

A Blueprint for Britain: Openness not Isolation

by Iain Mansfield



EUROPE



THE WORLD



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Disclaimer:

His entry is in a personal capacity and does not represent the formal position of the British Embassy Manila, Foreign and Commonwealth Office or Her Majesty's Government.

Summary

Exiting from the EU should be used as an opportunity to embrace openness. The UK should pursue free trade agreements with major trading nations such as China, the USA and Russia and deepen its engagement with organisations such as the G8, G20 and OECD. In Europe, a priority must be to secure open trade relations, ideally by membership of the European Free Trade Area, though remaining outside the European Economic Area. Bilateral strategic relationships with allies such as Australia, Canada and France, as well as emerging powers in Asia and Latin America, should be cultivated.

Domestically, a 'Leaving the EU' Bill should be brought forward rapidly, to implement the legal secession from the EU two years after activation of Article 50 of the Lisbon Treaty. Separately, a 'Great Repeal Bill', based upon the Public Bodies Act (2011), should be enacted, bringing about within three years the comprehensive review and, where appropriate, repeal, of regulation of EU origin with the aim of lessening the bureaucratic burden on business, the public sector and third sector. Administratively, the Government will need to strengthen its capacity in a wide range of areas from trade negotiations to anti-trust enforcement. Current levels of funding from the EU to sectors and regions should initially be maintained domestically, including in agriculture, to prevent economic shocks whilst the surplus should be recycled to help pay down the deficit. Measures such as tax breaks and supply-side incentives would help preserve the UK's position as the number one inward investment destination in Europe.

The outcome would be to accelerate the shifting pattern of UK's exports and total trade away from the EU to the emerging markets, where the majority of the world's growth is located. A more business friendly regulatory regime and the new security of the City of London from European interference will enhance competitiveness and compensate for the partial loss of access to European markets. The total long-term

impact is estimated to be between -2.6% and +1.1% of GDP, with a best estimate of +0.1%. Although the years immediately surrounding the exit are likely to feature some degree of market uncertainty, if the right measures are taken the UK can be confident of a healthy long- term economic outlook outside the EU.

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1. Framing the Endeavour

An 'out' vote has occurred and the Government has triggered Article 50 of the Lisbon Treaty. Under the terms of the Treaty (see Box 1¹), the UK² will cease to be a member of the EU two years after that date. To steady the markets, the UK Government should declare as soon as possible that it intends to observe the two-year period and not negotiate for an earlier or later date. This will allow as much time as possible for the many necessary preparations and remove a potential distraction from the many other and more complex items that will need to be negotiated. This paper assumes that, in the result of an 'out' vote, the Government of the day, regardless of party, would respect the position of the British populace in demanding a substantive change in the UK's relationship with the EU and would therefore not seek to essentially duplicate the current status via a series of bilateral treaties. Equally, it assumes that the purpose of leaving the EU would not be to reject everything connected with Europe, but simply to regain the sovereignty to choose which aspects of the EU and European law should apply in the UK. The paper further assumes that the objective of the Government upon exit is to promote a free and prosperous UK economy and that it would therefore wish to take steps to achieve this aim.

1 <http://www.lisbon-treaty.org/wcm/the-lisbon-treaty/treaty-on-European-union-and-comments/title-6-final-provisions/137-article-50.html> - last accessed 01/08/2013.

2 This paper assumes that the forthcoming referendum in Scotland has resulted in a decision by Scotland to remain in the Union and that 'UK' therefore refers to the UK in its present form.

2. External Negotiations

Box 1: Article 50 of the Lisbon Treaty

Under Article 50, to leave the EU a Member State need simply notify the European Council of its intent. The EU treaties shall cease to apply to the Member State two years after the date of notification – unless a different date is agreed to before that date (by qualified majority and obtaining the consent of the European Parliament) or after that date (by unanimity).

During the period between notification and exit, the EU is required to negotiate and agree (by qualified majority and obtaining the consent of the European Parliament) with the Member State the arrangements for its withdrawal and future relationship with the EU.

2.1 Trade and Economic

One of the most critical factors in determining the UK's success following an exit from the EU will be its terms of trade, both with the EU and with the rest of the world (RoW). A sharp rise in tariffs to either party would not only be economically costly, but could deliver a symbolic blow far beyond its actual economic effect, leading to capital flight, loss of business confidence and a reduction in foreign direct investment. Any descent into protectionism by the UK would send similarly negative messages around the world, as well as directly harming UK competitiveness.

Trade with Europe

Even if current trends continue³, it is likely that until at least the end of this decade the EU will remain our single most important trading partner. The single highest economic priority should therefore be to ensure that

³ As discussed in more depth in Section 2.1.2, the relative importance of the EU as a trading partner compared to the rest of the world has been decreasing year on year for at least the last decade.

zero tariffs are maintained on bilateral trade between the UK and the EU in all areas other than agriculture⁴. This would ideally be achieved by joining the European Free Trade Area (EFTA), similar to Norway, Iceland or Switzerland, but could also be achieved by joining European Union Customs Union (EUCU), similar to Turkey. Box 2 sets out the distinctions between these options in more detail.

Whilst trade access is critical, full membership of the Single Market should not be sought. As Box 3 sets out in more detail, the Single Market is far more than just a customs union, or even a deep and comprehensive free trade zone. Should the UK retain membership of the Single Market, almost all of the most onerous or controversial aspects of EU membership would continue to apply, including the free movement of people and the Working Time Directive. Accordingly, the UK should, unlike Norway, seek to remain outside the European Economic Area (EEA). The position sought should be somewhere between that of Turkey's and Switzerland's: membership of EFTA but not of the European Economic Area (EEA) and without application of significant portions of EU law.

4 See section 2.1.3 for a further discussion on agriculture.

Box 2: Comparative positions of Norway, Switzerland and Turkey and proposed UK position after exit				
Issue	Norway	Switzerland	Turkey	UK after exit ((proposed
Membership of EFTA	Yes	Yes	No	Yes
Membership of EEA	Yes	No	No	No
Membership of EUCU	No	No	Yes	No
Free movement of goods	Yes	Yes	Yes	Yes
Free movement of agricultural goods	No	No	No	No ⁵
Free movement of services	Yes	Yes	No	Partial
Free movement of people	Yes	Yes	No	No
Free movement of capital	Yes	Yes	No	Yes
Contributes to EU budget	Yes	Yes	No	No ⁶
Significant portions of EU law applied.	Yes	Yes ⁷	Partial	Partial ⁸
Can negotiate own external trade agreements independently of EU	Yes (usually, though not required, to do so with other EFTA states)	Yes (usually, but not required, to do so with other EFTA states)	No	Yes (though would usually do so with other EFTA states)

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- 5 'Yes' would be preferred but is almost certainly unachievable.
 - 6 An outcome in which the UK contributed minimally to a small number of specific programmes would be acceptable.
 - 7 Although not a member of the EEA, Switzerland has a series of over 100 bilateral agreements that largely duplicate the application of much of the *acquis communautaire* that would be applied if it were a member - <http://ec.europa.eu/trade/policy/countries-and-regions/countries/switzerland/> - last accessed on 01/08/2013
 - 8 'No' would be preferred but is almost certainly unachievable if significant market access is also desired.

Box 3: What is The Single Market?

The Single Market is far more than a customs union or a comprehensive free trade agreement. The treaty that instigated the Single Market was not the Treaty of Rome, but the Single European Act of 1987, which concerned much more in depth matters of economic integration.

At its most basic, the Single Market refers to the creation of an area in which there are no functional barriers to the free movement of goods, people, services and capital.

Subsequent Treaties have seen the addition of other areas, such as environmental, social and employment policy. Regulatory harmonisation in these areas, and in others including health and safety regulation, environmental regulation, public procurement, infrastructure markets and standards, form a core part of the Single Market. It has been concluded that it is not possible to establish a clear division between Member State and EU competence in the Single Market area: that any situation where there is a national regulation that could act to restrict of movement on people, goods, services, or financial flows is potentially unlawful and subject to legal challenge⁹.

A further significant aspect of the Single European act was the introduction of Qualified Majority Voting – and the recent rejection of the UK's challenge of an EU ban on short selling was welcomed by the European Commission as having 'vindicated the use of a single market legal base, which requires approval of a weighted majority of member states, to empower the agencies.'¹⁰ Deepening the Single Market has been used to justify the regulation of how businesses conduct dispute resolution schemes, and the recognition of professional qualifications between Member States. It has been behind issues such as metrication and the Working Time Directive. A recent Commission booklet¹¹ references subjects as diverse as patents, European bonds, access to capital and a common consolidated tax base.

Whilst many individual aspects of the Single Market are beneficial, 'creating a level playing field for business' can ultimately be used to justify almost any intervention.

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- 9 Review of the Balance of Competences between the United Kingdom and the European Union: Single Market (July 2013) – https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/227069/2901084_SingleMarket_acc.pdf - last accessed 31/01/2014
- 10 <http://www.ft.com/cms/s/0/68cbcb64-834c-11e3-aa65-00144feab7de.html#axzz2rxTc4HJN> – last accessed 31/01/2014.
- 11 http://ec.europa.eu/internal_market/smact/docs/brochure-web_en.pdf – last accessed on 18/01/2014

The UK will, inevitably, need to accept some EU regulation in order to gain the necessary trade access in both goods and services¹². Financial services are a particularly critical sector: from 2019 onwards, providers outside the EEA will only be able to offer a more limited range of services, unless they establish a subsidiary within the EEA¹³. In addition to the impact on UK businesses, London currently benefits as the subsidiary location of choice for financial companies from countries outside the EEA such as the USA and Switzerland. The UK should therefore seek to negotiate an exit agreement that will allow this access to be preserved, potentially accepting a certain degree of regulatory cooperation as the price for access.

The UK should also be prepared to accept regulation on standards for electronic machinery or for health and safety inspection requirements for food exports: many of these will be based on international standards and similar in type if not specifics, to what exporters to other countries such as the US must abide by. There is no similar justification, however, once having left the EU, to accept regulation on purely internal matters such as working hours, hygiene requirements for domestic restaurants or mandatory quotas for women on boards¹⁴. A reasonable compromise between access and regulation might resemble the trade-off offered to members of the Eastern Partnership, who are expected to adopt approximately two-thirds of the *acquis communautaire*, though a successful negotiation could reduce the burden of regulation still further.

12 Services trade is of great importance to the UK: trade in services makes up almost 40% of total UK trade (ONS Pink Book, 2013). Full access for services is not practical – even now, the Single Market is not complete for services even for EU members – but access in the most important areas for UK exports would be important.

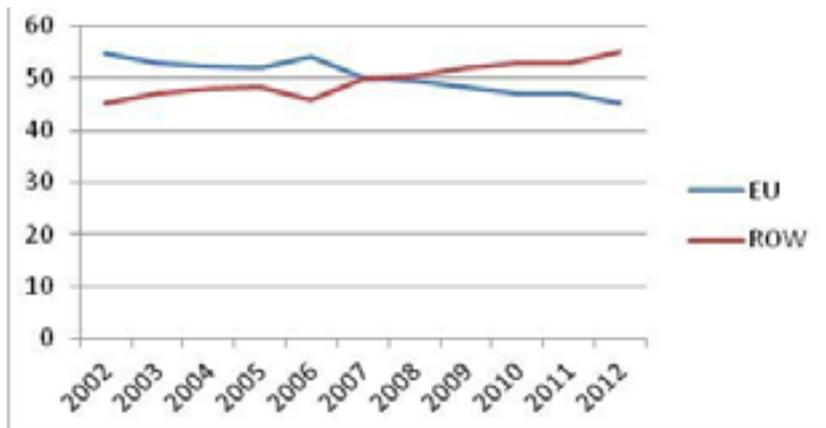
13 House of Commons Library: Leaving the EU (2013) – Research Paper 13/43

14 That is not to say that the UK might not choose to legislate on these matters domestically; however, this would be a matter for the UK Parliament.

