



What would 'out' look like?

Testing Eurosceptic alternatives to EU membership

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Summary

Advocates for Brexit have suggested a range of alternative options for the UK instead of EU membership. This report rigorously examines four of the most widely canvassed alternatives: the Norwegian option, the Swiss option, relying on WTO trading rules alone, and a special preferential UK deal. The study involved six months of work and interviews around Europe. The analysis shows that the arguments advanced for how Britain could do better outside the EU are based on false premises which do not survive close scrutiny. The document also reviews the economic literature that attempts to quantify the costs and benefits of leaving the EU. The report concludes that a precise figure is hard to establish but that a reasonable person would conclude that overall the likelihood is there would be substantial economic costs.

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Chapter One

1. Introduction

During this parliament, and possibly as early as next summer, the people of England, Wales, Northern Ireland and Scotland will jointly decide whether or not the UK remains a Member State of the European Union (EU).

While small minorities may vote on the basis of either an intrinsic liking or disliking of the EU, we believe that most people will make a pragmatic decision based on the best future for the UK.

This decision may be influenced by what the Prime Minister negotiates with other members of the EU. Nonetheless, we think enough information can be collected together now so that people can judge whether remaining in or voting to come out of Europe will make us better off or worse off.

An important part of the Eurosceptic case is the claim that Europe makes us worse off than would otherwise be the case. And, in so far as membership does provide us with benefits, they argue, we will be able to retain them even if we leave.

Much of the debate so far has concentrated on people's views of being in, whether that is related to free movement of people or the rules and regulations affecting business and trade.

This paper focuses on the most commonly canvassed options for out. It does so in a non-polemical way, taking Eurosceptic claims at face value and testing them against the current position of being an EU member.

The UK currently benefits from access to the single market in a number of ways – tariff free export of goods, a big say on the rules, and, the benefit of being part of the biggest global marketplace when striking trade deals with the rest of the world. This combination in conjunction with the UK's own strengths in sectors such as advanced manufacturing, finance, information technology and research makes us attractive for inward investment and is good for jobs and business.

Importantly, the benefits of EU membership are not just about market access. Over the years, a Social Europe agenda has been developed which has enhanced the employment rights and protections of people at work. Rights from which our workers benefit, but which many may not realise stem wholly or in part from EU-level agreements include rights to set amounts of paid leave, equal treatment for part-time workers, protection when a company is taken over by a new owner through Transfer of Undertakings (Protection of Employment) regulations and equal pay for agency workers.

Our paper looks at the most commonly canvassed options for the UK to pursue outside of the EU, should we choose to leave. We do not argue that life outside the EU is impossible. Some of what makes Britain a successful enterprising country would remain. But the question is not simply survival. The question is whether any of the versions of "out" offer the UK a better future than continuing to be 'in'.

We have discussed the issues with a large number of people from academia, businesses, trade associations, and, trade unions. Against all the major canvassed alternatives to EU membership for the UK, we find that there would be significant disadvantages compared to the current situation.

At the heart of all this is an argument about sovereignty. Eurosceptics argue that withdrawal increases Britain's sovereignty and power over our own destiny. We take the view that every alternative to being in moves us from being a "rule maker" to becoming a "rule taker" and more dependent than at present on decisions over which we have no say. Our view is that by being 'in', we play an important part in shaping our most important trading relationship.

Eurosceptics often point to Norway and Switzerland as European countries outside the EU that have gained a trading relationship with the EU while retaining their sovereignty. Our detailed analysis shows that these countries have instead traded away the substance of decision-making for the appearance of making decisions on their own.

The fundamental rule for any European country taking part in the European single market is straightforward; if you want to take part, you have to play by the rules. And you will be asked to contribute towards the costs that the players jointly decide upon and which underpin the Single Market.

Norway and Switzerland, in different ways, have opted for a system where their governments agree to exercise their sovereignty by adopting rules as and when they are decided in the EU but with no input into these rules. And these countries still have to make financial contributions.

The UK is a larger country than Norway and Switzerland. This leads some to argue that surely we would obtain a better deal than these two, via a specific UK-EU Free Trade Agreement. Our review of the practical outcome of a UK-EU negotiation leads us to conclude that we would end up being offered something very similar to those two countries. Ironically, perhaps, the unintended consequence of the UK Independence Party getting what it says it wants would not be greater control but greater dependence, and, a less well-off country than otherwise.

It may be that the British people would not tolerate the obvious disadvantages of a deal like the Swiss or Norwegian agreements. Faced with the option of having to follow EU rules with no say in order to access the single market, it might be that the UK would make no agreement and UK businesses would be left to trade with Europe as best they could. As a consequence, they would be subject to regulations which the UK government no longer shaped and to tariffs. Many service industries, including important financial services, would no longer be permitted to trade across borders into the EU at all. They would have to relocate if they wished to trade. Just as American financial services are required today to relocate to Dublin and London in order to do business in the EU.

Eurosceptics sometimes claim that, because we currently import more from our EU partners than we export to them, we would have the upper hand in any negotiations for trade access. This ignores that our exports to them are the equivalent of 14% of GDP while their exports to us are just 2.5% of EU GDP.

The size of the loss we would suffer if we had no agreement on trade with Europe is disputed. We also review the existing economic literature on the costs and benefits of EU membership. We note that it is necessarily inconclusive as we cannot in reality simultaneously compare the consequences for a UK that is "in" and a UK that is "out". However, we do note that by reviewing both the more sceptic and less sceptic literature on costs that it may be possible to identify a more or less comprehensive set of costs and benefits of exit. And, when this set is examined, it seems more probable that the costs of exit outweigh any benefits, and, that the risks are materially greater on the downside.

In line with the discussion above, the paper consists of 6 further chapters. It examines in turn the Norwegian Option, the Swiss Option, the situation where there is no agreement with the EU and the UK relies on global trading relations, and the possible content of a UK-EU trade agreement. The paper then examines the Eurosceptic and pro-European attempts to quantify the costs and benefits of EU membership before providing a set of summary conclusions.

Our view is that the debate over the coming months will allow pragmatic people to weigh up the options and come to their own conclusions. This paper is intended to inform the debate and focusses much needed attention on what the various versions of being out might mean for the UK.

Chapter Two

The “Norwegian” Option

1. Eurosceptic general claims

A claim is often made that the UK could have the same allegedly advantageous position as Norway.¹ Those making this claim take the view that Norway is able to benefit from membership of the Single Market without being subject to EU regulation or bureaucracy.² This section of the report subjects these views to critical scrutiny.

2. Norway’s relationship with the EU

2.1. Norway’s relationship with the EU has been heavily shaped by the European Economic Area (“EEA”) Agreement. However, in total, Norway in fact has 74 agreements with the EU, including Schengen (which extends the free movement of people), regional development, justice and home affairs, and defence policy.

2.2. Norway rejected membership of the EU via referenda in 1972 and 1994.

3. Nature of the EEA

3.1. A key contextual point about the EEA is that when the agreement was adopted between the EU and the European Free Trade Association (‘EFTA’) member states, the EFTA member states were treated favourably because they were expected in time to become members of the EU. The political expectation was that the EEA was a transitory agreement.

3.2. The EEA agreement obliges the EU and the three EFTA states of Iceland, Lichtenstein and Norway to uphold the EU’s four fundamental freedoms including the free movement of people (The other EFTA Member State, Switzerland, is not a signatory of the EEA). It excludes the EU’s Common Agriculture and Fisheries’ Policies, Customs Union, Common Trade Policies, Common Foreign and Security Policy, Justice and Home Affairs, and the Monetary Union. However, as per 2.1. above, it is not the only agreement between Norway and the EU.

3.3. The EEA is an association agreement, which commits Norway (and the other EFTA signatories) to adopt already existing EU rules (i.e. Norway associates to the *acquis communautaire*). The content of the EEA Agreement is EU law and everything else consists of procedures designed to ensure that the rules are applied in the same way in the EEA-EFTA states as in the EU.

3.4. Norway has no vote in EU processes – which means that the form of association is entirely reactive.

3.5. EEA law (i.e. EU legislation and Court decisions), once implemented, takes priority over Norwegian law.³ It is enforced through the domestic institutions but also through the EFTA Surveillance Authority and the EFTA Court which mimic the Commission and the ECJ.

1. For example, see Dr Richard North, (2013) “The Norway Option. Re-joining the EEA as an alternative to membership of the European Union” The Bruges Group, London. See also “Can Norway show the UK how to prosper outside the EU” <http://www.bbc.co.uk/news/uk-england-21715114>

2. For example, Jim Ratcliffe, the founder and chairman of chemicals giant Ineos, said Britain would be “perfectly successful as a standalone country, part of the European marketplace like Norway and Switzerland, but without the expensive EU bureaucracy” <https://www.politicshome.com/foreign-and-defence/articles/story/billionaire-chemicals-boss-backs-eu-exit#tshash.atW4AwBW.dpuf>

3. Eriksen, E and Fossum, J. (2015) The European Union’s members: independence under hegemony, p.90
Norberg, S. “The EEA – more relevant than ever for Switzerland!” Lecture, Basel University 21 September 2012, p.6.

- 3.6. The EFTA Court is autonomous and so its interpretations of EU law could diverge from the European Court of Justice (ECJ). However, under the EEA Agreement rules, the EFTA Court shall follow the relevant case law of the ECJ on provisions of Union law that are identical in substance to provisions of EEA law rendered prior to the date of signature of the EEA Agreement (2nd May 1992) and shall pay due account to the principles laid down by the European Court of Justice's relevant case law rendered after that date. The distinction between old and new ECJ case law has not been relevant in practice. The EFTA Court also refers to the case law of the General Court of the European Union (EGC). All three EEA courts (ECJ, EGC, EFTA Court) have not only emphasized the need for a uniform interpretation of EU and EEA law, but have actively seen to it that consistency of decisions has been preserved.

The EFTA Court is often considered to be more "catholic than the Pope" in enforcing EU Law. The independent Norwegian Committee ("INC") set up to review the workings of the EEA reported in 2012 that "...there is certain evidence to say that during certain periods it has been stricter with the EFTA States than the EU Court has been".⁴ A Norwegian expert also told us that the EFTA court is careful not to pre-empt important EU policy proposals or ECJ judgements in EFTA cases where they know there are forthcoming EU decisions. In the case of Norway vs ESA regarding permission for private gambling, for example, the EFTA court was careful not to pre-empt a forthcoming legislative proposal from the European Commission or legal proceedings between the Commission and other EU member states

- 3.7. According to the EFTA web-site over 10,000 EU legal acts have been incorporated into the EEA Agreement as of 2012.⁵ The INC estimated in 2012 that "Norway has over the period [1992-2011] adopted roughly $\frac{3}{4}$ of EU legislation, compared with EU states that participate in everything, and EU rules are implemented no less effectively in Norway than in many EU States."⁶

4. Eurosceptic supporting argument

- 4.1. Eurosceptics sometimes allege that statements of Norwegian politicians regarding the downsides of EEA membership compared to EU membership are political propaganda deriving from a pro-EU agenda.⁷

In February 2001, for example, the then Norwegian Prime Minister, Jens Stoltenberg, used the phrase "fax democracy" to describe a situation where Norwegian officials, sitting by the government fax machine waited for the latest rules to arrive from Brussels. North, for example says this is an "untruth" as Norway does have some influence.⁸

- 4.2. In addition, sceptics argue that there are institutions inside the EEA which allow Norway to have a "say"

There is the ministerial-level EEA Council, the EEA Joint-Committee of senior officials, and subcommittees and working groups of officials and experts. There is also the EEA joint-parliamentary committee and the EEA consultative committee. Through these institutional mechanisms Norway has a "say".

- 4.3. They may concede that Norway has no formal vote when EU institutions decide but provide a range of reasons for why this does not mean Norway has no "say":
- 4.3.1. It can seek to convince.
- 4.3.2. It has an opt-out (Article 102 of the EEA Agreement): "EFTA countries in the EEA thus have the right to opt out of new EU legislation that EU countries do not have".⁹

4. Independent Norwegian committee Unofficial translation of Chapter 27, p.33

5. <http://www.efta.int/legal-texts/eea>

6. Unofficial translation of Chapter 26, p.1 of INC report. This is a rather different picture from that painted by North in the "Norway option" where he argues that Norway has adopted far less EU legislation than EU Member States (4,179 legal acts compared to 100,000). However, it should be noted that he does not attempt to compare like-with-like. For example, he includes the roughly 12000 ECJ decisions within the EU column only, whereas these are (as described in 3.6 above) just as applicable in Norway.

7. <http://www.hannan.co.uk/how-norway-beats-the-eu/>

8. North Op.cit, p.5.

9. Ibid, p.7

- 4.3.3. The rules which constitute the Single Market do not originate solely with the EU. "In a global trading environment, regulation is being globalised and standard-setting is now shared between many different bodies. Many of these act at a global level. There, Norway has considerable influence, far greater than is exerted by individual EU Member States. This more than compensates for the notional lack of influence within EU institutions".¹⁰

5. Assessment disagreeing with UK Eurosceptic position

- 5.1. Norway's own independent committee, the INC, noted that:

"Norway adopts EU legislation and commits itself to conform with it as if it were in the EU. Yet Norway does not participate *institutionally* in the EU, to the extent that it is not a member, and only to a very limited extent has the possibility to participate in and influence decision-making"¹¹

"For EU states the transfer of power to the EU involves the replacement of national decision processes with collective decision-making procedures. One gives something in order to get something in return. The influence that the individual state achieves at the EU level counterbalances to a greater or lesser extent the loss of power at the national level. This is lacking in the Norwegian model of association. The modest opportunities to influence decision processes that Norway can have through an active European policy, can neither formally nor actually compensate for its substantial transfer of powers. As such, the net power-shift from national to supranational levels is viewed as being just as comprehensive for Norway as for the EU States".¹²

- 5.2. The EU spokesman for the Norwegian Conservative Party, Nikolai Astrup MP, argues that:

"If you want to run the EU, stay in the EU. If you want to be run by the EU, feel free to join us in the EEA."¹³

- 5.3. The British Prime Minister, David Cameron, stated in a speech on Europe on the 23rd January 2013:

"[Norway] has no say at all in setting its [EU] rules: it just has to implement its directives."¹⁴

- 5.4. The House of Commons Library says:

"Norway has little influence on the EU laws and policies it adopts."¹⁵

- 5.5. The Confederation of British Industry states:

"[...] Norway is a passive "standards-taker"-accepting all rules from Brussels without any formal say in the process. The model would not be suitable for the far more complex British economy. Nor does it in any way accommodate those who want to see a reduction in Brussels' influence on the UK and our regulatory development. If anything the position would be worsened. Norway makes a significant financial contribution in return for market access but accepts rules it has virtually no influence over".¹⁶

- 5.6. Implicit disagreement of Accession countries

Thirteen central, eastern and Mediterranean countries had the option of joining either the EEA or the EU in the 2000s. Central and Eastern countries explored the EEA option and all bar one rejected it as inferior. Slovakia considered it more seriously, but its potential EEA membership was vetoed by Norway.¹⁷

10. Ibid, p.7

11. http://www.eu-norway.org/Global/SiteFolders/webeu/NOU2012_2_Chapter_3.pdf, p.7.

12. Independent Norwegian committee Unofficial translation of Chapter 26, p.20

13. http://www.cbi.org.uk/media/2133649/doing_things_by_halves_-_lessons_from_switzerland_and_norway_cbi_report_july_2013.pdf

14. http://www.conservatives.com/News/Speeches/2012/12/Prime_Ministers_Speech_on_Europe.aspx

15. <http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN06522#fullreport>

16. http://www.cbi.org.uk/media/2133649/doing_things_by_halves_-_lessons_from_switzerland_and_norway_cbi_report_july_2013.pdf

17. Evidence presented to INC: Ask, A. O., Norge nølende til EFTA-utvidelse, Dagens Næringsliv. 07.12.1994 og Ask, A. O., En seier og et tap for Norge i EFTA, Dagens Næringsliv. 15.12.1994

One might attempt to argue that these countries all faced special circumstances: either exiting Communism or comprising micro-states. However, in that case, one must also provide an explanation for why 3 larger EFTA states (Austria, Finland and Sweden) who helped negotiate the EEA agreement and participated for one year then left and joined the EU in 1995. The INC noted "...during the EU debates in these countries in 1993-1994 heavy criticism was voiced against the EEA agreement which many saw as an unacceptable model for the transfer of authority without co-determination".¹⁸

- 5.7. The Institute of International and European Affairs ("IIEA"), Ireland
- The IIEA has written an extensive report looking at the options for Ireland in the context of a Brexit. Its view of the Norwegian option is as follows: "The Norwegian Model has come to be known as the "Norwegian Fantasy", which is precisely what it is: a delusion. In real terms, it offers nothing to those seeking to escape from the obligations of EU membership regarding the free movement of persons or social policy."¹⁹

6. Flaws in the Eurosceptic argument about trade

- 6.1. It would appear that many Norwegian politicians have become advocates of EU membership because they realise that Norway does not participate in decisions but has to abide by them. This appears to be the driver rather than any a priori attachment to the EU. The Norwegian independent review committee on the EEA states that "Out of all the political parties in Norway only two of the smallest ones, KrF (Christian Democrats) and Venstre (Liberals) have accepted this form of association as their first choice. For the other parties, this is a second choice that nobody particularly likes but that most people can live with".²⁰

- 6.2. It is important to distinguish what is meant by having a 'say'. This allows us to appreciate why the range of commentary set out in section 5 comes to a different conclusion from that of UK Eurosceptic.

6.2.1. The ability to comment

- 6.2.1.1. First, the Eurosceptic assessment conflates the ability to submit your comments and a right to participate in decision-making. In any negotiating process, lack of the latter is likely to mean the weight of your comments is lessened and potentially ignored. Open Europe provide a good example of outcomes arising in relation to Norwegian and UK national practices in retail financial services which ran counter to the general principles of EU rules under negotiation. Neither the Norwegian and UK practices had any potential detrimental effect on cross-border trade. Using the EEA mechanism, Norway, despite trying, was unable to secure an exemption. Conversely, UK MEPs and officials were able to obtain an exception for UK practices.²¹ When the EU adopts rules, the EFTA members are not present. Formally, they get to present their arguments as to why EEA legislation should be different after the EU has adopted rules as EU legislation.²² The consequence is that they cannot realistically ask for changes. Instead, they are restricted to asking for temporary or permanent opt-outs.

- 6.2.1.3. It is also worth noting that an opt-out is not of much use if your trading advantage lies in positive change. The UK's trading advantage lies in further opening markets in the EU for trade in services – an opt-out is useless in achieving this.

18. Unofficial translation of Chapter 27, p.11 of Norwegian independent committee

19. O'Ceallaigh and Gillespie "Britain and Europe: the End-game: an Irish perspective", p.125

20. Unofficial translation of Chapter 27, p.8 of Norwegian independent committee

21. Open Europe, "The Economic Impact of different Brexit scenarios", p.53.

22. Norwegian experts are invited to give their opinion to EU working groups considering draft legislation.

6.2.2. Second, the argument that Norway has “the right to opt out of new EU legislation that EU countries do not have”²³ is an inaccurate description of the situation and by itself misleading. There is in fact no reference in the agreement to an opt-out from specific legislation, only to a suspension of wider sectoral access if a specific item of legislation is not adopted by the EFTA Members collectively (Article 102). The process referred to as an ‘opt-out’ is in fact a mechanism which allows the EFTA member states to delay the application of EU rules in their territory but not to avoid them. The process works as follows:

6.2.2.1. If an EEA member state continues to object to a piece of legislation after various time-periods then not just the specific piece of legislation is “provisionally suspended” but all of the “affected part” of the EEA. The “affected part” is undefined but the interpretation could potentially be broad. For example, an argument over postal services would fall within the sector defined as “electronic communications, audiovisual services and information society”.²⁴ Therefore, if the EEA Committee is unable to adopt a piece of legislation then all of the consumers and businesses in the EEA member states might potentially be unable to access the Single Market on equal terms with EU consumers and businesses in all of the areas where suspension took place.

6.2.2.2. As a consequence, the so-called ‘opt-out’ has never been deployed. As the INC states: “...there is little opportunity for Norway to pursue cherry picking in the areas where it has actually entered into agreements. The most important agreements (EEA and Schengen) are *packages*, where the condition prevails that if Norway wishes to participate, then it has to participate in everything, both in what it likes and what it dislikes. There is little room for eternal opt outs. Sure enough for formal and constitutional reasons Norway must give explicit agreement to all expansion of EEA and Schengen, but from the EU’s perspective this is not seen as an opportunity to engage in cherry picking by saying no to legislation it dislikes... In the EEA Agreement there is a possibility for the EFTA states to “opt-out” of new legislation that may be EEA relevant. But from the EU perspective this is not viewed as a routine measure. Rather, at best it is considered to be a safety valve to be used in extraordinary circumstances. Furthermore an opt out by the EFTA side following detailed procedures would have the consequence that the section of the agreement to which it applied (“the affected part of the annex”) would be taken out of force.”²⁵

6.2.2.4. It is also important to note that the ‘opt-out’ does not by definition apply to all existing legislation, much of which provides the European Commission, national governments, EU agencies and national regulators to take delegated executive action in accordance with EU legislation. A future legislative ‘opt-out’ would be irrelevant to such acts. EU Agencies, for example, in sectors such as aviation, energy, finance, pharmaceuticals, rail and telecoms have delegated executive authority to set standards subject to European Commission supervision. This had been viewed as a constitutional problem in Norway since it has no right to vote on these bodies and must accept the decisions, despite the fact that they require no further agreement in the EEA Joint-Committee. Controversy over this issue has led to a severe delay in implementation of the financial services acquis by the EEA countries and is currently unresolved.

6.3. Rules affecting trade within the single market are set in Brussels

6.3.1. North argues that “Rather than [the EU] initiating law, it is now more likely to be converting standards handed down from international bodies into law. In effect, the EU have [sic] become a vast processing factory, converting international standards into law”.²⁶ While it is true that many general regulatory principles are adopted on a global basis, many are not. In addition, general regulatory principles then vary, often substantially, in their detailed application. Indeed, the fact that this is the case, is witnessed by the lengthy negotiations over TTIP which involve attempts to set up mechanisms to agree joint regulatory rules. A good example of this is with respect to standards for the car industry where negotiations between the EU and the US are seeking to define ways in which standards for car safety could be jointly set between them.²⁷

23. See section 4.3.2. above.

24. http://www.law.stanford.edu/sites/default/files/child-page/205024/doc/slspublic/bersagel_eulawwp5.pdf, p.20

25. Unofficial translation of Chapter 27, p.13 of Norwegian independent committee

26. North, op. cit., p.11.

27. http://bruegel.org/wp-content/uploads/imported/publications/pc_2013_15_TTIP.pdf

6.3.2. North makes the general statement that the setting of capital adequacy regulation for banking is an illustration of the primacy of international rule-setting and says the rules are set by the Basel Committee. He also says Norway is able to make independent representations to the Committee.²⁸ This example is not developed any further. In fact the detailed rules on capital adequacy are set at EU-level. Analysis of the EU and US approaches to implementing Basel rules finds that they are “structured in fundamentally different ways.”²⁹ Open Europe find that of the top ten most expensive EU financial regulations for UK businesses to implement, in only two cases can the impetus be seen to directly come from global regulation. In addition, Open Europe note “...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.”³⁰

6.3.4. North also gives the example of the International Telecommunications Union saying “it is the equivalent for telecommunications”³¹ of these bodies which allegedly set detailed rules. However, in fact, it is only the equivalent in the sense that it too is a venue in which discussion takes place and binding standards are not set. It is of little relevance to the substantive economic and social regulation of telecoms within the EU. The latter is set at EU-level. Let us take one example, mobile roaming rates. The ITU has no say on deciding EU roaming rates. The EU has collectively decided to reduce and then eliminate these against the wishes of mobile operators and, indeed, some national politicians.³² Another example is data protection, hold ups in agreeing EEA adoption of EU data protection rules meant Norway qualified as a third country where EU data could not be stored. Consequently, a Norwegian expert told us, at a point where data intensive multinationals were looking at sites for housing data centres, Norway, despite attractions such as cheap and abundant green energy, was disqualified.

