

# Alternatives to the EU for the UK

*“British people should always remember that the EU was created for the benefit of member states, not for those outside. You don’t get anything without giving something in return.”*

*Lars Vesterbirk, Greenland’s former representative to the EU who led the exit negotiations<sup>1</sup>*

## I. Introduction

The High Court’s ruling on November 3, 2016 is unlikely to stop Brexit altogether, but it could definitely change UK’s negotiation strategy. It could delay the moment when Article 50 is pressed and push it beyond Mrs May’s March 31 deadline. It could also generate the need for an interim agreement until a final deal is struck. In this context and with the search for 'pre-fixed' alternatives being perhaps more timely than at any other point since the referendum took place, we shall consider the main alternative regimes, EFTA and EEA.

When considering the options, there are two things that should be kept in mind; that mainly geography defines trade policy and that the trade-off in any deal is the same- economic integration over sovereignty and vice versa. In particular,

1. The best-known fact in international economics is that international trade and investment fall substantially with distance. Doubling the distance between two countries roughly halves the trade between them. It thus comes as no surprise that half of the UK’s trade is with the EU (47% imports and 49% exports).<sup>2</sup> Put differently, it is geography rather than policy that makes the EU the UK’s most important economic partner.

Reorienting the focus of the UK’s trade policy away from Europe will not change this underlying reality. The revival of the Commonwealth is regarded by many as an alternative to the EU via an agreement on freedom of movement between the UK, Canada<sup>3</sup>, Australia, and New Zealand (CANZUK).<sup>4</sup> One of the main arguments is that the aforementioned countries are in the top 16% of the most competitive economies

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<sup>1</sup> <http://www.politico.eu/article/greenland-exit-warning-to-britain-brexit-eu-referendum-europe-vote-news-denmark/>.

<sup>2</sup> Ottaviano, G, J Pessoa, T Sampson and J Van Reenen (2014) ‘The Costs and Benefits of Leaving the EU’, CEP mimeo ([http://cep.lse.ac.uk/pubs/download/pa016\\_tech.pdf](http://cep.lse.ac.uk/pubs/download/pa016_tech.pdf)).

<sup>3</sup> Annual immigration will need to be raised to 407,000 by 2030, otherwise the economy could decline as demographics indicate a rapidly aging population; See <http://www.cfmo.org/2016/10/canada-could-depend-on-freedom-of.html>.

<sup>4</sup> See more on “The Commonwealth Freedom of Movement Organization” at <http://www.cfmo.org/>.

worldwide.<sup>5</sup> The US is not likely to become part of such an agreement due to its 10-time greater population than the CANZUK's.<sup>6</sup>

2. No matter what the option, the trade-off will remain the same; higher economic integration comes along with higher political cost since countries need to give up more of their sovereignty. Prime Minister May seems to remain faithful to the referendum's mandate for preference on political independency over the economic losses, believing that with the appropriate industrial policy ('Midlands engine') the UK can overcome the shock. The priorities could change if the High Court's decision is upheld and the MPs have a say on Art. 50. However, politicians have been over-estimating the strength and scale of British manufacturing.<sup>7</sup> When the UN statisticians measure per head, Britain has less manufacturing than Switzerland.<sup>8</sup> When looked at by company size, Britain's businesses are shrinking; manufacturing is often less about huge or even medium-sized factories and more typically one- or two-man bands.<sup>9</sup> Consider the British car industry, usually touted by ministers as proof that manufacturing is alive and kicking, which is less 'Made in Britain' than 'Assembled in Britain'.<sup>10</sup>

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<sup>5</sup> <http://www.cfmo.org/2016/10/canzuk-countries-ranked-in-top-16-of.html>.

<sup>6</sup> Economically speaking, the risks of overpopulating a free movement area can be substantial, especially for smaller countries such as New Zealand. Reallocate without consideration of migrant influx vs. Infrastructure can entail significant risks. For example, in 2015, the UK saw a net population increase of 184,000 people from the EU, as the UK economy was considerably stronger and more prosperous compared to other EU economies. Even if just 1% of the American population decided to emigrate throughout the CANZUK area, this would equate to over 3.2 million US citizens. For further details, see <http://www.cfmo.org/2016/10/the-case-for-against-free-movement-with.html>.

<sup>7</sup> <https://www.theguardian.com/commentisfree/2016/oct/09/the-guardian-view-on-industrial-policy-consistency-not-catchphrases>.

<sup>8</sup> <https://www.theguardian.com/commentisfree/2016/may/18/making-things-matter-britain-forgot-manufacturing-brexit>.

<sup>9</sup> <http://www.cresc.ac.uk/medialibrary/workingpapers/wp87.pdf>.

<sup>10</sup> <https://www.theguardian.com/commentisfree/2016/oct/09/the-guardian-view-on-industrial-policy-consistency-not-catchphrases>.

## II. Setting the Scene: UK's characteristics, policy areas, alternatives

### i. Characteristics of the British Economy<sup>11</sup>

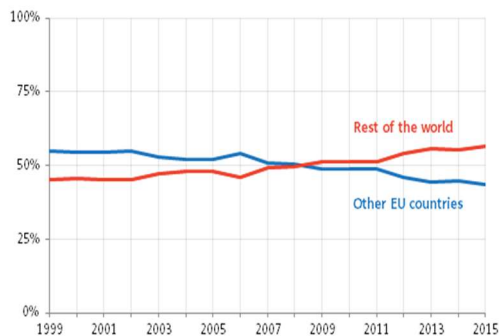
- The UK represents 13% of the EU's population (ranks 2<sup>nd</sup> after Germany with 16%).
- The UK represents 18% of the EU's GDP (ranks 2<sup>nd</sup> after Germany with 21%).
- The annual average GDP growth (2010-2015) is 2.0% (EU average 1.2%)
- The unemployment rate stands at 5%, whilst the EU average is 8.8% (ranks 25<sup>th</sup>).
- 44.4% of the UK's exports go to the EU, whilst 52.9% of its imports derive from the EU (see Annex – Table A).
- The UK contributes £89 per head to the EU Budget -8<sup>th</sup> highest (see Annex – Table B).

### Trade with other EU countries

Balance of trade in goods and services with other EU countries, 2014

#### Who's buying UK exports?

UK exports of goods and services to other EU countries and to countries outside the EU, as a proportion of total exports.



Source: ONS 'Exports/Credits Goods and Services' Table L7D7 and 'Balance of Payments: Exports: Total Trade in Goods and Services' Table KTMW



Source: Office for National Statistics, The Pink Book 2015, Table 9.3

### ii. Main policy areas

- **Decision making.**
- **Freedom of movement of persons:** current and future EU workers.
- **Financial Services:** EU passport, red tape, regulatory deficiencies.
- **Agriculture:** Departure from the CAP, guaranteed current level of subsidies until 2020; what next?, UK agro-industry, environmental concerns.
- **Fisheries:** EEZ, fish quotas with the EU and other countries, UK fisheries management and enforcement mechanism.
- **Energy:** nuclear production.

<sup>11</sup> Brexit: impact across policy areas, Briefing Paper 07213, House of Commons Library, Edited by V. Miller, 26 August 2016, p. 9.