Trade with the Rest of the World

For at least a decade the UK's exports have been shifting steadily more towards the rest of the world than the EU27 (see Figure 1 (ONS 2013¹⁵)). Deepening those relationships will be of critical importance if the UK is to maintain its place as a major trading nation and economic power.

Figure 1: Percentage of UK Exports to EU and ROW



As a WTO Member and signatory of the EU's Free Trade Agreements (FTAs) in its own right¹⁶, the UK will continue to be bound by these obligations and should expect other countries to reciprocate¹⁷. To do so would be in the interest of both parties: aside from the basic economic benefits of free trade, continuing to honour their FTAs with the UK would require no additional negotiation and would maintain the status quo; to repudiate them would result in the raising of tariff barriers and increased costs for both exporters and importers in the partner countries as well as the UK. Whilst it might not be a priority for all of these partners to negotiate an FTA with the UK if one did not exist already, maintaining an existing one would almost always be advantageous.

¹⁵ Data taken from the ONS Pink Book 2013.

¹⁶ The UK, like all other EU Member States, is a member in its own right of the WTO. Though currently its tariffs and services obligations are incorporated in the schedules for the EU, they would still stand as an obligation on the UK if the country exited the EU. Similarly, the UK signs and ratifies EU trade agreements in its own right, even though all negotiation is done by the Commission.

¹⁷ There may be technical complications, such as the UK being subject to EU dispute settlement procedures for these FTAs, but these would be an acceptable price to pay.

Although in theory the situation could be resolved via legal means at the WTO Dispute Resolution Mechanism, it is not expected that this would be necessary. Nevertheless, this should not be taken for granted. An urgent dialogue with key trading partners should take place shortly after the referendum to establish the above as a common position and reaffirm the existence of FTAs between the UK and its partners.

Simultaneously, the UK should attempt to establish FTAs with major trading partners.

Box 4: Free Trade Agreements of Switzerland, Norway, New Zealand and the EU with non-EU G20 countries

	Argentina	Australia	Brazil	Canada	China	India	Indonesia	Japan	Mexico	Russia	Saudi Arabia	South Africa	South Korea	Turkey	USA
Switzerland				√	√			√	√		√ ¹⁸	√ ¹⁹	√	√	
Norway				√					√		√ ²⁰	√ ²¹	√	√	
New Zealand		√			√										
EU				√					√			√	√	√ ²²	

18 As part of an agreement with the Gulf Cooperation Council

19 As part of an agreement with the Southern African Customs Union

20 As part of an agreement with the Gulf Cooperation Council

21 As part of an agreement with the Southern African Customs Union

22 As part of the EUCU

Box 5: UK's Top 10 Non-EU, Non-EFTA Export

Country	UK Export
USA	84.1
China	13.7
Australia	10.9
Japan	9.4
Canada	8.1
Russia	7.6
Saudi Arabia	7.5
Hong Kong	7.5
Singapore	7.2
India	6.9

As the experience of other small, developed trading nations such as Switzerland and New Zealand shows, the advantages of being unconstrained by the concerns of more protectionist EU Member States and of a streamlined negotiating process should more than outweigh the disadvantages of reduced bargaining power (see Box 4). The UK could therefore enjoy a more favourable position than it enjoys within the EU, which to date has FTAs with not one of the BRIC countries²³. For countries with which the EU is close to concluding negotiations²⁴ the UK should seek to negotiate a side-agreement with the country concerned, whereby the UK was treated as part of the EU for the purposes of that specific trade agreement.

23 The EU has FTAs with many of the neighbourhood countries (including Turkey), South Africa, South Korea, Chile, Mexico and a number of Central American countries. Negotiations with India have yet to reach a conclusion, those with Mercosur have stalled and those with the USA and Japan are at an early stage. Negotiations for an FTA with China have not begun.

24 Which could potentially include the USA or India, depending on the progress of current negotiations.

Priority of FTA Negotiations

It is possible to rank the priority of forming an FTA with each of these countries using an analysis based on three factors: volume of UK exports to that country, relative growth of UK exports over the last 10 years and average applied tariff imposed by that country. In addition to the 15 non-EU G20 members, the analysis also includes Hong Kong and Singapore, as the only two non-G20 members to appear in the list of the UK's top-ten export destinations²⁵ (see Box 5)²⁶. The full analysis is at Annex A.

The 17 countries can be categorised into three initial categories, of high, medium and low priority, as set out in Box 6.

Box 6: Initial Priority Order for non-EU, non-EFTA FTA negotiations	
Priority	Countries
High	China Russia
Medium	Argentina Australia Brazil India South Korea USA
Low	Canada Indonesia Japan Mexico Saudi Arabia South Africa Turkey Singapore Hong Kong

The priority listing above is necessarily limited and could be supplemented by more detailed econometric analysis that carried out a dynamic modelling of the likely benefits of an FTA with these countries. In particular, the consideration of tariff data does not take into account the potential gains from trade in services, deeper integration and elimination of non-

²⁵ Though the data may not be fully representative due to many of the imports to these two countries being subsequently re-exported to other countries in the region.

²⁶ Data from ONS Pink Book 2013

tariff barriers, which would be likely to be of particular economic benefit in trade with other developed nations such as the USA, Canada and Australia²⁷. In consequence, the relative priority of these nations is likely to be underestimated and they should potentially be given a higher priority than in the table above.

Equally crucially, the table above does not take into account the political economy factors that will determine the relative likelihood of being able to successfully conclude FTA negotiations. Canada, Mexico, South Korea, Turkey and South Africa all have existing FTAs with the EU – it should be relatively simple to secure an agreement that the terms of these negotiations should continue to apply, as discussed above. Equally, some countries such as Argentina, are unlikely to wish to negotiate an FTA with the UK in the near-future due to other long-term issues of dispute that dominate the bilateral relationship. It should be noted that although an FTA with China or Russia would undoubtedly be challenging due to these countries' economic power and outlook, the potential benefits make the attempt worthwhile.

A revised version of Box 6, in which these qualitative factors are taken into account, is set out in Box 7.

Box 7: Revised Priority Order for non-EU, non-EFTA FTA negotiations		
Priority	Countries	
High	China Russia USA	
Medium	As an extension to existing EU FTA	As new agreements
	Mexico Turkey South Africa South Korea	Australia Brazil India
Low	Argentina Indonesia Japan Saudi Arabia Singapore Hong Kong	

²⁷ For the UK, tariffs are roughly 0.5 percent of the value of exports to the US, while NTBs are roughly 8.5 percent of the value of exports to the US; over 90% of the estimated gains from the TTIP come from removal of NTBs. 'Estimating the Economic Impact on the UK of a Transatlantic Trade and Investment Partnership (TTIP) Agreement between the European Union and the United States' (Centre for Economic Policy Research, March 2013).

Trade Promotion

In addition to concluding FTAs, the Government should continue to invest significant resources in trade promotion activities to assist individual firms export into new markets. This activity will be of most value in fast-growing, emerging markets that are not traditional export destinations – British businesses, particularly small and medium sized enterprises (SMEs), will typically need more assistance to do business in a country such as China or Vietnam than in the relatively familiar markets of the USA or Germany.

The RBS Research Paper ‘In Search of Export Opportunities’²⁸ considers a number of non-traditional markets against four axes, Compatibility; Growth; Prosperity; and Ease of Exporting, to conclude that in the ‘attractive and large’ category are countries such as China, Korea, Mexico, Turkey, Brazil, Taiwan, Hong Kong, Singapore, UAE, Malaysia, Thailand and Indonesia, as well as identifying a cluster of Latin American markets in its ‘attractive but small’ quadrant. The number of countries included in the survey was limited, not only excluding developed markets (including Russia) but also a number of developing countries such as Burma and most central Asian countries; nevertheless, it does provide useful pointers.

It’s clear that the ASEAN group of nations²⁹, their northern neighbours such as Taiwan and South Korea, Latin America, and the Gulf States are becoming increasingly important export markets. Assisting firms do business in these areas will ensure that the UK secures its share of the growth of these markets. The network shift from developed to emerging markets that is already underway in organisations such as the Foreign Office and UK Trade and Investment should be redoubled, with the necessary resources used to increase support for Government to Government deals, strengthen overseas business networks and help UK business win major opportunities with both the private and public sector.

28 In Search of Export Opportunities (RBS, September 2013) <http://www.rbs.com/content/dam/rbs/Documents/News/2013/09/uktradetargets-september2013.pdf> – last accessed 02/01/2014

29 The UK already exports more to ASEAN than to either India or Japan – <https://www.gov.uk/government/speeches/south-east-asia-forum> – last accessed 21/01/2014

Other economic matters: agriculture, migration and science

Three further issues warrant explicit consideration: agriculture, migration and science.

Agriculture

It is unlikely that the UK would continue to enjoy duty free access to the EU³⁰ in agriculture; nor would it be likely to be able to negotiate such access. In consequence, the UK agricultural sector will need to rely much more significantly on the domestic market to survive³¹. To mitigate this, the Government should maintain some degree of targeted subsidy for the sector and/or maintain external tariffs to Europe at the rate the EU chooses to impose them on us. Subsidies would result in a lower price of food for consumers and may therefore be politically, as well as economically, preferable.

Migration

The Government should end the automatic right to free movement to EU citizens and treat future immigration from EU nations in the same way as immigration from outside the EU. The current situation constrains policy space in two significant ways.

Firstly, the fact that EU citizens can not only move to the UK but can then enjoy many of the benefits, from domestic-rated university fees to welfare payments, puts a significant pressure on the public purse³² and can reduce the ability of the Government to devise policies that meet their objectives³³. Notably, broader policies that a Government might decide are desirable, such as free or subsidised university education or

30 None of Iceland, Norway, Switzerland and Turkey enjoy such access – agriculture is included in neither EFTA nor the EUCU. Though some of the countries in these agreements enjoy separate bilateral agreements in agriculture, all fall considerably short of duty free quota free access.

31 Although the UK is a net food importer, it nevertheless exported over £12bn of food and non-alcoholic drinks in 2012, approximately ¾ of which went to EU countries – http://www.fdf.org.uk/exports/ukexports/topline_performance.aspx - last accessed 06/09/2013.

32 To take just one example, in 2011/12 nearly £104m was paid in fee loans to EU students (House of Commons Library: Leaving the EU (2013) – Research Paper 13/43)

33 For example: “UK faces European Court over benefits for EU nationals” <http://www.bbc.co.uk/news/uk-22712569> - last accessed 03/09/2013

particular approaches on welfare, may be rendered unviable because free movement across the EU renders them liable to exploitation.

Secondly, given the domestic pressure to reduce net migration, free movement for EU citizens curtails the Government's ability to devise migration policies that grant more access to individuals – from anywhere in the world – with the skills or potential to benefit the UK.

The UK should not, however, unduly antagonise the rest of Europe. Short-term, visa-less access for EU citizens should be maintained and reciprocal access negotiated. The Government should also grant all EU citizens legally residing in the UK at the time of exit indefinite leave to remain and again should seek to obtain a reciprocal understanding from the rest of the EU³⁴. Together, these changes would reclaim the necessary policy space whilst maintaining the benefits of freedom of short-term travel throughout Europe.

