Net cost of EU membership stands at 1.75% of GDP per annum.

2.

Legal and political route to EU withdrawal

The process of leaving the EU would be politically and legally complex. New arrangements would need to be made for the UK's trading arrangements with the EU and the rest of the world, while the domestic implications of potentially untangling Britain from over 40 years of European integration would also need to be considered carefully.

2.1 The withdrawal process at the EU level

Negotiated withdrawal

The Lisbon Treaty introduced a formal but as yet untested mechanism by which a country can leave the EU. Article 50 of the EU Treaties would allow the UK to notify the EU of its withdrawal and obliges the EU to negotiate a 'withdrawal agreement'.[11] As one might expect, the dynamics of Article 50 are inherently biased against the country leaving (see Table, 'Advantages and drawbacks of Article 50'). The form of any withdrawal agreement would depend on the negotiations and there is therefore no guarantee the UK would find the terms acceptable. The EU Treaties would cease to apply to the UK on the entry into force of a withdrawal agreement or, if no new agreement is concluded, after two years, unless there is unanimous agreement to extend the negotiating period. The decision to leave therefore does not need the endorsement of the other member states, which cannot block withdrawal or delay it for longer than the two-year period.[12]

Advantages and drawbacks of Article 50

Advantages	Drawbacks
• A guaranteed way to trigger negotiations with the EU – the decision to leave does not need the approval of others. • Striking a new agreement would not necessarily require unanimity among the other member states, unlike an EU treaty change, which does. However, a complex 'mixed agreement' would require ratification in every EU member state.	• One way street – once you have decided to leave, in practice, there is no turning back and you must be prepared to leave. • No UK vote on withdrawal agreement – the rest of the EU will have the final say. • Without a UK vote, the centre of gravity in the remainder EU is likely to be more protectionist, which could affect UK's trade terms. • European Parliament veto over a continuity deal or future free trade deal. • The EU is in charge of the negotiating timetable.

Source: Open Europe[13]

During the two-year negotiation period, EU laws would still apply to the UK. The UK would continue to participate in other EU business as normal, but it would not participate in discussions or decisions on its own withdrawal.

On the EU side, the agreement would be negotiated by the European Commission following a mandate from EU ministers and concluded by EU governments "acting by a qualified majority, after obtaining the consent of the European Parliament." This means that the European Parliament would be an additional unpredictable factor in striking a deal. However, if the final agreement cuts across policy areas within the preserve of the member states, such as certain elements of services, transport and investment protection – as many recent EU FTAs have done – it will be classed as a 'mixed

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[11] Article 8 of the EU Treaties, which stipulates that the EU "shall develop a special relationship with neighbouring countries, aiming to establish an area of prosperity and good neighbourliness," reinforces the EU's obligation to seek some form of agreement with neighbouring states.

[12] House of Commons Library, 'Leaving the EU', 2013, p9-10; Martin Howe QC, 'Zero plus: the principles of EU renegotiation', Politeia, 2014; www.politeia.co.uk/sites/default/files/files/Zero Plus The Principles for EU Renegotiation.pdf

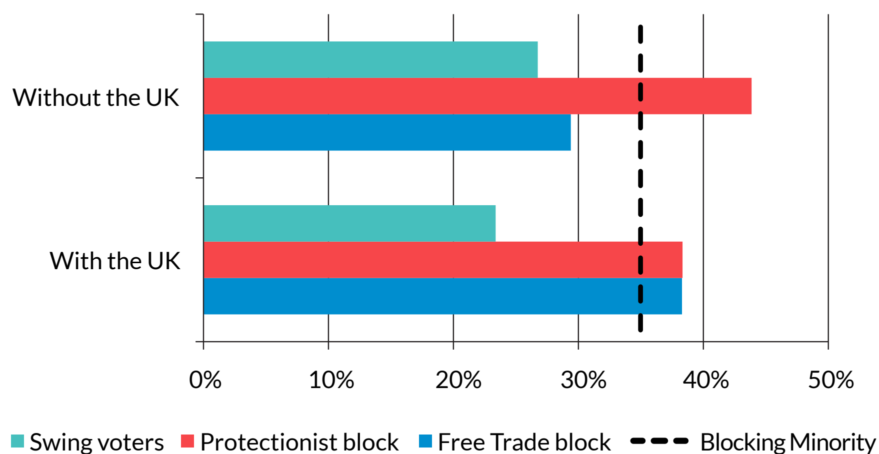
[13] Open Europe, 'Gaming Europe's future: simulating the negotiations that could determine Britain's place in Europe', 2014; www.openeurope.org.uk/intelligence/britain-and-the-eu/eu-wargame/

agreement' and require additional ratification by every national parliament in the EU.[14] The EU Treaties would also need to be amended to reflect the UK's departure. In effect, this means that the final deal at the end of a negotiated UK exit from the EU would need to be ratified by:

- EU leaders via a qualified majority vote;
- The European Parliament;
- The remaining 27 national parliaments across the EU.

The UK's exclusion from EU deliberations on its withdrawal could have implications for how liberal successor UK-EU trade arrangements would be. The UK's absence from the EU's qualified majority voting arrangements would affect the balance within the rest of the EU by handing a French-led protectionist bloc a large sway in the negotiations as it would be able to command a blocking minority (35% of the voting weight), while the UK's natural allies such as Germany, the Netherlands, Sweden and others would no longer be able to. While this would not necessarily preclude a continuity deal, it could certainly influence the degree of EU market access the UK could secure and on what terms.

QMV blocking minorities with and without the UK (%)



Source: Open Europe[15]

The negotiating period of two years foreseen under Article 50 can be extended by mutual consent. Examination of previous free trade negotiations illustrates that two years is not a long time to conclude a comprehensive agreement. For example, the EU's negotiations with South Korea started in May 2007 but the agreement was not signed until October 2010 and did not enter into force until July 2011. The EU's deal with Mexico took over four years and its negotiations with Canada started in October 2009 but the agreement has yet to enter into force. Meanwhile, following Swiss voters'

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[14] The EU FTAs with Colombia, Peru and Canada have to be ratified by national parliaments, as will TTIP if negotiations are concluded successfully. See European Commission Vice-President Maroš Šefčovič's response to national parliamentarians on this issue on 16 October 2014 www.ec.europa.eu/transparency/regdoc/rep/3/2014/EN/3-2014-7557-EN-F1-1.Pdf

[15] Our Free Trade block includes the UK, Ireland, Germany, the Netherlands, Sweden, Denmark, Finland and the Baltics. Our Protectionist block includes France, Italy, Spain, Greece, Portugal and Cyprus. Clearly these are not fixed blocks but they do provide an illustrative picture of the likely alliances particularly on trade issues.

rejection of EEA membership in 1992, it took Switzerland around ten years to establish its bilateral agreements with the EU. These lengthy time periods are not unique to EU negotiations. The US deal with Australia took over three years to complete and Switzerland's deal with China took almost four years.

UK-EU negotiations would be complex and could therefore potentially run longer than two years. However, there would also be an incentive on both sides to minimise the economic disruption resulting from withdrawal, which would certainly act as motivation to conclude an agreement relatively quickly.

Unilateral withdrawal

The UK could avoid the Article 50 process and take unilateral action to withdraw from the EU Treaty by simply repealing the 1972 European Communities Act and relying on the Vienna Convention on the Law of Treaties.[16] This option could be open to the UK if it wanted to truly 'go it alone' outside the EU.

There has been a long academic debate about the right of countries to unilaterally withdraw. One view is that a right of unilateral withdrawal existed even in the absence of any explicit reference to it in the treaties, since sovereign states were in any case free to exercise their sovereign right to withdraw from their international commitments. Greenland withdrew from the EU in 1985, for example.[17] The opposite view was that the lack, until recently, of a formal exit clause in EU primary law must have been intentional, which is irreconcilable with a unilateral right of withdrawal.[18]

In practical terms, there is nothing to stop a British government unilaterally withdrawing from the EU. Article 50 compels only the EU to seek a negotiation, not the withdrawing member state. Under the uncodified British constitution, the sovereignty of parliament means the government of the day does not even need to seek the approval of the British people through a referendum.[19]

However, while this may be the case in principle, such an approach would likely damage the UK's chances of striking a preferential trade agreement with the EU after exit – since its first act as an 'independent' nation would have been to have reneged on its EU treaty commitments. Any potential FTA the UK struck with the EU at any point after withdrawal would come up against the same restrictions as Article 50, most notably requiring approval by EU leaders, MEPs and national parliaments. Unless the UK is truly prepared to 'go it alone', the 'unilateral' option is tricky.

Transitional arrangements would need to be put in place

In addition, even if the UK went for a unilateral withdrawal, there would still have to be some negotiations – at the very least, the UK and EU would need to reach an agreement on transitional arrangements. Withdrawing from a treaty releases the parties from any future obligations to each other, but does not affect any rights or obligations acquired under it before withdrawal.[20] UK courts will not be obliged to apply the rules of EU law on legal certainty after the Lisbon Treaty is terminated. However, they may still be obliged to apply the minimum standards of protection of acquired rights.[21]

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[16] Gerard Batten MEP, 'The road to freedom', 2013; www.gerardbattenmep.com/wp-content/uploads/2013/03/The-Road-to-Freedom_WEB.pdf

[17] Greenland withdrew from the then European Economic Community on 1 Feb 1985 having gained home rule from Denmark in 1979. However, in this case only part of a territory exited the EU and Greenland became associated with the EU as an Overseas Country and Territory (OCT) through the Greenland Treaty. This kind of association would not be an option for the UK if it left the EU.

[18] See P. Athanassiou, 'Withdrawal and expulsion from the EU and EMU: some reflections', ECB, 2009, p11; www.ecb.europa.eu/pub/pdf/scplps/ecblwp10.pdf

[19] See Tim Oliver, 'The five routes a British exit from the EU could take', Huffington Post, 30 June 2014; www.huffingtonpost.co.uk/tim-oliver/eu-referendum_b_5542483.html

[20] House of Commons Library, 'Leaving the EU', 2013, p15

[21] Graduate Institute Geneva: Centre for Trade and Economic Integration, 'The future of the United Kingdom in Europe: exit scenarios and their implications on trade relations', 2014, p21-26;

Practically, the single biggest issue would likely be migration and the status of EU/European Economic Area (EEA) nationals in the UK and the 1.4-1.8 million UK nationals living in the EU on a permanent basis.[22] The UK Government would have to decide how to deal with those exercising their free movement rights at the point of withdrawal, e.g. as workers or self-employed persons, and EU/EEA nationals who might have acquired rights in the UK, e.g. those who have gained permanent residence or who currently qualify for social security. Withdrawal might also have implications for UK nationals living in other EU/EEA countries, since member states could be free to impose restrictions on entitlement to benefits.

One example would be the costs to the National Health Service (NHS) resulting from free movement of UK and EEA nationals. For example, under EU law, old-age British expatriates in receipt of a UK state pension are entitled to state healthcare, which is reimbursed by the UK. In 2011-12 the NHS ran a major payments deficit with other EU member states for this type of claim, with the UK making payments of £903.4 million to other EU countries for healthcare provided to UK pensioners, while it only received £48.7 million for providing healthcare costs to pensioners from the rest of the EU resident in the UK.[23]

Brexit could affect these costs in different ways, but this cost is best thought of as a UK liability, since if UK pensioners no longer had access to this treatment abroad in the EU, many could return to the UK in order to receive it.

Costs to the NHS also arise from EU migrants receiving treatment in the UK. The Department of Health does not keep full records of overseas visitors who come to the UK from the EU, meaning it is impossible to know how many people come from the EU to the UK and receive treatment. Under EU law, EEA nationals working in the UK have access to free treatment, but if they are economically inactive or if they are temporary visitors, the UK Government is able to reclaim the cost of that treatment from their home country in the EEA. However, in 2013, Health Secretary Jeremy Hunt said, "The fact is that we do that very poorly indeed at the moment and that is one of the things we need to change."[24]

Other acquired rights of/against UK individuals and entities could stem from the UK's current participation in the EU's CAP, acquired fishing rights under the Common Fisheries Policy (CFP) and any other liabilities due to the UK's participation in EU funding schemes and the EU institutions. Lesser issues to be resolved would be the tenure of UK nationals working in the EU institutions and the future status of any EU agencies based in the UK.[25]

Is there a middle way?

At the same time, since Article 50 clearly reduces the UK's leverage in negotiations, any UK government should try to avoid it being used. As often in EU talks, the politics of necessity is likely to trump the letter of the law. Since the EU cannot throw the UK out, one way would be for the UK government to use a No vote in the referendum as a de facto negotiating mandate, with the precise legal status of the negotiations left hanging

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www.graduateinstitute.ch/files/live/sites/iheid/files/sites/ctei/shared/CTEI/Law Clinic/Memoranda 2013/Group A_The Future of the United Kingdom in Europe.pdf

[22] There is no single consistent figure for the number of UK migrants living in the EU. Oxford University's Migration Observatory estimates the number at 1.4 million while IPPR estimates it at 1.8 million or 2.2 million when including UK nationals residing abroad for part of the year.

[23] See Written Answer by the Parliamentary Under-Secretary of State, Department of Health (Earl Howe), Hansard, 10 Apr 2013 : Column WA303; www.publications.parliament.uk/pa/ld201213/ldhansrd/text/130410w0002.htm#column_WA302

[24] Hansard, 25 Mar 2013 : Column 1295; www.publications.parliament.uk/pa/cm201213/cmhansrd/cm130325/debtext/130325-0001.htm#13032510000004

[25] Adam Łazowski, 'How to withdraw from the European Union? Confronting hard reality', CEPS, 16 January 2013; www.ceps.be/book/how-withdraw-european-union-confronting-hard-reality

– and then trigger Article 50 as a mere formality, once talks are concluded. This could allow Britain to avoid some of the booby traps hidden in Article 50 – including being forced into a take it or leave it deal after a two year period.

Nevertheless, such an approach could lead to demands for a second UK referendum on the negotiated deal – as otherwise the government could be open to accusations of a stitch-up and, as we will see in Section 5, the range of post-Brexit UK-EU relationships is tremendously varied. In addition, in any negotiated exit it will be impossible for the UK to avoid the need for others' approval of the final deal.

2.2 The withdrawal process at the UK level

Given the high degree of integration that now exists between the UK and the EU, there is a vast body of EU law that currently applies in Britain, either directly or where passed because of the UK's EU obligations or commitments. Following withdrawal, how the UK dealt with this legacy of EU law would depend on its future relationship with the EU and the consequent degree of freedom to deviate from EU standards and regulations. The domestic task of reviewing the stock of existing EU law in the UK would be substantial. Existing EU law would have to remain in force until some formal legal reform takes place.

Firstly, there are directly applicable EU laws – known as EU regulations – which would cease to apply at the moment of withdrawal. There would need to be a case-by-case assessment of which of these laws the UK would want to keep, which would require new UK legislation. Secondly, there are EU directives or other EU obligations, which have given rise to domestic implementing legislation (see Box, 'Different types of EU legislation'). These would remain in place in UK law until they were repealed or amended.[26] Furthermore, a much wider pool of British law currently relies on reference to EU law. This is because all British law, not simply implementing legislation, has to be interpreted in the light of EU law where it is touched by it.[27] This would likely continue to be the case until the UK developed its own case law over time.

Which laws to keep, repeal or amend would no doubt be subject to intense political debate (see *Section* 6 and *Annex* 3).

Different types of EU legislation

Regulations: Not to be confused with the generic term "regulation", EU regulations are directly applicable in EU member states and become immediately enforceable in law. In practice, however, EU Regulations are sometimes subject to additional implementing measures. In the UK, Regulations are not always subject to Impact Assessment and their resulting cost is therefore often unknown.

Directives: Not directly applicable, EU directives usually require further measures in order to be transposed into national law. They are binding on member states, but have no effect in national law until they are transposed. In the UK, they can be implemented either via primary legislation (Acts) or secondary legislation (Statutory Instruments). In practice, in the UK, the majority of Directives are implemented via secondary legislation.

Decisions: Used for any purpose other than approximating the laws and regulations of the member states. They are binding, but very few EU decisions generate new UK laws.

ECJ rulings: ECJ case law can have a significant impact on existing legislation. The ECJ has huge scope to interpret individual Regulations and Directives, meaning that its case law can have a significant impact on how EU regulation evolves and how it affects individuals and member states.

[26] Martin Howe QC, 'Zero plus: the principles of EU renegotiation', Politeia, 2014; www.politeia.co.uk/sites/default/files/files/Zero Plus The Principles for EU Renegotiation.pdf

[27] Professor Damian Chalmers, 'Democratic self-government in Europe', Policy Network, 2013, p15

2.3 International agreements

A parallel issue would be the status of the international agreements and FTAs the UK is currently party to by virtue of its EU membership. The EU has agreements of various forms (these often have political as well as trade provisions) with countries including those bordering the EU and those farther afield including South Korea, Mexico, Chile and South Africa.[28] In addition, the EU has completed negotiations with Canada and is conducting negotiations with many other countries including the US, India and Japan.

While it remains unclear exactly how it would work in practice, upon exit from the EU the UK would not automatically retain the FTAs it is party to via the EU. Therefore, in addition to having to negotiate with the EU, the UK may also have to engage in parallel negotiations with 55 other countries and territories with which the EU currently has some form of preferential trading arrangements in place in order to secure a stand-alone agreement.

In a practical sense, there would not be any strong reason for a third country to terminate its trade agreements in relation to the UK, if the level of tariffs and other benefits in the agreement remained unchanged. Replacing these agreements with the UK as a signatory in its own right would be a largely technical and therefore potentially relatively quick process. However, this would mean that the UK will have to follow the policies and duties negotiated and fixed by the EU – a continued restriction on UK trade independence, at least in the short term. One argument put forth by those in favour of withdrawal is that the UK could negotiate better deals than the EU, but if the UK wished to negotiate new trade terms or pursue different policies to that of the EU, this would require a fundamental renegotiation of the agreements, which could be subject to the long timescales described above.[29]

Many other international agreements would be unaffected by UK withdrawal. For example, there is no obvious reason why the UK's UN membership and Security Council membership under the UN Charter would not continue as before.[30]

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[28] European Commission, 'Trade Policy: Agreements in place'; www.ec.europa.eu/trade/policy/countries-and-regions/agreements/#_other-countries

[29] Graduate Institute Geneva: Centre for Trade and Economic Integration, 'The future of the United Kingdom in Europe: exit scenarios and their implications on trade relations', 2014, p47-48;

[30] See Martin Howe QC, 'Zero plus: the principles of EU renegotiation', Politeia, 2014, p10-11

3.

The importance of EU and global trade to the UK

With the UK's economy heavily dependent on world trade in goods and, increasingly, in services, along with its ability to attract foreign investment, its continued economic success, inside or outside the EU, will rely on its openness to trade and access to global markets.

This openness provides greater consumer choice, the benefits of specialisation and comparative advantage, and a boost to competitiveness and productivity. Exporting firms contribute 60% of UK productivity growth, are more likely to engage in research and development, and more likely to be innovative relative to firms which do not export.[31] It is the firms that make the move to global orientation that ultimately generate the exports that help pay for imports.

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[31] BIS, 'Trade and investment analytical papers', 2011; www.gov.uk/government/uploads/system/uploads/attachment_data/file/32471/11-858-trade-promotion.pdf

3.1 The UK's key economic sectors for trade and inward investment

The UK's trade to GDP ratio increased from 54.5 in 2002 to 65.3 in 2012, making the UK the second-highest ranked G8 country, behind Germany, for trade 'openness'.[32] The UK is also the number one country for inward FDI stock in Europe, and only the second in the world after the US, in nominal terms.

Openness to trade and investment indicators

	Merchandise trade as % of GDP (2013)	Services trade as % of GDP (2012)	Imports of goods and services as % of GDP (2013)	Exports of goods and services as % of GDP (2013)	Inward FDI stock as % of GDP (2013)
UK	**44.7**	**18.1**	**32**	**30**	**60.0**
Australia	31.7	7.7	21	20	39.1
Canada	51.1	10.6	32	30	35.5
China (excluding Hong Kong)	45.0	5.8	24	26	10.3
France	44.9	14.0	30	28	39.5
Germany	70.8	16.2	40	46	23.5
India	41.5	14.8	28	25	11.8
Italy	46.3	10.1	26	29	19.5
Japan	31.5	5.4	19	16	3.5
Russia	41.3	8.5	22	28	26.9
US	23.3	6.8	17	13	29.2

Source: World Bank and UNCTAD

The value added created in the UK economy comes from a wide range of sectors but the contribution of services, accounting for over 70%, dwarfs the contribution of traditional sectors such as manufacturing. Professional services and financial services together account for up to 20% of all UK wealth creation. The Graph on page 22, showing the UK's total GVA by industry sector, highlights the concentration in the 'knowledge economy', other services and high-tech manufacturing (once the UK's housing and property market are excluded). Traditional production sectors make the lowest contribution.

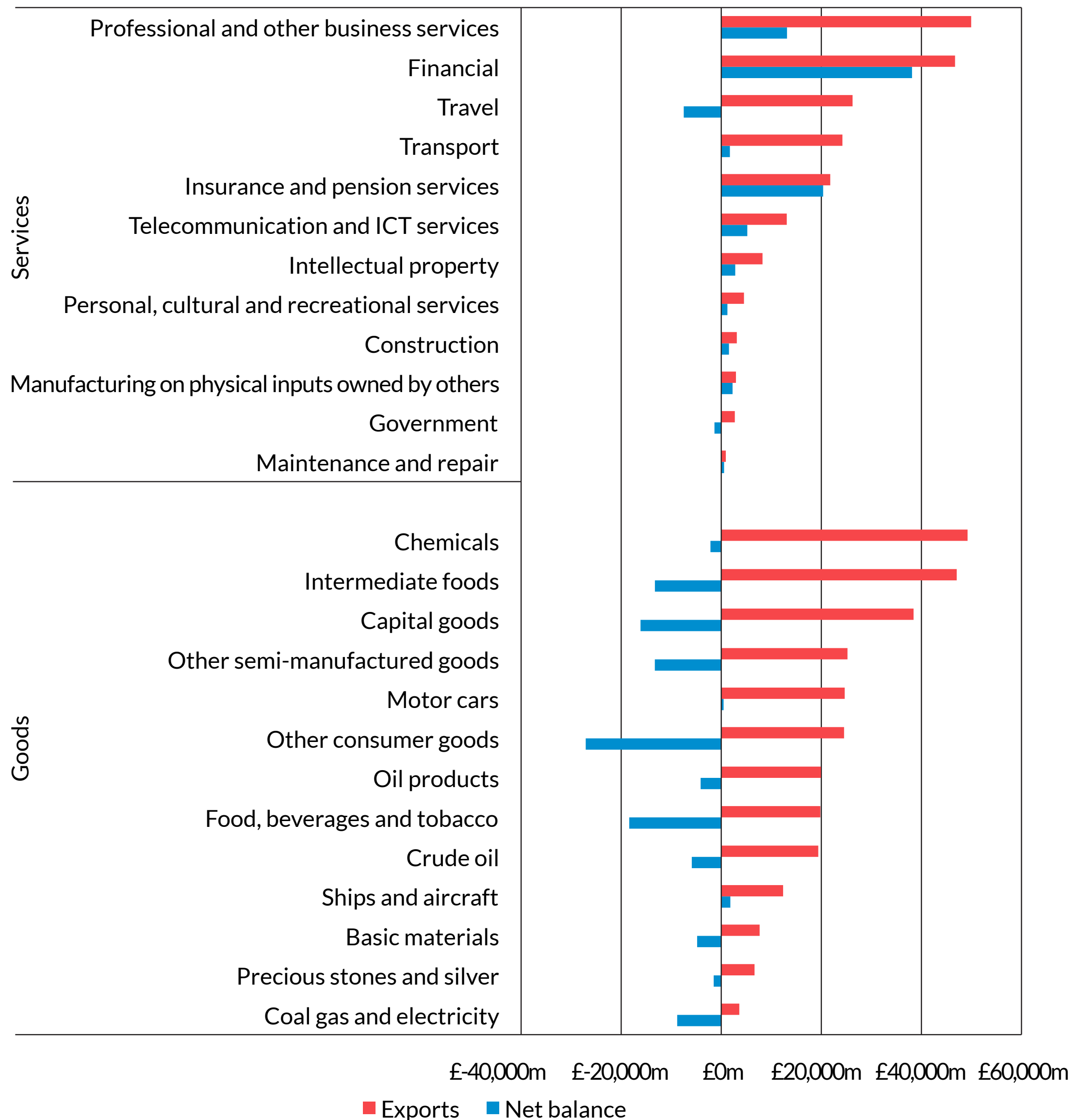
[32] The trade-to-GDP-ratio is the sum of exports and imports divided by GDP. This indicator measures a country's 'openness' or 'integration' in the world economy. It represents the combined weight of total trade in its economy, a measure of the degree of dependence of domestic producers on foreign markets and their trade orientation (for exports) and the degree of reliance of domestic demand on foreign supply of goods and services (for imports). BIS, 'Openness to trade: exports plus imports as a share of GDP, ranked against major competitors', December 2013; www.gov.uk/government/uploads/system/uploads/attachment_data/file/269948/BIS_performance_indicators_Openness_to_trade_2_.pdf

Source: ONS Blue Book 2014[33]

[33] ONS, 'Blue Book 2014'; www.ons.gov.uk/ons/rel/naa1-rd/united-kingdom-national-accounts/the-blue-book--2014-edition/chapter-2--the-industrial-analyses.xls

The Graph below highlights that financial services and insurance make the largest contribution to the UK's net export position, followed by professional and other business services. While the UK tends to run a trade deficit in goods sectors, it records small surpluses in high-tech sectors such as automotive and aerospace. Other important export sectors are chemicals, capital goods such as machine tools, and the food and beverage industries.

UK global exports and trade balances by sector in 2013 (£ million)



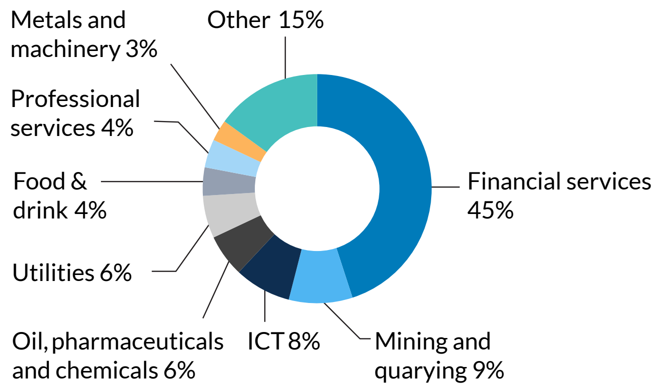
Source: ONS Pink Book 2014

The UK's inward stock of FDI is also spread across a range of industry sectors. Nevertheless, the largest concentration is in financial services (45%), followed by mining, ICT and oil, pharmaceuticals and chemicals. European investors remain the largest holders of FDI stock in the UK (58%), while the US is the largest single source country (29%).[34]

3.2 The UK's key export markets

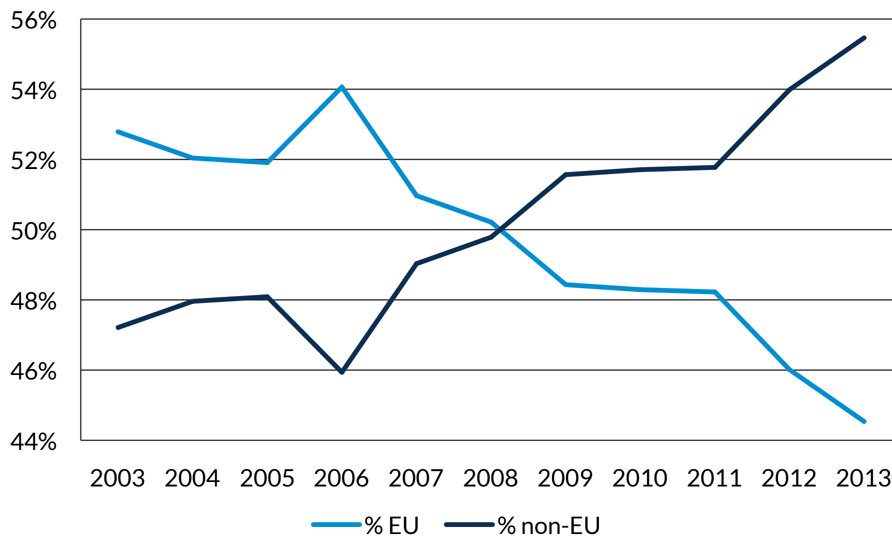
The EU remains the UK's most important single export market, although the share of exports to the rest of the world has been increasing over the last decade. In 2013, the UK exported 44.5% of its goods and services to the EU, compared to nearly 53% in 2003.[35]

Distribution of FDI stock across UK sectors (2012) (%)



Source: ONS

Share of UK exports of goods and services to EU and non-EU (%)



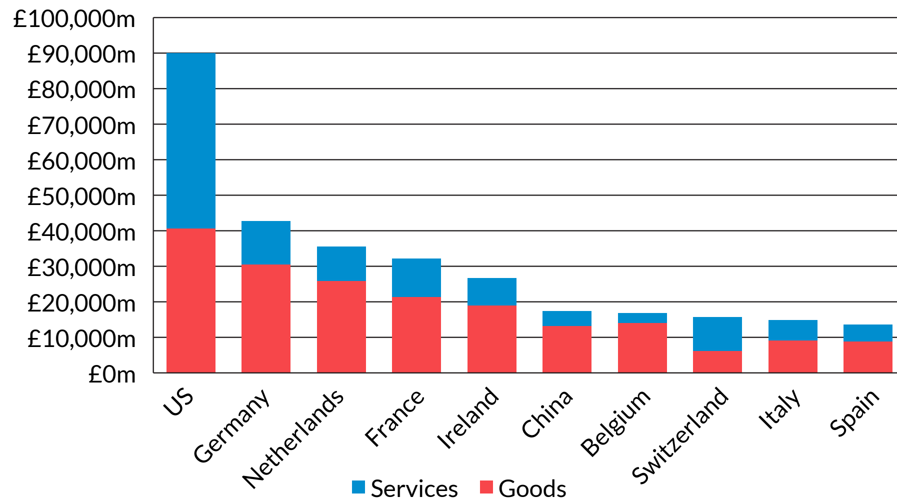
Source: ONS Pink Book 2014[36]

The US is by far the UK's most important non-EU export destination. The UK exports more to the US than to the next nine largest non-EU export markets combined.