- **Human rights:** EU Charter of Fundamental Rights, Convention of Human Rights, EU Court of Justice.
- **Financial Contribution to the EU Budget.**

iii. Alternatives

	Full EU membership	Soft exit				Hard exit	
		1 EEA (Norway)	2 EFTA (Switzerland)	3 Continental Partnership (Bruegel Proposal)	4 Customs Union (Turkey)	5 FTA (Canada)	6 WTO Rules
<b>Access to single market?</b>	Yes	Yes	Partial	Yes, with possible labour market limits	No	No	No
<b>Duty free trade in goods</b>	Yes	Yes	Yes	Likely	Yes	Yes	No
<b>Market access for services</b>	Yes	Yes	Partial	Likely	No	Partial	No
<b>Free to negotiate bilateral trade agreements with non-EU trade countries?</b>	No	Yes	Yes	Probably not	No	Yes	Yes
<b>Must adhere to EU social and employment rules</b>	Yes	Yes	No	Likely partial	No	No	No
<b>Makes EU budget contributions</b>	Yes	Yes, but reduced	Yes, but reduced	Yes, but probably reduced	No	No	No
<b>Part of Common Agricultural Policy</b>	Yes	No	No	No	No	No	No
<b>Ability to restrict inward EU migration</b>	No	No	No	Yes	Yes	Yes	Yes

Source: HSBC

A. EFTA

- **Members:** Iceland, Norway, Lichtenstein, Switzerland (the assent of all four is required in order for the UK to join EFTA).
- **Background:** EFTA is an intergovernmental organisation established in 1960 with the objective of liberalising trade between its Members. As such, and with no legislative component whatsoever an agreement by the UK ratifying the EFTA Convention would be sufficient. The latest version of the EFTA convention is the so-called EFTA 'Vaduz Convention', and it includes free movement of persons between all EFTA members, certain provisions on trade in services, movement of capital, and protection of intellectual property.
- **History:** At the time of its creation, EFTA included the following seven countries: Austria, Denmark, Norway, Portugal, Sweden, Switzerland and the United Kingdom. Finland joined in 1961, Iceland joined in 1970 and Liechtenstein in 1991. In 1973, the

United Kingdom and Denmark left EFTA to join the EC. Today, EFTA includes the following four Member States: Iceland, Liechtenstein, Norway and Switzerland.

EFTA was established as an economic counterbalance to the more politically driven European Economic Community (EEC). Relations with the EEC, later the European Community (EC) and the European Union (EU), have been at the core of EFTA activities from the beginning. However, as of 2010 EFTA had already established 23 contractual FTAs with 31 partners (EFTA, 2011e).

- **Administration:** The main task of the EFTA MS is negotiating and managing FTAs. The EFTA Secretariat (its Geneva office, approx. 15 staff members) assists the four EFTA Member States in the negotiation (**but does not negotiate on behalf of them**) and in the daily management of FTAs. The two core activities of the EFTA Secretariat these days are:
  - i) The management of the EEA Agreement, and
  - ii) The management of EFTA's free trade agreements.
  
- **EFTA's FTAs:** EFTA is not a Customs Union and does not issue legislation. Member States are free to conduct their own trade policy and the EFTA Convention does not oblige EFTA Member States to conclude free trade agreements as a group. They maintain the right to enter into bilateral third-country arrangements. Thus far, though, the EFTA countries have mainly negotiated as a group and concluded 27 FTAs. The EFTA countries have also negotiated a limited number of bilateral FTAs. For instance, Switzerland has concluded bilateral FTAs with Japan and China; Iceland has also concluded a bilateral FTA with China (*for a detailed break-down of Switzerland's bilaterals see Annex C*).

All EFTA FTAs consequently cover trade in industrial goods, including fish, and in most cases processed agricultural products. They also contain rules on competition, protection of IP, and payments and transfers. Unprocessed, basic, agricultural goods are also part of FTAs, as annexes, but they are being negotiated bilaterally between the individual EFTA MS and their respective negotiation partners. In other words, EFTA provides for free trade with the EU in all non-agricultural products. This seems to be a plus point for the UK since negotiating independently for its agriculture is significant both economically and politically.

A weakness of the EFTA Agreements is, that because there was a need to trade more and more often with less developed countries, it was necessary to take the different levels of development of the partner countries' into account, when negotiating FTAs. As a result, asymmetrical approaches arose, with EFTA MS abolishing all tariffs and restrictions, while the partner country was granted a transitional period, allowing it to only gradually remove trade restrictions.

Another challenge that EFTA has to face is that, as an international organisation, it faces other globally significant issues, put forward mainly by different interest groups and NGOs. Such issues concern environmental sustainability of worldwide trade, social inequalities (e.g. labour rights), and will need to be addressed in future FTAs.

The only country that applies a pure EFTA regime today is Switzerland since the other three countries (Iceland, Liechtenstein and Norway) have proceeded to further integration with the EU by signing the EEA Agreement. Switzerland voted against EEA Membership in a referendum in 1992, but still remains an EFTA Member.

- **Institutional set-up:** Like the EEA model (see below), Switzerland has to adopt a number of EU policies and legislation without participating in the decision-making process. Under the current agreements, there is a Joint Committee for resolving matters, including disputes.

As an EFTA member, Switzerland enjoys the observer status in the EFTA pillar of the EEA, which allows for close monitoring of the current progress of the EEA, EU acquis.

The sectoral agreements are "static" in nature and do not foresee a dynamic process of continuous updates in light of evolving EU acquis in contrast to the EEA Agreement. This is seen as one of the major weaknesses of the Swiss bilateral model. The bilateral agreements were originally intended as a temporary feature. The EU is now insisting that the institutional framework needs to be improved before Switzerland can gain further access to the Single Market (e.g. electricity). In practice, Switzerland autonomously adapts its legislation in line with EU acquis ("autonomer Nachvollzug").

In 2014, the EU and Switzerland launched negotiations on institutional matters creating an overarching framework agreement for the various bilateral agreements. However, these negotiations have made limited progress to date partly due to Switzerland's referendum on limiting immigration. The Brexit issue is likely to further divert attention and resources away from the negotiations with Switzerland on the institutional and free movement of persons, but the two negotiations also have some commonalities touching on core issues – thus, interlinkages will be made.

## B. EEA<sup>12</sup>

- **Members:** The European Economic Area (EEA) between Norway, Iceland, Liechtenstein and the EU entered into force in 1994. Currently, the EEA comprises the 28 EU Member States and the three EEA EFTA States. Accession to the EEA Agreement as an EFTA State is likely to be more difficult since it would require the consent not only of the other EFTA/EEA States, but also of the EU/EEA States. Such membership would mean that the UK would remain an EEA member, but from the EFTA pillar this time.

Article 128 of the EEA Agreement: *“Any European State becoming a member of the Community shall, and the Swiss Confederation or any European State becoming a*

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<sup>12</sup> Rasmussen ruled out suggestions that Britain would “copy a well-known model, like Norway’s; See <http://www.politico.eu/newsletter/brexit-files/politico-brexit-files-team-brexit-denmark-in-the-dark-londons-battle-plan/>.

*member of EFTA may, apply to become a party to the Agreement. It shall address its application to the EEA Council. The terms and conditions for such participation shall be the subject of an agreement between the Contracting Parties and the applicant State....*“ This Article has so far only been used in cases of EU enlargement when any new EU Member *shall* also become a member of the EEA with subsequent negotiations on EEA enlargement. Under the present wording, it is therefore impossible to be an EEA member without being a member of either the EU or EFTA.