6.4. UK Eurosceptics neglect to notice the key commercial problem with the EEA Agreement

6.4.1. As Eurosceptics are often focused on how you can sustain disagreement and avoid collective solutions rather than how you might agree, they neglect to observe that the EEA agreement gives rise to commercial problems.

6.4.2. EU legislation can only be adopted in the EEA Committee by unanimity (Article 93(2)). It is not possible to go faster than the slowest Member State. Iceland and Lichtenstein struggle with the output of the EU. Experts told us that the current lag is 6-24 months. This hands competitors in other Member States a commercial advantage (and as noted above, failure to adopt specific legislation could lead to a more extensive suspension of participatory rights.).

6.4.3. If it were a member of the EEA, the access of UK firms to the EU single market on the same terms as its competitors would be dependent on Iceland, Norway and Lichtenstein agreeing to adopt EU legislation in a timely fashion. The consequence of being 6-24 months behind in terms of implementation hands competitors in other Member States an advantage in adapting to new rules and standards.

6.4.4. One consequence of this kind of problem is that Norwegian firms have on occasion simply moved their investments to EU countries instead. This may be feasible for large companies, it will generally not be for SMEs. A Norwegian expert told us that Den Norske Veritas – the world leading marine Norwegian classification society (a competitor of Lloyd’s shipping of London) had to acquire its German competitor, in order to offer maritime classification to its international customers. They were obliged to do so as the time lag in EEA adoption of EU rules meant that it was unable to receive mandates from the Norwegian government until 12-18 months, at best, after its competitors based in EU member states.

28. North, op. cit., p.11

29. <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD438.pdf>, p.23.

30. Open Europe “The Economic Impact of different Brexit scenarios”, p.82.

31. North, op.cit., p.14

32. <http://www.euractiv.com/sections/infosociety/europe-split-abolition-mobile-roaming-charges-315084>

- 6.5. Effect of the rules of origin/not being in customs union on Norwegian EU trade?
Norwegian companies face border costs as they must demonstrate that goods meet rules of origin requirements. Open Europe estimate that if UK companies had to meet similar costs that this would reduce UK GDP by a very substantial 0.94% per annum.³³ One quantitative analysis has found that being a member of the EU leads a country to trade significantly more with other members of the EU than if it were only a member of EFTA. This study could imply that leaving the EU and joining EFTA would similarly reduce trade with EU members by 25% over time.³⁴

Rules of origin requirements demand that businesses importing into a customs union from a country with a preferential trading arrangement prove that sufficient of the content of their product originates in their country rather than other countries that do not benefit from a preferential arrangement. The rules are highly complex and compliance is administratively demanding and expensive.

- 6.6. How successful is Norway in negotiating trade agreements compared to EU?
The recent difficulties Norway has had with China (despite its trade deal) are illustrative of what happens when asymmetric size coincides with the larger power prioritizing politics over trade. Reports indicate that ever since a Chinese dissident was awarded the Nobel Peace Prize, China has imposed import barriers to Norwegian salmon.³⁵ Fish comprise Norway's second largest export.³⁶

7. Flaws in the UK Eurosceptic argument about bureaucracy

- 7.1. Norwegian firms do not face less bureaucracy as a result of being in the EEA, they face more. They have to seek to lobby with all the existing EU legislators while having no national representatives within any of the decision-making institutions. When their national government comes to decide whether to agree legislation within the EEA, they have to lobby again and may have to continue to also deal with the EU Commission as national legislators may be interacting with the EU Commission to try and understand legislation which they did not participate in agreeing and drafting. After legislation is adopted, they have to deal with the EFTA Surveillance Authority and the EFTA Court, who in turn will be interacting with the EU institutions.³⁷
- 7.2. In addition, Norwegian firms exporting to the EU have to comply with the administrative complexity of rules of origin.

8. Flaws in the UK Eurosceptic argument about the reach of the EU into Norwegian regulation

- 8.1. The Norwegian agreement with the EU does not limit the reach of EU law and regulation. The ICN state: "The main pillar of Norway's relationship with the EU is the EEA Agreement...and for the last 20 years it has an impact on most areas of Norwegian society, directly and indirectly, perceptibly and less perceptibly. Hardly a single year has passed during the last 18 years without headlines in the media concerning small and large EEA issues, and the agreement forms part of the daily life for many Norwegian citizens and companies".³⁸

"Norway's agreements with the EU are characterized by a *substantial gap between formality and reality*. The agreements are based on Norway not entirely transferring formal authority to the EU – whether legislative, executive or judicial. In reality, though there is massive delegation of legislative power to the EU, a considerable delegation of judicial power to the EU Court and the EFTA Court, and some delegation of executive power to the EFTA Surveillance Authority as well as to the Commission and a number of other EU organs (agencies)".³⁹

33. Open Europe, op. cit, p.80.

34. Baier, Bergstrand, Egger and McLaughlin (2008) "Do Economic Integration Agreements Actually Work? Issues in Understanding the Causes and Consequences of the Growth of Regionalism", The World Economy, 31(4), 461-497.

35. <http://www.undercurrentnews.com/2015/03/19/china-warns-of-partial-ban-on-norwegian-salmon-imports/>

36. http://www.worldsrichestcountries.com/top_norway_exports.html

37. "Within the EEA there is an entire institutional structure to ensure that the EFTA side adopts new EU legislation, and that it is appropriately monitored and implemented. This is intended to mirror the supervision of compliance within the EU http://www.eu-norway.org/Global/SiteFolders/webeu/NOU2012_2_Chapter_3.pdf, p.7.

38. http://www.eu-norway.org/Global/SiteFolders/webeu/NOU2012_2_Chapter_3.pdf, p.3

39. Unofficial translation of Chapter 27, p.5 of Norwegian independent committee

9. Free movement of people

It is worth restating that Norway's agreement includes all of the freedoms including the Free Movement of People.

10. Levels of contribution

10.1. Formally, there is no membership fee for the EEA Agreements. However, Norway contributes via contributions to economic and social cohesion in the EU through the EEA funds, contributions for Norwegian participation in common European programs (research, education, innovation, regional cooperation etc.), contributions for Norwegian participation in EU agencies, and, costs for the management of EFTA and the EU institutions.

10.2. The per capita net contribution of Norway in 2011 was £106, which compared to £128 for the UK.⁴⁰

11. Could Norway veto UK membership of the EEA?

11.1. Article 128 of the EEA agreement requires an applicant to the EEA to have the support of the existing members.

11.2. As referred to in section 5.6 above, Norway informally vetoed Slovakia's membership. This was because Norway had concerns that what was then a new country would have administrative difficulties in processing EU legislation which had to be agreed in the EEA process. This would hold up Norway's ability to implement EU rules and therefore prejudice the ability of Norwegian companies to access the single market.⁴¹

11.3. Currently Norway dominates the EEA process as the other members are Iceland and Lichtenstein.

11.4. It is likely that Norway would have concerns that the UK would hold up EEA agreement of EU rules for reasons of policy difference and this might not dovetail with Norwegian interests.

12. Could the EU veto UK membership of the EEA?

12.1. Article 128 of the EEA agreement also provides the EU with veto over membership of the EEA.

12.2. EEA arrangements were intended for states that were on the way to becoming EU members and it could be assumed that they therefore intended to adopt all EU rules. EEA is therefore likely to be a poor fit for a former Member State that is leaving because it is uncomfortable with EU rules.

12.3. The EEA agreement provides only that sectoral regulation falls away as a result of failure of an EEA state to adopt EU rules in a particular sector. It would seem likely that the EU would want a "guillotine" clause in any arrangement with a Member State leaving the EU. The guillotine clause in the Swiss arrangement allows the EU to suspend as much or all of the trading arrangement which it wishes in response to a failure of the third party to be compliant with any part.

40. House of Commons Library, (2013) "The Economic Impact of EU membership on the UK", p.25

41. Evidence given to the Norwegian Independent Committee: NOU 2012:2: Ask, A. O., Norge nølende til EFTA-utvidelse, Dagens Næringsliv. 07.12.1994 og Ask, A. O., En seier og et tap for Norge i EFTA, Dagens Næringsliv. 15.12.1994

The “Swiss Option”

1. Eurosceptic claim

The Norwegian example is not the only possible alternative to EU membership. The agreements between Switzerland and the EU are sometimes put forward as a more attractive alternative to full EU membership for the UK.¹

2. Assessments which suggest that the UK Eurosceptics may have misunderstood the Swiss arrangement

2.1. The Irish Institute of International and European Affairs has written a detailed report on how Ireland should react to a potential Brexit. Its view of the Swiss option is: “The Swiss Model, which is sometimes advanced as an alternative solution, is not an option either. It is nothing more than a variant on the Norwegian model in that, instead of an overarching agreement providing for access to the Single Market, Switzerland has concluded a series of bilateral agreements with the EU that simply add up to the same thing.”²

2.2. The Swiss government admit that its agreement with the EU contains severe weaknesses: “Until now, these goals [room for maneuver in decision-making as well as adequate access to EU markets] have been largely achieved thanks to the conclusion of bilateral agreements, even if this solution has certain weak points, for example the lack of options for influencing standards that directly concern Switzerland, restrictions on sovereignty in those areas where Switzerland is required to adapt its legislation to that of the EU in order to avoid competitive disadvantages, the lack of full access to the EU single market, and latent legal uncertainty.”³

2.3. According to the Confederation of British Industry: “Switzerland has no formal say in the development of new EU rules and unlike the EEA countries the agreements do not even provide for any informal structured involvement. As a general rule Swiss experts are not allowed to sit on EU expert groups. Moreover, a lack of information on and notification of new EU legislative proposals that involves even the fields covered in the bilateral agreements limit the possibilities of the Swiss in participating in the decision shaping process... As with Norway, the result of the fact that the Swiss are not involved in the practical aspects of EU decision-making is that certain developments go unseen by the national administration.”⁴

3. Switzerland’s relationship with the EU

3.1. Switzerland helped negotiate the EEA Agreement between the EU and EFTA. It signed the agreement in May 1992, and submitted an application for accession to the EU. However, after a Swiss referendum held in December 1992 rejected EEA membership, the Swiss government suspended the negotiations for EU membership, which had not yet started, until further notice. Its application was not formally withdrawn.

3.2. In 1994, Switzerland and the EU started negotiations about a special relationship outside the EEA. Switzerland wanted to reduce the risk of discrimination against its producers that the referendum result created.⁵

1. Jim Ratcliffe, the founder and chairman of chemicals giant Ineos, said Britain would be “perfectly successful as a standalone country, part of the European marketplace like Norway and Switzerland, but without the expensive EU bureaucracy” <https://www.politicshome.com/foreign-and-defence/articles/story/billionaire-chemicals-boss-backs-eu-exit#sthash.atW4AwBW.dpuf>

Daniel Hannan: “Switzerland has most of the benefits of full membership, but few of the costs. It is wholly covered by the four freedoms of the single market – free movement, that is, of goods, services, people and capital – but it is spared the regulatory burden of Brussels directives. When it harmonizes its standards with those of the EU, it does so through bilateral agreement and following a deliberate act of the Federal Assembly in Bern” <http://blogs.telegraph.co.uk/news/danielhannan/100194407/outside-the-eu-we-should-aim-to-copy-switzerland-not-norway/>

2. O’Ceallaigh and Gillespie (2015) “Britain and Europe: the Endgame-An Irish perspective” p.125

3. https://www.eda.admin.ch/content/dam/dea/en/documents/berichte_botschaften/Report-European-Policy-101027_en.pdf, p.14

4. “CBI” “Doing things by halves? Alternatives to EU membership. Lessons from Switzerland and Norway.” (2014), p.5”

5. Bonte, C. (1999) “La Suisse et L’Union européenne. Entre Espace économique européen et Accords bilatéraux » Euryopa, Articles et conférences 10-1999, p.3.

- 3.3. These negotiations resulted in a total of 17 treaties, negotiated in two packages. The treaties are:
- Bilateral I (which took six years, 1993-1999, to negotiate and was implemented in 2002)
1. Free movement of people
 2. Air transport
 3. Road traffic
 4. Agriculture
 5. Technical trade barriers
 6. Public procurement
 7. Research (participation in EU Framework Agreements)

Bilateral II (which took 3 years to negotiate, 2001-2004)

1. Security, asylum and Schengen membership
 2. Cooperation in fraud pursuits
 3. Savings Taxation
 4. Final stipulations in open questions about agriculture, environment, media, education, youth, statistics and services.
- 3.4. A large number of other agreements (120 in total) cover other aspects of trade; for example non-life insurance services.
- 3.5. Note that bilateral agreements do not include free movement of services (including financial services other than non-life insurance services) or capital.⁶
- 3.6. Switzerland does not participate in the Common Agricultural Policy, the Monetary Union, Customs Union, Common Foreign and Security Policy ("CFSP"), and does not apply EU employment legislation.
- 3.7. The free movement of people included a temporary safeguard clause which allowed Switzerland to cap migration until 2014.
- 3.8. In the Bilateral I negotiations, Switzerland wanted a wider set of market arrangements including services and the EU declined. Switzerland did not want to include free movement of people and wanted to limit the transit of heavy goods vehicles but the EU successfully insisted this was part of the price of obtaining market access. The EU made it clear from the start that the Swiss did not have an "a la carte" choice.⁷

4. The nature of the bilateral agreements

- 4.1. The EU insisted on a "guillotine clause" in each bilateral agreement in the first package. This means each has to be adopted, maintained and expire simultaneously i.e. they operate as a package despite a Swiss desire for each agreement to be separate. In addition, the "guillotine" is not discretionary but automatic.⁸
- 4.2. Unlike the EEA Agreement, the Swiss bilateral agreements do not necessarily require Switzerland to apply EU law going forward – except where they explicitly do require this, as in air transport, partial application of competition law and Schengen. The bilateral agreements largely incorporated EU law in the relevant sectors at the date of signature.⁹ The agreements are not based on a complete transposition of the *acquis* into Swiss legislation but on the equivalence of EU and Swiss law, in which Switzerland typically copies new EU legislation but in an autonomous way. This is described in Switzerland using the German concept of 'autonomer Nachvollzug'.

6. See the incorrect statement in footnote 1 above.

7. Bonte (op. cit), p.3.

8. Bonte (op.cit)p.46

9. https://ius.unibas.ch/uploads/publics/7183/Kientzheim_2011.pdf

- 4.3. The agreements provide for the free movement of goods. Tariffs on trade are eliminated. However, there is no mutual recognition of regulation as in the EU or the EEA. Swiss goods must meet the regulatory requirements of the EU and EU goods must meet Swiss regulatory requirements.¹⁰ Automatic mutual recognition of each other's regulation was not possible because the agreement did not create any common institutions to set standards and police implementation. Instead, Switzerland and the EU agreed to license certification agencies in each other's territory which could then verify the conformity of goods with each other's regulation. Where there is no regulation, goods are permitted to enter under 'Cassis de Dijon' principles.
- 4.4. Unlike the EEA agreements there is no mechanism for automatically updating the bilateral agreements. The consequence is that specific bilateral agreements agreed in 1999 have to be amended to keep up with changes in the EU. Alternatively, in order to ensure that the EU will consider that goods are subject to 'equivalent' regulation, the Swiss government has to adopt legislation which is the same as EU legislation. If the Swiss government does not do so, Swiss businesses lose their access to EU markets.
- 4.5. 27 'joint committees' determine whether mutual recognition requirements are met. Most of the joint committees only meet once or twice a year so lags can occur.
- 4.6. In practice, what happens is that Switzerland opts to monitor and "autonomously" adopt similar measures in order to ensure that its businesses continue to have market access.¹¹ As part of the Swiss legislative process, all new Swiss federal laws with possible cross-border effects go through an assessment of compatibility with EU law. EU legislators do not go through a reciprocal process of assessing whether their draft legislation is compatible with Swiss law.¹²
- 4.7. However, it should be noted that the Swiss adoption of EU-equivalent laws does not easily work where the EU laws transfer competence to make regulatory decisions to EU agencies in which Switzerland is not a voting member.
- 4.8. Enforcement of the bilateral agreements is a matter for the authorities and courts of the EU and Switzerland respectively. As there are no joint legal institutions (but only political ones), there is no certainty that they will enforce them in the same way, which reduces the extent to which there is a reliable single market between the EU and Switzerland.¹³

5. Effect of lack of free market in services on financial services

- 5.1. Swiss financial firms face licensing and other barriers in the EU that do not apply to EU incorporated and authorized firms.
- 5.2. A number of Swiss banks operate their investment bank business through subsidiaries in the UK in order to be able to operate in the EU. The Swiss government has noted:

"...The existing barriers to market access place Switzerland at an economic disadvantage. With no legal certainty on EU market access, the cross-border activities of Swiss banks are in a (legally) grey area, i.e. Swiss financial intermediaries can only expand their EU business by way of subsidiaries in the EU, which means that Switzerland loses out in terms of jobs, value creation and tax receipts. This also makes it difficult to obtain economies of scale and thus a more cost-effective handling of financial services. Moreover, financial intermediaries incur substantial extra costs when they have to use subsidiaries. Finally, there are also restrictions with respect to the selling of products. Even the foreign branches of Swiss institutions are affected by this and are restricted in sales and distribution of financial products developed in Switzerland."¹⁴

10. Bonte (op. cit), p.23

11. Bonte (op cit)p.48

12. Bonte (op cit),p.48

13. Slides from Dr Christa Tobler contain an illustrative set of legal cases: https://ius.unibas.ch/uploads/publics/7183/Kientzheim_2011.pdf

14. Strategic directions for Switzerland's financial market policy (December 2009) <https://www.sif.admin.ch/sif/en/home/dokumentation/berichte/strategische-stossrichtungen-fuer-die-finanzmarktpolitik--beric.html>, p.43

- 5.3. There is some access to the EU market to firms from non-EU jurisdictions which have equivalent legal regimes and which provide reciprocal access to EU firms. However, the EU tends not to permit the sale of financial products to retail customers from third country providers based outside the EU. The Markets in Financial Instruments Directive (or MiFID), for example, widely defines retail customers to include corporate customers as well as individuals i.e. the permitted customers for third country providers are EU-based financial institutions only.
- 5.4. Where third country equivalence is accepted, this depends on the ability of the non EU regime to pass an equivalence assessment by the European Commission (which may require the non EU jurisdiction to conform all or part of its legislation to EU standards). This may not be possible if the EU regulatory bodies have not completed the adoption of their own standards against which compliance would be assessed.
- 5.5. In the view of representatives of Swiss financial institutions to whom we spoke, the supervision of Swiss regulation by the EU is greater than that which occurs within the EU. Their view was that the Swiss financial services regulators have less room to exercise their discretion in a way that varies from what the EU Commission thinks is appropriate than financial services regulators such as the FCA have within the EU. When the EU verifies Member State implementation it looks at the letter of national laws, when it assesses 'equivalence' it looks at regulatory practice as well as the nature of national laws.
- 5.6. The assessment of equivalence involves time lags. For example, assessing the equivalence of the Swiss rules on OTC derivatives has taken ESMA two years so far and the decision on equivalence by the Commission based on that assessment can only take place once that has concluded. There is no deadline applied to the Commission's decision on equivalence and Swiss experts believe that timing of these decisions can become part of wider political debates. This has the effect that those Swiss companies which wish to trade within the EU have to do so by setting up branches subject to EU regulation in EU member states. It also means that smaller Swiss banks are deterred from trying to operate international services.

6. Trade effects

- 6.1. UKIP argue that Switzerland is not a member of the EU and it successfully trades with the EU to the extent that it exports 4.5 times more per head to the EU than the UK.¹⁵ However, there are a number of reasons why this is misleading:
- 6.1.1. Switzerland has "autonomously aligned"¹⁶ its national regulation with EU law in order to allow its businesses to have access to the EU. In practice, it is therefore operating as part of the Single Market and not outside it. This primarily affects goods markets.
- 6.1.2. As a result of most services being outside the Swiss-EU agreement, Switzerland may be less successful at exporting services into the EU than the UK. Trade figures suggest that Switzerland might only be a successful exporter of services in the single limited sector where it does have an agreement on services with the EU, in non-life insurance services. Swiss exports of non-life insurance to the EU comprise 40% of its foreign revenue from the non-life insurance sector.¹⁷ Total non-life insurance revenue was £76bn in 2014.¹⁸ We can therefore estimate that £30bn may have come from EU sales. Total Swiss services exports into the EU in 2012 were £42bn compared to £122bn exports in goods into the EU.¹⁹ This suggests that Switzerland exports successfully where it has an agreement and far less successfully where it does not.

15. UKIP, "The truth about trade beyond the EU" (2015), p.10.

16. See section 4 above

17. <http://www.svv.ch/en/media-info/press-releases/european-challenge-swiss-insurers>

18. <http://www.svv.ch/en/publications/facts-and-figures-2015>

19. <http://ec.europa.eu/trade/policy/countries-and-regions/countries/switzerland/>

- 6.1.3. It is worth noting in this context that Switzerland has an economy with a relatively larger financial services sector than the UK (12% compared to 8% of GDP). The difference in access to the EU for services compared to the UK may be part of the explanation for Switzerland running a deficit in services as well as goods with the EU, whereas the UK only has a deficit in goods.
- 6.2. UKIP argue that Switzerland has trade agreements with countries with which the EU does not and that therefore the UK would be better off outside because it could have trade agreements with such countries too.²⁰ Daniel Hannan MEP argues "Being outside the Common External Tariff, they [Switzerland] have pursued a much less protectionist policy than the EU and are now, among other things, negotiating a free trade agreement with China – something Britain cannot do while it is in the EU."²¹
- 6.2. UKIP say that Switzerland has agreements with Canada, China, Japan and Singapore²² and the EU does not. In fact, the EU has an agreement with Canada, the agreement with Singapore is going through the formalities of being adopted, and a Japanese agreement is currently under negotiation. If one examines the terms of the Swiss-Chinese agreement, it is notable how bad the terms are and how particularly bad they would be if they applied to an agreement between the UK and China.²³
- 6.3. The key defect of the Swiss-China agreement from a UK perspective is that it provides little access to Chinese services markets which is greater than the limited access permitted under existing global agreements, while conversely permitting tariff-free access for goods to the Swiss goods market.²⁴ In addition, as the Centre for European Reform highlight, the key point is that it is not in practice actually what UKIP are calling it: "It is not truly a free trade agreement. Switzerland has agreed to eliminate tariffs on the vast majority of Chinese imports immediately. China has promised to reduce tariffs on some goods over a 5 to 15 year period. For example, tariffs on Swiss wrist watches will be gradually reduced from the current rate of 11 per cent to a preferential rate of 4.4% over ten years. The Chinese insisted that there be a review of the agreement every two years, which would allow them to change the terms of the deal."²⁵
- 6.4. It is also worth noting that the Swiss agreement with Canada covers goods only whereas the EU trade agreement with Canada also covers services. 50% of the total expected gains for the EU are related to trade in services.²⁶

7. Levels of contribution

The Swiss contribution is substantially lower than the Norwegian contribution.²⁷ If the UK paid the same per capita rate its net contribution would fall by 55%.²⁸ However, contributions are in part meant to cover the costs of the EU ensuring and developing the freedoms in the Treaty as well as flanking measures such as the Common Foreign and Security Policy. Neutral Switzerland has much more limited ambition as regards security measures than the UK, and has no bilateral agreement with the EU on services and capital – all key issues from a UK perspective.

20. UKIP (op cit), 19

21. <http://blogs.telegraph.co.uk/news/danielhannan/100194407/outside-the-eu-we-should-aim-to-copy-switzerland-not-norway/>

22. Apart from China, these are agreements between those countries and EFTA rather than Switzerland individually.

23. <http://www.seco.admin.ch/themen/00513/00515/01330/05115/index.html?lang=en>

24. Wenfei Attorneys-at-law "A practical guide to the new free trade agreement between Switzerland and China", December 2013, p.6. For example, one of the major changes is that Swiss investors in Chinese financial institutions can hold larger minority stakes. However, they are still not permitted to have outright controlling ownership in Chinese companies in which they invest.

