



HM Government

Alternatives to membership: possible models for the United Kingdom outside the European Union

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Presented to Parliament pursuant to section 7 of the European Union Referendum Act 2015

This paper is the first part of the report that the Government will publish to meet the requirement of section 7(1) of the European Union Referendum Act 2015. The second part of this report, which will provide information about the rights and obligations that arise as a result of the UK's membership of the EU, will be published at a later date.

March 2016



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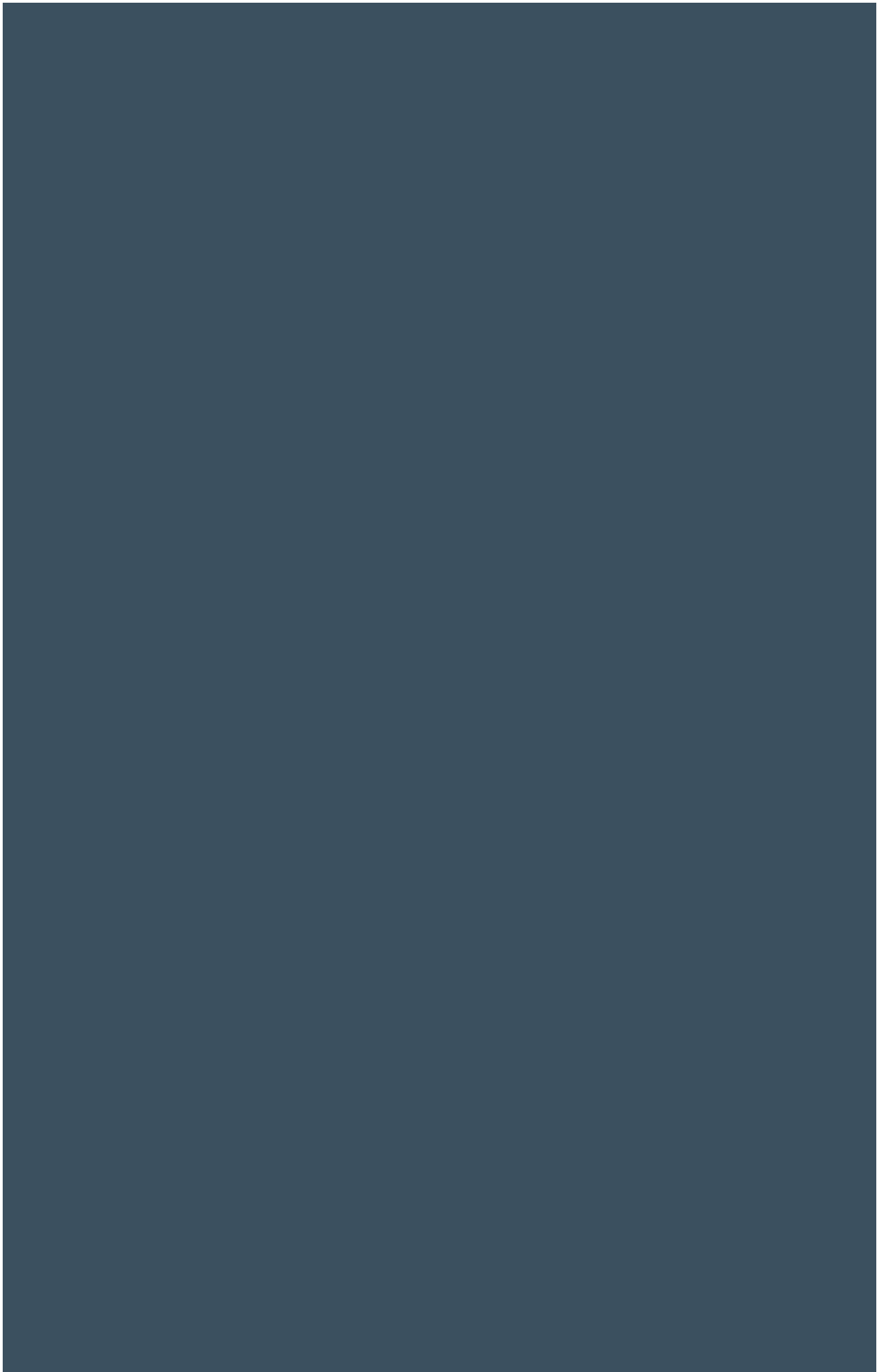
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Chapter 1 – executive summary

1.1 This paper looks at the potential models for the UK's relationship with the European Union, if there were to be a vote to leave. It provides examples of countries that are not members of the EU but have other arrangements with it – specifically Norway, Switzerland, Canada and Turkey – and describes those arrangements. It also looks at a possible relationship based only on World Trade Organisation membership.

1.2 These models offer different balances in terms of advantages, obligations and influence. If the result of the referendum were a vote to leave, we would seek the best possible balance of advantage for the UK. However, regardless of the preferred outcome that the UK seeks, the precedents clearly indicate that we would need to make a number of trade-offs:

- in return for full access to the EU's free-trade Single Market in key UK industries, we would have to accept the free movement of people;
- access to the Single Market would require us to implement its rules. But from outside, the UK would no longer have a vote on these rules. And there is no guarantee that we could fully replicate our existing cooperation in other areas, such as cross-border action against criminals;
- full access to the Single Market would require us to continue to contribute to the EU's programmes and budget;
- an approach based on a Free Trade Agreement would not come with the same level of obligations, but would mean UK companies had reduced access to the Single Market in key sectors such as services (almost 80 per cent of the UK economy),¹ and would face higher costs;
- we would lose our preferential access to 53 markets² outside the EU with which the EU has Free Trade Agreements. This would take years to renegotiate, with no guarantee that the UK would obtain terms as good as those we enjoy today; and
- in order to maintain the rights of UK citizens living, working and travelling in other EU countries, we would almost certainly have to accept reciprocal arrangements for their citizens in the UK.

¹ ONS UK GDP, low level aggregates; Second Estimate of 2015 GDP.

² See map and list of FTAs in the Annex.

1.3 It would take up to a decade or more to negotiate a new agreement with the EU and to replace our existing trade deals with other countries. Moreover, each of the alternative models would come with significant obligations and costs for the UK:

- the Norway model has considerable access to the Single Market but not in agriculture and fisheries. It does not give access to the EU's trade deals with countries outside the EU and still requires customs checks on goods crossing into the EU. It also involves making a significant contribution to EU spending, accepting free movement of people, and taking on EU rules without having a vote on them;
- bilateral agreements vary, but none provide full access to services, which constitute almost 80 per cent of the UK economy. Higher levels of access to the Single Market involve implementing EU rules in domestic legislation, accepting free movement (as in the case of Switzerland), and in some cases making contributions to EU spending. The EU-Canada Trade Agreement provides reduced access to the Single Market for example in services and agriculture; and
- if we could not reach agreement with the EU on a new arrangement, our trading arrangements would revert to WTO rules. This would provide the most complete break with the EU. It does not entail accepting free movement, budgetary contributions or implementing EU rules. But it would cause a major economic shock to the UK. WTO rules mean that the EU, and all countries with which we currently have trade deals, would have no choice but to apply WTO tariffs on exports from the UK – putting our companies at a competitive disadvantage. Meanwhile, the UK would face a difficult choice between either raising tariffs on imports from the EU or lowering tariffs on imports from all countries. Raising tariffs would have knock-on effects on UK jobs and incomes, as well as on the attractiveness of the UK as a destination for international investment. Lowering tariffs would deny the UK revenue, and undermine our negotiating position in future trade deals.

1.4 Under any of these alternatives, there would also be a non-economic cost, in terms of the UK's security and strength. The European Arrest Warrant and the Schengen Information System, for instance, allow our law-enforcement agencies to obtain and act on information from their EU counterparts. Even if over time we manage to negotiate replacement bilateral agreements, there is no guarantee that we could fully replace our access to current EU measures for police and security cooperation. And we would no longer be able, as we are now, to use the EU as one of our major tools, like our membership of the UN or other international organisations, to project UK influence in the world, or to use the EU's economic weight to impose sanctions, such as those it has imposed on Russia or Iran.

1.5 We need to assess the benefits offered by any alternative model against what the UK's membership of the EU gives us now. The UK Government believes that no existing model outside the EU comes close to providing the same balance of advantages and influence that we get from the UK's current status inside the EU.

Chapter 2 – introduction

2.1 This paper looks at a number of possible alternatives for the UK’s relationship with the EU, if there were to be a vote to leave. It sets out the key features and implications of each of the key existing models for the relationship, and assesses their suitability for the UK.

2.2 This paper is the first part of the report that the Government will publish to meet the requirement of section 7(1) of the European Union Referendum Act 2015. The second part of this report, which will provide information about the rights and obligations that arise as a result of the UK’s membership of the EU, will be published at a later date. Both parts of the report will be available to read together on the GOV.UK website.

2.3 An accompanying White Paper “The process for withdrawing from the European Union” describes the process required to exit the EU.³ As the paper sets out, this would be far from straightforward. The legal provision for exit (Article 50 of the Treaty on European Union) has never been used. There are important areas where the situation is unclear, including on whether the legal process to create a new relationship should be separate from the process of withdrawing from membership.

2.4 This legal uncertainty could affect negotiations on a future relationship between the UK and the EU. Some of the models described in this paper, such as a broad bilateral trade and cooperation agreement between the UK and EU, could require unanimous approval by the remaining 27 EU Member States. This would create a more difficult negotiating dynamic, in which any of the 27 could exercise a veto. If the UK sought to retain membership of the European Economic Area (EEA) along the lines of the Norway model, all EEA members, including Norway, Liechtenstein and Iceland, would also need to agree.

2.5 The UK would face difficult choices. As a country, we would need to weigh up the value of our freedom to act alone against the benefits of acting in coordination with the EU. This involves three key questions:

- the continuing access we wanted to retain, both to the Single Market, and to EU co-operation on issues ranging from policing to foreign policy;
- the obligations required for this access, which would almost certainly include the need to adopt EU rules, make financial contributions, and accept the free movement of people; and
- the influence we wanted over decisions made in the EU, including on the rules of the Single Market.

³ 29 February 2016. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/504216/The_process_for_withdrawing_from_the_EU_print_ready.pdf

2.6 These factors are inter-connected. For all the alternatives described in this paper, access comes with obligations and costs. And securing the maximum benefit from any access depends on having influence over the rules.

Where we are now: the UK's special status in the EU

2.7 The UK now has a special status in the EU, as a sovereign nation acting in partnership with the other Member States where the Government believes it is in our interests to do so, but with special arrangements in place where it does not. We have full voting rights, a full voice at the table and a full say over the rules of the Single Market. Our special status gives us:

- a leading role inside the EU;
- a permanent annual rebate on our payments to the EU budget that reduces our net contribution;
- access to the biggest Single Market in the world, with a leading voice in deciding the rules of that market, so that it reflects the best interests of UK businesses and consumers, creating jobs and making UK families more financially secure;
- cooperation on issues of international security, helping tackle crime and terrorism across borders to keep our country safe, while keeping our legal right not to take part in EU measures that are not in our national interest; and
- the ability of UK citizens to live, work and travel freely across the EU, but the power to take action where there is abuse of our welfare or immigration systems.

2.8 In addition, under the new settlement secured by the Prime Minister at the February European Council and set out in “The best of both worlds: the United Kingdom's special status in a reformed European Union”⁴ we will have:

- an emergency brake to limit full access to in-work benefits for newly arrived EU workers;
- a specific exclusion for the UK from ‘ever closer union’;
- greater power for our own Parliament;
- a fairer and more transparent relationship between the pound and the euro, reinforcing financial security for our businesses in the future; and
- an EU commitment to reforms to boost the EU's competitiveness through reducing regulatory burdens on business; extending the Single Market particularly in key areas like services, energy and digital; and Free Trade Agreements with the world's most dynamic economies.

2.9 The UK has also opted out of several key areas of EU cooperation. We have permanent opt-outs from the euro, including the Banking Union, and from the Schengen border-free area. We can opt in to individual measures on EU Justice and Home Affairs matters if we choose to. This means that the UK can choose to participate in EU-level actions on asylum, immigration from outside the EU, and police and judicial cooperation; but is under no obligation to do so.

⁴ February 22, 2016. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/502291/54284_EU_Series_No1_Web_Accessible.pdf

2.10 No other country has the same special status in the EU. Over its four decades of EU membership, the UK has secured this range of opt-outs, exemptions, a rebate and guarantees. We have full votes and veto rights. We are in those areas of EU activity that serve our national interest (the Single Market and foreign policy cooperation, for example), and outside those that do not (such as the euro and the Schengen border-free area). The new settlement confirmed and extended this special status. This hard-won set of agreements gives the UK a unique combination of access and influence with obligations that match our needs rather than the EU's norms. No other country has achieved this. This unique set of arrangements underpin the UK's remarkable economic performance in generating growth and creating jobs. Any alternative model for the UK would have to offer at least as good a balance if it is to support our continuing success.

Box 1: What is the Single Market?

The Single Market, created in the 1980s, makes the European Union the world's largest economic zone. It was inspired by a UK vision, and created through the leadership of Margaret Thatcher's Government and the UK's allies in Europe. No economy anywhere else in the world compares in terms of size, openness or the access given to businesses wanting to trade and invest across national borders.

The Single Market works by treating the EU's Member States as a single economic area.⁵ In particular, it promotes the free movement of goods and services within the EU in three key ways, by:

- removing import duties on goods, known as tariffs, and removing quotas;
- creating a single customs area for the movement of goods without the bureaucracy and paperwork of customs checks; and
- developing a level-playing field by removing other barriers to free trade such as differing regulations or technical specifications, known as 'non-tariff barriers'. This opens up both goods and services markets, which ensures that UK companies are treated in a fair and non-discriminatory way.

The EU forms a Customs Union, with no tariff barriers between Member States, and a common external tariff on imports from countries outside. Aligning these is an inherent part of any Customs Union and is necessary to ensure consistent treatment of imports into any EU country. For this reason the EU negotiates and agrees Free Trade Agreements with other countries on a collective basis. To date the EU has 36 such agreements covering 53 markets.⁶ As a Member State, the UK does not have separate trade deals with each of these other countries, but participates in EU ones. This brings advantages. It means the UK is part of a bigger, more powerful trading area and a stronger economic bloc in negotiations.

Each of these elements is explained in more detail below. Together, they mean that UK businesses can sell their goods and services freely into a market of 500 million people⁷ on our doorstep without having to comply with 28 different sets of rules and regulations. This means less waste of time and cost. The added competition also improves quality and

⁵ See the definition of the internal market in Article 26(2) of the Treaty on the Functioning of the European Union.

⁶ These agreements also give access to another seven countries in the EU Customs Union and the EEA. See the full list in the Annex.

⁷ Eurostat Population data.

brings down prices for consumers. It has been estimated that EU GDP is more than 2 per cent higher than it would have been had the Single Market not been launched in 1993 – adding more than £200 billion a year to the EU economy in today's prices.⁸

The ingredients of the Single Market

Tariff-free trade in goods means that there are no duties charged on trade between the UK and other EU Member States. If a business based outside the EU wants to sell its goods into the EU, then it needs to pay applicable import duties to be able to do so. Import tariffs are used across the world. By removing these tariffs within the EU, UK goods can compete with goods from all other EU countries on a level playing field, and UK consumers can buy a much wider range of goods from other EU countries at lower prices.

Tariff-free trade is necessary for the EU to be a Customs Union. In a Customs Union goods can be shipped across national borders without tariffs being imposed. This makes internal trade cheaper and less bureaucratic because it removes costly and time-consuming processes. These checks can be complex, for example where they require manufacturers to say where they sourced the components in their products, in order to make sure the whole product complies with all the different external trade policies (the so-called 'Rules of Origin'). An engine made in the UK may contain parts from all over the world. Without the Customs Union, some of those parts would be liable for tariffs and have to prove their origin. The engine therefore would need to be inspected and checked, and tariffs paid as it crossed the border into another EU Member State. The Single Market means none of that expense and bureaucracy is necessary.