- **Background:** The objective of the EEA is to extend the **Internal Market** of the EU to the three EFTA States. The EEA covers the four freedoms: goods, services, capital and persons. All relevant Internal Market **legislation is continuously integrated** into the EEA Agreement through secondary laws so that it applies throughout the whole of the EEA. In addition, the EEA Agreement covers **horizontal areas** such as social policy, consumer protection, environment, company law and statistics. **It also provides for participation in EU programmes** such as research and education. To ensure equal conditions of competition throughout the EEA, the EEA Agreement mirrors the competition and state aid rules of the EU treaties.

The EEA is **not a Customs Union** either – so its tariffs for non-EU trade are not set by the EU, and does **not** include other EU policies such as the common **agricultural** policy, the common **fisheries** policy, justice and home affairs, harmonised taxation or the economic and monetary union. There is no harmonisation with regards to tax law, and no common trade policy towards third countries. The latter would allow the UK a free hand in establishing free trade agreements with non-EU States.

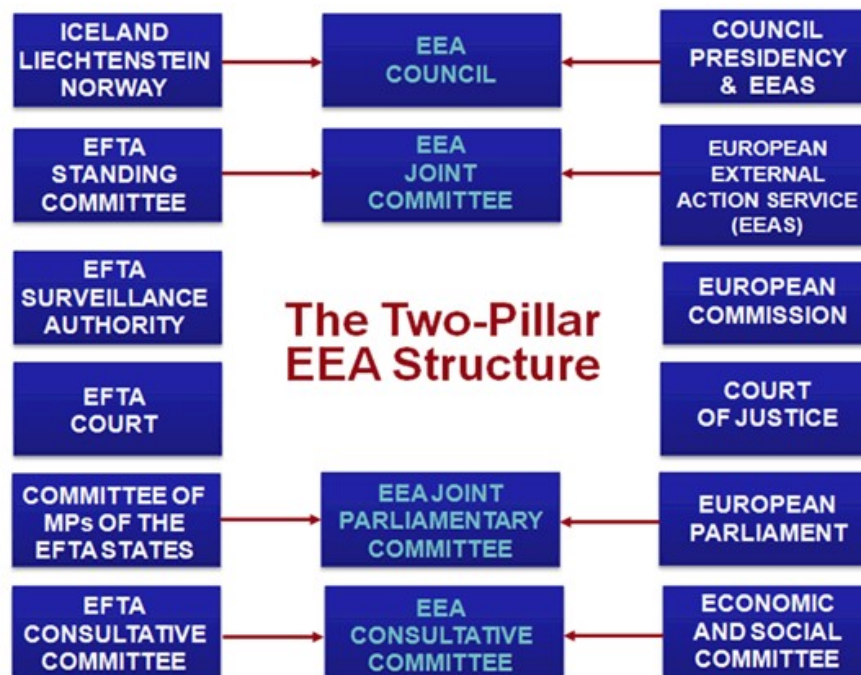
Schengen is not part of the EEA Agreement. However, all the four EFTA countries participate in Schengen and **Dublin** through bilateral agreements.

- **Institutional set-up:** The effectiveness of the EEA depends on the uniform application and implementation of the common rules in all the participating 31 EEA countries. The EEA’s institutional set-up is characterised by the so-called **two-pillar structure** (see diagram below): the EEA EFTA countries mirror the EU structures for supervision and judicial control. The EEA EFTA institutions and EU institutions form the two pillars with joint EEA bodies linking the two.

The unique two-pillar institutional apparatus reconciles far-reaching economic integration with the rejection of supra-nationalism by the EEA-EFTA States. The structure of the EEA Agreement implies that decisions are not directly applicable in the EFTA pillar. The Agreement is administered, monitored and adjudicated in two independent pillars, with the EFTA States having their own court and surveillance authority, separate from the CJEU and the Commission.

The EEA EFTA side has thus established an EFTA Surveillance Authority (comparable to the surveillance functions of the European Commission), EFTA Court (comparable to the EU Court of Justice), EFTA Standing Committee (comparable to the EEAS),

Committee of MPs of the EFTA States (EP) and EFTA Consultative Committee (Economic and Social Committee). The joint EEA bodies include the EEA Council, the EEA Joint Committee, the EEA Joint Parliamentary Committee and EEA Consultative Committee (see in more detail below).



The EEA EFTA States have not transferred any legislative competences and they do not accept any direct decisions by the EU institutions for constitutional reasons.

*- EFTA Surveillance Authority*

The EFTA Surveillance Authority (henceforth Authority) has monitoring and enforcing powers, which correspond to those of the European Commission. The overall objective is to ensure that EEA EFTA States respect their obligations under the EEA Agreement.

The Authority can initiate proceedings against an EEA EFTA State at the EFTA Court. The Authority also has the competence to enforce restrictions on state aid and competition comparable to the European Commission.

There is close cooperation between the European Commission and the EFTA Surveillance Authority as the two oversee the application of the same laws in different parts of the EEA.

*- EFTA Court (on EEA issues)*

The EFTA Court operates in parallel to the Court of Justice of the EU. It has jurisdiction with regards to Iceland, Liechtenstein and Norway. The Court is mainly competent to deal with infringement actions brought by the EFTA Surveillance Authority against an EFTA State with regard to implementation, application or interpretation of EEA rules, for giving advisory opinions to courts in EFTA countries on the interpretation of EEA rules and for appeals concerning decisions taken by the EFTA Surveillance Authority. The Court has three judges (and a staff of 13 persons).



When it comes to the EFTA court interpreting and enforcing the EEA law, it should be noted that the EU doctrines of direct effect or supremacy do not apply. However, there are other doctrines that may affect the UK legal order, namely conform interpretation, the provisions of Protocol 35 to the EEA Agreement, and the doctrine of state liability.<sup>13</sup> In particular,

- regarding *conform interpretation*, the EFTA court has stated that national courts must 'apply the interpretative methods recognised by national law as far as possible in order to achieve the result sought by the relevant EEA rule'.<sup>14</sup> This is a method frequently used by national courts when applying international law in domestic cases.
- With regards to *Protocol 35 to the EEA Agreement*, one should refer to its sole article: 'For cases of possible conflicts between implemented EEA rules and other statutory provisions, the EFTA States undertake to introduce, if necessary, a statutory provision to the effect that EEA rules prevail in these cases. Even though, closely related to the rule of primacy, there is one important difference; the wording refers to 'implemented' EEA rules, leaving aside the direct effect of non-implemented acts. However, the implemented EEA law must be unconditional and sufficiently precise.<sup>15</sup> Under the Norwegian model, Protocol 35 is understood as a principle of presumption, meaning that absent express intent, the legislator is presumed not to have wished to legislate contrary to the EEA law.<sup>16</sup> This principle is identical to what applies now in the UK, where it is assumed that the Parliament does not seek to legislate contrary to EU law, representing the basis for according priority to EU law over subsequent contrary national rules. The Parliament can thus overrule implemented EEA law if it expressly enacts legislation to that end. Nevertheless, such action could be considered as a violation of the EEA Agreement, potentially giving rise to state liability actions before national courts or infringement proceedings initiated by the EFTA Surveillance Authority.
- That brings us to the third 'alternative', which is the doctrine of state liability.<sup>17</sup> If harmonious interpretation of domestic legislation with EEA law is not possible, an individual may thus be able to obtain compensation from the EEA Member State.