25. Centre for European Reform (2014) "The economic consequences of leaving the EU, p.34.

26. <http://ec.europa.eu/trade/policy/countries-and-regions/countries/canada/>; http://trade.ec.europa.eu/doclib/docs/2014/december/tradoc_152982.pdf

27. The Swiss contribution is mostly structured as participation in funding to assist accession states.

28. Centre for European Reform, Op. cit , p12.

8. Will the Swiss-EU arrangement endure?

- 8.1. The EU does not consider the Swiss arrangement to be viable on a continuing basis. In 2010, the Council of the EU stated:
- 8.2. "...the approach taken by Switzerland to participate in EU policies and programmes through sectoral agreements in more and more areas in the absence of any horizontal institutional framework, has reached its limits and needs to be reconsidered. Any further development of the complex system of agreements would put at risk the homogeneity of the Internal Market and increase legal insecurity as well as make it more difficult to manage such an extensive and heterogeneous system of agreements".²⁹
- 8.3. Bonte notes that negotiating on a sectoral basis becomes more and more difficult with the growing number of countries in the EU and the variety of economic and social interests held by the different Member States. Trade-offs incorporated in an EU- Swiss arrangement in one sector might be unacceptable for a particular EU Member State unless compensated by a trade-off in another sector.³⁰
- 8.4. It seems more likely that the Swiss Agreement would mutate in the direction of the EEA Agreement and the EU Member States have collectively issued a statement to that effect:

"The Council reaffirms that by participating in parts of the EU's internal market and policies, Switzerland is not only engaging in a bilateral relation but becomes a participant in a multilateral project...The EU believes that an ambitious and comprehensive restructuring of the existing system of sectoral agreements would be beneficial to both the EU and Switzerland. A precondition for further developing a bilateral approach remains the establishment of a common institutional framework for existing and future agreements through which Switzerland participates in the EU's internal market, in order to ensure homogeneity and legal certainty in the internal market. The Council welcomes the opening of such negotiations on such a framework in May 2014, expects further efforts in order to progress with these negotiations and reiterates without such a framework no further agreements on Swiss participation in the internal market will be concluded".³¹

- 8.5. Consequences of the Swiss referendum vote against immigration
- 8.5.1. In 2014, the Swiss population voted by referendum to restrict immigration.
- 8.5.2. This potentially means that if an implementing law were adopted by the Swiss government, then Switzerland would be in breach of the bilateral agreement on free movement of people. If this were the case, then the "guillotine" could be triggered and all the agreements fall away.
- 8.5.3. The Council of the EU has stated: "...the Council reconfirms the negative reply in July 2014 to the Swiss request to renegotiate the Agreement. It considers that the free movement of persons is a fundamental pillar of EU policy and that the internal market and its four freedoms are indivisible. The Council confirms its view that the planned implementation of the result of the vote threatens to undermine the core of EU-Switzerland relations, namely the so-called "bilateral I agreements"³²
- 8.6. No proposals have yet been made by the Swiss government to the Swiss parliament. It is expected that it may do so in January 2016 after the general election in October 2015. The deadline for an implementing law to be in place is 9 February 2017.
- 8.7. Sufficient signatures have been collected by a citizens' initiative calling for a new referendum to ensure that the agreement with the EU does not fall.³³

29. European Council, Conclusions on EU relations with EFTA countries, 3213th Transport, Telecommunications and Energy Council meeting Brussels, 20 December 2012, para 31

30. Bonte (op cit)p.45.

31. Council of the European Union, "Council Conclusions on a homogeneous extended single market and EU relations with Non-EU Western European Countries, 16 December 2014, p.7.

32. Ibid

33. <http://www.rts.ch/info/suisse/7013973-l-initiative-rasa-a-recueil-plus-de-100-000-signatures.html>

The World Trade Organisation (“WTO”) Option

1. Eurosceptic statements

- 1.1. Conservative MP John Redwood says we have faster growing trade with the rest of the world, with the implication being that EU trade is less significant.¹ Elsewhere he has said that leaving would “allow us to decide to have free trade agreements with parts of the world which the European Union has not bothered to negotiate with”.²
- 1.2. UKIP say that it is not true (i) that we need to be in the EU Single Market in order to have access; (ii) that we have to be a member of the EU in order to be able to export successfully; and (iii) that a country cannot negotiate trade arrangements without being part of a larger trading bloc.³
- 1.3. Conservative MP Christopher Chope MP has said that “We have a clear alternative to EU membership. The WTO alternative. “It’s clear, it’s simple, and it represents a clean break.”⁴
- 1.4. UKIP leader Nigel Farage has said: “We would be substantially better off not being in the EU because the opportunity cost of us not being able to make our own trade deals with the emerging economies of the world is holding back British business. In terms of trade, the EU is now a millstone around our neck.”⁵

2. Assessments which suggest trade barriers would be a problem for the UK

- 2.1. UKIP’s specific points in 1.2. are true, up to a point. Any country can trade with the EU, export without being a member of the EU, and negotiate trade agreements without being part of a large bloc. However, the question is whether the UK, or any other individual European country, would do all of these things better or worse if it is not a member of the EU?
- 2.2. Norway, Switzerland and the other EFTA states have not pursued a pure WTO option. Nor did the UK in 1973 or any of the other countries which have successively joined the EU.
- 2.3. The US government’s official analysis of US-EU trade does not bear out UKIP’s analysis of the absence of trade barriers under the WTO regime:

“Despite the broadly successful character of the US-EU trade and investment relationship, US exporters and investors face chronic barriers to entering, maintaining, or expanding their presence in certain sectors of the EU market.”⁶
- 2.4. The CBI’s view on the matter is that: “Refraining from entering any formal relationship with the EU and simply relying on WTO rules is not a model that would assist Britain in achieving the global trading role to which it aspires. Access to European markets on WTO terms would hit British exporters and importers- as well as those in their supply chains – with tariffs and logistical delays, and this restricted access would see investment into the UK fall over time. The “WTO option” would give the power to pursue trade negotiations with any country of choice, but this freedom is offset by the risk of a period of dislocation while new deals are being drawn up and, more crucially, the likelihood that the UK would sign significantly fewer comprehensive bilateral deals than the EU could achieve.”⁷

1. “We should remember that Britain has faster growing trade with the rest of the world, where we do not belong to a special club, than it does with the rest of Europe, where we do belong to a special club. There are many such trade clubs around the world, but very few of them are evolving in the European way of imposing more and more government and bureaucracy on their companies and trades, because they believe in prosperity and more free trade. We do not belong to any of those clubs, but we trade extremely successfully with the countries that are in them. If someone is in a club that genuinely promotes trade, they are happy to trade with people from outside that club as well, because they obviously need to be able to trade with the whole of the rest of the world.” Hansard 9 June 2015, Vol. 596, No13, 1101.

2. <http://www.cherwell.org/comment/interviews/2015/03/05/interview-john-redwood>

3. UKIP “The truth about trade beyond the EU. Why exiting the EU takes the UK into a world of new opportunity” (2015)

4. <http://www.euractiv.com/sections/uk-europe/wto-preferable-eu-say-uk-eurosceptics-312274>

5. <https://theconversation.com/fact-check-would-the-uk-be-better-off-leaving-the-eu-41225>

6. https://ustr.gov/sites/default/files/European%20Union_0.pdf

7. CBI, “Our global future”, p.14

3. World Trade Organisation membership

- 3.1. The UK has in its own right been a member of the General Agreement on Tariffs and Trade (GATT) since 1947 and of the WTO since its creation in 1995. But within the WTO, EU member states act together and negotiations are conducted at the WTO on their behalf by the EU.
- 3.2. The WTO's Most Favoured Nation (MFN) principle in theory underpins today's multilateral trading system. The principle requires that a country allow the exporters of another country to trade on the best terms the first country offers to the exporters of any third country. In multi-lateral rounds, countries have signed up to general access principles and maximum tariffs (with some variation in the specific terms agreed by individual countries).
- 3.3. However, customs unions and FTAs are an exception to the MFN principle; members of a customs union can remove tariffs among themselves and must impose a single tariff for third countries. In practice, this exception allows any country or set of countries to strike free trade or semi-free trade agreements between each other.
- 3.4. Since the failure of the Doha round, states have set out to agree regional or bilateral trading agreements rather than pursuing freer trade on a global multi-lateral basis.
- 3.5. The Doha round of multilateral negotiations failed because emerging market countries wanted to protect nascent industrial and services markets (and some wished also to protect agricultural sectors) and advanced economies wished to continue protecting agricultural sectors.⁸ Note that the concerns which emerging markets have as to trade distortion include income support measures in advanced countries for farmers.⁹

4. Features of WTO membership for a non-member of the EU

- 4.1. Control over own trade policy (subject to WTO rules)
- 4.2. Control over own borders – no requirement for free movement of persons (usually limited right of temporary presence for providers of an economic service only) .
- 4.3. No a priori requirement to contribute to EU budget or to take part in CAP, CFP, regional or research programmes (though of course this implies the disadvantage of also receiving no funding), funding programmes or political (CFSP) or monetary programmes.
- 4.4. EU law would not apply in the UK except to the extent to which the UK voluntarily chose to adopt it. However, this would also come with the disadvantage that British citizens and companies could not benefit from the protection of EU law in other member states.

5. Tariff Effects of relying on WTO membership alone

- 5.1. UK businesses exporting goods and services to EU Member States would be subject to the EU's Common External Tariff. The maximum tariff under WTO are those which the EU currently applies under the general WTO regime. While tariffs would be imposed on roughly 90% of the goods which the UK exports to the EU, on average EU tariffs are low (1%).¹⁰ However, as the House of Commons library points out, these can be considerably higher in particular areas. For example, car exports would be subject to a tariff of 10% and car-parts to a tariff of 5%.¹¹ Despite the general reduction of tariffs under the WTO, there remains scope for gains from trade (or losses if WTO consistent tariffs applied because the UK left the EU) which is why tariff reductions form one limb of the current TTIP negotiations between the US and the EU.¹²

8. The Economist (2008) "The Doha round...and round...and round" <http://www.economist.com/node/11848592>

9. <http://www.voxeu.org/article/doha-and-agriculture-don-t-throw-out-baby-bathwater>

10. House of Commons Library, "Leaving the EU", Research Paper 13/42, (2013) p.27 Business for Britain estimate that on the specific goods British exporters trade in that the average rate would be 4.3%. Business for Britain Chapter 30, Tariff costs on exports are manageable, p.770.

11. Note that profit margins for car producers are low. In 2015, they ranged from 2.9% – 9.7% for a range of the largest manufacturers <http://www.statista.com/statistics/280346/ebit-margin-of-the-leading-car-manufacturers/>

12. http://trade.ec.europa.eu/doclib/docs/2013/july/tradoc_151605.pdf

13. CityUk "Analysing the case for EU membership" (2014), p.6"

- 5.2. It is important to note that an increase in costs does not necessarily mean that a company will remain an exporter but simply sell less. Instead, if the market in which it sells is highly competitive then it may sell nothing at all abroad. The estimate provided by the CityUK is that a 10% increase in UK export prices would lead to a fall in export volumes of between 15-25%.¹³

6. Product Standards

- 6.1. UK businesses exporting goods and standards into the EU would have to follow the EU's product standards. UK businesses would not benefit from mutual recognition of standards and UK businesses would not be able to help set the standard which would best suit them commercially for the EU market.
- 6.2. The Centre for Economic Policy Research reported for the Balance of Competence review that on a scale of 0 (no non tariff barriers ie completely open) to 100 (completely closed), on average market access barriers scored 18 for firms inside the EU and 28 for firms from outside. This compared to 38 for firms seeking to access the rest of the world and 23 for firms seeking to access the US.¹⁴ In other words, if the UK were outside the EU, UK-based firms would be at a competitive disadvantage trading into the EU as well as when they traded elsewhere in the world. While such barriers may represent different approaches to public policy concerns and risk, they can also constitute deliberate barriers for competitors.¹⁵
- 6.3. It is sometimes argued that standards are less of an issue for goods markets where many standards are set by global international standards bodies. However, we should not imagine that standards bodies are purely neutral entities always operating to a scientific consensus. New standards can impose greater costs or threats to competitiveness for some companies than others, depending on the extent to which their existing production processes are compliant with the proposed standard. Where the distribution of costs is uneven, imposing more costs on companies located in one country or trading bloc, one can expect the representatives of the country or bloc to vote against the measure. Conversely, where a country or bloc gains a competitive advantage then it will vote in favour.
- 6.4. Eurosceptics sometimes argue that the UK could have more influence in standards bodies if it were not represented by the EU.¹⁶ This is wholly implausible; and such an implausibility is well-illustrated by the setting of global car standards. Currently, the major car building countries or trading blocs are: the EU, Japan, South Korea and the US and Canada together, who all have their own standards bodies. The EU belongs to a UN body, the United Nations Economic Commission for Europe ("UNECE"), whose objective is to set mandatory global standards and requires mutual recognition. While 58 countries belong to UNECE including the EU countries, on whose behalf the EU negotiates, these do not include the other major car building countries. The latter participate in a lesser agreement which prepares non-binding standards and does not require mutual recognition. In UNECE, it is one vote per country; the EU agrees its policy in Brussels and votes as a bloc in Geneva where it has 28 out of 58 votes, thereby dominating the body. If the UK were outside the EU, it would not be able to participate in policy-setting in Brussels and would have 1 out of 58 votes in Geneva. 80% of vehicle standards are set in this forum, others are set in the EU or in the other regional standards setting bodies. The dominance of EU standard-setting in car safety and environmental regulation is such that KPMG notes that EU standards are often adopted by other non-EU countries and cite the fact that China has adopted EU car emissions standards since 2000.¹⁷ While this may meet China's ambition to become a car exporter to the EU, it also facilitates UK and other EU car exporters access to the Chinese market.

14. CEPR, (2013), Trade and Investment Balance of Competent review, study for the department of Business Innovation and Skills p.60

15. "In the current international market, trade conflict has increasingly shifted from battles over tariff levels to regulatory incompatibilities. The politics of international trade has come to focus increasingly on regulatory difference, rather than tariffs, as a means of protecting domestic markets". When Jho (2014) "Building Telecoms markets. Evolution of Governance in the Korean Mobile Telecommunications Market", p.78.

16. See North, (2013) "The Norway Option. Re-joining the EEA as an alternative to membership of the European Union" p.11

17. KPMG (2014) "The UK Automotive Industry and the EU", p.14.

- 6.5. It is important to note that the standards set by international bodies may also lag technical developments. Technical standards may then be set nationally or regionally with the country or bloc then seeking to have their standard adopted as the global standard. A country is more likely to succeed, the larger the size of its economy is. In the 1990s, this was precisely what occurred with mobile telephone standards, where the critical mass of European consumers using European standards privileged EU based telecoms companies and equipment providers versus international rivals.¹⁸ Mandatory standards were adopted in the EU by the European Telecommunications Standards Institute ("ETSI") whereas the global body, the International Telecommunications Union ("ITU") only became involved later and it does not adopt binding standards.
- 6.6. Seeking access simply on the back of WTO rules, UK businesses would not benefit from the EU focus on eliminating non-tariff regulatory standard barriers to trade within the EU. These are considered to be the key barrier to increasing trade between advanced economies.¹⁹ The EU achieves this by agreeing minimum common standards and requiring each Member State to accept goods and services from other Member States which meet the minimum common standards (an approach known as "mutual recognition").²⁰ The importance of harmonising regulation to expand trade can be seen from the fact that it comprises the major limb of the Transatlantic Trade and Investment Partnership ("TTIP") negotiation. Here the negotiating parties are attempting to harmonise regulation, either up-front as part of the TTIP deal, or by setting up institutions to achieve harmonisation of regulatory standards in the long run. An example of the kind of area in which they are trying to achieve regulatory co-ordination in the future is car-safety standards.
- 6.7. In other areas, where there are strong public concerns over the public effects of imports (for instance, the effect of US audiovisual products on national cultures) and the public risks of exports (such as the personal data of Europeans), such concerns have led to the exclusion of audiovisual and data protection services from the TTIP negotiation altogether, since in these sectors supply in the EU is restricted exclusively to EU based providers. UK membership of the WTO would not provide any market access for products in these sectors.
- 6.8. It is important to note that regulation is not simply a negative phenomenon for businesses as is sometimes claimed.²¹ KPMG point out that setting emissions standards for vehicles on a Europe-wide basis facilitates exports and reduces the costs firms, and ultimately consumers, would have to pay in order to configure vehicles for each national market. The Scotch Whisky Association similarly consider that standardisation of bottle sizes and labelling across the EU has reduced cost and complexity, supporting major export success.

7. WTO and services

- 7.1. Services are a much larger part of the economy but are traded less frequently across borders than goods.²² This is partly because some services are generally incapable of being consumed at a distance e.g. there is little or no cross-border trade in personal services such as haircuts. However, other services such as business services, financial services, information technology, telecommunications and tertiary education can be traded across borders. These are all sectors in which the UK is a leader.²³

18. An ITU case study states "The deployment of GSM is most aptly characterised by the commitment of 26 European national phone companies to standardise a system, and the working processes responsible for this accomplishment has been deemed a great success worthy of replication. Essentially these countries and firms realised the advantages of a cross-border standard and the amount of money and energy that can be wasted when competing for mobile technology "world domination". Generally speaking, the story of the establishment of GSM is of interest to anybody studying the growth and trajectory of digital technology and its commercial applications. After all, as some have argued, the nature of digital economies implies that control over network evolution translates into control over the architecture of the digital marketplace." <https://www.itu.int/osg/spu/ni/3G/casestudies/GSM-FINAL.pdf>, p.1.

19. Centre for European Reform ("CER"), "The economic consequences of leaving the EU", p.33; BIS "Protectionism" Trade and Investment Analytical Paper 5 (2011) p.11

20. http://ec.europa.eu/growth/single-market/goods/free-movement-sectors/mutual-recognition/index_en.htm

21. <http://businessforbritain.org/eu-excessive-business-regulation-2.pdf>

22. Services account for 75% of global GDP but only account for around 20% of total trade. CityUk, p.60

23. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/34607/12-1140-industrial-strategy-uk-sector-analysis.pdf

- 7.2. It is also important to note that many advanced product markets are becoming mixed goods and services bundles. An oft-cited example is Rolls-Royce which has moved from becoming a simple producer of aero-engines to a provider of aerospace solutions. Rolls Royce's service element began with the supply of spare-parts, evolved to include maintenance and overhaul services and later included an offer of "power by the hour"²⁴ or total care packages where customers buy the engine capability, while Rolls Royce takes responsibility for maintenance and risk. Research suggests that in Western economies 25 – 60% of large manufacturers of durable goods offer bundles of goods and services.²⁵
- 7.3. The UK is the second largest exporter of services in the world.²⁶
- 7.4. The UK has a large surplus in services with the rest of the EU and a larger deficit in goods. In 2011, for example, the UK's surplus in services was £68 billion with the rest of the EU while its deficits in goods was £81 billion.²⁷
- 7.5. Individual EU countries (including the UK) import services equivalent to approximately 32% of global trade in services. The EU comprises a much more valuable market than the US which imports just under 10% of the global trade in services.²⁸
- 7.6. Any claim that we should concentrate more on supplying commonwealth countries²⁹ is not supported by the evidence as to the relatively small markets for imported commercial services. Australia imports services worth 1.5% of global trade, Canada 2.5% and New Zealand is too small to list in the top 40 countries.³⁰
- 7.7. Trade in services is lower partly because the WTO General Agreement on Trade and Services ("GATS") allow members to choose to which out of 160 different service sectors they wish to provide access. Even where access is permitted, GATS explicitly allows members to regulate services to achieve their own policy objectives. For goods, where assuming it is profitable to produce solely for the destination market, a producer can produce to the regulatory standard of the country to which it wishes to import. When the good is consumed it is inside the importing country and it has met that country's standard in order to pass customs. When a service is supplied at a distance, the importing country has no control over the standards which apply at the moment of sale in the exporting country. As a consequence, GATS members often require that a foreign service provider establish itself within their country in order to offer services and will not permit cross-border activity.

8. Non-tariff barriers and financial services

- 8.1. Free trade across borders in the EU is not generally available in financial services for countries from outside the EEA. At the retail level, this is justified by consumer protection. At the wholesale level, this is because of the public policy concern at the ability of poorly regulated financial services to damage the wider economy. All countries tend to be very sensitive as to any divergence from their regulatory standards with respect to prudential regulation and will not accept activity in their territory from providers that are not compliant with the host country's standards. Currently in the TTIP negotiations, it is the US which is less willing to discuss regulatory harmonisation of financial services.³¹
- 8.2. If the UK was outside the EU, then the UK government and UK individuals and companies would not have automatic access to the EU and national bodies in the Member States of the EU which protect the rights of market participants from EU countries. For example, Eurozone authorities prefer wholesale trading in the Euro to take place within the Eurozone whilst the Eurozone's largest wholesale financial centre is London. The British government has already successfully taken the European Central Bank to the European Court of Justice over its attempt to make clearing houses specialising in euro-denominated trading relocate to the Eurozone.

24. Neely (2008) "Exploring the consequences of the servitization of manufacturing" Operations Management Research, p.3.

25. Neely (2008) "Exploring the consequences of the servitization of manufacturing" Operations Management Research, p.19

26. https://www.wto.org/English/res_e/statis_e/its2013_e/its2013_e.pdf, p.26

27. Ottaviano et al "Costs and benefits of leaving the EU" (2014), p.5.

28. https://www.wto.org/English/res_e/statis_e/its2013_e/its2013_e.pdf, p.26

29. <http://www.conservativehome.com/platform/2015/07/daniel-hannan-mep-the-case-for-brexite-5-global-engagement.html>

30. https://www.wto.org/English/res_e/statis_e/its2013_e/its2013_e.pdf, p.26

31. <http://www.euractiv.com/sections/euro-finance/ttip-will-not-include-financial-services-says-us-ambassador-303536>

9. Enforcement of rights in the EU compared to WTO

- 9.1. It is important to note that the power of individuals to use institutions to achieve market access exists in the EU and does not exist under WTO. Under WTO, individuals and companies have no ability to access any tribunal to protect their rights. Their country of origin has discretion to do so on their behalf but countries bring only a few cases and typically only on behalf of very large companies like Boeing or Airbus. In the EU, every national court and tribunal must and does apply EU law to protect the rights of all EU citizens and businesses, regardless of their Member State of origin. In addition, the European Commission and other European Agencies actively pursue infringements of EU Law.
- 9.2. The Commission alone formally pursues roughly 500 new single market infringement cases a year on average against Member States.³² This figure does not include actions taken to ensure conformity of private actors with competition rules. In contrast, since the Second World War, GATT/WTO has dealt with 944 dispute settlements in total.³³ However, these figures alone underestimate the enforcement capacity of the EU since the primary agents of enforcement in a devolved system like the EU are national courts and national administrations. There is no parallel to that with respect to the WTO.
- 9.3. As a member of the EU, the UK also has the ability to set market rules through its membership of the European Council, where the heads of governments meet to set the agenda and agree rules, its MEPs which also approve the rules and its' Commissioner (who acts collectively with the other Commissioners to implement the agreed agenda and rules). The UK has a powerful role in setting the rules which apply within the EU.
- 9.4. Some claim that the UK does not have a powerful role. However, the UK has a comparable vote to the three other big Member States (France, Germany and Italy) in the Council, the same number of Commissioners and a similar number of MEPs (Germany has more reflecting its larger population). The UK has also driven the agenda in many of the key areas where the EU is focusing: services generally, aviation, energy, financial services, rail and telecoms specifically. Estimates have been made of the number of times Member States voted against EU legislation or abstained. The UK voted against 3.9% of legislation and abstained on 3.6% of legislation. Germany voted against 4.5% of legislation and abstained with respect to 3.2% of legislation. Sweden voted against 4.4% of legislation and abstained with respect to 1.7% and so on. Purely on number of times voted against, the UK cast the fifth highest number of votes against. Combining votes against and abstentions, it was the second most negative Member State. Nonetheless, the UK voted positively for legislation on 92.5% of occasions.³⁴

10. Foreign Direct Investment

- 10.1. The UK has been the largest beneficiary of foreign direct investment (FDI) from outside the EU.³⁵
- 10.2. A survey of CBI members in 2013 found that 3/4s of its members thought that leaving the EU would have a negative impact on foreign investment in the UK.³⁶ In addition, six times as many warned that they would be likely to cut their own investment rather than increasing it, and eight times as many thought they would employ fewer people if the UK left the EU.
- 10.3. These views have been echoed by foreign governments. The Japanese government made the point in its submission to our government's review of EU powers in 2013: "More than 1,300 Japanese companies have invested in the UK, as part of the single market of the EU, and have created 130,000 jobs, more than anywhere else in Europe. This fact demonstrates that the advantage of the UK as a gateway to the European market has attracted Japanese investment. The Government of Japan expects the UK to maintain this favourable role."³⁷

32. http://ec.europa.eu/internal_market/scoreboard/performance_by_governance_tool/infringements/index_en.htm#maincontentSec3

33. https://www.wto.org/english/res_e/booksp_e/historywto_07_e.pdf

34. Von Aken (2012) "Voting in the Council of the EU. Contested decision-making in the EU Council of Ministers", pp.38-43.