The EU has also developed a level playing field for trade and investment by removing other barriers to free trade such as differing regulations or technical specifications for goods, known as 'non-tariff barriers'. These impose hidden costs on businesses that want to trade across borders. There are a huge range of these barriers, from requirements for additional documentation, to differing technical requirements on particular products, to packaging and labelling requirements, and numerous others. Reducing these barriers means developing common technical requirements across the EU, for example on the levels of certain chemicals allowed in children's toys, or the design of investment funds for retail investors, so that differing requirements do not create unnecessary barriers to trade. Ensuring that type of consistency means that UK firms can supply a single product for sale throughout the whole of the Single Market, rather than needing to make different products for each of the 28 EU countries. Where goods have been certified as compliant for the UK market, they will automatically be compliant for sale across the whole of the EU.

The same principle can be applied to services, which constitute almost 80 per cent of the UK's economy. A level playing field for services aims to open markets and ensure that a firm authorised to operate in one Member State can operate in all other EU countries. The Services Directive, introduced in 2006, has made some progress in opening up the market and covers services activities accounting for 46 per cent of EU GDP,⁹ including in sectors

⁸ Available at: http://ec.europa.eu/internal_market/publications/docs/20years/achievements-web_en.pdf. Original source in euros.

⁹ Available at: http://ec.europa.eu/growth/single-market/services/index_en.htm

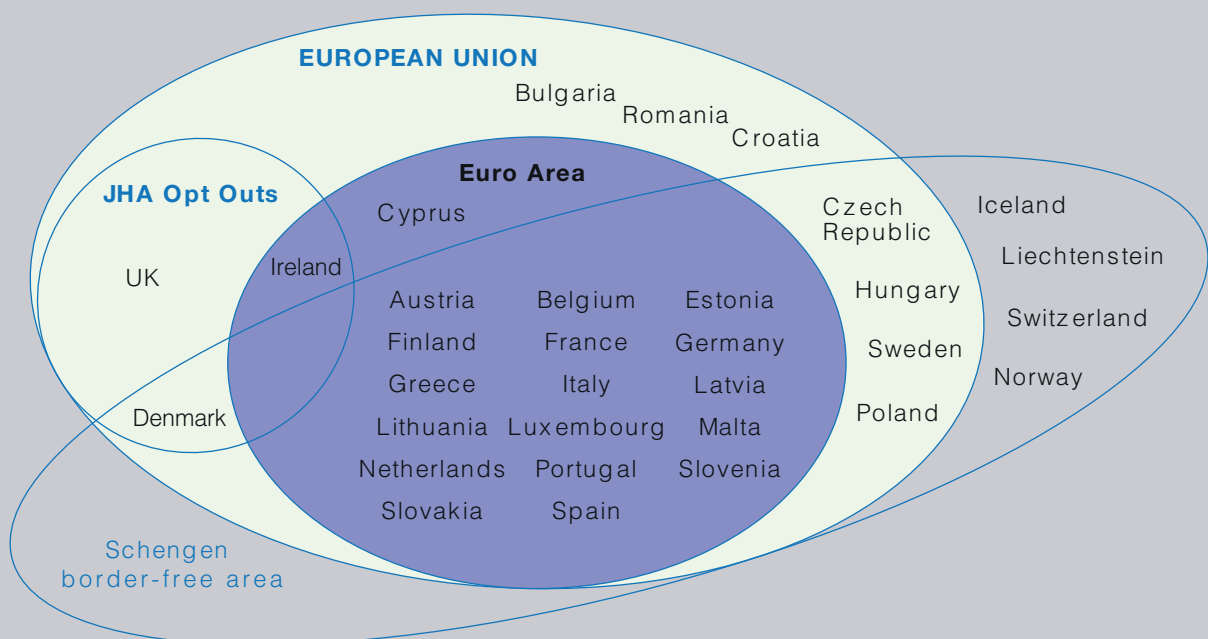
like retail, tourism, construction and business services. Further opening of this market is planned by the current European Commission. The Single Market has also made inroads in liberalising highly regulated services sectors such as air travel. This has created an environment in which airlines, and in particular low-cost operators such as easyJet have flourished, opening up new routes and reducing the cost of air travel to consumers.

One strength of the Single Market in services is on the mutual recognition of professional qualifications, which means that UK architects, doctors or vets can work across the EU. It is one of the elements of the Single Market that gives it a unique breadth and depth, and is important for an economy like the UK.

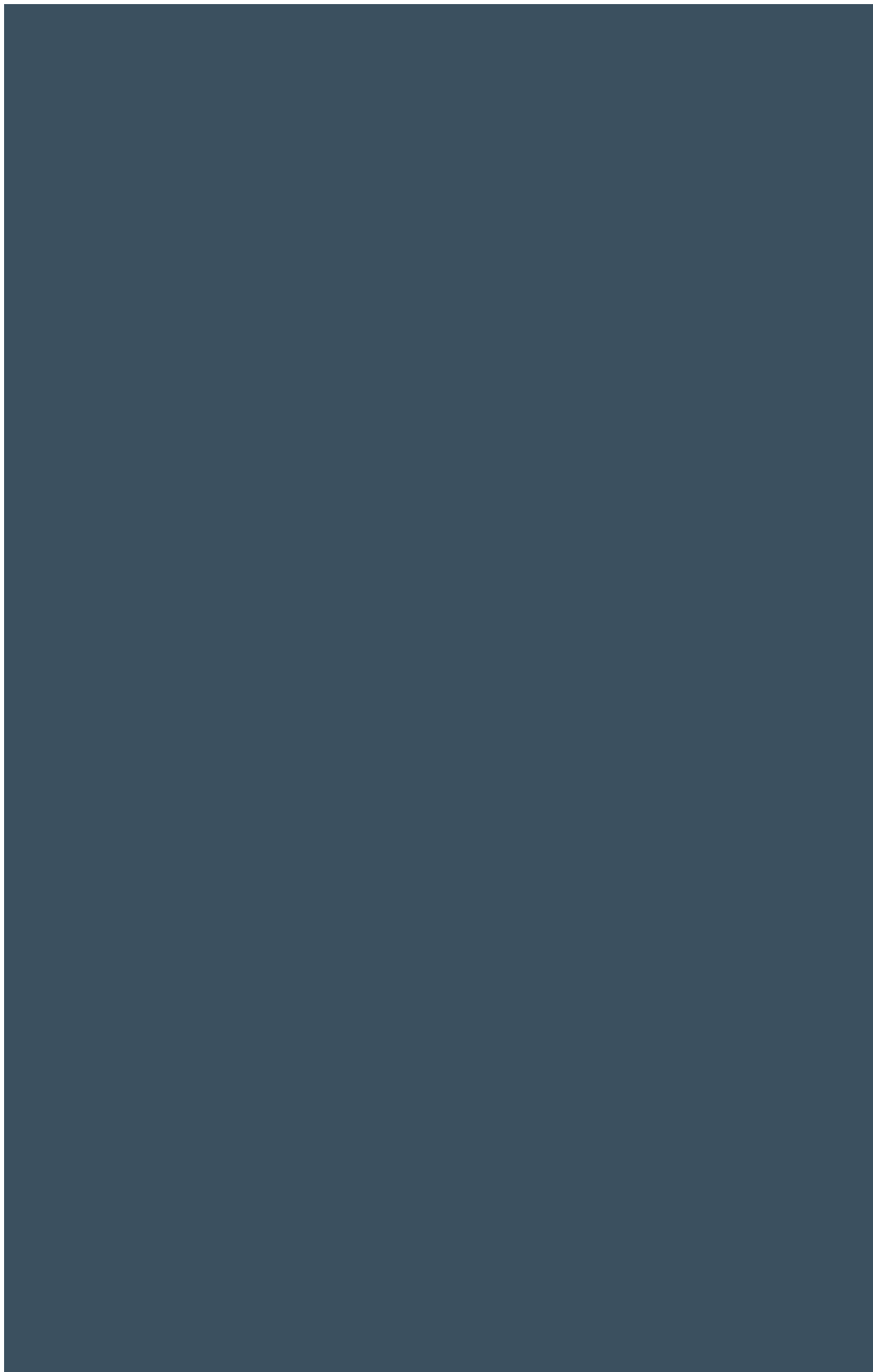
How might the alternatives to EU membership affect this Single Market access?

None of the alternative relationships to full EU membership offer full access to the Single Market. Some options have no access at all to key elements – for example, Norway is not a member of the Customs Union, so Norwegian firms must comply with costly procedures when they trade with the EU. In others, key sectors are excluded – for example the Canada deal does not fully extend the level playing field to financial services. These issues are explored in more depth in the analysis of the different alternatives below.

Box 2: Europe and the European Union¹⁰



¹⁰ Norway, Iceland, Liechtenstein and the 28 EU Member States comprise the European Economic Area. Switzerland, Norway, Iceland and Liechtenstein are members of the European Free Trade Association (EFTA).



Chapter 3 – the alternatives

3.1 The pattern of existing relationships between the EU and third countries suggests that there are three main models of relationship:

- (a) The Norway model. Norway is in the European Economic Area (EEA)¹¹ but not in the EU. This is the model outside of the EU which is most integrated with the Single Market. It means that Norway has considerable access to the EU market. It also takes part in some important non-economic cooperation negotiated separately, like counter-terrorism. The Norway model includes many of the key obligations of EU membership, and Norway makes contributions to EU spending. Norway is required to follow most of the rules of the Single Market, though without a vote or vetoes in how those rules are made. It has to accept the free movement of people and it has chosen to be part of the Schengen Area. Norway has a higher share of EU migrants per capita than the UK.
- (b) A negotiated bilateral agreement. There are different ways this can be done. Such arrangements typically offer limited access to the Single Market, offering some combination of tariff-free trade, open access to the services market and guarantees that companies operating in these markets are treated in a fair and non-discriminatory way. But they rarely go far in establishing a Customs Union or addressing non-tariff barriers. Switzerland's arrangements with the EU go furthest in replicating the benefits of EU membership, but bring an increased proportion of the obligations, including accepting the free movement of people, making a significant contribution to EU spending, and compliance with the majority of rules governing the Single Market. An advanced Free Trade Agreement, such as that negotiated between the EU and Canada, brings less access to the Single Market. The EU-Canada agreement does not give tariff-free access to all Canadian manufactured goods, does not cover a number of key service sectors, such as audio-visual and the majority of air transport, and requires Canada to accept EU rules when exporting to the EU, as well as quotas on some agricultural exports. This has taken seven years to negotiate from scoping and it is not yet in force.
- (c) WTO membership. The UK, like all other EU countries, is a member of the WTO. If the UK had not agreed a new relationship with the EU by the time we left, then we would revert to our common membership of the WTO as the basis for trade – just like Brazil does in its trade with the EU. Under WTO rules, this would not include any preferential access to the Single Market, or to any of the 53 markets with which the EU has negotiated Free Trade Agreements. It would also affect the price of imported goods paid by UK consumers, if reciprocal tariffs were imposed on imports from EU countries. It would involve no coordination or obligations in non-economic areas like fighting crime or terrorism.

¹¹ All EU Member States are signatories to the EEA Treaty. The non-EU signatories are Norway, Iceland and Liechtenstein.

3.2 The table below provides an overview of these different relationships. The remainder of this paper sets each of these out in detail.

Summary Table – Models of relationship to the European Union

		Access to the Single Market in goods and services									
		Votes on EU law	Tariff-free trade	Customs Union and external trade	Level playing field for business	'Ever closer union'	Justice and Home Affairs (JHA)	Free Movement of People	Schengen border-free area	Contribution to EU financing	Eurozone membership
UK membership of the EU		Full	Full	Full	Full	None	Partial	Partial (a)	None	Partial (b)	None
Standard EU membership		Full	Full	Full	Full	None	None	None	None	None	None
Norway (non-EU EEA)		None	Partial	None	Partial	None	Partial	None	None	Partial	None
Bilateral Agreements	Switzerland	None	Partial	None	Partial	None	Partial	None	None	Partial	None
	Canada	None	Partial	None	Partial	None	None	None	None	None	None
	Turkey	None	Partial	None	Partial	None	None	Partial	None	None	None
WTO membership		None	None (c)	None	None (d)	None	None	None	None	None	None

Legend	
Full	Green
Partial / voluntary / special arrangement	Yellow
None	Red

- a) Free movement of people: at the 2016 February European Council the Prime Minister secured a new settlement that will enable the UK to have a new emergency brake to limit full access to in-work benefits by newly arrived EU workers for up to four years when they enter our labour market. This will be in force for seven years.
- b) The UK receives a rebate on its contributions to the EU budget.
- c) Except where the EU has bound tariffs at zero per cent in WTO commitments.
- d) Except where the EU has made commitments under General Agreement on Trade and Services.

Key	
Votes on EU law	The extent to which a country has a vote (and in some areas a veto) over EU legislation and policy decisions.
Tariff-free trade	Full preferential access, meaning that all goods traded between the country in question and EU Member States are free from tariffs. Partial access reflects that some goods – normally agricultural products – are subject to tariffs when traded.
Customs Union membership and aligned external trade policy	Membership of the EU Customs Union that allows for the free movement of goods between Member States by: eliminating the need for customs checks; and agreeing a common external tariff on imports from third countries into the Customs Union.
Access to the level playing field for business	Participation in measures that: 1) set common regulatory requirements for business and remove distortions to competition, such as those associated with Government subsidies (state aid) and national public procurement rules; 2) remove non-tariff barriers to trade such as differing product safety rules; and 3) open up services markets, giving companies certainty that they will be able to access EU markets, and that once in them, they will be treated in a fair and non-discriminatory way.

Ever closer union	The EU Treaties include reference to an ‘ever closer union among the peoples of Europe’. At the 2016 February European Council, the Heads of State or Government of the EU Member States agreed that the EU Treaties would be amended in the future to make it clear that these references do not apply to the UK.
Justice and Home Affairs (JHA)	The ability and/or obligation to participate in measures such as the European Arrest Warrant, Europol, EU asylum (Dublin Regulation) and immigration rules, Schengen Information System, the Prüm Decisions and the Lugano Convention. The UK can choose to participate in some measures, but is under no obligation to do so.
Free movement of people	The obligation to treat the citizens of other EU Member States the same as nationals and remove unjustified obstacles to their movement within the EU, including giving them the right to live and work in the UK and access to the labour market and welfare system. At the 2016 February European Council the Prime Minister secured agreement to an emergency brake to limit full access to in-work benefits for newly arrived EU workers.
Schengen border-free area	The Schengen border-free area is the area within which passport and other border controls have been abolished.
Contribution to EU financing	Participation in the EU budget for EU Member States; making significant contributions to EU spending for EEA States that are not EU members. The UK receives a rebate on its contributions to the EU budget.
Eurozone membership	The Eurozone refers to the 19 of the 28 EU Member States that have adopted the euro as their common currency. The UK and Denmark are under no legal obligation to adopt the euro and join the Eurozone. All other Member States who have not yet adopted the euro as their currency are committed under the Treaties to doing so in future. At the 2016 February European Council the Prime Minister secured agreement to a set of legally-binding principles that will make sure the UK is not penalised or discriminated against by EU rules because we have chosen to keep the pound.

Box 3: Northern Ireland

The United Kingdom and Ireland are both members of the EU. Since the 1920s the countries have operated a Common Travel Area, which allows for nationals of both countries to travel and live in each country without immigration controls. In addition, both countries are part of the EU Customs Union, which means that there are no customs controls on the border between Ireland and Northern Ireland. Without this, goods being exported across the border could be subject to various forms of customs controls and their liability to duty determined according to complex Rules of Origin.

The absence of cross-border restrictions has both encouraged cooperation and increased trade over the last twenty years. Overall, nearly 60 per cent of Northern Ireland's exports go to the EU, with 37 per cent going to Ireland alone.¹²

In addition, Northern Ireland receives considerable EU funding to support agriculture, job creation and business development. Since the Good Friday Agreement in 1998, it has benefited from EU programmes to support peace and reconciliation as well as promote social and economic stability. It is unclear what would happen with funding to these programmes, particularly if the UK were to leave the EU in the middle of the EU budget cycle (currently 2014-2020).