The EFTA Court has no power to impose a financial penalty upon States in cases of non-implementation of its judgements. National judges are never obliged to refer cases for advisory opinions to the EFTA Court, and EFTA States can limit court's power

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<sup>13</sup> C. Bürke at al., *Life on the Edge: EFTA and the EEA as a Future for the UK in Europe*, *European Public Law*, no. 1 (2016): 69-96.

<sup>14</sup> Case E-1/07 *Criminal Proceedings against A*, EFTA Court Report para 39 (2007).

<sup>15</sup> Case E-1/01 *Einarsson* EFTA Court Report 1, para 50 (2002).

<sup>16</sup> Henrik Bull, *The EEA Agreement and Norwegian Law*, *Eur. Bus. Law Review* 12, 291-296 (1994).

<sup>17</sup> Case E-9/97, *Sveinbjörnsdóttir v Iceland*, EFTA Court Report 95 (1998).

to request an opinion. The extent of the right of lower courts to ask for advisory opinions is exclusively a matter of domestic law. Moreover, the EFTA Court is not provided with exclusive rights to interpret the EEA Agreement in relation to the EFTA-States. Instead the Norwegian Supreme Court does under the Norwegian regime.

### C. WTO- the fallback option?

While it seems that 'hard-Brexit' is the most likely scenario<sup>18</sup>, it is useful to briefly discuss that option.

- Cabinet ministers are being warned that the Treasury could lose up to £66 billion a year in tax revenues under a "hard Brexit", according to leaked government papers.<sup>19</sup>
- GDP could fall by as much as 9.5 per cent if Britain leaves the single market and has to rely on World Trade Organisation rules for trading with the continent, compared with if it stayed within the EU, the forecasts show. Such a steep drop in revenue would force ministers to slash public spending or raise taxes.
- Compared to the EU, EEA, or EFTA membership, this would raise the cost of exporting to the EU for UK firms.<sup>20</sup> The UK's services trade would also be subject to WTO rules, and since the latter are less liberalised than the EU's in the trade in services, this would have a significant impact on the UK's economy. Free mobility of labour between the UK and the EU would cease, but free movement of capital between the UK and the EU would continue, as the EU prohibits restrictions on capital mobility not only within the EU, but also with countries outside the EU.
- On the other hand, after leaving the EU, the UK would no longer be bound by the EU's common external tariff, but would be free to set its own MFN tariffs on imports. As a starting point, the UK would be most likely to inherit the EU's tariff commitments, but it could then choose to reduce its tariffs below EU levels to lower import costs for UK consumers and firms and increase the competition faced by UK businesses. However, since the average tariff charged on imports to the EU is only 1%<sup>21</sup> there is limited scope for further tariff reductions.
- The UK would be free to explore other alternatives. Closing a trade deal with the Commonwealth is definitely on the table. A deal with the Gulf countries is also being discussed.<sup>22</sup>

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<sup>18</sup> <https://www.theguardian.com/politics/2016/oct/13/its-hard-brexit-or-no-brexit-at-all-says-eu-council-president>.

<sup>19</sup> <http://www.thetimes.co.uk/article/hard-brexit-could-cost-66bn-a-year-phpmh6fcd>.

<sup>20</sup> See note 2, Ottaviano et al., 2014.

<sup>21</sup> World Bank, 2015.

<sup>22</sup> <http://www.cityam.com/250987/britain-has-golden-opportunity-leapfrog-eu-and-secure-free>.

#### D. Continental Partnership

Finally, the Continental Partnership<sup>23</sup> option is 'sui generis': it belongs neither to the 'hard' (i.e. WTO option) nor 'soft' Brexit categories (EEA, EFTA). Instead, the Continental Partnership:

- Shares some important features with the EEA option: the UK would have full access to the single market for goods, services and capital in exchange for respecting all single market rules, abiding by pertinent ECJ rulings and contributing to the EU budget;
- The UK would not maintain free labour mobility with the EU, but would have controlled mobility;
- The UK would have duty-free access to the EU goods market, but it would not participate in the EU agricultural and fisheries policies;
- The UK would have a voice – not a vote – in the EU's single-market rulemaking process.

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<sup>23</sup> Pisany-Ferry, Roettgen, Sapir, Tucker, Wolff, Europe after Brexit: A proposal for a continental partnership, 2016, available at: <http://bruegel.org/2016/08/europe-after-brex-it-a-proposal-for-a-continental-partnership/>.

### III. Assessing the alternatives

On a sectoral basis we shall examine the impact of applying the EFTA or the EEA regime, in contrast to the current status under the EU. As an EFTA model, we shall use the Swiss model, and as an EEA model, we shall choose Norway.

#### *i. Decision making*

##### ❖ Norway

An independent study commissioned by the Norwegian Government in 2012 calculated that, in return for its access to the EU market, Norway has had to incorporate approximately three-quarters of all EU laws into its own domestic legislation.<sup>24</sup>

Liechtenstein, Norway and Iceland have no representation in any of the EU institutions and only indirect influence – including the right to be consulted – on EU proposals affecting them.

The EFTA website explains how EEA members can influence EU legislation: The EEA Agreement does not grant the EEA EFTA States formal access to the decision-making process within the EU institutions. However, the EEA EFTA States can participate in shaping a decision at the early stages of preparing a legislative proposal.

The EEA Agreement provides for input from the EEA EFTA side at various stages of the preparation of EEA-relevant legislation:

- First, representatives of the EEA EFTA States have the right to participate in expert groups and committees of the European Commission. They participate extensively in the preparatory work of the Commission and should be consulted in the same manner as EU experts. The Commission may seek advice from the EEA EFTA experts by phone or by correspondence, or in meetings. The experts may also be associated with the preparatory work through regular committee meetings.
- Second, the EEA EFTA States have the right to submit EEA EFTA comments on upcoming legislation.
- While the EEA EFTA States use these opportunities to contribute to the legislative process, they can neither sit nor vote in the European Parliament or the European Council.

More information on this subject may be found in the EFTA Bulletin (2009) on Decision Shaping in the European Economic Area.<sup>25</sup>

Moreover, whatever adoption of EU law needs to be made, it has to go through a separate and independent Joint Committee Decision (JCD), which means that there can be no such adoption without the EFTA states influencing its content. In this respect, it is worth noting that the EFTA States and NGOs representing EFTA state interest groups –including the Norwegian regional offices, have been successful in lobbying activities in Brussels (e.g. Green Paper on a future Maritime Policy for the Union, influenced by Norway and Iceland).<sup>26</sup>

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Union, March 2016, para 3.12.

<sup>25</sup> <http://www.efta.int/>.

<sup>26</sup> C. Bürke et al. (2016), see note 13.

Furthermore, EFTA states have managed in the past to negotiate with the EU side a partial derogation from the material scope of new EU legislation, which is officially agreed upon and written into the Joint Committee Decision in question. This might occur, for example, in cases where the situation in an EFTA state differs substantially from that prevailing in any EU MS and the EU act does not tackle those specific needs and conditions. Norway has used that tool a lot.<sup>27</sup>

❖ Switzerland

The EFTA countries have almost no influence over the design of the EU programmes in which it participates. They just make an in or out choice, and they have no ability to change the shape of the programmes.