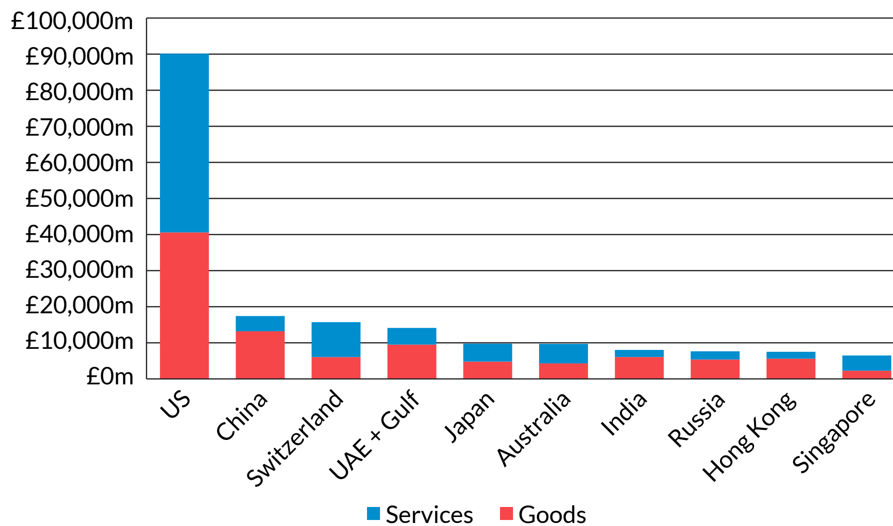
[34] UKTI, 'Inward investment report 2013/14', 2014; www.gov.uk/government/uploads/system/uploads/attachment_data/file/341601/UKTI_Inward_Investment_Report_2013-2014.pdf

[35] This is before adjusting for the 'Rotterdam-Antwerp effect', which masks the share of UK goods re-exported to the rest of the world from these EU ports.

[36] www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-321799



Source: ONS Pink Book 2014[37]



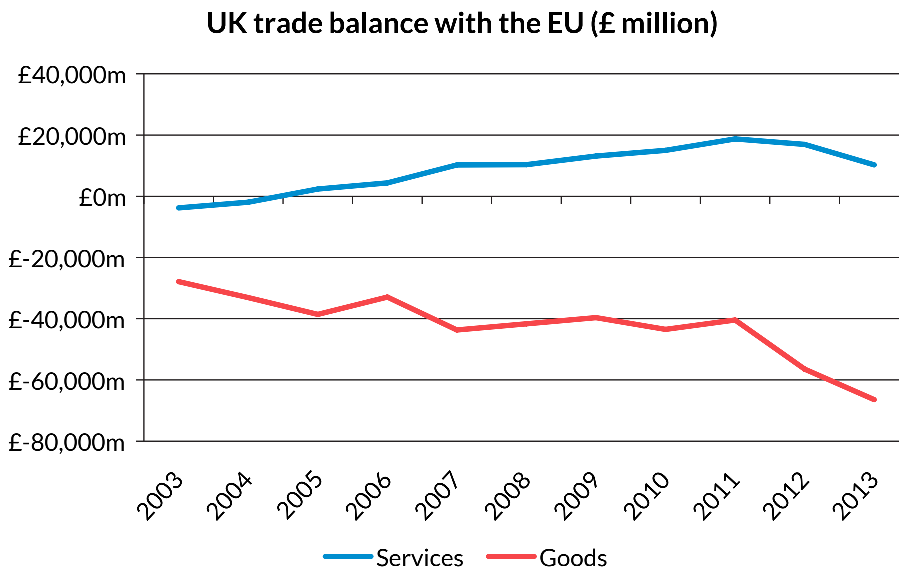
Source ONS Pink Book 2014[38]

37 www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-321799

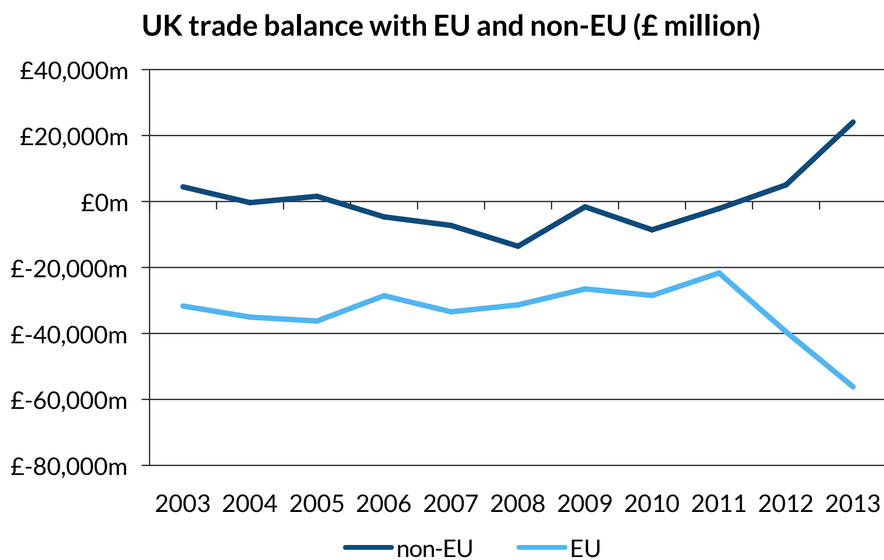
38 www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-321799

Overall, the UK runs a trade deficit with the EU, but this masks a UK surplus in services. In 2013, the UK exported £155 billion of goods to the EU, equivalent to 50.5% of the total. Goods imports from the EU were worth £221 billion, resulting in a deficit in trade in goods with the EU of £66.4 billion in 2013. Meanwhile, the UK exported £72.8 billion of services to the EU (36% of the total) and imported £62.5 billion, resulting in a surplus of £10.3 billion.

Since 2010, as the Eurozone has continued to stagnate, the UK has seen its trade balance with the rest of the world move into surplus while the trade deficit with the EU has increased.



Source: Pink Book 2014



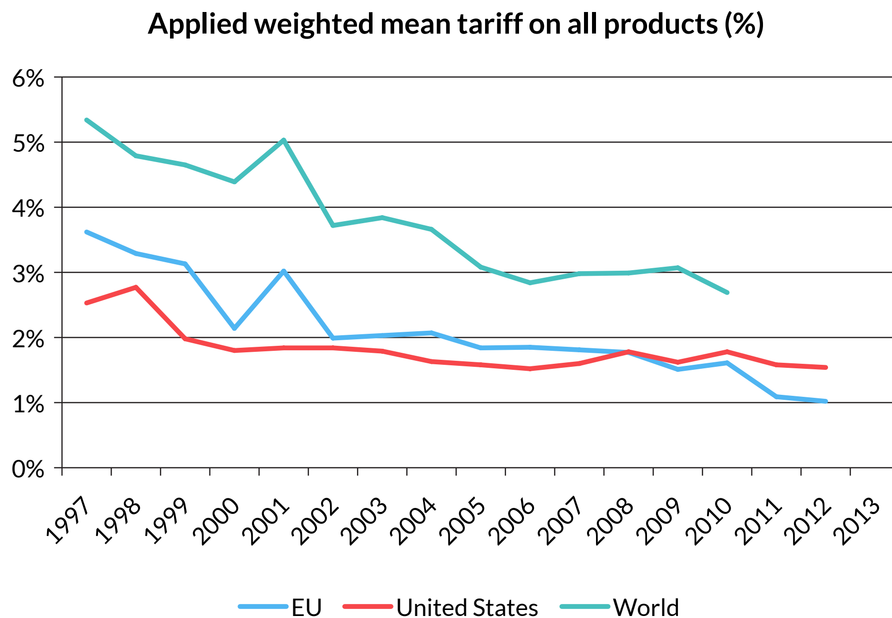
Source: Pink Book 2014

3.3 Changing patterns in global trade

Globalisation and the rise of emerging markets have transformed global trade. Since 1945, trade growth has outstripped GDP growth, with trade growth averaging about 1.4 times GDP growth.[39] Global trade has also become more open with global trade tariffs falling consistently over recent decades and the focus of liberalisation has increasingly turned to non-tariff barriers (NTBs).

The declining importance of tariffs masks some individual high-tariff sectors

The graph below illustrates how the EU's average tariff has fallen substantially in recent decades. In addition, the EU is locked into zero tariffs for many non-agricultural products.[40] This means that the cost of being outside the EU's common external tariff has fallen over time and that many exports to the EU do not face tariffs – even without the benefit of EU membership or a FTA with the EU.



Source: World Bank

However, while the EU's average tariff is low, this masks several 'tariff peaks' in important sectors. For example, just over 35% of UK goods exports to the EU are in sectors where the EU imposes high-tariffs such as cars, chemicals, clothing and food, beverages and tobacco. These sectors would therefore be vulnerable under a Brexit scenario which did not involve a preferential UK trade agreement with the EU.

[39] Standard Chartered, 'Global trade unbundled', 2014; www.sc.com/en/resources/global-en/pdf/Research/2014/Global_trade_unbundled_10_04_14.pdf

[40] 31.3% of agricultural products and 26.1% of non-agricultural products are imported duty free into the EU under MFN rules (based on import value). WTO, 'Tariff profile: European Union', accessed January 2014; stat.wto.org/TariffProfile/WSDBTariffPFView.aspx?Language=E&Country=E28;

UK exports to the EU that could face highest tariffs upon exit

	Exports to EU (£ billion)	EU's simple average applied MFN EU tariff	Share of goods exports to EU
Cars	8.55	10%	5.69%
Chemicals	28.08	4.6%	18.66%
Clothing and footwear	4.63	11.5% for clothes 4.2% for footwear	3.07%
Food, beverages and tobacco	11.41	Around 15% for processed food; other products can face tariffs over 30%	7.59%
Total goods exports to EU	**150.47**		**35.01%**

Source: HMRC and WTO tariff profile

In addition, the growing complexity of global supply chains has made the conventional measures of valuing trade increasingly outdated. Goods are no longer 'made in China' or 'made in the US', but 'made in the world'. With complex supply chains even relatively low tariffs can have an impact on trade costs as inputs may cross borders several times before a final product is assembled.

As a result of these complex supply chains, conventional bilateral trade statistics that measure gross imports and exports often under- or over-estimate the underlying bilateral trade balances between economies (though the overall trade balance for a country remains unchanged).[41] Using traditional gross measures of trade, in 2009, services accounted for 43.37% of the UK's exports.[42] However, in value added terms, services reflected about 58% of the UK's exports.[43]

[41] Standard Chartered, 'Global trade unbundled', 2014, p31; www.sc.com/en/resources/global-en/pdf/Research/2014/Global_trade_unbundled_10_04_14.pdf

[42] ONS, 'Pink Book 2013'; www.ons.gov.uk/ons/rel/bop/united-kingdom-balance-of-payments/2013/index.html

[43] The domestic value added and intermediate imports contained in exports combine to reveal notable differences in the UK's trade balance with some of its major trading partners. For example, the UK-US bilateral trade relationship is stronger in value added terms than in gross terms, and the UK's surplus with the US is also bigger in value added terms. Meanwhile, the UK bilateral trade deficit with Germany is bigger in value added than gross terms. OECD-WTO, 'Trade in value added (TiVA) Indicators: United Kingdom', May 2013; www.oecd.org/sti/ind/TiVA_UNITEDKINGDOM_MAY_2013.pdf

Increasing focus on non-tariff barriers to trade and investment

The decline in global tariffs has shifted the focus of trade liberalisation, particularly between developed economies, to non-tariff barriers, which involve complex negotiations about equivalence or mutual recognition of regulations, market access for services and the investment environment. For example, economic estimates of the economic gains from the proposed EU-US Transatlantic Trade and Investment Partnership (TTIP) suggest the benefits will primarily come from reductions to non-tariff barriers.[44] These barriers can come in a number of different forms, including anti-dumping measures that prevent goods being exported at a price below production cost (usually by the application of an additional duty), and product standards, such as labelling, packaging and phytosanitary requirements.

Multilateralism has given way to bilateral and regional trade agreements

Recent commitments to liberalise the global economy have primarily been achieved outside the WTO's multilateral model. The number of regional or bilateral trade agreements has increased steadily since the 1990s and there are now 397 regional trade agreements, including customs unions, such as that across the EU, in force.[45]

While the WTO remains an important forum for multilateral liberalisation, the pursuit of major regional trade agreements such as the Transpacific Partnership (TPP), between twelve countries in the Asia-Pacific region, and the TTIP may come to define the global trading environment for the decades to come. If the EU and US are successful in concluding an agreement, withdrawal from the EU would see the UK potentially excluded from the two biggest preferential trading arrangements in the world: the EU and the TTIP. This would necessitate that the UK deploy an active independent trade policy.

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44 CEPR, 'Estimating the economic impact on the UK of a Transatlantic Trade and Investment Partnership (TTIP) agreement between the European Union and the United States', March 2013; www.gov.uk/government/uploads/system/uploads/attachment_data/file/198115/bis-13-869-economic-impact-on-uk-of-tranatlantic-trade-and-investment-partnership-between-eu-and-us.pdf

45 WTO, 'Regional trade agreements', accessed January 2015; www.wto.org/english/tratop_e/region_e/region_e.htm

4.

How could key UK export sectors be affected by Brexit?

EU regulation now covers large parts of the UK economy, including the public sector, which is largely non-tradable, and other domestic firms which do not export. This means that Brexit – for better or worse – would have an impact across the entire UK economy. In this section, however, we focus on the impact of EU withdrawal on some of the UK's key goods and services export sectors. Based on interviews with businesses, trade associations and additional research, we identify how Brexit would impact eight of the UK's key exporting sectors:

- **Goods:** cars; chemicals and pharmaceuticals; aerospace; capital goods and machinery; and food, beverages and tobacco;
- **Services:** financial services; insurance; and professional services.

Together these sectors account for 53% of the UK's global exports and 47% of its exports to the EU.[46] The Table on page 31 sums up our assessment of the initial disruption a Brexit could cause the sectors assessed and the chances of these industries gaining similar access to EU markets as they do now.

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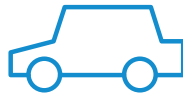
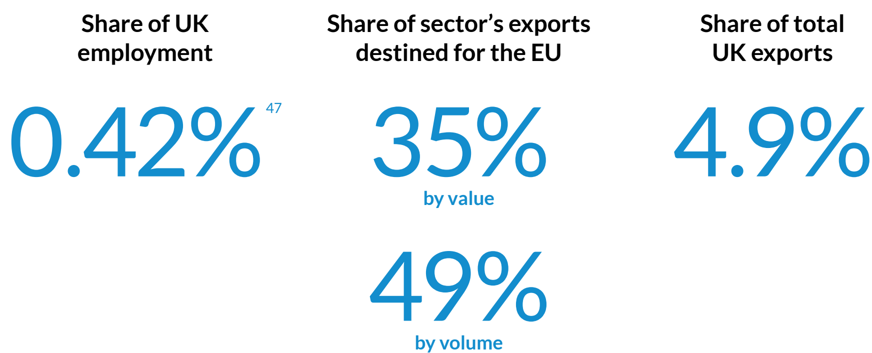
[46] Mineral fuels, such as crude oil, and miscellaneous manufactured goods make up the majority of other UK exports to the EU not assessed here.

Initial Impact of Brexit

Sector		% Exported to EU	Trade deficit/ surplus with EU (£bn)	Potential barriers to EU markets	Risk of disruption	Chances of similar EU access	Possible conditions attached
Goods	**Cars**	35.0	-13.95	10% tariff	**High**	**High**	Basic standards
	Chemicals	56.6	-7.82	4.6% tariff	**High**	**Medium** to **High**	Adhering to EU's regulatory standards
	Aerospace	44.6	2.56	Zero tariffs	**High**	**High**	Basic standards
	Machinery	30.7	-5.47	1.7% to 4.5% tariffs	**Medium**	**High**	Basic standards
	Food, Beverages & Tobacco	60.5	-16.56	Average tariffs over 20% and higher	**High**	**Medium** to **High**	Keep external tariff with rules on foreign content
Services	**Financial services**	41.4	16.06	Various EU market access regulations	**High**	**Low**	Equivalent regulation; possibly still with patchy access
	Insurance	18.4	3.85	Various EU market access regulations	**Medium**	**Medium**	Equivalent regulation; possibly still with patchy access
	Professional services	29.8	-1.92	Primarily national market access regulations	**Medium**	**Medium**	Mutual recognition, free movement of professionals



4.1 The Automotive Sector



Bottom line

After initial disruption it is likely that the UK would strike a deal on market access with the EU, although car manufacturers may face extra administrative costs at the border.

Initial disruption: High

- UK car exports could face EU tariffs of 10%. This would have a particular impact on volume manufacturers in the UK, such as Honda, Nissan, Toyota, and Vauxhall, which are oriented to the EU market. However, premium manufacturers such as BMW Group and Jaguar Land Rover are less reliant on the EU for sales and would be less affected.[48]
- Leaving the EU's customs union would mean adjusting to new administrative procedures at the EU border and could lead to uncertainty over EU-wide supply chains – on average, only 37% of the value of the supply chain that goes into a UK manufactured vehicle originates in the UK.
- Potential exclusion from the EU-US TTIP trade agreement and existing EU FTAs with other markets.

[47] House of Commons Library, 'The motor industry' 27 March 2014; www.parliament.uk/business/publications/research/briefing-papers/SN00611/motor-industry

[48] Only 18% of Jaguar Land Rover's 462,678 sales in 2014 were to European markets. Jaguar Land Rover, 'Jaguar Land Rover reports strong full year sales for 2014', press release 12 January 2015; www.newspress.co.uk/public/ViewPressRelease.aspx?pr=55367&pr_ref=22781

Likelihood of a deal granting similar access to the EU: High

- UK trade deficit of £13.9bn with the EU, of which Germany accounts for £10.85bn.
- EU firms with a presence in the UK would want to minimise disruption to their supply chains.
- Relatively easy to negotiate deals on rules of origin[49] and market access: the experience of supply chains in the US, Canada and Mexico under the North American Free Trade Agreement (NAFTA) illustrates a customs union is not a prerequisite for an integrated, cross-border car industry.[50]

Impact of losing voting rights

- Problematic but could be mitigated by increased say in global standard setting forums.

Impact on FDI and jobs

- Existing investment is unlikely to be affected by a UK exit as it is already a 'sunk cost' and uprooting production plants cannot be achieved in the short-term. Long-term decisions will be based on individual manufacturers' exposure to EU markets, the exact trade arrangement that replaces EU membership, and the ability to maintain an integrated EU supply chain.

Benefits of Brexit

- The freedom to negotiate trade agreements with high-growth markets could benefit an industry already diversifying away from EU markets. For example, the EU has no deal with China, where a Range Rover Evoque currently attracts a 25% import tariff, 17% sales tax and 9% consumption tax.[51] Ability to de-regulate but limited ability to reduce costs of regulation.

The global future

- The industry has already undergone strong diversification in global markets, largely as a result of demand for premium and luxury vehicles in high-growth markets in Asia. Asia is now the UK automotive industry's largest export market after Europe, with 18.5% of all cars destined for the region and exports of cars to China have increased seven-fold since 2009.[52]

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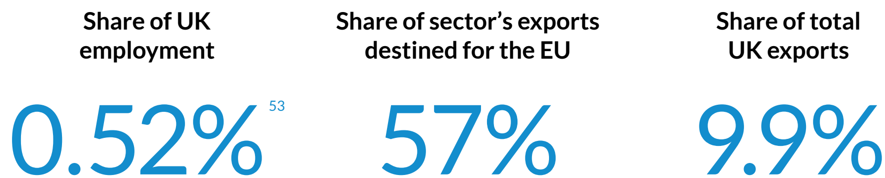
[49] The administrative rules governing the allowable foreign content in finished products under an FTA.

[50] Canadian Council of Chief Executives, 'Made in the world: defragmenting rules of origin for more efficient global trade', June 2014, p14

[51] KPMG / SMMT, 'The UK automotive industry and the EU', April 2014, p9; www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-KPMG-EU-Report-100414.pdf

[52] SMMT press release, 'Number of car exports to China multiplied seven times since 2009', 19 February 2015

4.2 The chemicals and pharmaceuticals sector



Bottom line

Potential disruption to complex supply chains, but strong incentive on all sides to conclude a deal. Manufacturers may face extra administrative costs at the border. Though there will be scope for domestic de-regulation, a deal may be subject to the UK retaining similar regulatory policies as the EU.

Initial disruption: High

- UK chemicals exports could face an average EU tariff of 4.6%.[54]
- In a highly traded sector, which relies on companies across the EU trading basic chemicals to create more sophisticated products, leaving the EU's customs union could disrupt supply chains.
- Potential exclusion from EU FTAs and crucially the EU-US TTIP agreement. As energy costs play a major role in the chemical industry's fortunes, TTIP could allow for the import of cheap US shale gas in addition to other benefits including tariff elimination and greater regulatory co-operation.[55]

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[53] Chemical Industries Association (CIA), 'Industry Facts and Figures' January 2014; www.cia.org.uk/Portals/0/Documents/CIA facts and figures 2014_MR.PDF

[54] AmCham EU, 'Position on the Transatlantic Trade and Investment Partnership (TTIP)', 2014, p7 www.amcham.it/detail.asp?c=1&p=0&id=9111

[55] All-Party Parliamentary Group on EU-US Trade & Investment, 'Note on the Chemical Sector and TTIP - June 2014', July 2014; www.tradeinvest.babinc.org/wp-content/uploads/2014/07/chemicals-note.pdf

Likelihood of a deal granting similar access to the EU: Medium to High

- UK trade deficit of £7.8bn with the EU.
- EU less likely to agree deal if UK manufacturers have secured major competitive advantages by securing less highly regulated inputs from elsewhere.
- EU firms with a presence in the UK would want to minimise disruption to their supply chains.

Impact of losing voting rights

- Limited impact since the EU is unlikely to reverse its high-levels of regulation in the sector. However, without input into EU regulations, new non-tariff barriers could develop over time.

Impact on FDI and jobs

- Many companies in the sector are multinationals. The sector is a major source of inward FDI. Given the sector's high degree of focus on EU markets, continued investment in the sector could depend on the UK's EU market access.

Benefits of Brexit

- The EU chemicals sector would be one of the biggest beneficiaries from slashing high energy costs currently driven by EU rules, including the renewables targets, but also existing UK policies.
- The EU's burdensome REACH regulation[56] could also be scrapped or amended, though the EU may well make a deal conditional on compliance with EU rules.
- A lighter regulatory regime may help UK chemicals firms tap growing demand in emerging economies and diversify away from EU markets. In reality, given the high regulatory barriers to entry to the EU – i.e. comply or lose market access – the industry may face a choice between the rest of the world and Europe.

The global future

- The UK and European chemical sector faces tough challenges: increasing competitive threats from the Middle East and Asia, a rejuvenated US following the development of shale gas, and the current emphasis on costly renewable energy in the UK and EU.[57]

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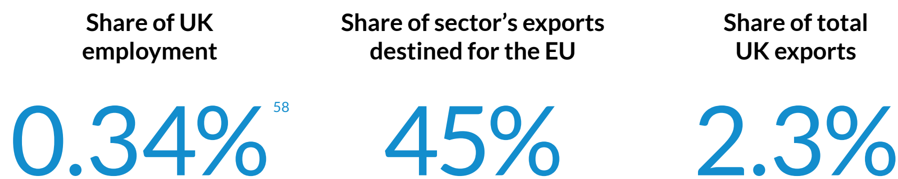
[56] Registration, Evaluation, Authorisation and Restriction of Chemicals

[57] CIA, 'Britain's chemical and chemistry-using industries Strategy for delivering chemistry-fuelled growth of the UK economy', July 2013, p8; www.cia.org.uk/Portals/0/Documents/Growth Strategy FINAL.PDF

4.3 The aerospace sector



Bottom line

Erecting EU barriers to UK exports in this sector would be equally damaging for all sides, given the importance of UK components to the wider European aerospace industry. Therefore, a deal to continue an integrated EU and transatlantic market is likely.

Initial disruption: High

- EU tariffs in this sector are zero, subject to meeting airworthiness requirements. However, the sector's complex and integrated supply chains across the EU would need to adjust to leaving the customs union.
- Gaining access to the EU-US civil aviation agreement – in effect a single transatlantic market for aerospace parts and associated services – would be essential.[59]
- Potential exclusion from cross-border research collaboration facilitated and co-funded by the EU via its Horizon 2020 programme.

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[58] ONS, 'What does the UK aerospace industry look like today' November 2014; www.ons.gov.uk/ons/rel/uncategorised/summary/changing-shape-of-uk-manufacturing---aerospace/sty-uk-aerospace-industry.html

[59] For example, the UK-headquartered Rolls-Royce, supplies engines for both Boring and Airbus airliners across the globe and its revenues are split: 36% come from Europe and 29% from North America. Rolls-Royce plc, Annual report, 2013; www.rolls-royce.com/Images/RR_Full Annual Report_tcm92-55530.pdf

Likelihood of a deal granting similar access to the EU: High

- The UK sells more to the EU than vice versa, with a trade surplus of £2.6bn. Still, given that UK-manufactured components are essential to Airbus and Europe's aerospace sector – not least in competing with the US – a deal is highly likely.
- Because of the incentives on all sides, the UK is also likely to negotiate access to the EU-US civil aviation agreement – similar to Canada and Switzerland.
- The future of the UK's aerospace industry also has implications for the EU's plans for defence procurement integration and defence and security cooperation generally. If the UK left the EU, maintaining good defence and security ties with major EU states may be an important factor in its ability to continue playing an active part in the European defence industrial strategy.

Impact of losing voting rights

- Limited if the UK manages to strike deals with the US and EU.

Impact on FDI and jobs

- A politically sensitive sector. Investment in UK plants and expertise could not be moved into the EU overnight. Some longer-term investment decisions would depend on continued degree of integration with the European aerospace industry but also ability to access US markets.

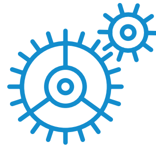
Benefits of Brexit

- The sector already benefits from a largely liberal global trading regime between the EU and the US. The ability to negotiate bilateral deals with high-growth markets could provide new benefits.

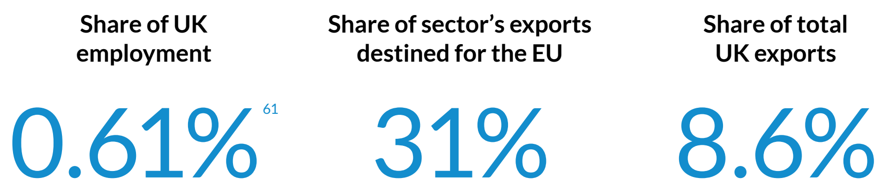
The global future

- The UK is the number one aerospace manufacturer in Europe and there is significant growth potential. It is estimated that up to 2031, the global demand for 27,000 passenger aircraft, 24,000 business jets and 40,000 helicopters will be worth around $4.5tr with the strongest demand expected to come from the Middle-East, China and Latin America.[60]

[60] HM Government, 'Lifting Off – Implementing the Strategic Vision for UK Aerospace', 2013; www.gov.uk/government/uploads/system/uploads/attachment_data/file/142625/Lifting_off_implementing_the_strategic_vision_for_UK_aerospace.pdf



4.4 The capital goods and machinery sector



Bottom line

Tariffs are relatively low and the UK runs a trade deficit with the EU – a trade agreement between the UK and the EU is likely.

Initial disruption: Medium

- Average tariffs are low but the UK could face EU tariffs. For example, machine tools face tariffs of between 1.7% and 4.5%.[62]
- Although the EU as a whole is the single biggest export destination, the sector is less reliant on the EU than other export sectors.
- Non-tariff barriers could emerge over time frustrating supply chains.
- Potential exclusion from TTIP and existing EU FTAs.

[61] ONS, Business Register and Employment Survey (BRES), 2013 www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-358355

[62] European Association of the Machine Tool Industries, 'Bringing transatlantic trade to a new level CEICMO's position on Transatlantic Trade and Investment Partnership', 2014; www.vdma.org/documents/4945442/0/CECIMO Position TTIP.pdf/dbdd7abe-68b6-4c21-a0f7-12685e401e41

Likelihood of a deal granting similar access to the EU: High

- UK trade deficit with the EU of £5.5bn and the lack of significant tariffs would provide a large incentive to conclude a deal.

Impact of losing voting rights

- Most standards would continue to be set internationally although the EU tends to gold-plate.
- Swiss and Turkish trade associations are members of EU-level machine tool umbrella bodies despite not being in the EU, so the UK could take a similar approach.

Impact on FDI and jobs

- Large international companies with production facilities which use the UK as a gateway to access the single market would be unlikely to re-locate immediately, but in the medium to longer term they could shift production into the EU if non-tariff barriers developed over time.

Benefits of Brexit

- The potential ability to sign a trade agreement with China, which is the single biggest export market after the EU.