If the UK left the EU, these arrangements could be put at risk. It is not clear that the Common Travel Area could continue to operate with the UK outside the EU, and Ireland inside, in the same way that it did before both countries joined the EU in 1973. Under most of the alternatives described in this paper, the UK would be outside the EU Customs Union and so trade across the border with Ireland would be subject to customs controls and rules on the origin of products.

A. The Norway model

- The Norway model would give the UK considerable but not complete access to the free-trade Single Market. We would be outside the EU Customs Union, and we would lose access to all of the EU's trade agreements with 53 other markets around the world. Re-negotiating these would take years.
- Norway is obliged to accept the free movement of people and has chosen to be part of the Schengen border-free area.
- Norway makes significant contributions to the EU and is subject to EU rules. If the UK negotiated the Norway model we would be bound by many of the EU's rules, but no longer have a vote or veto on the creation of those rules.
- To adopt the Norway model, the UK would need the agreement of all the remaining 27 EU countries, along with Iceland, Liechtenstein, and Norway.

¹² Available at: <https://www.detini.gov.uk/sites/default/files/publications/deti/bee-infographic.pdf>

	Votes on EU law	Access to the Single Market in goods and services			'Ever closer union'	Justice and Home Affairs (JHA)	Free Movement of People	Schengen border-free area	Contribution to EU financing	Eurozone membership
		Tariff-free trade	Customs Union and external trade	Level playing field for business						
UK membership of the EU	Green	Green	Green	Green	Red	Yellow	Green	Red	Yellow	Red
Norway (non-EU EEA)	Red	Yellow	Red	Yellow	Red	Yellow	Green	Green	Yellow	Red

Background

3.3 Norway is a member of the European Economic Area (EEA), but not a member of the EU. The EEA comprises the 28 Member States of the EU, along with Norway, Iceland and Liechtenstein.

3.4 In the 1960s, Norway, Iceland and the UK all belonged to the European Free Trade Association (EFTA). Norway agreed terms to join the European Communities (as the EU was then known) in 1972, along with the UK, Denmark and Ireland. But this was rejected in a referendum later that year. In the early 1990s, Norway, along with Sweden and Iceland, negotiated entry to the European Economic Area (EEA) as preparation for joining the EU. But in 1994 the Norwegian electorate rejected EU membership. Norway remains outside the EU and inside the EEA along with Liechtenstein and Iceland. Together with Switzerland these countries also belong to EFTA.

Key features of the Norway model

Access

3.5 The Norway model brings less access to the EU market than the UK currently enjoys in three ways: it is outside the EU's Customs Union for all goods; it has limited access to the Single Market for agriculture and fisheries; and it does not benefit from the EU's external trade agreements.

3.6 Being outside the EU's Customs Union means that all trade in goods between Norway and the EU is subject to customs procedures, and companies must be able to prove the origin of the components in their exports. To benefit from preferential rates, Norwegian exporters have to provide documentary evidence proving that their products are either made inside the EEA, or that they comply with over 500 product-specific rules.¹³ In practice, were the UK to adopt the Norway model, it would mean that UK companies that sought to take advantage of preferential tariff rates would need to submit forms for many goods transported across all UK borders (including the border between Northern Ireland and Ireland). This would impose significant administrative costs.¹⁴ Being outside the EU's Customs Union also means that restrictions would have to be reintroduced on goods that consumers wanted to transport across borders, making them more expensive.

3.7 Norway is outside the Single Market for agricultural produce. This means that it does not trade products in these sectors freely with the EU. 64 per cent of the UK's fish exports

¹³ Available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:L:2005:321:FULL&from=en>

¹⁴ A review of the literature in a BIS commissioned Centre Economic Policy Research study suggests complying with Rules of Origin could add from 4 per cent to perhaps 15 per cent to the costs of goods sold under a UK-EU FTA: Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/271784/bis-14-512-trade-and-investment-balance-of-competence-review-project-report.pdf

and 73 per cent of vegetable exports go to the EU.¹⁵ Under an arrangement like Norway, a number of these would be liable to tariffs.

3.8 Norway must conclude its own trade and investment deals with countries outside the EU. Norway has the right to do this on its own, but all of its current agreements have been negotiated through the European Free Trade Association (EFTA), which comprises Norway, Switzerland, Iceland and Liechtenstein. EFTA has so far negotiated 25 Free Trade Agreements (FTAs), covering 36 countries¹⁶ – compared with 53 markets for the EU. In addition, agriculture and fisheries are not covered in these FTAs. EFTA has not yet begun FTA negotiations with some large economies, such as the US, as the focus of these countries has been on negotiating with the EU. China has declined to negotiate with EFTA as a group, and instead has concluded bilateral deals with Iceland and Switzerland. Negotiations between Norway and China were suspended in 2011.

3.9 Norway chose to join the Schengen border-free area in 2001. (It is also obliged to accept free movement of people from both EU and EEA countries – see below). This means that Norway applies policies agreed between Schengen countries on visas and external border control and some police cooperation measures. As a result, Norway and the other Schengen states have no internal passport controls between them.¹⁷ Norway is involved in decisions over the Schengen border-free area taken by those EU countries which participate, but has no vote in these decisions. Norway has limited voting rights in Frontex (the EU Frontiers Agency) through its Schengen membership. Norway has access to the Schengen Information System II (SIS II), which allows for the pro-active, real-time sharing of data on the movements of suspected terrorists and criminals.

3.10 Norway does not have an automatic right to participate in wider EU cooperation on police and criminal justice. In order to benefit from equivalent arrangements to the European Arrest Warrant (EAW), Norway has had to negotiate a separate bilateral agreement with the EU. This separate negotiation process can be lengthy and would require the agreement of the European Commission and the European Parliament. Norway engages with Europol (the EU agency that coordinates cooperation between police forces) through a cooperation agreement. It has similar arrangements with Eurojust, which coordinates contact between judicial authorities. Through a further cooperation agreement, Norway participates in certain parts of the Prüm Decisions to share police data, including vehicle registrations, fingerprint and DNA records. Norway is a member of the revised Lugano Convention on civil law together with the EU, Switzerland, and Iceland. It is not a member of the European Criminal Records Information System (ECRIS), which shares information on criminal convictions between EU Member States.

3.11 The Norway model means that Norway does not have a voice in decisions over the EU's international and security policy. It can opt to align with the position of EU Member States and can participate in sanctions imposed against external countries, for example in the case of Iran or Russia. Norway has participated on this voluntary basis in more than 90 per cent of EU sanctions, and has sent military personnel on EU defence missions. Norway's membership of NATO means that it has a close defence relationship with most EU countries. But it does not have a vote in the EU's decisions on international security issues.

¹⁵ UN COMTRADE Harmonised System Product Group 03.

¹⁶ Available at: <http://www.efta.int/free-trade/free-trade-agreements>

¹⁷ As a result of the recent migration crisis, Norway has introduced temporary passport checks at its borders with EU Member States.

Costs and Obligations

3.12 Norway is required to ensure its domestic law complies with any EU legislation that forms part of the EEA Agreement. 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.¹⁸ This includes not only sector-specific product and service rules, but also cross-cutting legislation in areas such as competition policy, State Aid, and intellectual property. Norway is also required to comply with EU legislation in areas not directly related to the Single Market, including elements of social policy, consumer protection and environmental standards. This includes the Working Time Directive, Agency Workers Directive and Renewables Directive.

3.13 Norway is obliged to accept the free movement of people from both EU and EEA countries. EEA and EU nationals moving to Norway to work or find a job are entitled to be treated on the same basis as nationals. This means that they have the right to access benefits, including unemployment allowances, sickness benefit and housing benefit. In 2014 more than 6 per cent of the population resident in Norway were nationals from other EU countries,¹⁹ a higher proportion than in the UK.

3.14 Norway makes a significant contribution to EU spending. Norway pays grants to poorer EU Member States each year. The size and nature of these funds is renegotiated periodically – the most recent deal started in 2014 and runs to 2021.²⁰ Norway also makes spending contributions to a number of EU programmes, including those on research and education in which it participates. In describing Norway's contributions to EU spending, the former Norwegian Minister for Europe said that “our financial contributions are on a par with comparable EU Member States.”²¹

Influence and Sovereignty

3.15 Norway has no representation and no vote in deciding EU law. The Norwegian Prime Minister does not attend the European Council. Norway does not participate in the Council of Ministers, has no Members of the European Parliament (MEPs), no national member of the European Commission, no judge of the European Court of Justice (ECJ), and its citizens do not have the right to vote in EU elections or to work in EU institutions.

3.16 This means that Norway has limited influence over decisions made by the EU.²² Norway can contribute expert views and does have some rights to be consulted over new EU laws through an EEA Joint Committee. It is represented on some Council working groups. Norway takes part in those decisions that relate to the Schengen border-free area. Norway can also attempt to influence EU policy through diplomatic contacts in Brussels. Norway has a ‘Right of Reservation’ over the application of new Single Market rules, but has never used it. In practice, this is difficult to use as invoking it could lead to suspension of Single Market access

¹⁸ Norwegian Government: http://www.eu-norway.org/Global/SiteFolders/webeu/NOU2012_2_Chapter_1.pdf

¹⁹ Eurostat Population Data.

²⁰ Available at: <http://eeagrants.org/News/2015/Agreement-secured-on-new-funding-round>

²¹ Available at: https://www.regjeringen.no/en/aktuelt/eu_alternatives/id2459944/

²² Norway has the right to speak in the Council of the European Union on decision-making for the Schengen border-free Area, but not the right to vote. This is set out in Article 99 of the EEA Agreement.

in the related area.²³ Norway also has the right to suspend free movement of people in certain limited circumstances, but this can only be activated on a reciprocal basis, which means that using it would remove the right of Norwegian citizens to move to the EU.

3.17 Norway is subject to complex arrangements to ensure compliance with EU law. For EU Member States, the ECJ adjudicates in disputes over compliance. Norway is subject to the jurisdiction of the EFTA Court, based in Luxembourg, comprised of judges from the EFTA countries. In the vast majority of cases, the EFTA Court follows the principles in the ECJ's rulings.

3.18 In 2012, the Norwegian Government commissioned a major independent report on the consequences of its position outside the EU and within the EEA. The report concluded that this model had brought economic benefits through access to the EU Single Market, but that it had come at a cost in loss of voice: "The most problematic aspect of Norway's form of association with the EU is the fact that Norway is in practice bound to adopt EU policies and rules on a broad range of issues without being a member and without voting rights", the report noted. "This raises democratic problems."²⁴

Suitability for the UK

3.19 In February 2015, the former Norwegian Minister for Europe, Vidar Helgesen, said "I find it difficult to imagine the UK, with your global ambition, dedication and contributions, being comfortable with such an arrangement".²⁵ The Norway model gives considerable but not complete access to the Single Market. It involves accepting most EU rules, but with little influence over the creation of those rules. This may be suited to the interests of countries like Iceland and Norway whose exports are dominated by just one or two products. In 2014 over three-fifths of Norwegian goods exports consisted of oil and gas, while over three-quarters of Icelandic goods exports were made up of fish and aluminium.²⁶ For countries whose exports are dominated by raw materials, Rules of Origin requirements are less problematic. EEA membership has allowed these countries to trade successfully in these commodities, while protecting other industries, notably farming.

3.20 For a diverse economy like that of the UK, this arrangement would work less well. Our manufacturers would see costs rise from being outside the Customs Union, particularly for firms operating as parts of international supply chains, such as the car industry. On average, 23 per cent of the value of UK exports is derived from foreign components.²⁷

3.21 If the UK withdrew from the EU, we would lose the benefit of all the EU's existing Free Trade Agreements with third countries. This means we would no longer benefit from the trade deals which the EU has negotiated with 53 markets like Mexico, South Africa or South

²³ The "right of reservation" (Article 102 of the EEA Agreement) provides EEA members with the right to reject a particular piece of EU legislation, even if it is relevant and falls within their membership agreement. However, the consequence of exercising this right is that the EU can choose to suspend any associated rights of the EEA states to linked benefits, such as market access. Moreover, when using the reservation rights, the EEA states are obliged to enter into negotiations to find a suitable solution for all parties. This entire process, and the extent to which Single Market access would be limited, remains untested. Norway used, but then withdrew, the Right of Reservation for the first time over the EU postal directive in 2011.

²⁴ "Outside and Inside: Norway's agreements with the European Union" (January 2012), Norwegian Government: EEA Review Committee, Chapter 13.

²⁵ Quoted in <http://www.telegraph.co.uk/news/worldnews/europe/11429894/Why-Britain-should-not-leave-the-EU-to-be-like-Norway-by-a-Norwegian-minister.html>

²⁶ UN COMTRADE.

²⁷ 2011 BIS estimates based on OECD Trade in Value Added database.

Korea, and those which it is currently negotiating with the United States and Japan. The UK would seek to negotiate replacement arrangements, but this would take years and there is no guarantee that the UK would manage to negotiate terms as good as those we enjoy today.

3.22 Adopting the Norway model would still mean making payments to the EU. In return for the type of access that Norway has to the Single Market, the UK would have to continue to make contributions to the EU. The UK would no longer contribute to the Common Agricultural Policy (CAP), but the size of any net saving resulting from this would depend on policy choices. The UK would have to decide how far to replicate the €3.5 billion in CAP subsidies currently allocated to the UK.²⁸ This would have to be weighed against other public spending priorities.

3.23 Full access to the EU market under the Norway model would still require us to accept free movement of people from EU and EEA countries. This would be without the welfare emergency brake limiting full access to in-work benefits from newly arrived EU migrants, which the UK has negotiated as part of our new settlement. The EU has made clear that full access to the Single Market can only come with the acceptance of the free movement of people.

3.24 The UK would have little or no say over future rules governing the EU Single Market. Over time, this would have a cumulatively damaging impact on the UK economy, as the UK Government would have little influence on new rules that might be potentially damaging to UK companies. The European Commission is due to propose new legislation covering areas such as legal, business and financial services, which are crucial areas for UK exports. Inside the EU we have a major voice on this legislation, including for instance the Capital Markets Union, which will improve the flow of investment into businesses across Europe. At present, the UK Commissioner holds the portfolio for financial services, and is leading on this particular area of legislation. Outside, we would have little influence and no ability to try to block measures that would put our companies at a disadvantage. UK manufacturers of goods such as cars, pharmaceuticals or chemicals could face problems accessing the Single Market if EU product rules became more onerous for UK companies. This would be particularly significant for a sector like car manufacturing, in which the UK both imports and exports high volumes, and our companies are in keen competition with their European counterparts.

3.25 More broadly, a relationship with the EU based on the Norway model would erode our global influence and there is no guarantee that it would fully replicate our current cooperation on measures which benefit our security. While the UK would remain an influential player on the global stage as a permanent member of the UN Security Council and the world's fifth largest economy,²⁹ we would no longer be able to drive united European positions towards countries like Iran or Russia, or use the economic and political weight of the EU to advance our global interests. We would lose our current special status, which gives us the right to choose which Justice and Home Affairs measures, such as those on policing and judicial cooperation, we join. It would be difficult, in practice, as Norway has found, to replicate this cooperation through new agreements with the EU.³⁰ This would impact on many key arrangements for police and judicial cooperation.

²⁸ Annex III of Regulation (EU) No. 1305/2013.

²⁹ IMF World Economic Outlook (October 2015).

³⁰ Rob Wainwright, Europol Director, noted in evidence to the Home Affairs Committee on 3 September 2013, that a co-operation agreement with Europol, akin to that which Norway has, would not provide the UK with as effective arrangements as the UK's current membership of Europol.