**ii. Freedom of movement of persons**

❖ Current/future workers

The withdrawal agreement is likely to cover many individual rights. But if there are areas not covered by a withdrawal agreement, or if the UK leaves without an agreement, would British citizens and businesses in Europe – and European citizens and businesses in the UK – be able to rely on any ‘acquired rights’ (also referred to as ‘executed’ or ‘vested’ rights), either under EU law or general international law? The EU Treaties say nothing about rights acquired during the currency of the EU Treaties automatically continuing after a Member State leaves the EU. There is no explicit ‘survival clause’ protecting acquired rights or covering the survival of claims based on EU law. General international law principles of certainty, stability, non-retrospectivity and mutual interest suggest some kind of continuing protection for individuals when the UK leaves the EU. But with no EU ‘survival clause’, where would this protection come from? The 1969 Vienna Convention on the Law of Treaties probably protects only the rights acquired under a treaty by states, not by individuals; and customary international law might protect some individual rights acquired under a treaty, but the scope of these rights is not clear and might not extend to rights of residence, for example. Opposite views that favour the protection of individuals as well have been expressed though.<sup>28</sup>

❖ EEA

EEA members accept free movement of people. The Government’s March 2016 report on the alternatives to EU membership noted, however, that there was a right to suspend free movement of people in certain limited circumstances. This could only be done in a reciprocal

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<sup>27</sup> Ibid.

<sup>28</sup> Bartels, The UK’s status in the WTO after Brexit, September 2016, p. 6.

way, so for example, if Norway used it, this would remove the right of Norwegians to move to the EU.<sup>29</sup>

Norway applied some national restrictions (residence permit conditional on offer of full-time employment) during a transition period concerning the free movement of persons in the first wave of EU enlargement.

Under the EEA Agreement, Liechtenstein has negotiated a permanent quota system concerning the free movement of persons due to its "specific geographic situation" which is reviewed every five years. Residence permits are required from the Liechtenstein authorities. The annual number of permits is calculated in such a way that the yearly net increase from the previous year is not less than 1.75%.

#### ❖ Switzerland

Switzerland accepts freedom of movement of persons. It is an integral part of a set of bilaterals that links freedom of trade and movement. If the one is not applied, the other is not applied either (Guillotini clause). Having said that, and combined with the recent referendum in 2014, according to which free movement of persons will be restricted, it is interesting to see the approach followed by the Swiss government. In particular, as a result of the acceptance of the referendum on limiting immigration ("Initiative gegen Masseineinwanderung"), Switzerland is scheduled to impose permanent quotas on residence/work permits for citizens from the EU and EEA EFTA countries starting from February 2017 in accordance with the referendum's text. This would be in violation of the principle of free movement of persons. The Swiss authorities are in talks with the EU to find an arrangement that satisfies both sides. If no agreement is found, the Swiss authorities would in principle need to suspend the free movement of persons agreement and the full first set of sectoral agreements would also need to be suspended due to their linkage (guillotine clause).

Switzerland was hoping to manage to get a deal that would allow it to impose some restrictions in the freedom of movement without losing access to the single market. However, the fear of creating a precedent just before the Brexit negotiations start, made the EU to toughen its position.<sup>30</sup> Swiss MPs have tried to come closer to a deal by approving legislation on Wednesday 21 September 2016 that would promote some local preference in job hires. The plan would encourage employers to give EU citizens and local Swiss nationals priority for job openings, and to advertise vacancies at local job centres before recruiting from abroad, in particular economic sectors if net immigration went above average levels in other European countries. Crucially, the plan does not include any fixed limits to EU immigration, and stipulates that specific EU approval would have to be obtained before any such curbs could be imposed. The European commission president, Jean-Claude Juncker,

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<sup>29</sup> HM Government, Alternatives to membership: possible models for the united Kingdom outside the European Union, March 2016, para 3.16

<sup>30</sup> 'EU tells Swiss no single market access if no free movement of citizens', Guardian, 3 July 2016.

said after talks with the Swiss confederation president, Johann Schneider-Ammann, in Zurich on Monday that he could back the proposal as long as a joint EU-Swiss commission approved it.<sup>31</sup>

The EU-Swiss talks became even more complicated after another referendum was held on the 25<sup>th</sup> September 2016 at the Italian-speaking Swiss canton of Ticino. In the poll, voters were presented with a choice between favouring local workers over foreign workers “with the same professional qualifications”. The campaign supporting the latter was the one to win the referendum achieving a 58%.

Switzerland has already made use of some restrictions to the free movement of persons during the seven-year transition period for the ten new EU Member States and also for Bulgaria/Romania and Croatia.

#### ❖ Possible regime

There is a discussion about following a points-based system, according to which it will be easier for high-skilled migrants to work in the UK, but access to low-skilled would be reduced.

### **iii. Financial Services**

#### a. Passporting

Within the common market EU institutions enjoy the benefits of the common passport. At the moment a range of authorised businesses, such as banks, insurance companies and asset managers, are able to operate across the EU as long as they have a base in the UK. This is called "passporting".

Passporting means that a British bank can provide services across the EU from its UK home. Importantly, it also means that a Swiss or an American bank can do the same from a subsidiary established in the UK. Goldman Sachs and JPMorgan both gave evidence to the Parliamentary Commission on Banking Standards before the referendum, flagging up the importance of the UK's EU membership in providing a base from which non-EU businesses can passport across the EU.

Passporting into the EU from the UK will not be possible following a Brexit unless a special arrangement can be negotiated. Financial services businesses wanting to continue to provide services across the EU may well have to establish subsidiaries in mainland Europe (to the extent that they do not already have them).

#### b. Red tape

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<sup>31</sup> 'Swiss climbdown over free movement may deal blow to UK hopes', Guardian, 22 September 2016.

Financial services is a highly regulated industry. Although much of this regulation emanates from Brussels, it is unlikely that regulation is going to lessen following a Brexit. While there are some examples of financial regulatory requirements which have been resisted by the UK (e.g. the bonus tax) much of the EU-derived requirements reflect the perceived need in the UK. It is therefore unlikely that the UK will repeal or amend significant parts of the financial regulatory law. Where the requirements have had direct effect in the UK, through Regulations, then the UK would need to decide whether to adopt these requirements or allow them to lapse on a Brexit.

If the UK wants to continue to do business with the remaining EU Member States following a Brexit, it will almost certainly need to comply with EU regulations in order to meet an equivalence assessment - but unfortunately without the ability that it previously had to negotiate, influence or challenge those regulations. Banks may also be faced with having to comply with UK as well as EU legislation, which may well diverge over time or at minimum be applied inconsistently.

#### c. Regulatory deficiencies<sup>32</sup>

Financial services regulation in the EU has moved quickly since the financial crisis. If UK firms have no say in the direction of that process, and cannot be guaranteed the application of the latest measures, then the current EEA model will not be suitable for the fast-changing regulatory challenges of the financial sector. This means that if the UK seeks to sign up to the EEA, it would need to ensure at least some mechanism to improve implementation speed for financial services measures and ideally some process for securing UK input to the rules. This would be in both sides' interests, because regardless of EU membership, their financial sectors will continue to be interwoven as a practical matter, posing a mutual source of potential systemic risk.

#### d. Remarks

The impact of losing the passport would vary across the financial sector. For investment banking, key parts of the incoming Markets in Financial Instruments Directive( MiFID II) legislation implies that financial services from non-EEA countries be afforded many of the passporting rights, provided they can prove that regulations are 'equivalent'. This legislation is due to come into play on 3 January 2018 – so before the UK leaves the EU.