35. <https://www.gov.uk/government/world-location-news/uk-named-top-european-country-for-fdi-stock-in-world-investment-report>

36. <http://www.cbi.org.uk/media-centre/press-releases/2013/09/8-out-of-10-firms-say-uk-must-stay-in-eu-cbi-yougov-survey/>. 77% of SMES surveyed also took the same view.

37. http://www.uk.emb-japan.go.jp/en/japanUK/governmental/130711_UKEU.html

10.4. Which sectors are the most vulnerable to disinvestment?

The Centre for European Reform considers that perhaps “the most vulnerable sector would be car manufacturing – the part of the UK’s manufacturing industry that is growing most strongly, and one which is almost entirely in foreign ownership. Factories would not close overnight, but it would be harder for firms to justify new investment in their British plants, and component suppliers could opt against building up industrial capacity in the UK. Both Nissan and Jaguar Land Rover – the sector’s two biggest investors- have already indicated that a UK exit would reduce the attractiveness of the UK as a manufacturing base.”³⁸ The Centre for European Reform also thought the food industry and the computer software industry were highly vulnerable.³⁹

11. Trade effects

- 11.1. The UK would no longer be party to any free trade deals with any country in the world as all of our trade deals have been conducted by the EU. It could potentially be an expensive and time-consuming exercise to renegotiate new trade deals with the 38 countries with which the EU has trade deals (and the further 12 under negotiation or in the process of being signed off). The EU single market plus the countries with which it has already signed free trade agreements cover around 60% of UK goods exports. If all of the EU’s current trade negotiations are successful this will rise to 85%.⁴⁰
- 11.2. Given the EU’s negotiating strength as currently the world’s largest economic bloc, it is unclear to what extent a smaller economic entity, such as the UK, could obtain equally good deals. For example, EU FTAs typically contain measures which protect investments made by EU companies, set up mechanisms to deal with regulatory disputes, and, provide access to public procurement. These are not dealt with substantively in WTO rules.
- 11.3. To give an example from a specific industry, KPMG’s view is that despite the size of the UK’s car industry, the UK would be unable to achieve as good as access for the industry as the EU can. In addition, KPMG report that emerging markets have put in place substantial barriers to trade which the EU works to reduce: “The UK produced 1.6 million vehicles in 2013, and is the fourth largest vehicle manufacturer in the EU, but does not have the critical mass to negotiate trade deals as effectively as the EU. Being part of the EU, therefore, enhances the negotiating strength of the UK...Emerging markets have been increasing the use of trade barriers to defend themselves against free trade, particularly through the economic downturn. In June 2013, the ACEA (“the European Automotive Manufacturers Association”) highlighted 154 new tariffs and restrictive measures that had been introduced over the previous 12 months...today the UK seeks to reduce these trade barriers through the collective bargaining position of the EU.”⁴¹
- 11.4. The UK government’s Trade and Investment Balance of Competence Review found that the trade disputes taken to the WTO’s Dispute Settlement Body by the EU disproportionately benefited target UK export markets more than overall EU export markets. It also found that current FTA negotiations would disproportionately benefit the UK compared to the other EU members.⁴²

38. CER, Op cit., p.36

39. Ibid.

40. CityUK, op. cit., p.7

41. KPMG, p.9.

42. CEPR (2013), Trade and Investment Balance of Competence review, study for the department of Business Innovation and Skills, p.8.

- 11.5. Eurosceptics often argue that Switzerland has trade agreements with countries with which the EU does not and that therefore the UK would be better off outside because it could have trade agreements with such countries too.⁴³ Daniel Hannan MEP argues “Being outside the Common External Tariff, they [Switzerland] have pursued a much less protectionist policy than the EU and are now, among other things, negotiating a free trade agreement with China – something Britain cannot do while it is in the EU.”⁴⁴ The inference is that the EU has been a laggard at promoting international trade. This is not the case. It is only since 1995 that preferential trade arrangements have started to proliferate in numbers.⁴⁵ The EU’s objective between 1999 and 2008 was to support multilateral agreements and not the fragmentation of world trade into regional blocs. It is only with the apparently definitive breakdown of multilateral trade agreements at Doha in 2008 that the EU has concentrated its efforts instead into negotiating bilateral trade agreements.⁴⁶
- 11.6. UKIP say that Switzerland has agreements with Canada, China, Japan and Singapore and the EU does not.⁴⁷ In fact, the EU has an agreement with Canada, the agreement with Singapore is going through the formalities of being adopted, and, a Japanese agreement is currently under negotiation. If one examines the terms of the Swiss-Chinese agreement, it is notable how bad the terms are for the European partner.⁴⁸
- 11.7. The key defect of the Swiss-China agreement from a UK perspective is that it provides little greater access to Chinese services markets than those permitted under the WTO agreement, while conversely permitting tariff-free access to the Swiss goods market.⁴⁹ In addition, as the Center for European Reform point out, it is not in practice actually the free trade agreement which UKIP is calling it: “It is not truly a free trade agreement. Switzerland has agreed to eliminate tariffs on the vast majority of Chinese imports immediately. China has promised to reduce tariffs on some goods over a 5 to 15 year period. For example, tariffs on Swiss wrist watches will be gradually reduced from the current rate of 11 per cent to a preferential rate of 4.4% over ten years. The Chinese insisted that there be a review of the agreement every two years, which would allow them to change the terms of the deal.”⁵⁰
- 11.8. UKIP’s analysis does not set out why the EU does not have a trade deal with China. It is not due to the alleged laziness put forward by John Redwood. Instead it may be because the EU would seek fairer terms than China would be prepared to concede. Similarly to the EU, the US does not have a trade deal with China. US government analysts state “It is tempting to group China in the “defensive” school of preferential trading—alongside large and developing economies like Brazil and India that are reluctant to open their borders through preferential trade. They stand opposed to the “offensive-minded” countries that either want genuine liberalization (e.g., the United States and EU) or are forced by their small market size to pursue trade agreements in order to remain competitive (e.g., Singapore and Chile)”⁵¹ The US government analysts viewed the deal between China and Switzerland as economic diplomacy intended to try and put pressure on the EU.⁵²
- 11.9. No evidence is provided by Eurosceptics to support the argument that the UK will be able to secure favourable trade deals with countries with which not only the EU but also the US has been unable to secure favourable trade deals.⁵³

43. UKIP (op cit), p19

44. <http://blogs.telegraph.co.uk/news/danielhannan/100194407/outside-the-eu-we-should-aim-to-copy-switzerland-not-norway/>

45. Horn, Petros and Sapir (2009) Beyond the WTO ? An anatomy of EU and US preferential trade agreements”p.3.

46. <http://www.publications.parliament.uk/pa/ld200708/ldselect/ldcom/200/20009.htm>

47. UKIP (op cit), p19

48. <http://www.seco.admin.ch/themen/00513/00515/01330/05115/index.html?lang=en>

49. Wenfei Attorneys-at-law “A practical guide to the new free trade agreement between Switzerland and China”, December 2013, p.6. For example, one of the few major lauded changes is that Swiss investors in Chinese financial institutions can hold larger minority stakes. However, they are still not permitted to have outright controlling ownership in Chinese companies in which they invest.

50. CER, op. cit, p.34.

51. US-China Security Review Commission, “China’s Trade Ambitions: strategy and objectives behind China’s pursuit of Free Trade Agreements”, Staff Research Report May 2015, p.13

52. Ibid, p.13.

53. The US does not have trade deals with Brazil, China, India or Russia. It is currently negotiating a Pacific trade deal which will include Japan but does not include China. <https://ustr.gov/trade-agreements/free-trade-agreements>

- 11.10. The Eurosceptic argument does not seem to factor in the extent to which outcomes in trade arrangements may depend on relative economic size and power. The UK now accounts for less than 1% of the world's population and less than 3% of its global income.⁵⁴ When we negotiate as part of the EU, we collectively account for 20% of world GDP and are the largest trade bloc on the globe. The description of the Swiss-China agreement is illustrative as to what can happen when smaller economies negotiate with larger ones. The current Chinese embargo of Norwegian salmon exports illustrates what happens when asymmetric size coincides with the larger power prioritizing politics over trade.⁵⁵
- 11.11. Even countries with economies more similar to the UK's are likely to use their relative economic power to force trading concessions that the UK would prefer not to make. For example, the US Trade Representative notes that one of the barriers to trade with which it is concerned is the pricing and access policies adopted by the NHS towards the products of US drugs companies. However, within the EU, the UK's policies are not singled out alone by US pharmaceutical companies. The UK finds itself alongside Austria, Belgium, Czech Republic, Finland, France, Germany, Hungary, Lithuania, Netherlands, Poland, Portugal and Spain.⁵⁶
- 11.12. The UK's Balance of Competence review concluded on the basis of Australian and Canadian experiences of negotiating with the US that US special interests would have a strong effect on trade deal outcomes and the UK could not expect a favourable deal: "The experiences of Canadian and Australian counterparts in their negotiations with the United States should give UK officials pause. Many of the reasons why those negotiations fell short of Ottawa and Canberra's goals would apply to any future US-UK negotiation over a free trade agreement. That US administrations can launch trade negotiations must not be confused with the fact that, in the US constitution, it is Congress that ultimately decides whether, and upon what terms, a trade agreement is approved... There should be no illusions about expecting the latter [a strong non-trade related diplomatic and military relationship with the USA] to "deliver" a high quality FTA that is of significant commercial interest. The parallels to the Australia-US FTA negotiation are evident. A strong security partnership is, as argued earlier, a double-edged sword: it makes not only the launch of an FTA negotiation with the USA more likely but also increases the odds that the UK will be offered a deal on US terms, indeed a deal that the UK will find it hard to reject for fear of harming its overall relationship with Washington. Moreover, given the greater importance of trade and investment to the UK economy than to the US, as their Canadian counterparts discovered, British officials will find themselves disadvantaged during the inevitable haggling by wanting a deal more than their negotiating partner."⁵⁷ In this highly sensitive area, as in many others, it helps that we are part of a larger trading bloc.
- 11.13. Redwood's claim that we have faster growing trade with the rest of the world than with the EU is correct as far as it goes, but it is potentially misleading; it confuses percentage change and levels. If with country 'A' we trade 1 widget in year 1 and 2 widgets in year 2, then we have achieved an impressive 100% increase in trade. If we trade 100 widgets in year 1 with the EU and 104 widgets in year 2, then growth in that trade is only 4%. However, it nonetheless means that our trade in widgets is more than 50 times bigger with the EU than with country 'A'. A concrete example of this is our export trade with India. It increased 59% between 2001 and 2012. And it now accounts for a rather less impressive 1.4% of UK exports. Our largest export markets are, in order, US, Germany, Netherlands, France, Ireland, Belgium, Switzerland, Spain and Italy. Combined, the EU trade far outweighs the US trade: 48% to 13% in 2012.⁵⁸ Only 2.8% of UK exports go to China, and just 6.6% go to the four BRIC countries in total.⁵⁹

54. Dixon, H (2014) "The In/Out question", p.2.

55. <http://www.undercurrentnews.com/2015/03/19/china-warns-of-partial-ban-on-norwegian-salmon-imports/>

56. https://ustr.gov/sites/default/files/European%20Union_0.pdf, p.144

57. CEPR, op. cit, p.85.

58. Treasury Pink Book, cited in Dixon, op. cit.

59. CBI, op.cit, p.9

11.14. In addition, there is no zero sum game between trading with the EU and trading elsewhere. It is precisely the large “home” EU market which gives us scale and inputs to make many UK firms competitive on world markets. A good example is provided by the UK car industry where the large EU home market supports the scale of production which keeps costs competitive. KPMG note that of the 500,000 cars manufactured by Nissan in Sunderland in 2013, only 19% were sold in the UK, 71% were exported to the rest of Europe⁶⁰ and 10% exported to the rest of the world. KPMG state that a similar proportion of production for Honda, Toyota and Vauxhall was exported to Europe.⁶¹

11.15. It is hard to argue that it is EU membership which is holding back our ability to export to the BRICs, since other Member States have a fast growing trade with them. German exports to the BRICs have increased from €27bn to €131bn in 2014, and is the equivalent of just under 12% of German GDP.⁶² The CBI, in their report on “Our global future”, note that this is because the goods in which the UK has comparative advantage: financial and business services and advanced knowledge-based manufacturing are those that are purchased by advanced economies and not primarily by emerging economies.⁶³ Germany on the other hand does have comparative advantage in producing more intermediate goods which are key inputs for a newly industrialising economy: machine tools for industrial production and basic chemicals.⁶⁴

12. Uncertainty effects of leaving

12.1. The length of time it would take to process, decide on repeal or retention, and replace UK legislation/court decisions based on EU law and which currently apply is unknown.

12.2. The length of time it will take to duplicate the FTAs which the EU has negotiated with UK negotiated treaties is unknown.

12.3. This level of uncertainty could only have a large impact on commercial decisions. It would mean businesses would not know under what future regulatory regime they will operate. It also affects historic decisions as commercial decisions already made may have their costs and returns altered by change in their regulatory environment.

12.4. An assumption often made is that UK exporters simply have to consider their relationship with EU customers, conceived of as individual consumers. If the change in circumstances makes sales to EU customers unprofitable, then UK firms could in theory simply find new customers in emerging markets. Leaving aside whether market entry in such markets is feasible, this assumption misunderstands the nature of much of contemporary cross-border trade. In fact, a very large volume of international trade, particularly in advanced economies, consists of trading within complex supply chains.⁶⁵ This trade is subject to contract. Existing contracts will continue to apply and a change in regulatory regime would not trigger force majeure clauses (where they exist). In other words, UK firms would have a material exposure to contracts to which they have already signed up to prior to Brexit and in respect of which they can be legally obliged to deliver/purchase in accordance with the existing terms. This could apply to both exporters and importers. If tariffs and the costs of non-tariff barriers turn profitable pre-Brexit contracts into loss-making post-Brexit ones, firms would still be legally obliged to proceed with them for the duration of the contract. The consequence is that the unwinding process would likely have a chilling effect on both trade and investment.

60. These KPMG figures include Russia in European sales.

61. KPMG (2014) “The UK Automotive Industry and the EU”, p.5.

62. [https://www.kfw.de/PDF/Download-Center/Konzernthemen/Research/PDF-Dokumente-Volkswirtschaft-Kompakt/One-Pager-PDF-Dateien-\(EN\)/VK-Nr.-73-April-2015_EN.pdf](https://www.kfw.de/PDF/Download-Center/Konzernthemen/Research/PDF-Dokumente-Volkswirtschaft-Kompakt/One-Pager-PDF-Dateien-(EN)/VK-Nr.-73-April-2015_EN.pdf)

63. CBI (2014), op. cit., p.30.

64. Ibid, p.30.

65. For example 57% of UK imports consist of intermediate inputs, ibid, p.23.

13. WTO only and effects on business of curtailing EU migration

13.1 The effects of curtailing EU migration would be felt in two respects, with the second likely to have severe and widespread ramifications.

13.1.1. Some businesses competing internationally, such as agriculture or tourism employing a lot of seasonal workers, may in some cases have to cease to trade.⁶⁶ Alternatively, where feasible, they might instead have to relocate to where lower cost labour was plentiful. In the case of agriculture, there might be some pressure for the UK to instead put in place trade barriers.

13.1.2. For the more typical advanced manufacturing or services which the UK trades internationally, the effect of migration limits would be disruption of supply-chain responsiveness. This would risk reducing the comparative efficiency of UK businesses and thus their competitiveness. The reason this could occur relates to the nature of modern production. Few companies produce all the parts of a final good or even a service; rather they specialise in producing the inputs at which they are most efficient.⁶⁷ 55% of international trade now comprise of trade in inputs.⁶⁸ As a result of this web-of-activity, coordination of supply requires a great deal of movement of workers in order to ensure that each part supplier is producing in way that optimises overall production. The producer that conducts the final assembly will be competing with other final suppliers to be the most efficient coordinator of inputs as well as being an efficient producer of whichever components it creates itself. If British firms cannot move around their workforce as required or can only do so slowly, this will compromise their ability to operate at any level in the supply chain.

13.1.3. If the UK opts for a WTO only relationship in order to impose the same rules on migration as it currently applies to the rest of the world, it could have the chilling effect on business described above. Whatever rules the UK imposes on EU nationals will likely be mirrored by exclusionary rules in the EU. KPMG quote a car manufacturer as saying “Our EU staff can travel at short notice if necessary. This is not possible for staff from non-EU countries such as India.”⁶⁸ Car companies need staff to be able to move between cross-border sites. The KPMG report includes the example of BMW. At any time, approximately 10% of the UK management is on an international assignment, with up to 80% of the placements at BMW Group locations across Europe. They note that international movement is particularly important during the start-up of a new production process and give the example of that for the new Mini in 2013 when 140 staff from other parts of the BMW company network were seconded to Oxford and an equal number of UK employees worked temporarily in Germany during key phases of the launch process.

14. The implications of the Eurosceptic case for British agriculture

14.1. In their analysis of the UKIP vote prior to 2009, Whitaker and Lynch found that the party performed disproportionately well in rural areas. The suggestion is that this is due to negative views of the EU’s Common Agricultural and Fisheries policies.⁷⁰

14.2. However, this is not a view backed by the National Farmers’ Union which is very clear that being in the EU is key to the British agricultural sector. For example, Martin Haworth, its deputy director general, said: “In general terms and purely from an agricultural sense, then of course British farmers would be better off inside the EU. For example, if we were outside the EU we would either lose our export markets to Europe, which in some sectors are valuable, or if we negotiated arrangements that allowed us to continue to trade freely we would have to follow rules over which we would have no influence and there would be a serious risk we would have to compete against other European farmers who would continue to have support while we would have none.”⁷¹

14.3. Eurosceptics sometimes argue that the UK ought to leave the EU in order to reduce its support for farmers.⁷² There are a number of problems with this assumption:

66. Guy Poskitt, chairman of the NFU’s national horticulture and potatoes board, farms near Goole in the East Riding of Yorkshire and employs some 180 eastern Europeans out of a workforce of 270 to 280. He says the British workers he has are good but he can’t find enough and describes the eastern Europeans as “fundamental to our business. If we are unable to employ them, we would be in a very dark place indeed. I do not see how we would be able to supply the supermarkets and the shops, the hotels and the restaurants with what they need. We would all be in a very serious position.” <http://www.theguardian.com/uk-news/2015/jun/13/farmers-fear-eu-referendum>

67. For example, a report cited by the CityUK found that only 1.5% of firms in Spain produced all their own inputs in-house. CityUK, op.cit., p.43. The Nissan Sunderland plant for example uses parts from more than 100 input providers in 22 countries.

68. https://www.wto.org/english/res_e/statistics_e/its2013_e/its2013_e.pdf, p.183

69. KPMG, op. cit., p.19.

70. Whitaker and Lynch (2009) “Explaining support for the UK Independence party at the 2009 European Parliamentary elections” Working Paper March 2011, p.4.

71. <http://www.theguardian.com/uk-news/2015/jun/13/farmers-fear-eu-referendum>

72. UKIP(2012) How much does the European Union cost Britain? p. 26 “... the UK devotes too high a proportion of its scarce resources to producing food, when it ought to be allocating those resources to exports (ie exports of manufactured goods and services) and using those exports to pay for cheaper food imports.”

14.3.1. Analyses which assume no ongoing subsidy costs in the UK are assuming that given an exit scenario income support for UK farmers would disappear. (The EU has been estimated to provide up to 60% of UK farmers' income).⁷³ This is politically unrealistic. It is also unlikely that any British government would be prepared to move away from a situation where Britain could potentially be capable of feeding itself if needed. No government could claim that it was impossible to envisage any future situation where there could be a disruption to trade, requiring Britain to be self-sufficient in food.

14.3.2. Any FTA with many emerging markets may require the UK to open its agricultural market fully to the main commerce of an emerging market, which is typically agriculture. Although one might have a picture of subsistence farming in one's mind when thinking of the poorest developing countries, this could give a misleading picture of the effects of free trade in agricultural goods. In many countries, and particularly in Latin America, parts of Africa and Russia, there has been a rise of superscale industrial farming, using advanced IT and cheap labour to maximise competitiveness. The average size of a British farm is 50 hectares. Industrial farms in emerging markets often exceed 10,000 hectares. Brazil is one of the leaders in industrial farming. A Brazilian study cited by the economists Deninger and Byerlee found that farm efficiency falls as farm size rises to 500 hectares but then rises as farms become industrial and the size of the farm reaches 10,000 to 20,000 hectares.⁷⁴ In a genuinely free market in agriculture, British agriculture might find it hard to survive.⁷⁵ There might be an overall economic gain from switching resources out of agriculture and into advanced manufacturing and into services, however it is unlikely that this is what UKIP's rural votes have in mind as one of the advantages of leaving the EU.

15. Why worry about tariff and NTB costs as they only impact on exporting firms?

15.1. UKIP argue that only some businesses are involved in exporting so why should we accept rules being placed on all businesses. UKIP argue that the "exact proportion of the British economy exporting to the EU was 11.1%" in 2008⁷⁶ and "100% of the economy and business are subjected to EU regulation irrespective of whether they trade with the EU or not – and of course about 89% don't trade with the EU".

15.2. These statements could easily mislead the reader, so it is worth clarifying some issues.

15.2.1. Roughly 18% of the value of British economy consists of government services. So 11.1% exports to the EU is in fact about 20% of production in the non-government sector.

15.2.2. As explained in section 11.13 above, the large EU market allows UK firms to develop the scale that allows them to sell exports to the rest of the world and this means that EU membership is important for almost 40% of production in the non-government sector.

15.2.3. In addition, while only a smaller number of firms may export final products, they will typically have a much longer supply chain. To be part of the supply chain, all participants need to be compliant with rules. If the rules are not uniform, this imposes costs on businesses, particularly SMEs, if they are having to operate to dual specifications and that cost may then prevent them from participating. Only a handful of UK car companies export finished cars to the EU, but the industry as a whole is in favour of operating to a single set of European rules because there are a further 2350 companies in the UK, employing 700,000 people, in the supply chain.⁷⁷

73. <http://www.theguardian.com/uk-news/2015/jun/13/farmers-fear-eu-referendum>

74. <http://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-5588>

75. US figures indicate that US and New Zealand farming are more strongly placed. <http://www.ofc.org.uk/files/ofc/papers/ofcreport2015.pdf>, p.15

76. UKIP(2010) "How much does membership of the European Union cost Britain"(2010) p.32

77. KPMG, op.cit, p.1.

15.2.4. The benefit of EU trade feeds back into the UK economy too by lowering costs and expanding the range of services available to British businesses and consumers. For example, British Telecommunications (BT) is the leading provider of telecommunications services to cross-border multi-site businesses in the EU. Their customers include household names headquartered in other Member States including BASF, BMW, BNP Paribas, Carlsberg, Crédit Suisse, Deutsche Post, E.ON, Eni, Fiat, L'Oréal, Novartis, Renault-Nissan, Scania, Société Générale, Solvay, Tetrapak; UBS, Unilever, Volvo and international European institutions such as NATO, the European Space Agency and the European Commission itself. The bulk of BT's business services division, Global Services, revenues are earned in the UK but they are earned as part of a cross-border network. The shared costs, personnel and systems mean that BT's Global Services is more competitive and can offer better services in both the UK, elsewhere in the EU, and, globally. EU regulation ensuring BT has access to other European markets is key in making this feasible.