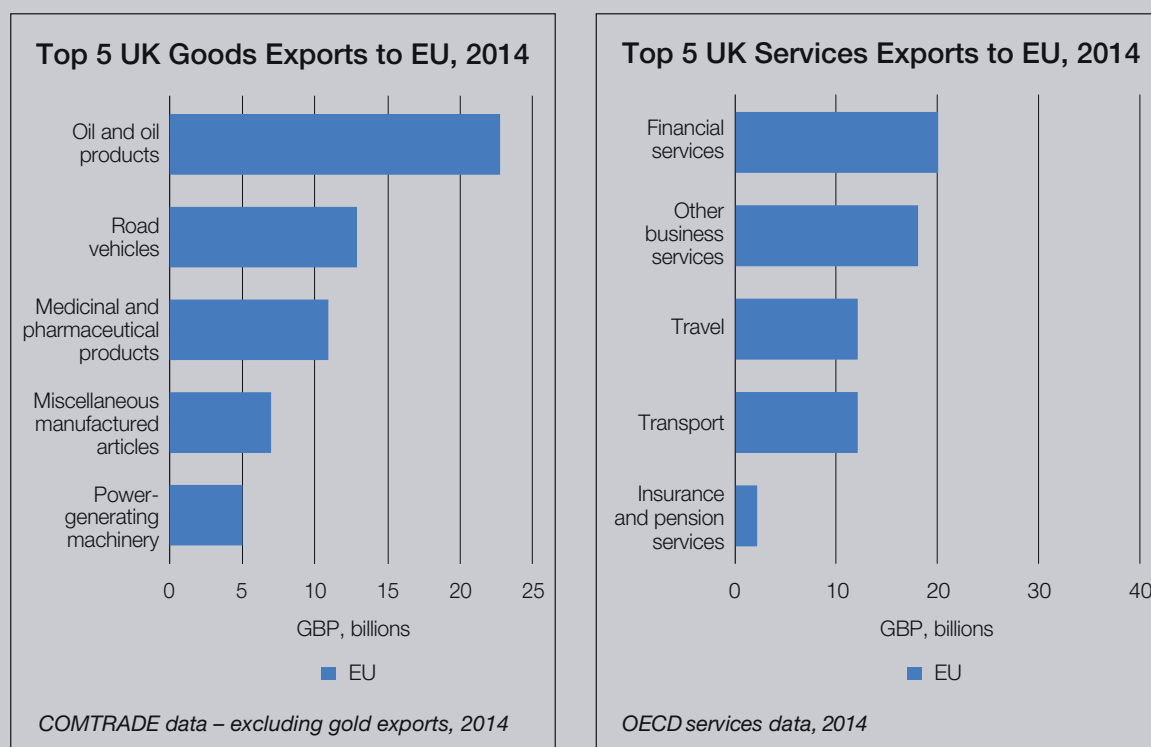
Box 4: The UK economy

The UK is the world's fifth largest economy, with an output of over £1.8 trillion.³¹ Services have increased as a share of the UK economy over the past 25 years, growing from 67 per cent in the early 1990s to 79 per cent in 2015. By contrast, manufacturing and agriculture make up around 10 per cent and 0.7 per cent of the economy, respectively.³²

This change in the balance of the economy has also been reflected in the rising number of jobs in the services sector, which now employs over 25 million people.³³ Some of the key business services sectors supporting the UK economy are engineering, advertising and finance. All of these services are highly tradable, and the UK is home to many world-leading service providers.

Historically, the UK has been an open economy. This growth in tradable services has coincided with an increase in the openness of the UK economy. Trade (imports and exports) as a proportion of GDP has steadily increased from 40 per cent in 1948 to 58 per cent in 2014.³⁴ This is more than twice the share for the US economy. The share of services in total exports has almost doubled over this time, with services now accounting for 43 per cent of total exports (£220 billion) in 2014 – the largest share of services exports of any major advanced economy. The UK trades at a surplus in services with the rest of the EU, but a deficit in goods. This means that the UK exports more services to the EU than it imports.

While manufacturing employs a much lower proportion of the labour force – 3 million people – it plays an important role in the UK economy because of the contribution to productivity made by a number of advanced manufacturing industries, for instance the automotive and aerospace sectors. These two sectors are also important drivers of UK goods exports:



³¹ IMF World Economic Outlook 2015, ONS (October 2015), ONS Second Estimate of GDP, February 2016.

³² ONS UK GDP low level aggregates (Second Estimate of 2015 GDP).

³³ ONS Labour Market Statistics (February 2016). (All labour market data in box).

³⁴ ONS Pink Book, October 2015. Historical data consistent methodology. (All trade data in box).

Box 5: ‘Passporting’ and Financial Services

The EU’s financial services ‘passport’ means that financial services firms authorised in the UK can provide their services across the EU, without the need for further authorisations. This is a huge advantage of our membership of the EU for UK firms. The passport also means that the main regulatory responsibility for UK firms’ activities across the EU/EEA remains with UK regulators rather than moving to other EU/EEA regulators.

The passport is a shorthand term. As the name implies, it provides for free movement of financial services across the Single Market. The passport covers a collection of measures in EU secondary law, which minimise regulatory, operational and legal barriers that would otherwise arise. The first sector to receive passporting rights was the banking sector, with the entry into force of the Second Banking Directive in 1993. Since then passports have also been introduced for insurance, investment services, asset management and payment services.

The EU’s financial services passport is only available to firms authorised in the EU or EEA countries. International firms therefore need to establish a subsidiary in at least one Member State, such as the UK, in order to benefit from the passport. The UK hosts Europe’s leading international financial centre. Around half of the world’s largest financial firms – ranging from commercial and investment banks to insurers, asset managers and hedge funds – have chosen to base their European headquarters in the UK.³⁵

The passport is able to operate because all EEA countries, including the UK, adhere to the same EU regulatory standards.

In some areas the EU has ‘equivalence regimes’ to allow financial services firms outside the EU to trade with the Single Market in a way that is similar to the EU financial services passport. It does this through assessing whether a country’s regulatory regime is equivalent to EU rules in the area. Where they exist, such regimes apply to all countries outside the EEA including WTO members. However, the requirements that come with such access arrangements – some of which are yet to be tested in practice – can be significant. For example, countries are effectively required to keep their financial regulation in the relevant area similar to the EU’s, despite not having a say over the content of the regulation.

³⁵ Bank of England (2015) report: ‘EU Membership and the Bank of England’: Available at: <http://www.bankofengland.co.uk/publications/Documents/speeches/2015/euboe211015.pdf>

Box 6: Negotiating trade deals outside the EU

At the moment UK companies get preferential access to many external markets thanks to EU trade agreements covering 53 markets. Combined with the 27 other countries in the Single Market, and the countries in the EU Customs Union and EFTA, this is effectively more than 80 trade deals – covering over a third of the world’s economy.³⁶ By comparison, the United States has 14 trade agreements (covering 20 countries),³⁷ and Australia has 10 (covering 19 countries).³⁸ These EU trade agreements are important for the UK economy. The EU accounted for 44 per cent of UK exports in 2014, while trade with those non-EU countries covered by EU trade agreements covered a further 12 per cent. The deals under negotiation would increase this still further – to 82 per cent of total exports – when they are successfully concluded.³⁹

Were the UK to leave the EU, without new arrangements in place, our companies would immediately lose preferential access to all these markets. This would continue until the UK was able to negotiate bilateral deals with these countries. It would put our large surplus in services⁴⁰ at risk and would take years:

- those countries, such as the US, currently negotiating trade deals with the EU as a whole would almost certainly want to conclude these first, before deciding whether to enter into separate negotiations with the UK. For example, Michael Froman, the US Trade Representative, has made it clear that the United States’ strategy is to develop platforms such as TPP and TTIP and that it is “not particularly in the market for FTAs with individual countries.”⁴¹ The US has indicated that negotiations with EFTA countries like Norway and Switzerland would likely wait until it has concluded its trade deal with the EU. In principle, the economic incentive is to conclude larger deals first. This same calculation might apply to the UK, US and the EU; in 2014 US exports of goods and services to the other 27 EU Members States were 3.2 times their level to the UK.⁴²
- we would have to expect that the 27 remaining EU countries would pursue the interests of their own industries. The UK is more reliant on exports to the EU than the rest of the EU is reliant on exports to the UK. Taken as a share of the economy, only 3.1 per cent of GDP among the other 27 Member States is linked to exports to the UK, while 12.6 per cent of UK GDP is linked to exports to the EU.⁴³ This would put us at a negotiating disadvantage.

All this means that agreeing such trade agreements is likely to take years. And there is a real risk that we would not be able to secure as favourable terms as those we currently enjoy through the EU.

³⁶ WTO data. Available at: <http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx>

³⁷ Available at: <https://ustr.gov/trade-agreements/free-trade-agreements>

³⁸ Available at: <http://dfat.gov.au/trade/agreements/Pages/status-of-fta-negotiations.aspx>

³⁹ ONS Pink Book (October 2015).

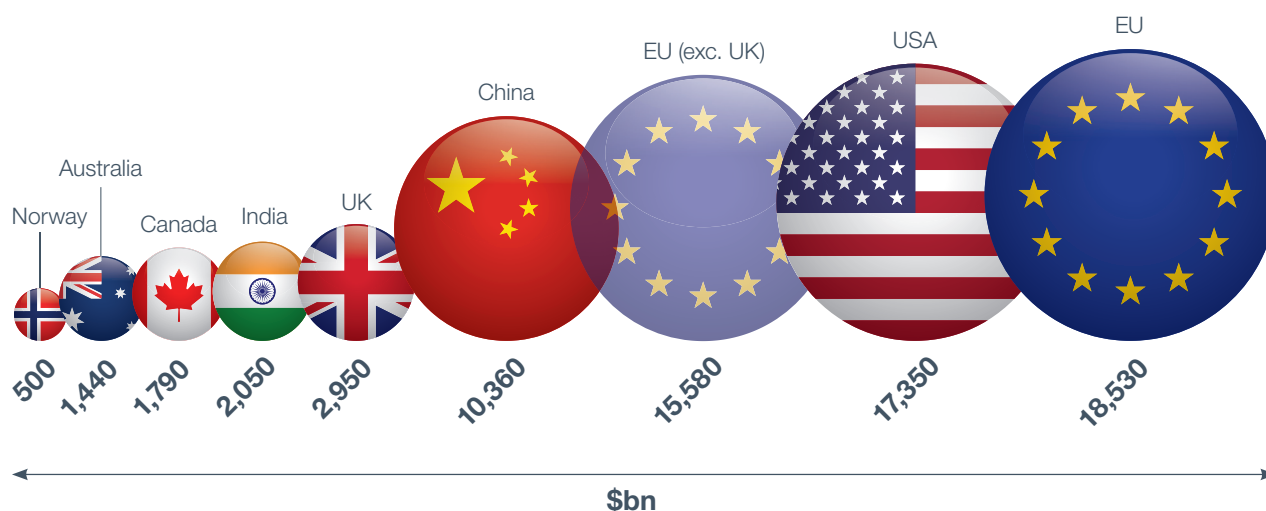
⁴⁰ ONS Pink Book (October 2015).

⁴¹ 28 October 2015: <http://www.reuters.com/article/us-britain-eu-usa-idUSKCN0SM2LS20151028>

⁴² Available at: http://bea.gov/newsreleases/international/trade/trad_geo_time_series.xls

⁴³ ONS Pink Book (November 2015), GDP data from Eurostat.

Size of economy (GDP, \$bn)⁴⁴



B. Negotiated bilateral agreements

- A bespoke UK-EU trade agreement would be complex to negotiate. The EU-Canada agreement, for example, has taken seven years to negotiate and is still not in force. A UK-EU agreement could require the agreement of all 27 of the remaining EU Member States. The European Parliament would also need to give its approval.
- No existing bilateral trade agreement would deliver the same level of access that the UK currently enjoys to the EU Single Market. In particular, none provide equivalent access for services, which accounts for almost 80 per cent of the UK economy.
- Access to the Single Market would be linked to the obligations which we would be prepared to accept. A trade agreement such as that between the EU and Canada would bring less access to the EU market than the UK currently enjoys in, for instance, financial services, but would not require the UK to accept the free movement of people or make significant contributions to EU spending. Switzerland has more access to the Single Market, but has had to accept these obligations in return.
- The UK would lose the benefit of EU Free Trade Agreements with other parts of the world: renegotiating these would take years.
- The UK would lose our voice and vote over EU rules.

3.26 There are a number of countries which have negotiated trade agreements with the EU. Switzerland has a complex set of bilateral agreements with the EU. Turkey is part of the EU Customs Union and has a long-term aspiration to join the EU. Canada has agreed a Free Trade Agreement with the EU, although it has not yet been signed and concluded. This section examines how far these models might work for the UK, if we were to leave the EU.

⁴⁴ IMF World Economic Outlook (October 2015).

Switzerland

	Votes on EU law	Access to the Single Market in goods and services			'Ever closer union'	Justice and Home Affairs (JHA)	Free Movement of People	Schengen border-free area	Contribution to EU financing	Eurozone membership
		Tariff-free trade	Customs Union and external trade	Level playing field for business						
UK membership of the EU										
Switzerland										

Key features of the Swiss model

Access

3.27 Switzerland has a relationship with the EU based on a series of bilateral agreements. In the mid-1980s, the European Community and the EFTA states (including Switzerland) started discussions aimed at establishing a new trade bloc that would expand the scope of the Single Market. This eventually became the European Economic Area (EEA). But in 1992 the Swiss electorate voted against EEA membership. This meant that, unlike Norway, Switzerland had no right to access the Single Market. As a result, Switzerland adopted a different approach. Over the last two decades, it has painstakingly negotiated over 100 individual agreements with the EU, covering market access in different sectors.⁴⁵

3.28 Switzerland has only partial access to the Single Market. It has most access to trade in goods. The bilateral agreements include various provisions to reduce practical barriers to cross-border trade. However, agriculture is not comprehensively covered by these agreements, so some agricultural products remain subject to tariffs.

3.29 Switzerland has limited access to trade in services. The bilateral agreements only provide partial coverage, with only some sectors covered, such as some types of insurance and public procurement. But Switzerland has limited market access for professional services, including accountancy, auditing, and legal services. Relevant individuals, including self-employed professionals, can only provide services in the EU for a maximum of 90 days each year. This places significant constraints on Switzerland's capacity to export to the EU in these sectors. And Switzerland has no general access to the EU market in financial services. It is not part of the passporting system that minimises the regulatory, operational and legal barriers to the provision of financial services across the EU (see Box 5). Because Switzerland does not have a bilateral agreement with the EU on banking, Swiss banks need to establish a subsidiary in an EU/EEA country, such as the UK, in order to obtain financial services passporting rights. UK banks would need to do the same inside EU countries if we were to leave the EU.

Costs and Obligations

3.30 The Swiss agreements are static in nature. While Norway is required to ensure its domestic law complies with any EU legislation that forms part of the EEA Agreement, Switzerland does not have the same direct obligation. But if it fails to introduce domestic legislation reflecting certain EU rules, the EU can block Switzerland from access to the related parts of the Single Market. To avoid this, Switzerland chooses in most cases to align with new EU laws as they are adopted. This, in practice, means Switzerland has a similar position to Norway – it is obliged to follow EU rules in its own laws. Examples include rules on competition, State Aid and environmental regulations. As a result Switzerland has to comply

⁴⁵ Available at: <http://ec.europa.eu/trade/policy/countries-and-regions/countries/switzerland/>

with large numbers of EU laws, but without any say over those laws and without full access to the EU market.

3.31 Switzerland is outside the Customs Union and can conclude its own trade agreements with other parts of the world. Switzerland has 29 such agreements, covering 41 countries⁴⁶ (by comparison, the EU has agreements covering 53 markets). In 2014, a Trade Agreement came into force between Switzerland and China. This requires Switzerland to reduce tariffs on almost all Chinese imports with immediate effect. In return, 84 per cent of Swiss exports to China will be exempt from tariffs, but reductions will be phased in over a fifteen year period to the late 2020s.⁴⁷

3.32 Switzerland has similar arrangements to Norway on borders and police cooperation. In 2008, Switzerland chose to join the Schengen border-free area. It takes part in EU arrangements for asylum seekers, under the Dublin Regulation. Switzerland has access to the Schengen Information System II database, for operational data on the travel movements of suspected terrorists and criminals. However, it is not party to the European Criminal Records Information System. Nor does it take part in the European Arrest Warrant. Like Norway, Switzerland engages with Europol, but with no voting rights and does not have access to the Europol Information System (EIS).