Given that, initially at least, UK financial regulations would be very similar to EU rules, 'equivalence' could be granted. But unlike a passport, 'equivalence' would be granted on a case-by-case basis for different financial services. It would mean the UK would have to 'keep up' with changes to EU regulation or risk losing equivalence. And financial firms would have to operate under ongoing uncertainty that equivalence could be revoked. It also means the UK might not be able to deregulate the financial sector significantly or stray far from the EU standard. In short, equivalence may allow UK-based investment banks to continue to access

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<sup>32</sup> J. Armour, Legal Aspects of Withdrawal from the EU- a briefing note in Brexit to the EEA: What Would it Mean?, June 2016, p. 32.



EU markets, at the cost of UK becoming a rule-taker and not a rule-maker in the affected areas of financial regulation.

For retail banking (which is not subject to MiFID), there are no equivalence provisions. This means that UK banks would require a banking licence in the EU, via a branch or subsidiary, to continue operating within the EU.

Without a new agreement, UK asset managers would not be able to distribute to EU clients directly. The UK would no longer be part of the UCITS directive, which is aimed at providing a harmonised framework to sell retail investments across the EU.

Focussing solely on the financial services perspective, however, it is only the Norway model which is appealing for the sector, but it is unlikely to be politically appealing. Switzerland's 120+ bilateral agreements with the EU require constant renegotiation. None of these agreements allows Switzerland full access to the EU's internal market for financial services. As a result, Switzerland tends to do banking business by passporting - often from the UK.

#### ***iv. Financial Contributions***

##### **❖ EU**

Within the EU, the UK is committed to pay 0.5% of its GDP to the EU Budget, or put differently, 1% of total public expenditure, or 8.5 bn in 2015.

However, certain regions with relatively lower living standards receive financial support from the European Regional Development Fund (ERDF)<sup>33</sup> and the European Social Fund (ESF), which is boosted as well from the government or the private sector. In particular, the ERDF supports 3 priority objectives, namely convergence<sup>34</sup>, regional competitiveness and employment<sup>35</sup>, and European territorial integration. The ESF has invested in England 2.5 bn in jobs and skills from 2007-2013<sup>36</sup>, i.e. an average of .42 bn per year.

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<sup>33</sup> <https://www.gov.uk/guidance/erdf-programmes-and-resources>.

<sup>34</sup> Convergence funding provides investment in the least-developed regions that have a gross domestic product (GDP) below 75% of the average in the European Union. Cornwall and the Isles of Scilly is the only area in England to qualify.

<sup>35</sup> Regional competitiveness and employment funding is for all regions that do not receive convergence funding. This funding is aimed at strengthening the region's competitiveness and increasing employment. There are 9 regional competitiveness and employment programmes in England with different levels of funding dependent on the relative need (total funding from 2007 to 2013: 2.8 bn): East Midlands: €268.5 million, East of England: €110.9 million, London: €181.9 million, North East: €375.7 million, North West: €755.5 million, South East: €23.7 million, South West: €124.7 million, West Midlands: €399.9 million, Yorkshire and the Humber: €583.6 million.

<sup>36</sup> <https://www.gov.uk/government/collections/european-social-fund-2007-to-2013>.

❖ EEA

Since the entry into force of the EEA agreement in 1994, the EEA EFTA states (Norway, Iceland and Liechtenstein) have made financial contributions to the EU in two ways. Firstly, they contribute to broad EU regional policy goals by providing grants to “reduce social and economic disparities in the EEA”. Since the 2004 enlargement, funds have been provided under two schemes: ‘EEA Grants’, which Norway, Iceland and Liechtenstein all contribute to, and which is targeted at the thirteen newer Member States, plus Greece, Spain and Portugal; and ‘Norway Grants’, which Norway alone contributes to, and is targeted at the thirteen newer Member States only. €1.8bn was allocated to both schemes for the period 2009-14, to which Norway provides 97% of the total.

Secondly, EEA countries contribute to the costs of the EU programmes in which they participate under the EEA Agreement, in proportion to their percentage of EU GDP. The EEA states have also committed to second national experts to the Commission as an ‘in kind’ contribution to these programmes.

Norway, which by virtue of its relative size provides the vast majority of EEA contributions, provided around £586 million in 2014, or £115 per capita. It is not possible to calculate a net contribution for Norway as complete data on receipts from the EU budget are not available. However, Norway participates in fewer EU programmes than the UK – for instance Norway is not part of Common Agriculture Policy – so it would be fair to assume that they would receive fewer receipts.

**Norway and UK - contributions to the EU and EEA/EFTA in 2014**

<b>Norway<sup>a</sup></b>	<i>£m</i>	<i>£ per capita</i>
EEA/EFTA commitment to EU operational costs	296	58
EEA Grants	153	30
EFTA budget	8	2
Norway Grants	129	25
<b>Total</b>	<b>586</b>	<b>115</b>

<b>UK<sup>b</sup></b>	<i>£m</i>	<i>£ per capita</i>
Net EU budget contribution	9,807	152
Gross EU budget contribution (after rebate)	14,346	222
Gross EU budget contribution	19,234	298

<sup>a</sup> contributions converted to GBP at average exchange rate for 2014

<sup>b</sup> estimated outturn

Sources: EFTA Annual Report 2014; Agreement between the Kingdom of Norway and the European Union on a Norwegian Financial Mechanism for the period 2009-14; Protocol 38 B of the EEA Agreement; EEAgrants.org; HM Treasury European Union Finances 2014, Credit Swiss exchange rates

The Institute for Fiscal Studies (IFS) suggest that the UK’s net contribution might fall by more than 25% if it entered into a Norway-style arrangement. Rather than assuming that the UK would contribute on the same per capita basis as Norway, the IFS assume contributions are

made relative to national income. This approach suggests that the UK's net contribution may fall by more than 50%.<sup>37</sup>

Of course, in reality the UK's contribution upon entering a Norway-style arrangement would depend on negotiations.

#### ❖ Switzerland

Like the EEA countries, Switzerland contributes to both enlargement costs 'to reduce economic and social disparities', and the EU programmes in which it participates under its array of bilateral agreements. Its enlargement contributions are provided under multi-year frameworks.

- In relevant terms, Switzerland's contribution in recent years has averaged around £53 per capita, 60% lower than the UK's net contribution per capita.<sup>38</sup>
- The financial contribution to the EU from 2007 to 2013 has been standing at 550 million CHF per year to reduce social and economic disparities in the EU. Switzerland share stands at 37.68% of the overall EFTA budget, whilst Norway pays for the 57.12%, Iceland 4.33%, and Liechtenstein's share amounts to less than 1%. The expenses for which the funds are used include managerial costs of the EFTA secretariat, the costs of ensuring the trade relations, and the expenses for EU-EFTA, and EFTA cooperation programs.
- In 2009 Switzerland's contribution was around 600 million francs, £420 million per annum, or £53 per head.<sup>39</sup>

It is difficult to reach any conclusions on what this might mean if the UK were to exit the EU today and contribute on the same basis as Switzerland – the UK's contribution has nearly doubled since 2009 whilst we have no information about the change in Switzerland's contribution. Of course, the impact of the UK joining EFTA would be significant, since that would mean that all countries would pay less, the UK would pay the larger share of the five, but –nevertheless- the costs would not increase significantly. Future exit of Iceland in order to join the EU, would not change things dramatically since its share is relatively low.