15.2.5. The statement that 100% of the economy and business is subjected to EU regulation would also be potentially misleading if it led a reader to think all businesses were subject to all EU regulation. Most regulation in the EU is very specifically focused on aspects of particular sectors. For example, a decision on harmonising aspects of rail safety so that freight trains can cross borders does not impose any regulation except on train operators and track providers. On the other hand, it does potentially positively affect many businesses by increasing the viability of rail freight as an alternative to road haulage.

15.2.6. Exporting firms are typically the most successful and productive firms in an economy and their activities drive development in the rest of business. If exporting firms are stifled, the repercussions would quickly be felt in the rest of the economy. In the case of the UK, it is estimated that 60% of UK productivity growth in the period 1996-2004 was generated by exporting firms, with exporters experiencing average productivity of 1.27% a year compared to 0.8% for non-exporters.⁷⁸

78. CityUK, op. cit, p,14.

Chapter Five

UK Free Trade Agreement

1. Eurosceptic comment

Eurosceptics sometimes argue that even if the Swiss or Norwegian arrangements are not quite suitable that we should nonetheless leave the EU as there will be no difficulty in the UK securing a preferential Free Trade Agreement ("FTA") with the EU from outside.¹

2. Comments by others

2.1. The CityUK "What is clear is that business would be better off in the EU ... Even an ambitious Free Trade Agreement [with the EU], similar to the one envisaged with the US (the Transatlantic Trade And Investment partnership, or TTIP), is estimated to lead to a fall in UK exports equivalent to 1.24% of UK GDP p.a."²

2.2. The CBI's view is that " ... the UK is more dependent on the EU for its trade than the EU is on the UK – around half of the UK's total trade is with the EU while just 8% of EU trade is with the UK. The fact that Britain happens to run a deficit in exports with the rest of the EU is of little relevance compared to its overall dependence, in absolute and relative terms, on access to the European market... The UK would not, therefore, be able to sign a UK-EU FTA that brings all the benefits with none of the costs"³.

3. Leaving negotiation

3.1. The key point is that the leaving negotiation is not the same as setting the long-term relationships between the remaining Member States and the Member State which is leaving. Once the leaving process is initiated, the leaving Member State will have left before the long-term relationship is negotiated. The agreement which must be concluded within two years of the demand for leaving being lodged is simply that which is necessary to achieve an efficient unwind of the existing membership.

3.2. The efficient unwinding agreement could, but would not necessarily, include transitional trading arrangements until an FTA was agreed. The reason it might not is because the remaining Member States and the leaving Member State might be unable to agree terms, in which case the relationship would default to the "WTO alone" trading relationship.

3.3. An exiting Member State cannot participate in discussions amongst the other Member States or European Parliament or in any votes regarding the terms of agreement.

3.4. The remaining Member States can agree to extend the 2 year negotiating period if they wish.

3.5. The terms of agreement for leaving must obtain consent in the European Parliament and a qualified majority in the Council.

3.6. If a country which has left decides that the subsequent terms for an FTA are not as good as the relationship it had as a Member State, it cannot withdraw the application to leave as it would have already left. Instead, it would have to apply to re-join the EU as if it were a new member, a process that is subject to unanimity.

1. John Redwood MP to the House of Commons "...our trade is not at risk, whether we stay in or leave. There is no need to accept my word for that-I am sure that many people will not-but they may accept the word of the German Finance Minister, who has very clearly stated that he would like Britain to stay in, but that if we leave, of course Germany would want to trade with us on the same terms as she currently does. And why is that? It is because Germany sells us twice as much as we sell her." Hansard 9 June 2015, Vol. 596, No13, 1101.

2. The CityUK (2014) "Analysing the case for EU Membership. How does the Economic Evidence Stack Up?"

3. CBI (2014) "Our global future: the business vision for a reformed EU", p.17.

4. Process of agreeing a new FTA with UK

- 4.1. In principle under the Lisbon Treaty, trade agreements are the exclusive competence of the EU and are agreed by qualified majority and a simple majority voting in the European Parliament.
- 4.2. If an agreement is considered of 'mixed' competence then it must also be approved by national parliaments. An agreement is of mixed competence if it covers issues that are the exclusive competence of the EU and issues that are within the competence of the individual Member States or where competence is shared between both.
- 4.3. Mixed agreements require unanimity in the Council and agreement by each national parliament.
- 4.4. Up until Lisbon, trade agreements have usually been considered mixed. If it is considered politically important, the House of Commons Library notes that the EU has treated agreements as mixed even where strictly this is probably not the case: "there are situations in which EU Member States insist on the mixed character of the agreement for political reasons, even if from a pure legal point of view there is no need to make the agreement mixed".⁴ The same note gives the EU-Turkey Association Agreement as an example.
- 4.5. Recent European legal cases would suggest that since Lisbon a trade agreement with the UK could fall within the exclusive competence of the Union and would not be considered as falling within shared competence and thus constitute a mixed agreement.⁵ It could in this light not require unanimity.
- 4.6. However, the UK balance of competences review on trade and investment notes that the scope of the EU's exclusive competence as defined in the Treaty omits agriculture and fisheries which implies that a trade agreement including them would be "mixed".⁶
- 4.7. In addition, national parliaments have been vociferous in arguing that trade agreements continue to be mixed. This includes the UK Parliament which sent a letter jointly with 19 other national parliaments to the European Commission in 2014 stating:

"The chairs of relevant committees in national parliaments who are signatories to this letter believe that free trade agreements should be considered as mixed agreements, since they contain provisions that concern policy areas which are within the competences of the member states. For CETA [the Canada-EU Trade Agreement], as well as TTIP (as well as can be foreseen at this stage), this is the case for certain elements of policy areas such as services, transport and investor protection. In the case of a mixed status, all Member-States, namely through their national Parliaments, have to ratify the agreement. In view of the important role national parliaments have in the democratic decision making process of the EU, we feel that it is of great importance that trade agreements such as CETA and TTIP are ratified by the national parliaments."⁷
- 4.8. In addition, even if a trade agreement is not considered to be mixed and falls within the exclusive competence of the EU, it may still require unanimity to be approved.
 - 4.8.1. Article 207(4) (a) and (b) of the Treaty on the Functioning of the EU ("TFEU") provide that trade agreements which include certain services may require an agreement to be agreed by unanimity.⁸ Such services would be included in an FTA unless they were expressly excluded. Whether unanimity is required is subject to the qualification that such an agreement must risk prejudicing national culture or national organisation of such services. The tests for assessing these risk are undefined. A Member State that wished for a trade agreement with the UK to be subject to unanimity or wished to exclude British broadcasting products and services would have scope to argue that unanimity should apply – and at the very least could use this for delay and hence leverage in talks.

4. Quote from The law of EU External relations: cases, material and commentary on the EU as an international legal actor" (2013) Kuijpers, Wouters, Hofmeister, de Baere, Ramopoulos cited in House of Commons Library Briefing paper CBP 7192, 19 May 2015 "EU external agreements: EU and UK procedures", p.11.

5. In light of the revisions made by the Lisbon Treaty and two important rulings of the European Court of Justice, it seems clear that the Common Commercial Policy now more clearly extends to services than previous opinions of the CJEU (Opinion 1/94) suggested. Once the Court concludes that the agreement pursues an objective with a specific connection to the Common Commercial Policy, it will be regarded as legitimately within the scope of the EU's competence under Article 207 TFEU. The fact that it is also related to the internal market does not justify the use of Article 114 TFEU as a legal basis (see Case C-137/12 Commission v Council). This shift in position was signalled in Case C 414/11 Daiichi Sankyo and Sanofi-Aventis Deutschland [2013] ECR

6. Centre for Economic Policy Research (CEPR) for BIS (2013) "Trade and Investment Balance of Competence review", p.13

7. http://www.ttip2014.eu/files/content/docs/Full%20documents/Letter_to_Mr_De_Gucht_-_role_of_national_parliaments_in_free_trade_agree..._181-238913.pdf

8. Article 207 states that; "The Council shall also act unanimously for the negotiation and conclusion of agreements: (a) in the field of trade in cultural and audiovisual services, where these agreements risk prejudicing the Union's cultural and linguistic diversity; (b) in the field of trade in social, education and health services, where these agreements risk seriously disturbing the national organisation of such services and prejudicing the responsibility of Member States to deliver them."

4.8.2. It may be unclear whether A 207(4)(a) and (b) apply to a trade arrangement with the UK. It may be more likely that a second and further limb of A 207(4) does apply. This states that “the Council shall act unanimously where such agreements include provisions for which unanimity is required for the adoption of internal rules”.

4.8.3. Internal rules requiring unanimity include:

- Harmonisation of national legislation on indirect taxation;
- EU finances (own resources, the multiannual financial framework)
- Certain provisions in the field of justice and home affairs (the European prosecutor, family law, operational police cooperation, etc.)
- Harmonisation of national legislation in the field of social security and social protection.

4.8.4. It may be possible to exclude most of these from an agreement between the UK and the EU. However, it is unlikely that an FTA can exclude provisions relating to a financial contribution.

4.9. If the UK seeks an association agreement rather than just a FTA then the voting basis is unanimity. An association agreement would be required if the UK wanted to maintain its membership of Common Foreign Security Policy, elements of Justice and Home Affairs or agreements around research funding.

5. Why do arcane voting rules matter?

5.1. Eurosceptics sometimes claim that it would be easy to negotiate a better deal with the other Member States.⁹

5.2. However, given the discussion in section 4 above, it is highly likely that any agreement will require unanimity. If unanimity applies, we can assume that particular demands of the eurosceptics, were they incorporated in any draft agreement, would have to pass through each individual Member State’s national parliament. In other words, a move to disapply the social chapter would, inter alia, have to get through the French parliament and a move to disapply the free movement of people, would, inter alia, have to get through central and eastern European parliaments. One might suspect that regardless of economic cost, it might be politically impossible to achieve this. In addition, the economic cost for a number of countries of the absence of a deal with the UK is low. For example, France’s current trade surplus with the UK is 0.2% of GDP and Bulgaria, Croatia, Romania and Slovenia have trade balances that are less than 0.5% of GDP.

6. Even if the voting basis is qualified majority voting, are we certain to get a good deal?

6.1. The claim is that the UK has an excellent negotiating position because (i) the UK has a trading deficit with the EU, and, (ii) Germany wants to keep the UK in the EU to balance against the less liberal Member States. The weaknesses with this argument are:

6.1.1. The assessments of likely trading losses indicate that the failure to achieve a deal will damage the UK economy more than the economies of the other Member States. With the exception of some smaller Member States, a report by the Bertelsmann Stiftung estimates that UK losses would be between eight to ten times as great as for the UK as for other large Member States (France, Germany and Italy).¹⁰

6.1.2. Our trade deficit in 2013 was £66bn with the EU. In fact this is remarkably similar to Switzerland’s deficit of roughly £63bn.¹¹ The EU has not agreed and has no current intention of adopting a services agreement with Switzerland.¹²

9. See footnote 1 above.

10. Bertelsmann Stiftung (2015) “Brexit- potential economic consequences if the UK exits the EU”

11. Euro 89.1bn in 2013, according to the EU Commission web-site: <http://ec.europa.eu/trade/policy/countries-and-regions/countries/switzerland/>

12. See the Switzerland chapter.

6.1.3. The analysis of the trade surplus as an “EU” surplus ignores the way that decision-making is conducted. While the estimated losses for some Member States in terms of lost GDP if the UK were to leave are high (although lower than the UK’s), for other Member States the estimated losses are low. Germany is an important Member State but so are France and Italy. While Germany’s trade surplus is 1% of GDP, France and Italy’s are 0.2% and 0.3% respectively. The UK also has trading surpluses with a few Member States.

7. Length of process of unwinding EU arrangements in the UK

7.1. Unwinding the relationship with the EU will take a substantial amount of time and create serious legal uncertainty as the outcome cannot be known ahead of time.

7.1.1. Swiss negotiations for the first package trade agreement took six years. The UK negotiations will be more complex.

7.1.2. The interim arrangements prior to an agreement after exit and before a trade agreement are also unknown: these can also take up to 2 years (or longer, as per 3.4 above) after the announcement of a Brexit to negotiate.

7.1.3. If the UK did not intend to simply adopt EU rules despite exiting, then UK negotiations will be more complex – as unlike the Swiss situation, the UK and EU legal regimes and political economy have been intertwined for 40 years. The UK would need to work out which laws, regulations, decisions by the Commission and other European Agencies, and Court decisions or parts thereof it wished to disapply.

7.1.4. The length of time it will take to process, decide on repeal or retention, and replace UK legislation/court decisions based on EU law and which currently apply is unknown.

7.1.5. The length of time it will take to duplicate the FTAs which the EU has negotiated with third countries is unknown.

7.2. In general, the Eurosceptic literature contains no discussion of how an unwind would take place and what might be the economic consequences of delay and uncertainty in that process. Mansfield’s paper is a welcome exception in that sense.¹³ However, what remains of concern in his paper is the unavoidable vagueness with which the issue is approached. The paper contains, inter alia, the following propositions in order for a successful Brexit:

7.2.1. It is vital for national prosperity that the UK secures full access to the Single Market immediately upon Brexit.¹⁴

7.2.2. The UK should not seek an inclusive arrangement like EEA membership but instead negotiate individual bilateral sectoral agreements with the EU, depending on the extent the UK is willing to accept the existing EU rules in each sector.¹⁵

7.2.3. The UK identify within 3 years the areas of EU law forming part of UK law in each sector which the UK considers unacceptable.¹⁶

7.2.4. The UK negotiate replacement trade deals with countries which have trade deals with the EU and new ones with BRIC countries. The paper notes that the UK civil service currently has no trained capacity to carry this out.¹⁷

13. <http://www.iea.org.uk/brexit>. For a more detailed review, see p.48 of chapter 6.

14. Mansfield p.47

15. Ibid, p.31-2

16. Ibid, p.30-32

17. Ibid, p.40

7.3. Purely on a process analysis, these proposals are open to criticism. In particular, 7.2.2. and 7.2.3. are not likely to occur simultaneously. The UK cannot negotiate bilateral sectoral deals while it does not know what it wishes to achieve and it cannot know the latter until it has worked out how much of EU law it wishes to retain in each sector. Indeed, Mansfield suggests that the UK undertake a three year assessment process of what it wishes to retain, whereas the EU timetable for exit is two years after notice of leaving. In addition, no explanation is provided as to how the UK will be able to administratively cope with conducting a deal with the EU within three years while simultaneously conducting a major set of trade negotiations with other countries.

7.4.1. This level of uncertainty cannot but have a large impact on commercial decisions. It means businesses do not know under what future regulatory regime they will operate. It also affects historic decisions as commercial decisions already made may have their costs and returns altered by change in their regulatory environment. No assessment of these costs are made in the Mansfield paper.

7.5. It should be noted that an assumption that is often made is that UK exporters simply have to consider their relationship with EU customers, conceived of as individual retail consumers. If the change in circumstances makes sales to EU customers unprofitable then UK firms could in theory simply seek to find new customers in emerging markets. Leaving aside whether market entry in such markets is feasible, this assumption misunderstands the nature of much of contemporary cross-border trade. In fact, a very large volume of international trade, particularly in advanced economies, consists of trading within complex supply chains. This trade is subject to contract. Existing contracts will continue to apply and a change in regulatory regime would not trigger force majeure clauses (where they exist). In other words, UK firms will have a material exposure to contracts to which they have already signed up to prior to Brexit and in respect of which they can be legally obliged to deliver/purchase in accordance with the existing terms. If tariffs and the costs of non-tariff barriers turn profitable pre-Brexit contracts into loss-making post-Brexit ones, firms are still legally obliged to proceed with them for the duration of the contract. This could apply to both exporters and importers. The consequence is that the unwinding process would have a chilling effect on both trade and investment as it could radically alter the cost of existing business.

8. Eurozone

8.1. An argument given for leaving is that the Eurozone members may form a caucus and overrule the UK on internal market matters. In particular Eurosceptics point to the greater integration measures outlined in the 'five presidents report' on the future of fiscal and economic coordination in the Eurozone.¹⁸

8.2. While it is true that on macro-economic issues, such as budget rules, the Eurozone appears to be moving in the direction of more coordination, it is far from clear that this will have much impact on micro-economic issues relating to the internal market.

8.3. There is limited evidence to date that Member States are forming a caucus on micro-economic issues:¹⁹ where it has occurred is in relation to prudential regulation of financial services, a policy making area in which tensions between micro and macro economic concerns can impact on policymaking (and there can be tensions between policymakers at national level depending on their respective areas of focus, just as much as between countries at EU level).²⁰ More generally, the Eurozone members continue to have divergent economies and divergent policy approaches. In very general terms, and on a fluid basis, there is a more liberal "northern" and a more protectionist "southern" group – where the former tend to be more sympathetic to UK policy objectives and the latter less. There is no evidence that agreement on macro-economic budgetary disciplines will lead, say, French and German policy-makers to have the same views on, for example, the content of regulation of rail services.²¹

18. http://ec.europa.eu/priorities/economic-monetary-union/docs/5-presidents-report_en.pdf

19. The UK's Permanent Representative to the EU, Sir Jon Cunliffe, told the Foreign Affairs Committee in February 2013 that: "In most areas, the alliances that countries make across different dossiers do not reflect the eurozone. Across the single market, some of the alliances can be very strange, but in agriculture, fisheries, single market, foreign policy and justice the alliances are very different. They are very dossier-specific. But the countries that normally group around what I call the northern economic liberal alliance look to the UK, Sweden, Denmark—all of them noneurozone countries—to be part of those alliances when they come to single-market issues such as trade. There is no evidence of caucusing around that. Indeed, from the start of the euro, the evidence has been that those countries very much want non-euro countries of similar mind in the discussions, because it adds weight—particularly the UK, because we are a large and influential member state." Corrected transcript of evidence to FAC, The Future of the European Union: UK Government Policy, 6 February 2013

20. <http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech733.pdf>

21. There is considerable variation in the openness of national rail systems, see for example http://www.deutschebahn.com/file/en/2236568/YJd5cVRPglkCOx1MfSPleGQfX4/2236524/data/study_rail_liberalisation_index_2011_presentation.pdf, p.13

- 8.4. If the UK leaves, it weakens the voting power of the “northern” liberal group.
- 8.5. Once the UK leaves the EU, it is irrelevant for the purposes of forming a voting bloc to support or block a particular proposal. It is not therefore possible to see the logic as to how leaving the EU improves the risk of a caucus with respect to Single Market measures, which will continue to apply to UK firms if there is to be trade with the EU.

9. Trade with rest of world

- 9.1. The issues in respect of obtaining FTAs with the rest of the world will be the same as in the WTO case.
- 9.2. Exports to the EU would be subject to Rules of Origin regulation. The compliance costs are estimated as adding 8% to the price of UK exports.²²

10. What terms could be expected in a UK-EU FTA?

- 10.1. The EEA-EFTA countries and Switzerland obtained access to the single market to the extent to which they signed up for the existing acquis. Where there was no mechanism to automatically update the non-Member State’s legislation to maintain “equivalence” then access to the single markets for goods would be subject to the exporter obtaining certification to say they met EU standards.
- 10.2. The EU may or may not agree that establishing equivalence is sufficient for UK service providers to trade into the EU. Assessing equivalence is time consuming and costly. Even if the EU did agree to this in general, there are important cases (particularly for the UK) where it is highly unlikely that scope to demonstrate equivalence would be granted. Banking, retail fund management and data storage service providers are required to be established in the EU if they wish to trade in the EU.
- 10.3. Switzerland was required to sign up to the free movement of people despite its objections (and it was an integral part of the EEA-EFTA deal). This agreement took place prior to the accession of the central and Eastern European countries with economies which are substantial beneficiaries of free movement of people. Note the discussion above about voting rules which suggests that these Member States will likely have to each individually approve any UK-EU FTA.
- 10.4. The EEA-EFTA and Switzerland have to make substantial contributions to EU funds.
- 10.5. EEA-EFTA and Switzerland are not part of the CAP or CFP or monetary aspects of the EU.
- 10.6. The likely need to obtain agreement from each Member State may make it particularly unlikely that any UK move to obtain opt-outs on the social chapter or free movement would meet with success.
- 10.7. Giving the UK a better deal than Switzerland would undermine the EU intention to move the Swiss agreement in the direction of EEA and undermines the EEA Agreement. It also potentially provides support for arguments of parties like the Front National in France which want their Member State to exit the EU. This decreases the likelihood that other Member States will give the UK an a la carte option.
- 10.8. It is unlikely that the UK would be allowed to join the EEA. It may be more likely that it would be offered an EEA type deal but with a guillotine rather than the right to exercise any opt-outs.

22. The CityUK (op. cit) p.33.

- 10.9. As discussed above in section 6, the bargaining power of the UK in this negotiation is weaker than the bargaining power of the other Member States collectively.
- 10.10. In other words, the likely terms of an FTA will from a business perspective turn the UK into a rule-taker. In addition, there is a risk that it may be unable to trade many key service exports at all. Note that a simple goods agreement, excluding services, would likely improve the balance of trade for many Member States vis-à-vis the UK and would likely benefit Paris and Frankfurt as financial capitals against London.

Chapter Six

Cost-benefit Analysis of EU Membership for the UK

1. Introduction

- 1.1. The review in the earlier chapters of this report of the different proposed alternative options to EU membership suggested that these alternative models would impose costs on UK businesses that would reduce their competitiveness. Our view is that this reduction in competitiveness would have negative effects on the wealth of the UK.
- 1.2. We acknowledge that a reduction in competitiveness and thus of business contribution to the UK economy is not the only effect that the EU has on the UK's overall wealth. The reduction could, in theory, be counterbalanced if the gain of no longer contributing to the EU budget, or avoiding other costs, equalled the lost benefits of production.
- 1.3. A number of quantitative studies have been attempted to calculate the costs and benefits of staying in the EU. We set out below our comments as to the strengths and weaknesses of these analyses. These critiques are informed by the same points we make about trade and investment in the preceding chapters.
- 1.4. It should also be noted that none of the quantitative assessments can directly scientifically test the proposition as to whether the UK is better off inside or out of the EU. This is unavoidable as exit is not something that has occurred to the UK or to any set of comparable countries. Doubts as to the definitive nature of any quantitative assessment have also been made by the House of Commons Library:

"There is no definitive study of the economic impact of the UK's EU membership, or equivalently, the costs and benefits of withdrawal. Framing the aggregate impact in terms of a single number, or even irrefutably demonstrating that the net effects are positive or negative, is a formidably difficult exercise. This is partly because many of the costs and benefits are, in certain respects, subjective, diffuse or intangible; and partly because a host of assumptions must be made about the terms on which the UK would depart the EU, and how government would fill the policy vacuum left in areas where the EU currently has competence. Any estimate of the effects of withdrawal will be highly sensitive to such assumptions, and can thus be embedded with varying degrees of optimism. This perhaps helps to explain why the wide range of estimates from the EU cost-benefit "literature" can appear influenced by the prior convictions of those conducting the analysis."¹

- 1.5. Our assessment commences with quantitative assessments produced by authors who make the case for leaving. We then review papers from authors making the opposite case. Finally, we draw some general conclusions.

2. Eurosceptic Cost Benefit Analyses

- 2.1. *Tim Congdon "UK Independence Party: How much does the European Union cost Britain?" (2013)*
- 2.1.1. Congdon estimates the combined annual direct and indirect costs of EU membership amounts to £165 billion a year or 11% of GDP. The table below summarises his assessment. Our comments are not included in this table. The first column contains the heads of cost. The second column contains the percentage cost in terms of GDP of the cost category. The third column summarises the argument provided by the author regarding the cost estimate.