Science

The UK benefits considerably through its participation in European science programmes such as the EU Framework Programme for Research and Innovation³⁵, the European Space Agency (ESA) and the European Centre for Nuclear Research (CERN).

International science cooperation is both highly valuable and, for large scale endeavours, can be more efficient, and the UK should aim to remain a full partner in all of these programmes.

Membership of CERN would not be affected by the UK leaving the EU as it is not an EU organisation; similarly for the Framework Programme and ESA, non-EU Membership should not be a bar³⁶. Whilst the UK would

34 Though whether they should have the right to continue to access public funds such as unemployment benefit or tuition fee support would be something the Government should review, considering each type of benefit individually.

35 In addition to the broader benefits of wider science collaboration, from a purely financial perspective the UK contributes around 11.5% of the cost and wins 16% of the funding available, a net gain – <https://theconversation.com/britain-should-stay-in-the-eu-for-science-18129> - last accessed 24/01/2014.

36 Both Switzerland and Norway are members of ESA; Switzerland, Norway, Israel, Turkey, Croatia, the Former Yugoslav Republic of Macedonia, Serbia, Albania, Montenegro and Bosnia & Herzegovina are associate members of Framework Programme 7, contributing to the budget and with the same access to grants as EU countries. http://cordis.europa.eu/fp7/who_en.html and www.esa.int/ – both last accessed 17/01/2014

not automatically be a member, it should seek to secure its participation as part of the exit agreement or by applying separately, ideally between the date of referendum and the exit from the EU.

2.2 Political

The UK is fortunate in that it is already a member in its own right of most international institutions: the G8, the G20, NATO, the OECD, the WTO³⁷, the United Nations Security Council, the Commonwealth and others. Leaving the EU should not alter this: the UK is the world's 6th largest economy³⁸ (World Bank, 2013), one of the leading manufacturing nations³⁹, the 4th highest defence spender⁴⁰ (SIPRI, 2013) and a significant contributor to the UN, IMF and World Bank. Nevertheless it will be important for the UK to maintain or increase its engagement with these global institutions, to emphasise that the withdrawal from the EU is not a withdrawal from globalism. In particular, a greater engagement with the OECD on global standards would pay economic dividends.

The UK should reinvigorate its engagement with those countries which share its desire for an open, transparent and rules-based international economic and political system. With less collaboration possible with the EU, the Foreign Office's resources should be increased to allow the UK to more effectively punch above its weight in the world, with a particular focus on the emerging powers.

In addition to our long-standing relationship with the USA, strategic partnerships with countries similar to us in size⁴¹ should be cultivated, with significant commitment of senior ministerial or prime ministerial time. Australia and Canada would make natural partners on a wide range of issues from trade to global governance. A scoping exercise should also be conducted to identify other countries, particularly in South East Asia and Latin America, with whom we share interests across a broad spectrum of issues.

37 As discussed in Section 2.1.2

38 The World Bank GDP Ranking – <http://data.worldbank.org/data-catalog/GDP-ranking-table> – last accessed on 04/09/2013

39 9th largest as of 2010: <http://www.economicinpictures.com/2013/01/changing-top-manufacturing-countries.html> - last accessed on 04/09/2013

40 SIPRI Military Expenditure Database – <http://milexdata.sipri.org/files/?file=SIPRI+mil+ex+data+1988-2012+v2.xlsx> – last accessed on 04/09/2013

41 And therefore which would see both sides regarding the relationship of similar importance and value.

Equally, we should not turn our back on Europe. Although we would be less able to collaborate with the Commission and other EU institutions, strong partnerships with individual Member States could and should be maintained. Despite some differences on economic affairs, analysis of UNGA voting patterns (see Box 7) shows that in international affairs, the UK agrees with France more than with any other major nation⁴² (Ferdinand, 2013). Our recent close military and political cooperation on topics including Libya and Mali demonstrates the value of this relationship. Germany, the most economically powerful nation in Europe, is also an essential partner and should be treated no less favourably. The establishment of quarterly Heads of Government summits with each of these nations, with more frequent dialogue between cabinet ministers, would do much to cement these relationships.

Box 7: The Index of Voting Cohesion** Scores for the P5 States in UNGA by pairs

	1974-2008	1992-2008	
China-France	60.16	62.66	<p>** The Index of Voting Cohesion relies upon calculating the degree of similarity of voting of each pair of states in a given group according to a formula:</p> $\frac{i/(C-(f+0.5g)) \times 100}{t}$ <p>where <i>i</i> denotes the number of cases where these two states vote identically (whether 'yes', 'no' or 'abstain'), <i>g</i> denotes the number of votes where one of the two states votes either 'yes' or 'no' whilst the other abstains, and where <i>t</i> represents the total number of votes in which the two states participate. As can be seen, the final figure is expressed as a percentage.</p>
China-Russia	82.53	80.73	
China-UK	55.78	58.91	
China-US	29.3	23.39	
France-Russia	60.84	75.66	
France-UK	92.42	95.06	
France-US	66.46	57.94	
Russia-UK	57.37	72.56	
Russia-US	34.75	39.98	
UK-US	72.25	61.95	
Average	61.19	62.88	

42 See Box 4; data from 'Paper for the Security and Defence Sub-Committee of the EU Parliament', Professor Peter Ferdinand, http://knjiznica.sabor.hr/pdf/E_publikacije/The_positions_of_Russia_and_China_at_the_UN_Security_Council_in_the_light_of_recent_crises.pdf - last accessed on 04/09/2013.

The UK should seek to establish a formal 'EU out-group' of European countries which are outside the EU but have close trading arrangements with it, including all non-EU members of EFTA and the EUCU^{43,44}. As befitting the diverse range of interests within this grouping, this would be a non-binding forum of independent nation states such as the OECD or the G8 rather than a supranational organisation such as the EU. Such a mechanism would allow this grouping to speak with a strengthened voice in discussions with the EU and reduce the possibility of decisions being taken to the disadvantage of its members. In addition, it would provide an attractive outer-circle of nations that could be joined by countries that wished close ties with the EU but did not wish or were not ready to pursue ever closer union, thereby helping to extend Europe and the UK's economic sphere of influence without compromising sovereignty.

2.3 European Negotiating Tactics

If handled correctly, the UK could be confident in achieving a positive result from the exit negotiations: whatever resentment is felt at the UK for leaving, an EU emerging from a fragile economic recovery would not wish to stifle trade with one of its most significant trading partners⁴⁵. This, however, is not an inevitable outcome: whilst it is in no-one's rational economic interests to erect trade barriers, the EU could afford a trade war far better than the UK could. Some EU nations would see leaving as a betrayal of the European project and may wish to ensure that a sufficient example is made of the UK to deter others; others will not want to 'reward' leaving. It would be therefore necessary to take great care in the negotiations to both accommodate the domestic 'needs' of various nations as well as mollifying, at the most senior level, those who might harbour resentment.

As set out in Box 1, the exit agreement must be approved by a Qualified Majority of Member States. However, some of the subsequent agreements that the UK might wish to include, such as membership of EFTA, would, for new members, need to be agreed by a unanimity of EFTA states. Whether

43 Iceland, Liechtenstein, Norway, Switzerland, Andorra, Monaco, San Marino and Turkey

44 Depending on the future development of the Eurozone compared to the rest of the EU over the next two decades, such a group could ultimately evolve to include non-Eurozone members as well.

45 The UK is Germany's fifth largest trading partner (Statistisches Bundesamt, Wiesbaden 2013, from <http://openeuropeblog.blogspot.com/2013/05/going-global-germany-is-shifting-trade.html> – last accessed 06/09/2013) and France's 4th largest trading partner (http://countries.bridgat.com/France_Trade_Partners.html#UivZsz_LJGM – last accessed 06/09/2013)

Qualified Majority or unanimity is required for a current EU (and therefore EFTA) member seeking to 'downgrade' its membership from EU to EFTA status is a matter of legal debate⁴⁶. It would, in any case, be preferable to have as strong as possible a majority amongst Member States in order to overcome inevitable opposition in the European Commission and European Parliament, whilst continuing to maintain the legal position that a simple Qualified Majority is required.

The two highest priorities must be to secure EFTA access⁴⁷ to the European market and to regain full national sovereignty without threat of further political or financial integration. Most other factors are secondary; in particular, it would be worth agreeing to one-off or time-limited measures, such as continuing to pay the UK's EU budget contributions to the end of this budget period, or concessions for EU workers currently residing in the UK, in exchange for achieving the former objectives. Box 8 sets out a list of likely topics for negotiation and their priority.

46 House of Commons Library: Leaving the EU (2013) – Research Paper 13/43

47 Or equivalent

48 A higher importance and a lower difficulty of achieving both contribute to the overall priority.

49 Including, in particular, autonomy from decisions of the European Court of Justice (ECJ).

50 Which would remove all tariffs and quotas for non-agricultural goods whilst retaining the right for the UK to carry out its own trade agreements and to be not covered by significant sections of EU law.

51 The EU may attempt to link membership of EFTA and the EEA.

52 There would be no objection to granting visa free access though.

53 There will be an inevitable trade off between the amount of regulation accepted and the access for services. A balance should be struck, as long as it does not endanger higher objectives.

54 A likely concession.

55 It would be quite acceptable to agree a time-limited, tapering contribution, or contribution to specific programmes, or even a small permanent contribution (10-20% of current contribution).

56 Very unlikely to be achieved.

57 Very unlikely to be achieved.

Box 8: Likely topics for negotiation in a UK exit agreement			
Issue	Importance	Difficulty of Achieving	Overall Priority⁴⁸
Regaining of full national sovereignty⁴⁹	High	Medium	High
Membership of EFTA⁵⁰	High	Medium	High
Non-Membership of EEA⁵¹	High	Med/High	High
Ability to opt-out of at least 1/3 of the <i>acquis</i>	High	Med/High	High
Free movement of capital	Med/High	Low	Medium/High
No free movement of people⁵²	Med/High	Medium	Medium/High
Significant access for services	High	Med/High	Medium/High ⁵³
Reciprocal indefinite leave to remain for current residents	Low/Med	Low/Med	Medium ⁵⁴
No contribution to EU budget	Medium	Med/High	Medium ⁵⁵
Access to EU Research Framework programme	Low/Med	Low	Medium
Guarantees regarding the nature of Single Market regulation and its impact on EFTA members	Med/High	High	Low/Medium ⁵⁶
Duty free access for agricultural goods	Medium	High	Low/Medium ⁵⁷

Throughout the negotiations it must be remembered that the UK is in the weaker position: in the case of no agreement, the UK would face the full trade barriers that any external nation does. It is unlikely to be possible to simply ‘park’ economic matters as joining EFTA – or the EUCU or the EEA – must be agreed upon by the EU and all its Member States⁵⁸. Brinkmanship by the UK could therefore be very costly. The UK should also take a conciliatory stance in all other EU negotiations ongoing at the time⁵⁹, using these as an opportunity to win allies.

Whilst a significant reallocation of UK officials currently working on EU affairs to exit negotiations is clearly necessary, the essential agreements to secure support would need to be done at the highest level, with significant investment of Ministerial and Prime Ministerial time. For example, whilst the initial opening bid might be for full duty free access in all goods, following a summit with the French President, the Prime Minister could agree to accept some agricultural tariffs in exchange for French support – which would likely bring with it that of other agricultural Member States such as Poland or Italy.