Influence and Sovereignty

3.33 In foreign policy, Switzerland has a tradition of neutrality. It is not a member of NATO, and only joined the UN in 2002. It does not take part in EU collective foreign policy decisions, although it has aligned itself with positions taken by EU countries, including sanctions against Russia and Iran. Switzerland has also seconded personnel to EU civilian and military missions.

3.34 Switzerland has no representation in the EU's institutions and no role in the EU's legislative processes. Switzerland has no right to be consulted on laws drafted by the European Commission. It has almost no opportunity to shape EU legislation. Switzerland is subject to ECJ jurisdiction in some areas, such as civil aviation. It is not in other areas, but this is a subject of dispute with the EU who have made a central part of the current negotiation on a new institutional agreement that Switzerland should be subject to binding ECJ jurisdiction more generally.

3.35 Switzerland makes a contribution to spending in the EU. As part of the bilateral agreements, Switzerland makes contributions to the EU. These contributions take various forms. Switzerland has made significant grants to Member States that have joined the EU since 2004. Switzerland also contributes to various programmes funded by the EU budget. These include EU research, education and satellite navigation.⁴⁸

3.36 The EU and Switzerland are currently in dispute over the terms of their relationship. The key issue is migration, which has become a politically sensitive issue in Switzerland. In 2015 almost 16 per cent of the population resident in Switzerland were nationals from other EU countries, a higher proportion than in the UK.⁴⁹ In February 2014, the Swiss voted in a referendum to introduce quotas for immigration of these nationals to Switzerland. The EU has made clear that this is a breach of the EU-Switzerland bilateral agreements, which contain a requirement for free movement of people. In response, the Council of the

⁴⁶ Available at: <http://www.seco.admin.ch/themen/00513/00515/01330/04619/?lang=en>

⁴⁷ Available at: http://www.seco.admin.ch/themen/00513/02655/02731/04118/index.html?lang=en&download=NHZLpZeg7t,Inp6l0NTU042l2Z6ln1ad1lZn4Z2qZpnO2Yuq2Z6gpJCGdYB3f2ym162epYbg2c_JjKbNoKSn6A--

⁴⁸ Available at: https://www.bundespublikationen.admin.ch/cshop_mimes_bbl/2C/2C59E545D7371ED496BD738AE6FC37C1.pdf

⁴⁹ Population Data, Eurostat.

European Union made its view on this issue clear in December 2014: ‘the free movement of persons is a fundamental pillar of EU policy ... the internal market and its four freedoms are indivisible’. In response to the Swiss vote, the EU has reduced Swiss access to EU educational programmes and research funding. The EU has also suspended negotiations on further access to the EU market.⁵⁰ If migration quotas were introduced, the EU could remove Switzerland’s privileged access to the EU Single Market.

Suitability for the UK

3.37 Even if we could negotiate similar arrangements to Switzerland, the Swiss model provides many of the same drawbacks as the Norway model, with a few modifications.

3.38 While Norway has considerable access, the Swiss model provides only partial access to the Single Market in goods, and more limited access in services, with such sectors as banking and professional services not being covered by the bilateral agreements.

3.39 For a diverse economy like the UK, this arrangement would not work well. Services account for almost 80 per cent of the UK economy, so any exclusions would mean this sector would suffer. The absence of passporting, for instance, would present challenges for the UK financial services sector. And our manufacturers would see costs rise from being outside the Customs Union, because of customs checks and Rules of Origin requirements, particularly for firms operating as parts of international supply chains, such as the car industry. On average, 23 per cent of the value of UK exports is derived from foreign components.⁵¹

3.40 The process of withdrawal from the EU means that all existing trade deals with third countries would cease were the UK to leave the EU. This means we would no longer benefit from the trade deals which the EU has negotiated with 53 markets like Mexico, South Africa or South Korea, and those which it is currently negotiating with the United States and Japan. The UK would seek to negotiate replacement arrangements, but this would take years.

3.41 If the UK were in the same position as Switzerland, each time that these rules changed, we would need to update our domestic legislation to maintain market access. Over time, this would have a cumulatively damaging impact on the UK economy, as the UK Government would have little influence on whether new rules were right for UK companies. The European Commission is due to propose new legislation covering areas such as legal, business and financial services, which are crucial areas for UK exports. Inside the EU we have a major voice on this legislation. Outside, we would have little influence and no ability to try to block measures that would put our companies at a disadvantage. UK manufacturers of goods such as cars, pharmaceuticals or chemicals could face problems accessing the Single Market as UK and EU product standards diverged over time.

3.42 More broadly, a relationship with the EU based on the Swiss model would erode our global influence and reduce our access to cooperation which benefits our security. While the UK would remain an influential player on the global stage as a permanent member of the UN Security Council and the world’s fifth largest economy, we would no longer be able to shape common EU positions towards countries like Iran or Russia, or use the economic and political weight of the EU to advance our global interests. The UK Prime Minister would no longer attend the European Council. We would lose our current special status which gives us

⁵⁰ The Council conclusions referenced and other related documents are available at http://eeas.europa.eu/switzerland/index_en.htm

⁵¹ 2011 BIS estimates based on OECD Trade in Value Added data.

the right to choose which Justice and Home Affairs measures we join. It would be difficult, in practice, to replicate this cooperation through new agreements with the EU. This would impact on many key arrangements for police and judicial cooperation.

3.43 It is unlikely that the UK could secure an arrangement like Switzerland. Even if we wanted to do so, it is unlikely that the remaining EU Member States would be willing to offer the UK a similar arrangement. The EU-Swiss bilateral agreements are complicated, and increasingly controversial both with the EU and in Switzerland. Both the EU and the Swiss are calling the viability of this model into question. In 2010, the Council of the EU described the model of EU-Swiss relations as “complex and unwieldy to manage and [it] has clearly reached its limits”.⁵² And in any case, the web of bilateral agreements between Switzerland and the EU has taken many years to negotiate.

Turkey

	Votes on EU law	Access to the Single Market in goods and services			'Ever closer union'	Justice and Home Affairs (JHA)	Free Movement of People	Schengen border-free area	Contribution to EU financing	Eurozone membership
		Tariff-free trade	Customs Union and external trade	Level playing field for business						
UK membership of the EU										
Turkey										

Key features of the Turkey model

Access

3.44 Turkey’s relationship with the EU is based on both an economic agreement and its candidacy for EU membership. The EU and Turkey have had a trade-and-economic-based Association Agreement since 1963 (known as the Ankara Agreement). In addition, Turkey has participated in a Customs Union with the EU since the end of 1995. It has also been a candidate country for EU membership since 1999. Accession negotiations began in 2005, and are on-going. They are likely to take a long time. To date, negotiations have only reached agreement on one area of accession arrangements (called Chapters), out of 35 which need to be agreed before Turkey can join the EU. In addition, each current Member State (including the UK) has a veto over each Chapter.

3.45 Turkey has partial access to the EU Single Market. The arrangements cover industrial goods and processed agricultural goods, which means that customs checks are not required for these products. However, arrangements do not cover raw agricultural goods or services. In areas where Turkey has access to the EU market, it is required to enforce rules that are equivalent to those in the EU. This includes competition, product, and environmental rules. Turkey is also required to align rules on State Aid (government support to businesses) with EU rules. The Agreement with Turkey provides some limited migration rights for Turkish nationals to reside in the EU.

Costs and obligations

3.46 While Turkey can agree trade agreements with countries outside the EU, as part of the Customs Union, Turkey’s external tariffs must be aligned with EU tariffs. This limits the trade deals that Turkey can agree. When the EU signs a trade agreement with a third country, such as South Korea, Turkey must give that country access to its own market on the same terms.

⁵² UN COMTRADE.

But this obligation is not reciprocal. The third country is not required to open its market on the same terms to Turkish exports. Instead, Turkey has to negotiate separate trade deals with these countries.

Influence and sovereignty

3.47 Turkey has limited cooperation with the EU on domestic and international security. It does not participate in EU policing and criminal justice measures. Turkey can align itself with the EU’s position on international issues, and seconds personnel to EU military and civilian missions. But it has no right to take part in decisions over such actions.

3.48 Turkey has no role in EU decision-making. It does not contribute to the EU budget. As a candidate for membership it is a recipient of EU funding. This supports reforms in such areas as the rule of law and civil society.

Suitability for the UK

3.49 Turkey’s relationship with the EU is founded on its status as an emerging market and its aspiration to become an EU Member State. The Turkish economy has historically been dependent on agriculture and manufacturing and exports few services to the EU, whereas the UK is a large and developed economy, with a services sector that contributes nearly 80 per cent of GDP.

3.50 Although Turkey is part of the EU’s Customs Union (including simpler Rules of Origin requirements), Turkey has more limited access to the Single Market than the UK. In particular, Turkey has full access to the EU for manufactured goods and processed agricultural products, but not for agriculture, services or public procurement. Turkey has to enforce rules that are equivalent to EU legislation in areas where it has access to the Single Market, but without having a vote on that legislation.

3.51 Moreover, under this model we would lose our decision-making power over the UK’s external tariffs, because we would be part of the Customs Union. Instead, we would be forced to open our borders to countries with which the EU had agreed trade deals, without necessarily being able to secure reciprocal access. Such a situation would put the UK economy at a substantial disadvantage.

Free Trade Agreements: Canada

	Access to the Single Market in goods and services									
	Votes on EU law	Tariff-free trade	Customs Union and external trade	Level playing field for business	‘Ever closer union’	Justice and Home Affairs (JHA)	Free Movement of People	Schengen border-free area	Contribution to EU financing	Eurozone membership
UK membership of the EU	Green	Green	Green	Green	Red	Yellow	Green	Red	Yellow	Red
Canada	Red	Yellow	Red	Yellow	Red	Red	Red	Red	Red	Red

Key features of the Canada model

Access

3.52 Free Trade Agreements involve a more detached relationship with the EU. This means fewer obligations, but less access to the Single Market. Countries agree market access and tariff levels with the EU, and set quotas for trade between them. Exporters who wish to sell

to the EU Single Market are required to comply with Single Market rules in the same way that exporters from Norway and Switzerland do.

3.53 The EU has trade agreements with 53 markets. These agreements provide varying levels of market access. For the EU, they are negotiated by the Commission, on behalf of the EU and its Member States. The agreement must then be approved by Member States, and the European Parliament.

3.54 The agreement between the EU and Canada goes further than any existing EU trade deal. Negotiations between the EU and Canada took seven years and were concluded in 2014.⁵³ Before the agreement can enter into force, it must be approved by the EU (including the Council and the European Parliament). Once it comes into force, the agreement provides for phasing out all tariffs on industrial and most agricultural goods entering the EU.⁵⁴ This deal addresses a number of other directly discriminatory measures such as quotas and subsidies for industrial goods.

3.55 Nevertheless, the EU-Canada Trade Agreement offers significantly less access to the Single Market than the UK currently enjoys under our special status in the EU. In particular:

- **Rules of Origin.** Trade between the EU and Canada is bound by Rules of Origin. This means that Canadian companies have to prove that a sufficient proportion of the product was originally made in Canada in order to qualify for preferential tariff rates. Complying with these rules creates an extra burden for businesses. A 2013 report commissioned by BIS from the Centre for Economic Policy Research estimated that the cost to UK business of implementing Rules of Origin requirements on UK-EU trade would be approximately £3 billion per year.⁵⁵ Currently UK companies do not have to meet this requirement when trading with the EU.
- **Enforcement.** At present, a UK company operating in the Single Market can bring an action against discriminatory or anti-competitive practices using the domestic courts of the Member State where the infringement took place. The UK Government or the European Commission can also bring a case to the European Court of Justice (ECJ) to protect companies' interests. Decisions of this Court, such as the recent ruling in the UK's favour on clearing-houses conducting trade denominated in Euros from locations outside the Eurozone, are immediately applicable in all the Member States and create legal precedent that applies in subsequent cases. By contrast, under the EU-Canada Agreement, a Canadian company trading in the EU would have more limited options to defend its interests. If the same model is used as exists in other trade agreements, in the event that the rights given to a Canadian company were breached, the Canadian Government could raise a case on the company's behalf using an arbitration tribunal established under the trade agreement.
- **Financial services.** Inside the EU, financial firms based in the UK can sell their services directly to other EU countries through passporting (see Box 5). Such provisions are not included in the EU-Canada, or any other EU Free Trade Agreements. Instead, Canadian financial firms, such as banks and insurance companies, have to establish local subsidiaries inside the EU market and operate

⁵³ EU-Canada Comprehensive Economic and Trade Agreement (CETA): Available at: <http://ec.europa.eu/trade/policy/in-focus/ceta/>

⁵⁴ "Technical Summary of Final Negotiated Outcomes: Canada-European Union Comprehensive Economic and Trade Agreement" (October 2013), Government of Canada.

⁵⁵ Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/271784/bis-14-512-trade-and-investment-balance-of-competence-review-project-report.pdf

under EU regulations and any local requirements in order to access the passport. Similar requirements could be a substantial restriction on UK companies compared to current passporting arrangements.

- **Services.** Inside the EU, the UK stands to benefit from further liberalisation of the Single Market in services under plans drawn up by the current European Commission. If all the EU's national services markets were as open as the top five performing European markets, this would add 2 per cent to the UK's GDP.⁵⁶ The EU-Canada Trade Agreement offers more limited liberalisation. The EU will open its market in services significantly for Canadian firms. But a number of key sectors are not included, such as audio-visual and the majority of air transport. In 2014, the UK enjoyed a surplus of £17 billion on trade in services with the EU.⁵⁷ Similar terms to the EU-Canada Agreement would have an adverse impact on this balance as our trade would be affected. For example, UK low-cost airlines currently benefit from full access to a liberalised EU air services market, which has created an environment in which routes have increased between European cities and which has brought down the cost of travel.
- **Setting and complying with the rules.** In the EU, common regulations apply to products sold across all 28 Member States. These protect consumers and ensure that our industries are not unfairly penalised. Toys and electrical products, for instance, must comply with EU safety rules. Each national authority assesses whether they do so, and these assessments are recognised by other Member States. This makes it easier for firms to do business. The UK can both influence the setting of rules and judge whether they are met or not. Moreover, as the EU covers a quarter of the global economy many countries voluntarily adopt EU rules to make trade easier. For example, Australia bases vehicle emissions regulation on EU rules. Under the EU-Canada Agreement, the EU has recognised Canadian assessments in only a minority of product categories. This leaves many Canadian products, such as medical equipment, dependent on approval by EU authorities before they can be sold in the Single Market. If the UK were to trade with the EU on similar terms as Canada, this would place many of our companies at a disadvantage.
- **Agriculture.** Tariffs are eliminated in most areas, but not all. Certain sensitive areas remain protected. Initially, Canada will only be allowed to export limited quotas of processed shrimp and frozen cod, beyond which tariffs of 20 per cent and 7.5 per cent respectively will be applied. EU tariffs on fish products will be phased out over seven years.⁵⁸ Quotas are introduced for export of other products, such as beef and pork. For example, Canada will only be able to export 50,000 tonnes of beef to the EU, beyond which it will have to pay tariffs. More than 90 per cent of both UK beef and sheep exports go to the EU (92,000 tonnes and 75,000 tonnes respectively). Based on the Canada deal, whatever beef we exported to the EU beyond the agreed quota (of the UK's £80 million annual beef exports to the EU) would face tariffs of more than 12 per cent. In addition, they could face additional duties on top of several

⁵⁶ European Commission, 2012. 'The Economic Impact of the Services Directive: A first assessment following implementation'. This figure measures the potential for growth from better implementation of the 2006 Services Directive, the existing legislation governing the single market in services. Future legislative interventions to open markets would be expected to deliver additional benefits.

⁵⁷ ONS Pink Book (October 2015).