The global future

- There remains significant potential to expand into new markets. For example, exports of machine tools in 2013 were 2.4% lower than in 2012, with deliveries to the EU falling by 4.6%. The largest single country market remains China which was the destination for 16% of UK machine tool exports measured by value, with the level 4% higher than in 2012. The US moved up to second place in the list of export destinations for the first time since 2009, with shipments nearly 50% higher than in 2012 and at their highest level since 2006.[63]

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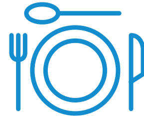
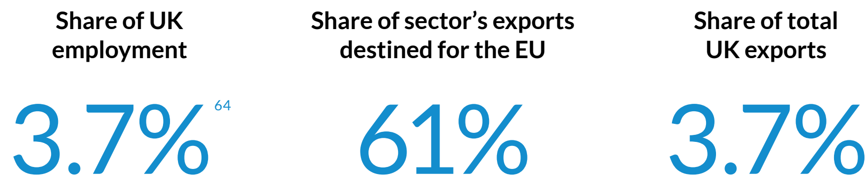
[63] Manufacturing Technologies Association 'Basic Facts 2014'
www.mta.org.uk/sites/default/files/MTA_2014_BasicFacts_Key Messages_Final.pdf



4.5 The food, beverage and tobacco sectors



Bottom line

This is currently a highly protected sector within the EU, which benefits producers at the expense of consumers. The UK's deficit would act as an incentive for the EU to conclude a deal. The sector would also be affected by trade policies with the rest of the world.

Initial disruption: High

- UK food exports to the EU could face high tariffs, such as 20% for animal products, 52.8% for dairy products, and 20.8% for beverages and tobacco.[65]
- Potential loss of EU FTAs would be a blow as global tariffs remain high.
- As a major importer, outside the EU, the UK might drop its own tariffs, which would benefit consumers but would also change the environment for UK producers and could lead to changes to supply chains – some food manufacturers could benefit from sourcing cheaper inputs and ingredients for their products from abroad, in turn making their exports more competitive, while others could face much stiffer international competition as rival imports become cheaper.
- Those food and drink sectors which have an EU Geographical Indication would see this instantly eliminated. Where it is recognised in foreign law, any protection that GI currently gives would be lost.

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[64] DEFRA, 'Food Statistics Pocketbook' 2013; www.gov.uk/government/uploads/system/uploads/attachment_data/file/315418/foodpocketbook-2013update-29may14.pdf

[65] It should be noted however that the biggest single food and drink export, Scotch Whisky, would face a zero tariff in exporting into Europe.

Likelihood of a deal granting similar access to the EU: Medium to High

- The UK runs a deficit of £16.6bn with the EU in these sectors, which the EU would want to maintain. If the UK retains a modest tariff with the rest of the world and offers the EU duty free access, it is likely that the EU would reciprocate because its producers would still have an advantage. Retaining such a tariff would continue to penalise UK consumers, while completely and immediately dropping UK tariffs with the world would remove the incentive for the EU to strike a deal.

Impact of losing voting rights

- This sector is subject to many non-tariff barriers even within the EU, such as labelling requirements, definition of products, and taxation. These could increase if the UK is unable to vote on EU legislation.[66]
- Many standards are developed internationally, so the UK could continue to exert some influence in international forums but would lose its vote on how the EU implements them.

Impact on FDI and jobs

- This would depend more on UK policies with the rest of the world than on the terms of an EU deal.

Benefits of Brexit

- Potential to source cheaper inputs for processed food products.
- UK firms would benefit from the ability to strike trade deals where the EU has not. For example, Scotch Whisky, which accounts for 23.5% UK food and drink exports, faces a duty of 150% in India.[67]

The global future

- Exports of food and non-alcoholic drink grew by 4.8% in 2014, with exports to non-EU markets (+12%) outperforming the EU (+2.5%).[68] The UK could benefit from growing demand from emerging economies for high-end products as middle-classes grow.

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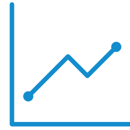
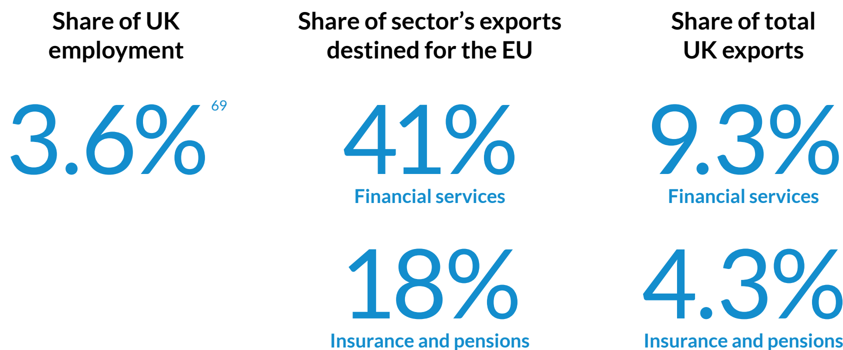
[66] Although arguably, the UK is one of the worst offenders, in fact, in pressing to have additional national rules.

[67] Scotch Whisky Association, 'Trade matters: International', 11 September 2013; www.scotch-whisky.org.uk/what-we-do/trade-matters/international/

[68] Food and Drink Federation, 'Exports snapshot', 2014; www.fdf.org.uk/exports/ukexports.aspx



4.6 The financial services and insurance sectors



Bottom line

Financial services are the most exposed sector and where a deal will be hardest to negotiate. Britain may be forced to choose between "*third country*" status with restricted EU market access, or somehow remaining a member of the single market (like Norway), i.e. EU rules but with no formal votes. Insurance is already far more globally oriented and therefore less is at stake.

Initial disruption: High

- No tariffs but loss of single market 'passport' would mean that UK-based banks and other financial firms could lose cross-border access to EU markets and may be forced to establish new subsidiaries in the EU in order to maintain their access, which would substantially increase their costs.
- The UK's insurance sector is far less exposed to EU markets.
- UK access would depend upon its regulation being deemed 'equivalent' by the EU – a process which could easily be politicised, at least in the short-term.
- Potential exclusion from existing EU FTAs and TTIP.

[69] House of Commons Library, 'Financial Services: contribution to the UK economy' February 2015; www.parliament.uk/business/publications/research/briefing-papers/SN06193/the-financial-sectors-contribution-to-the-uk-economy

Likelihood of a deal granting similar access to the EU: Low

- UK has a major trade surplus with the EU of £19.9bn, so following the 'trade deficit' logic, EU partners would have limited incentive in striking a deal.
- The EU has an established policy of only offering firms in non-EU countries – including Switzerland – limited cross-border access to EU markets predicated on strict conditions. Only EEA membership offers full access, but also involves accepting all the EU rules without a vote on their design or implementation.
- Post-Brexit, the centre of gravity within the EU may shift towards a tougher regulatory regime for accessing the single market. The European Parliament's hostility to 'Anglo-Saxon finance' could prove a major stumbling block.
- In combination, the UK would struggle to replicate its current level of access for banks and funds.

Impact of losing voting rights

- Problematic and hard to compensate for. The UK could be home to 36% of Europe's wholesale finance market but with no votes on a big chunk of the rules governing that market.

Impact on FDI and jobs

- Around 49% of the UK's annual inflow of FDI is in financial services (2013)[70], some of which would be at risk. Given the mobility of the sector, there is a higher risk of businesses relocating – particularly foreign firms using London as an entry point to the single market – than in manufacturing.
- However, much of this investment is linked to UK financial services strengths – language, legal system and global role – which would continue after withdrawal.

Benefits of Brexit

- The future of the sector inside the EU is full of uncertainty as well, with the risk of the single market in financial services becoming increasingly dominated by Eurozone interests at the expense of vibrant financial markets.
- Outside the EU, the UK would be able to reduce or better tailor regulation so as to increase the sector's competitiveness in global markets.
- The ability to strike trade agreements with greater focus on financial services in global growth markets, with the US and Asian markets potentially being particularly important.

The global future

- Increasing global demand. For example, whilst in 2005 the UK, Germany, France, Spain and Italy accounted for 27% of global banking assets, PriceWaterhouseCoopers projects that in 2050 that will have decreased to 12.5%. PWC also projects that Brazil, Russia, China and India will see their share of global banking assets leap to 32.9% in 2050 from the 2005 figure of 7.9%.[71]

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[70] ONS

[71] PwC, 'The world in 2050 – The accelerating shift of global economic power: challenges and opportunities', January 2011

4.7 The professional services sector

Bottom line

The lack of a genuine single market in this sector means that the effect would be limited. If the EU pressed ahead with more services liberalisation in future, the negative impact on the UK would increase significantly.

Initial disruption: Medium

- No tariffs and many UK firms would continue to be able to export professional services to the EU under WTO rules. In more highly regulated sectors, such as legal services or accountancy, losing the mutual recognition of professional qualifications would reduce the ability of firms to move their employees across borders in the EU.
- If the financial services industry is badly affected by Brexit, there could be a knock-on effect on linked sectors, such as legal, accounting and consultancy services.

[72] BIS, 'A Strategy for Professional and Business Services'; www.gov.uk/government/uploads/system/uploads/attachment_data/file/211842/bis-13-922-growth-is-our-business-professional-and-business-services-strategy.pdf

Likelihood of a deal granting similar access to the EU: Medium

- The UK has a small trade deficit with the EU of £1.9bn.
- Given the link between trade in these sectors and the free movement of professionals, much would depend on the future of free movement of people between the UK and the EU.
- Many of the regulatory issues regarding market access for professional services lie at the national level. However, as with Switzerland, the EU is likely to strike an agreement on mutual recognition of professional qualifications, which would allow continued mobility of professionals.
- UK and EU would likely continue to facilitate cross-border investment and provide for commercial presence in these sectors.

Impact of losing voting rights

- The long term effect will depend on whether the EU moves towards a single market in services, which could see the UK lose out – both in terms of the ability to shape it and reap economic benefits.[73]

Impact on FDI and jobs

- Likely to be small since the sector is not that reliant on EU markets and the fragmented nature of EU professional services markets.

Benefits of Brexit

- The UK might seek to exploit its comparative advantage in this area by placing more focus on this sector in free trade agreements than the EU has done in the past.

The global future

- The sector is already largely focused on non-EU markets for exports and is likely to continue to experience stronger growth in non-EU markets.

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[73] Open Europe, Kick-starting growth (2013); www.openeurope.org.uk/intelligence/economic-policy-and-trade/single-market-in-services/

4.8 The overall picture

The UK's trade deficit as a negotiating tool?

It is often argued that the UK's trade deficit (and the EU's surplus with the UK) is the UK's trump card when negotiating a preferential trade agreement with the EU from the outside. German carmakers will not want to lose access to the UK car market, it is said, so there is mutual benefit in avoiding tariffs and trade restrictions. There is some merit to this argument but it should not be overstated.

The UK's deficit should be put into wider context. Firstly, the UK is the single biggest destination for EU exports but, while the EU accounts for 44.5% of UK exports, the UK only accounts for 17.1% of EU exports.[74] Secondly, the UK's overall trade deficit with the EU masks a UK surplus in services. Using the trade deficit logic, there is far less rationale for the EU to conclude a liberal agreement on services access than on goods. Against this is the fact that trade patterns criss-cross the EU. The UK deficit is the sum of very much larger movements, with goods being imported either from outside or inside the EU, processed, and re-exported. As goods cross and re-cross borders it makes less and less sense for either side to impose tariffs on these repeated movements (which is also one of the justifications for TTIP). Switzerland also runs a substantial trade deficit with the EU – in goods and services – but this has not necessarily facilitated wide ranging market access in all areas (see Section 5).

	UK		Switzerland	
2013	Goods (£)	Services (£)	Goods (€)	Services (€)
Exports to EU	£155 billion	£72.8 billion	€94.3 billion	€61.9 billion
Imports from EU	£221 billion	£62.5 billion	€169.6 billion	€82.5 billion
Balance with EU	-£66 billion	£10.3 billion	-€75.3 billion	-€20.6 billion

Source: ONS and Eurostat

[74] ONS, Part 3 Chapter 9 "ONS Pink Book 2014"; www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-321799; WTO, EU trade profile; www.stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=E28

All exporting sectors would experience initial disruption and uncertainty in the event of Brexit. The UK's goods exports to the EU that could be subject to high tariffs (above 4%) upon exit – such as cars, chemicals and food – and the highly regulated financial services sector would be particularly vulnerable to initial disruption. It is likely that this would spill over to a short-term negative impact on foreign direct investment (FDI). Around half of UK FDI inflows are in financial services, some of which could be at risk.

However, in a UK and EU exit negotiation, we assess that there is a high likelihood that the UK and the EU could conclude preferential trade deals covering the five goods sectors assessed. In all these sectors UK firms would face new administration costs at the EU border, due to rules governing foreign content in their products. In the case of chemicals and food, a deal would potentially come with strict conditions such as adhering to the EU's high regulatory costs or maintaining tariffs with the rest of the world to the cost of consumers – negating some of the potential benefits of Brexit.

For the remaining services sectors, and financial services in particular, guaranteeing seamless access to EU markets for UK businesses will be more difficult, not least because the UK has a deficit with the EU in goods, but a surplus in services.

All sectors would suffer from the UK's loss of voting rights in the EU, but for industries such as the financial sector the impact could be greater since the barriers to entry could be increased by new EU regulations over which the UK has no votes.

However, outside the EU, Britain would also be nimbler, and could pursue policies which may bring benefits to several of the sectors we assessed. Exactly what would happen to these sectors will depend on the precise terms of any exit agreement and new UK-EU relationship (see Section 5). Equally importantly, their fate would depend on the decisions on trade and regulation that the UK would make. In Section 6, we assess how the UK could take advantage of these potential freedoms.

5.

What model for the UK's relations with the EU?

The analysis of the UK's main export industries in the section above illustrates that they could be affected by withdrawal from the EU in different ways. But exactly how they would be affected depends on the exact terms of the new UK-EU relationship that replaced full membership and the policy choices made by an independent UK Government.

In this section we assess the existing alternatives to EU membership and how they might be adapted to better suit the UK.

In the debate about the UK's membership of the EU there are a series of reasons, political and economic, stated as to why Britain would be better off outside the EU. The most commonly cited are:

- Regaining parliamentary sovereignty over law-making;
- The ability to deregulate and increase economic competitiveness free of EU interference;
- The ability to limit or better control immigration from EU member states;
- The ability to conduct an independent trade policy to reduce UK import costs and gain market access in foreign markets;
- The ability to replace UK involvement in supranational EU common policies in areas such as the CAP, CFP, justice and home affairs, and climate change with domestic or intergovernmental arrangements;
- Reducing or eliminating the fiscal burden of contributing to the EU budget.

This is not necessarily an exhaustive list and some of those who favour withdrawal would attach much greater weight to some of the above reasons than others. But they can be summarised as 'gaining greater independence from the EU'.

Therefore, taking all these factors into account, we base our judgment on the suitability of the existing and alternative models below based on four tests:

Assessing what model would be best for the UK's relations with the EU	
Test 1	Does the model provide sufficient EU market access for UK businesses?
Test 2	Does the model provide sufficient say over the rules governing that market access?
Test 3	Are the long-term gains from UK independence and democratic accountability worth bearing the short term costs of Brexit?
Test 4	What is the negotiability of the given model?

5.1 The existing alternatives to EU membership

5.1.1 European Economic Area membership

Test 1: EU market access – High

The EEA is an agreement between the EU and three members of the European Free Trade Association (EFTA), Norway, Iceland and Lichtenstein, which grants these countries tariff-free access to the single market and means that the 'four freedoms' (goods, services, capital and people) apply on the same basis as to full EU members. Such an option could effectively allow the UK to 'remain in the single market'.

As the table below shows, via the EEA agreement, Norway is bound by EU legislation in a number of policy areas ranging from those strictly concerned with implementing the 'four freedoms' to so-called 'flanking and horizontal' policy areas which include social and employment policy and the environment. In addition, Norway also participates in EU justice and home affairs and some aspects of EU foreign policy on a voluntary basis.

Included under EEA agreement / EEA access to EU markets	Voluntary add-ons	Norwegian independence / not included in EEA
Goods: Some agriculture and fisheries products; Energy; Competition and state aid; Trade facilitation and technical cooperation. **Services:** Financial services; Transport; Postal services; Electronic communication, audio-visual services and information society; **Capital** **Persons:** Free movement of persons; Social security; Recognition of professional qualifications. **'Flanking and horizontal' policies:** Consumer protection; Cultural Affairs; Education, training and youth; Research and innovation; Public health; Enterprise policy; Civil protection; Health and safety at work and labour law; Environment; Employment and social policy; Company law; Budgetary matters; Gender equality, anti-discrimination and family policy	**Justice and home affairs:** Associate member of Schengen border-free area; Participates in 'Dublin system' for asylum claims; Participates in Europol and Eurojust **Foreign policy:** Norway is actively seeking association with the EU's foreign & security and security & defence policies and participates in EU joint missions	**Agricultural policy** **Fisheries policy** **Regional policy** **External trade policy** **Foreign policy**

Source: Adapted from EFTA[75]

[75] EFTA, 'European Economic Area: policy areas', accessed March 2015; www.efta.int/eea/policy-areas

Test 2: Say over the rules – Low
While the EEA Agreement includes provisions for the non-EU members to be consulted on new legislation, the EEA states have:

- No veto in the European Council
- No votes in the Council of Ministers
- No MEPs or votes in the European Parliament
- No European Commissioner and no European Commission staff
- No judges or staff at the European Court of Justice (ECJ)

What powers does Norway have?
Norwegian officials take part in just over 200 committees in the European Commission.[76] Norway, and the other EEA/EFTA states, also have to agree to an EU rule being incorporated into the EEA agreement. Once EU laws have been passed, the EEA Joint Committee (in which the EU is represented by the European Commission) works to extend them – generally without any amendment – to the non-EU members of the EEA. At this stage, Norway has the power to:

Amend: Some adjustments – substantive or geographical limitations, institutional adjustments, transitional arrangements or exceptions – may be permitted. However, the European Commission has the final say.[77]

Contest: All decisions of the Joint Committee are taken by unanimity and, if approved, the acts are listed in the relevant Annexes to the EEA Agreement. This provides an opportunity for Norway to contest whether an EU act is 'EEA relevant' and therefore whether it should be part of the agreement.

Refuse implementation: The final recourse for Norway is refusal to implement legislation into the EEA agreement. Whilst this is a legitimate tool, it has major drawbacks limiting its practical effectiveness.[78] First, this 'right of veto' does not stop the EU enacting the legislation and, if it relates to new product standards, for example, Norway cannot use the old ones to continue to export to the EU. Second, once a 'veto' is used, this not only applies to the individual measure concerned but to the 'affected part' of the annex to the EEA Agreement, which would also cease to apply – again at the discretion of the EU. As the Norwegian government itself has noted "financial services can hardly be viewed in isolation from each other".[79] Therefore, if the UK were to use the EEA Agreement to 'veto' a piece of financial services regulation – say the bankers' bonus cap – this could potentially see the UK locked out of the single market in financial services altogether, including the passport provisions.

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[76] Norwegian Ministry of Foreign Affairs, 'The EEA and Norway's room for manoeuvre', White Paper, 2000-2001; www.regjeringen.no/en/find-document/dep/UD/reports-to-the-storting/20002001/report_no-12_to_the_storting_2000-2001/7/id193725/

[77] House of Commons library, 'Norway's relationship with the EU', January 2013

[78] For a discussion see Annie Golden Bersagel, 'Norway's Planned Reservation of the Third European Postal Directive and the Future of the European Economic Agreement', European Union Law Working Papers No 5, Stanford Law School and the University of Vienna School of Law, 2012; www.law.stanford.edu/sites/default/files/child-page/205024/doc/slspublic/bersagel_eulawwp5.pdf

[79] Norwegian Ministry of Foreign Affairs, 'The EEA and Norway's room for manoeuvre', White Paper, 2000-2001; www.regjeringen.no/en/find-document/dep/UD/reports-to-the-storting/20002001/report_no-12_to_the_storting_2000-2001/7/id193725/

Norway has never exercised this veto right.[80] The closest it came to doing so was over the Third Postal Directive, where the incoming Conservative government reversed the previous Labour government's decision to refuse implementation of the Directive into the EEA agreement.[81]

Input into EU legislation as an EEA or EU member

Opportunities to influence	In the EEA	In the EU
Global institutions, some of which set down detailed global standards, while others set out political guidelines for regulation.	Independent seat on all trade and standard-setting bodies.	Represented by the EU in most bodies but UK has own seat at G20 Financial Stability Board and Basel Committee on Banking Standards.
The European Council of EU leaders which sets out the EU's strategic and legislative priorities.	No representation. The EEA Council, comprised of the EEA/EFTA states and the EU, meets twice a year and provides political impetus for the development of the EEA Agreement.	UK has a veto.
European Commission which proposes legislation.	No EU Commissioner or nationals working in the Commission. Representation and input via expert working groups, committees and comments on legislative proposals.	The UK has a European Commissioner, British nationals in the Commission and is represented in its expert working groups and committees.
European Parliament and Council of Ministers which amend and adopt legislation.	No representation. Can lobby friendly governments and MEPs. The EEA Joint Parliamentary Committee is a forum to allow national parliamentarians from EEA/EFTA states and MEPs to discuss the EEA agreement.	UK ministers vote in the Council of Ministers and UK has 73 MEPs in the European Parliament.
EEA Joint Committee which incorporates EU legislation into the EEA agreement.	EEA state can contest EEA relevance, negotiate amendments or veto.	European Commission represents EU and plays an important role in deciding which EU acts are to be incorporated into the EEA Agreement.
Implementation in member state	Can delay implementation with prospect of EU legal action. Can refuse to implement (i.e. veto)	Can delay implementation with prospect of EU legal action.
Law in force	Monitoring and enforcement by the EFTA Surveillance Authority and the EFTA Court. In order to guarantee homogeneity between the EU's Court of Justice and the EFTA Court jurisprudence, the EFTA Court follows the relevant case law of the ECJ. No judge at the ECJ.	Monitored and enforced by the European Commission and ECJ. The UK has a judge at the ECJ and as one of the largest member states it also has a permanent Advocate-General.

[80] Yoichi Ito, 'EEA law: unexpected success', in 'The EEA and the EFTA court: decentred integration', edited by the EFTA court, Hart publishing, 2015, p523

[81] See J. Lindsell, 'The Norwegian way: a case study for Britain's future relationship with the EU', Civitas, February 2015, p60; www.civitas.org.uk/pdf/TheNorwegianWay

Examples of Norwegian and UK attempts to affect EU policy

Norway forced to follow EU's lead on deposit guarantee scheme

When the EU decided to introduce a maximum level of state guarantee for bank deposits of €100,000 within its Deposit Guarantee Schemes Directive, Norway had little option but to follow. This conflicted with Norway's existing €250,000 (NOK 2 million) deposit guarantee, which the Norwegian government wished to retain. In Norway, the proposed €100,000 protection level covered only 47% of deposits, while the former €250,000 level of protection covered 58% of deposits. The Norwegian government therefore attempted via the EEA mechanisms to negotiate an exemption from the deposit guarantee limit, writing to EU finance ministers to explain that a Norwegian exemption would not distort competition in the single market.[82] However, Norway was unable to gain such an exemption.[83]

UK secured changes to EU proposals to safeguard its unique retail investment model

Due to distinct national markets and cultures the retail finance industry is engaged in relatively little cross-border EU trade, but it is still subject to EU regulations. This can pose challenges to the UK, which has an almost unique retail investment model based on wide consumer choice from a range of investment products. On the continent, on the other hand, individuals are largely content to invest in a limited range of products sold through banks. As originally drafted, the EU's PRIIPS Regulation would have required retail investors to return signed Key Information Documents (KIDs) – which outline the features, risks, and costs of investment products – for each investment before trades took place. The result could have been an end to real-time share dealing in listed funds in the UK. However, lobbying by the Wealth Management Association, UK MEPs and officials resulted in the several amendments that enabled the UK's practices to continue.[84] Outside of the EU but inside the EEA, this sector would remain subject to EU rules, despite the lack of significant cross-border trade, but with little or no UK input into such legislation to tailor it to UK circumstances.

Test 3: Gains from independence – Low

Under the EEA agreement most EU policy areas would continue to apply to the UK

There are different measures of the share of EU law applying to Norway – in particular when set against the UK which itself has several opt-outs from EU law. Essentially, EEA membership means accepting the application of EU single market law according to its broadest possible definition: the Working Time Directive, banking rules, REACH, climate change legislation, full free movement of people and other measures.

To illustrate the extent to which Norway is affected by EU legislation, of the 100 costliest EU-derived rules in force in the UK[85] – which collectively impose a cost of £33.3bn on the UK economy[86] – 93 of them would apply if the UK joined the EEA (the original agreement, not the Norwegian 'add-ons').

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[82] Letter to EU finance ministers 15 March 2012; www.regjeringen.no/en/dokumenter/deposit-guarantee-scheme/id676785/

[83] OECD background to deposit guarantees, p23-24, www.oecd-ilibrary.org/docserver/download/5k46l8sz94g0.pdf?expires=1418659815&id=id&accname=guest&checksum=71D032CA4140C617BCCF01307A2D601A

[84] WMA, 'WMA celebrates major successes on EU regulation', 9 April 2014; www.thewma.co.uk/news/press-releases/wma-celebrates-major-successes-on-eu-regulation/

[85] For the full list see Open Europe, 'Top 100 EU rules cost Britain £33.3bn', March 2015; www.openeurope.org.uk/intelligence/britain-and-the-eu/top-100-eu-rules-cost-britain-33-3bn/

[86] This includes the cost of EU laws that have already been passed, but have yet to come into force – such as the new rules on insurance companies' capital requirements (the Solvency II Directive). The cost figures have been taken from UK Government Impact Assessments except for the cost and benefit estimates for the CRD IV package which are from the Prudential Regulation Authority (The Bank of England).

These 93 EU-derived regulations come with a cost of £31.4bn (94% of the total cost). All of the five single costliest pieces of EU-derived legislation in force in the UK would continue to apply in the EEA:

1. *The UK Renewable Energy Strategy* – Recurring cost: £4.7bn a year
2. *The CRD IV package* – Recurring cost: £4.6bn a year
3. *The Working Time Directive* – Recurring cost: £4.2bn a year
4. *The EU Climate and Energy Package* – Recurring cost: £3.4bn a year
5. *The Temporary Agency Workers Directive* – Recurring cost: £2.1bn a year

There are two political problems with this situation. First, many of the areas of EU over-regulation most frequently cited by business – including financial services, social and employment law and climate change rules[87] – would actually not be repatriated at all, but continue to be cemented in European legislation, and as outlined above, the UK's ability to both amend these regulations and shape new laws would be substantially limited.

In addition, the EEA agreement is not immune from the EU's 'mission creep', with laws relating to, for example, climate change and agriculture proposed and passed under EEA-relevant articles (in this case, energy and animal welfare respectively).[88] As a result, the question of 'EEA relevance' has become increasingly ambiguous and contentious.[89]

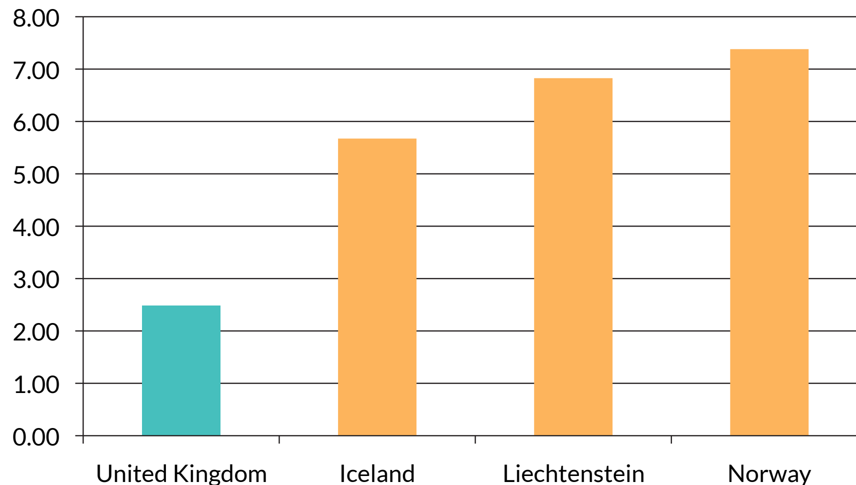
Second, under the EEA, the UK would be subject to the full free movement of people. While there are economic arguments for maintaining EU free movement, polling frequently shows that immigration tops UK voters' list of concerns about EU membership,[90] so from a political perspective, EEA membership would mean accepting the same levels of EU immigration as now but without a vote on the rules. In fact, in 2013, Norway was the destination of over twice as many EU migrants per head as the UK.

[87] See for example IoD, 'Business support for EU membership "conditional on fundamental reform', 20 May 2014 www.iod.com/influencing/press-office/press-releases/business-support-for-eu-membership-conditional-on-fundamental-reform-finds-new-iod-survey

[88] Norwegian Ministry of Foreign Affairs, 'The EEA Agreement and Norway's other agreements with the EU', 2012-13; www.regjeringen.no/en/dokumenter/meld.-st.-5-2012-2013/id704518/?docId=STM201220130005000ENGEPIS&q=&navchap=1&ch=2

[89] In evidence to the House of Commons Foreign Affairs Committee, Dr. Johanna Jonsdottir, of the EFTA Secretariat, noted that "Cases where EEA relevance is controversial can potentially lead to an expansion of the scope of the EEA Agreement into new areas which were not foreseen when it first came into effect, at least when the EU attaches importance to their adoption by the EFTA states." See evidence of Dr. Johanna Jonsdottir, Policy Officer, European Free Trade Association Secretariat, to House of Commons Foreign Affairs Committee, 'The future of the European Union: UK Government policy', June 2013, p77; www.publications.parliament.uk/pa/cm201314/cmselect/cmfaff/87/87.pdf

[90] See Survation poll for Sky News, 1-3 June 2013; www.news.sky.com/story/1099378/eu-immigration-tops-list-of-uk-concerns; ComRes poll for Open Europe, 22-24 May 2013; www.openeurope.org.uk/intelligence/britain-and-the-eu/eu-reform/; YouGov poll for the Sunday Times, 30-31 October 2014; www.d25d2506sfb94s.cloudfront.net/cumulus_uploads/document/n965i9mzb8/YG-Archive-Pol-Sunday-Times-results-311014.pdf



Source: Eurostat

Does Norway have an 'emergency brake' on EU free movement?
The EEA Agreement grants member states the ability to take 'safeguard measures', which potentially allows the EEA/EFTA countries to temporarily suspend parts of the EEA agreement, including the free movement of people. Such measures are only meant to be temporary. Unlike the veto described above, which applies to new legislation, the safeguard measures can be applied to the existing agreement. The safeguard measures can be triggered by a country unilaterally but the agreement also allows the EU to take retaliatory "proportionate rebalancing measures".[91] The use of safeguard measures triggers a negotiation between the EEA/EFTA countries and the European Commission "with a view to finding a commonly acceptable solution."