58 As discussed above.

59 Under the Lisbon Treaty a withdrawing state maintains full negotiation and voting rights until withdrawal itself in all dossiers other than the terms of its own withdrawal.

It would be critical to engage business organisations across Europe in making the case for an open trade settlement. Regardless of their views on whether the UK should leave, once the decision has been taken, bodies such as the Confederation of British Industry (CBI) and British Chamber of Commerce (BCC) – and their sister organisations across Europe, such as Eurochambres or the Bundesverband der Deutschen Industrie – are unlikely to want trade stifled by the imposition of tariffs and non-tariff barriers (NTBs)⁶⁰.

Close cooperation between the Government and domestic business organisations would support the establishment of a consistent and vocal call for open markets from European business, which would in turn put encourage the governments of other EU member states to agree to maintaining as open markets as is possible⁶¹.

Germany would be one of the most likely nations to be pragmatic, but would not want to endanger the European project. The German Chancellor must be closely engaged throughout and, where possible, UK negotiating positions and compromise papers should be taken forward with German support. As the most economically influential nation in the EU, Germany would be an invaluable ally in forging a position that could be accepted by other nations in Europe. The Dutch and Nordic nations, traditional UK allies who may feel the most betrayed by a UK exit, have broadly similar economic and political positions to Germany and so would also be most likely to agree to proposals that have German support.

60 See, for example, <http://www.cbi.org.uk/media-centre/press-releases/2013/09/8-out-of-10-firms-say-uk-must-stay-in-eu-cbi-yougov-survey/> –last accessed 22/01/2014

61 Again, this is unlikely to be effective in the agricultural sector where domestic lobbies are overwhelmingly protectionist.

The eastern Member States are most likely to be placated by a commitment to a tapering off (as opposed to an immediate cessation) budget contributions, whilst many of the smaller Member States may need to be 'bought off' with a minor concession in exchange for coming on board. The Commission and European Parliament are likely to be amongst the most hostile⁶², so securing a strong consensus with active support amongst Member States would be essential in overcoming that inevitable resistance⁶³.

Overall, a consensual, pragmatic approach to the negotiations would be essential, with the direct personal engagement of the Prime Minister and close cooperation with the most influential EU members in order to achieve a successful outcome.

62 Though the anticipated election of a greater number of Eurosceptic MEPs from across Europe in the 2014 European elections may alter this.

63 The Commission has no direct power over the negotiations, but considerable influence both public and behind the scenes. The European Parliament may simply approve or veto – whilst of critical importance, ultimately it is unlikely to block an agreement that has the strong support of Member States – particularly as many MEPs are at least somewhat responsive to their parent governments. Securing that firm consensus, one that, as in the recent budget negotiations can withstand and overcome Parliamentary opposition, will be critical to success.

3. Internal Preparations

The fact that the UK is a member of neither the Euro nor the Schengen Zone will greatly simplify the needed preparations. The challenge of re-establishing an independent currency whilst preventing capital flight and maintaining open capital markets would be an unenviable task. Nevertheless, both legislatively and administratively, there will be a significant degree of preparation required.

3.1 Legislative

As soon as possible after the referendum, the Government should introduce a 'Leaving the EU Bill' into Parliament. The Government should prioritise Parliamentary time for the Bill to reduce international and business uncertainty, whilst still allowing the necessary time for the extensive debate that such a Bill will require⁶⁴.

The Bill should cover not only the necessary constitutional aspects of leaving the EU but should also make provision for the more pragmatic aspects of departure⁶⁵. Given the likely need to introduce and pass the Bill before negotiations with the EU have concluded⁶⁶, the Bill should include a significant number of delegated powers, predominantly making use of the affirmative procedure⁶⁷, to allow these issues to be determined after

64 As a highly significant Bill, it is likely that it will need to be debated by a Committee of the whole House.

65 For example, determining at what level tariffs will be set, issues concerning border controls and passports, transferral of administrative or regulatory functions currently carried out by the Commission and the continued rights of EU citizens currently in the UK.

66 It is likely that these negotiations will continue until very close to the date of exit, due to the complexity and controversy of the matters which will need agreement.

67 Under the affirmative procedure, both Houses of Parliament must expressly approve the order.

the EU-exit negotiations have concluded, subject to a final affirmatory vote of Parliament⁶⁸.

One consideration is what should be done with the large number of existing EU regulations and directives (see Box 9⁶⁹). Such a high proportion of UK law has now originated from Brussels – the House of Commons Library considers “*it is possible to justify any measure between 15% and 50%*” of total UK regulation as coming from EU⁷⁰ – that to abolish it all could have significant undesirable and unforeseen consequences⁷¹. Yet to simply incorporate all EU law untouched would be missing a valuable opportunity for reform. In addition to simple repeals, operating outside the EU would allow regulation to be tailored to achieve the best results for the UK economy and society, rather than having to use regulations that are the result of compromise between 28 widely differing nations.

Box 9: Regulations and Directives

Regulations are legislative acts of the EU which have direct legal effect. As they are not replicated in domestic law, after exit from the EU the default position would be that these would no longer be binding.

Directives are legislative acts of the EU which do not have direct legal effect, but rather set out an objective that must be achieved by each Member State by means of devising its own laws to bring them into effect. As directives are implemented by Acts of the UK Parliament, these Acts would continue to have binding effect in the UK unless explicitly repealed, even though the directive itself would no longer be binding.

68 This would function in a similar way to that in which the United States Congress may grant the President ‘Fast Track Negotiating Authority’ to conclude a trade agreement with a certain country, within certain parameters. The final agreement must be put back to Congress for approval, but can only be approved or denied, not amended. As described, for example: <http://www.bloomberg.com/news/2014-01-09/congressional-deal-reached-on-obama-trade-talks-authority.html> – last accessed 24/01/2014

69 http://europa.eu/eu-law/decision-making/legal-acts/index_en.htm - last accessed 17/01/2014

70 “How much legislation comes from Europe?” – House of Commons Research Paper 10/62, October 2010.

71 One would probably not wish, for example, to simply repeal Regulation (EC) No 178/2002 (which lays down the general principles and requirements of food law and procedures in matters of food safety) without first considering how to regulate food safety after it had been repealed.

The Government should therefore bring forward a 'Great Repeal Bill', based in some respects on the principles of the Public Bodies Act (2011). The Great Repeal Bill would have three consequences:

- Incorporate certain selected existing EU regulations⁷² temporarily into UK law from the date of exit.
- Require the Government to, within three years, explicitly review all of these regulations, as well as any Acts of Parliament or UK secondary legislation that predominantly enacts an EU directive⁷³, to determine whether it is desirable that they continue in force.
- Provide that the Government must, for each law listed in the Act, make a positive decision within the three year period to retain the legislation by means of an Order brought forward under the super-affirmative procedure (see Box 10)⁷⁴, or else the law will cease to apply.

Box 10: Super-affirmative procedure.

Most secondary legislation is subject to either the negative procedure (in which the order comes into force unless Parliament votes against) or the affirmative procedure (in which both Houses of Parliament must expressly approve the order).

In rare cases, the super-affirmative procedure is used, which requires the Minister to have regard to representations, House of Commons and House of Lords resolutions, and Committee recommendations that are made within 60 days of laying, in order to decide whether to proceed with the order and (if so) whether to do so as presented or in an amended form. The super-affirmative procedure was used for a number of procedures in the Public Bodies Act (2011), due to the extremely broad powers that the Act gave Ministers concerning the abolition of a wide range of public bodies – a circumstance analogous to here, where it is a wide range of Acts and regulations that would potentially be being repealed.

72 The expectation would be that only those regulations or parts of regulations which could be considered to apply in a purely domestic consequence, and where there seemed a risk of potential serious harm to the UK if they were to suddenly lapse, would be incorporated. Only regulations explicitly named would be incorporated.

The majority of the *acquis communautaire* relevant to the four freedoms (free movement of goods, people, services and capital), as well as those pertinent to 'flanking policies' (i.e. transport, competition, social policy, consumer protection, environment, statistics and company law) would not be incorporated.

73 Each such piece of legislation again to be explicitly named.

74 <http://www.parliament.uk/business/committees/committees-archive/regulatory-reform-committee/regulatory-reform-orders/> - last accessed 31/08/2013

3.1.1 Regulatory Repeals

A non-exhaustive examination of EU regulation shows some clear potential candidates for repeal or reform.

Employment Law

The Working Time Directive (2003/88EC) should be repealed. As well as increasing flexibility for both employers and employees, this would reduce bureaucracy in maintaining records of who had opted out. Some of the provisions other than that governing the maximum working week – such as the need for rest periods or minimum paid annual leave – could be maintained, though a careful assessment should be made of whether any cause unreasonable burdens on business.

Sectoral provisions, including for fishing, offshore and transport workers should similarly be reviewed to ensure that these take into accounts the needs and pressures of these industries. Where not abolished these should be simplified: the current complexity (Box 11 gives an example) means that even where there is little impact on working patterns, the administration can cause a significant burden for large and small companies, as well as restricting the rights of employees to work as they would wish to.

Box 11: Excerpt from a summary of EU Driving Regulations for vehicles over 3.5 tonnes

The driver must not drive more than:

- 9 hours in a day - this can be extended to 10 hours twice a week
- 56 hours in a week
- 90 hours in any 2 consecutive weeks
- All driving done under EU rules must be recorded on a tachograph.

The driver must take:

- at least 11 hours rest every day – this can be reduced to 9 hours rest 3 times in a week;
- an unbroken break of 45 hours every week – this can reduce this to 24 hours every other week;
- a weekly rest after 6 days of working – coach drivers on an international trip can take their weekly rest after 12 days a break or breaks totalling at least 45 minutes after no more than 4.5 hours driving.

Other areas of EU employment law should be examined carefully with a view to simplification and ensuring that they remain fit for purpose in the UK's labour market. The extensive provisions regarding consultation of workers' representatives in the Collective Redundancies Directive (98/59/EC), for example, appear outdated in the UK's increasingly un-ionised labour force⁷⁵. Even where the protections are, in principle, considered to be worth keeping, the administration and implementation should be simplified. The Agency Workers Directive (2008/104/EC) has increased the burden of hiring agency workers, reduced the flexibility that business has to hire people and should therefore be repealed or amended to give greater flexibility for individual employers and workers to reach their own arrangements⁷⁶.

Agriculture and Environment

The recent EU practice of banning pesticides and fertilisers based on hazard rather than risk^{77 78} (*inter alia* 2000/1107/EC, 2009/128/EC) should be changed: a reversion to a more scientific risk-based approach would prevent substances that are safe to use being banned and increase farming productivity. Regaining regulatory control over Genetically Modified (GM) crops would allow the UK to better respond to future developments in the scientific evidence as to whether these can be safely grown.

The Waste Framework Directive (2008/98/EC) should be amended by removing the requirement for SMEs to register as waste carriers if they only transport a small amount of their own non-hazardous waste. This could benefit up to 460,000 small businesses in the UK alone⁷⁹.

A wide range of environmental regulation, including the Waste Electrical and Electronic Equipment (WEEE) Directive (2002/96/EC), the Regulation

75 Around 6.5 million employees in the UK were trade union members in 2012, below the peak of over 13 million in 1979. (Trade Union Membership: Statistical Bulletin (2012), Department for Business, Innovation and Skills)

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/204169/bis-13-p77-trade-union-membership-2012.pdf - last accessed 13/01/2014.