⁵⁸ Available at: http://trade.ec.europa.eu/doclib/docs/2014/december/tradoc_152982.pdf

hundred Pounds for every 100 kilograms. Canada does not export lamb to the EU. But we could expect the EU to demand similar arrangements for UK lamb exports.⁵⁹

- **Cars.** Inside the EU, the UK makes and sells cars without tariffs or regulatory barriers. By contrast, car imports from countries outside the EU without preferential trade arrangements are subject to a 10 per cent tariff. Although under the EU-Canada deal, the current tariff on cars would fall from an average of 11.2 per cent over a transition period, UK car manufacturers would still be subject to the bureaucracy and associated costs of complying with EU Rules of Origin. Furthermore, UK exporters could still face a 10 per cent tariff when exporting to the EU depending on the amount of non-EU content involved in the final product.
- **Mutual recognition of professions.** The EU is moving towards a more flexible market for professionals to travel and work across borders. Doctors, pharmacists, architects and vets are able to practise freely across the EU, based on qualifications gained in their country of origin. The EU-Canada Trade Agreement contains much more limited provision in this area. It establishes a framework for professional associations to recognise each other's qualifications, rather than granting access as of right. In practice, this will require Canadian firms to establish local subsidiaries in individual EU countries, employing professionals who hold qualifications gained in that country. For international businesses such as architecture and law, this can be a significant constraint. It means that these firms operating inside the EU would need to accept local standards and employment restrictions, different to those in the UK.
- **Investment.** Despite some concessions, for example in uranium mining, the EU-Canada trade deal will maintain investment restrictions in a number of sectors, such as banking and aerospace.

Costs and Obligations

3.56 All trade deals involve difficult choices. Reaching agreement between the EU and Canada required both sides to make concessions. If the UK were involved in similar negotiations with the EU, it would need to be prepared to offer concessions. Negotiators seek to gain access to each other's markets, in return for conceding access to their own market. Economic weight matters in these negotiations. The EU economy is ten times larger than Canada's. This greater market size helped the EU in negotiations. The UK is a larger economy than Canada, but it is still only about a fifth of the size of the rest of the EU economy.⁶⁰

3.57 The trade agreement between the EU and Canada will facilitate the temporary movement of skilled professionals. It is likely that any similar agreement between the UK and the EU would at least have to feature similar obligations.

Suitability for the UK

3.58 A trade agreement similar to that between the EU and Canada would involve less favourable terms for access to the Single Market than those we have now.

3.59 This is particularly the case for services, which comprise almost 80 per cent of the UK economy. The EU-Canada Trade Agreement does not come near the level of access for services that we have inside the EU, where substantial progress has already been made to liberalise services across the EU, and where the European Council has set out its

⁵⁹ BIS calculation based on HMRC data presented and available at: www.beefandlamb.ahdb.org.uk/markets/industry-reports/uk-statistics

⁶⁰ IMF World Economic Outlook (October 2015).

determination to bring down remaining barriers.⁶¹ For example, entire sectors (such as audio-visual and the majority of air services) are carved out of the EU-Canada deal and financial services companies are not able to benefit from passporting under the agreement. Given that the UK is the second largest exporter of commercial services in the world, and the EU market is our largest market for services exports, this would have a damaging impact on the UK economy.⁶²

3.60 There would also be a difference in terms of UK companies' ability to enforce the terms of the agreement – under a Canadian-style agreement, they would not be able to go to the European Court of Justice, and would instead have to rely on special dispute tribunals which also have fewer powers of enforcement. This would mean a more costly, less effective and more time consuming process for companies facing discrimination.

3.61 Based on the EU-Canada model, UK agricultural and manufacturing exporters, would also face restrictions in some areas. Even where tariffs had been liberalised, there would still be quotas, customs checks and onerous Rules of Origin requirements. And UK exporters to the EU would have still to comply with EU product standards and technical requirements, but without the UK having had any say in the setting of those standards. All this could have a costly impact on a number of important sectors, including car manufacturing.

3.62 As in the Swiss and Norwegian models, the UK would have little or no say over future rules. Outside, we would have little influence and no ability to try to block measures that would put our companies at a disadvantage. Manufacturers in UK sectors such as cars, pharmaceuticals or chemicals could face problems accessing the Single Market as UK and EU product rules diverged over time, and exporters to the EU could be forced to comply with different standards, when now they only have to comply with a single standard.

3.63 Under the EU-Canada Agreement, Canada is not subject to an obligation to make contributions to the EU's budget. And because Canada is not part of the Single Market, there is no obligation to accept the free movement of people, although the agreement does involve a requirement to accept arrangements for the temporary movement of professionals working in service sectors, which according to WTO rules are known as 'Mode 4' (under the General Agreement on Trade in Services).⁶³

3.64 More broadly, a relationship with the EU based on the Canada model, which does not extend beyond the economy, would reduce our access to cooperation which benefits our security. While the UK would remain an influential player on the global stage as a permanent member of the UN Security Council and the world's fifth largest economy, we would no longer be able to shape common EU positions towards countries like Iran or Russia, or use the economic and political weight of the EU to advance our global interests. And such an agreement would not provide for the arrangements we have in place for police and judicial cooperation with the EU in the interests of UK security – these would have to be negotiated separately, and even then are unlikely to include the full range of existing cooperation.

3.65 Overall, a Free Trade Agreement along the lines of EU-Canada would bring less advantageous terms for UK trade than those we currently enjoy, with particular issues for UK services losing access to the Single Market.

⁶¹ February European Council, 2016.

⁶² Available at: https://www.wto.org/english/res_e/statis_e/its2014_e/its14_world_trade_dev_e.htm table 1.9

⁶³ Available at: https://www.wto.org/english/tratop_e/serv_e/mouvement_persons_e/mouvement_persons_e.htm

Box 7: Car manufacturing: the impact of withdrawal from the EU

Access to the Single Market is important for the UK's manufacturing sector. Last year the UK exported a record number of cars (1.23 million). More than half of these went to the EU market.⁶⁴ The industry directly employs 147,000 people,⁶⁵ and supports a further 300,000 jobs in the wider supply chain.⁶⁶ The North-East of England has one of the highest shares of EU exports in the UK's regional economy,⁶⁷ with major foreign investment from Japanese car manufacturers.

If the UK withdrew from the EU, unless preferential access was agreed as part of the exit negotiations, UK car manufacturers would face a 10 per cent tariff on exports to the EU. In 2015 UK exports of cars to the EU were worth £10.2 billion.⁶⁸ A 10 per cent tariff would imply a surcharge of over £1 billion. Moreover, if the UK was forced to raise tariffs under WTO rules, components sourced from the EU would become more expensive for UK vehicle manufacturers. As over 40 per cent of components purchased by these manufacturers come from the EU, this could place such exporters at further disadvantage.⁶⁹

C. A WTO-only Model

- WTO rules represent a minimum threshold. It would be the most definitive break with the EU, offering no preferential access to the Single Market, no wider co-operation on crime or terrorism, no obligations for budgetary contributions or free movement of people.
- If we did not manage to secure an agreement on better terms, we would be forced to revert to this model. This would cause a major economic shock to the UK, with serious consequences for companies, consumers, jobs and prices.
- The UK would face immediate and heavy costs to our trading relationships, both with the EU and with the wider world. If reciprocal tariffs were introduced on imports from the EU, these goods would become more expensive.
- UK nationals would not have the rights that they currently enjoy to live, work and travel in the EU.
- Under WTO rules neither the UK nor the EU could offer each other better market access than that offered to all other WTO members.
- Our privileged access to 53 markets outside the EU through the EU's Free Trade Agreements would be terminated. We could seek to negotiate new agreements, but this would take years. It would be difficult to replicate the terms that we currently enjoy.

⁶⁴ Annual figures from The Society of Motor Manufacturers and Traders.

⁶⁵ ONS Workforce Jobs.

⁶⁶ BIS analysis using ONS job multiplier estimates from Analytical Input-Output tables.

⁶⁷ HMRC Regional Trade Statistics.

⁶⁸ HMRC Regional Trade Statistics.

⁶⁹ 2014 KMPG report for The Society of Motor Manufacturers and Traders.

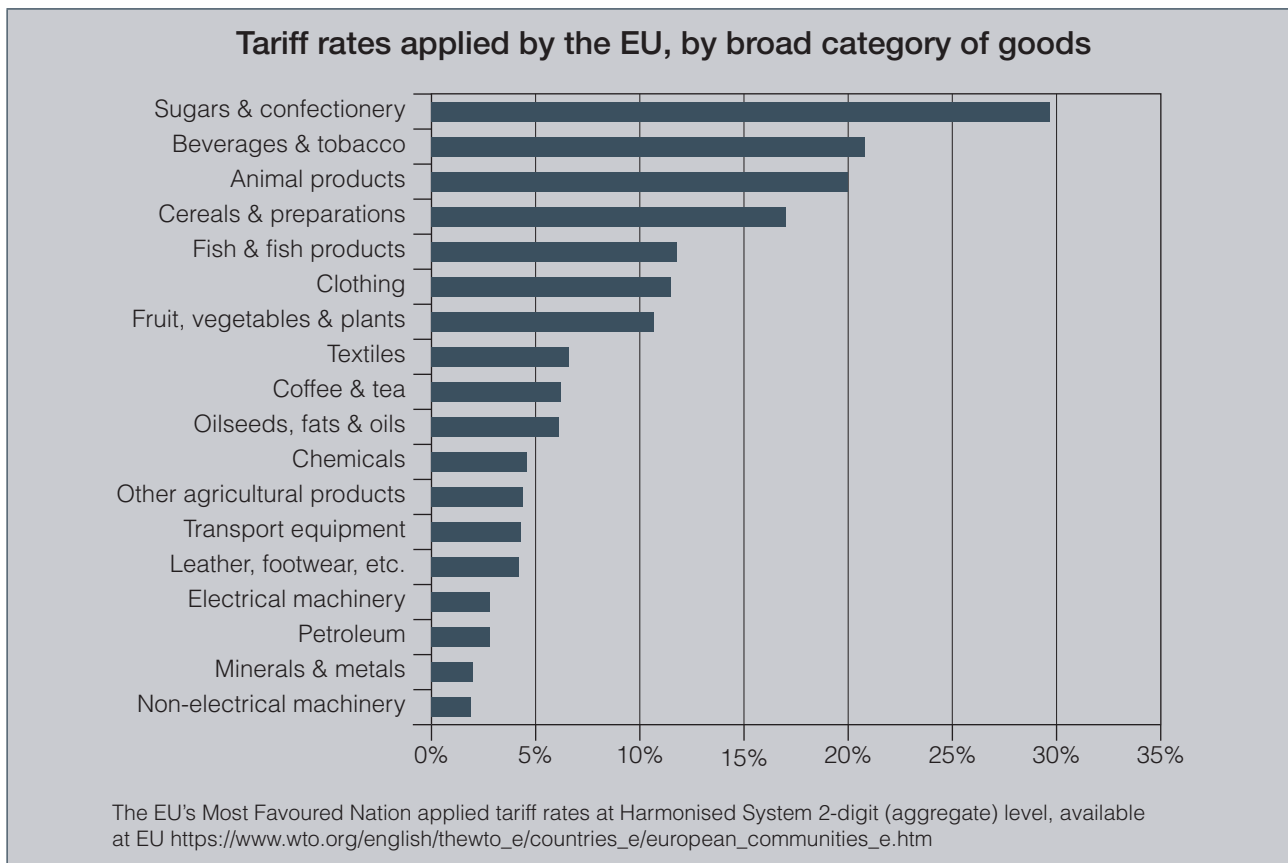
	Access to the Single Market in goods and services				'Ever closer union'	Justice and Home Affairs (JHA)	Free Movement of People	Schengen border-free area	Contribution to EU financing	Eurozone membership
	Votes on EU law	Tariff-free trade	Customs Union and external trade	Level playing field for business						
UK membership of the EU	Green	Green	Green	Green	Red	Yellow	Green	Red	Yellow	Red
WTO	Red	Red	Red	Red	Red	Red	Red	Red	Red	Red

3.66 The WTO provides a global framework for trade relations between countries. The UK and other EU countries are members of the WTO in their own right. In the absence of any other arrangements between the UK and the remaining EU countries, or if the two-year time limit under Article 50 expired (and was not extended) before alternative arrangements could be agreed, we would be forced to fall back on our WTO membership as the basis of our trading relationship with the EU.

Key features of a WTO-only arrangement

Access

3.67 Countries which have a relationship based on WTO terms alone have much less favourable access to the EU Single Market. The EU imposes a common external tariff on countries outside, except those that have negotiated preferential trade agreements with it. The table below shows the EU's average applied tariff rates for the high-level broad categories. Within each category there can be wide variation for sub-categories. Among these, for example, there is a 10 per cent tariff on car imports, and in the agricultural sector, dairy tariffs averaged 36.1 per cent in 2014.⁷⁰



⁷⁰ WTO calculated 2014 figure.

3.68 Without a preferential trade deal, there would be no scope to vary these rates for the UK. Under WTO rules, the EU is required to apply a ‘common external tariff’ in line with the ‘Most Favoured Nation’ principle, which means that WTO members must offer the same terms to all 161 other WTO members.⁷¹

3.69 The WTO governs the conduct of international trade. It does not cover matters relating to co-operation on policing, criminal justice, counter-terrorism or security and in foreign policy. So relations based on WTO membership alone would not include co-operation in these wider areas.

Obligations

3.70 The WTO-only model involves the fewest direct obligations to the EU. WTO countries which do not have preferential trade agreements with the EU are not required to implement EU legislation. They are not subject to decisions from the European Court of Justice. They are not required to contribute to the EU budget, or to accept the EU’s free movement of people rules. However, UK businesses would still have to comply with EU rules, such as on the environment or safety, in order to trade with the Single Market.

Influence and Sovereignty

3.71 A WTO arrangement would give no say at all over EU decisions. Some limited, indirect influence might be possible both through diplomatic contact and indirectly through other international organisations such as the G20, IMF and UN. But, of all the models described in this paper, a WTO arrangement would involve the most definitive break with the EU.

3.72 In terms of trade negotiations, as a member of the WTO, the UK would be one among 162 members. At crucial stages in multilateral trade rounds, the largest players – the United States, China and the EU – usually command the greatest negotiating weight.

3.73 The WTO provides much more limited arrangements to handle trade disputes than the Single Market. Businesses cannot directly enforce their rights under WTO rules. Only Governments can bring cases on behalf of businesses. The WTO dispute-settlement process is burdensome, both in time and resources.

3.74 The UK would also lose the benefit of the collective weight of the EU in dealing with any trade difficulties that we might encounter with third countries. Writing and enforcing the rules of global trade is easier for larger economic blocs. As a quarter of the global economy, the EU carries considerable weight in trade negotiations and measures to enforce compliance with the rules. The EU, for example, has used its collective weight to impose tariffs against the dumping of Chinese steel imports. If the UK attempted to take similar measures on its own, they would carry less weight (the UK economy is about a sixth of the total EU economy in size, so such measures would have correspondingly less impact).

Suitability for the UK

3.75 The WTO model would bring a number of significant draw-backs for the UK. Most importantly, our companies would lose all privileged access to the Single Market, and to all 53 markets with which the EU has Free Trade Agreements. This would have a huge impact on UK companies, exports, investment and jobs.

⁷¹ Under the WTO generalised system of preferences, the UK could choose to continue to grant preferential tariffs to imports from developing countries.

3.76 Without negotiating a Free Trade Agreement, we would no longer be able to apply a different tariff regime to our trade with the EU from the tariff we apply to every other WTO member. And without an agreement, the EU would not be able to give the UK better rates than it gives every WTO member in the world. We would have more limited scope to protect our trade and commercial interests against international competitors. And we would have no influence over the rules governing the Single Market.