The EEA Agreement does therefore include an emergency brake as a 'nuclear option', which could be used to bring the EU to the negotiating table rather than as an indefinite policy tool. The outcome of any such negotiations would ultimately be determined politically. Norway has never used the safeguard measures for this purpose but, in the late 1990s, Liechtenstein applied safeguard measures to restrict free movement while it negotiated the ability to apply restrictions on foreign EEA nationals' residence and employment which it has applied since 2000.[92]

Where would the UK gain independence?
Outside the EU's customs union, EEA member states have the ability to negotiate and conclude their own FTAs with non-EU countries. Membership of EFTA is a prerequisite of EEA membership and the EEA-EFTA states have chosen to do the majority of their free trade negotiations via EFTA, but they can also do so independently.

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[91] Articles 112 to 114. Article 112 states that "If serious economic, societal or environmental difficulties of a sectorial or regional nature liable to persist are arising, a Contracting Party may unilaterally take appropriate measures."

[92] In 1997, Liechtenstein started negotiations in order to extend a transitional arrangement on free movement it had negotiated under the original EEA treaty. Liechtenstein applied safeguard measures of the EEA Agreement in the interim period, by restricting the number of work permits to EU migrants. EFTA Surveillance Authority, 2001, p36; www.eftasurv.int/media/esa-docs/physical/852/data.pdf

Currently, the EFTA states have 25 free trade agreements covering 35 countries.[93] EFTA concluded FTAs with Canada and Singapore ten years ahead of the EU and with South Korea five years before the EU – so the UK could potentially strike deeper and quicker trade deals, including with countries such as China which the EU currently has no plans to negotiate with. However, the EFTA states have no deal with the US and depending on the outcome of the TTIP and TPP negotiations, EFTA countries could face new market access restrictions, discrimination and trade distortion, even where they already have free trade agreements.[94]

The EEA would free the UK from the supranational Common Agricultural Policy, Common Fisheries Policy, regional subsidies, and justice and home affairs policies, as these are not covered by the EEA Agreement.[95] The UK would also be free to set its own levels of Value Added Tax (VAT).[96]

As part of the price for access to the single market, Norway contributes to the EU budget in two ways. Firstly, it has to contribute in proportion to its percentage of EU GDP for the programmes it is a part of, and, secondly, by way of a substitute contribution to the EU's regional development policy under the EEA funds.[97]

Crucially, the UK would no longer be subject to ECJ jurisdiction. EFTA states are not subject to monitoring and surveillance by the EU institutions but have their own Surveillance Authority and Court which monitor compliance with EEA law. EFTA infringement procedures are fairly similar to the mechanisms for monitoring compliance in EU member states but the EFTA Court does not have the same authority as the EU's Court of Justice to issue binding decisions, only recommendations and advisory opinions.

Test 4: Negotiability – Medium

It is important to note that, to accede to the EEA, the UK would first need to apply to re-join EFTA – a move that could potentially be vetoed by any EFTA member.[98] Accession ought to be relatively straightforward since EFTA is simply a free trade area among the EFTA states. UK accession to the EEA would also require unanimous approval of the EFTA states and the EU's member states.

Politically, joining the EEA could be complicated by the organisation's current setup and voting rules. There are two schools of thought regarding the EEA/EFTA countries' incentives to admit the UK into the EEA. On the one hand, the UK's accession would greatly boost the political weight of the EFTA countries vis-à-vis the EU. On the other hand, the UK could upset the power balance among the existing EFTA states, and Norway in particular could see its role as the lead EFTA state in the EEA eclipsed by the UK.[99] As noted above, the requirement for unanimity in order for new EU legislation to enter into the EEA agreement could see the UK vetoing legislation that governs the

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[93] EFTA; www.efta.int/free-trade/free-trade-agreements

[94] Professor Thomas Cottier, 'EFTA free trade agreements: past, present and future', EFTA Bulletin, December 2013, p45; www.efta.int/sites/default/files/publications/bulletins/EFTA-Bulletin-2013.PDF

[95] Norway has signed additional agreements with the EU on matters outside the scope of the EEA, including on police cooperation, membership of the passport-free Schengen zone and foreign and defence policy. However, these are optional add-ons to the EEA agreement.

[96] European Parliament, 'Overview of EU rules applicable to EEA/EFTA countries in financial services, competition and taxation', 2008; www.europarl.europa.eu/document/activities/cont/201108/20110818ATT25100/20110818ATT25100EN.pdf

[97] Norway mission to the EU; www.eu-norway.org/eu/Financial-contribution/#.VLVGYiusVyQ

[98] Martin Howe QC, 'Zero plus: the principles of EU renegotiation', Politeia, 2014, p5; www.politeia.co.uk/sites/default/files/files/Zero Plus The Principles for EU Renegotiation.pdf; House of Commons Foreign Affairs Committee, 'The future of the European Union: UK Government policy', June 2013, p77; www.publications.parliament.uk/pa/cm201314/cmselect/cmfaff/87/87.pdf

other EFTA states' access to EU markets and vice versa. For example, it is unlikely that the UK would be happy with an arrangement that handed Iceland a potential veto over its access to EU markets.

Therefore, the UK's admission would not be straightforward – on the UK side or the current members' side – due to the way the EEA is currently constructed. It is therefore likely that there would need to be changes to its institutional design.

5.1.2 Swiss-style trade and bilateral agreements

Test 1: EU market access – Medium

Switzerland participates in specific parts of the single market on the basis of a FTA dating from 1972 and a series of bilateral agreements concluded with the EU in 1999 (Bilaterals 1) and 2004 (Bilaterals 2). All in all, there are 20 principal bilateral agreements and around 100 supplementary accords. Switzerland gains access to the relevant parts of the single market in return for adopting law and regulation equivalent to the EU's.

Included in Swiss FTA and bilaterals / Swiss access to EU markets	Swiss independence / Not included in EU deals
Goods: No import, export duties or quotas for industrial products; Some agricultural products (processed food); Trade facilitation and technical cooperation. **Services:** Limited cross-border provision of services for a maximum of 90 days per year under the terms of the free movement of persons agreement (excluding employment agencies and financial services). **Capital:** Non-life insurers have the freedom to establish operations in one another's territory.[100] **Persons:** Free movement of persons; Social security; Recognition of professional qualifications. **Other areas:** Public procurement; Research; Overland transport; Air transport; Member of Schengen border-free area; Participates in 'Dublin system' for asylum claims; Taxation of savings; Fight against fraud; MEDIA programme. **'Cooperation agreements':** Membership of European Environment Agency and EUROSTAT; Education, vocational training and youth; Cooperation with Eurojust and Europol; Cooperation between competition authorities; European Asylum Support Office.	**Cross-border financial services** **Social and employment policy** **Energy and climate policy** **Consumer rights** **Agricultural policy** **Fisheries policy** **Regional policy:** Switzerland makes an independent contribution to reducing economic and social disparities within the EU, which is made available for projects in the 12 'new' member states that joined the EU in 2004 and 2007. **External trade policy** **Foreign policy**

Source: Adapted from Federal Swiss Government[101]

[99] Following its visit to Oslo the House of Commons Foreign Affairs Committee noted that "Our impressions in Norway tended to confirm the suggestion made to us by Professor Schwok, namely that the accession to EFTA of a state of the UK's size might be regarded by the EFTA countries as a disruptive and not wholly welcome prospect." House of Commons Foreign Affairs Committee, 'The future of the European Union: UK Government policy', June 2013, p77; www.publications.parliament.uk/pa/cm201314/cmselect/cmfaff/87/87.pdf

[100] Life insurers, reinsurers and insurance forming part of a statutory system of social security do not fall within the scope of the agreement. Direct cross-border nonlife insurance business is also excluded

[101] Swiss Federal Department of Foreign Affairs, 'Switzerland and the European Union', 2014; www.eda.admin.ch/dam/eda/en/documents/publications/EuropaeischeAngelegenheiten/Schweiz-und-EU_en.pdf

Where does Switzerland's EU market access fall short?

While Swiss goods exporters enjoy tariff-free access to EU markets, unlike the EEA, it has no catch-all agreement with the EU on services. The free movement agreement only establishes the right to provide cross-border services "for a period not exceeding 90 days of actual work in a calendar year".[102] This provides limited access for self-employed services providers without settlement in the EU/Switzerland, and employees of firms based in either territory which are sent to either territory to provide a service.[103]

Crucially from a UK perspective, Switzerland has no agreement with the EU on financial services, except for a 1989 agreement on non-life insurance. Major Swiss banks largely get around this lack of cross-border market access by establishing subsidiaries in an EU member state, often the UK. However, this approach results in higher costs because it requires personnel and separate capitalisation. Smaller financial firms are finding it increasingly hard to do cross-border business in the EU. New EU financial services regulations have exacerbated the problem for Switzerland, as they have added complexity and legal uncertainty in accessing EU markets from outside the single market.

The regulatory requirements for EU market access vary for different sectors and even for different types of entity within the same sector depending on the types of clients served.[104] Claude-Alain Margelisch, CEO of the Swiss Bankers Association, warned in 2013 that the impact of new EU regulations "is a further deterioration in the status quo" for Swiss banks and wealth managers. He concluded that, "In the end we may even have to negotiate a services agreement for medium- and long-term access to the EU market."[105] For example, under the EU's MIFID II regulations, an 'EU passport' will only be available if a Swiss investment firm establishes a branch in a member state and the European Commission judges Switzerland's regulation as equivalent to the EU's.

Test 2: Say over the rules – Low

There is currently no formal mechanism to resolve Swiss-EU disputes over the interpretation of the agreements. In addition, unlike the EEA, the Swiss arrangement is not a 'living agreement'. The Swiss Directorate for European Affairs notes that "problems with regard to implementation and delays in adjusting legislation to new legal developments can lead both to new obstacles to market access and to discrimination against the actors involved, as well as to legal insecurity."[106]

As a result, this has led to indirect adaptation of Swiss law by adopting EU legislation even where there are no formal agreements with the EU.[107] With every new Swiss federal law considered, it is mandatory for the Swiss parliament to include a paragraph summarising the EU position on the relevant matter.

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[102] Prof Inga Kawka, 'The movement of services between the European Union and Switzerland', 2014; www.cyelp.com/index.php/cyelp/article/viewFile/189/128

[103] The activities of employment agencies and agencies hiring out services are not included; nor are financial services which require authorisation. See Swiss Federal Department of Foreign Affairs, 'European nationals in Switzerland: information on the free movement of persons', 2013, p16; www.eda.admin.ch/dam/eda/en/documents/publications/EuropaeischeAngelegenheiten/EU-Buerger-in-der-Schweiz_en.pdf

[104] Shearman & Sterling LLP, 'Extraterritoriality Revisited: Access to the European Markets by Financial Institutions, Funds and Others from Outside Europe', August 2014; www.shearman.com/~/media/Files/NewsInsights/Publications/2014/08/Extraterritoriality-Revisited-Access-to-European-Markets-by-Financial-Institutions-Funds-and-Others-FIA-082714.pdf

[105] Media conference of the Swiss Bankers Association on 3 September 2013 – Speech by Claude-Alain Margelisch

[106] Swiss Directorate for European Affairs, 'Institutional issues', November 2014; www.eda.admin.ch/dam/dea/en/documents/fs/11-FS-Institutionelle-Fragen_en.pdf

[107] Professor René Schwok and Cenni Najy, 'UK returning to EFTA: Divorce at 40 and going back to Mom and Dad?, June 2012; www.publications.parliament.uk/pa/cm201213/cmselect/cmfaff/writev/futunion/m21.pdf

Under pressure from the EU to develop closer cooperation and in a bid to improve the workings of the agreements, Switzerland and the EU started negotiations on 'institutional issues' in May 2014. The negotiations centre on the following objectives:[108]

- *Interpretation of EU legislation and dispute settlement:* Switzerland has proposed that questions concerning the interpretation of EU law that is covered by the bilateral agreements could be submitted to the ECJ by either party. Based on the interpretation of the ECJ, the mixed committees would seek to find an acceptable compromise. However, should this prove unsuccessful, appropriate measures "could be taken even up to the partial or complete suspension of the agreement in question."

- *Adoption of legislation:* The Swiss government notes that "it [is] as much in Switzerland's interest as in that of the EU to find mechanisms to allow for a rapid adjustment to developments in EU legislation (acquis) and therefore the homogeneity of law in order to prevent new obstacles for Swiss economic players in accessing the EU single market." However, Switzerland remains opposed to the automatic adoption of EU law, and wants to retain the right to say 'No' to adopting EU legislation in the areas covered by the bilateral agreements. Some form of joint committee would therefore be needed to agree on whether Swiss laws are to be considered equivalent to those of the EU.

- *Influence on EU legislation:* Switzerland's negotiating mandate also calls for it to "gain a right to extensive consultation and participation in the drafting and deliberation of new EU legal acts and similar measures so as to be involved in the process early on."

Should these proposals become reality, for those policies covered by the Swiss-EU bilateral agreements, Switzerland would find itself in an increasingly identical institutional position to that of the EEA states. Switzerland would gain 'decision shaping' rather than 'decision making' rights over EU legislative proposals and the adoption of EU law would become more standardised, if not identical. Switzerland would continue to have the right to refuse to adopt EU law, which EEA states can also do in theory, but at the potential cost of partial or full suspension of the market access agreement in question.

Test 3: Gains from independence – Medium

The Swiss bilateral agreements are more limited in scope than the EEA agreement. While, in the case of services this limits Swiss market access, in other areas it offers Switzerland more room for manoeuvre. The current Swiss-EU arrangement is a result of Switzerland's fiercely guarded sovereignty. Therefore, rather than being obliged to adopt the EU acquis, as EEA states are, Switzerland commits to adopting equivalent legislation. The bilateral agreements, therefore, involve no transfer of decision-making to a supranational authority and there is no enforcement mechanism for the bilateral accords.

However, like Norway, Switzerland also has to accept the free movement of labour from the EU and, also like Norway, Switzerland currently accepts far more EU migrants per head than the UK. In 2013, net EU immigration was just over four times higher in Switzerland than in the UK, proportionate to their populations. This is also borne out in the composition of the countries' populations. 15.6% of the Swiss population was born in an EU country, while only 4.2% of the UK population was born in another EU country.[109]

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[108] Swiss Directorate for European Affairs, 'Institutional issues', November 2014; www.eda.admin.ch/dam/dea/en/documents/fs/11-FS-Institutionelle-Fragen_en.pdf

[109] See Open Europe, 'Britain's EU immigration debate: Norway and Switzerland are not the answer', 2014; www.openeurope.org.uk/intelligence/immigration-and-justice/norway-and-switzerland/

In a referendum in February 2014, the Swiss voted to introduce quotas on EU migrants from 2017 and this issue is set to have a major bearing on the future of the Swiss-EU relationship. Such quotas would violate the terms of Switzerland's free movement treaty with the EU. The EU has so far refused to agree to Swiss quotas for EU migrants and has threatened to suspend the other EU-Swiss agreements and market access if Switzerland unilaterally imposes quotas.

The EU-Swiss free movement treaty is linked to agreements on technical barriers to trade, public procurement, agriculture, transport, civil aviation, and research by a so-called 'guillotine clause'. This means they can only take effect together, and if one of the agreements is terminated the other six would cease to apply – which could result in reduced market access to the EU for Swiss firms.

Where would the UK gain independence?

Unlike Norway, Switzerland has the freedom to pursue its own social and employment policies, and has greater freedom to regulate other aspects of its domestic economy. In theory, only its exporters to the EU need to comply with EU regulations.

Switzerland is outside the CAP, CFP, regional subsidies, and justice and home affairs policies, but has negotiated participation in the Schengen border-free agreement. As under the Norway option, the UK would be free to negotiate an independent trade policy – either as part of EFTA if it elected to apply for membership – or via its own FTAs with non-EU countries. Switzerland has successfully signed FTAs with countries the EU has not, such as China, and signed its deal with South Korea before the EU.

Is Switzerland heading for more EU integration?

As noted above, since 2012 Switzerland and the EU have been in talks about creating new forms of institutional cooperation that would increase Switzerland's integration with the EU. Negotiations are also underway on greater Swiss-EU cooperation and reciprocal market access for electricity markets, agricultural products, the EU's emissions trading scheme, and access to the EU's culture programme.[110] At the same time, Swiss voters' rejection of free movement threatens the current form of bilateral cooperation. Both issues may end up being settled by a further 'take it or leave it' Swiss referendum in 2016 on the entire bilateral arrangement.[111]

The Swiss-EU dispute over free movement and wider discussions about the future of the bilateral approach could prove to be a litmus test for the suitability of this model for the UK. If, for example, Switzerland is successful in imposing quotas with minimal adverse consequences, this would illustrate that significant influence and bargaining power over the EU can be had from the outside.

Test 4: Negotiability – Medium to High

The essence of the Swiss-EU relationship is a very comprehensive trade and economic agreement. Recently, the EU has concluded and ratified an FTA with South Korea, has concluded talks with Canada, and is currently negotiating with the US – all modern, complex, developed economies. These modern FTAs no longer focus simply on tariffs and typically include provisions on a wide range of government policies, including foreign investments, the mobility of staff, dispute settlement, technical barriers to trade and government procurement.

For example, the stated aim of the recently concluded EU-Korea FTA was to "create an expanded and secure market for goods and services and a stable and predictable environment for investment, thus enhancing the competitiveness of their firms in global markets."[112] Such a comprehensive deal would therefore be similar to the

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110 Swiss Federal Department of Foreign Affairs, 3 February 2015; www.eda.admin.ch/dea/en/home/verhandlungen-offene-themen/verhandlungen.html

111 Swiss Federal Department of Foreign Affairs, 'Switzerland's European policy', February 2015, p30; www.eda.admin.ch/dam/dea/en/documents/folien/Folien-Europapolitik_en.pdf

112 www.eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2011:127:FULL&from=EN

patchwork of bilateral Swiss-EU deals that have been reached over time and similar issues would need to be addressed.

It is likely that the UK and EU would negotiate such a bespoke agreement, but as with all trade negotiations the devil would be in the detail of the agreement negotiated.

5.1.3 Going it alone under the WTO

Test 1: EU market access – Low

Included / Access to EU markets	Independence / Not included
Goods: MFN treatment; Technical barriers to trade – the WTO works to remove "unnecessary obstacles to trade"[113] **Services:** Under the GATS (General Agreement on Trade in Services) UK companies selling services through subsidiaries should not be discriminated against.[114] The TISA (Trade in Services Agreement) is a potential plurilateral trade agreement aimed at opening up services trade covering 23 states and 70% of world GDP.[115] **Capital:** The TRIMs (Trade Related Investment Measures) is designed to avoid trade distorting effects of investments in the goods trade. [116] The OECD's 'Code of Liberalisation of Capital Movements' includes legally binding rules on non-discrimination on capital flows.[117] **People:** The Uruguay trade round added liberalising measures on intra-company transferees regarded as "essential personnel" and business visitors.[118] **Other:** Agreement on Government Procurement – a plurilateral deal on opening up of government procurement market.[119]	**Free movement of people** **Cross-border financial services** **Social and employment policy** **Energy and climate policy** **Consumer rights** **Agricultural policy** **Fisheries policy** **Regional policy** **External trade policy** **Foreign policy**

Those who advocate that the UK 'go it alone' outside the EU argue that the main economic costs of membership to the UK are a misallocation of resources resulting from the protection afforded to certain industries from the EU's external tariff and non-tariff barriers to trade. Essentially, membership of the EU diverts more trade than it creates.

Aside from EU tariffs and the trade-distorting costs imposed by the CAP, another aspect of the EU's protection for manufacturing sectors is its controversial anti-dumping policy – trade defence measures such as applying emergency tariffs against floods of cheap imports. Anti-dumping provisions are largely justified on the grounds of ensuring that global markets are not distorted by predatory and monopolistic interests, i.e. ensuring 'fair' trade. However, anti-dumping duties usually far exceed bound tariff levels, making them a useful tool for any industry in the EU wanting to prevent new entrants to the market. For example, between 1998 and 2008, 33% of EU anti-dumping investigations concerned the chemicals sector and 17% concerned the

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[113] WTO, Technical Barriers to Trade, www.wto.org/english/tratop_e/tbt_e/tbt_e.htm

114 WTO, General Agreement on Trade in Services, www.wto.org/English/tratop_e/serv_e/gatsintr_e.htm

[115] European Commission; www.ec.europa.eu/trade/policy/in-focus/tisa/

[116] WTO, Agreement on Trade-Related Investment Measures www.wto.org/english/tratop_e/trims_e.htm

[117] OECD, www.oecd.org/daf/inv/investment-policy/codes.htm

[118] WTO, Mode 4, Free movement of People, www.wto.org/english/tratop_e/serv_e/mouvement_persons_e/mouvement_persons_e.htm

[119] WTO, plurilateral 'Agreement on Government Procurement; www.wto.org/english/tratop_e/gproc_e/gp_gpa_e.htm

steel sector. Of the 307 completed investigations, metals, chemicals and steel all saw more than 70% of investigations resulting in duties being applied.[120]

Goods

Under the WTO option, instead of the tariff-free market access to EU markets the UK currently enjoys, the UK goods exporters would have no preferential access beyond the most favoured nation (MFN) tariff guaranteed by its WTO membership. With the exception of free trade agreements and customs unions, WTO rules ensure that members cannot treat any other member less favourably than any other, and therefore the tariff that applies to the so-called MFN must apply to all. This would prevent the EU or the UK from imposing discriminatory tariffs on one another following withdrawal.

Since the EU's average tariff has fallen substantially in recent decades, as noted above, the cost of being outside the EU's common external tariff has fallen. Nevertheless while the EU's average tariff is quite low, in several sensitive goods sectors, such as cars, chemicals and food, the EU's MFN tariffs remain quite high. For example, while the EU's headline tariff for transport equipment is 4.3%, within that, US car exports to the EU currently face a trade-weighted tariff of 8%. US processed foods face a tariff of 14.6%.[121]

In addition, the EU is able to offer preferential treatment to those countries with which it already has FTAs (over 50) and those countries (over 80) with which it is currently negotiating. Without preferential terms, UK manufacturers of high-tariff products could become relatively disadvantaged versus their EU competitors.

Services

Withdrawal from the EU without a preferential trade agreement in place would mean that UK services exports to the EU would also be governed by WTO rules, and the EU's commitments under the General Agreement on Trade in Services (GATS). This would provide limited access compared with the current EU arrangements for several reasons:

- The EU's single market confers certain rights for companies that do not exist internationally in the WTO. While many barriers remain within the EU for services trade, the rights to free movement and establishment in another EU member state go beyond what exits in the GATS and in existing free trade agreements.
- For some sectors (financial services, transport and telecommunications) the EU has developed a new common system of regulation that in effect replaces national regulation.
- EU competition policy is meant to prevent unfair advantages due to state subsidies or monopolistic behaviour.
- The European Commission and ECJ enforce the EU rules, while at the WTO level there is no presumed right of market access or enforcement mechanisms.

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[120] ECIPE, 'Ten years of anti-dumping in the EU: economic and political targeting', February 2009; www.ecipe.org/app/uploads/2014/12/ten-years-of-anti-dumping-in-the-eu-economic-and-political-targeting.pdf

[121] CEPR, 'Reducing transatlantic barriers to trade and investment: an economic assessment', March 2013, p14; www.trade.ec.europa.eu/doclib/docs/2013/march/tradoc_150737.pdf

Therefore, while the EU's single market for services is far from perfect, outside of the EU, UK services exporters are likely to face even more barriers to trade with the EU.[122] The barriers would be greatest in the most highly regulated sectors such as financial services.

There could, however, be future progress on services liberalisation at the global level. For example, the "Really Good Friends" group has signalled a willingness to go further on services liberalisation and create a new plurilateral Agreement on the Trade in Services (TISA). The EU is already a member of this group and the UK could seek to join in its own right.[123] This could be a way to benefit from greater liberalisation globally and within the EU.

Test 2: Say over EU rules – Low

Fully outside of the EU, the UK would have no say over EU decision-making on the rules governing trade in the single market. The UK would however regain its seat at the WTO and other trade or standard setting bodies where it is currently represented by the EU.

Test 3: Gains from independence – High

Going it alone would clearly represent the greatest degree of independence from the EU. Withdrawal from the EU would mean that the UK would no longer need to implement EU regulations and standards, except when exporting to EU markets. The UK would be fully independent from common EU policies and political structures.

Completely outside of the EU, the UK would be free to either negotiate its own FTAs with the rest of the world and/or adopt the 'Hong Kong option' of unilaterally dropping its trade tariffs without seeking reciprocal action on the part of foreign governments. The major benefit of such an approach would be to reduce import costs for consumers and reduce the cost of inputs for manufactured goods that are re-exported.

5.2 Adapting the existing models to the UK

5.2.1 A new Single Market-Lite model

Adapting the EEA model to the needs of the UK

Problem with the EEA	Remedy	Likelihood of negotiating it
Scope too wide	Reduce agreement to a tightly defined single market excluding areas such as employment law and climate change	Low
No formal vote over EU proposals	Equal voting rights	Low
Right of refusal is weak	Equal voting rights / a new single market court	Low
Weak protection against mission creep	Single market court	Low
Unanimity amongst EEA members	Majority vote	Medium
Limited ability to limit EU migration	Negotiate a 'safeguard clause' or 'emergency brake'.	Medium

[122] CEPS, 'Access barriers to services markets: mapping, tracing, understanding and measuring', June 2013; www.ceps.eu/system/files/Access Barriers to Services Markets_0.pdf

[123] European Commission, 'A plurilateral agreement on trade in services', 15 February 2013, www.europa.eu/rapid/press-release_MEMO-13-107_en.htm

Many have argued that the logic of the current trend of EU integration is the creation of a more tightly politically, economically and fiscally integrated constellation of countries centred on the euro, on the one hand, and a looser political union, retaining the economic integration of the single market on the other.[124]

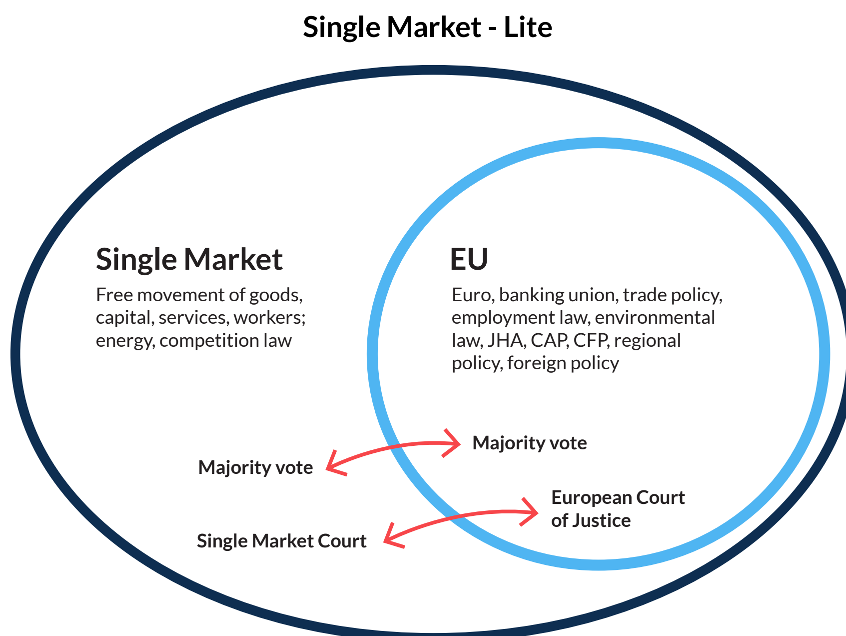
The UK could seize this opportunity to create a new 'single market tier', loosely based on the EEA. This would be a new 'Single Market-Lite' model: full membership of the single market, but with minimal political integration.

The idea would be to create a comprehensive institutional wrapping for a range of different countries that cannot take part in full-scale, eurozone-led EU integration, including:

- Countries inside the EU not happy with status quo, most notably the UK
- Countries inside the EU that may in the long-term be forced into alternative arrangements due to Eurozone integration, such as Sweden or Denmark
- Countries outside the EU but largely integrated in the EU via sub-optimal models, such as Norway and Switzerland
- Countries outside that are very unlikely to ever join a euro-centred, highly integrated EU, such as Turkey.

However, in order for such a model to get a more satisfactory score under our Brexit tests several significant changes would be required.

Test 1: Market access – stays the same
Such a model would replicate the UK's existing market access with the rest of Europe in the areas falling under the single market (see below).



Source: Open Europe

[124] House of Commons Foreign Affairs Committee, 'The future of the European Union: UK government policy', 2013, p79-80; www.publications.parliament.uk/pa/cm201314/cmselect/cmfaff/87/87.pdf

Test 2: Say over the rules – voting rights and judicial filter
In this revamped model, non-EU member states would need to be given a series of new institutional checks on decisions relevant to the single market. To avoid the 'regulation without representation' dilemma, this would entail a different arrangement to that of the existing EEA, in two respects: first, voting rights over any decisions that apply to the Single Market-Lite tier. Second, a judicial mechanism whereby single market states beef up their ability to challenge rules which are beyond the remit of the Single Market-Lite.