#### **v. Fisheries**

While the UK's Exclusive Economic Zone is amongst the largest in the EU, Britain receives only a fraction of the rights associated with the zone, whilst other EU MS are being allocated fishing quotas in accordance with their population, rather than their sovereign rights under international law. Moreover, 'quota-hopping' entails that even the allocated British share of fishing rights often ends up being consumed by foreign commercial operators who register a

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<sup>37</sup> Institute for Fiscal Studies. *Brexit and the UK's Public Finances*, May 2016, pp 13 - 15.

<sup>38</sup> S. Dhingra, T. Sampson, *CPE BREXIT ANALYSIS- Life after BREXIT: What are the UK's options outside the European Union?*, Centre for Economic Performance, LSE, 2016, p. 6.

<sup>39</sup> Based on information published by the Swiss Government in its 2009 brochure 'Bilateral agreements Switzerland-EU'.

portion of their business in the UK.<sup>40</sup> The UK has been barred from legislating to prevent 'quota-hopping' by EU law. Both those factors reduce the UK's capacity to exploit its fisheries industry. To that, one can add the disastrous consequences for the environment, including the dumping of dead fish in order to comply with EU-imposed quotas.

Within the EEA Agreement, the Common Fisheries Policy (CFP) has no place. Fisheries are regulated by the general rules of the EEA Agreement only to a limited degree. In practice, bilateral agreements generally determine the EFTA States' rights regarding fisheries under the Agreement. Norway, for example, has such an agreement with the EU States, which allows for the contracting parties to fish certain agreed upon quotas in each others' waters. However, the UK would be under no legal obligation to pursue a similar course. The UK could simply exploit its own EEZ according to the regulations of the international law of maritime delimitation.

#### **vi. Agriculture**

**Agriculture and Brexit: Key Issues for the food and farming industry**

**Main areas of uncertainty**

- Levels of direct financial support and rural development funding after 2020
- Trade models and level of continued access to the Common Market, degree of protection from cheap imports
- Provision of market safety nets
- Access to labour
- Overall national farm policy and regulation and approach across the Devolved Administrations
- Food labelling requirements
- Pesticides and GM food and crops approval approach
- What kind of future CAP UK farmers will be competing with as the policy is currently being simplified and will be reformed for 2021.

**Potential areas of opportunity**

- A simpler and more targeted approach to agricultural policy and support, incentivising farmers to UK priorities
- Potential for greater deregulation and innovation outside CAP.
- New trade deals
- New agri-environment schemes, tailored to UK needs and environmental priorities.
- No disallowance fines for incorrect CAP payments

#### ❖ EU

Brexit, in all scenarios, means a departure from the Common Agricultural Policy (CAP) and its subsidy and regulatory regime.

Almost 40% of the EU's budget is related to agriculture and rural development through the CAP. It provides an EU framework of regulation for direct payments to farmers, market support measures and rural development programmes to support the wider rural economy. EU farm subsidies currently make up to around 50-60% of UK farm income. The UK Government has guaranteed the current level of direct subsidies to 2020 "as part of the

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<sup>40</sup> European Commission, The Common Fisheries Policy- A user's guide (2009).

transition to new domestic arrangements". This is in line with the current CAP funding period and hence the timescale over which farmers and regulators have already invested and planned.

However, it is not clear what levels of support the UK Government will be willing to provide beyond this, or whether it will target subsidies in a different way. Previous Government positions on CAP reform have indicated that the UK Government and Devolved Administrations would be unlikely to match the current levels of subsidy and would require more 'public goods' in return for any support, such as environmental protection, which the UK Government views as the overarching market failure in this sector.

The terms of a UK exit will also affect pesticides approval, approval for genetically modified organisms (GMOs) and plant and animal health regulatory regimes. All of these are currently harmonised at an EU level.

#### ❖ EEA

The EEA Agreement does not apply to agriculture. However, even if the main provisions of the EEA Agreement do not apply to such product categories, certain technical rules dealing with these subject areas have been incorporated into Annexes I and II to the EEA Agreement, as well as into Protocol 47 to the EEA Agreement with the aim to facilitate trade in these products within the EEA area. Key areas of frustration in the sector such as elements of EU pesticide and GM regulation would continue where there are concerns that scientific assessment processes have become overtly politicised. The Common Agricultural Policy (CAP), however, is excluded from EEA law. That said, no matter whether the UK will opt in EFTA or EEA, agricultural and fisheries will be an area of independent action, and this constitutes a change that will likely benefit the UK.<sup>41</sup>

#### **vii. Rules of Origin<sup>42</sup>**

Because the EU, as a customs union, operates with a common external tariff, goods entering from outside can travel freely within the Union once that tariff has been paid (e.g. a mobile phone imported into the UK from China can be re-exported to the rest of the EU tariff free). The same is not true of goods that enter the EU via the EEA<sup>43</sup> (e.g. a mobile phone from China re-exported to the EU from Norway) or via other countries with which the EU has a free or preferential trading relationship, because they do not share the EU's common external tariff. Determining where a good originated, and hence whether it should attract

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<sup>41</sup> Philippidis and Hubbard, 2001.

<sup>42</sup> Brexit: impact across policy areas, see note 11, p. 29.

<sup>43</sup> With respect to non-EU countries in the EEA, the EU generally requires at least 60% of the content to be local (i.e., EEA origin).

tariffs, is done through the EU's Rules of Origin. Given the complexity of some global supply chains and the range of preferential trading relationships the EU operates, this can be a difficult, time-consuming and often subjective process. In particular, Customs checks would be imposed on the 56% of UK imports, which come from the EU customs union. As well as the additional administrative burden and lengthened journey time, this also throws up big questions as to how the Channel Tunnel and Northern Irish border would be managed.<sup>44</sup>

The costs of rules of origin were discussed in research published alongside the Coalition Government's Balance of Competences Review: With the UK as a customs union member within the European Union, British firms are saved the compliance and administrative costs linked to proving the origin of products shipped in the European market. With the UK instead taking direct control over its external trade policies, and so operating outside the customs union, rules of origin would become necessary under free trade with the customs union. This means British firms would be exposed to a combination of administrative and compliance costs linked to rules of origin, ranging (based on existing estimates) from 4 percent to perhaps 15 percent of the cost of goods sold. For low tariff products, it is therefore likely that firms would instead simply opt to pay the common external tariff of the EU, and so avoid costs linked to rules of origin. This means that, for low tariff products, there would be very little difference between no trade agreement, and one involving free trade combined with rules of origin.

#### ***viii. Remarks***

EFTA is a homogenous bloc in terms of countries' size, economic development and trade preferences. The UK might not fit in or might change the dynamic of the group to the disadvantage of existing members.<sup>45</sup>

Adopting the Swiss model would be appealing if the UK is looking for an 'à la carte' approach to European integration. Re-joining EFTA would guarantee UK goods tariff-free access to the EU and ensure the UK did not impose tariffs on goods imported from the EU.

However, certain drawbacks need to be stressed. There will be no freedom of movement of movement between the UK and the EU, without access to the Single Market for goods. Access to the services market is not given to Switzerland as well, and this is the reason why Swiss financial institutions often serve the EU market through subsidiaries based in London. Applying the Swiss model also means giving a significant portion of the state's sovereignty, without having a say in EU decision-making anymore, but would have to adopt EU legislation to participate in the Single Market. Since the UK would not belong to the Single Market, re-joining EFTA would also probably result in a gradual divergence between economic regulation in the UK and the EU, which would ultimately lead to an increase of the 'non-tariff

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<sup>44</sup> HSBC, Global Research, Brexit getting harder?, 6.10.2016, p. 7.