3.77 A WTO-only arrangement would create a particularly difficult dilemma for the UK over trade tariffs. Inside the EU we have no tariffs on our trade with other EU countries, we operate common EU tariffs with the rest of the world, and we benefit from EU preferential trade deals. Under a WTO arrangement, we could not differentiate in this way. In the absence of bilateral trade agreements, the UK would have to determine a single, universal set of tariff rates. These would be set out in a new schedule of tariff commitments that we would be required to submit to the WTO. This would be a complex exercise involving a review of every tariff line – over 5,000 – to determine what rate the UK would wish to apply.⁷²

3.78 Extending these existing tariffs to imports from the EU would make these imports more expensive. They currently account for more than half of what the UK imports.⁷³ In addition, many industries, including car manufacturers, rely on tariff-free imports of components from the Single Market to support complex supply chains. The individual price calculations behind these would change if tariffs were reintroduced. This would have considerable implications for the competitiveness of UK businesses. It could also change investment decisions, including for foreign investors who have located in the UK. Over time, we could offer to reduce the UK's tariffs as part of negotiating new trade deals. But in the shorter term the UK would have suffered a serious negative economic impact.

3.79 Conversely, lowering tariffs would make imports cheaper, but there is no guarantee that this would be reciprocated. If we chose to go down this route, the UK would need to lower tariffs on all imports, for the EU and the rest of the world alike. If we had already lowered tariffs, giving duty-free access to the UK market, other countries would have no incentive to give preferential access to their own markets for UK companies. We would have lost a significant lever in trade negotiations.

3.80 The UK would face a stark choice: lower tariffs for all countries in the world, or raise tariffs with respect to the EU. The first option would undermine our position in future trade negotiations. The second option would raise costs for businesses and consumers.

3.81 Trade in services would be affected significantly. At present, through our membership of the EU and the EU's Free Trade Agreements, our services companies enjoy certainty that they will be able to access overseas markets and that, once in them, they will be treated in a fair and non-discriminatory way. Without a preferential trade agreement, the EU and other international partners would only be obliged to give us access in line with WTO rules flowing from the General Agreement on Trade in Services (GATS). This provides a much more basic framework, and much less access.

⁷² WTO. Available at: https://www.wto.org/english/tratop_e/tariffs_e/tariff_data_e.htm

⁷³ ONS Pink Book (October 2015).

3.82 A WTO arrangement would affect UK consumers travelling abroad. EU mobile roaming charges fell by 73 per cent between 2005 and 2011, and will be abolished entirely by June 2017.⁷⁴ Mobile phone calls abroad could become significantly more expensive.⁷⁵ Inside the EU, travellers are entitled to compensation for delayed flights, through accommodation, meals and up to €600 in compensation.⁷⁶ Similar provisions apply to cross-border travel by rail, coach and ferry within the EU. Compensation arrangements also cover cancellation of package-holidays. Under a WTO-only model, UK nationals travelling in the EU would not automatically be entitled to these benefits.

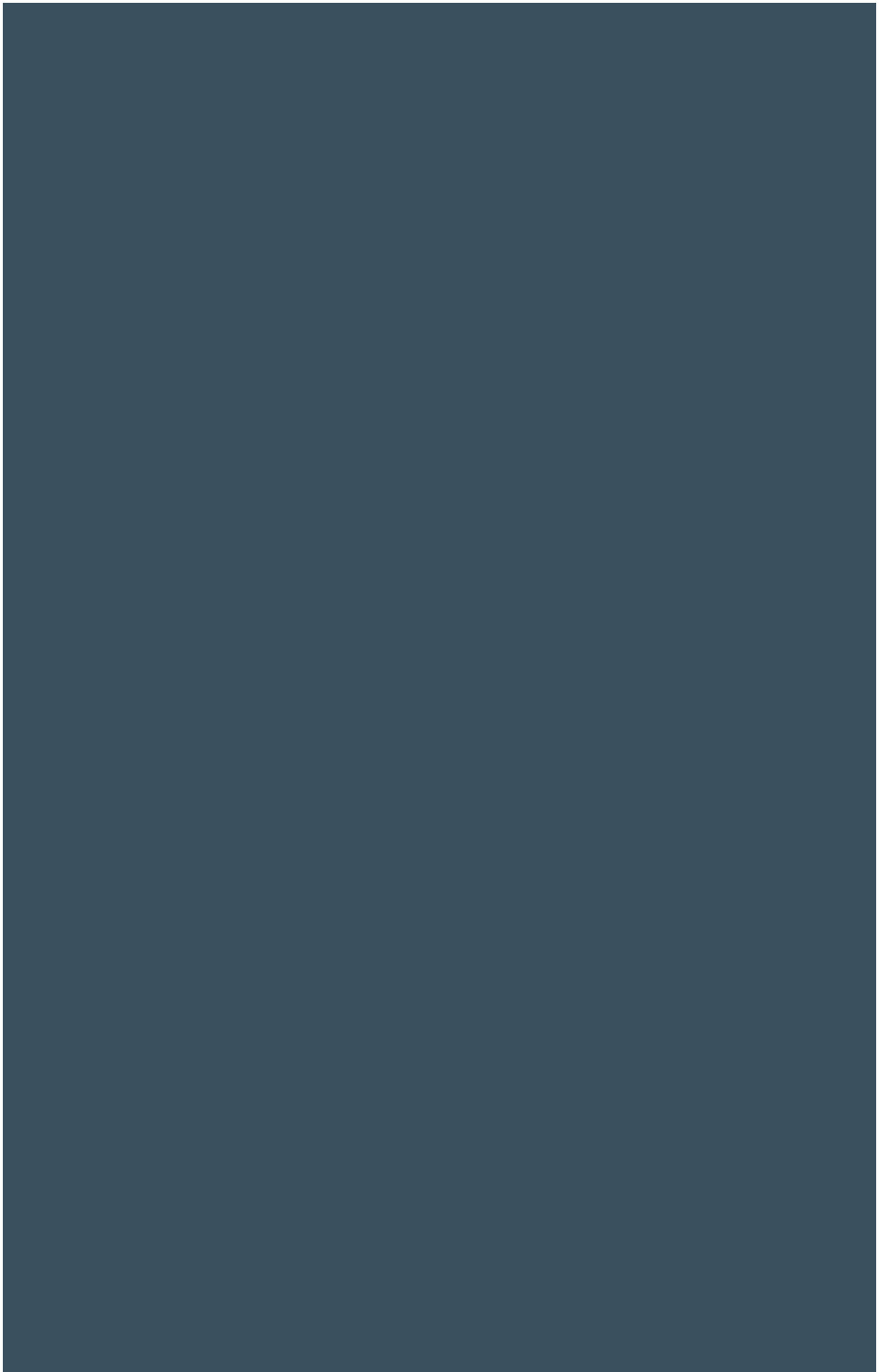
3.83 We would lose a significant component of our cooperation with EU countries on policing, criminal justice and counter-terrorism. If we wished to replicate existing cooperation with the EU in areas such as sharing information on criminals and terrorists, we would need to negotiate separate bilateral arrangements. Doing so would take time, as Norway and Switzerland have found, and there is no guarantee that it would fully replicate the current arrangements.

3.84 The UK would no longer be required to maintain free movement for EU and EEA nationals. New rules could require all foreign citizens that wish to move to the UK to apply for and receive a visa. But if we did this, other countries could be expected to impose similar restrictions on UK nationals living in, or travelling to, other Member States. The UK would still need to comply with WTO obligations relating to the temporary migration of professionals. And we might find, in seeking to negotiate trade deals that other countries, such as India and Japan, prioritised access to the UK labour market in FTA negotiations.

⁷⁴ Available at: http://europa.eu/youreurope/citizens/travel/money-charges/mobile-roaming-costs/index_en.htm

⁷⁵ For example, making a call to the UK from Singapore with a UK mobile would cost between 80 pence and £2 per minute for a pay monthly subscriber (based upon a range of UK providers' quoted call rates).

⁷⁶ Available at: http://europa.eu/youreurope/citizens/travel/passenger-rights/index_en.htm



Chapter 4 – conclusion

4.1 If the UK voted to leave the EU, the Government would do all it could to secure a positive outcome for the country. We would seek the agreement of the remaining 27 EU Member States for the best access for UK companies and consumers to the Single Market. We would start the slow process of agreeing Free Trade Agreements with countries outside of the EU. We would aim to keep those elements of non-economic cooperation that serve our national interest, enhance UK power in the world and increase our ability to get our way. And we would use all the levers at our disposal to achieve such an outcome.

4.2 It would, however, be hard even to come close to replicating the level of access and influence from which the UK currently benefits as a result of our special status in the EU. In addition to the pressure imposed on the UK by the Article 50 process to secure a deal quickly, reaching agreement on a wide range of issues with 27 Member States, each of which would seek to fight for their own interests, is likely to be challenging and involve difficult trade-offs. If we failed to reach agreement within two years under the Article 50 process, our membership of the EU – including our access to the Single Market and to Free Trade Agreements with 53 markets around the world – would lapse automatically, unless all 27 other Member States agreed to an extension.

4.3 The UK would therefore have to make some difficult decisions about its priorities. Each possible approach would involve a balance between securing access to the EU's Single Market, accepting costs and obligations and maintaining the UK's influence.

4.4 In particular, we would need to decide if we wanted full access for UK companies to the EU's free-trade Single Market. If we did, we would have to accept the rules of the Single Market. But outside the EU, we would not have a vote on those rules. And full access to the Single Market would almost certainly require us to accept many of the costs and obligations of EU membership, including the free movement of people and substantial contributions to EU budgets and programmes (but without the UK rebate, which we would lose upon leaving the EU).

4.5 Alternatively, we could seek a relationship based on a Free Trade Agreement. Even the most advanced of these agreements offers less access to the Single Market. In particular, they offer less access for services, which make up almost 80 per cent of the UK economy.

4.6 In the absence of any agreement, we would have a relationship based on WTO membership alone. This would provide the most definitive break with the EU. It would mean we did not have to follow EU rules when exporting outside the EU (though UK companies exporting to the EU would still have to comply with EU Single Market rules, such as on

the environment or safety, in order to trade with the EU). We would not have to accept the free movement of people and we would not have to contribute to the EU's budgets and programmes. But this would come at a serious price for UK businesses and jobs.

4.7 Every alternative to membership would involve the UK losing its vote and vetoes over how EU laws are written. And regardless of our preferences and choices, the EU will continue to be the UK's biggest export market (at present, UK exports to the EU are worth more than two and half times UK exports to the United States – our next largest overseas market). So those EU laws will continue to be of fundamental importance to UK companies. At the moment, the UK has a significant voice in how these rules are written. Under weighted voting rules determined by population size, the UK, France and Germany have the largest voting shares when legislation is decided. We can veto decisions on such crucial issues as tax or the EU budget, when these are not in the national interest. Under every alternative we would surrender our vote and have no right to veto.

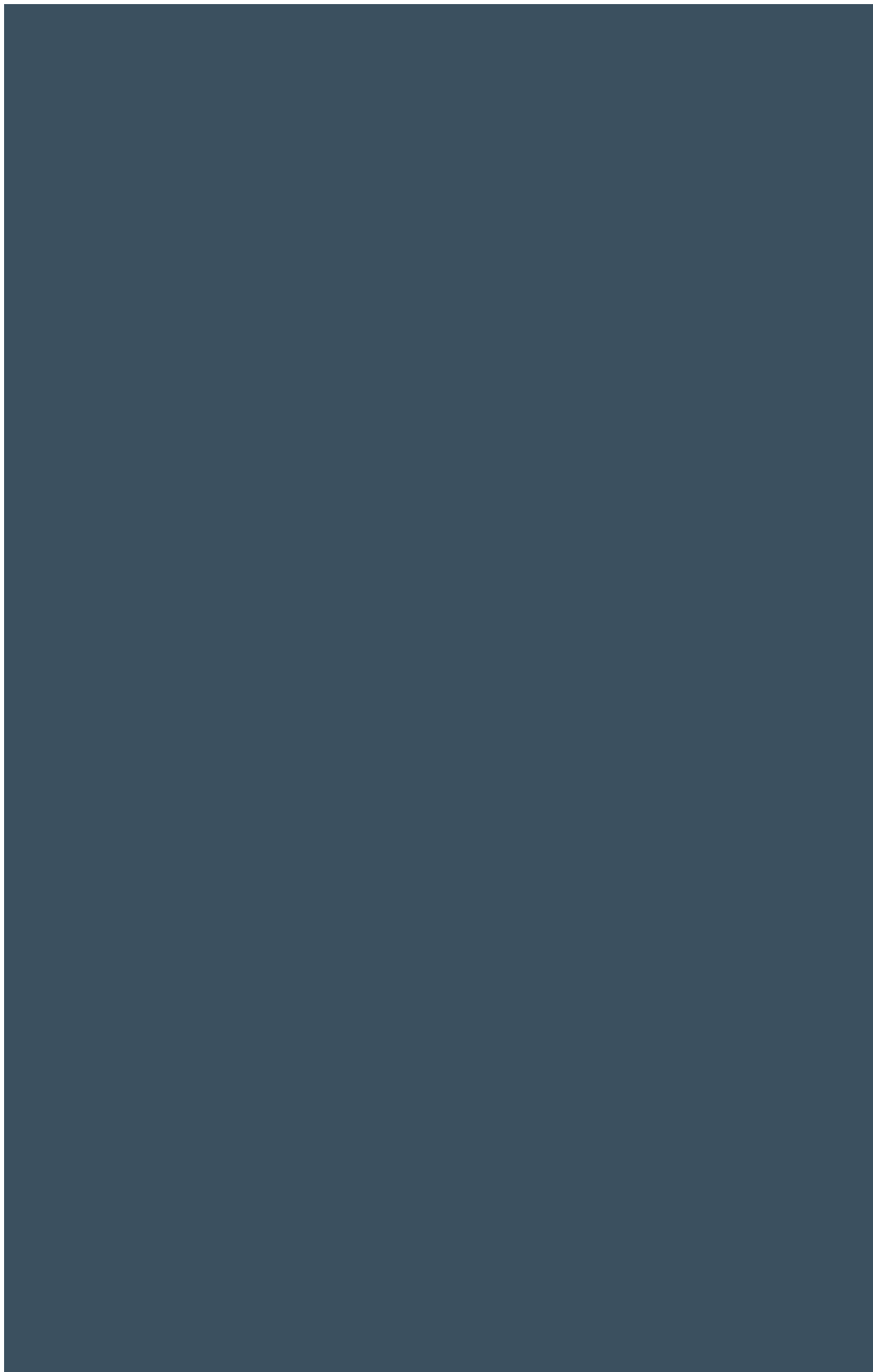
4.8 This loss of influence would be keenly felt by UK companies. As the EU continued to develop its rules without us, we would not be able to protect and promote the interests of UK companies as we can now. In particular, we could not prevent the creation of non-tariff barriers that would cause particular issues for the UK services sector, and for UK manufacturers dependent on cross-border supply chains. Moreover, outside of the EU, UK companies would lose the strong legal protection that ensures a level playing field for competition, with the right to secure redress.