Voting rights for Single Market-Lite members:
There are several ways in which this could be achieved:

Double Majority: There is a strong argument that areas covered by the single market remain subject to majority voting – not unanimity. For example, the Single European Act, which first introduced QMV, provided the impetus for trade facilitation within the single market which is unlikely to have occurred under national vetoes. While there is a constant trade-off, compared to political integration in other areas, rules facilitating a genuine market are often (though not always) of a less sensitive nature and can therefore be subject to majority voting, without a prohibitively high democratic cost.

For example, for a proposal to apply across the entire single market there could be a requirement for a majority amongst the EU states and a separate majority amongst the Single Market-Lite states. This is similar to the 'double majority' principle – first floated by Open Europe[125] – that now applies to decisions taken within the European Banking Authority.

Blocking minority amongst all states: A new 'blocking minority threshold' could be established amongst all the members of the EU and the Single Market-Lite. For example, under a compromise reached under the Lisbon Treaty, from April 2017, if member states representing 20% of the EU population indicate their opposition to the EU adopting an act by a qualified majority, the Council of Ministers must discuss the issue and "do all in its power" to find a "satisfactory solution to address concerns raised".[126] It could be agreed that if a similar proportion of the wider single market block disagreed with a proposal, normal voting procedures would be suspended.

Structured defection: As argued by Professor Damian Chalmers, instead of a formal voting mechanism at the European level, there could be a way for national parliaments in the relevant states to object to a proposal. For example, if all or a proportion of national parliaments in Single Market-Lite states object to a proposal, it should fall.[127]

Judicial filter
A beefed up single market court: Leaving the ECJ to police the relationship between the EU tier of membership and the wider single market risks the Single Market-Lite falling prey to judicial capture – with ECJ case law developing a bias for the inner tier at the expense of the outer one. There would be a need to avoid a scenario whereby the European Commission uses a single market treaty base to pass a measure outside the scope of the Single Market-Lite. A new Single Market Court could be established for this purpose.

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[125] Open Europe, 'Continental shift: safeguarding the UK's financial trade in a changing Europe', 2011; www.openeurope.org.uk/intelligence/economic-policy-and-trade/eu-financial-regulation/

[126] A blocking minority is currently 35%. Declaration on Article 16(4) of the Treaty on European Union and Article 238(2) of the Treaty on the Functioning of the European Union introduces, from April 2017, an additional safeguard. This is triggered if 55% of the of the EU population or of the number of member states necessary to constitute a blocking minority (i.e. 20%) indicate their opposition to a proposal.

[127] Professor Damian Chalmers, 'Democratic self-government in Europe', Policy Network, 2013; www.policy-network.net/publications/4399/democratic-self-government-in-europe

The EFTA court could serve as a model. It already has the power to deviate from EU law in certain circumstances and has occasionally done so in the past – for example, in the Icesave case. However, this would require a number of changes to the EFTA court, including substantially strengthening its capacity – it currently only employs around 20 judges and staff in total[128]. What exactly would happen if the ECJ and the Single Market Court were to disagree and came to loggerheads would be a difficult issue to resolve.

Strengthen national courts: An alternative way would be to give national courts in the Single Market-Lite states the right to appeal or even reject ECJ case law.

Proposals for associate membership or two-tier European Union	
Michiel van Hulten, 'To get out of this crisis we need to rebuild Europe from scratch', *European Council on Foreign Relations*, 2011[129]	The creation of an outer European Area of Freedom, Security and Prosperity, and an inner European Political and Economic Union. The outer tier would be based on the Single Market but would also involve a common foreign and security policy. Decision-making in the 'outer-tier' would be by unanimity. Democratic control would be exercised by national parliaments, not the European Parliament. The inner tier would involve full political and fiscal union and would take all decisions by qualified majority.
Lord Owen, 'Europe Restructured: The Eurozone Crisis and Its Aftermath', *Methuen*, 2012[130]	The establishment of an outer European Community and an inner European Union. The European Community would comprise the single market as it applies in the EEA operating under qualified majority decision-making, with coordinated foreign and security policies. The inner European Union, based on the Eurozone, would involve common fiscal and monetary policies.
Thierry Chopin, 'Two Europes?', in 'Europe in search of a new settlement', *Policy Network*, 2013[131]	A two-tier model in which the EU effectively becomes the Eurozone and the states wishing to join it, and the EEA is revised to give the EEA's non-EU member states equal voting rights over the single market and other relevant common policies.

Test 3: Independence – a tightly defined 'single market'

To make Brexit worth it, Single Market-Lite membership would have to be far more strictly defined than the EEA. In addition to the areas already excluded under the EEA, the following could be removed (*See Annex 2, for a full list of policy areas that would be included*)

[128] EFTA Court, Annual report, 2013, p1028; www.eftacourt.int/fileadmin/user_upload/Files/AnnualReports/EFTA_Court_Report_Book_2_2013.pdf
[129] ECFR; www.ecfr.eu/article/commentary_to_get_out_of_this_crisis_we_need_to_rebuild_europe_from_scratch
[130] See also articles in The Times, 'My vision for a new Europe', 7 June 2012; www.thetimes.co.uk/tto/opinion/columnists/article3437756.ece; and Evening Standard, 'We must start to prepare now for an EU referendum', 20 May 2013; www.standard.co.uk/comment/comment/lord-owen-we-must-start-to-prepare-now-for-an-eu-referendum-8623900.html
[131] www.policy-network.net/publications_download.aspx?ID=8274

What would a Single Market-Lite look like?

Included	Not included
• Free Movement of Goods (*with/ without Customs Union and with/ without agricultural goods).* • Free Movement of Services. • Free Movement of Capital. • Free Movement of Labour. • Energy and Transport in so far as the measures are aimed at creating a single market. • Competition law, state aid measures and non-discriminating measures on tax.	• Social and employment policies • Regional policy • Employment law • Health & safety • Climate change legislation *(although there may be room for overall cross-border targets)* • Tourism, industry and culture • Energy and Transport policies not related to single market • Justice and Home affairs *(although there could be intergovernmental bilateral agreements)* • Common defence and foreign policy *(although there could be intergovernmental bilateral agreements)*

It is also likely – although not necessary – that members of this tier would not be part of the EU's customs union, meaning the UK could conduct its own trade policy.

What to do with free movement of workers would much depend on the membership of the Single Market-Lite – a club that could include Turkey and Ukraine would, for political reasons, have to involve stronger controls.

Test 4: Negotiability

Of all the potential models, this would arguably be the hardest to negotiate as it would require a series of negotiations to parallel treaty structures covered by 31 national vetoes. The EEA, EFTA and EU Treaties can only be changed through unanimous agreement if all participating member states agree.

The EEA Treaty would have to be amended on multiple points: to allow the UK in, to narrow the scope of the Treaty and to introduce new voting structures. The UK would need to apply to re-join EFTA[132] and the EU Treaties would have to be changed in various ways to change the UK's status and to accommodate for the new voting structures.

What would be the incentives for the others to strike a deal?

Two of the drawbacks with the current EEA/EFTA arrangements are the democratic deficit and the mismatch in power between the EU and EEA/EFTA. The UK leaving the EU to create a new single market tier would go a long way to correct this under the model we describe above. An 'outer tier' Single Market-Lite including the UK – Europe's second largest economy – would have far more leverage in any talks, including in the negotiations to establish the new arrangement itself.

For Switzerland, in particular, this could add the benefit of providing an institutional wrapping for an increasingly contested and unequally yoked relationship with the EU.

From the UK perspective, it would make the associate membership club bigger and therefore act as a greater counterweight to the Eurozone countries.

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[132] Martin Howe QC, 'Zero plus: the principles of EU renegotiation', Politeia, 2014, p5; www.politeia.co.uk/sites/default/files/files/Zero Plus The Principles for EU Renegotiation.pdf; House of Commons Foreign Affairs Committee, 'The future of the European Union: UK Government policy', June 2013, p77; www.publications.parliament.uk/pa/cm201314/cmselect/cmfaff/87/87.pdf

It is not clear what the incentives for EU partners would be, but they are not difficult to imagine in a scenario where Brexit is a new fact of life: having the UK and other European countries that are growing economically as part of a large, vibrant and rules-based single market; expanding the zone of trade and stability to countries that previously did not have a realistic prospect of joining the same tier as other European states, such as Turkey – coming with geopolitical benefits; and keeping 'Europe' together.

However, there would no doubt be a huge number of general and specific sticking points.

- The UK joining the EEA/EFTA alone would massively upset the balance of power in the club given that the UK would be so much larger – this is the weakness of a "double majority" voting arrangement. Would Norway and Switzerland agree?
- On the EU-side, there would be a range of objections ranging from granting single market access without the current costs and agreeing the new voting structure.
- Membership of the single market and acceptance of the four freedoms has also traditionally meant accepting the free movement of persons. The EU's reaction to Swiss demands to renegotiate their agreement on free movement suggests that adhering to this principle may be a non-negotiable condition of membership of the single market.
- Removing areas like employment law and climate challenge will face push-back from EU member states concerned about 'social dumping'. In combination, negotiating a single market plus model may actually be easier from within the EU than from outside.

5.2.2 The outline of a comprehensive UK-EU free trade agreement

Adapting the Swiss model to the needs of the UK?

Problem with Swiss model	Remedy	Likelihood of negotiating it
No agreement on cross-border access for financial services	a) Aim to secure "equivalence" with EU regulations b) Negotiate a comprehensive financial services agreement a part of an FTA	a. Medium b. Low
Forced to play catch up to EU regulations to ensure market access	Create a 'living agreement' with mechanisms to coordinate regulation and prevent discrimination.	Medium
No legal recourse if new EU regulation causes trade barriers	Negotiate some form of investor state dispute resolution mechanism.	High
No ability to limit EU migration	Negotiate a 'safeguard clause' or 'emergency brake'.	Medium

An alternative to Single Market-Lite would be to attempt to secure, as far as possible, the level of access to EU markets UK exporters currently enjoy but from outside the single market. Such an option could take the form of an adapted Swiss-style FTA and series of bilateral deals or a single ambitious deep and comprehensive free trade agreement. This would therefore be a looser relationship than 'associate membership'.

Test 1: Market access – incorporating services and financial services

Goods

The EU has a policy of offering its preferential trade partners wide-ranging tariff free access in goods trade.

For example, the proposed EU-Canada trade deal (CETA) will ultimately see 100% of the tariff lines on industrial products fully eliminated for both sides and the EU will eliminate 93.8% of its agricultural tariffs.[133] There is little reason to think that its approach to the UK would be different, once UK-EU trade negotiations were underway.

Suitable rules of origin would need to be negotiated so that UK firms faced minimal disruption to their value and supply chains. This would likely mean the UK adopting the EU's rules of origin as set down in the 'System of Pan-Euro-Med Cumulation' in both its FTA with the EU and seeking to maintain these in any FTAs with non-EU partners, along with provisions for cross cumulation to the extent possible with third parties that have FTAs with the EU. UK firms would still face the administrative costs of filling out customs forms, but reaching agreement on the terms of rules of origin would allow UK firms to fully benefit from zero tariffs under its deals with the EU and the rest of the world.

Financial services

However, in order to improve on the situation of Switzerland and the EU's other existing FTA partners, the UK would want to secure an ambitious agreement on cross-border services, and financial services in particular. The advent of the single market passport for financial services and the high degree of integration has created a genuine EU cross-border market for certain financial activities, which also acts to raise the barriers to entry for firms based outside the single market.

Broadly, the UK would have two options in attempting to secure market access for financial services:

1. *Aim to secure EU 'equivalence'*: This would depend on UK 'equivalence' with the EU's regulatory and supervisory regime, co-operation arrangements between the UK and EU countries or the European Securities Markets Authority (ESMA), and the anti-money laundering and tax regimes implemented by the UK. Given that the UK currently is an EU member, these requirements should not be difficult to satisfy on a technical level. This could however change if the UK sought to alter its financial regulation or supervision post-exit.

   However, the decision on equivalence is not merely a technical decision it is also political. The European Commission makes the equivalence decision on the advice of ESMA, but this decision is then put to a vote of EU member states.[134] Following a UK exit, under the EU's current policy for non-EU members, the UK's market access in financial services would not therefore be purely an administrative matter, it could become highly politicised in the immediate aftermath of exit or withdrawal negotiations. A report for the Swiss government notes that the EU's unilateral

[133] European Commission, 'CETA – summary of final negotiating results', 2014; www.trade.ec.europa.eu/doclib/docs/2014/december/tradoc_152982.pdf

[134] Shearman & Sterling LLP, 'Extraterritoriality Revisited: Access to the European Markets by Financial Institutions, Funds and Others from Outside Europe', August 2014; www.shearman.com/~/media/Files/NewsInsights/Publications/2014/08/Extraterritoriality-Revisited-Access-to-European-Markets-by-Financial-Institutions-Funds-and-Others-FIA-082714.pdf

recognition procedure "creates a situation in which Switzerland has a relationship of dependency on the EU."[135] This approach would therefore entail political risk, a high degree of UK dependence on EU goodwill and would still fall short of the UK's current market access.

2. *Negotiate a comprehensive financial services agreement:* The option above is clearly not an ideal solution, providing patchy market access and little legal security. The UK could therefore attempt to secure its current level of cross-border market access through a financial services chapter in its FTA with the EU – effectively securing EEA-style access and no longer being considered a 'third country'. However, there is currently no EU FTA that offers this kind of cross-border access. For example, the outlined EU-Canada deal makes clear that it does not require either party to permit cross-border suppliers to do or solicit business in its territory.[136]
   The negotiations would therefore likely depend on the extent to which the UK would be willing to accept the EU acquis in the area of financial services. There would also need to be substantial cooperation of UK and EU supervisory authorities. Such an agreement would need to be anchored in a wider institutional agreement on questions such as the dynamic adoption of EU legislation, the recognition of ECJ case law, dispute resolution and participation in the decision-making process.[137]
   Such a financial services agreement would essentially entail the UK becoming a quasi-member of the single market in financial services. This could pose the same institutional challenges and limitations on UK sovereignty as are discussed elsewhere. Therefore, while remaining outside the single market does not rule out some UK market access in principle, there appears to be little middle ground between being treated by the EU as a third country, with the restrictions and uncertainty regarding cross-border market access that involves, and somehow remaining a member of the single market, which raises familiar questions about the UK's influence over EU rules and limited freedom for manoeuvre.

Professional services

Given the absence of a genuine single market in other EU cross-border services markets, the immediate value of a UK-EU agreement is less than that for goods. However, the UK would nevertheless be seeking to retain its current levels of access because, in the longer term, if the EU liberalises the UK would be in a strong position to benefit.

Previous EU FTAs' focus on services liberalisation has tended to concentrate on the right of establishment, conditions on foreign investment, the mobility of workers and the recognition of professional qualifications. CETA is the most advanced services agreement the EU has concluded to date.

The EU guarantees Canadian service providers its current level of liberalisation in many sectors and Canada benefits in areas like mining, certain services related to energy, environmental services and certain professional services. For 'critical and sensitive' areas or sectors, however, CETA safeguards the ability of the EU and individual governments to introduce discriminatory measures or quantitative restrictions in the future.[138]

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[135] Swiss Federal Government, 'Annex 2: Situation analysis and areas of action in market access', 2014, p22; www.news.admin.ch/NSBSubscriber/message/attachments/37605.pdf

[136] European Parliament, 'Financial services in EU trade agreements', 2014, p22; www.europarl.europa.eu/RegData/etudes/STUD/2014/536300/IPOL_STU(2014)536300_EN.pdf

[137] Swiss Federal Government, 'Annex 2: Situation analysis and areas of action in market access', 2014, p25; www.news.admin.ch/NSBSubscriber/message/attachments/37605.pdf

[138] European Commission, 'CETA – summary of final negotiating results', 2014, p10; www.trade.ec.europa.eu/doclib/docs/2014/december/tradoc_152982.pdf

A key issue would be labour mobility. Much would depend on wider discussions with the EU about the free movement of people, although both parties would likely want to maintain a high degree of mobility for workers and professionals. In terms of investment, the UK would ideally lock in the status quo, preventing EU member states from imposing ownership restrictions on UK foreign investments in the single market.

Test 2: Say over the rules – create a 'living agreement'

In order to maintain EU market access over time, the UK would need mechanisms to cooperate with the EU over future regulation and settle disputes over market access in as timely and legally predictable manner as possible.

EU FTAs typically provide for a Trade Committee, plus specialised committees and working groups, responsible for ensuring the proper operation of the agreement. The different bodies provide an opportunity both to seek resolution of market access concerns and to engage in closer regulatory cooperation.[139] For example, the Swiss-EU bilateral agreements are implemented and enforced by Switzerland and the EU in their own territories and 15 'mixed' committees are responsible for overall supervision of the agreements. As regards the EU-US agreement currently being negotiated, former EU Trade Commissioner Karel De Gucht expressed the hope that TTIP would include "a living part, whereby you put in place structures that make sure that, in future, you will have much more common regulation than you presently have."[140]

Test 3: Independence – Depth and scope of the agreement will define UK's freedom to act

The rationale for pursuing a trade agreement rather than some form of associate membership would be a looser form of association with the EU. Upon leaving the EU, the protection of UK sovereignty could be a political prerequisite of any UK-EU deal. However, this would be subject to an on-going trade-off: securing deep and comprehensive EU market access involves complex institutional arrangements and high-levels of cooperation.

The UK, as a bigger political player than Switzerland and a little less dependent on EU markets, might not wish to be drawn into similar institutional arrangements and seek looser ties. For example, the regulatory cooperation between the EU and its other FTA partners such as Canada or Korea is far less developed than that with Switzerland, and these countries are not expected to adopt equivalence with the EU acquis to the same extent.

However, as the Table on page 72 illustrates, for the foreseeable future, the EU is likely to be a far more important market for the UK than for Canada and so the importance of EU market access is far higher for the UK. In this sense, the UK is probably more similar to Switzerland than to Canada and could not afford not to take an interest in some form of alignment with EU decision making. Switzerland's experience illustrates this is a tricky balance to pull off.

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[139] See European Commission, 'The EU-Korea Free Trade Agreement in practice', 2011, p17; www.trade.ec.europa.eu/doclib/docs/2011/october/tradoc_148303.pdf

[140] Evidence to House of Lords EU Committee, 'The Transatlantic Trade and Investment Partnership', Fourteenth report, May 2014; www.publications.parliament.uk/pa/ld201314/ldselect/ldeucom/179/17902.htm

	UK	Norway	Switzerland	Canada	Korea
Exports of goods and services going to EU	42%[141]	74.3%[142]	55%[143]	7.6%[144]	8.8%[145]
Trade arrangement with EU	Member of EU Customs Union	Member of European Economic Area (EEA)	Bilateral trade deals with EU	WTO terms – Canada European Trade Agreement CETA is pending	EU / Korea FTA
GDP[146]	£1,780bn	£341bn	£455bn	£1,214bn	£867bn
GDP per capita [147]	£27,768	£66,995	£56,361	£34,526	£17,262
Key exports to EU[148]	Financial Services and insurance, chemicals, aerospace, cars and food and drink.	Oil, fish, aluminium and shipping.	Chemicals and medicinal products, machinery, instruments and watches and commercial services.	Precious stones, metals and other minerals. Machinery and equipment and aerospace products. Services including transportation, travel and insurance.	Machinery and appliances, transport equipment and plastics.

Nevertheless, a significant potential benefit of entering into a bilateral trade relationship with the EU would be greater UK freedom for manoeuvre to regulate important aspects of its economy than under the existing EEA or adapted Single Market-Lite models.

The free movement of people

Following UK withdrawal from the EU, there would likely be considerable pressure to ensure that the UK secured greater control over migration from the EU. On the other hand, the combination of the large number of UK citizens currently enjoying free movement rights and the EU's stance on the issue to date suggests that a relatively liberal free movement regime would be part of the EU's conditions for granting the UK market access.

The UK could however seek amendments to the status quo. It could insist that:

1. It is able to impose longer restrictions on EU migrants' access to welfare and public services.
2. It could ensure that the concept of EU citizenship is excluded from its free movement agreement, which might enable the UK to deny EU migrants long-term residence status.
3. It could seek an 'emergency brake' or 'safeguard clause' similar to that discussed above in the EEA model.

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141 ONS Pink Book 2014, Goods and Services exports for 2013, www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-321799

142 European Commission, Norway Trade picture; www.ec.europa.eu/trade/policy/countries-and-regions/countries/norway/

143 Swiss Department of Foreign Affairs, www.eda.admin.ch/dam/dea/en/documents/folien/Folien-Abkommen_en.pdf

144 www.international.gc.ca/economist-economiste/performance/monthly-mensuel.aspx?lang=eng

145 WTO, trade profiles, www.stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Country=KR&Language=F

146 World Bank data, www.data.worldbank.org/indicator/NY.GDP.MKTP.CD/countries

147 World bank data, www.data.worldbank.org/indicator/NY.GDP.PCAP.CD

148 European Commission country profiles

A UK Government might aim for stronger restrictions on inflows. As noted above, the outcome of Swiss-EU negotiations on free movement could also have a bearing on what the UK might be able to secure.

Test 4: Negotiability – goods more straightforward than services
As we have seen in Section 4, there is a strong incentive for the EU to conclude an agreement with the EU on market access for various goods sectors. However, in financial services the EU is likely to be reluctant to extend unprecedented access to the UK unless it conforms to EU rules.

5.2.3 Unilateral free trade – the 'Hong Kong model'

Adapting the WTO model to the UK?

Problem with WTO model	Remedy	Likelihood of negotiating it
No preferential EU market access	Declare unilateral free trade	High

'Going it alone' without a trade agreement in place with the EU would seem to necessitate an aggressive UK policy of trade liberalisation with the rest of the world – in its purest form this would be a UK declaration of unilateral free trade. The rationale is that to the extent that the EU offers protection to sensitive industries, this represents a cost to UK consumers and a misallocation of resources in the UK economy at the expense of the sectors that would be more productive and globally competitive in the global marketplace without high levels of state interference. [149]

The economic case for unilateral free trade is well known. Removing barriers to trade allows countries to specialise in the goods they can produce most cheaply and efficiently relative to other countries, and such specialisation enables all countries to achieve higher real incomes. A tariff on imports is equivalent to a tax on exports. Therefore, the removal of this tax on imports boosts imports, which leads to production cost reductions that make exports more competitive. The competitive pressure of new import entry into the domestic market also increases domestic competitiveness.

The expansion of two-way trade results in more domestically-oriented companies participating in international trade – both as exporters and as importers of intermediate goods and services – which boosts their productivity.[150]

For instance, the UK imports over £40bn of agricultural goods per year, the overwhelming majority (£30bn) of which is from the EU. But this large EU share is largely a result of trade diversion, whereby imports to the UK from the rest of the world face the EU's high level of tariff protection for agricultural goods, while goods imported to the UK from the rest from the EU are tariff free. This EU tariff protection means UK consumers are forced to purchase food from the EU at inflated prices, over and above world prices. The OECD has estimated that EU agricultural tariffs cost EU consumers €10.7bn in 2011.[151] Outside the EU and the CAP, the UK could remove such tariffs and agriculture subsidies to the benefit of UK consumers. On the other hand, eliminating these protections could also have significant effects on the structure of the domestic agriculture sector. For example, a Dutch study has found that 15% of UK farms would be unviable under a totally liberalised system, a scenario similar to that which occurred when New Zealand removed all its subsidies.[152]

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[149] Prof P. Minford, 'Setting business free: into the global economy', Freedom Association, 2013, p11; www.library.constantcontact.com/download/get/file/1102527958638-256/bis+book+clear+with+NO+bleed+CLEAN.pdf

[150] D. Ciuriak and J Xiao, 'Should Canada unilaterally adopt global free trade?', Canadian Council of Chief Executives, May 2014, p5; www.ceocouncil.ca/wp-content/uploads/2014/05/Should-Canada-unilaterally-adopt-free-trade-Ciuriak-and-Xiao-May-20141.pdf

[151] DEFRA, consultation, p14; https://consult.defra.gov.uk/agricultural-policy/cap-consultation/supporting_documents/131022_CAP_Evidence_Paper_Final.pdf

[152] LEI, 'Farm viability in the European Union: assessment of the impacts of changes in farm payments', April 2010; www.edepot.wur.nl/138917

Test 1: EU market access – sectors would need to adjust to trading at world prices and facing EU protectionism

Goods

Were the UK to withdraw from the EU under unilateral free trade, it would unilaterally remove all its tariffs on imports from the EU and the rest of the world.

The consequence of this is that 'going it alone' would have implications for the UK industries that currently benefit from EU tariff protections and trade preferences within the single market/customs union. Professor Patrick Minford notes that,

"Necessarily there would be a contraction in some industries currently supplying the EU because they benefit from protection. However, after departure and a return to free trade other industries would expand that offer good prospects for profit and employment. As is well-known the UK economy has been through big structural changes since the 1970s as services have expanded employment massively and manufacturing employment has fallen."

"Much the same sort of thing would occur on leaving the EU, though on a much smaller scale as workers were redeployed from inefficient protected industries to more efficient industries, probably in services. Overall there would be a rise in productivity and thus also a rise in employment."[153]

For example, the UK's automotive sector would see a major change under unilateral free trade. While consumers would benefit from cheaper car imports, UK car exports to the single market would face the EU's tariff of 10%. As noted above, the UK's car manufacturing sector is not uniform. Those manufacturers that do not rely on the EU market for a significant proportion of their sales, and already export to markets such as the US and China at world prices, would be far less affected by EU tariffs, and could potentially see their costs fall due to cheaper imports of inputs from outside the EU. However, for those manufacturers that are based in the UK predominantly in order to access EU-wide supply chains and EU export markets, their business model would no longer make sense from a UK base.

Services

As we have seen, EU single market regulation has created an environment in which financial services firms exporting to the EU in effect benefit from regulatory protection against competitors from outside. With the UK outside the single market, the EU could increase these single market protections for financial services, particularly for transactions involving the euro currency, for example, at the expense of UK firms seeking to sell inside the single market. Meanwhile, the loss of EU passporting rights would mean that the non-UK banks headquartered in the UK in order to access the single market would face strong incentives to move some or all of their operations to financial centres inside the single market, or otherwise face the increased costs of maintaining separately capitalised subsidiaries in the UK and in the single market.

However, outside the single market, the UK would be free to set its own financial regulation, within the confines of global agreements. Given the UK's comparative advantage in financial services, the already global nature of much of the industry and the level of infrastructure that exists in the UK and London in particular, the UK's financial services industry would no doubt adapt to exploit new markets, but the transition is unlikely to be seamless and could take several years.

The adjustment process to unilateral free trade would therefore have transitional costs, creating 'losers' as well as 'winners'. As the UK economy adjusts it will experience

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[153] Prof P. Minford, 'Setting business free: into the global economy', Freedom Association, 2013, p12; www.library.constantcontact.com/download/get/file/1102527958638-256/bis+book+clear+with+NO+bleed+CLEAN.pdf

'frictional unemployment' as jobs shift to the most productive sectors that can maintain global competitiveness without the protections or distorting advantages currently afforded by EU membership.

Test 2: Say over the rules – the UK would be just another country

Fully outside of the EU, the UK would expect no say over EU decision-making on the rules governing trade in the single market. Strictly speaking, the UK would be treated as any other 'third country' by the EU when it comes to trade. However, it is likely that given their close proximity, the UK and the EU would continue to cooperate on a number of issues on an intergovernmental basis.

The UK would however regain its seat at the WTO and other trade or standard setting bodies where it is currently represented by the EU.

Test 3: Gains from independence – UK would be free to adopt liberal trade and regulatory policies

As we have seen in the case of Norway and Switzerland, gaining preferential trade access to EU markets means accepting varying but high degrees of integration with the EU on matters of product regulation or 'regulatory equivalence'. These countries must also accept other conditions such as adherence to the free movement of persons. A unilateral free trade policy would, on the other hand, maximise the UK's independence from the EU. For example, Ian Milne concludes that,

"On the face of it, following withdrawal from the EU, a UK which declared unilateral free trade with all comers would realise maximum savings compared with being a full member of the EU. Adopting the semi-detached option à la Norway or Switzerland inevitably means being stuck with some of the ongoing costs associated with Single Market membership."[154]

In addition to the benefits of lower prices to consumers and competitive pressure to increase specialisation and productivity above, outside the EU, the UK would be able to take advantage of its independence from the EU to pursue independent policies in fields including regulation, energy and immigration.

Test 4: Negotiability – High

Unlike the other options discussed above, 'going it alone' has the major benefit of not requiring lengthy negotiations with EU partners over market access or institutional arrangements. However, there would still need to be an agreement on the transitional arrangements for withdrawal, as discussed in *Section 2* above.

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154 Ian Milne, 'Time to say No: alternatives to EU membership', Civitas, 2011, p11; www.gov.uk/government/uploads/system/uploads/attachment_data/file/278499/Civitas_MilneTimeToSayNo.pdf

5.3 The UK-EU models compared

Brexit tests		Existing model	Adapted for UK under Brexit
		EEA	**Single Market-Lite**
1	EU market access	High	High
2	Say over the rules	Low	High
3	Gains from independence	Low	Medium
4	Negotiability	Medium	Low
		Swiss-type bilateral deals	Comprehensive UK-EU free trade agreement
1	EU market access	Medium	Medium to High
2	Say over the rules	Low	Medium
3	Gains from independence	Medium	Medium
4	Negotiability	Medium to High	Medium
		Going it alone under WTO	Unilateral free trade
1	EU market access	Low	Low
2	Say over the rules	Low	Low
3	Gains from independence	High	High
4	Negotiability	High	High

Single Market-Lite scores the highest on the first three tests, and is likely the most economically beneficial model for the UK. Britain would retain full access to the single market but would benefit from the reduced costs of a slimmed-down single market. It could amend or scrap many EU-derived regulations that are currently holding back competitiveness, including employment and climate change rules but which would fall outside the Single Market-Lite. The UK could pursue free trade deals with the rest of the world but this would come at the cost of leaving the customs union and effectively imposing a new border between the UK and the EU. In practice, this would be the hardest option to negotiate, and it may actually be easier to achieve a model along these lines by renegotiating from inside the EU.