1. House of Commons Library, "The Economic Impact of EU Membership on the UK" SN/EP/6730 of 17 September 2013, p.5.

Nature of Cost	% of GDP	Rationale provided by Congdon
Direct fiscal cost	1 ¼	Relatively easy to quantify from official publications and balance-of-payments data; concept is of gross payments to EU institutions over which UK government has no further control
Costs of regulation	5 ½	Reduced employment due to “Social Chapter”-type legislation, cost of renewables agenda and financial regulation, businesses closed because of substance and procedure regulations
Costs of resource misallocation	3 ¼	CAP long recognised to cause large resource misallocation. This may now be only ½% of GDP, but other EU protectionism estimated by Minford et al 2005 to cost further 3% of GDP
Cost of lost jobs	3/8	Open UK labour market from 2004 allowed 700,000 Eastern Europeans to the UK, taking away jobs of over 100,000 UK-born people, labour market soon to open to Bulgaria and Romania
Costs of waste, fraud and corruption	¼	CFP involves fish discard and effective “gift” to other nationals of fishing rights in UK territorial waters, but costs under 0.1% of GDP. Waste under pillar 2 of CAP; waste of over-prescriptive water standards; abuse of UK student loan system
Unforeseen commitments	¼	Costs of “benefits tourism”, plus some allowance for possible recapitalization of EIB and other EU institutions

2.1.2. The section below analyses these claims in turn

2.1.2.1. Direct fiscal costs

According to the objective House of Commons Library, the net contribution made by the UK government to the EU in 2011/12 was 0.5% of GDP.² Congdon elects to use the gross figure prior to agriculture payments to UK farmers and development funding paid to UK regions. UKIP argue excluding these figures is reasonable since the EU spends the money and it is not subject to UK discretion. This is not constitutionally accurate since the UK is a member of the Council and its MEPs in the Parliament have to agree the budget. In any event, the effect on UK GDP is not accurately portrayed since it excludes receipts to the UK.

As a comparison, it is worth noting that the net cost has been estimated as the sixth highest per capita level after Sweden, Denmark, Finland, Germany and the Netherlands.³

2. A figure which is predicted to fall to 0.4% of GDP per annum from 2017/18.

3. CBI “Our global future”, p.75.

2.1.2.2. Cost of regulation

2.1.2.2.1. The assumption which is made in this paper appears to be that regulation is only a cost. In fact, as examples provided in section 6.8 of chapter 4 illustrate, regulation is not simply a cost, it can be a market-making rule. Market-making rules including standards are the primary activity of the EU. While individual market-making rules may be designed well or poorly, it is implausible to assume that the majority are loss-inducing. No sensible figure can be included in this column unless it records the net costs or net gains from regulation. To give a concrete example, the approach adopted by Congdon would require us to attribute the costs for Scotch Whisky producers of EU rules on bottle-size and labelling as a negative. While compliance does have a cost, two issues have to be borne in mind (i) Scotch whisky producers would still have to make bottles and label them absent EU rules and potentially in compliance with UK regulation and (ii) it is precisely EU harmonisation which means that Scotch whisky producers can produce for a “home market” of 500 million people using one set of product standards and avoiding any idiosyncratic national rules which acted as a barrier to their products.⁴ Even an example of regulation which more obviously gives rise to a cost for a set of businesses in a sector may also give rise to benefits which mean there is not a net cost to the economy as a whole or, alternatively, a lower overall cost. For example, Congdon repeats that Open Europe cite the Temporary Agency Workers Directive as one of the most costly EU regulations, costing £1.9bn a year.⁵ But, as Open Europe also recognise but Congdon does not, the UK government’s Impact Assessment finds that some £1.4bn of that “cost” to affected industries consists of higher wages which are of benefit to the employees affected and also for the further firms whose goods and services would be purchased by those higher wages.⁶ Hire wages redistribute income but do not necessarily lead to any reduction in UK GDP.

2.1.2.2.2. The only systematic evidence that has been produced found that the average benefit/cost of EU legislation adopted between 1998 and 2009 in the UK and measured by Open Europe was 1.02.⁷ In other words, the average ratio of economic gains to losses from adoption of new legislation was positive and gains outweighed the costs by 2%. However, in this specific period 1998–2009, 40% of EU legislation was employment and environmental legislation and this may explain why it gave rise to relatively low economic gains. In any event, overall, since such systematic evidence exists, provided by Open Europe, Congdon cannot claim a net cost of regulation at all. Impact assessments provide a net figure after summing the respective economic costs and benefits of a measure. Simply adding up all the costs and ignoring the benefits cannot provide a measure of the overall effect on GDP.

2.1.2.2.3. As discussed in the previous chapters, the argument that the UK can avoid EU regulation by leaving the EU is not correct.

2.1.2.2.4. Even if, hypothetically, the UK could leave the EU and avoid EU regulation, it would still be likely to regulate in many of the areas in which the EU regulates. For example, a large proportion of the £2.6 billion per year gross cost to UK business of the Working Time Directive is the result of employees being entitled to paid annual leave. The CBI is sceptical that were the UK to leave the EU that there would be an appetite to remove such a legal requirement.⁸ Indeed, in many areas of EU regulation, including airlines, electricity, financial services, gas, rail and telecoms, the general EU approach has been copied from practice in the UK in the first place.

2.1.2.2.5. There is no recognition that this regulation supports the single market and no figure representing the benefits of participating in the Single Market. Presumably this reflects the Eurosceptic contention that the UK, like Switzerland and Norway could participate in the Single Market without being subject to EU legislation: a contention that chapters 2 and 3 above make clear is simply not true. The correct figure under this heading should probably be a positive rather than a negative one.

4. Next, made a similar statement to the UK Balance of Competence Review: “Harmonisation of regulation across the EU (in certain defined areas only) is necessary for the internal market to function effectively.

Next may not agree with the detail and manner of implementation of some of the regulation derived from the EU (which can be both burdensome and expensive to comply with) we need to balance this against the benefit to Next of having a single set of rules which apply across the EU”. HM Government Review of the Balance of Competences between the United Kingdom and the European Union. The Single Market (2013) p.41.

5. <http://archive.openeurope.org.uk/Content/documents/Pdfs/stilloutofcontrol.pdf>, p.9

6. http://www.legislation.gov.uk/ukxi/2010/93/pdfs/ukxiem_20100093_en.pdf

7. <http://openeurope.org.uk/intelligence/economic-policy-and-trade/still-control-measuring-eleven-years-eu-regulation/>

8. CBI, op. cit., p.71. Our view would be that the effect on employee incentives from removing the paid leave currently required by EU law would likely reduce employee productivity not increase it.

2.1.2.3. Costs of resource misallocation

2.1.2.3.1. To allocate the costs of protecting UK agriculture to misallocation is to make a strategic decision to abandon agriculture. It is unlikely that any UK government would do this. There does not appear to be any assessment of what the net difference in cost would be between EU support mechanisms and any hypothetical UK support mechanisms.

2.1.2.3.2. The author takes the view that the EU obstructs reductions in tariffs and maintains non-tariff barriers. However, the reality is that the EU also negotiates free trade agreements to reduce both. It is far more feasible for the UK to achieve free or at least fairer trade as part of a larger market of 500 million people to which other countries want access.

2.1.2.3.3. Minford et al. take the view that all UK tariffs should move to zero and that this would be a net benefit. The essence of the argument is that because the tariffs UK producers paid abroad would stay the same, consumers would be better off since imports would be lower cost. See discussion on Minford et al at 2.3. below as to potential criticisms of this argument.

2.1.2.3.4. No assessment is included of the beneficial effects of foreign direct investment into the UK from outside the EU intended to avoid EU barriers, benefit from participation in EU supply chains, and export into the EU.

2.1.2.3.5. There may be areas where special industrial interests in the EU are able to impede the agreement of lower tariffs which the UK would favour. However, a systematic analysis of where this is the case would need to be presented, rather than a limited number of examples. Equally, it may also be the case that EU membership prevents some UK companies from achieving tariff protection or other forms of regulatory protection from UK politicians at the expense of UK consumers.⁹

2.1.2.3.6. There may well be a cost for misallocation of resources compared to a theoretical universal free trade model. However, it should be noted that when the current suite of EU trade negotiations are completed, they will cover 85% of UK exports.

2.1.2.4. Cost of lost jobs

2.1.2.4.1. The official research which Congdon cites does not support his argument that EU migration has led to a loss of native jobs. It found that in the period 1995-2010 that migration from outside the EU did lead to a loss of jobs on the part of British-born citizens during economic downturns but specifically that migration from the EU did not.¹⁰ Congdon argues that both types of migration ought to have the same effect, even though the statistical analysis found that they did not. This is a complex area and there could be differences between non-EU and EU migrants in respect of their differential impacts on growth through, inter alia, differential facilitation of specialisation and knowledge transfer; differential impact on employment and employability of UK workers; differential impact on public services; and, differential congestion impacts on transport and housing. One explanation could be education, EU migrants tend to be more highly educated than non-EU migrants and British-born.¹¹ To give another possible micro example of differentiation, if EU migrants participate in the construction industry more than non EU migrants this would have a differential effect, as employment here is estimated to lead to roughly one-for one job creation in other UK sectors.¹²

9. Historically, EU competition law has been more effective at protecting the consumer interest than UK competition law, Scott, A (2009) "The Evolution of Competition Law and Policy in the UK", LSE Law, Society and Economy Working Papers, 9/2009.

10. <https://www.gov.uk/government/publications/analysis-of-the-impacts-of-migration>, p.113

11. <http://www.theguardian.com/uk-news/2014/nov/05/eu-migrants-uk-gains-20bn-ucf-study>

12. In construction, it is estimated in the UK that 233,000 construction jobs induce between 191,310 and 235,630 jobs in the wider economy <http://nlpplanning.com/uploads/ffiles/2015/03/774691.pdf>, p.15

2.1.2.4.2. A net assessment of the costs and benefits of the EU for British-born citizens should presumably also take into account the number of British people who have found jobs elsewhere in the EU. Congdon suggests that EU migration ought to have led to the loss of jobs for 135,000 British-born citizens between 2005 and 2010, even though the official evidence says this is not the case.¹³ There are no comparable figures available for the effects of British people emigrating to the rest of the EU. However, the figures available do indicate that 2.2 million British people may live in the rest of the EU, and, up to 1.8 million of them may be of working age.¹⁴ An objective assessment would attempt to construct a methodology for assessing the benefits to Britons of jobs abroad and netting this of against job losses in the UK and this has not been attempted.

2.1.2.4.3. The evidence does not suggest there is an overall cost.

2.1.2.5. Costs of waste, fraud and corruption

2.1.2.5.1. A scientific methodology would consist of an estimate of the costs of waste, fraud and corruption for comparable UK and EU policies and a calculation of net cost or benefit across the piece. Picking a select number of policies where the author considers that the EU performs badly is not a scientific approach. The specific comments on his selected items are set out below. There is also a distinction to be made between waste, by which the author means policies whose priorities he disagrees with, and, fraud or corruption which are illegal. Fraud or corruption is objective since it breaches rules whereas waste is subjective, since it is a matter of opinion.

2.1.2.5.2. Specific comments on the areas identified by the author:

2.1.2.5.2.1. While the comment on the fishing industry was accurate at the time of being written, this section is now out-of-date: fish discards have been banned in the EU.

2.1.2.5.2.2. The argument that the continuing access of other EU vessels to UK waters is a cost would be similar to the argument that the access of UK headquartered Vodafone to the mobile spectrum of 11 other EU Member States, allowing it to sell in those countries, is a cost to those countries. There would appear to be a contradiction between the author's views on protection in agriculture (against) and fishing (apparently for).

2.1.2.5.2.3. Contrary to what the author appears to argue, set-aside ended in 2008.¹⁵ However, views differed on whether set-aside was a good policy, with conservationists arguing that it had beneficial environmental effects.¹⁶

2.1.2.5.2.4. The issue in water is unlikely to be the quality levels sought by EU rules – which have probably been beneficial for the UK. But the author is probably right that more benefit could have been obtained at this point of time in the UK by concentrating scarce investment funds on improving infrastructure rather than water quality. However, once again, costing would require an assessment as to the difference in costs which would have arisen between EU water quality rules and hypothetical UK ones.

2.1.2.5.2.5. EU rules provide a mechanism by which a national legal system can be used to efficiently pursue debt-defaults on an EU-wide basis.¹⁷

13. See footnote 10 above.

14. <https://euobserver.com/social/123066>

15. <http://www.hmrc.gov.uk/manuals/ihtmanual/ihtm24064.htm>

16. <http://www.bbc.co.uk/news/world-europe-11216061>

17. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/278472/Law_Society_of_England_and_Wales.pdf, p.1

2.1.2.5.2.6. There may well be a cost for waste, fraud and corruption. It is either not evidenced at all or weakly evidenced by the arguments presented. For there to be a net figure, there would have to be a deduction of the costs incurred for waste, fraud and corruption under hypothetical UK equivalents.

2.1.2.5. Unforeseen commitments

2.1.2.5.1. Health Tourism: The absence of data makes it difficult to construct any meaningful figures, which the author acknowledges. However, consistent with the rest of this paper, there is no attempt to assess net costs. The absence of a calculation for the cost of those health services received by UK citizens in the EU which are not reimbursed by the NHS means those figures constructed by the author are potentially misleading. The difference in demography between EU immigrants to the UK and UK emigrants to the EU may mean the balance is in the UK's favour.¹⁸ In addition, it should be noted that tax payments by EU immigrants in the UK outweigh the costs of the public services which they consume, leading to a net gain for UK public finances.¹⁹

2.1.2.5.2. Benefit tourism: a similar comment can be made as in the para above. Roughly the same number of British people claim unemployment benefit in other European countries as immigrants from the UK claim benefit in the UK.²⁰

2.1.2.5.3. The author thinks it is unreasonable that the UK pays fines for breaches of EU law. But it is the same fining system that ensures that British citizens and firms can enforce their rights in other EU countries.

2.1.2.5.3. The author says that the liabilities of the European Investment Bank could be a risk for the UK. The European Investment Bank has been profitable every year since 1958.²¹ So a comment that the author has not retained from the 2012 version of his paper may be the best review of this point "the validity of these concerns is to some extent a matter of conjecture".²²

There is no convincing evidence of net cost in this category.

2.1.2.6. Additional comment

The effects on GDP set out by Congdon are all costs, so do not include any of the potential benefits. All of the other reports we review, whether sceptic or non-sceptic, contain in their review of the costs and benefits at least the possibility of some benefits.

2.2. *Civitas "A Cost Too Far? An analysis of the net economic costs and benefits for the UK of EU Membership" (2004).*

2.2.1. Civitas argue that the balance of the costs and benefits of UK membership is unequivocally negative. They estimate the recurring annual direct cost to the UK of EU membership at between 3-5% of GDP.

18. <http://www.economist.com/news/britain/21635041-britain-imports-young-sprightly-migrants-and-exports-creaky-old-ones-balance-ailments>

19. <http://www.cream-migration.org/files/FiscalEJ.pdf>

20. <http://www.theguardian.com/uk-news/2015/jan/19/sp-thousands-britons-claim-benefits-eu>

21. <http://www.eib.org/attachments/general/reports/fr2012en.pdf>, p.5.

22. Tim Congdon "UK Independence Party: How much does the European Union cost Britain?" (2012), p.46.

2.2.2. A breakdown of the assumptions is set out below:

Category	Cost as % of GDP	Rationale
Regulation	2	Based on (i) estimate of costs of EU regulation in the Netherlands given in a speech by a Dutch politician; and (ii) figures on costs in impact assessments
Common Agricultural Policy	1.5	Cost of agricultural tariffs to UK consumers.
EU budget	0.5	Gross figure less aid.
Single Market	0	The balance of costs and benefits for the UK economy is zero, that it could be negative, and that the UK would not suffer economically by being outside the Single Market
Inward Investment	0	The attributes of the UK would ensure that inward investment stayed at the same levels

2.2.3. Comment on the assumptions below:

2.2.3.1. Regulation

Evidence for the cost of regulation is referenced as a speech by the Dutch Vice-Prime Minister given at a conference in London on 26 January 2004.²³ It is not possible to assess from what is contained in the Civitas report as how this figure is estimated and whether it is a net figure. Most of the comments made in 2.1.2.2. are likely to apply (although unlike Congdon, Civitas have given their estimates of the net benefits of the single market, even if it is an implausibly low and evidence-free one (see 2.3.2.4. below)). With respect to the reference to impact assessments, there does not seem to have been an attempt to calculate benefits, so the actual net position is not assessed, only the costs.

2.2.3.2. CAP

Civitas recognise this figure could be reduced by 0.5% to reflect the cost of subsidising UK farmers. The high figure for the effects of agricultural tariffs would be much reduced now due to the reduction of tariffs which has taken place since this report was written.

2.2.3.3. EU Budget

Unlike the Congdon figure, the Civitas figure does include receipts to arrive at a net figure.

2.2.3.4. Single Market

This is not a substantive attempt to estimate the costs and benefits of the Single Market. It simply says the existing evidence is not conclusive and that countries can obtain the benefits of the Single Market without being part of it and subject to its regulation by agreeing FTAs instead. However, as discussed in the previous chapters of this report, countries cannot obtain the benefits of the Single Market through FTAs, unless they accept the *acquis*.

23. A Cost Too Far? An analysis of the net economic costs and benefits for the UK of EU Membership" (2004), p.72.

2.2.3.5. Inward investment

The claim is that “as factors in decisions to locate manufacturing plant, neither geographical proximity to the end consumer, nor tariff or non-tariff barriers, count for much...Access to the single market is largely irrelevant for the non-manufacturing part of the economy and of minor and diminishing relevance in manufacturing itself”.²⁵ This does not fit with the submissions made to the UK Balance of Competences Review by the CBI, British-American Business, the US Chamber of Commerce, Vodafone, the Bio-Industry Association, The CityUK²⁵ or the very public statements of the Japanese government.²⁶ The UK Government’s Balance of Competence review found that “The UK’s membership of the EU and the Single Market is plainly significant to investment decisions, though of course the broader economic and legal environment and the English language also play an important role”²⁷. In the last decade, the UK received 60% of all foreign direct investment (“FDI”) into the EU and nearly half of FDI into the UK is in banking, the EU services sector most comprehensively liberalised by the EU.²⁸

2.3. Minford et al “Should Britain leave the EU? An economic analysis of a troubled relationship” (2005).

2.3.1. The argument here is that the tariff rules which apply in the EU are costly for Britain.

2.3.2. As in the previous analysis, this table attempts to summarise the authors’ argument without containing any comment from us, which instead follows in a further section.

Traded category	Cost to the UK of EU tariffs and NTBs as % of GDP	Breakdown
Agriculture	0.3%	Tariff is on average 36% and UK net imports are 0.8% GDP so cost is $0.36 \times 0.8 = 0.3\%$.
Basic Manufacturing	1.4%	Tariff is 16% on average and UK net imports are 1.7%, so cost of UK remaining in EU is 0.3% GDP as transfer and consumer surplus burden of 1.1%
Advanced Manufacturing	1.6%	Tariff is 58% on average and UK net imports are 0.8% GDP so cost to remaining in EU is 0.5% as transfer and consumer surplus burden of 1.1%
Services	0	There is no customs union, only protection at national level, so no gain or loss to leave even although UK has a surplus.
Total	3.3%	

2.3.3. Comments

24 Civitas, op. cit., p.25.

25. HM Government Review of the Balance of Competences between the United Kingdom and the European Union. The Single Market (2013) p.40.

26. See page p.24 above.

27. HM Government, Op.cit., p.40

28. CER The Great British Trade Off, p.7.

2.3.3.1 Figures for tariffs are too high. Agriculture tariffs are now 11% on average, so the authors' figure for agriculture would now be 0.1% of GDP. The figures for manufacturing and advanced manufacturing include estimated non-tariff barriers. These are imputed from a range of sources including retail prices published in secondary sources in the early 2000s containing data from the late 1990s. Minford et al, for example, estimate that retail prices for typical consumer goods were 30-80% higher than in the US in the period examined.²⁹ However, more recent figures would indicate that the EU has not acted as a mechanism for preserving a price-fixing cartel. OECD price indices indicate that by 2011, price differentials were much lower which would imply that the combined tariff/non-tariff barriers were then also much lower than the authors feared they would remain. The OECD estimate is that the US price index was 129 in 2011 compared to 79.3 in Poland, 112.5 in Portugal, 139.6 in Germany and 144.2 in the UK.³⁰ So even in the case of the UK, the differential with the US was only 11.7%. From these figures, it might be inferred that one weakness of the original model is that it did not appear to contain any mechanism to account for the likely dynamic effects of increased competition due to a single EU market and the dynamic effects of EU sponsored reductions of intra-EU non-tariff barriers as well as external tariff barriers.

2.3.3.2. Minford et al. considered that since the UK was in deficit in food and goods at a (then) much higher price than would be the case on the world market, it would only be logical to stay in the EU if the UK were also extracting a higher than world price for services from the EU (as there is no theoretical place for scale advantages in Minford's model, the UK cannot gain in the model from a competitive EU services market).³¹

2.3.3.3. One problem with the authors' analysis is that it related to producers making homogeneous products in separate countries. Non-tariff barriers in this scenario simply consist of measures additional to tariffs, the purposes of which are to further handicap imports. They are just a form of disguised tariff. Contemporary production, however, is increasingly analysed by economists as being characterised by cross-border supply chains and where the main non-tariff barriers comprise of regulatory rules and standards which facilitate cross-border production.³² The consequence of UK exit from a regional body like the EU in the authors' model is simply that imports become cheaper. The consequence of UK exit under the second analysis is that producers cannot participate in complex production processes.

2.3.3.4. The authors include explicit tariffs and NTBs to construct high effective tariffs for goods. However, in their model services are considered to trade tariff-free. This is correct as far as explicit tariffs are concerned. However, it is not correct as far as NTBs are concerned. Indeed, NTBs for services are typically higher than they are for goods.

2.3.3.5. While it is correct to say that there are no tariffs in services, this needs to be distinguished from saying there is no single market in services. There is a single market in services and the UK has a large surplus in trade in services with the rest of the EU.³³ Minford et al. recognise that while there is no tariff, if the EU constructs tariff-equivalents (such as European as opposed to national NTBs) then the analysis would change.³⁴ They thought there was no prospect of this occurring and cite evidence of service markets in air transport, posts, rail and telecoms which were all national monopolies in 1998. However, in 2015 these are all sectors where there are no longer national monopolies, the EU now exercises exclusive legislative jurisdiction (while sharing regulatory competence with the national regulators), and many leading EU providers are based in the UK.³⁵ An example of a European-level NTB is that the rights to provide retail and many wholesale financial services are restricted to providers based in the EU. Other tariff-barrier equivalents from which EU based service providers benefit, compared to non-EU providers are participation directly and through national representatives in setting standards and in the right to access the Commission and all courts and tribunals in the EU to enforce their rights to market access.

29. Minford et al (2005) "Should Britain leave the EU? An economic analysis of a troubled relationship", p.117

30. http://siteresources.worldbank.org/ICPEXT/Resources/ICP_2011.html

31. Op. cit, p.180.

32. See Baldwin (2011) "21st Century regionalism: filling the gap between 21st century trade and 20th century trade rules" WTO Staff working paper, for a discussion as to how regional trade organisations are trade creating not trade diverting.

33. See p.23

34. Op. cit, p.179

35. In the Review of the Balance of Competences, the UK government described the opening of the air transport market as follows: "Air transport had been traditionally a highly regulated industry, dominated by national flag carriers and state-owned airports. Liberalisation began in 1987 but they key element was the Third Air Transport Package, agreed in 1992, and coming into force fully in 1997. Liberalisation covered carrier licensing, market access and fares. The result was that decades of restrictions that had limited air transport markets in Europe and prevented cross-border investment were removed. The international aviation market now gives every EU carrier freedom [our emphasis: EU carriers only] to carry out flights within any EU Member State and/or between them whatever the airline's home country." Budget airlines comprise a third of the airlines in Europe and the budget airlines operating hubs in the UK include AirJet2.com, Atlantic Airways, AtlasJet, Blue1, bmi Baby, Easyjet, Fly Niki, Flybe, Germanwings, Kibris Turkish Airlines, Monarch, Norwegian.No, Ryanair, Thomas Cook, Thomson Airways, Transavia, Wizz.

- 2.3.3.6. The model also does not include border costs, which are estimated to be substantial for producers from outside the EU.³⁶
- 2.3.3.7. The model does not include any benefits for scale.³⁷
- 2.3.3.5. Minford et al. do not include any inward investment advantages for the UK from being in the EU in their model.³⁸
- 2.3.3.6. The authors expect that the removal of all tariffs on imports to the UK will negatively impact the UK's agricultural and manufacturing industries. In their model, there appears to be an assumption that there are no "hysteresis" effects arising from this transition. Employees would transfer frictionlessly to new jobs in service industries. "Hysteresis" occurs when frictional unemployment turns into long-term unemployment.³⁹
- 2.4. *Mansfield "A Blueprint for Britain: Openness not Isolation" (2014)*
- 2.4.1. This paper won the Institute of Economics Brexit Prize in 2014. It estimates the total long-term impact of Brexit at between -2.6% and +1.1% of GDP, with, in the author's view, a best estimate of +0.1%.
- 2.4.2. The author's estimates are set out below in £bn.