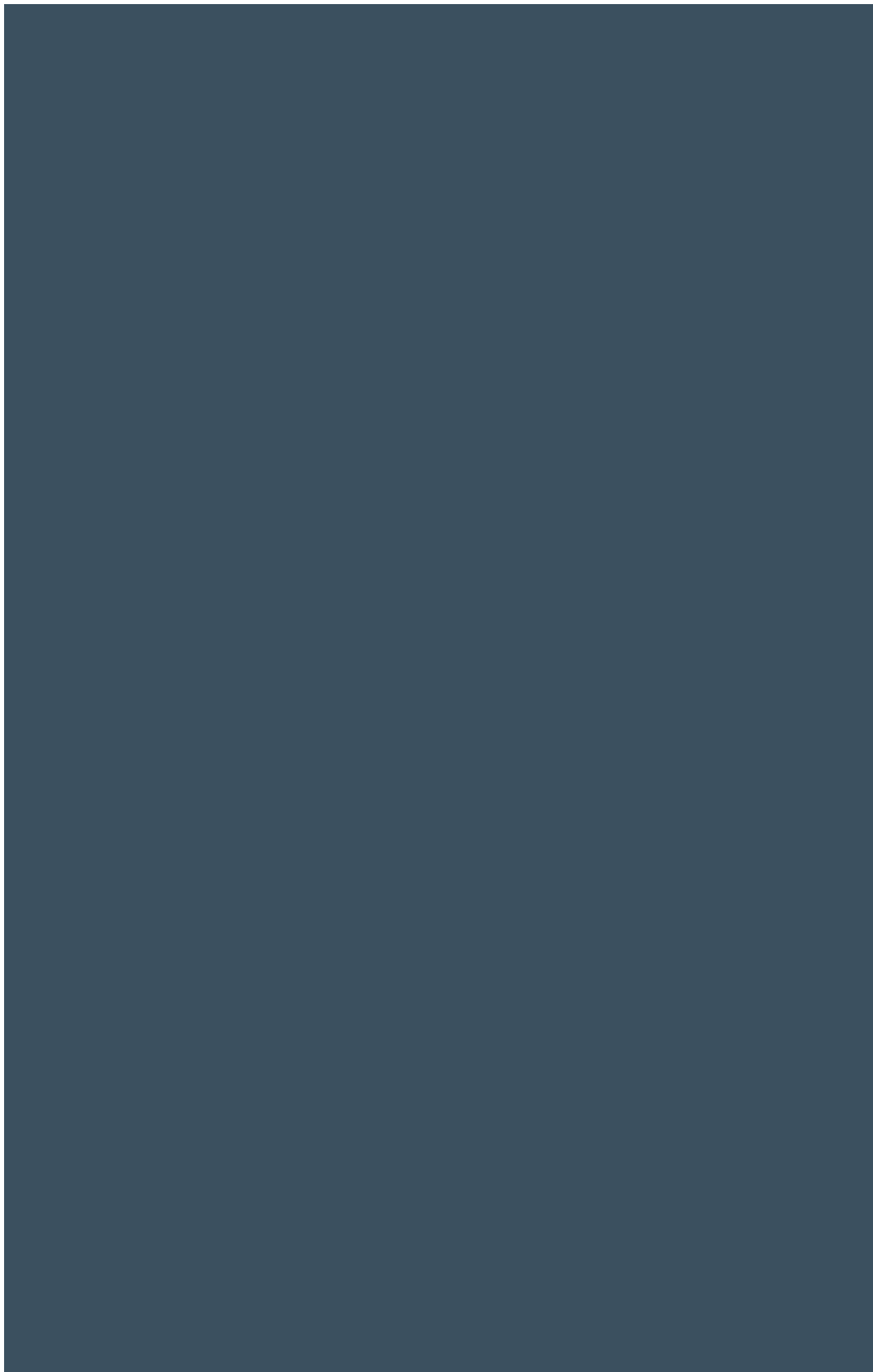
4.9 Despite our negotiating advantages, the UK would not get a free choice on its future relationship with the EU. Any model except a basic WTO arrangement would need to be agreed with the other Member States and approved by the European Parliament. Some of the models described in the paper could also require unanimous agreement by the remaining 27 Member States and ratification by their national parliaments. Reaching agreement on such a wide range of issues with a large number of negotiating partners, each of which would seek to defend their individual interests, is likely to be difficult and could involve potentially unpalatable trade-offs.

4.10 It would not be quick or straightforward to establish a new relationship. The models described in this paper are the result of complex negotiations, conducted over many years. International trade negotiations are notoriously slow and complicated. The more comprehensive the agreement, the more drawn-out negotiations tend to be. Negotiating exit from the EU, a new relationship for the UK with the EU, and then a new set of trade deals with third countries, would be at the most complicated end of the spectrum. We should expect this process to take up to a decade or more to complete.

4.11 There would also be a cost in terms of co-operation in non-economic areas. Given recent events in the wider EU neighbourhood, this is not a time to disrupt arrangements that contribute to our security. Under any of the alternative models there is no guarantee that we could fully replace our access to the current measures for police and security cooperation, which allow our law-enforcement agencies to work with their EU counterparts. Bilateral agreements outside the EU could not replicate the reach and influence that we currently enjoy in these areas, or our right to choose which we wish to participate in. We would not be able to ensure that EU action reinforced our foreign and security goals, or to use the EU's economic weight to impose sanctions against countries like Russia or Iran. None of the countries outside the EU that are described in this paper can shape or drive EU action in the way that the UK can today.

4.12 Whatever alternative to membership the UK seeks following a decision to leave the EU, we will lose influence over EU decisions that will still directly affect us. We need to weigh the benefits of access to the EU and global markets against the obligations and costs incurred in return. It is the assessment of the UK Government that no existing model outside the EU comes close to providing the same balance of advantages and influence that we get from the UK's current special status inside the EU.





Glossary of key terms

Term	Definition
Ankara Agreement	The Association Agreement signed between the European Community and Turkey in 1963, and the Additional Protocol added in 1970. They set out basic agreed objectives for relations between the EU and Turkey, such as the strengthening of trade and economic relations and the establishment of a Customs Union.
Banking Union	The Banking Union is an EU-level supervision and resolution system for the banking sector in the euro area, and participating member states. It aims to ensure that banks in the euro area are safe and reliable and that non-viable banks are resolved without recourse to taxpayers' money and with minimal impact on the real economy.
Capital Markets Union	The Capital Markets Union (CMU) is a plan of the European Commission to create a true single market for capital in Europe. It will channel increased capital to all companies, including Small and Medium Enterprises (SMEs), and to infrastructure projects.
Common Agricultural Policy (CAP)	The Common Agricultural Policy (CAP) is the agricultural policy of the European Union. It implements a system of agricultural support through direct income payments to farmers and guaranteed prices.
Common External Tariff	A common external tariff must be introduced when a group of countries forms a customs union. The same customs duties, import quotas, preferences or other non-tariff barriers to trade apply to all goods entering the area, regardless of which country within the area they are entering.
Common Fisheries Policy (CFP)	The Common Fisheries Policy (CFP) is a set of EU rules for managing European fishing fleets and for conserving fish stocks.
Common Travel Area	A travel zone comprising Ireland and the UK. It allows for nationals of both countries to travel and live in each country without immigration controls.
Council of the European Union (also known as Council of Ministers)	The Council of the EU brings together the representatives of EU Member States' governments. It is the EU's main decision-making body and agrees EU laws, usually together with the European Parliament.

Term	Definition
Customs Union	An agreement between two or more countries to remove customs barriers and reduce or eliminate external customs duties on mutual trade. Customs unions generally impose a common external tariff (CET) on imports from non-member countries.
Dublin Regulation	An established set of criteria for identifying the Member State responsible for the examination of an asylum claim in Europe. Under Dublin, the claim for asylum must be made in the first EU country entered.
EU-Canada Free Trade Agreement (CETA)	The Comprehensive Economic and Trade Agreement (CETA) is a trade agreement negotiated between the EU and Canada. Once implemented, it will remove customs duties, end limitations in access to public contracts, open up services markets, and help prevent illegal copying of EU innovations and traditional products.
Eurojust	Eurojust is an agency of the European Union dealing with judicial cooperation in criminal matters.
European Arrest Warrant (EAW)	A legal framework that facilitates the extradition of individuals between EU Member States to face prosecution or to serve a prison sentence for an existing conviction.
European Commission (the Commission)	The European Commission is responsible for proposing draft legislation, implementing decisions, upholding the EU Treaties and managing the day-to-day business of the EU.
European Council	The European Council is the body in which the Heads of State or Government of the EU's 28 Member States, together with an appointed President and the President of the European Commission, take strategic decisions about the direction of the EU.
European Court of Justice (ECJ)	The European Court of Justice (ECJ) is a supranational court based in Luxembourg and made up of one judge from each of the EU Member States. The Court deals with cases concerning the interpretation and application of the EU Treaties.
European Criminal Records Information System (ECRIS)	A system for criminal records held by Member States to be exchanged with the authorities of other Member States.
European Economic Area (EEA)	The EEA is an internal market providing for the free movement of persons, goods, services and capital. It is made up of 31 countries: the EU's 28 Member States plus Norway, Iceland and Liechtenstein. It is governed by a common set of rules.
EEA Joint Committee	An institution of the European Economic Area (EEA), in which decisions are taken by consensus to incorporate EU legislation into the EEA Agreement.
European Economic Community (EEC) and European Community (EC)	The European Economic Community (EEC) was a regional cooperation organisation and precursor to the EU, as one of the European Communities. It was founded in 1957 to promote economic integration between its member states. When the Maastricht Treaty created the European Union (EU) in 1993, the EEC was incorporated and renamed the European Community (EC). In 2009 the Lisbon Treaty provided for the EC to be fully incorporated into the European Union.

Term	Definition
European Free Trade Association (EFTA)	The European Free Trade Association (EFTA) has four members: the three non-EU EEA member states – Norway, Iceland and Liechtenstein – plus Switzerland. It has the right to conclude Free Trade Agreements with the rest of the world on behalf of its four members.
EFTA Court	The EFTA (European Free Trade Association) Court is a supranational judicial body that deals with cases concerning the interpretation and application of the EEA Agreement. It is essentially the equivalent of the ECJ for the EFTA countries that are also members of the EEA (Norway, Liechtenstein and Iceland).
European Parliament	The European Parliament was established in 1979 in order to represent the views of citizens directly in EU decision-making. It shares responsibility with the Council for passing EU laws and for agreeing the EU's budget, although the Council enjoys broader decision-making powers. The Parliament is made up of 751 members (MEPs) who are directly elected across the 28 Member States and serve a five-year term. The UK has 73 MEPs.
European Union (EU)	The European Union is an international organisation made up of 28 European countries, including the UK. The EU has its origins in the European Coal and Steel Community, founded by six European states after the Second World War. However, its remit has evolved and is much broader today. The EU facilitates cooperation between its Member States on a wide range of objectives, from facilitating trade to protecting the environment, and security and development overseas. The EU has created the world's largest Single Market, enabling the free movement of goods, services, people and capital.
Europol	Europol is an EU agency that assists Member States' law enforcement agencies in tackling cross-border crime. It carries out over 18,000 cross-border investigations a year to tackle security threats such as terrorism, international drug trafficking and money laundering, organised fraud, counterfeiting and people smuggling.
Europol Information System	The Europol Information System (EIS) is a central criminal information and intelligence database covering the areas under Europol's remit. Europol and all EU Member States can use the EIS to store and look up data on serious international crime and terrorism.
Free Trade Agreement (FTA)	A Free Trade Agreement (FTA) is a treaty between two or more countries or trading blocs that reduces, but does not eliminate, barriers to trade and investment. WTO rules allow its member states to sign FTAs granting each other preferential market access, subject to certain conditions. FTAs usually cover agreements to reduce tariffs and other restrictions to trade on goods and, to a lesser extent, services.
Frontex	Frontex is the EU's Borders Agency, which manages cooperation between national border guards to secure the EU's external borders.
G20	The Group of Twenty (G20) is a forum for international economic cooperation and decision-making. It comprises 19 of the world's leading economies, including the UK, plus the European Union.

Term	Definition
GATS	The General Agreement on Trade in Services (GATS) is a treaty of the World Trade Organization (WTO) that came into force in January 1995. The treaty was created to extend the multilateral trading system to the service sector, in the same way the General Agreement on Tariffs and Trade (GATT) provides such a system for merchandise trade. All members of the WTO are parties to the GATS. The basic WTO principle of most favoured nation (MFN) applies to GATS as well. However, upon accession, members may introduce temporary exemptions to this rule.
International Monetary Fund (IMF)	The International Monetary Fund (IMF) is an international organisation of 188 countries. It works to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. The UK is a member.
Justice and Home Affairs (JHA)	Justice and Home Affairs refers to EU cooperation on asylum and immigration, judicial matters, civil protection and the fight against serious and organised crime and terrorism, as well as the Schengen Border-free area. The UK has secured a set of exemptions that mean it is not required to participate in JHA matters, but can choose to do so if it wishes.
Lugano Convention	The Lugano Convention facilitates the recognition and enforcement of judgments in civil law cases in the EU and EFTA countries.
Most Favoured Nation (MFN)	Under WTO rules, countries cannot normally discriminate between trading partners that are members of the WTO. So a country or trading bloc cannot grant another a preferential arrangement (such as a lower customs duty rate for one of their products) without doing so for all other WTO members. This principle is known as Most Favoured Nation (MFN) treatment.
Non-tariff barriers	A non-tariff barrier is a form of trade barrier other than a tariff. Non-tariff barriers include quotas, levies, embargoes, sanctions and other restrictions. They are frequently used by large and developed economies.
Passporting	Passporting entitles a financial services firm authorised in a European Economic Area (EEA) state to carry on permitted activities in any other EEA state by either exercising the right of establishment (i.e. setting up a branch and/or agents), or providing cross-border services. These rights are subject to the fulfillment of conditions under the relevant Single Market directive.
Preferential market access	A country or trading bloc grants preferential market access to another when it grants it better terms of trade than as standard, for instance by reducing tariffs or providing access to public tenders. The WTO sets a number of rules about how countries and blocs can grant each other preferential access. Between developed economies this is usually granted through Free Trade Agreements, through which each side agrees to reduce trade barriers.

Term	Definition
Prüm Decisions	The Prüm Decisions are EU Council Decisions which embed into EU law a pre-existing Convention between several European Union States. They provide mechanisms to exchange information between Member States on DNA, fingerprint and vehicle registration data for the prevention and investigation of cross-border crime and terrorism. The UK has recently decided to apply to re-join the regime.
Qualified Majority Voting (QMV)	Qualified Majority Voting is the principal method of reaching decisions in the Council of Ministers. It allocates votes to the different Member States according to an agreed formula, based partly on population size. Under Lisbon Treaty rules, a decision or law is passed by qualified majority when 55% of Member States vote in favour (in practice this means 16 out of 28) and the Member States supporting represent at least 65% of the total EU population.
Rules of Origin	Rules of Origin are the criteria needed to determine the national source of a product. They matter because duties and restrictions often depend upon the source of imports. The complex supply chains of the global economy mean that this is not always straightforward to determine. The bureaucracy involved is a cost for businesses.
Schengen border-free area	The Schengen border-free area comprises the 26 European countries (22 EU member states and four others) that have abolished passport and any other type of controls at their common borders. It also has a common visa policy.
Schengen Information System II (SIS II)	The Schengen Information System II (SIS II) is a large-scale database that supports external border control and law enforcement cooperation within the Schengen States. SIS II enables competent authorities, such as police and border guards, to enter and consult alerts on certain categories of wanted or missing persons and objects. A SIS II alert contains not only information about a particular person or object but also clear instructions on what to do when the person or object has been found.
Single Market	A single market is a common trade area that extends beyond the deepest and most comprehensive Free Trade Agreements. It works to remove all regulatory obstacles to the free movement of capital, people, goods and services. It stimulates competition and trade, improves economic efficiency and helps to lower prices. The EU's Single Market is the largest in the world.
Stabilisation and Association Agreements	Stabilisation and Association Agreements are bilateral agreements between the EU and the countries of the Western Balkans designed to promote regional peace, stability and eventual accession to the EU. As well as establishing a Free Trade Area with the EU, the agreements pledge the parties to work towards common political and economic objectives and encourage regional cooperation.
State Aid	State Aid refer to any advantage or subsidy granted by public authorities through state resources on a selective basis to any organisations that could potentially distort competition and trade in the EU. The definition of state aid is very broad because 'an advantage' can take many forms.

Term	Definition
Tariffs	A tariff is a tax or duty imposed on a particular class of imports or exports.
Trade deficit	A trade deficit occurs when a country imports more goods and services than it exports. The deficit equals the value of goods and services being imported minus the value of goods and services being exported.
United Nations (UN)	The United Nations (UN) is an international organisation formed in 1945 to increase international cooperation and uphold peace and security. It has 193 members.
WTO	The WTO is the international organisation that regulates global trade between nations. It was established in 1995 as the successor to the General Agreement on Tariffs and Trade (GATT). The WTO enables participating member states to agree trade rules, negotiate trade agreements, and resolve disputes. A total of 162 countries are members, including the UK.



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