The comprehensive UK-EU FTA option looks politically more realistic. A UK-EU FTA, substantially improving on the Swiss model by including financial services within its scope, would score reasonably well on most tests, but would also involve more disruption for UK firms.

Unsurprisingly, the unilateral option scores poorly on EU market access and well on UK independence. There are likely to be domestic constraints that could prevent the UK from realising the full theoretical gains from unilateral free trade and high levels of deregulation (*see Annex 3*).

In *Section 6*, we assess the economic impact of different Brexit scenarios including the economic impact of moving to a new relationship with the EU and how the UK might take advantage of the freedom to pursue an independent trade policy with the rest of the world.

6.

The economic impact of different Brexit scenarios

6.1 Overall results

In this section we examine the economic impact of the UK leaving the EU under different scenarios. Specifically, we examine:

- **Beyond the border:** The impact of different trading relationships between the UK, the EU and the rest of the world. These results are based on economic modelling by Ciuriak Consulting on behalf of Open Europe.[155]
- **On the border:** The impact of changes to policies relating to labour migration.
- **Behind the border:** The extent to which the UK might wish to or have to cut rules and regulations previously locked in at the EU-level in order to maximise its potential outside the EU. These results are based solely on Open Europe calculations of the cost of EU regulation as set out in UK government impact assessments.

[155] Open Europe commissioned Ciuriak Consulting to run a detailed modelling exercise on the trade impact of Brexit on the UK. Open Europe worked in conjunction with Ciuriak Consulting to devise the detailed scenarios which were tested. See Annex 1 for a detailed explanation of the model used and of the scenarios run by Ciuriak Consulting. The estimates of the gains that could be achieved from deregulation set out in this section have been conducted solely by Open Europe.

We assume in our assessment that the UK would leave the EU on 1 January 2018. We then model the economic impact up until 2030. This allows time for the various economic effects to fully take hold (see below). It also allows enough time for the UK to change its policies and trade arrangements, while allowing the maximum period for which reasonably credible forecasts are available. The results are presented in terms of a welfare loss relative to staying inside the EU, which is our baseline scenario. Under this baseline, against which the other scenarios are compared, the UK stays in the EU and there are no major shocks (the model is run up to 2030 to provide a baseline for the entire period, see Annex 1 for further detail). As the graph and table below show, the costs/benefits can be seen as declines/increases in GDP relative to the baseline. The GDP gap in 2030 compared to the baseline represents the final and permanent loss to GDP from each individual scenario.

It is important to note that there are a range of effects not quantified in these sections. The approach utilises a version of the GTAP CGE model which captures a wide range of dynamic effects across the economy. For example, factor endowments (capital, labour and land) as well as factor prices (wages and return on capital) adjust to clear the market in the model, and FDI responds to changes in investment opportunities in the UK. However, overall constraints on the size and complexity of the model mean that the impact of domestic regulatory changes are not captured, which may miss changes in the overall potential of the economy over time. Moreover, the model does not capture productivity impacts at the firm level in response to trade liberalisation due to a lack of granularity beyond the sector level.

Impacts on UK of Brexit on Real GDP and Welfare, 2030

	Worst-case Brexit		UK-EU FTA 1		UK-EU FTA 2		Brexit best case	
	% GDP	£bn	% GDP	£bn	% GDP	£bn	% GDP	£bn
Total welfare gain/loss	**-2.23**	**-55.52**	**-0.81**	**-22.12**	**0.64**	**8.78**	**1.55**	**34.78**

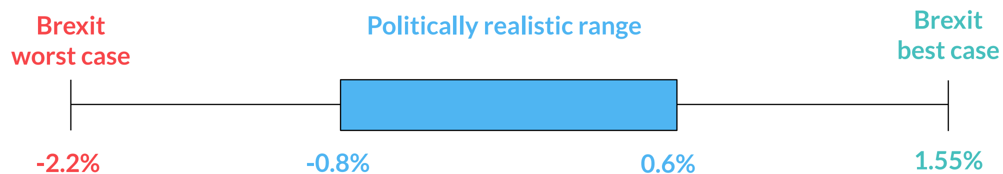
Overall, the results show that the impact of Brexit will depend on a number of variables and decisions both within the UK itself and in Europe. Here are our main scenarios:

- *Worst case:* In a worst case Brexit scenario – where the UK does not negotiate a new agreement with the EU (thereby falling back on WTO rules) and does not embark on a free trade and deregulation approach – the impact will be a permanent loss of 2.2% of GDP in 2030; the associated welfare loss would be about £70bn in 2015 prices. This includes the full saving of the UK's annual net contribution to the EU budget.[156]
- *Mid-range FTA 1:* The UK strikes a comprehensive FTA with the Remaining EU (REU). Here, the permanent GDP loss by 2030 reaches -0.81%. This scenario does include some saving from a reduced annual net contribution, although we assume the UK still makes some payment as part of the FTA deal.

[156] The UK's EU budget share is taken from HM Treasury figures. We base the share on the average cost of the UK's net budget contribution to the EU for the latest year and the years up to and including 2017 (2014 - 2017), under our scenarios the final year of the UK's contribution. This is then converted to a share of GDP which is assumed to be roughly constant throughout our baseline scenario inside the EU – meaning it is saved in scenarios where the UK leaves the EU. For the equivalent welfare figure, this is converted proportionately based on ratios used by Ciuriak Consulting for the original modelling results. See HM Treasury, 'European Union Finances 2014', p.18: www.gov.uk/government/uploads/system/uploads/attachment_data/file/388882/EU_finances_2014_final.pdf

- *Mid-range FTA 2:* The UK strikes an FTA with the EU and combines it with a unilateral free trade approach vis-à-vis the rest of the world. This could deliver additional gains of 0.75% GDP via the removal of tariffs and the introduction of low cost competition from other parts of the world which would cut costs and boost specialisation. In addition, the UK also pursues an ambitious deregulation agenda, delivering 0.7% in gains. Such an approach would push the UK back into the black, with a final welfare gain of 0.64% of GDP, again including a smaller budget contribution as in the first FTA scenario.
- *Best case:* This could be pushed further with an extremely ambitious deregulation approach pushing the overall gain to 1.55%. Here, we again assume the most optimistic scenario that the UK is able to avoid making any contribution to the EU budget.

Impact of Brexit on UK GDP (2030)



Source: Open Europe and Ciuriak Consulting

What is the GTAP model and how does it work?
The GTAP model is a computable general equilibrium (CGE) model which integrates a number of accounts to provide a complete description of an economy, these include: headline national income and expenditure accounts, 57 sectors within the economy each with an individual production function (based on capital and labour inputs) and a trade account which details linkages of each sector to the rest of the global economy. Based on the shocks detailed in a policy scenario, the model determines how the changes filter through the economy to give an overall picture of the welfare impacts in the given scenario.

Various versions of the model are widely used by international organisations – including the European Commission and the WTO – as well as academics when assessing trade related issues. The version of the GTAP model used in the present study is a dynamic version that takes into account impacts of policy shocks on FDI.

6.2 Beyond the border: trade with Europe and the world

6.2.1 Economic impact on trade of Brexit and ensuing EU negotiations

Non-negotiated Brexit

This is for the most part a worst-case scenario. Here the UK exits the EU without a new preferential trading agreement with the REU in place. This is unlikely but could materialise if the UK leaves on hostile and chaotic terms with no clear plan in place for how it wants to trade with Europe and the rest of the world.

Impacts on UK of Brexit on Real GDP and Welfare, 2030

	GDP Percent Change	Contribution of Policy Measure	Welfare Impact (GBP billions)	Contribution of Policy Measure
Tariffs	-0.947	34.33%	-19.880	28.14%
Border Costs	-1.197	43.40%	-32.526	46.04%
Goods NTBs	-0.468	16.97%	-13.310	18.84%
Services NTBs	-0.144	5.22%	-4.880	6.91%
FDI NTBs	-0.002	0.08%	-0.049	0.07%
Total	**-2.759**	**100.00%**	**-70.65**	**100.00%**
EU budget saving	0.53	19%	14.1	20%
Total incl EU budget	**-2.23**	**81%**	**-55.52**	**80%**

The key findings are:

- *Border costs:* The main chunk of the cost (-1.2%) results from the creation of a hard border between the UK and REU. This comes in the form of the imposition of new time and out-of-pocket costs on cross-border trade, for example time spent at customs and the administrative cost of getting through customs. This is a cost which is missed or underestimated by almost all other studies in this area. There is a clear advantage to being part of the customs union for quick and easy movement of trade across borders. It is a fundamental and lasting cost which is difficult to reduce. Over time it has dynamic effects as it impacts import and export decisions. Importantly, unlike tariffs (see next point), this is a deadweight cost rather than a transfer and therefore is lost from the global economy completely.
- *Tariffs:* The second significant cost results from the introduction of Most Favoured Nation (MFN) tariffs under the WTO rules. While the EU's applied MFN tariffs are generally low, the introduction of tariffs on the significant volume of trade between the UK and REU results in a fairly sizeable cost of -0.95% GDP. While this is a cost to both the UK and REU, given that the UK's trade with the REU is a much larger share of its GDP, the tariff impact as a share of GDP is higher.
- *Global value chains:* The model does not fully consider the impact of border costs and tariffs on global value/supply chains. As a developed and global economy the UK is highly integrated into global value chains in many

sectors. The imposition of these costs could severely disrupt such chains. However, capturing such an impact is difficult. For example, for production where the UK adds only a small percentage of the total value added, the imposition of these costs would be relatively large and could see the UK part of the chain being excised as it is no longer efficient.[157] Conversely, when the large majority of value added is created in the UK, the costs could force other parts of the chain to be dropped and could see a reshoring of some production. This process would of course hit the most globally integrated and focused firms hardest, these are often the most efficient as well.

- *NTBs:* As might be expected, outside the single market, higher NTBs on both goods and services have a noticeable impact on GDP and welfare. With the UK no longer being part of the single market, regulation on each side diverges, while it seems likely that existing NTBs would be significantly exacerbated.

GDP and Welfare Impacts of Brexit, Relative to Baseline, by Region

	GDP (Percent Change over Baseline)				Welfare (GBP billions at 2015 Prices)			
	2018	2020	2025	2030	2018	2020	2025	2030
UK	**-1.391**	**-1.675**	**-2.306**	**-2.759**	**-32.29**	**-38.96**	**-55.91**	**-70.65**
REU	-0.142	-0.180	-0.266	-0.335	-18.86	-24.27	-37.79	-49.91

- *Dynamic effects:* Often it is assumed there would be a significant one off cost to exit, followed by a steady erosion of the loss over time. However, in our model, somewhat counterintuitively, the effects build up over time due to two factors: the gradual build-up of NTBs between the UK and the REU and the gradual response of investment to the changes in rates of return induced by the Brexit shock. This latter effect reflects the lead-time for investment decisions. Furthermore, the border cost imposed is not simply a one off shock which dissipates but a permanent deadweight loss. As noted above, over time this has dynamic effects as it impacts trade decisions.

- *FDI:* One further interesting point is that the impact on FDI is not as significant as is often assumed. NTBs on both goods and services prove to be more important. Generally, the model suggests that, while FDI is welcome and useful, it can often crowd out domestic investment rather than be in addition to it. As such, while FDI may be more efficient and promote competition, it does not necessarily impact overall investment levels. On net there may be some losses in terms of productivity but investment is likely to be made up according to these results.[158]

[157] The costs in such an instance would accrue on both sides of the transaction as the UK is likely simply one part of the global production line. This process would obviously also hit EU firms but it is fair to assume that, given the relative sizes of the UK and REU, there will be more firms in the UK that are part of European or global value chains than vice versa.

[158] This will of course vary depending on the exact state of the economy and the source of FDI. If investment is running well below capacity then the scope for crowding out is lower. Furthermore, it is unclear how much of FDI is linked to EU membership or access to the single market for example. Lastly, the literature remains inconclusive one whether aspects such as whether FDI and trade are compliments or substitutes.

- *EU budget:* One fillip is that the UK would save its entire annual net EU budget contribution (£10.2bn in 2014).[159]
- *REU:* Lastly, as can be seen, while the REU is hurt by the UK's exit it is a significantly lower order of magnitude than the UK itself.

Negotiated exit: UK-EU FTA

Under this scenario the UK succeeds in negotiating a comprehensive FTA with the REU. This involves single market-style access for goods. The services sector manages to gain unusually large degrees of market access – beyond the current EU-Canada deal, for example. However, some additional NTBs will be imposed. The key findings are:

Source of Impacts on UK of UK-EU FTA on Real GDP and Welfare, 2030

	GDP Percent Change	Contribution of Policy Measure	Welfare Impact (GBP billions)	Contribution of Policy Measure
Border Costs	-0.94	92%	-25.63	92%
NTBs	-0.08	8%	-2.29	8%
Total	-1.03	100%	-27.92	100%
Total incl EU budget	**-0.81**	**78%**	**-22.12**	**78%**

- *Border costs:* As in the previous scenario the main cost is the imposition of the new time and out-of-pocket costs on cross-border trade through the imposition of a new hard border. Because of the need to enforce the FTA between the UK and the REU, there is an additional cost of demonstrating compliance with rules of origin. Thus while the Brexit tariff shock is not incorporated here, there is an additional cost that goes with that freedom from tariffs. Importantly, reflecting it being a negotiated exit, the border is assumed to be similar to the EFTA border in that it operates at almost optimum levels and does not constitute any onerous security requirements. Therefore, while it is a hard border, it is much more efficient and permeable than the border in the Brexit scenario above. The FTA also reduces problems for global value chains which run predominantly through Europe. Nevertheless, the border costs could still pose problems and cause some upheaval. As the table shows, compared to a non-negotiated Brexit, such an approach significantly reduces the permanent welfare loss from the UK leaving the EU to -1.03% GDP.
- *EU budget:* In this scenario, given the level of market access granted to the UK, we have assumed that it would need to make some form of contribution to the EU budget – though it is likely to be spent in a far more effective way. We have used Switzerland as a model here and assumed the UK would contribute proportionately the same. This saving reduces the overall effect to -0.81% GDP. That said, FTAs do not usually involve a direct fiscal element. As such, in our best case scenario, given the incentives on all sides, we believe the UK could feasibly negotiate an FTA without any contribution, thereby saving the full amount (see Table at the start of this section).[160]

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[159] Source HMT. This saving is likely a lower bound since we do not apply any fiscal multiplier and since, given the inefficiencies of the EU budget, the UK's spending is expected to produce greater value for money.

[160] A strong case can be made that the UK would contribute even less than Switzerland if anything

- *NTBs:* As the table on page 82 shows, the impact of NTBs is small. This is implicit in the scenario construction that the four freedoms would largely be retained and accordingly there would be limited regulatory drift that would raise NTBs. As we discuss in our sectoral analysis (Section 4), we believe that certain services sectors, most importantly financial services, could face significant NTBs outside the EU. To the extent this would be true, the reported results would underestimate the negative impact here. However, we also feel it may slightly overstate the cost of the border under an FTA, especially since the UK and the REU will be creating a border from scratch and can introduce state of the art procedures, minimising the impact. Therefore, we believe the headline impact remains quite accurate.

GDP and Welfare Impacts of the UK-EU FTA Relative to Baseline, by Region

	GDP (Percent Change over Baseline)				Welfare (GBP billions at 2015 Prices)			
	2018	2020	2025	2030	2018	2020	2025	2030
UK	**-0.66**	**-0.74**	**-0.91**	**-1.03**	**-15.84**	**-18.05**	**-23.26**	**-27.92**
REU	-0.07	-0.08	-0.10	-0.12	-8.29	-9.70	-13.12	-16.30

- *Dynamic effects:* As before, the dynamic effects accrue over time as NTBs increase and the two sides drift apart on certain issues. The new border also drives behavioural changes over time which compounds its introduction causing costs to once again rise over time. There are of course some uncertainties about exactly how this would progress over time and depends on uncertain decisions by importers and exporters, but the broad trend seems correct. This would of course be impacted by the UK's decisions outside the EU, some of which could help offset the cost, discussed in detail on page 84.
- *REU:* As for the REU, the overall impact represents a small share of GDP. Of course, as before, this examines the economic effects and primarily the trade impacts of a UK exit. There are a multitude of other political issues which would impact the REU if the UK left.

at all. Switzerland contributes to economic development in the new EU member states, certain EU agencies and also funded trans-European infrastructure. The UK may well not choose to contribute via such mechanisms. As a larger state it may also be able to strike a slightly better deal, paying proportionally less per capita.

Transitional versus steady-state costs

Our model provides an accurate representation of the continuous steady state costs based on our scenarios and highlights the potential permanent welfare loss from a Brexit and related policy choices. One aspect which may not be fully captured is the short term transitional cost caused immediately after the UK leaves the EU. Firstly, the model is not particularly well suited to capturing such a cost, but secondly there are also few credible estimates on how much this would cost. We can however identify the key factors involved in such a cost.

1. **Fiscal cost of installing a border** – as our results show, the introduction of a border between the UK and EU is a significant cost and causes a loss of welfare. While the continuous costs are significant, there may also be a larger one off cost associated. For the government this would be a potentially not insignificant, fiscal cost of installing the border. This would involve capital and labour investment at the border to ensure all the new checks are done as well as a higher administrative burden for officials to make sure all the paperwork is completed and thoroughly checked. As with the longer term costs, these would likely be larger under a worst case Brexit scenario than under an EU-UK FTA.
2. **Company cost of new border** – again, while the longer term costs of this are captured by our model, there could be larger one-off costs if firms are forced to audit all the trade they do with Europe and create new processes for dealing with the new trading relationship. This could include hiring new workers and/or investing in training to ensure all new requirements are met.
3. **Investment disruption** – one of the surprising results of our model is that any European FDI decrease does not have a huge impact on the economy, since it is seen to be compensated for by domestic or global investment. While this could well be true in the longer term, it is unlikely to happen in the very short term when there is significant uncertainty around Brexit. During the transition phase the high level of uncertainty could put off other investment from filling in any gap.

It is hard to say exactly how large this churn could be, but the additional short term impact would go above and beyond the steady state cost in the first year at least.

6.2.2 Trade with the rest of the world

One important gain from leaving the EU would be the ability for the UK to control its own trade policy. A proactive and aggressive free trade agenda will likely be essential to further offset the welfare loss from exit.

Unilateral free trade

In this scenario we assume that the UK has already struck a FTA with the REU. Over time the UK then eliminates all remaining border protection unilaterally, and with that also removes the requirement of the many countries which access the UK preferentially to demonstrate originating status of their goods. This delivers a benefit of 0.75% GDP. This benefit is generated through a number of avenues. The removal of tariffs on any and all trade introduces a huge amount of new competition into the UK economy via low cost imports, particularly from emerging markets. This new competition will spur on efficiencies, drive a better allocation of capital and produce greater specialisation via a distillation of comparative advantages. It will also allow for a significant influx of a broad range of cheap imports which will lower prices for both consumers and businesses (particularly those which import component parts for their own production).

Of course, taking such an approach would be quite radical and would force the UK government to take some tough decisions since it would expose some previously protected industries to a significant shock – one which some may not be able to withstand. This would have politically sensitive knock on effects on aspects such as

employment but also for broader goals such as self-sufficiency and reliance on external producers.[161] Our model focuses on tariffs and trade and the knock-on effects from changes in these areas. However, a unilateral approach could be even more radical with wider-ranging implications. In principle, it could also allow full and free competition for foreign firms and investors in the UK economy, even on sensitive issues such as public procurement and healthcare. This would likely increase the economic gains from unilateral trade by breaking down domestic barriers inside the economy but would also be a very tough political sell for any government.

Impacts of post-UK-EU FTA Unilateral Liberalisation, Relative to Baseline

	Real GDP Accumulated Change over Baseline (Percent)				Economic Welfare Impacts (GBP Billions)			
	2018	2020	2025	2030	2018	2020	2025	2030
UK	**0.503**	**0.555**	**0.666**	**0.754**	**7.77**	**8.46**	**10.21**	**11.92**
REU	-0.012	-0.016	-0.024	-0.029	-2.45	-3.19	-4.85	-6.35
World Total	0.015	0.016	0.018	0.018	9.19	10.59	13.96	17.43

Other FTAs

Another obvious option for the UK would be to try to strike FTAs with other large economies and fast growing emerging markets. However, if it decided to go down this route, it would need to do so before adopting a unilateral trade approach. The UK would need to strike these deals, along with the EU FTA, without revealing its plans to eventually adopt unilateral trade, otherwise it would have no negotiating hand.[162] Theoretically, it could strike these other FTAs quite quickly since it will be opening up its borders anyway, so should not fight too hard over the details, but simply seek to secure the highest level of access to these markets possible.

Ciuriak et al note that, according to a back of the envelope calculation, “an Australia-like run of FTAs with the major East Asian economies (China, Japan, India and ASEAN), should generate something on the order of a net of 0.6% of GDP for the UK, half of which would be additional to the gains from unilateral liberalization.” Therefore, such an approach could provide an economic boost for the UK outside the EU.

Similarly, the UK would be free to pursue a deep and comprehensive deal with the US which it might be able to complete before the EU is able to finalise TTIP, although given the low level of tariffs between the UK (Europe) and the US, it is possible the gains from such a deal may be overstated (especially relative to the gains from deals with the countries mentioned above).

The politics of free trade

Unilateral free trade and FTAs are different things. The former involves genuine free trade (at least on one side) – including the complete removal of tariffs and often some domestic regulations. The latter involves ‘directed’ and negotiated opening of certain sectors between two parties, to the exclusion of others.

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[161] Again it is important to note that this focuses on the trade and external effects, rather than the potential domestic changes of unilateral trade. There are some dynamic impacts on the domestic economy which may not be captured by our model.

[162] Trade deals largely work on the basis of exchanging access. If it is already known one side will fully open its economy to the entire world then there is no need for these countries to give access to their own economies to secure the FTA. As such this would need to be the final act on trade policy.

Both approaches have one thing in common, however: they tend to be politically contentious. For this reason, very few countries have ever engaged in unilateral free trade in the first place, with Hong Kong and Singapore often seen as exceptions. Even striking FTAs can prove very difficult, particularly with low-cost countries such as China, India and the ASEAN – exactly the countries with which Britain would need to strike deals with outside the EU. Even FTAs with other industrial nations can be controversial. 1.6 million Europeans have, to date, signed a petition against TTIP – 223,000 of them from the UK.[163] Despite Britain being traditionally more open to free trade than the EU as a whole, a recent YouGov poll found that 39% of voters thought that TTIP would be bad for the UK while only 13% thought it would be good for the UK.[164]

Therefore, a series of ambitious FTAs between the UK and emerging economies would certainly come up against some opposition in the UK. Opening up to unilateral trade could be even more politically contentious, as it would involve giving countries like China and India full access to the UK market without securing anything in return. Therefore, both from a political and economic point of view, the most feasible approach would be to secure FTAs with various countries and trade blocs including the EU beforehand – to secure market access – and then take the unilateral free trade approach.

6.3 On the border: the economic impact of free movement of labour

The UK's policy on the free movement of people between the EU and the UK, and levels of immigration generally, is likely to be the most politically contentious area of policy post-Brexit. The free movement of workers within the EU has the potential to boost growth and competitiveness in both the UK and Europe and many companies based in the UK see the ability to draw on a wide talent pool as a major advantage. However, free movement also throws up a huge number of political challenges, such as a substantial loss of national control over who can enter the country, increased competition in low skilled sectors of the labour market, downward pressure on wages, and increased demand for public services and infrastructure.[165]

There are two primary considerations that the UK would have to take into account. Firstly, the EEA and Swiss models of EU association illustrate that accepting the principle of EU free movement of people may be the 'price' the UK has to pay in order to gain liberal access to the single market.[166] Therefore, restricting EU free movement could mean that the UK is unable to strike an EU trade deal as liberal as the deal in our model, reducing its ability to claw back the costs of Brexit.

Secondly, from a trade policy perspective, placing restrictions on the movement of labour is likely to be negative since restricting the potential labour supply would mean that the UK economy would react differently to growth opportunities. For example, the gains from unilateral trade liberalisation or new FTAs with the rest of the world would be translated primarily into higher wages and prices rather than output, which could have adverse knock-on effects for the UK's productivity and competitiveness.[167]

The evidence suggests that the vast majority of EU migrants come to the UK to work. According to the ONS Labour Force Survey, foreign-born migrants from the new EU member states have an employment rate of 81%, while those from the older EU countries have an employment rate of 75%. In comparison, UK-born workers have an

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163 Stop TTIP – Signatures by country www.stop-ttip.org/

164 YouGov poll for 38 Degrees, 25-26 August 2014 d25d2506sfb94s.cloudfront.net/cumulus_uploads/document/umt71i8wcn/38degrees_results_140826_TTIP_W(new tabs).pdf

165 Open Europe, 'Open Europe submission to the UK Government's Balance of Competence Review: Free Movement of Persons', July 2013; archive.openeurope.org.uk/Content/Documents/130726_BoC_Open_Europe_submission_-_Free_Movement_of_Persons.pdf

166 Open Europe, 'Britain's EU immigration debate: Norway and Switzerland are not the answer', November 2014; www.openeurope.org.uk/intelligence/immigration-and-justice/norway-and-switzerland/

167 Ciuriak Consulting

employment rate of 73.8% and non-EU migrants just 66.5%.[168] This suggests that EU migrants are likely to be more economically beneficial to the UK than non-EU migrants.

It should be noted that our analysis of the free movement of labour in this report is not the same concept as 'immigration' writ large, which also includes migration for reasons of family, study or asylum. Clearly, free movement of labour does not preclude immigration and border control policies. Outside of the EU, and depending on its negotiations with the EU, the UK could potentially adopt different immigration policies to alter the mix of imported skills and enforce border control, such as a new visa regime or rules on intra-company transfers. However, our analysis does suggest that if these policies were to restrict the UK labour supply or services provided by that labour, this would have the negative impact described above. For example, under unilateral free trade, limiting labour could make the UK less competitive by raising wages and prices. If this happened at the same time as the UK opened up to free trade and new low cost competition from emerging markets, some UK-based businesses may find it even harder to compete.

6.4 Behind the border: what could the UK deregulate post-Brexit?

In this section we look at what alternative domestic regulations and policies any UK government could pursue post-Brexit. The vast majority of the UK economy and business activity is not accounted for by exports to the EU and one of the most frequently cited arguments for leaving the EU is over-interference with non-exporting businesses and the UK's public sector – including the NHS – currently covered by the EU's rule book, the acquis communautaire. In contrast, only Swiss firms actively trading with the EU have to comply with the bloc's rules.

According to the World Bank, UK exports of goods and services account for 29.8% of its GDP.[169] Furthermore, in 2013, only 15.6% of UK registered businesses engaged in international trade in the non-financial business economy.[170] These measures clearly under-play the importance to the economy of productivity gains associated with trade. Furthermore, in practice, it is also difficult to disentangle 'non-exporting' sectors from EU regulations due to the prevalence of European and global value chains which many firms may be directly or indirectly involved in. Nevertheless, this illustrates that outside the EU, Britain would be able to cut regulations it previously could not.

Based on our regulatory database – covering over 2,300 EU and domestic regulations – we examine nine broad areas below. We estimate, based on the Government's own Impact Assessments (IAs), that the 100 most expensive EU-derived regulations currently cost the UK economy £33.3bn a year (2014 prices). For a range of reasons, this is not the total cost of EU rules to the UK economy. Many regulations are not subject to IAs in the first place and not all the costs associated with regulation – such as indirect effects – are captured by the IAs' methodology.[171] Our calculations also only include the annual recurring costs, but some regulations also come with substantial one-off costs.

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[168] ONS, 'UK Labour Market', November 2014; www.ons.gov.uk/ons/dcp171778_381416.pdf

[169] World Bank, 'Exports of goods and services (% of GDP)' 2013 www.data.worldbank.org/indicator/NE.EXP.GNFS.ZS/countries

[170] Those businesses registered for VAT and/or PAYE in the UK. Many very small businesses (those without employees and with a turnover below the tax threshold) are therefore excluded. At the start of 2014, of the 5.3 million private sector business, 2.9 million were unregistered. The UK Non-Financial Business Economy covers around two-thirds of the whole UK economy (measured in terms of Gross Value Added). It includes the Production, Construction and Distribution sectors, some parts of the Service sector (excluding finance, public administration and defence, and publicly provided health and education) and some parts of Agriculture.

[171] For a wider discussion, see Open Europe, 'Still out of control', 2010, p13; www.openeurope.org.uk/intelligence/economic-policy-and-trade/still-control-measuring-eleven-years-eu-regulation/

Sector	Current annual cost (£bn)	Feasible annual saving (£bn)	Maximum annual saving (£bn)	Would EU rules continue to apply post-Brexit?			
				EEA	FTA	Unilateral free trade	Single Market-Lite
Social, Employment, Health & Safety laws	9	5.6	6.7	Yes	No	No	No
Environment and Climate Change laws	11.9	5.8	9.9	Yes	No	No	No
Energy	1.6	0	1.5	Yes	No	No	Yes
Consumer protection	1.2	0	0.6	Yes	No	No	No
Competition and public procurement	N/A	N/A	N/A	Yes	No	No	Yes
Financial Services	7	1.4	4.1	Yes	No	No	Yes
Product Standards	1.9	0	1.2	Yes	No	No	Yes
Life Sciences	0.4	0	0.4	Yes	No	No	No
Total Regulation	**33**	**12.8**	**24.4**				

Large-scale deregulation would require a major change of heart

As we note in the sectoral analysis in Section 4, there is a regulatory quid pro quo for accessing the single market from outside the EU, which in practice could limit the UK's ability to deregulate. Still, the biggest obstacle to an ambitious deregulation drive is likely to be domestic politics, with major deregulation requiring a major change of heart on matters ranging from climate change through to consumer protection. Any ambitious attempt to cut regulations would run into significant opposition in Parliament, from trade unions and a range of lobby groups at a time when parties espousing a range of anti-liberal views appear to be on the rise. It is also far from clear that a majority of voters would support radical deregulation.