<sup>45</sup> Foreign Affairs Committee, The future of the European Union: UK Government policy, 11 June 2013, HC 87-II, 2013-14, Ev 135.

barriers' to trade between them.<sup>46</sup> Of course, it would lead to less economic integration between the UK and the EU than EEA membership, leading to higher economic costs of Brexit.<sup>47</sup>

Last but not least, it needs to be noted that the EFTA does not aim to reduce non-tariff barriers. Instead, EFTA members have either left to join the EU or sought greater integration with the EU through other channels (Switzerland's bilaterals). The TTIP agreement aims to tackle the non-tariff barriers and focuses on the trade in services and capital.

The EEA does not look a promising avenue for the UK as well. Straightforwardly applied, it would involve no additional immigration control and a greatly enfeebled version of the financial services passport. Of course, the UK might try to negotiate exceptions to the EEA's free movement parameters: Liechtenstein, for example, obtained a five-year transitional period. However, the UK's prospects for such an 'EEA minus' deal seem distinctly unpromising, given the risk to the EU of setting a precedent that other member states might follow. More concerning for the UK is the risk that other EU member states, jealous of London's success in financial services, might offer an 'EEA minus' version that permitted the UK to opt out of free movement but tore up the passport for financial services.<sup>48</sup>

Apart from EFTA and EEA, we should also consider a simplest alternative; A customs union, as Turkey's case. For the UK, joining the customs union would mean that goods could continue to move more or less freely across the bloc, without the checks and controls that are undergone by non-members. Crucially, it would also have control over inward migration. The UK would also be bound by the customs union's commercial policy, and have no seat at the table for law-making and regulations. A customs union deal would probably not cover trade in services. And the government would not be able to negotiate new external deals with third parties, because of the requirement to maintain a common external tariff.

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<sup>46</sup> According to some studies, non-tariff barriers could become equivalent to a tariff of 10-15% on UK trade, see HSBC Global Research, *Brexit getting harder?*, 6.10.2016, p. 1; One EU sponsored study (ECORYS, 2009) defines non-tariff barriers as "all non-price and non-quantity restrictions on trade in goods, services and investment, at federal and state level. This includes border measures (customs procedures, etc.) as well as behind-the border measures flowing from domestic laws, regulations and practices".

<sup>47</sup> Ottaviano et al (2014) estimate the costs of Brexit to the UK economy would derive primarily from increases in non-tariff barriers, not from changes in tariffs, see note 2.

<sup>48</sup> Ibid.

#### IV. Concluding Remarks; lessons from the past- the case of Greenland

Greenland and the U.K. are, of course, very different cases. It is, though, the only form of precedent we have.

Greenland, as part of Denmark, joined what was then the European Economic Community in 1973. After the introduction of home rule in 1979, the push to leave the EU gathered pace, mostly because of concerns about losing control over fishing rights — its main source of revenue. The people of Greenland had voted against EU membership in 1972, but had to join because of their ties to Denmark. When a second referendum was finally held a decade later, 52 percent voted to quit the bloc. Denmark then submitted a proposal to the Council suggesting that the bloc's rules "cease to apply" to Greenland.

It wasn't a complete split, however. The Greenland treaty signaling the end of EU membership, signed in 1985, called for "close and lasting links between the [European Economic] Community and Greenland to be maintained and mutual interests, notably the developments needs of Greenland, to be taken into account."

"The negotiations were rather subtle because Greenlanders were ready to remain in the Kingdom of Denmark but under the conditions that they would no longer be involved in the EU," said Pierre Sellal, the current French ambassador to the EU who headed a special group on Greenland years after the negotiations. That was the difficult part that delayed the negotiations. They had to define the future relationship to the EEC, which was even more complicated since Greenland couldn't be totally withdrawn from the EEC since it has strong constitutional connections to Denmark. So that was probably the reason it had to be exactly defined which parts Greenland were completely left out while the country retained some of the duties and benefits of membership.<sup>49</sup>

A fisheries deal was eventually struck, giving the island the right to govern its fishing sector and sell its catch to other countries. "The EU got almost the same amount of fishing rights they had before, and we had the same amount of money for our fish," Vesterbirk said.

Today, the island is one of 25 overseas countries and territories, including the Turks and Caicos Islands and French Polynesia, that are not EU members but have a special partnership with the bloc.

Greenland receives funding from the EU's general budget through the EU-Greenland Partnership. For 2014-2020, a total of €217.8 million was earmarked for cooperation with Greenland.

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<sup>49</sup> <http://www.bloomberg.com/news/articles/2016-08-09/greenland-s-exit-from-eu-holds-history-lessons-for-u-k-q-a>.



*'If it took Greenland more than two years to negotiate mainly on fisheries, in my eyes it will be an immense job for the U.K. and it will take many more years before they find a valid situation.'*

*Lars Vesterbirk<sup>50</sup>*

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<sup>50</sup> See note 1.

## ANNEX

Table A

Trade					
UK's largest export markets, 2014			UK's largest import markets, 2014		
	£ billion	% of total		£ billion	% of total
Total EU	228.9	44.4%	Total EU	290.6	52.9%
USA	88.0	17.1%	Germany	70.6	12.8%
Germany	43.3	8.4%	USA	51.6	9.4%
Netherlands	34.1	6.6%	China	38.3	7.0%
France	30.6	5.9%	France	37.0	6.7%
Ireland	27.9	5.4%	Netherlands	36.1	6.6%

Table B

EU budget contributions					
Highest net contributions, 2014			Highest net contributions per head, 2014		
	£ billion			£	
Germany	14.2		Netherlands	305	
France	6.0		Sweden	218	
UK	5.7		Germany	177	
Netherlands	5.1		Denmark	143	
Italy	4.2		UK	89 (8th highest)	

### C. Agreements between Switzerland and the EU

Switzerland has negotiated a series of bilateral agreements with the EU covering, inter alia, parts of the Internal Market. The EFTA Secretariat is not involved in the management of Switzerland's **bilateral agreements with the EU**.

Apart from the bilateral agreements with the EU, Switzerland signed (after a five-year negotiation process) **seven sectoral agreements** in 1999. Those sections included:

1. Freedom of movement of persons;
2. Mutual recognition in relation to conformity assessment;
3. Public procurement;
4. Agricultural products;

5. Road & rail transport;
6. Air transport;
7. Research.

A crucial point is that among those 7 sectoral agreements, the so-called **Guillotine clause** applies, meaning that if one agreement is suspended the whole set of agreement ceases to exist.

A **second set of bilateral agreement** was concluded in 2004. Initially, the EU was reluctant to negotiate a second set of agreements, but was then interested in concluding an agreement on savings taxation and enhanced cooperation on combatting fraud (cigarette smuggling). Switzerland in return requested the addition of participation in Schengen and Dublin. The final second set of sectoral agreements included:

1. Savings taxation;
2. Fight against fraud;
3. Processed agricultural products;
4. Environment;
5. Statistics;
6. MEDIA;
7. Pensions (retired EU officials living in Switzerland).

Overall, there are currently over **120 bilateral sectoral agreements** in place, including on a range of customs issues. These sectoral agreements provide Switzerland with access to the EU Internal Market.

Bilateral agreements have also been signed with Faeroe Islands, Japan, China.