76 EU Business Taskforce Report (October 2013) - <https://www.gov.uk/government/publications/cut-eu-red-tape-report-from-the-business-taskforce/cut-eu-red-tape-report-from-the-business-taskforce> - last accessed 31/01/2014

77 See, for example, <http://www.fwi.co.uk/articles/26/09/2013/141248/regulatory-threats-to-pesticides.htm> - last accessed 26/01/2014.

78 Hazard is the severity of what could happen; risk is hazard multiplied by the likelihood of it happening.

79 EU Business Taskforce Report (October 2013)

on Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) (1907/2006/EC), the Directive on Packaging and Packaging Waste (94/62/EC) and the Water Framework Directive (2000/60/EC), amongst others, should be examined and, where possible, simplified. Many of these serve a useful purpose and should not be abolished without replacement; however, simplifying the administration, reporting and enforcement regimes could help to significantly reduce burdens on business.

Financial Services

It would be important to ensure that domestic control was reasserted over areas of core economic interest such as the City of London. Regulations such as the Markets in Financial Instruments Directive (2004/39/EC), the Capital Requirements Directive IV (CRD 4)⁸⁰ and the Alternative Investment Fund Managers Directive (2011/61/EU), amongst many others should be scaled back to ensure that the UK does not face additional burdens beyond the standards set out in international agreements such as Basel III. If specific legislation is needed beyond this to deal with any risks specific to the UK market, they should be implemented on a national level.

Energy and Transport

Directive 2009/28/EC, establishing binding renewable energy targets for 2020, should be repealed. Whilst it may be desirable to achieve these, establishing the matter in statute reduces the ability to appropriately respond to the evolving energy needs and environmental pressures in the UK⁸¹. The energy performance of buildings (2010/31/EU) is also more appropriately the province of national legislation.

There is much room for cooperation in transport, particularly in air transport and in the movements of goods. However, rules covering the rights of passengers (including 1177/2010/EU and 181/2011/EU), on driving time regulations (2002/15/EC) and on the form in which driving licences must be issued (2006/126/EC), amongst others, could be

80 See Draft Implementing Technical Standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 which includes, amongst others, the cap on bankers' bonuses; http://ec.europa.eu/internal_market/bank/regcapital/legislation_in_force_en.htm#maincontentSec1 – last accessed 17/01/2014

81 For example, investment in gas or nuclear could reduce the need for coal, which could potentially reduce greenhouse gases more than an arbitrary renewables target.

reformed and simplified, particularly where the principles are established in other existing regulations.

Business and Commercial Law

The EU's permissive stance on jurisdictional "forum shopping" should be reversed and the fundamental English and common law tradition that the parties' choice of forum should be regarded as paramount⁸² reinstated. Currently, within the EU it is no longer possible for an English court to prohibit by injunction the commencement of proceedings in an EU court even if it is in breach of a contractual choice of forum clause. This can allow litigants to significantly delay legal resolution by pre-emptively commencing proceedings in other EU nations with less efficient legal systems, which in turn adds to the legal costs of business and makes the UK a less attractive place to conduct major contractual deals.

If passed, the draft directive imposing mandatory quotas for women on boards (2012/0299 (COD)) should be reversed, as an unnecessary and potentially counterproductive measure that would be better served by non-legislative means combined with existing equalities legislation. Similarly, the decision of the ECJ (*Test-Achats*) which found that insurance and annuity providers could not take gender into account when determining the prices for their products should be reversed. Preventing providers of such risk-based products from utilising evidence-based risk factors weakens the operation of a true market in such products and risks increasing the prices for all users.

The Prospectus Directive (2010/73/EU) places disproportionate burdens on the ability of small companies to make a public equity offer: for a £5m offering, the cost of producing a prospectus in the UK is estimated at between £350,000 and £600,000⁸³. This significantly inhibits the reduces the liquidity of the public (retail) investor market. Raising the exemption thresholds from €5m to €50m and from 150 to 2000 shareholders⁸⁴ could make it significantly easier for smaller companies to fund business growth⁸⁵.

82 Subject to limited exceptions.

83 EU Business Taskforce Report (October 2013)

84 Similar to the reforms recently carried out in the US

85 EU Business Taskforce Report (October 2013)

Health and Safety Law

A wide range of EU health and safety regulations should be either repealed or reformed. The EU's summary page of legislation lists five general provisions and twenty-two specific provisions on product safety⁸⁶, ranging from the Machinery Directive (2006/42/EC) to the Dangerous Products Resembling Foodstuffs Directive (87/357/EEC). Such a detailed and specific approach, attempting to legislate for each individual case, inevitably places a large burden on businesses, particularly SMEs, whilst being unable to deal with the full complexity of the market. A more principles based legislative approach, in which all consumer products are required to meet a reasonable standard of safety with penalties for negligent or wilful transgression, would allow much of the more detailed and sector specific European regulation to be repealed.

Where businesses are exporting to the EU they may reasonably be expected to demonstrate that they have met certain EU standards. However, whilst it is reasonable for a food exporter to have to comply with EU legislation on animal feed, there is no good reason why businesses operating purely domestically, such as a restaurant or a community organisation, should have to comply with EU regulations⁸⁷. This principle should be applied consistently throughout when determining which regulations to repeal. In fact, even where a product can be exported, there is no reason that unnecessarily high EU standards or processes should be retained in EU legislation. Businesses that wish to export would be free to adopt the higher standards – including adopting these across their entire production process if this is simpler and cheaper – whilst SMEs that are producing only for a local or regional market would not be required to. To avoid any possibility of double regulation for exporters, compliance with the relevant EU legislation would be considered sufficient (but not necessary) to count as following the principles of any domestic principles-based legislation.

The Health and Safety at Work Framework Directive (89/391/EEC) requires all businesses to keep written records of risk assessments carried out in their workplace, regardless of risk. Either repealing or modifying it to exempt small businesses working in low-risk sector would benefit at least 220,000 UK small businesses⁸⁸.

86 http://europa.eu/legislation_summaries/consumers/consumer_safety/index_en.htm - last accessed 17/01/2014

87 Such as the Food and Feed Safety Regulation (178/2002/EC)

88 EU Business Taskforce Report (October 2013)

Consumer Law

A similar principle should be adopted as for health and safety regulation in order to free domestic business or non-exporters from regulations such as Textile Products Regulation (1007/2011/EU) and the Labelling of Foodstuffs Regulation (1169/2011/EU). National legislation would need to replace some of the requirements contained in these, particularly the latter, but the adoption of a principles-based approach would simplify the burden across different sectors. Cooperation could helpfully be maintained on cross-border issues such as roaming charges and cross-border bank payments.

The Unfair Commercial Practices Directive (2005/29/EC) could potentially be largely retained without alteration as it largely adheres to the principles-based approach advocated above. However, some of the supporting pieces of regulation, notably the recently adopted regulations on Consumer Alternative Dispute Resolution (2013/11/EU) and Online Dispute Resolution (524/2013/EU) which require, amongst other things, all businesses to offer recourse to an independent entity that offers out-of-court dispute resolution for all disputes, both domestically and across borders, should be abolished as unnecessarily burdensome.

Conclusion

The above analysis is simply a brief glance at the over 3000 pieces of EU legislation⁸⁹ that currently exist to give an indication of some of the areas where reforms and repeals could be implemented. It is not intended to be comprehensive, nor does it necessarily identify all of the most egregious pieces of legislation. A thorough review, as set out in Section 3.1, would be essential in order to achieve the most positive outcome.

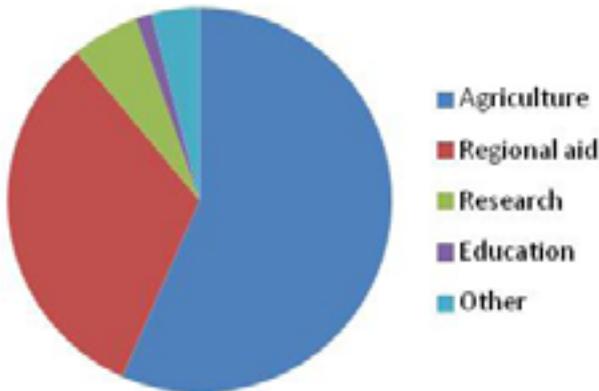
Which exact pieces of regulation are repealed will be a political decision for the Government of the day. As long as some, meaningful, repeals take place, this will succeed in lightening the burden on businesses, the public sector and third sector, as well as for individuals⁹⁰.

89 http://europa.eu/legislation_summaries/index_en.htm contains over 3000 summaries of EU legislation - last accessed 17/01/2014

90 The British Chamber of Commerce estimates that the annual burden of EU regulation introduced since 1998 is £7.5bn (British Chamber of Commerce 'Burden Barometer', 2010).

3.2 Administrative

Figure 2 – How does the UK spend the money it receives from the EU?



The UK currently benefits from many EU schemes including the Common Agricultural Policy, the European Framework Programme for Research and Innovation and the European Regional Development Fund (see Figure 2)⁹¹. A sharp reduction in this funding would cause an undesirable shock to those sectors and regions. The Government should therefore, after exiting, increase proportionately the programme budgets of the relevant departments to ensure that these sectors and regions receive no immediate drop in funding. Following this, the budgets of these departments can be tensioned as normal, but from the new baseline.

Given that the UK is a net contributor to the EU, after reallocating funds in this way, the Government will have a surplus of approximately £10bn⁹². Whilst much of this could be used simply to reduce the budget deficit⁹³, some will need to be spent to increase the UK's administrative capacity in areas that had previously been solely or primarily the competence of the EU.

91 Data obtained from <http://news.bbc.co.uk/2/hi/europe/8036096.stm#> – last accessed 04/09/2013

92 Net of receipts under the CAP, EU regional funding, and the budget rebate, the Government contributed £10bn to the EU in 2012 (House of Commons Library: Leaving the EU (2013) – Research Paper 13/43).

93 The Office of Budget Responsibility forecasts that the UK will have a budget deficit of until at least 2018 ('Economic and Fiscal Outlook: December 2013', Office of Budget Responsibility).

Trade, in particular, is an area that would need to be significantly enhanced: the UK has essentially no external negotiating capacity as trade negotiations are conducted entirely by the European Commission. It will be particularly important to bolster this capacity if the UK is to be able to rapidly conclude FTAs with major emerging powers⁹⁴.

In other areas from anti-trust enforcement to fisheries policy, UK agencies will need to have their capabilities increased – though, equally, the UK should have no shame in simply pronouncing that in certain matters it will follow the EU's lead⁹⁵. Where possible, the UK should seek to build expertise by inviting back UK nationals from the relevant branches of the Commission, paying enhanced salaries where appropriate for skills and experience that cannot currently be obtained within the UK civil service⁹⁶.

3.3 Judicial

The complexities of exiting from several decades of EU law and EU jurisprudence will not be simple. Some laws and regulations may simply be abolished, but in cases where the same or similar laws remain in place, important questions must be answered, including whether UK courts remain bound by precedent set by the European Court of Justice (ECJ) prior to the UK's exit, or whether UK judges should pay heed to future interpretations of EU judges when similar laws may remain in place in both jurisdictions⁹⁷ – such as competition law. Unless positively addressed as a whole by Parliament, the judiciary will be forced to fill the vacuum via ad-hoc decisions on individual cases, which is undesirable.

The Government should therefore establish and resource a cross-party commission, similar to the Parliamentary Commission on Banking Standards⁹⁸ populated by some of the most influential and informed members of both the House of Commons and House of Lords to set out the outline of a Bill that would clarify the situation and reassert

94 See Section 2.1.2, above.

95 There is no reason, for example, why the UK should feel the need to conduct its own inquiries into the safety of global airlines, when it could instead simply co-opt the list of banned airlines maintained by the Commission.