Based on a case-by-case analysis of the 100 most expensive EU-derived regulations to the UK economy, we look at two potential deregulatory scenarios post-Brexit. Both assume that the UK Government would actively pursue a deregulatory strategy despite the obstacles outlined above and illustrate which regulations the UK outside the EU may wish to or have to cut. Even under a comprehensive FTA with the REU there would be scope to deregulate, particularly on issues which are not directly linked to the single market – such as social employment law and climate change. Of course, some of these regulations come with benefits. However, a significant majority do not have quantified benefits and/or have high net costs.[172] Furthermore, these represent only a snapshot of overall regulations and do not include potential multiplier effects. As such we think the potential savings are an accurate approximation and possibly even a lower bound. For a full discussion of this see *Annex 3*.

The first scenario envisages an ambitious yet politically feasible deregulatory drive including the scrapping of several regulations and targeted amendments to others. This would deliver a saving of £12.8bn (0.7% of GDP). The second scenario envisages an extremely ambitious deregulatory drive pursued by a very economically liberal

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[172] Open Europe, 'Top 100 EU rules cost Britain £33.3bn', March 2015: www.openeurope.org.uk/intelligence/britain-and-the-eu/top-100-eu-rules-cost-britain-33-3bn/

government including the outright scrapping of a substantial number of politically sensitive regulations. This would deliver savings of £24.4bn (1.3% of GDP). These are detailed in the table on page 88, though a fuller breakdown of the regulatory savings by policy area can be found in *Annex 3*.

However, there is also a significant risk that post-Brexit, a UK Government could increase costs on businesses and undermine competitiveness, for example by pursuing interventionist policies currently prohibited under EU state aid rules.

Global versus EU influence over regulation

It has been argued that, since a significant amount of regulation is set at the global or international level rather than at the EU or national level, the UK would have equal or more influence over such rules outside the EU.

However, looking at a vital sector for the UK economy – financial services (which is often cited as an example) – the vast majority of the most costly regulations are EU driven not globally driven.

Body	EU representation	UK representation	Norway represented?	Switzerland represented?
Basel Committee on Banking Supervision	ECB[173]	BoE[174] (PRA)[175]	No	Yes
Financial Stability Board (FSB)	ECB + EC[176]	BoE + HMT[177]	No	Yes
International Organization of Securities Commissions (IOSCO)	ESMA (associate member only)	FCA[178]	Yes	Yes
International Association of Insurance Supervisors (IAIS)	EC	FCA + PRA	Yes	Yes
International Accounting Standards Board (IASB)	Independent members			
Financial Action Task Force on Money Laundering (FATF)	EC	HMT	Yes	Yes

[173] European Central Bank
[174] Bank of England
[175] Prudential Regulation Authority
[176] European Commission
[177] HM Treasury
[178] Financial Conduct Authority

There are ten financial regulations in our database of the top 100 EU regulations. In eight out of these cases the regulation is entirely EU driven – in only two cases can the impetus be seen to directly come from global regulation. Furthermore, even in cases where it is not entirely EU driven, all these international bodies simply provide guidelines and have no legal mechanisms of enforcement. All enforcement and detailed technical standards are left to the EU or national level.

It is also worth remembering that the exact formulation of these rules also governs access to the single market. Therefore, if the UK were outside the EU it would still be subject to the EU's interpretation of the rules, even if they are driven by a global impetus. Meanwhile, inside the EU, for a global economy such as the UK (and a global sector such as financial services), the EU formulation of the rules remains vitally important since it governs access for foreign firms into the single market and UK trade with the rest of the world. Finally, in some cases the EU has actually become a standard setter with global rules following the EU's lead and/or the formulation being copied in other jurisdictions.

Top 10 EU financial services regulations	Recurring cost (£m 2014)	Recurring benefit (£m 2014)	Impetus	Enforcement
CRD IV	4,590	15,555	Global	EU
AIFMD	1,532	0	EU	EU
MiFID I (2007)	284	530	EU	EU
Solvency II	210	466	EU	EU
Consumer Credit Regulation	155	260	EU	EU
MiFID I (2003)	117	0	EU	EU
Money Laundering Regulations	59	37	Global	EU
Payment Services Regulations	43	9,623	EU	EU
UCITS IV	11	0	EU	EU
Statutory Auditors Regulations	8	0	EU/Global	EU

Source: Open Europe regulation database[179]

CRD IV – based on Basel III (Cost £4.6bn pa)

A recent assessment of the EU's implementation of the Basel III rules found it to be "materially non-compliant".[180] Since the Basel Committee on Banking Supervision has no powers of enforcement and no legal recourse it can do nothing but note this poor implementation. There is also notably a significant amount of divergence between different jurisdictions in how they structure and implement the Basel rules.

Similarly, when comparing the EU and US approach to implementing Basel rules IOSCO found that, while they share "common purposes", they are "structured in fundamentally different ways".[181]

On top of this the EU has also ended up tacking on other unrelated pieces of legislation – notably the bankers' bonus cap which, despite protestations, has little to do with the Basel III approach of reducing risk and absolutely nothing to do with the details of the plans.

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179 Costs are taken form the UK Government's own impact assessments of these regulations.
180 Open Europe blog, 'EU falling short on implementing bank capital rules', 5 December 2014' www.openeuropeblog.blogspot.co.uk/2014/12/eu-falling-short-on-implementing-bank.html
181 www.iosco.org/library/pubdocs/pdf/IOSCOPD438.pdf

Outside the EU the UK would still likely adopt some version of the Basel III rules, but it would have significant leeway in how it implements them. In the end, it could significantly alter the nature of the rules without facing any legal consequences. With that in mind, the UK outside the EU could of course choose to have higher or more stringent capital requirements than the EU.

AIFMD – EU driven (Cost £1.5bn pa)

The asset management industry is one which lacks any global body driving a single regulatory approach. IOSCO and the FSB are examining areas of the industry, such as its links to systemic risk and determining a set of 'good practices'. However, this process remains investigatory and someway from yielding any serious plans (which would in any case not be binding).[182]

As with many areas therefore the EU has taken it upon itself to regulate the sector and try to create a single market within the EU. Outside the EU the UK would be almost entirely free to regulate this sector as it pleased. However, access to the passport created under AIFMD would require regulation being judged equivalent – a highly political process and not guaranteed – meaning UK regulations may have to remain similar to the EU's if it wants access.

MiFID – EU driven (Cost £400m pa)

MiFID I was a large part of the EU's FSAP which was conceived and implemented in the early 2000s. This was largely before the renewed push for global financial regulation. Rather than being driven at the global level, significant parts were based on the UK's own regulatory approach.

MiFID II is a slightly different story, as it represents part of the response to the crisis and in particular the need for tighter regulation and oversight of OTC transactions. However, it is also significantly influenced by the broad consultation undertaken around the issue by the European Commission in response to the crisis. It is hard to chart exactly how discussions and ideas at the global and European level feed into each other here. The key point remains though that at the EU level MiFID II is broad and interacts with a number of other EU regulations. Together, these form a significant hurdle to which EU-based firms must adhere and to which non-EU countries' regulation must be equivalent in order to gain access to the EU market. Such concrete impacts are not discernible from any of the global discussions.

Solvency II – EU driven (Cost £210m pa)

Globally, regulation of the insurance market is changing and developing fast. However, there is no doubt that the EU kicked this round off with Solvency II, again a purely EU led initiative. While international organisations such as International Association of Insurance Supervisors, the Financial Stability Board and the G20 are beginning to look at the issue of insurance market regulation and systemic risk in the system, they are someway behind.

Consumer Credit – EU driven (Cost £233m pa)

This is an EU-driven push to increase transparency and protection for consumers as well as integration of the consumer credit market in the single market. Global discussions are underway but seem to significantly lag behind the EU's approach, and are also devoid of the single market element.[183]

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182 www.sifma.org/newsroom/2015/sifma_amg_statement_on_g-sifi_designation_for_investment_funds_and_asset_managers/

183 www.financialstabilityboard.org/2011/10/fsb-publishes-report-on-consumer-finance-protection-with-particular-focus-on-credit/

Money laundering regulations – FATF driven (EU enforced) (Cost £50m pa)
This is again a mixed story. The Financial Action Task Force (FATF) Forty recommendations issued in 1990 have formed the basis of anti-money laundering regulation in the EU and globally. There has also generally been a clear link between new recommendations from FATF and an update in the EU's regulation.[184] Nevertheless, as with all of the above, the EU remains the enforcer of these rules and EU rules have, in certain areas, progressed beyond the FATF recommendations.[185] Furthermore, in any case where criminal activity is detected, the EU and national courts are the bodies through which the laws will be put into effect.

Payment Services Regulations – EU driven (Cost £43m pa)
This is an entirely EU driven regulation, with the focus of creating a framework and set of rules for payments in the single market – which now take the form of the Single European Payment Area (SEPA). While international organisations, in particular the BIS and IOSCO, are looking at the issue of payments within the broader topic of clearing and settlement of financial transactions, the specific creation of SEPA and its framework are solely EU issues.[186]

UCITS – EU driven (Cost £11m pa)
Similar to the above, the focus of the UCITS series of legislation is to create a single market for collective investment schemes across Europe. While there is increasing interest around investment funds at the global level it remains superficial and far below what the EU is implementing in regulatory terms. Interestingly, UCITS has become somewhat of a template for regulation elsewhere with other jurisdictions adopting the framework.

The Statutory Auditors and Third Country Auditors Regulations 2007 and The Partnerships (Accounts) Regulations 2008 – EU driven (Cost £8m pa)
This area was originally entirely EU driven and remains largely so, though this may slowly be changing. The EU is in the process of adopting and implementing the International Standards on Auditing.[187] As with all other regulations, while international standards have been agreed for some time and are in force in some member states, until the EU enforces them across the bloc they will simply be guidelines or recommendations.

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[184] European Commission press release, 'Frequently asked questions: Anti-Money Laundering', 5 February 2013: www.europa.eu/rapid/press-release_MEMO-13-64_en.htm?locale=en

[185] European Commission press release, 'Money laundering: Commission proposes to update and improve Directive', 30 June 2004: www.europa.eu/rapid/press-release_IP-04-832_en.htm?locale=en

[186] Bank for International Settlements, 'Implementation monitoring of PFMIs: Level 2 assessment report for central counterparties and trade repositories - European Union', February 2015: www.bis.org/cpmi/publ/d128.htm

[187] European Commission press release, 'Reform of the EU Statutory Audit Market - Frequently Asked Questions', 3 April 2014: www.europa.eu/rapid/press-release_MEMO-14-256_en.htm?locale=en

6.5 Additional non-quantifiable costs and benefits

As noted in the introduction, this report has attempted to assess the impact of Brexit on the aspects of the UK-EU relationship that are to a reasonable extent quantifiable. However, there are several important concerns and issues that are unquantifiable which should also be weighed when contemplating Brexit.

Returning to self-government

The most significant non-quantifiable benefit of leaving the EU would be returning the UK to self-government. The economic and social issues outlined above – such as labour relations and the UK's energy policies – would again be contested in national politics and at national elections, greatly increasing democratic accountability to the British electorate and boosting the role of Parliament in Westminster and the devolved administrations.

Justice and home affairs

Following withdrawal, EU crime and policing laws, such as the European Arrest Warrant or criminal databases, would no longer apply in Britain and the UK would no longer be formally involved in the police and judicial agencies Europol or Eurojust. However, the UK would wish to maintain cooperation in some of these areas. The UK could enter into bilateral or intergovernmental agreements with the EU on specific cross-border issues such as crime and policing but Parliament would be able to repeal or renegotiate such agreements if they were no longer working in UK interests.

Rights legislation

Withdrawal from the EU would see the UK leave the EU's Charter of Fundamental Rights. However, the extent to which the UK would regain greater control over human rights legislation would largely depend on its relationship with the Council of Europe, the European Convention on Human Rights – upon which the EU Charter is largely modelled – and the European Court of Human Rights.[188]

Fisheries

Withdrawal from the EU could see the UK regain control over its Exclusive Economic Zone (EEZ), which according to international maritime law stretches to 200 nautical miles from a country's coastline. This would not necessarily mean that the UK would stop cooperating with the EU institutions and other EU member states altogether. In particular, the UK could continue to respect the historical rights of its neighbours to fish in its waters, provided that UK fishermen are granted the same rights in EU waters. However, the UK would regain the right to modify or withdraw these rights and regain management of fish stocks in its waters.[189] Trade in fish products would be subject to the trade arrangement in place between the UK and the EU.

Foreign policy and defence

In the EU decisions in Common Foreign and Security Policy decisions are generally taken by unanimity and remain subject to national veto. Outside the EU, the UK would no longer take part in the EU's external policies, such as the neighbourhood policy, or institutions such as the European External Action Service. But given the UK's size and military capabilities, the UK and the EU would likely maintain a close relationship on issues relating to Europe's security and state's neighbouring the EU. NATO would continue to be the main focus of the UK's international defence cooperation, but it could continue to cooperate with European efforts via bilateral agreements with individual member states or on an ad hoc basis with bodies such as the European Defence Agency.

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[188] For a discussion see Policy Exchange, 'Bringing rights back home: making human rights compatible with parliamentary democracy in the UK', 2011; www.policyexchange.org.uk/images/publications/bringing rights back home - feb 11.pdf

[189] Fresh Start project, 'Options for change green paper: renegotiating the UK's relationship with the EU', 2012, p101; www.eufreshstart.org/downloads/fullgreenpaper.pdf

Annexes

Annex 1: Economic modelling framework

This annex includes a detailed explanation of the modelling approach and the scenarios run and is provided by Ciuriak Consulting.

1. Empirical Approach

1.1 Modelling Framework

The ex-ante analysis of economy-wide trade policy changes is conventionally and necessarily conducted using a multi-sector, multi-region CGE model.[190] CGE models integrate a number of accounts to provide a complete description of an economy:

- The standard national income and expenditure accounts.
- A breakdown of industry by sector that reflects inter-sectoral input-output links, which take into account internationally-sourced intermediate goods and services. In all, the Global Trade Analysis Project (GTAP) dataset, on which we draw, allows representation of up to 57 sectors, 43 of which are goods.
- A production function for each sector that determines the quantity of capital, skilled and unskilled labour, and intermediate inputs required to produce a unit of output in that sector.
- A trade account that models the international linkages for each sector of the economy.

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[190] See Dixon (2006) for a concise history of the evolution of quantitative modelling of trade policies and the emergence of the CGE model as the standard tool.

The model generates impact results for national account aggregates, industry output and prices, factor inputs and prices, and trade flows. For a technical description of the GTAP model, see Hertel (1997); for a discussion of the degree of confidence in CGE estimates, see Hertel et al. (2003).

On the production side, the model evaluates efficiency gains from the reallocation of the factors of production across sectors. Land, labour (skilled and unskilled), and capital substitute for one another to generate domestic value-added by sector in the first stage ("nest"). Composite intermediate inputs that include imported intermediate inputs substitute for domestic value-added at the next stage.

We use a recursive dynamic version of the GTAP model. In our modelling approach, labour responds to changes in the wage rate with a long-run elasticity of unity and capital supply responds to changes in the rate of return on capital; the investment response is based on the Monash capital model (Dixon and Rimmer, 1998).

Both labour and capital are assumed to be mobile across all sectors within a country. Capital is also mobile internationally in our model, which incorporates a foreign-owned representative firm in each GTAP sector; FDI flows respond to changes in restrictions on FDI, which are modelled as "phantom taxes" that influence behaviour, but do not generate government tax revenue.[191] Labour is not, however, mobile internationally and we cannot directly take into account Brexit-induced changes to the labour supply through existing mechanisms in the model. We can, however, take these effects into account indirectly by modifying the elasticity of labour supply for skilled and unskilled labour.

Implicitly, Brexit reduces the UK's effective labour supply elasticity, which results in changes in growth opportunities, such as would be afforded by unilateral trade liberalization or an agreement with the US, being translated to a greater degree into wage changes rather than output, with knock-on competitiveness impacts on the UK's trade relations with the rest of the world. Brexit does the same for the REU, but in a proportionately smaller degree. Available estimates of the effective labour supply exchange between the UK and the REU within the single market context suggest that in terms of overall numbers, the effect is roughly balanced; accordingly, the main impact is in terms of improved matching of jobs and workers. Assuming that existing workers are grandfathered under any Brexit scenario, the overall effect on labour supply elasticity would be small. We do not attempt to calibrate this effect.

On the demand side of the model, an aggregate Cobb-Douglas utility function allocates expenditures across private consumption, government spending, and savings so as to maximize per capita aggregate utility. Following a shock, such as Brexit, the changes in consumption are allocated across these three aggregates based on their income shares in each region.

Private household demand responds to price changes and to changes in income. This latter effect reflects the fact that consumption of particular types of goods, such as luxury goods, increases more with higher income than does consumption of other goods, such as staple food products.[192] Notably, cuts in protection not only result in a decline in the prices of intermediate production goods, but also in the prices of consumer goods, which induces demand responses.

The trade module is structured on the assumption of imperfect substitution based on product differentiation across regions. The key parameter determining the scale of impacts on trade from a tariff shock is the elasticity of substitution – a high substitution

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[191] The incorporation of FDI is an increasingly important feature of CGE model development. This is essential for modelling the effects of investment chapters in modern trade agreements and also for capturing the effects of services sector liberalization, given the importance of Mode 3 (commercial presence) trade in the services sector. This study incorporates the FDI-model developed in Ciuriak and Xiao (2014b) with an extension to the goods sector.

[192] Household demand is modelled using a Constant Difference of Elasticities (CDE) function. This captures the fact that the structure of household demand does not remain uniform as income increases (i.e., in technical terms, it is "non-homothetic").

elasticity generates relatively large trade impacts for a given size of tariff shock. Note that the GTAP sectors reflect relatively large aggregates of individual products; accordingly, substitution elasticities are lower than they would be for narrower product categories.

Economic welfare is based on "equivalent variation", the lump sum payment at pre-shock prices that would have to be made to households to leave them as well off as in the post-shock economy.[193]

We use a perfect competition specification of the GTAP model; other specifications commonly used include imperfect competition for industrial goods sectors[194], while some models are beginning to appear that incorporate heterogeneous firms features.[195] However, while the incorporation of heterogeneous firms features is clearly the path of the future, a lack of well-developed databases to calibrate the distribution of firm-level characteristics limits the ability to deploy this feature for the present study.

1.2 Implementation

We work with the full 57-product group level of disaggregation permitted by the GTAP database and a regional disaggregation featuring 28 economies, including, inter alia, the UK and 17 REU regions. We aggregate several of the smaller EU economies into the following groups: Bellux (Belgium and Luxembourg), Baltics (Estonia, Latvia, and Lithuania), Iberia (Spain and Portugal), Adriatica (Croatia and Slovenia), CEECs (Bulgaria, Czech Republic, Hungary, Romania and Slovakia), and Mediterranea (Cyprus, Greece and Malta). Other economies represented include the G8 economies and China.

To simulate our various scenarios, we first develop a forward simulation of the GTAP database to 2030, using GTAP dynamic database tools, which draw on available macroeconomic data (Fouré et al., 2012). According to this macroeconomic projection for the world economy, global growth averages about 3.06% per annum over the period 2016-2030. The UK grows at 2.12% over this period, the REU by 1.56%, and the US by 1.53%. China's growth slows to 5.38% over this period; accordingly, it is a fairly conservative view of global growth prospects.

For convenience (mainly to limit the number of years in our forward projection of our dataset), we assume the UK's exit occurs as of 1 January 2018.[196] The individual

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[193] Technically, equivalent variation is the Hicksian income-compensated variant of Marshallian consumer surplus.

[194] A number of CGE models used to model major trade agreements incorporate imperfect competition by introducing price mark-ups that represent monopolistic pure profits in equilibrium. Generally, such treatment is reserved for manufacturing sectors, which feature differentiated products, while perfect competition assumptions are retained for the primary sectors. An important feature of the imperfect competition assumption is that price mark-ups are reduced by intensified competition attributed to the policy shock. This reduction of price mark-ups generates additional welfare gains. However, the use of this market structure raises additional issues about calibrating the impact of a policy shock on competition and mark-ups (see Roson, 2006 for a review).

[195] CGE modelling is starting to catch up with the theoretical and empirical revolution that has been going on in international trade economics since the establishment of the heterogeneous firm model as the industry standard (Melitz, 2003; and Bernard et al., 2003). While the standard CGE models have a single "representative firm" that stands for an industry sector and, thus, features industry average characteristics, heterogeneous firms theory and empirics demonstrate that industries are populated by firms that vary widely in size, productivity, and many other characteristics. Moreover, the theory recognizes that firms face fixed costs of entry into export markets. Models that incorporate heterogeneous firms features include Zhai (2008); Dixon et al. (2013); Balistreri and Rutherford (2013); Oyamada (2013); and Itakura and Oyamada (2013). See Roson and Oyamada (2014) for a review of this emerging field.

[196] Given the legal provisions for exit, this would imply a Brexit referendum in the UK in 2015 and notification to the EU of intent to withdraw by year end. Matthews (2015) comments on the process.

elements of the shocks are simulated sequentially in order to show the relative contributions of each element.

1.3 Model Closure

In CGE simulations, there is a limit to the number of variables that can be calculated endogenously; the others must be set exogenously by assumption. In performing simulations, the modeller decides which variables in the model are to be exogenous (i.e., fixed at predetermined values specified by the modeller) and which are to be endogenous (i.e., the values which are solved by the model). These decisions define the "closure" of the model. CGE models can be simulated with various alternative closures; the choice influences the results significantly.[197]

Under the GTAP model's default microeconomic closure, the factor endowments (i.e., the total supply of labour, both skilled and unskilled, as well as of capital and land) are fixed; factor prices (i.e., wages and return to capital and land) adjust to restore full employment of the factors of production in the post-shock equilibrium.[198] Under alternative microeconomic closures that are sometimes used, the return to capital or to labour can be fixed and the supply of capital and/or labour adjusts to restore equilibrium.[199] Each of these closure rules makes an extreme assumption about the supply of labour and/or capital: it is either perfectly elastic or perfectly inelastic. The reality is likely to be somewhere in between.

In the GTAP-FDI model that we employ, investment adjusts to changes in the rate of return; similarly, we allow labour supply to adjust to changes in wages. As a result, the policy shocks that we simulate generate "endowment" effects: that is, the amount of labour and capital in an economy changes based on changes in returns to labour and capital.

As regards GTAP's macroeconomic closures, two approaches are available. First, the current account can be fixed. This assumes that the external balance is determined entirely by domestic investment-savings dynamics. When trade policy shocks result in unbalanced changes in imports and exports, the original trade balance is restored by implicit exchange rate adjustments. Alternatively, the current account can be allowed to adjust to the trade shock. The change in the current account then must be offset by equivalent changes in capital flows. In reality, unbalanced trade impacts are likely to have both effects: induce subsequent exchange rate adjustments and offset capital flows.

The choice of macroeconomic closure can have significant implications for the model outcomes.[200] We necessarily adopt the closure where the current account adjusts; this reflects the active role of FDI in our model.

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[197] The sensitivity of the results to alternative closure rules is shown by Ciuriak and Chen (2008) in the simulation of the Canada-Korea FTA (CKFTA) (see Tables 7 and 8). In this study, GDP impacts varied between 0.064% in the standard closure scenario (labour and capital supply both fixed) and 0.268% in scenario (vi), where both capital and labour supply are flexible. In the central scenario (labour supply elasticity = 1, capital supply flexible), the GDP gain for Canada was 0.114%.

[198] This is sometimes described as reflecting a medium-term time horizon in which labour supply is relatively "sticky".

[199] The closure in which the rate of return to capital is fixed is sometimes described as reflecting "steady-state" growth. For an example, see Gilbert (2004), who reports net economic welfare gains in a GTAP simulation of a KORUS that are 2.7 times larger for Korea, and 2.4 times larger for the US with this closure compared to the standard closure. For an example of the labour market closure, under which the wage rate is fixed, see Francois and Baughman (2005).

[200] Gilbert (2004) uses alternative macroeconomic closures in the KORUS. The fixed current account simulations reduce Korea's welfare gains to 3/5 the level of the simulation with flexible current account and US gains by 5%.

1.4 Scenario Design

1.4.1 Scenario 1: Brexit

This scenario aims to capture the pure cost of the UK leaving the single market, without any immediate policy response. This scenario assumes the following:

- The UK inherits EU WTO commitments, including the tariff regime and commitments under the General Agreement on Trade in Services (GATS), the Government Procurement Agreement (GPA), etc., and trades with the rest of the world on this basis.
- UK-REU trade shifts to an MFN tariff basis, subject to the modifications discussed below. Bilateral restrictions on services and investment access change from assumed EU internal standards to the levels applied by the UK and REU to third parties. We base our estimate of Community internal standards for cross-border services and FDI on the least restrictive regime maintained by any EU Member State under the OECD's Services Trade Restrictiveness Index (STRI).
- The EU's current FTAs would also stay in place. Both the UK and the REU would honour outstanding liberalization commitments vis-à-vis third parties under existing treaties and we assume that third parties would do the same. This avoids the need to factor in the effect of changes to existing FTAs or to introduce outstanding liberalization commitments vis-à-vis third parties. Implicitly, honouring outstanding commitments includes continuing to allow cross-cumulation of UK and REU value-added in claiming access to references available to UK and REU exporters under existing FTAs.[201]
- A rules of origin issue would also arise under the WTO's General System of Preferences (GSP): currently, the bilateral cumulation provisions under the EU's GSP regime provide for diagonal cumulation, under which UK content exported for processing to some 150 developing countries is eligible for GSP preferences when these goods are exported back to other EU Member States. Under the EU's post-Cotonou Economic Partnership Agreements (EPAs) with African, Caribbean, and Pacific (ACP) countries, diagonal cumulation could continue under regionalized ROOs. We assume a device such as ROOs derogations would be used to cover this.
- We introduce customs clearance costs for UK-REU trade. These are based on estimates drawn from the literature on the increased time costs for customs clearance and additional paperwork.
- We assume that UK economic regulation would be identical to REU regulation out of the exit gate. Nonetheless, NTBs would gradually emerge as UK and REU rules drift apart under independent reforms and differing legal determinations by their respective courts. We phase-in NTB costs equivalent to those faced by EU firms in Canada, which we consider to be a good proxy for a liberal, efficient trade environment tailored for access to both EU and US markets.[202]

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[201] The Rules of Origin derogation under the Canada-EU Comprehensive Economic and Trade Partnership (CETA) for the auto sector provide an example that would cover this assumption. Along with the derogation, the CETA contemplates the possibility of auto-parts originating in the US to count towards the originating status of a vehicle produced in the EU or in Canada. CETA also leaves open for the future the possibility of cumulation of origin with third countries with which both the EU and Canada have free trade agreements, provided these also foresee the possibility of cumulation. These latter provisions effectively would regionalize the individual bilateral agreements; such a condition could also be negotiated, contemplating a future UK-REU FTA.

[202] See Petri et al. (2011: 66) for estimates of NTBs in goods trade across different regimes.

- Brexit would raise a multitude of issues regarding the managed agricultural trade regime under the EU's CAP. Over the years and the course of numerous GATT/WTO negotiations, the EU has accommodated the agricultural export interests of third parties. But no such agreements have been put in place for the UK – or, conversely, for REU exporters in the UK. We adopt what might be termed "halfway house" assumptions for trade in a few highly protected agricultural products, where a move to MFN tariffs would shut down trade entirely. In these cases, we assume that the UK and the REU would reach pragmatic accommodation that limits the increase in bilateral protection levels to no more than those that currently apply between the EU and the US.

- Finally, we assume that mode 4 trade is significantly grandfathered for expatriates currently employed, but more restrictive for future workers or those without jobs. This implies no initial rise in labour costs, although it does imply a less elastic supply response of labour to future UK trade liberalization.

- We do not factor in the one-time costs of erecting a customs border control between Ireland and Northern Ireland, nor the one-time administrative costs of Brexit on British and REU firms. For example, VAT would no longer be charged on UK-REU shipments, so firms would have to put in place the paperwork to modify their VAT collection and reporting systems. Membership of UK firms in EU internal organizations would lapse, requiring repatriation of representatives, etc. Websites, letterheads, advertising, etc. would all have to be modified. We could not find a basis to calibrate these latter costs and so do not include them, although they are likely to be non-negligible when cumulated across businesses.[203]

1.4.2 Scenario 2: Brefta (UK-EU FTA)

This scenario aims to capture the less disruptive outcome under a negotiated exit that grandfathers existing bilateral trade positions and erects only the minimum of new barriers implied by the shift from a single market environment to one in which a border re-appears. No new tariffs are imposed.

- However, a ROOs compliance cost would emerge. We assume this to be equal to 1% of the value of trade (we effectively assume 100% utilization of the EFTA-type preferences), which is at the bottom end of the range of estimates of ROOs costs in the literature.

- ROOs issues with third party FTAs would be managed by regionalizing the FTAs by providing for regional cumulation of value added, thus preserving the current EU FTAs undisturbed in this regard.

- We also introduce new border costs. We retain the estimates of the administrative costs developed for Brexit, but assume that a negotiated exit would include a border regime that is state-of-the art in terms of minimizing time costs to minimize the disruption to bilateral trade between the UK and the REU. Where the Brexit border resembles the Canada-US border in terms of costs, the Brefta border resembles the EU-Swiss border.