	(a) Best case	(c) Most Likely	(b) Worst Case
EU trade (£bn)	-7.7	-9.3	-19.2
External trade (£bn)	5.6	2.1	-1.8
Budget Contribution (£bn)	10	6.0	10
Regulatory (£bn)	3.8	2.5	3.8
FDI (£bn)	4.5	0	-15.6
Debt interest (£bn)	0	0	-17.2
Total gain or loss (£bn)	16.1	1.3	-40.0
Total Gain or Loss %GDP	1.1%	0.1%	-2.6%

- 2.4.3. Description of scenarios in the paper: Best case (a), worst case (b), "most likely" (c)

2.4.3.1. EU trade

In (a) the UK obtains within 3 years either full access to the Single Market including for services in exchange for accepting half or less of the existing EU law. In (b) the UK withdraws with no trade agreement in place and must pay WTO tariffs. In (c) the UK secures access within 3 years for most services in exchange for accepting two-thirds of existing EU law.

2.4.3.2. External trade

In (a) within 3 years, all existing trade partners of the EU give UK the same terms and UK also signs good free trade agreements with China, Brazil, Russia, Australia and India. Under (b) no major free trade agreements are signed and some major nations with FTAs with the EU will not give UK the same terms. In (c), all existing EU trade partners extend same terms to UK and UK secures new agreements with Australia and Brazil though negotiations go more slowly with China, the US and Russia.

36. See p.11 below.

37. Op. cit. p.14

38. Op. cit., p.15.

39. For example, the Bank of England estimated in 2013 that the effect of job losses during the economic crisis from 2008 was to raise the long-term rate of unemployment in the UK from 5% to 7%. Bank of England "Monetary Policy trade-offs and forward guidance August 2013, p.6.

2.4.3.3. Budget contribution

In the best case, (a) no contribution is made to the EU budget at all. In the worst case (b), where the UK has no relationship, the same occurs. Under the most likely scenario, the UK makes some contribution.

2.4.3.4. Regulatory burden

Under (a), halving of the regulatory burden in three years causes exports to boom. Under (b), the UK cuts burdensome regulation “but this is not enough to mitigate the impact of being shut off from world markets”.⁴⁰ Under (c), as the UK accepts two-thirds of *acquis*, less regulation is cut and positive effect on GDP is less.

2.4.3.5. Foreign Direct Investment (“FDI”)

Under (a) full access to EU and lessening of regulatory burden increases FDI. Under (b) without the ability to export tariff free, inward investment “plummets”.⁴¹ Under (c) with a stable trading arrangement with the EU combining less access but also less regulation inward investment stays about the same.

2.4.3.6. Debt interest

Under (a), everything happens for the best so money markets are not affected. Under (b), international money markets react badly, causing the UK’s borrowing costs to soar. Under (c) stable trading relationship and no impact on FDI means no money market concern about UK debt.

2.4.4. Comment

2.4.4.1. On its own terms, this paper sets out that the most likely outcome is a negligible increase in GDP of 0.1% with the risk of a large loss of GDP of -2.6% per year.

2.4.4.2. However, this report is very optimistic in many of its assumptions, including in its construction of a so-called most-likely scenario:

2.4.4.2.1. It is unlikely that the UK will be able to negotiate a set of sectoral bilateral deals with the EU within three years which include a carve out of those areas in which the UK does not want to continue to apply EU law.

In the first instance, this is because the UK does not know which areas of EU law it wishes to continue to apply and which it does not. In the second instance, this is because the precedent of Switzerland tells us that the negotiations will take longer than three years once the UK has adopted a negotiating position. In the third, the author notes that “throughout the negotiations, it must be remembered that the UK is in the weaker position”,⁴² it is hard to see how the UK will secure the services agreement which Switzerland was unable to secure unless the UK is willing to adopt all of EU law. Note that, like Switzerland, the author does not expect that the UK will be able to secure full access for financial services.⁴³

2.4.4.2.2. There is no estimation of the effects on investment of uncertainty and delay in securing access.

2.4.4.2.3. No evidence is presented as to why FDI would not react negatively to exit. Such evidence should be required given that there is extensive academic work which suggests that it would, including in the work by Pain and Young reviewed below.⁴⁴ It is unclear but it would not appear that this study takes into account the disruption to global supply chains to which exit could give rise. It is stated that the UK should apply subsidies to mitigate the risk to affected industries without noting that these are likely to be illegal and therefore infeasible.⁴⁵

40. Mansfield, I. (2014). A Blueprint for Britain: Openness not insulation”, p.46.

41. Ibid, p.46”

42. Ibid, p 27

43. Mansfield “...the new security of the City of London from European interference will enhance competitiveness and compensate for the partial loss of access to European markets” op. cit, p.3. A view that does not appear to be shared by the body which represents the City of London, CityUK, see <http://www.thecityuk.com/research/our-work/reports-list/analysing-the-case-for-eu-membership-how-does-the-economic-evidence-stack-up/>

44. We review one of these papers at p.54 below.

45. See p.51, below.

- 2.4.4.2.4. There is no estimation of the long term effects of a reduction in FDI on the rest of the economy i.e. the dynamic effects of reduced FDI.
- 2.4.4.2.5. There is no estimation of the possible deterioration of future trade with the EU as the EU continues to remove NTBs within the EU to the benefit of companies within the Single Market, improving their competitiveness relative to companies in an exited UK.
- 2.4.4.2.4 Although an exiting UK would obviously like all of the EU's existing partners to extend the benefit of trade deals to the UK, this is not the same as presenting evidence that they would actually do so. No evidence is in fact presented as to why the UK will be able to do better deals with more countries than the EU is able.
- 2.4.4.2.5 As regards the regulatory burden, this is intimately tied to access to the Single Market. The regulations are the rules that govern the market. It is unclear how this scenario, under which the avowedly weaker negotiating partner secures access with an ability to avoid rules by which the other players must abide, is labelled as "most likely".⁴⁶
- 2.4.4.2.6. In addition, it is unclear that at any substantial GDP gain from a partial reduction of EU regulation is feasible. The UK is already one of the least regulated European countries.⁴⁷
- 2.4.4.2.7. The neutral effects on money markets and FDI are dependent on market access to the EU being secured. As discussed above, this cannot happen in the time frame Mansfield says is necessary and is unlikely to happen in a longer timeframe unless the UK accepts the application of EU law like Norway and Switzerland. In other words, it is highly unlikely that the UK can have full market access and sovereignty over deciding the rules of access to what is a shared market. However, the UK could contrive, if the Eurosceptic path is followed, to expend a great deal of potential national wealth, in order to achieve market access on the basis of rules decided without its participation.
- 2.5. *Business for Britain "Chapter 30 'tariff cost on exports are manageable" (2015).*
- 2.5.1. This study undertakes a line-by-line analysis of Britain's goods exports to the 27 other EU Member States and to another 28 countries with which the UK had an EU-arranged trade treaty in 2013. It calculates the tariff costs that UK exports would meet on exports.
- 2.5.2. The argument is that "assessing the cost British exporters would have to bear if we were outside the EU is the simplest method of placing a value on what EU membership is worth".⁴⁸
- 2.5.3. The UK net contribution to the EU of 0.66% GDP is unfavourably compared to the 0.43% of GDP burden which British exporters of goods would allegedly have suffered had they been forced to operate on a WTO basis only.⁴⁹
- 2.5.4. The report finds that material losses due to tariffs would be concentrated and that this is effectively a good thing since it would allow the losers to be precisely identified and compensated for that loss: "Business responsible for less than 15% of Britain's exports to the whole world bear nearly three-quarters of the cost, a degree of concentration that would allow targeted assistance to be delivered".⁵⁰ They argue that this is because the identified tariff costs comprise £2.8bn for agricultural products and £2bn for non-agricultural and the latter are incurred at levels where compensating payments to the exporters would not trigger "serious prejudice" of overseas competitors under WTO rules. They argue that the material tariff cost borne by the 22 non-agricultural products could be ameliorated by a package of transitional measures which would place the emphasis upon support for research and development.

46. There may also be an arithmetic error in the author's calculations regarding regulation. Given that the author appears to take the view regulation is only a cost and that eliminating all EU regulation leads to a gain of 3.8bn, it is unclear how accepting 2/3rds of EU regulation leads to a GDP gain of £2.5bn (2/rds of 3.8). According to the author's logic, it should presumably be a gain of £1.3bn only. Nonetheless, this error(if it is one) would not make much difference to the author's calculation of the outcome

47. CER, op. cit., p.44-47.

48. <http://businessforbritain.org/2015/06/23/chapter-30-tariff-costs-on-exports-are-manageable>, p.770.

49. Ibid, p.771

50. Ibid, p.770

2.5.5. Comments

2.5.5.1. The methodology deployed here is likely to seriously underestimate the cost to British exporters for the following reasons:

2.5.5.1.1. Business for Britain only includes the cost burden on businesses which would face a tariff of greater than 5%. It is not clear that a tariff below 5% has the insignificant effect that Business for Britain state.⁵¹ This would require an assessment of profit levels in all of Britain's exporting industries, an exercise which has not been undertaken here. In Minford et al.'s model, being outside the tariff wall meant that UK exporting manufacturing businesses would not be able to compete on either EU or world markets and would shrink significantly even though in their model the formal monetary value of the average tariff was 4.4% and therefore below a figure which Business for Britain would consider material.⁵² The application of this filter does have the property of allowing Business for Britain to exclude the costs that would be imposed on 85.2% of the UK's exports and therefore delivers a much lower cost for businesses figure.

2.5.5.1.2. Simply using tariffs as a measure of costs to business of being outside the customs union is odd when it is pretty much universally acknowledged that the costs of non-tariff barriers including regulatory standards are far more significant. The estimation is that these make the effective tariffs of more than 30% in many sectors.⁵³ Restricting the assessment simply to tariffs also has the property of shrinking the value to British business of being inside the customs union and the number of exporters affected.

2.5.5.1.3. Tariffs only apply in goods markets. By ignoring NTBs, the authors exclude exporters of services from their calculation. This is also odd given the importance of services to UK exports and certainly means that they have not succeeded in their ambition of "assessing the cost British exporters would have to bear if we were outside the EU."

2.5.5.2. We have also received advice that the Business for Britain analysis relies on an incorrect analysis of the WTO rules. It appears that while the UK could provide the suggested subsidy for farmers, the UK government could not rely on Article 8 of the Agreement on Subsidies and Countervailing Measures ("SCM") to justify subsidies which the authors state would "place the emphasis upon support for research and development"⁵⁴ for non-agricultural businesses. The Business for Britain paper appears to rely on WTO legal provisions which have lapsed.⁵⁵ In this event, the UK would be at risk of WTO sanctions requiring compensation including countervailing EU tariffs raised to match the subsidies. An exit agreement with the EU might also contain an agreement on state aid rules and these would likely also prohibit such a subsidy. In addition, given the filters that Business for Britain has applied, the subsidy required to mitigate the actual barriers that UK exporters would face would likely have to be far higher to achieve its effect and the sanctions for illegal subsidy consequently also correspondingly higher. It seems unlikely that such subsidies would be forthcoming in reality.

2.5.5.3. Additional comment: by restricting itself to the net costs of membership against the tariff costs of exporting post-Brexit, this particular exercise does not of course review other sources of cost-benefit to the UK contained in other studies such as levels of FDI.

2.6. *Open Europe "What if... the consequences and challenges and opportunities facing Britain outside the EU" (2015).*

51. Ibid, p.780

52. Minford et al, Op. cit., p.97.

53. See discussion in the WTO Alone chapter at p.21 See also the estimated index of perceived NTBs in the EU and US for goods and service sectors by ECORYS and BBVA (2013) at https://www.bbvaresearch.com/wp-content/uploads/migrados/131219_EconomicWatchEEUU_214_tcm348-416209.pdf, p.3. Note that on average across goods and services markets NTBs are higher on average for importers to the US than to the EU.

54. Op. cit., p.802.

55. The provisions of Article 8 lapsed as they were not renewed in 1999 see Article 31 at https://www.wto.org/english/res_e/booksp_e/analytic_index_e/subsidies_04_e.htm#article31

- 2.6.1. This report sets out to conduct a cost-benefit analysis. It finds that there are four possible scenarios: non-negotiated Brexit: annual GDP loss of -2.23 by 2030; UK-EU FTA 1: annual GDP loss of -0.81; UK-EU FTA2: annual gain of 0.64% and Brexit best case: annual gain of 1.55% GDP.
- 2.6.2. In Open Europe's view the range of -0.81 to +0.64 represents the range of politically feasible options.
- 2.6.3. The authors' breakdown of the costs and benefits of each scenario are set out below.

2.6.3.1. Non-negotiated Brexit

In this scenario, the UK exits the EU without an FTA. This report includes border costs in terms of the cost of delay and customs formalities. This is a cost which the other studies reviewed previously in this chapter do not appear to have factored in.⁵⁶ However, the report also acknowledges that the model used does not take into account the potentially disruptive impact of border costs and tariffs on global value/supply chains.⁵⁷ This is likely to be a rather significant missing assessment in reality. This latter cost is also one which the other studies reviewed so far have not taken into account.

	GDP% change
Tariffs	-0.947
Border Costs	-1.197
Goods NTBs	-0.468
Services NTBs	-0.144
FDI NTBs	-0.002
Total	-2.759
EU budget saving	0.53
Total incl EU budget saving	-2.23

56. "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"; Open Europe; "What if... the consequences and challenges and opportunities facing Britain outside the EU" p.80

2.6.3.2. UK-EU FTA1

In this scenario, the UK negotiates a comprehensive FTA with the EU. It involves a single-market access for goods. The services sector gains an "unusually large degree of market access". The UK contributes at the same rate as Switzerland.

Border costs	-0.94
NTBs	-0.08
Total	-1.03
Reduced budget payment	0.22
Total incl EU budget	-0.81

57. "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. 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"; Ibid, p.80

2.6.3.3. UK-EU FTA2

In this scenario, the UK has an FTA with the EU and then eliminates all remaining border protection unilaterally. This also removes the requirement of the many countries which access the UK preferentially to demonstrate the originating status of their goods. The benefit is generated through the following channels: "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)".⁵⁸

Border costs	0
NTBs	0
Unilateral elimination of UK tariffs	0.75
No budget contribution	0
Total	0.75

2.6.3.4. UK-EU FTA2 plus scrapping regulation

As above, but with the cutting of EU-derived regulation.

Border costs	0
NTBs	0
Unilateral elimination of UK tariffs	0.75
No budget contribution	0
Removal of regulation	0.7
Total	1.55

2.6.4. Comment

2.6.4.1. It seems surprising that the effects of NTBS in 2.6.3.1. are calculated to be lower than the tariff costs as most studies find that NTBS are higher than tariff costs.⁵⁹

2.6.4.2. The model does not appear to account for the dynamic downward evolution of NTBS as the EU progressively reduces intra-EU NTBs which would increase the relative competitiveness of EU firms versus external firms such as those in an exited UK.

2.6.4.3. The figure for the impact of lower FDI seems surprising given the widespread consensus that exit would impact on FDI. The statement that "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"⁶⁰ may be somewhat misleading if labelled as a result if the model assumes this by theoretical construction in the first place.

58. Ibid p.84

59. CEPR (2013), Trade and Investment Balance of Competent review, study for the Department of Business Innovation and Skills, p.59.

60. Open Europe, op.cit., p.84

2.6.4.4. In 2.6.3.2., it is unclear why the UK would be able to negotiate a similar budgetary contribution to Switzerland while obtaining greater market access for financial services than Switzerland has. The figure for NTBs seem very low given that under this model the UK is assumed to be a non-participant in regulatory standard-setting and simply a rule-taker of rules set elsewhere.

2.6.4.5. It appears that the border costs that arise as a consequence of the UK being outside the customs union and UK exporters to the EU having to undergo the costs of complying with country of origin rules have not been taken into account in the scenarios set out in 2.6.3.3. and 2.6.3.4.. Exporters from EEA countries have to comply with these rules. If the cost has been taken into account and netted off, the assumptions about the beneficial dynamic effects of lower increased competition from non-EU companies in the UK need to be set out more clearly and their plausibility explained. It is unclear why the figure for NTBs disappears altogether in these scenarios.

2.6.4.6. In 2.6.3.4., the elimination of EU-derived regulation is based on the assumption that the EU would not insist on the UK adopting the full-acquis and UK companies would simultaneously be permitted to compete in the Single Market while not applying social, employment, health and safety rules and environmental and climate change rules. It also assumes the UK could remove EU rules relating to financial services which seems particularly unlikely to be compatible with access. The same possible additional difficulties with the analysis identified in the paragraph above would also apply.

2.6.4.7. In all the exit scenarios, the UK is assumed to be able to achieve trade outcomes in negotiations with third countries which are just as good as those achieved by the EU.

3. Pro-staying cost-benefit analyses

3.1. *Pain and Young "The macro-economic impact of UK withdrawal from the EU" (2004).*

3.1.1. This academic paper assesses the macroeconomic consequences of withdrawal using simulation analyses on the National Institute of Economic and Social Research ("NIESR") macro-econometric model of the UK economy. The paper considers the impact of four changes on the UK economy: the effects of a reduction in productive efficiency as a result of lower inward FDI, the impact of increased barriers to trade with the EU, the impact of an ex-ante fiscal windfall due to lower net transfers to the EU and the impact of lower food prices. The combined effect of these changes is estimated to be a reduction of 2.25% in GDP in the long run. The key driver of this outcome is the reduction in FDI which they assume will only gradually produce its effect over a ten year period.

3.1.2. Comment

3.1.2.1 An econometric study with panel data is used to estimate the extent to which FDI is the result of EU membership.

3.1.2.1 The key finding is that lower fiscal contributions to the EU do not compensate for increased barriers to trade with the EU and lower FDI.

3.1.2.2 The main criticism would be that it is not possible to be certain that the gains of entering the EU would necessarily be forfeited as a result of exiting the EU. This would partly be dependent on the nature of the continuing relationship with the EU.

3.1.2.3. This paper is sometimes cited as evidence for the argument that leaving the EU would not lead to a substantial rise in unemployment.⁶¹ Indeed, the authors do find that there would only be a limited increase in unemployment. However, we should not confuse this with the absence of negative consequences. The reason the model does not predict a substantial increase in unemployment in the long run is because it assumes the UK labour market is flexible. The authors state: “The reason for the relatively small decline in employment in spite of a large shock to output is that wages fall in real terms as the labour market slackens”.⁶² In other words, their model does predict UK citizens would be worse off if the UK leaves the EU.

3.2. *Centre for Economic Policy Research (CEPR) “Trade and Investment Balance of Competent review, study for the Department of Business Innovation and Skills” (2013).*

3.2.1. The CEPR conducted an analysis of the overall trade costs of alternative arrangements to membership of the EU. This report was conducted for the UK government. It maps tariff costs and the effect of NTBs onto the structure of UK production and trade.

3.2.2. CEPR found that a change from EU membership to a reliance on WTO alone would decrease GDP by 1.77% and a UK FTA would reduce GDP by 1.24%.

	Share of GDP; WTO alone	Share of GDP; UK FTA
Rules of origin		-0.19
Tariffs	-0.26	
NTBS	-1.51	-1.05
Total	-1.77	-1.24

3.2.3. Comment

3.2.3.1. This is purely an accounting exercise and therefore does not tell us what would happen to FDI. It does not factor in full border costs to firms. It does not include the costs of uncertainty or loss of preferential trading arrangements with third countries.

3.2.3.2. From a sceptic point of view, it does not include the saving from no longer having to pay a contribution, reduced regulation (although in our view there is unlikely to be any saving under that cost heading) and potential new trade deals with third countries (although again we are sceptical that the UK will do better than the EU and may more likely be obliged to accept inferior deals).

3.3. *Ottaviano, Pessoa, Sampson “The costs and benefits of leaving the EU” (2014).*

61. http://www.civitas.org.uk/pdf/EUCosts_Factsheet.pdf, p.2.

62. Pain and Young, “The macro-economic impact of UK withdrawal from the EU”, p.405

3.2.1. This paper focuses on the welfare gains arising from trade openness with EU countries. The authors find that bilateral increases in tariffs and non-tariff barriers between the UK and EU generally lead to a drop in UK welfare even after accounting for the benefit of lower fiscal transfers to the EU. They also find that the UK has even more to lose in a scenario where non-tariff trade costs within EU countries continue to fall more over time than in other OECD countries which they assess as something which seems likely to occur. They estimate the static welfare changes as ranging from -1.13% of GDP in an optimistic scenario to -3.09% in a pessimistic one. In the optimistic case, the UK secures an FTA and the UK faces non-tariff barriers that are equivalent to a ¼ of those faced by the US and over a decade the EU decreases the intra-EU barriers by 10%. In the pessimistic scenario, the UK does not secure an FTA, the non-tariff barriers faced by the UK are 2/3rds of those faced by the US and intra-EU barriers decrease by 40% (the historical rate).

3.3.2. They also point out that this static assessment will be an under-assessment of the outcome if dynamic effects are included. Dynamic effects are knock-on effects which are foregone as a consequence of investment or trade not occurring. Dynamic effects include technology diffusion, export learning effects and greater investment in R&D. The authors state that “when we factor in more realistic dynamic losses from lower productivity growth, a conservative estimate would double losses to 2.2% of GDP even in the most optimistic case. In the pessimistic case, there would be income falls of 6.3% to 9.5% of GDP, a loss of a similar size to that resulting from the global financial crisis of 2008/09. These numbers show that leaving the EU appears to be a risky gamble.”⁶³

3.3.3. Detailed findings of the static effects below:

OPTIMISTIC SCENARIO		Change in welfare
	Increase in EU/UK tradeable tariffs 0%	0%
	Increase in EU/UK non-tariff barriers (=2.01%)	-0.4%
	Future falls in intra-EU non- tariff barriers (-5.68%)	-1.26%
	Lower contributions	0.53%
	TOTAL WELFARE CHANGE	-1.13%
PESSIMISTIC SCENARIO	Increase in EU/UK tradeable tariffs (WTO rates)	-0.14%
	Increase in EU/UK non-tariff barriers (=5.37%)	-0.93%
	Future falls in intra-EU non- tariff barriers (-10.54%)	-2.55%
	Lower contributions	0.53%
	TOTAL WELFARE CHANGE	-3.09%

3.3.4. Comment

3.2.4.1. The methodology here is not dissimilar from that employed by Business for Britain with the critical exceptions that (i) the authors also estimate the effects of current non-tariff barriers; and (ii) the effects of future falls of intra-EU non-tariff barriers over the next 10 years.

63. Ottaviano et al, “The costs and benefits of leaving the EU” p.11.

3.2.4.2. The estimations for the increase in non-tariff barriers may be too high in the optimistic case since in that case the UK may have conceded automatically updating UK law in line with EU Law. Similarly, if the UK has agreed to an automatic updating system a la Norway then further intra-EU falls in NTBS would also be captured. Nonetheless, these costings do indicate that not all the FTAs are the same and the further the UK moves from an EEA model, the higher the costs are likely to be.

3.2.4.3. The estimations for the increase in non-tariff barriers may be too low in the pessimistic scenario as it is unclear why they would be any lower than those currently faced by US companies.

3.2.4.4. The reductions in intra-EU non-tariff barriers represent a record based on a historical rate then tempered by various arbitrary filters to make it more conservative. It is not possible to say whether this is likely to be accurate or inaccurate.

3.3. *Centre for European Reform (CER) "The Great British Trade-Off. The impact of leaving the EU on the UK's trade and investment" (2014).*

3.3.1. To capture the extent to which membership of the EU (ie the set of special rules which incorporate the UK economy and the other member state economies) has an effect on UK trade and therefore the effect leaving it could also have, CER undertake an econometric analysis. Their analysis examines the extent to which the size of total trade between the UK and another country is on average different as a consequence of the other country being a member of the EU or not. The regression design permits the isolation of the effect of membership compared to the effects of other variables which could impact on trade, such as size of the economy, distance from Britain, whether the country is English-speaking and so on. If these other factors are held constant and Britain still trades more with the EU than with countries outside the EU, then that trade is attributable to membership of the EU.