96 It is an open question as to whether UK nationals currently working in the Commission would be permitted to continue working there following a UK exit. If UK nationals were forced to leave then the UK might benefit from the sudden pool of recruitable talent; on the other hand, if nationals were allowed to remain in place it could be a means of continuing to have some influence.

97 House of Commons Library Research Paper 13/43: 'Leaving the EU' (2013)

98 <http://www.parliament.uk/bankingstandards> - last accessed on 23/12/2013

unambiguously the supremacy of UK law and British courts⁹⁹. Although technically distinct from the question of leaving the EU, it would also be helpful for the commission to consider the matter of the European Court of Human Rights (ECtHR) and the interaction of UK courts with this institution. The commission should be tasked with reporting shortly after the date of the UK's exit from the EU, with a view to the Government introducing a Bill in the following Parliamentary Session.

3.4 Inward Investment

A significant risk of a UK exit is a drop in the quantity of Foreign Direct Investment (FDI) coming to the UK, which currently makes a significant contribution to jobs and economic activity¹⁰⁰. Whilst it is not possible to say definitively the extent to which membership of the EU is a factor in inward investment decisions, it is undoubtedly a factor. Furthermore, in the two years between the referendum and exit, the uncertainty created by the unknown trading relationship with the EU could cause businesses (both external and internal investors) to delay investment decisions until this is resolved.

As soon as the exit agreement with the EU is agreed, the UK Government should therefore conduct a strong and sustained outwards campaign to communicate the reality of the terms of the exit. This will be essential if the UK is to maintain its position as the number one destination for FDI in Europe¹⁰¹. The UK's attractiveness for FDI, and its value as a gateway to Europe, will remain strong¹⁰² – and the UK's fundamentals, including liberalised energy and employment markets, ease of raising capital and ease of starting a business will be as strong as ever¹⁰³. The repeal of selected European regulation to create an even more business-friendly environment, together with the new security of the City of London from

99 The review and any bill would need to explicitly take into account the very different legal systems prevailing in England and Wales, Scotland and Northern Ireland.

100 In 2012/13, 1559 inward investment projects created or secured over 170,000 jobs (UKTI 2012/13 Inward Investment Annual Report, 2013) <http://www.ukti.gov.uk/investintheuk/investintheukhome/item/553980.html> - last accessed 26/01/2014.

101 In 2012 the UK was the largest recipient of net FDI in Europe, receiving net inflows of over \$62bn – Data from UNCTAD World Investment Report 2013.

102 Any investor for whom use of the Euro is essential will already be going elsewhere.

103 The UK is currently considered the 10th most competitive country in the world – World Economic Forum Global Competitiveness Rankings 2013-14. Switzerland, a non-EU country European country is ranked 1st.

external interference¹⁰⁴, will only strengthen this; however, by itself, such a campaign may not be sufficient to maintain the current high levels of FDI.

In a 2013 survey of over 2000 multinationals, 72% of companies interviewed in North America and 66% of those in Asia thought reduced integration with the EU would make the UK more attractive as a destination, against 38% of those interviewed in Western Europe¹⁰⁵. Accordingly, the Government should, after exit, quickly put in place policies to capitalise on this viewpoint and actively encourage inward investment. These should include some or all of the following:

- A step-wise lowering of the rate of corporation tax to 15% over 5 years¹⁰⁶.
- Extend the period in which losses can be off-set against profits for new investors.
- Establish sector strategies for key industries, developed in collaboration with business, with a particular focus on maintaining and developing the supply chain, to encourage investment in those areas which will most benefit industries in which the UK has existing strengths.
- Create special economic zones in poorer regions of the UK, offering incentives to investors such as a 12 month employer's National Insurance holiday or tax breaks. Such zones have had a demonstrated impact in countries as varied as the Dominican Republic, Taiwan and Vietnam¹⁰⁷, provided they are well aligned to the country's overall economic policy framework and comparative advantage.

104 Professor Philip Booth of the Institute of Economic Affairs has said that "The danger is another financial centre could take London's place' and that, 'The pernicious aspect of EU legislation is, it seems, to be intended to promote protectionism and driven by ignorance and suspicion of those who make money from finance. From <http://www.thisismoney.co.uk/money/markets/article-2313153/CITY-FOCUS-Londons-status-global-financial-centre-challenged-abroad.html> - last accessed 05/09/2013

105 Ernst and Young UK Attractiveness Survey (2013)

106 It is assumed that the rate of corporation tax at the time of exit is 20%.

107 <http://www.voxeu.org/article/special-economic-zones-what-have-we-learned> - last accessed 26/01/2014

- Increase the R&D tax credit for new investors by 25% over the standard rates for two years after investing, to encourage investment and job creation in high value, knowledge intensive industries.
- Implement flanking policies that support an attractive investment climate, in particular investing in adequate new transport infrastructure, investing in sufficient generating capacity to provide affordable power and ensuring the planning regime is fit for purpose.
- Where appropriate, negotiate international agreements on foreign direct investment, something which the UK has not been able to do since the Lisbon treaty entered force in 2009.

Even with such measures, there will be a probably inevitable dip, due to the uncertainty surrounding the exit; however, following this there is no reason that the volume of FDI should not fully recover and even increase further.

4. Outcomes

It is difficult to say with certainty the overall costs and benefits of exit: reputable organisations have found the cost/benefit of EU membership to be anywhere from -5% to +6% of GDP¹⁰⁸. Though being in the EU offers benefits, being outside may offer just as many, ranging from a reduction in regulation and a reduced cost to the Exchequer to a greater ability to conclude trade agreements with the major emerging economies. In particular it is very difficult to accurately estimate dynamic effects, such as the long-term impact of trade creation or of reduced regulation increasing the competitiveness of business.

The existing shift in the UK's trade pattern from the EU to the rest of the world will accelerate, as weaker ties to the EU are combined with new free trade agreements with major emerging powers. Such a shift will stand the UK in good stead as the balance of world growth shifts eastwards and south¹⁰⁹. It can also safely be predicted that there will be a greater impact – positive and negative – in areas such as trade, agriculture and regulation than in energy or transport.

Much will depend on the success of the exit negotiations with the EU and with other potential trading partners, the steps taken domestically to ease the burden of regulation and the reaction of world markets and international business. Below are set out 'best case', 'most probable' and 'worst case' scenarios for the UK's situation 3-5 years after the referendum (1-3 years after exit), though it should be emphasised that nothing can be predicted with certainty.

108 House of Commons Library: Leaving the EU (2013) – Research Paper 13/43

109 EU GDP growth has consistently lagged world GDP growth by approximately 2-3% for the last decade – data taken from Index Mundi <http://www.indexmundi.com/g/g.aspx?c=xx&v=66> – last accessed 04/09/2013.

4.1 Scenarios

Best Case Scenario

The UK negotiates a generous exit agreement with the EU, securing EFTA access, including some concessions for agriculture, and access for significant service exports in exchange for accepting half or less of the *acquis*. Undiminished trade access and a halving of the regulatory burden imposed by the EU on business causes exports to boom, fuelled additionally by a range of new agreements with major and mid-sized external trading partners including China, Brazil, Russia, Australia and India. Existing EU trading partners maintain their FTAs with the UK, some with minor amendments. The reduction in regulatory burden and competitive tax environment more than compensates for the EU exit, causing foreign investment to increase slightly. Total impact on GDP is +1.1%.

Most Probable Scenario

The UK negotiates a satisfactory exit agreement with the EU, securing EFTA access and access for significant service exports in exchange for accepting approximately two-thirds of the *acquis*. Regulatory reforms free up business to operate more competitively and contributions to the EU are gradually phased out over a period of five years, though the UK continues to contribute to a small number of common programmes. Existing EU trading partners maintain their FTAs with the UK, some with minor amendments, and the UK also secures new agreements with several mid-level trading partners such as Australia and Brazil, though negotiations go more slowly with China, the USA and Russia. After some initial market wobbles, the stable trading relationship with the EU reassures international business and the positive steps taken to promote investment ensure within two years inward investment levels have regained their pre-exit levels. Total impact on GDP is +0.1%.

Worst Case Scenario

The UK fails to negotiate an acceptable exit agreement with the EU and withdraws with no agreement in place. All access to the Single Market is lost and the UK exporters must pay the full 'most favoured nation' (MFN)¹¹⁰ tariffs paid by other developed nations. No other free trade

110 The tariffs imposed by the EU on nations with which it does not have a preferential trading agreement such as an FTA.

agreements are signed and some major nations with FTAs with the EU, including Canada and South Korea, refuse to honour theirs with the UK. Without the ability to export tariff free to the UK inward investment plummets, whilst international money markets react badly, causing the UK's borrowing costs to spike. Both exports and imports fall. Contributions to the EU cease. With no exit agreement in place, the UK is free to cut burdensome regulation and does so significantly, but this is not enough to mitigate the impact of being shut off from world markets. Total impact on GDP is -2.6%.

In total, the impact of each of the three scenarios is given in Figure 3. Annex B provides the full working for how the GDP changes in each scenario have been calculated.

Figure 3: Impact on GDP of the Best Case, Most Likely and Worst Case Scenarios			
	Best Case	Most Likely	Worst Case
EU Trade (£bn)	-7.7	-9.3	-19.2
External Trade (£bn)	5.6	2.1	-1.8
Budget Contribution (£bn)	10.0	6.0	10.0
Regulatory (£bn)	3.8	2.5	3.8
FDI (£bn)	4.5	0.0	-15.6
Debt interest (£bn)	0.0	0.0	-17.2
Total Gain or Loss (£bn)	16.1	1.3	-40.0
Total Gain or Loss (%GDP)	1.1%	0.1%	-2.6%

Although the most likely scenario shows a small positive gain, it should be emphasised that this should not be taken to mean that a UK exit would automatically be a good thing. The +0.1% gain is well within the margin of error for such estimations and, in any case, the high degree of variance between the best case and worst scenarios means that a positive outcome could not be guaranteed. Ultimately, the decision of whether or not the UK should remain within the EU is a political rather than an economic one.

4.2 Avoiding and mitigating the worst-case scenario

The most likely scenario may be economically acceptable; however, what if the worst case occurs? The aspect that is least within the UK's control is whether or not the rest of the EU will permit continued preferential trading arrangements – whether through membership of EFTA, the EUCU or some other bilateral special agreement. Section 2.3 makes clear that securing this should be the primary objective of the negotiations and discusses how it can be achieved; however, it must be acknowledged that there is a non-zero risk that such an agreement will not have been put in place by the time of the UK's exit from the EU. In such a scenario there are two possibilities: firstly that the negotiations are proceeding well, but that slightly more time is needed to finalise the exact details; or, secondly, that there has been a repeat of De Gaulle's '*Non*': one or more powerful Member States has explicitly blocked the UK's entry into a preferential trading arrangement.

In the first instance, the UK should take all possible steps to conclude the agreement as rapidly as possible. In the interim, the UK's current MFN tariffs should be applied to EU goods (and the EU will undoubtedly do the same to UK exports): this will have an immediate impact on business, thereby creating a strong pressure from the private sector on both sides of the Channel to conclude negotiations swiftly. Individual bilateral discussions, at Cabinet or PM level and in person rather than by phone where possible, should be held with any recalcitrant Member States who are blocking a deal to see what concessions they wish: this should be given a high priority and the strong presumption should be that any minor concessions for special industrial interests should be accepted. As soon as these are completed – within three months or six at the most – the Presidency should be asked to put forward a compromise proposal incorporating these amendments, which could then be approved by the Council and European Parliament.