- NTBs in goods markets do not emerge since we assume an EFTA-type relationship agreement requires the UK to largely implement EU rules and

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[203] For example, a study conducted by the Centre for International Economics Canberra & Sydney (2008) estimated that the cost of one-off label changes was around 1.1% of product costs. We note that there have been some instances of countries leaving the EU – e.g., Algeria upon independence from France. The frictional costs of the transition from these episodes are not available. In any event, the modern context seems quite different and the most relevant basis for identifying the scale of these costs is recent EU accession experience.

standards. By the same token, the UK shares in future deepening of the EU single market and thus does not face the costs of drift hypothesized in Ottaviano et al. (2014).

- We assume a modest increase in barriers to cross-border services trade and FDI based on less flexible provisions for movement of personnel. The OECD's STRI, which we use to code the services and FDI shocks, has an element for "other" restrictions related to movement of persons. We shock this element to increase services trade restrictions under a Brefta, with the interpretation that it would reflect measures related to the issue of "benefit tourism", which has been a point of friction for the UK.
- We do not take into account the risk of additional NTBs emerging that might affect the ability of UK firms to access EU services markets on a cross-border basis.
- We do not take into account the possibility of unravelling of value chains in which the UK provides a relatively small share of the value added, which would bear the full cost of the additional border frictions as goods enter and exit within the value chain.

1.4.2 Scenario 3: UK Unilateral Free Trade

A withdrawal of the UK from the EU would create uncertainty about future market access conditions, which would affect firms' decision as to where to invest, including fixed investment for production, as well as the "soft" investment associated with market entry costs. One option that the UK would have in order to address this situation, which is not held hostage to negotiation with third parties, would be to unilaterally adopt global free trade. Here, we draw on the analysis underpinning the scenario of Canada adopting global free trade developed in *Ciuriak* and *Xiao* (2014a).

For much of the post-WWII period, trade liberalization was characterized mainly by reciprocal agreements, initially through the GATT rounds, which culminated in the formation of the WTO, and subsequently also through bilateral or regional preferential trade agreements. While reciprocity may have been an essential element to allow the world to move from a low-trade/high-protection equilibrium to one that featured high levels of trade and low protection[204], more recently, unilateral trade liberalization has been responsible for a surprisingly large share of the liberalization that has been achieved globally. As documented by *Martin* and *Ng* (2004), globally, applied tariffs declined from 29.9% in 1983 to 9.3% in 2003, with autonomous liberalization accounting for 2/3 of the liberalization (compared to about 25% by multilateral cuts and only 10% by FTAs). Poorer countries, such as China and India, made greater unilateral tariff cuts than the richer.[205]

Baldwin (2011) argues that this trend was related to the evolution of the global production paradigm (the "great unbundling") that has seen the emergence of the "made in the world" production system, characterized by global value chains and a high level of trade in intermediate goods and services.[206] *Ciuriak* and *Xiao* (2014a) suggest

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[204] Bagwell and Staiger (2011) provide a formal exposition of an argument that reciprocal trade agreements provided the solution to a "prisoner's dilemma" problem, which results in a low-trade/high-protection equilibrium. Insofar as tariffs force foreign exporters to lower their prices, a country improves its terms of trade by raising tariffs; however, when all countries engage in this behaviour, the result is a sub-optimal global production system where all involved lose. Another rationale that has been advanced to explain the need for reciprocity is that international treaties enable governments to make credible commitments to their own private sectors; see, e.g., Maggi and Rodriguez-Clare (2007).

[205] The basic source is a World Bank mimeo by Will Martin and Francis Ng, which has been widely cited in the literature; and Hoekman et al. (2006). See also Langhammer (2011).

[206] See, Crovitz (18 August 2008).

that we may in fact be seeing the twilight of reciprocity and the emergence of a new trade policy paradigm that aims to produce a seamless two-way trading system for a made-in-the-world production system based on unilateral liberalization.

The gains under a unilateral liberalization come from two sources: the elimination of tariffs, and the lapsing of ROOs requirements for imports into the UK. As the EU family of ROOs is estimated to be more costly than the NAFTA ROOs, we adopt a somewhat higher estimate for imports from third parties than *Ciuriak* and *Xiao* (2014a) did for Canada, namely an often-cited estimate by *Francois, Hoekman* and *Manchin* (2006) and *Manchin* (2006), who identified the tariff threshold below which preferences lose their attraction to trading firms because of compliance costs to be about 4-4.5%. We use 4% for our simulations.

The unilateral liberalization scenario we develop thus involves the following elements:

- The UK dismantles industrial and agricultural tariffs immediately against all of its trading partners, including the remaining restrictions on imports from current FTA partners. For UK trading partners represented in our data set that have signed FTAs that are not reflected in the GTAP dataset (including Canada and Korea), we reduce tariffs only by an amount equivalent to assumed under-utilization of preferences. The overall utilization rate of EU preferences is relatively high at 87% (Keck and Lendle, 2012). For regions in our data set that have FTAs with the UK that are not yet implemented, we reduce the protection in the GTAP data base by 13% to capture the remaining unutilized preferences.

- We eliminate the 1% ROOs cost on UK imports from the REU imposed under the Brefta scenario.

- For other regions with FTAs with the UK, we impose a cost reduction shock due to removal of ROOs requirements on 87% of their exports to the UK. Applying a 4% ROOs cost to flows that utilize existing preferences, this translates into a cost reduction due to simplified access of 3.48%.

- For the rest of the world, we assume that half of the UK's imports are under a form of preference, including the GSP. The remaining protection in the GTAP is eliminated. The assumption that half of the imports are subject to ROOs results in a cost reduction of 4%*0.5*.087 = 1.74% for these regions, taking into account the utilization rate of EU preferences, which we apply to the UK.

Annex 2: What would a Single Market-Lite look like?

Policy area	What would that allow the UK to do?	Treaty Articles
Free Movement of Goods	The free movement of goods is a key principle and policy of the EU. This policy has led to the elimination of internal tariffs, the harmonisation of product standards and the elimination of artificial barriers to cross-border trade allowing physical goods to be bought and sold across borders with minimal interference and legal protection.	Art 26, 28, 34 - 37 [Article 28 is difficult to disentangle from Customs Union]
Customs Union	As well as allowing free movement of goods between states, the EU is also a customs union in which the free movement of goods is facilitated within a common external customs wall. The Customs Union is not an EEA policy, so being a part of the EEA could exempt the UK from participation in this area. However there are some parts of the EU legislation the UK may wish incorporated in the EEA: • Customs facilitation and harmonisation, customs cooperation. • Common external commercial policy (trade deals), either as a full party to the trade deals or with the right to participate if it wishes to.	Art 28, 29, 30, 31, 32, 33 200-204 Common Commercial Policy art 206, 207
Agricultural products	The EU's single market and customs union includes the free movement of agricultural goods. The EEA does not include agricultural goods and Norway operates its own agricultural policy, subsidising it to a higher level than the EU. If the UK wished to exempt itself from the EU's Common Agricultural Policy it would either have to gain guarantees that EU agricultural policies and subsidies would not distort trade in these goods. Alternatively the UK could remain outside the customs union.	
Free Movement of Services	The right to sell services across borders • Right of establishment in other EU states on equal terms • The facilitation of mutual recognition on qualifications	Art 26, 49-62
Free Movement of Capital	The right to invest in other EU member states on the same terms as domestic companies	Art 26, 63-66
Catch all power?	The EU includes powers on the "approximation of laws" that allow it to act to push forwards the single market in areas that do not obviously fall under other treaty articles. Although misused in the past to push measures it was not intended to cover some form of power may be necessary.	Art 114 and 115

Single Market protections: • **Competition law** • **Rules against state aid** • **CAP reform** • **Nondiscrimination on tax**	The Single Market freedoms are backed up by a series of policies designed to ensure that member states cannot subvert the overall objective of allowing trade on an equal, nondiscriminatory basis. These rules are essential to allowing states to compete on an equal basis and would be something the UK would wish to retain. In addition, as described above, the UK would need to ensure that the trade in (subsidised) agricultural products did not disadvantage UK farmers. The UK would also wish to keep provisions against discrimination by national taxation systems.	Competition: Art 101-106 State Aid Art 107-109
Free Movement of Labour	The free movement of Labour was one of the original "four freedoms." Whether it should be considered essential to the Single Market is controversial. Having been originally designed with cross border workers in mind, it is now seen by proponents of EU integration as an essential "EU citizenship right" and a part of building a common nationality. By contrast ASEAN, as a free trade area is based on the "free movement of goods, services, investment, skilled labour, and freer flow of capital."[207] NAFTA, however, does not include free movement.	Art 45, 46 and 48
Energy	EU energy policy unites three very different objectives. The liberalisation of the EU energy market by facilitating more cross-border trade, the EU's climate change policies and the EU's external security policy vis-à-vis Russia. It is possible that the UK would wish to participate in a liberalised EU energy market.	The EU includes an article on Energy – Art 194 – included under the Lisbon Treaty. It is arguable that if the aim is a liberalised energy market it could be done so under existing single market articles rather than under the new article that includes security and climate change objectives.
Tax	Tax is subject to unanimity in the EU. The UK would not wish to be bound into EU taxation policies given proposals such as the Financial Transaction Tax. Whereas some taxation policies – such as those on nondiscrimination are potentially beneficial others are more arguable. The major EU taxation policy, outside customs and tariffs, is the alignment of VAT rates. Aligning VAT rates is designed to facilitate cross border trade and distortions and ease the calculation of EU budget contributions. The UK has occasionally wished to diverge, for instance on energy efficient products and food.	Articles 110-112 – non discrimination Art 113 indirect taxes
Transport	The EU has included specific legislation on a "Common Transport Policy". The UK may wish to pare back some of the more integrationist parts of this policy but remain in those parts that promote cross border trade and competition.	Art 91-100 sets out a 'common transport policy'. Removing Art 58 could allow Transport to be dealt with alongside other single market provisions.

[207] ASEAN, www.asean.org/archive/5187-10.pdf

Annex 3: What might the UK deregulate post-Brexit?

1. EU Social, Employment, Health & Safety laws

Annual recurring cost	£9bn
Regained control	FTA, Hong Kong, Single Market-Lite
Continue to apply	EEA
Contenders for de-regulation	On-call time rules, compensatory rest, agency workers rules, holiday roll-over, redundancy, works councils
Politically sensitive/unfeasible	Holiday entitlements, some anti-discrimination, asbestos
Annual savings under politically feasible scenario	£5.6bn
Annual savings under extremely liberal scenario	£6.7bn
Conclusion	Substantial scope for deregulation but would trigger domestic battles

EU social and employment laws come with a significant cost to the UK economy – 22 of the 100 costliest EU-derived regulations fall into this category - and they are particularly burdensome for small business. We envisage that under both our deregulatory scenarios the UK government will seek to cut costs in this area including by scrapping the Agency Workers Directive entirely (£2.1bn saving) and reining in the costs of the Working Time Directive, in particular those stemming from the ECJ's SiMAP and Jaeger rulings. We envisage that under the politically feasible scenario, WTD costs would be cut by 50% (£2.1bn), and by 75% (£3.1bn) under the extremely liberal scenario. The latter scenario would also see additional savings achieved by cutting the cost of EU-derived health and safety legislation.

The domestic politics

Significant de-regulation will require a major change in mentality and it would also mean taking on a series of domestic interests, including the trade unions. The Labour Party in particular is less pro-business than when it was previously in government. Areas where even the most liberal UK government would be reluctant to de-regulate include:

- The entitlement to 20 days paid holiday (on top of bank holidays) enshrined in the WTD.
- Most of the non-discrimination laws such as the right to equal pay would certainly stay, although the UK government could reverse some EU rules and ECJ rulings such as the requirement for insurance firms to charge men and women the same premium.
- Health and safety regulations protecting workers from exposure to asbestos and excessive noise would likely remain, although they could be adapted to better suit UK circumstances and adjusted to factor in the size and nature of individual businesses.

It should be noted that the UK has at times driven the legislative agenda in Europe and has sometimes gold-plated EU-derived legislation, for example rules restricting vibration and noise levels at work.[208]

[208] For a more detailed discussion see Open Europe, 'Repatriating EU social law: the best choice for jobs and growth?', November 2011 www.openeurope.org.uk/intelligence/economic-policy-and-trade/eu-social-law/

2. EU Environment and Climate Change laws

Annual recurring cost	£11.9bn (£3.47bn + £8.47bn)
Retained control	FTA, Hong Kong, Single Market-Lite
Continue to apply	EEA
Contenders for de-regulation	Renewables target, electrical waste standards, EU ETS
Politically sensitive/unfeasible	Air pollution, water quality
Annual savings under politically feasible scenario	£5.8bn
Annual savings under extremely liberal scenario	£9.9bn
Conclusion	Where the UK could gain the most competitiveness outside the EU but would take major change of heart for any UK government to deregulate

The EU's environmental and climate change laws come with a substantial cost to the UK economy and this is arguably the area in which a post-Brexit UK government could make the greatest savings for both consumers and businesses, whilst boosting the country's overall competitiveness:

- The EU's Climate Change rules are meant to deliver a net benefit of over €200bn to the UK economy by 2020, but without a global deal on emissions this falls to a net cost of between €11.4bn and €20.6bn up to 2020.
- In 2013, the average household's dual gas and electricity bill was £59 (5%) higher due to EU regulations or the UK's implementation of EU defined targets. By 2020, EU-related regulations or targets are set to increase annual household bills by £149 (11%).
- In 2013, the average medium sized business' bill was 9% (£130,000) higher due to EU regulations or the UK's implementation of EU defined targets. By 2020, EU-related regulations or targets will increase medium sized firms' bills by 23% (£350,000).[209]

We envisage that, under the politically feasible scenario, the UK would keep the bulk of climate change legislation in place and retain its ambition to cut emissions, but it would be free to pursue an alternative strategy and abandon the EU mandated renewables target – a total saving of £5.4bn.[210] Under the extremely liberal scenario, we envisage that the UK would go even further and scrap climate change laws entirely, saving £8.5bn.

In terms of the broader environmental measures, we envisage the costs associated with laws combatting air and water pollution will remain unchanged under both scenarios, however laws on the composition of motor fuels which include the EU's discredited biofuel targets would be completely scrapped saving £0.8bn.

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[209] For a more detailed discussion of the costs associated with current EU climate change policy see Open Europe, Rotten Foundations: Time to reassess the EU's Environment and Climate Change policies', September 2014 www.openeurope.org.uk/intelligence/energy-and-environment/europe-2020/

[210] This comprises the £4.67bn cost of the EU's Renewable Energy Directive and the £0.76bn Fuel Quality Directive (which includes provisions on biofules, part of the renewables taregt).

The domestic politics

Deregulation would mean some tough choices for the UK, particularly as this is one of the areas where the UK has gone further than EU standards and continues to do so. The current UK government has proposed to reduce emissions by 80% of 1990 levels by 2050 via legally enforced carbon budgets. It has also committed to pursue a Carbon Price Floor at £16 per tonne of CO2, well above the EU's carbon price of around €5 per tonne under the Emissions Trading System. This suggests that it would take a major change of a heart for any UK government to pursue far-reaching de-regulation in this area. The potential benefits to consumers and businesses could however be a major political incentive.

It would also be very hard for any government to significantly roll back rules on air and water quality, hence why the costs associated with these rules remain fixed under both of our scenarios.

3. Energy regulation

Annual recurring cost	£1.6bn
Independence	FTA, Hong Kong
Continue to apply	EEA, Single Market-Lite
Contenders for de-regulation	Energy Performance of Buildings, Environmental permitting
Politically sensitive/unfeasible	
Annual savings under politically feasible scenario	£0
Annual savings under extremely liberal scenario	£1.5bn
Conclusion	Only those laws directly linked to cross-border energy trading would remain while others could be scrapped

We have deliberately calculated the cost of energy regulation separately from the cost of climate change regulation, as while the former is part of the single market, the latter should be considered as an optional add-on. Nonetheless, there remains a significant degree of overlap - £1.5bn of the total £1.6bn cost associated with this policy area stems from the Energy Performance of Buildings Directive which aims to improve energy efficiency and reduce emissions, and mandates that all properties must have an Energy Performance Certificate (EPC) when sold, built or rented. We envisage that this would be retained under the politically feasible scenario but scrapped entirely under the extremely liberal one.

The domestic politics

Not the most controversial area, although environmental groups would protest and consumer groups tend to like the EPCs. A policy which results in an increased use of coal as a source of electricity, for example, could likewise prove unpopular. Ultimately, the domestic politics could overlap with those for the climate change targets mentioned above.

4. Consumer protection

Annual recurring cost	£1.2bn
Independence	FTA, Hong Kong
Continue to apply	EEA, Single Market-Lite
Contenders for de-regulation	Data protection
Politically sensitive/unfeasible	
Annual savings under politically feasible scenario	£0
Annual savings under extremely liberal scenario	£0.6bn
Conclusion	Some scope for de-regulation

The bulk of the costs in this area (£1.1bn) are accounted for by the 1998 Data Protection Act which implements the EU Data Protection Directive. We envisage that under the politically feasible scenario this would remain in place while under the extremely liberal scenario the associated cost could be cut by half. We do not envisage that data protection rules could be scrapped completely due to a combination of domestic sentiment, market access issues, and international legislation in the form of the Council of Europe's Data Protection Convention.

The domestic politics
Data protection and consumer rights lobby groups would oppose significant de-regulation.

5. Competition and public procurement

Annual recurring cost	N/A
Independence	FTA, Hong Kong
Continue to apply	EEA, Single Market-Lite
Contenders for de-regulation	Tendering rules, extension of small business exemption
Politically sensitive/unfeasible	
Annual savings under politically feasible scenario	N/A
Annual savings under extremely liberal scenario	N/A
Conclusion	Limited scope for deregulation, overall UK may become more protectionist

Outside the EU's single market, the UK would be free to set its own competition policy. Despite strongly protectionist tendencies in some member states, overall the EU currently has a liberal competition regime so. The same applies to public procurement where the EU market is relatively open to both internal and external competition – according to the European Commission, 85% of the EU's public procurement market is open to competition compared to 32% and 28% for the US and Japan respectively.[211]

[211] European Commission, 'External public procurement initiative - Frequently Asked Questions', 21 March 2012 www.trade.ec.europa.eu/doclib/docs/2012/march/tradoc_149242.pdf

Therefore if the aim is to be a liberal, open economy, the UK may not need to make too many changes under either scenario, although it could further reform public procurement rules to encourage greater participation from SMEs.

The domestic politics
This is one of the areas where there is a genuine risk that the UK could end up with more protectionist legislation outside of the EU than within it. As demonstrated during the dispute over whether Bombardier ought to have been preferred over Siemens for the Thameslink tender and also during the row over Pfizer's proposed takeover of Astrazenica, there is a substantial protectionist streak among politicians and wider public opinion. Likewise, outside of the EU, it would be easier to re-nationalise the railways and other sectors of the economy and to attach various conditions to public procurement tenders; the SNP has for example proposed that EU public procurement law should be amended to allow public bodies to insist that workers delivering public contracts should receive the 'living wage' instead of the UK minimum wage.[212]

6. Financial Services

Annual recurring cost	£7bn
Independence	FTA, Hong Kong
Continue to apply	EEA, Single Market-Lite
Contenders for de-regulation	AIFMD, bankers' bonus cap, insurance capital rules, short selling regulation
Politically sensitive/unfeasible	Capital requirements, money laundering, payments systems
Annual savings under politically feasible scenario	£1.4bn
Annual savings under extremely liberal scenario	£4.1bn
Conclusion	Some scope for de-regulation but much will depend on market access deals

Given the importance of financial services to the UK economy, this will be a crucial area for de-regulation and there are a number of provisions the UK would seek to scrap or amend. The top contenders for deregulation in this sector include:

- The bankers' bonus cap – the UK was the only EU country to oppose this measure.
- Emergency bans on short selling.
- Solvency II capital rules for insurance companies and pension funds.
- Excessive reporting and disclosure requirements for fund managers.

However, the scope for de-regulation is constrained both by domestic politics and the need to maintain market access.

As such we envisage that savings under the politically feasible scenario would be relatively limited. The UK would scrap Solvency II (£0.2bn) and scrap the application of EU rules such as AIMFD and MiFID domestically, applying them only to the 41% of businesses exporting to the EU, saving £1.2bn, although the entire £4.6bn cost

[212] The Scottish Government, 'Scotland's Agenda for EU Reform', 20 August 2014 www.gov.scot/Resource/0045/00458063.pdf

associated with CRD IV would remain in place. The extremely liberal scenario would, on top of the savings achieved under the politically feasible scenario, achieve a further £2.9bn saving by also limiting the application of CRD IV rules only to EU-exporting businesses.

The domestic politics

Given the political climate in the UK in the wake of the financial crisis and a number of scandals involving the industry, any government proposing substantial deregulation will face stiff opposition.

Britain would also have some international commitments that it needed to take into account. For example, CRD IV remains the most costly of EU financial regulations with an annual recurring cost of £4.6bn. Since, this is based on the internationally agreed Basel III rules, it seems likely the UK would choose to keep some version of these in place, although it would gain greater flexibility over their implementation.

7. Product standards

Annual recurring cost	£1.9bn
Independence	FTA (limited), Hong Kong
Continue to apply	EEA, Single Market-Lite
Contenders for de-regulation	Eco-design rules, REACH, Motor vehicles regulations
Politically sensitive/unfeasible	Tobacco packaging
Annual savings under politically feasible scenario	£0bn
Annual savings under extremely liberal scenario	£1.2bn
Conclusion	Some scope for de-regulation for domestic and non-EU exporting businesses but EU-bound exports will continue to have to meet EU standards

This is a very broad category and an integral part of the single market covering everything from cocoa and chocolate products to manufactured goods accounting for 19 of the costliest 100 EU-derived regulations. Of the total £1.9bn cost, £1.3bn stems from EU rules on the testing and approval of road vehicles but other notable examples include eco-design rules which have amongst others banned incandescent light bulbs and introduced the requirement that from 2017, vacuum cleaner motors cannot exceed 900 watts.

Of all the policy areas taken into consideration, when it comes to product standards the scope for de-regulation is most constrained by the need to maintain market access.

Given that many manufacturers will wish to avoid the hassle of producing goods to different specifications for domestic and/or non-EU markets and the EU market, under our politically feasible scenario we envisage no savings in this area. In our extremely liberal scenario however we envisage that costs associated with EU product standards could be completely eliminated on goods that are not exported to the EU (e.g. 65% of motor vehicles, 43% of chemicals), giving a saving of £1.2bn.

The domestic politics

Providing that the safety element of product standards is maintained, the government might alter some product standard rules. However, manufacturers that already meet high standards, including those that would continue exporting to the EU, would oppose significant de-regulation as complying with different standards regimes may actually impose additional costs on businesses.

8. Life sciences

Annual recurring cost	£0.4bn
Independence	FTA, Hong Kong, Single Market-Lite
Continue to apply	EEA
Contenders for de-regulation	Medical research
Politically sensitive/unfeasible	GM cultivation
Annual savings under politically feasible scenario	£0bn
Annual savings under extremely liberal scenario	£0.4bn
Conclusion	Significant scope for de-regulation but liberalising rules on GM could run into significant opposition

Life Sciences is an umbrella term for a range of cross-cutting fields encompassing biotechnology, medicine – including cancer research – pharmaceuticals and genomics. As a scientifically advanced nation with a flourishing knowledge economy, the UK is perfectly placed to use its competitive advantage to generate inward investment and export opportunities; however this potential is currently hindered by the EU's regulatory framework which is orientated around the avoidance of risk as opposed to innovation.[213]

Practical examples include the dysfunctional approval system for GM crops which has effectively frozen them out of the EU, as well as the two-year ban on neonicotinoid pesticides taken despite the UK government's objection that it was based on flawed scientific analysis.[214] Although the direct cost of EU-derived legislation in this area is limited (£0.4bn stemming from the EU's rules on GM crops), there is a significant opportunity cost in terms of forgone growth, investment and export opportunities.

Outside of the EU, there are a few specific changes the UK could make in this area:

- Making it easier to cultivate GM crops in the UK - there is currently no commercial cultivation in the UK because so few products have been approved at the EU level.
- Better targeted data protection rules in order to facilitate medical research, in particular given the recent shift towards targeted and personalised treatments.
- We envisage that under both our de-regulatory scenarios the UK will liberalise life sciences regulation in order to promote growth and innovation although under the politically feasible scenario the UK will keep restrictions on GM crops in place, while under the extremely liberal scenario they would be scrapped.

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[213] For a more detailed discussion see Fresh Start, 'EU impact on life sciences', January 2014 www.eufreshstart.org/downloads/lifesciences.pdf

[214] BBC, 'Bee deaths: EU to ban neonicotinoid pesticides', 29 April 2013 www.m.bbc.co.uk/news/world-europe-22335520

The domestic politics
Rolling back EU laws and introducing more innovation-friendly policies will be easier in areas such as medical research compared with others such as GM where even outside of the EU there would be a significant anti-GM lobby including the Scottish and Welsh governments. Access to medical records will remain sensitive.

Might the UK lose out on some benefits of these regulations?
According to the government impact assessment some of these regulations come with benefits or even produce net benefits. There are a few reasons why we believe that the total savings from these deregulation drives would largely be in line with the costs of the regulations.

In the first scenario the package of regulations we cut sees the costs significantly outweigh the benefits. Under the UK-EU FTA 2 the regulations cut have a cost of £12.7bn, but a benefit of only £4.3bn. Therefore cutting this package should deliver a clear net benefit. Under the best case Brexit scenario the regulations have a cost of £24.1bn but a reported benefit of £45.6bn. However, there are valid reasons for believing the benefits are overstated and the costs possibly understated.

In the ambitious but realistic scenario (UK-EU FTA 2) 8 out of 23 regulations cut do not have quantified benefits, while a further 8 actually have a net cost and 2 are essentially in balance. So for 78% of this deregulation push, no clear net benefits would be lost. Half of the benefits come from social employment law and the Agency Workers Directive in particular. Previous analysis has shown this is a significantly overestimated benefit, not least as it comes from a transfer payment from employers to workers and as such largely crowds out already productive investment (as seen in our model more broadly for FDI).[215] The remainder are largely down to financial regulation and environment and climate change regulation, discussed below.

In the unprecedented scenario 15 out of 56 regulations do not have quantified benefits, while a further 15 have a net cost and 2 are in balance. So for 54% of this deregulation push, no clear net benefits would be lost. On top of this, much of the saving is delivered by cutting regulation rather than scrapping it all together.

For regulations which are tied to access to the single market, it is likely that only those firms which export to the EU will need to implement them. For example, this is particularly true in financial services where only firms wanting to access the EU passport would need to adhere to EU regulations (see Section 4.6) for a detailed discussion of this).

In this scenario 47% of the benefits to the regulations come from climate change regulation – we believe this is hugely overstated. As the impact assessments themselves confess, the benefits hinge on there being a global deal on climate change and emissions reduction. This clearly has not materialised and therefore, Open Europe estimates that almost none of the benefits have been achieved. A further 36% of the savings come from scaling back the financial services regulation as noted above. Part of this also involves a change in the bank capital rules. This is of course a tough choice but not an impossible one. As with everything else in this scenario it is what is potentially and theoretically possible.

On top of these points it's important to remember that these costs and benefits are derived from simply the 100 most costly EU regulations on an annual basis.[216] This is a partial share of total EU regulation. Due to the significant uncertainty over how the money would be used we also avoid applying an economic multiplier to these savings. Therefore we think it is very likely our estimates of savings from deregulation are actually an underestimate of the overall impact.

For these numerous reasons then, we think the costs are a decent approximation of the potential savings since they underplay the dynamic savings but also because the benefits, in the limited cases where they apply, are often overstated.

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[215] Open Europe, 'Repatriating EU social law: The best choice for jobs and growth?', November 2011: www.openeurope.org.uk/intelligence/economic-policy-and-trade/eu-social-law/

[216] Open Europe, 'Top 100 EU rules cost Britain £33.3bn', March 2015: www.openeurope.org.uk/intelligence/britain-and-the-eu/top-100-eu-rules-cost-britain-33-3bn/

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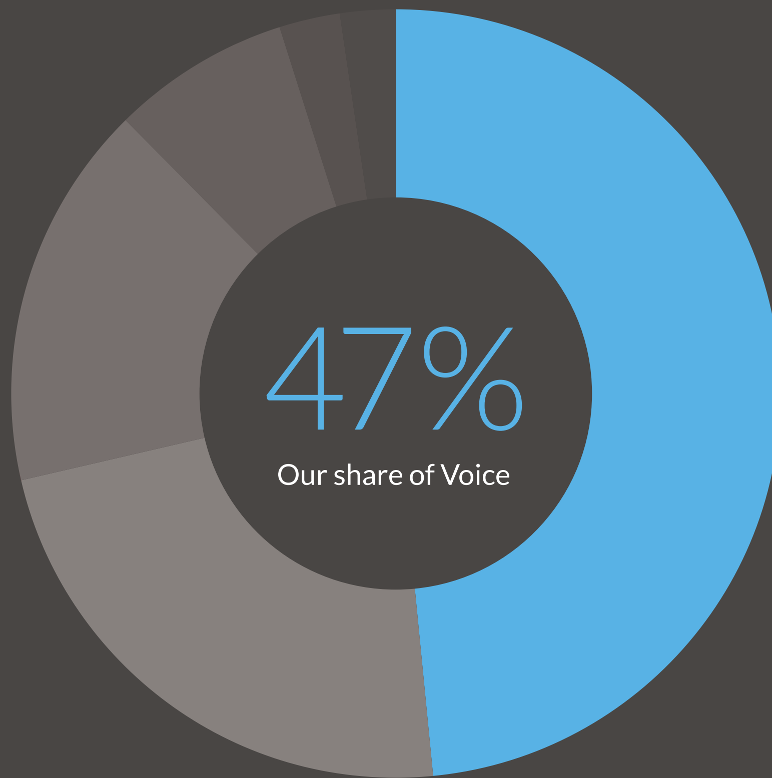

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