3.3.2. Their data set consists of trade figures for goods between 181 countries for the period 1980-2010. Their results are highly statistically significant and they find that on average UK trade with a country is 55% higher if the other country is an EU Member State. As in 2010, 54% of the UK's goods trade was with the EU, UK membership of the EU boosted the UK's goods trade by about 30%.

3.3.3. Comment

3.3.3.1 The main point to be made is that this is only intended to be a study of trade effects. The latter is only one of a number of economic relationships which would potentially be impacted by exit.

It is also only covers trade in goods and not services.

3.4. *Campos, Coricelli and Moretti "Economic and Political Integration: Estimating the benefits from membership in the European Union using the synthetic counterfactuals method" (2014).*

3.4.1. The authors construct a weighted average control group of countries that do not join the EU with similar economic features to a country that does join the EU. In other words, they create a projection as to how the economy of a country that joined the EU would have performed had it not joined the EU: a synthetic counterfactual. Growth in GDP in the control group is then compared with growth in GDP in the country which joins the EU.

3.4.2. The non-EU Britain is 91% New Zealand and 9% Argentina: an artificial construct whose growth closely matches the UK's prior to joining the EEC. By comparing the UK's actual growth post membership with that of the construct, the authors estimate that UK GDP is 28% higher than it would otherwise have been.

Comment

- 3.4.3. While conceptually neat, since very specific politico-economic factors may have shaped the trajectories of the Argentinian and New Zealand economies after the period when the UK joined the EU, and which would not have impacted on the UK had it been outside the EU, it may not be appropriate for these countries to be considered a control.
- 3.5. *Gasoriek and Mendez-Parra "Ties that bind: the British jobs data that really shows the value of the EU" (2014)*
- 3.5.1. This paper looks at data on UK employment in export production. By examining this data, the authors conclude that the UK is economically integrated with EU countries quite differently to how it is integrated with non-EU countries. UK exports to the rest of the world are primarily finished products. Whereas almost 40% of UK exports to the EU are included in products that are then exported from a partner-EU country to the rest of the world.
- 3.5.2. 4.5 million people are employed in the UK producing goods and services for exports to the rest of the world but only 700,000 are employed in producing goods and services which are incorporated into final products exported from a third country. 3.8 million people are employed in the UK producing goods and services to the EU, but 1.46 million of those 3.8 million are employed in producing goods and services which are incorporated in exports by an EU partner.
- 3.5.3. This supply chain integration is increasing in intensity. In 1995, 27.3% of the jobs in producing for EU markets were for intermediate elements in a supply chain whereas by 2011 this represented 38.7%.
- 3.5.4. The jobs figures broken down by sector show that UK jobs in producing intermediate elements then incorporated in EU exports to the rest of the world are as much in services as in manufacturing (in fact 6 out of the 10 leading sectors).
- 3.5.5. The authors conclude "...this data suggests that the UK employment is very closely tied to EU partners via value-chains in a way that non-EU export jobs simply are not. This is no doubt in part driven by the simple fact that [the] EU is so close, but it is also hard to believe that this is not driven by regulatory commonalities in the single market. These interwoven relationships along the value chain are in stark contrast to the kind of "ship and forget" trade that appears more characteristic of non-EU trade."⁶⁴

Comment

- 3.5.6. This paper provides strong supporting data backing the comments we make above about the Minford et al analysis which we believe is based on a model and outdated data that does not capture the nature of contemporary trade with the EU.
- 3.5.7. We do not argue that exiting the EU will necessarily eliminate all the jobs of those employed in exporting to the EU. In the long run, economists tend to model economies as rebalancing to achieve more or less full employment (except to the extent to the models include the effects of hysteresis). However, it is perfectly feasible in such models for that full employment to obtain at higher or lower levels of wages. Disrupting UK participation in the trade in high value add goods and services within the EU is likely to mean that overall UK wages are lower.

64. Gasoriek, M and Mendez-Parra, M (2014) "Ties that bind: the British jobs data that really shows the value of the EU", *The Conversation*, p.1.

3.6. Bertelsmann Stiftung "Brexit – potential economic consequences if the UK exits the EU" (2015)

- 3.6.1. This paper analyses the costs of Brexit for the UK under different scenarios and the consequences for other Member States. The paper examines the following heads of cost: lower trade levels with the EU; lower productivity levels due to a decline in cross-border activity; loss of access to existing (but not future) EU trade agreements; savings in the form of cancelled contributions to the EU budget.
- 3.6.2. Their finding is that in the event of a Norwegian or Swiss style arrangement ("the soft exit") that UK growth in 2030 would be 0.63% lower and in the event of an exit where the UK no longer had an agreement with the EU and is unable to replicate the EU's existing FTAs with third countries ("the hard exit") that the GDP loss would be 2.98% per annum.
- 3.6.3. The authors find that tariffs are a very small cause of losses. Instead it is non-tariff barriers that drive the vast bulk of losses.
- 3.6.3. However, they do also note that losses would be incurred by the other EU Member States, relatively high for Ireland and Luxemburg in the event of a "soft exit" (-0.82 and -0.48 respectively) and in the event of a hard exit above -0.3% for Ireland (-2.66%) Luxemburg (-0.8%), Belgium (-0.96%), Sweden (-0.48%), Netherlands (-0.35%), Germany (-0.33%) and Spain (-0.32%).
- 3.6.4. They note that their analysis is based on static effects ie it does not take into account the dynamic effects that international competition, access to foreign markets and international capital mobility can have on growth rates. When they model this they find that the negative effects of Brexit for the UK double, although they add that "the sheer range of results suggests that the uncertainty following a Brexit referendum with negative outcome is truly substantial".⁶⁵
- 3.6.4. This report also models effects on sectoral added value in the UK looking at all UK sectors that contribute more than 1% to national value-added. What this underlines is that in all Brexit scenarios there are negative repercussions for all services and for manufacturing and motor vehicles. Conversely where the UK achieves a FTA with the EU, processed food, chemicals, mining, paper, petroleum have improved outcomes. The latter are the 8th, 10th, 15th, 16th and 19th most important sectors in terms of value-add. Absent an FTA there are positive outcomes for food processing, paper and mining only.

Comment

- 3.6.5. In addition to its modelling of overall outcomes, the significance of this report lies in once again underlining that there is an EU services market from which the UK benefits and that services would they predict be a large loser from Brexit. The sectors which would gain from exit are comparatively low value add sectors.

4. Conclusion

- 4.1. What we take from the detailed review of costs and benefits is that it is difficult to bring this down to exact figures on costs and benefits. However, we think that there are nonetheless some general conclusions which can be drawn about the appropriate heads of costs and their likely relative magnitude.
- 4.2. The work undertaken by the different authors suggests that the relevant categories of net cost/benefit are: fiscal costs; effects of tariffs and NTBs on trade with the EU; effects of continuing reduction in intra-EU NTBs; border costs; foreign direct investment; effect of uncertainty on domestic investment; trade with rest of the world; and, regulation. Taking each of these in turn:

65. Bertelsmann Stiftung (2015) "Brexit- potential economic consequences if the UK exits the EU", p.43.

- 4.2.1. The net fiscal costs appear to be less significant than other factors which potentially effect GDP.
- 4.2.2. The effects on trade with the EU of Brexit are likely to be high and there is a direct trade off with prioritising the removal of EU-derived regulation in the UK. For each sector where the UK seeks not to apply EU-derived regulation or something effectively equivalent, there will not be free access to the EU. We see wishful thinking but no compelling evidence that the UK has the negotiating strength to compel EU members to accept that it ought to be able remove EU-derived law with which all other Member States have to comply and still have free access to the shared market.
- 4.2.3. Most eurosceptic studies seem to be based on a model where regulation is solely business-restraining rather than business-facilitating. This is contrary to the evidence. The dynamic of the Single Market is to continue to facilitate and extend intra-EU trade, without prejudicing social standards. It also seems plausible to us that firms in an exited UK would face competition from firms within the EU which continued to benefit from further reductions in NTBs.
- 4.2.4. It seems to us that border costs are neglected in many of the reports and it seems logical that they should be included. However, border costs are not just those imposed by EU rules on imports into the UK, they would also in the context of Brexit be imposed on UK exports into the EU. They would apply even if an FTA were agreed with the EU.
- 4.2.5. The balance of analysis indicates that exiting the EU will lower FDI and this will have both static and dynamic effects on GDP.
- 4.2.6. We think the investment effects will not be limited solely to FDI. The likely decade of uncertainty as to the final deal with the EU and the need to negotiate trade agreements with all third countries could have a chilling effect on domestic investment. Even if there is a catch up once the uncertainty is resolved, the effects of a decade of reduced investment may have longer-lasting dynamic effects on growth. Most of the reports do not seem to deal with this issue.
- 4.2.7. The EU has FTAs with a large number of countries and if current negotiations conclude successfully, EU agreements with third countries will cover 85% of UK exports. Outside of the EU, it may be sensible to assume that the UK may not obtain as extensive a coverage and it may not be on such beneficial terms. We see the assertion that the UK will be able to strike preferential deals which the EU and the US have not and with countries that US government officials describe as protectionist. No analysis as to how the UK will achieve what the EU and US have not been able to achieve is provided.
- 4.2.8. Regulation generates costs but it also opens markets and allows the construction of complex cross-border supply chains. The benefits of regulation are captured by the extent of trade within the EU. We recognise that in so far as some regulation is poorly tailored for UK businesses that its removal would be a benefit in a world where this could be achieved without any repercussions. However, we also note that the actual analysis of the costs of EU regulation finds that in aggregate that EU regulation does not negatively impact the UK economy. In addition, we note that, even in the Open Europe study, where the UK is able to eliminate a selection of regulation which is considered by the authors of the reports to be unfavourable, that the gains are not spectacular. The savings would not appear to us to compensate for the likely losses imposed by exit.

Chapter Seven

What Would “Out” Look Like? A summary of the individual chapters and a short conclusion

1. In this report we have reviewed the most widely canvassed alternatives to EU membership. We have done this to see whether they are likely, as sceptics claim, to make us better off and to give us greater control over our destiny.
2. **The “Norwegian Option”**
 - 2.1. In “The Norwegian Option”, we question why some sceptics claim that Norway has agreed an arrangement which gives them the benefit of being members of the Single Market without being subject to EU regulation and bureaucracy. Our chapter explores these claims in detail and shows that they are based on some fundamental misunderstandings of the agreement between Norway and the EU. Norway is subject to less EU regulation, primarily in fishing and agriculture, but has adopted, according to estimates made by an independent Norwegian committee, about 2/3rds of EU rules. These rules include free movement of people. As well as this, Norway contributes to EU budgets.
 - 2.2. The trade-off for not being a member is that Norway has no say on the 2/3rds of rules it is obliged to adopt to have access to the single market. We show that the specific claim that Norway has an “opt-out” from the application of EU law is incorrect.
 - 2.3. The chapter also shows that the nature of the arrangement and the bureaucratic delays in rule adoption to which it gives rise can place Norwegian companies at a disadvantage vis-à-vis their competitors in other Member States.
 - 2.4. In any event, if the UK left the EU and tried to negotiate membership of the EEA, our assessment is that it is probable that neither any of the current EEA members nor the EU would agree to the UK joining.
 - 2.5. Since all this is evident on examination, it may be that those who advocate this as an option are insincere, seeking to allay concern in the UK at the risks of leaving by saying Norway provides an example of a safe and feasible alternative.
3. **The “Swiss Option”**
 - 3.1. In our section entitled “The Swiss Option”, we explore how some Eurosceptics recognise that the Norwegian arrangement does not in fact provide a model for the UK. Instead, they say that Switzerland has achieved the kind of arrangement which the UK seeks.
 - 3.2. In one sense, the Swiss have retained sovereignty. In most areas, formally they do not have to update their laws to keep in step with changes in EU rules. However, the practical consequence of Swiss laws not being kept in alignment with EU rules is that their companies would not be able to trade with the EU. The result is that they adopt a practice of copying EU rules (or ‘autonomously updating’) and all Swiss federal legislation contains an assessment of its compatibility with EU law. Swiss legislators do not have the right to vote on EU rules, so the practice of formal sovereignty means the Swiss largely end up as rule-takers.
 - 3.3. In addition, while the Swiss wished to exclude free movement of people and include free movement of capital and services in their agreement with the EU, the opposite occurred and the Swiss were obliged to permit EU immigration and were not granted privileged access for services exports. The Swiss found that when they negotiated with a much larger partner, the larger partner dictated the terms. Switzerland also contributes to EU budgets.

- 3.4. Those who think that the UK would have a stronger negotiating position with the EU because we have a trading deficit with the EU should note two key facts set out in our detailed chapter. First, the Swiss trade deficit with the EU is very similar in absolute size to that of the UK. Second, the UK has a surplus in trade in services with the EU whereas Switzerland has a deficit in services as well as goods. A deal in which the UK and EU achieved mutual free trade in goods but not services, just like Switzerland, might be advantageous for the trade balances of some of the other EU member states whilst being at the expense of the UK.
- 3.5. Some sceptics point out that the Swiss export more per capita to the EU than the UK even although Switzerland is outside the EU and the UK is in. However, this could potentially mislead the reader. The Swiss export successfully in goods markets and in non-life insurance; in other words, where they have an agreement with the EU and where they update their laws to stay in line with the EU. Outside of non-life insurance, the Swiss do not have a strong export performance in services even though financial services are more important for the Swiss economy than the UK economy.
- 3.6. Sceptics point to the global free trade agreements struck by Switzerland and say that they have achieved more than the EU and provide a model for what could be achieved by the UK. In fact, the EU has free trade agreements in place or in the pipeline with all the significant economies, except China, with which Switzerland has a deal. Unsurprisingly, as our chapter details, Swiss deals can be weaker and the deal with China appears unfavourable.

4. The World Trade Organisation (WTO) Option

- 4.1. Our report then considers 'The WTO option'; it highlights that many Eurosceptics argue that we could trade just as successfully with the EU if we left and this would also allow us to strike deals independently from the EU with emerging economies and so leaving could only be a benefit.
- 4.2. For a range of reasons which we explain at length in the WTO option chapter, the first contention is wrong.
 - 4.2.1. If the UK left the EU and was unable to negotiate a free trade agreement (FTA), UK exports of goods would be subject to tariffs. While on average these tariffs are low, in specific sectors such as car production they are material and significant.
 - 4.2.2. In addition, as a consequence of being outside the EU, UK exporters would be subject to administratively complex and therefore economically costly border controls, particularly relating to origin of content declarations.
 - 4.2.3. Further, exporters entirely located outside the EU cannot access national courts in the EU to protect themselves from discriminatory rules. WTO enforcement capacity is a tiny fraction of EU enforcement capacity and unlike national courts applying EU laws cannot be accessed by individuals or companies at all. This is more of an issue for SMEs as larger companies can also establish themselves within the EU.

- 4.2.4. Critically, the main barrier to trade is not tariffs, but non-tariff barriers ('NTBs'). Historically, NTBs were thought of simply as disguised tariffs. Contemporary trade economists, however, recognise that while standards and other forms of regulation are barriers to those outside regional trade groupings, they are also facilitators of trade for those within systems where production is made through complex supply chains located in more than one country. Outside the EU, if the UK government were not making UK rules that mimicked EU rules, firms would have to independently duplicate what the UK government had been doing more efficiently on their behalf collectively. Even worse, the UK government would no longer be contributing to the design of those rules which would likely lead over time to these rules no longer taking into account UK production technologies and requirements.
- 4.2.5. For services as distinct to goods, firms cannot self-police. The EU might agree to monitor and assess equivalence of UK regulatory regimes and allow UK service providers to supply on a cross-border basis or it might not. Even where it did, UK firms would be at risk of hold ups in EU assessments. For certain services, any retail financial services, for example, the EU does not permit cross-border provision from outside the EU. As discussed above, it is notable that Switzerland is relatively weak at exporting services covered only by WTO rules to the EU.
- 4.3. The second contention that the UK could achieve superior trade deals to the EU is less testable. This is because all of the UK's current trade deals are negotiated by the EU, so we cannot assess in parallel how well the UK does. There is however logical reasons to expect that the UK would struggle to achieve the same terms enjoyed by the EU, let alone improve on them.
- 4.3.1. The UK now accounts for less than 1% of the world's population and 3% of its global income. When we negotiate as part of the EU, we collectively account for 20% of world GDP and are part of the largest trading bloc in the world.
- 4.3.2. If all of the EU's current trade negotiations are successful, they will cover 85% of the UK's goods exports, should the UK remain part of the EU. The UK currently has very little in the way of technical capacity for negotiating trade arrangements and this would have to be rebuilt within UK government machinery. There is also no obligation on the EU's trading partners to extend the same terms to an exited UK. It is far from clear within what time-frame the UK could match this 85% figure or even if it could.
- 4.3.3. Sceptics point to the fact that Switzerland has an agreement with China and the EU does not in order to argue that the UK could agree advantageous arrangements with faster-growing emerging markets. There are a number of reasons why agreements with emerging markets would not replace what we already have.
- 4.3.3.1. We already have, through the EU, FTAs with many emerging markets and more are in the pipeline. These deals only apply to the UK whilst we are members of the EU.
- 4.3.3.2. The economies of scale UK businesses achieve in a big European home market assist them in selling into emerging economies.
- 4.3.3.3. We may not be able to get good deals with all emerging markets, particularly negotiating on our own. The Swiss agreement with China is not a favourable one.
- 4.3.3.4. Emerging markets are still small importers of our goods. 48% of UK exports go to the EU, 2.8% go to China and 6.6% go to all four BRIC countries together. The US considers many of these countries to be protectionist and has not struck deals itself with Brazil, China, India or Russia.

4.3.3.5. Sceptics sometimes argue that it is membership of the EU which makes us uncompetitive in selling into emerging markets. This seems unlikely and no detailed argument has been presented as to why this could be the case. It certainly isn't true for Germany, whose exports have increased 500% to emerging markets between 2000 and 2014. The growing but lesser extent of UK exporting success relates more to the nature of UK production. Whereas Germany produces goods such as machine tools that countries need when they are industrialising, the UK specialises in goods such as advanced manufacturing, finance, and business services which are purchased by customers in more advanced economies such as our European neighbours.

5. UK Free Trade Agreement

5.1. Some sceptics argue that the concerns set out in the WTO Alone chapter are immaterial because if the UK exits the EU it will easily achieve a free trade agreement with the remaining members of the EU.

5.2. There are a number of reasons that this may not be as easy as such advocates claim.

5.2.1. According to our legal and political analysis, it is highly likely that any trade agreement with the UK will require unanimity amongst all Member States. Given the diversity of economic and political interests amongst Member States and the low economic costs for some Member States of an UK exit, it seems unlikely that the UK will achieve what the sceptics claim is possible: free-trade, no budgetary contribution, and, an ability to freely pick which European rules it wishes to observe and which it does not.

5.2.2. Access to the single market depends on observing the rules of the market. If the UK does not observe goods markets rules, it could pass the costs of doing so to its exporters instead – raising their costs of doing business. The EU may or may not agree that establishing equivalence of UK national rules is sufficient for UK service providers to trade into the EU. Assessing equivalence is time-consuming and costly. Even if the EU did agree to this in general, there are important cases (particularly for the UK) where it is highly unlikely that scope to demonstrate equivalence would be granted. Services including banking, retail fund management and data storage service providers are required to be established in the EU if they wish to trade in the EU.

5.2.3. Critically, as in WTO alone, a free-trade agreement only avoids tariffs. It still means that the far more important nontariff barriers remain in place.

5.2.4. Unless the UK simply agrees to adopt EU rules then negotiating a suite of sectoral agreements will be time-consuming and complex. Eurosceptic analyses mostly ignore the economic consequences of a drawn out interregnum. If it wished to avoid those damaging consequences, the UK would likely have to simply agree to adopt EU rules, but if it did so there would have been no hypothetical logic for leaving in the first place. If it wished to renegotiate everything, the UK would have to identify those aspects of EU rules which it wished to remove – not an easy task after 40 years of legal integration. Only once it did that could it begin to negotiate and for the reasons we describe in 5.2.1. above, it is likely that it will end up with a deal that leaves it in a substantively weaker trading position vis-à-vis the rest of the EU than it currently enjoys.

6. Cost-benefit Analysis of EU Membership for the UK

6.1. Our review of the various analyses of costs and benefits of EU membership suggests it is difficult to bring this down to an exact figure but we do think that there are some general conclusions which can be drawn about the appropriate heads of costs and their relative likely magnitude.

- 6.2. The work undertaken by sceptic and non-sceptic economists suggests that the relevant categories of net cost/benefit are: (i) fiscal costs; (ii) effects of tariffs and NTBs on trade with the EU; (iii) border costs; (iv) foreign direct investment; (v) trade with the rest of the world; and (vi) regulation.
- 6.3. On balance, it could be that exit would improve the UK's position with respect to (i) and possibly (vi) – if the effect of removing regulation were restricted only to those elements poorly calibrated to UK requirements (by definition lifting effective well-calibrated regulation has a negative not a positive impact). We note that overall that actual systematic study shows no net overall cost and in fact a benefit for the UK economy from EU regulation.
- 6.4. It seems highly probably that exit would lead to a deterioration in the UK position with respect to (ii), (iii), (iv) and (v).
- 6.5. On the basis of the studies we reviewed it seems to us that the net losses are likely substantial and in some scenarios very substantial. Where economic studies predict possible gains or very small losses, the assumptions behind these predictions appear to be implausible.

7. Overall conclusion

It is likely that a Brexit will leave the UK in a substantively weaker trading position vis-à-vis the rest of the EU than it currently enjoys, leading to the UK being poorer than it would otherwise have been. Overall, in the pursuit of “sovereignty” we would be exchanging our current position as a leading joint rule maker for the position of a rule taker which would give us less influence over the rules under which our economy operates than at present.

An enormous political and administrative effort will be required, possibly lasting a decade. It will also require large time resources and financial costs for UK firms.

This seems a very large price to pay for a highly uncertain prize, if there is a prize at all.

At the end of the day, this prize may consist either of a slightly smaller budgetary contribution, which does not match the losses from lower trade, foreign direct investment and other costs, and an ability to achieve nominal Swiss-style sovereignty: “autonomer nachvollzug”: autonomously updating our law to mimic EU-law; or, it may consist of being outside the Single Market altogether, forcing UK firms to absorb higher costs and loss of influence on regulatory rules and in some cases having to relocate to the EU. Either option would be a very bad deal for the United Kingdom compared to continued membership of the EU.

List of Acronyms Used

ACEA	European Automobile Manufacturers Association
Brexit	British exit from the EU
BRICs	Brazil, Russia, India and China
CAP	Common Agricultural Policy
CBI	Confederation of British Industry
CEPR	Center for Economic Policy Research
CER	Center for European Reform
CFP	Common Fisheries Policy
CETA	Canadian-EU Trade Agreement
CFSP	Common Foreign and Security Policy
ECJ	European Court of Justice
EGC	European General Court
EEA	European Economic Area
EFTA	European Free Trade Association
ESMA	European Securities and Markets Authority
ETSI	European Telecommunications Standards Institute
EU	European Union
FCA	Financial Conduct Authority
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GATS	General Agreement on Trade and Services
GDP	Gross Domestic Product
INC	Independent Norwegian Committee reviewing Norway's membership of the EEA
ITU	International Telecommunications Union
MEP	Member of the European Parliament
MiFID	Market in Financial Instruments Directive
MFN	Most favoured nation
NFU	National Farmers Union
NTB	Non-tariff barrier
OTC	Over the Counter
SME	Small and medium enterprises
TFEU	Treaty on the Functioning of the EU
TTIP	Transatlantic Trade and Investment Partnership
TUPE	Transfer of Undertakings (Protection of Unemployment) Regulations
UK	United Kingdom
UKIP	United Kingdom Independence Authority
UNECE	United Nations Economic Commission for Europe
US	United States of America
WTO	World Trade Organization