In the second case, the UK must prepare for an indefinite period with no special access to the EU market. Whilst not absolutely disastrous – the total trade weighted applied average tariff of the EU is only 2.7%¹¹¹ – it would undoubtedly have a significant impact on large segments of UK industry and on GDP as a whole. Furthermore, it would materially

111 31.2% of agricultural products and 26.1% of non-agricultural products (by value) have an applied MFN tariff of 0; the total applied tariff; – World Tariff Profiles (WTO, 2013) http://www.wto.org/english/res_e/booksp_e/tariff_profiles13_e.pdf - last accessed 26/01/2014

decrease the UK's attractiveness as a destination for overseas investment as such investors would no longer have duty free access to the EU¹¹².

To some extent, mitigation involves taking the same steps that would be taken in the event of any UK exit and redoubling them. Securing trade access with external partners, encouraging inward investment and slashing business regulation to promote competitiveness all become even more critical to make up for the loss of access to EU markets. In addition, the UK should put in place temporary subsidies for those sectors that will be most impacted by the imposition on EU tariffs¹¹³. These subsidies should be strictly time-limited, tapering and aimed at helping those industries to improve their competitiveness and export to new markets outside the EU to prevent them fostering inefficiency and rent-seeking behaviour.

With respect to the EU, the UK should impose the same MFN tariffs that other developed exporters face. Notwithstanding the theoretical positive economic case for unilaterally removing tariff barriers¹¹⁴, it is important that shutting the UK out of EU markets is not a cost-free decision for continental business, in order to build the environment for a future deal once the political climate has altered¹¹⁵. The UK should not, however, seek to unduly antagonise the EU via restrictive measures such as safeguards and, as far as possible, should seek to decouple other matters – such as regulatory cooperation or rights for EU citizens currently domiciled in the UK and vice-versa – from the failed negotiations on trade. Needless to say, without trade access the UK should accept none of the *acquis* and should make no contribution to the EU budget.

112 In November 2013 the CEO of Nissan said that 'Nissan will reconsider its investment in the UK' if Britain leaves the EU – <http://www.bbc.co.uk/news/business-24859486> - last accessed 26/01/2014

113 Such as alcoholic beverages or the automotive sector, both of which are key UK export sectors and where EU tariffs are relatively high.

114 In its pure form, the theory of comparative advantage indicates unilateral tariff removal is beneficial – a practical manifestation of which, in this case, is that tariffs on imports of intermediate goods from the EU would increase costs for manufacturers.

115 In addition, imposing anything other than MFN tariffs would violate our WTO obligations.

5. Conclusion

It is abundantly clear that the UK can have a positive economic future either inside or outside the EU. Canada, a smaller economy than the UK¹¹⁶, prospers alongside its much larger neighbour, the United States; New Zealand has forged a successful nation despite its decision not to join with Australia in the late 19th century¹¹⁷. The UK is a modern, developed economy of almost 65 million people¹¹⁸, the 6th largest economy in the world¹¹⁹ with strong international alliances. Whilst close economic and diplomatic relations with other European countries are both inevitable and to be greatly welcomed, this does not imply that membership of the EU is the only way these can be achieved.

What is equally apparent is that a UK exit from the EU would result in different costs and opportunities than a path of ever closer union. Many of these costs are an inevitable consequence – even if joining EFTA there would be at least some degree of reduced access to the Single Market – meaning that appropriate policies and wise negotiation must be carried out if the UK is to reap the benefits. Whatever the arrangement, there is likely to be a trade-off between the level of access to the single market, and freedom from EU product regulations, social and employment legislation, and budgetary contributions¹²⁰.

116 \$1.797 trillion for Canada compared to \$2.443 trillion for the UK – CIA World Fact Book – last accessed 26/01/2014

117 The counterfactuals, clearly, cannot be properly evaluated. One cannot say what Canada or New Zealand's GDP per capita would be if they were part, respectively, of the United States or Australia; however, one can definitively say that all four of the nations discussed are successful, developed countries which provide a good standard of life for their citizens.

118 63.7 million in mid-2012 - <http://www.ons.gov.uk/ons/rel/pop-estimate/population-estimates-for-uk--england-and-wales--scotland-and-northern-ireland/mid-2011-and-mid-2012/index.html> - last accessed 26/01/2014.

119 The World Bank GDP Ranking - <http://data.worldbank.org/data-catalog/GDP-ranking-table> - last accessed on 04/09/2013

120 House of Commons Library Research Paper 13/43: 'Leaving the EU' (2013)

Throughout, the theme of this paper has been that the UK's policies after exit should be an embrace of openness: openness to global trade, openness to worldwide diplomatic partners, openness to international business and investment. Domestically, reforms should take advantage of the freedom from European regulation whilst preserving common standards and cooperation where this is in the UK's best interests.

Nothing can be guaranteed – but that is true both inside and outside the EU. It is not in the UK's gift as to whether its major trading partners will agree to new FTAs, though rational self interest on their part implies that, if the negotiations are conducted sensibly, at least some will succeed. Equally, we cannot be sure that remaining part of the EU would prevent the EU from bringing forward legislation that would directly disadvantage UK industry – EU membership has not prevented the recent implementation of a succession of financial services legislation, against the UK's wishes¹²¹.

It is probably inevitable that the couple of years immediately surrounding the exit would feature some degree of market uncertainty and fluctuating economic performance, whilst the terms of the UK's exit are determined upon. The initial actions to ensure a strong and prosperous UK must be begun during that time. The challenge would be to ensure that the UK can gain sufficient advantages – new trade partners, sufficient access to EU markets, minimal further contributions to the EU budget, an attractive investment climate and a reduced regulatory burden – to compensate for the loss of access to Europe and the loss of its voice in Brussels.

If the policies in this paper are adopted, 5-10 years after the date of exit it is likely that the pattern and structure of the UK's trade and economy would have shifted to reflect a greater global outlook, with greater bilateral trade with the emerging powers of the world and with the United States. The EU would continue to be a major trade partner, perhaps the single most important, but probably with a share closer to 30-35%

121 In the last two years the UK has challenged at least four new EU financial regulations as having the potential to significantly impinge on the success of the City of London. Short selling rules, the imposition of a financial transaction tax, the cap on bankers' bonuses and the European Central Bank's policy on providing liquidity to clearing houses. The first challenge was thrown out in January 2014; the others remain to be ruled on. See, for example, <http://www.ft.com/intl/cms/s/0/68cbcb64-834c-11e3-aa65-00144feab7de.html#axzz2rpSgbVR1> – last accessed on 30/01/2014.

of the UK's trade than its current 48%¹²². In international politics the UK would continue to punch above its weight, working with a wide range of allies both European, Commonwealth and others, though – like all other developed nations – would be affected by the global shift of power from north and west to east and south.

Domestically, one would expect to see a nation of less and simpler regulation and a lower budget deficit, but that remained a beacon for foreign investment, albeit with rather more investors from North America and Asia and rather less from Western Europe¹²³. Its character, that of a global nation open to the world, would be unchanged. Overall, the UK would probably be neither significantly richer nor poorer: there is no recorded correlation between EU membership and GDP growth. The fundamental assets of the country, its population, global connections, infrastructure and knowledge base mean that the long-term growth, balance of trade and economic outlook should remain strong.

Ultimately, whether or not the UK exits from the EU is a political, not an economic decision. A wide range of factors, in particular the ideological question over where sovereignty should reside, will be at the heart of any future referendum. This paper does not, therefore, address the question of whether or not the UK should leave, or advocate for or against such a course of action. What it does do is demonstrate that, in the event of such an exit, there exists a scenario for an open, prosperous and globally engaged UK that is eminently achievable.

122 The EU's market share of total UK trade fell steadily between 2002 and 2012 by 11 percentage points, from 59% to 48%. Extrapolating this trend with no change for another 10 years would see it at 37%. Exiting the EU could be expected to increase the trend, perhaps by 50-100%, which would leave the EU's market share at approximately 30-35%.

123 As discussed in Section 3.4

Annex A: Analysis of Trade Policy Options

This annex sets out the analytical data and calculations behind the recommendations in Section 2.1.2.

Considering the analysis carried out in Section 2.1.2 regarding the non-EU, non-EFTA, members of the G20, let us consider with which of these countries might lie the strongest interest for the UK in forming FTAs. To these 15 countries, we will also add Hong Kong and Singapore, as these are the only two of the UK's top 10 non-EU, non-EFTA export destinations that are not in the G20 (see Box 11)¹²⁴.

Box 11: UK's Top 10 Non-EU, Non-EFTA Export Destinations

Country	UK Export:
USA	84.1
China	13.7
Australia	10.9
Japan	9.4
Canada	8.1
Russia	7.6
Saudi Arabia	7.5
Hong Kong	7.5
Singapore	7.2
India	6.9

To determine where the greatest advantage to the UK might lie in forming FTAs we will consider each country against three criteria:

- Total volume of UK exports to that country in 2012¹²⁵
- Growth of UK exports to that country relative to the overall trend of UK exports¹²⁶.
- Average applied tariff imposed by the country¹²⁷.

Each country will receive 0, 1 or 2 points in each of these three categories.

Export Volume

Exports to each of the 17 countries and – for comparative purposes – to the EU and to the whole world – are set out in Figure 4.

Figure 4: UK Trade Export Data (Goods and Services) 2002-2012 in £bn

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Argentina	0.20	0.21	0.31	0.26	0.33	0.38	0.48	0.43	0.62	0.72	0.62
Australia	3.93	4.34	4.76	5.46	5.54	6.08	7.48	7.55	8.77	10.26	10.87
Brazil	1.18	1.15	1.10	1.23	1.45	1.55	2.34	2.54	3.13	3.74	4.17
Canada	4.59	4.81	5.08	5.09	6.06	6.12	6.43	6.79	7.73	8.82	8.09
China	2.19	2.80	3.64	4.25	4.91	5.33	7.60	7.60	10.30	12.43	13.67
Hong Kong	3.45	3.67	3.74	4.48	4.26	4.40	5.89	5.55	6.18	7.38	7.47
India	2.36	2.98	3.22	4.00	4.47	4.71	5.92	4.65	6.18	8.30	6.89
Indonesia	0.50	0.62	0.59	0.57	0.63	0.58	0.68	0.74	0.85	1.05	1.08
Japan	7.39	7.67	8.12	8.49	8.79	8.64	9.11	8.41	8.88	9.89	9.43
Mexico	0.95	0.95	0.97	0.95	1.17	1.16	1.31	1.24	1.47	1.56	1.68
Russia	1.56	2.14	2.37	3.04	3.85	4.96	6.51	4.31	5.26	7.20	7.58
Saudi Arabia	3.33	4.19	4.17	3.96	4.39	4.30	4.34	4.78	5.67	5.38	7.50
Singapore	2.59	3.25	3.89	4.90	5.55	5.97	6.47	6.98	7.23	7.79	7.16
South Africa	2.58	2.85	2.95	3.26	3.65	3.75	4.32	3.87	4.77	5.45	4.96
South Korea	1.97	1.94	2.39	2.45	2.67	2.84	3.69	3.13	3.51	4.05	6.37
Turkey	1.71	2.08	2.31	2.72	3.08	3.13	3.36	3.32	4.42	5.19	4.79
USA	50.50	53.10	54.49	56.76	63.64	68.72	73.32	70.38	77.55	81.46	84.08
World	280.00	293.08	305.82	339.84	387.59	380.52	429.76	402.17	447.27	492.88	492.81
EU	153.42	154.93	159.57	176.08	209.93	191.13	213.01	193.60	210.74	231.97	222.13

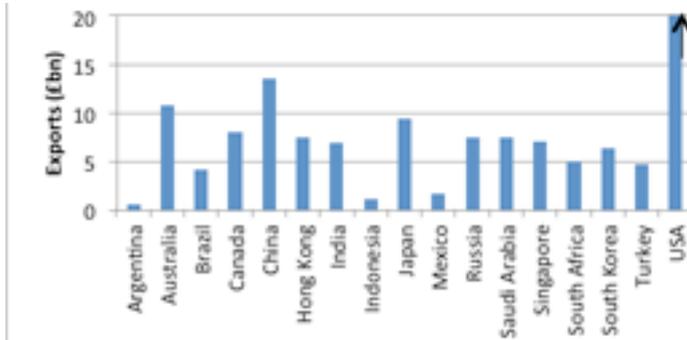
125 Ibid

126 Ibid

127 WTO Tariff Data, simple average, applied, as provided at http://www.wto.org/english/res_e/statis_e/statis_maps_e.htm – last accessed 28/12/2013

Export volumes for 2012 are displayed in Figure 5.

Figure 5: 2012 UK Export Volumes to Selected Countries



A country is allocated 2 points for an export volume of over £10bn, 1 point for £5bn-£10bn and 0 points for <£5bn. It should be noted that exports to the USA is, at £84bn, over six times larger than those to the second largest export destination, China. Therefore, exceptionally, the USA shall receive 3 points in this category¹²⁸.

Growth

In addition to the absolute volume of exports, it is important to consider the trend of how the UK's exports to that country are growing. Any exit from the EU will be several years in the future; furthermore, in signing FTAs the UK should consider the future as well as the present.

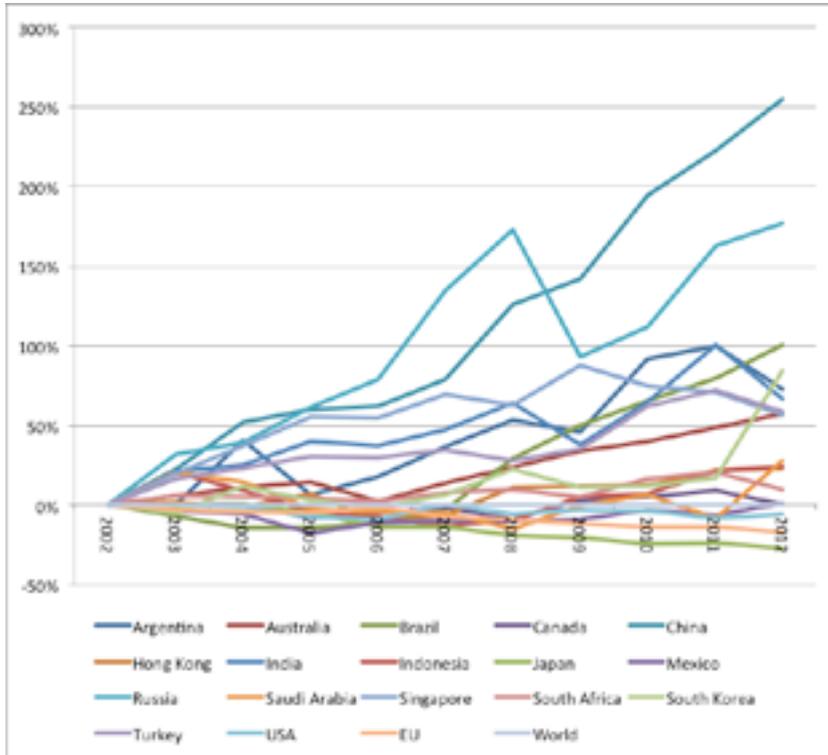
Exports to all 17 of the countries have increased over the 2002-2012 period; however, for more appropriate comparison, we will consider how exports to each of the countries have grown when set against the overall growth of UK exports (a 76% increase over the period). Figure 6 sets out the data and Figure 7 displays it in graph form¹²⁹.

-
- 128 This is justified: the size of the market makes it a significant outlier and it has been estimated that an FTA with the USA, as part of the TTIP, would be worth up to £10bn annually to the UK (Estimating the Economic Impact on the UK of a Transatlantic Trade and Investment Partnership (TTIP) Agreement between the European Union and the United States (Centre for Economic Policy Research, March 2013), compared to the £0.5bn it gained from an FTA with South Korea.
- 129 Normalised Growth figures scale the actual growth rate for the country concerned by the overall growth of UK exports (76%), so a growth of 76% would show as 0%.

Figure 6: UK Trade Export Growth (Goods and Services) 2002-2012

Country	UK Exports 2002 (£bn)	UK Exports 2012 (£bn)	Growth	Normalised Growth
Argentina	0.20	0.62	204%	73%
Australia	3.93	10.87	177%	57%
Brazil	1.18	4.17	252%	100%
Canada	4.59	8.09	76%	0%
China	2.19	13.67	524%	255%
India	2.36	6.89	192%	66%
Indonesia	0.50	1.08	119%	24%
Japan	7.39	9.43	28%	-27%
Mexico	0.95	1.68	77%	1%
Russia	1.56	7.58	387%	177%
Saudi Arabia	3.33	7.50	125%	28%
South Africa	2.58	4.96	92%	9%
South Korea	1.97	6.37	224%	84%
Turkey	1.71	4.79	180%	59%
USA	50.50	84.08	67%	-5%
Singapore	2.59	7.16	177%	57%
Hong Kong	3.45	7.47	116%	23%
World	280.00	492.81	76%	0%
EU	153.42	222.13	45%	-18%

Figure 7: UK Trade Exports Growth (Goods and Services); normalised; 2002-2012

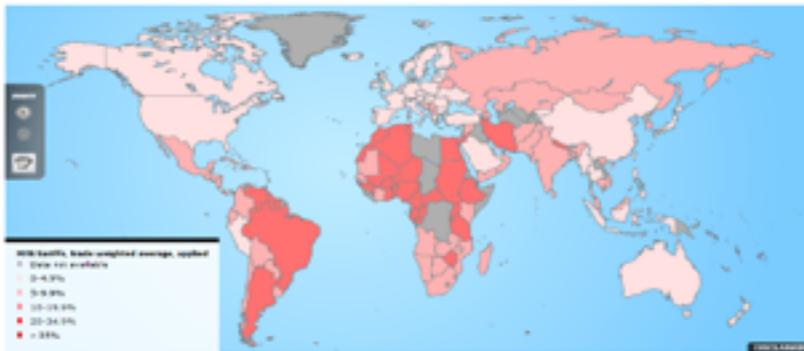


A country is allocated 0 points for an export growth of <50% above trend, 1 point for 50%-99% above trend and 2 points for export growth of 100% or greater above trend.

Average applied tariff

For each of the 17 countries, we consider the average applied tariff, using data from the WTO. Considering the average applied tariff gives an indication of how much UK exporters stand to gain from an FTA: if applied tariffs are very low, they will benefit less than if tariffs are high. Figure 8, below, is reproduced from the WTO website¹³⁰

¹³⁰ WTO Tariff Data, simple average, applied, as provided at http://www.wto.org/english/res_e/statis_e/statis_maps_e.htm – last accessed 28/12/2013

Figure 8: World Tariff Data

A country is allocated 0 points for an average applied tariff of <5%, 1 point for an average applied tariff of 5-9.9% and 2 points for an average applied tariff of 10% or above.

Figure 9: FTA Priority Conclusions

Country	Volume	Growth	Tariffs	Total	Category
Argentina	0	1	2	3	Medium
Australia	2	1	0	3	Medium
Brazil	0	2	2	4	Medium
Canada	1	0	0	1	Low
China	2	2	1	5	High
Hong Kong	1	0	0	1	Low
India	1	1	2	4	Medium
Indonesia	0	0	1	1	Low
Japan	1	0	0	1	Low
Mexico	0	0	1	1	Low
Russia	1	2	2	5	High
Saudi Arabia	1	0	1	2	Low
Singapore	1	1	0	2	Low
South Africa	0	0	1	1	Low
South Korea	1	1	2	4	Medium
Turkey	0	1	1	2	Low
USA	3	0	0	3	Medium

Summary

After allocating all points, each country is allocated into a category of low, medium or high priority for formation of an FTA, as set out in Figure 9. This gives rise to the priority order set out in Section 2.1.2, where the findings are discussed further.

Annex B: Analysis of outcomes

As discussed in Section 4.1, it is hard to say with certainty the overall costs and benefits of exit. In particular it is very difficult, even with detailed economic modelling, to accurately estimate dynamic effects, such as the long-term impact of trade creation or of reduced regulation increasing the competitiveness of business. Nevertheless it is possible to clearly identify certain areas in which one can be confident that a UK exit will have an impact and to estimate how large that impact will be.

Throughout this annex, UK GDP in 2012 is taken as \$2440bn¹³¹ or £1510bn and the dollar/pound exchange rate as 1.615¹³². In all cases, the analysis considers the steady state scenario, after any immediate transitional period is over.

Trade with Europe

In the time available it has not been possible to construct a detailed economic model of how much trade with Europe would be affected by a UK exit. Instead, the impact is modelled by considering the predicted impact of another trade agreement, the Trans-Atlantic Trade and Investment Partnership (TTIP) on the UK and relating this to the EU.

131 <http://www.tradingeconomics.com/united-kingdom/gdp> – last accessed 05/01/2014

132 The rate on 31/12/2013 – <http://www.oanda.com/currency/converter/> – last accessed 05/01/2014.

The TTIP can be considered a reasonable model for the UK trading relationship with the EU:

- The US and the EU are the UK's two largest trading partners – both will have a significant impact on the UK's overall trading patterns.
- The US and EU are both highly developed economies with low external tariffs.
- The TTIP is proposed as a deep integration FTA, tackling issues such as NTBs, procurement and regulatory issues, similar to the UK's relationship with the EU.

The paper prepared by the Centre for Economic Policy Research for the UK Government to model the impact of the TTIP¹³³ employs a Computable General Equilibrium (CGE) model to analyse a number of scenarios for the final shape of the TTIP and estimates the benefit to the UK of each. Taken in reverse, these scenarios are likely to be comparable to the costs to the UK of leaving the EU. One can model the 'basic modest' scenario as the best case scenario for a UK exit (relatively little disruption), the 'modified modest' scenario as the most likely scenario¹³⁴ and the 'modified ambitious' as being broadly equivalent to the worst-case scenario (full reversion to MFN tariffs; significant erection of NTBs).

In order to complete the analysis, it is necessary to scale up the impact to account for the greater importance of the EU compared to the US as a UK trading partner¹³⁵. The final costs are set out in Figure 9¹³⁶:

133 Estimating the Economic Impact on the UK of a Transatlantic Trade and Investment Partnership (TTIP) Agreement between the European Union and the United States (Centre for Economic Policy Research, March 2013) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/198115/bis-13-869-economic-impact-on-uk-of-transatlantic-trade-and-investment-partnership-between-eu-and-us.pdf - last accessed 05/01/2014.

134 As set out above, the most likely and best case scenario are relatively similar in terms of the trade access achieved; the difference being that in the most likely scenario the UK is forced to pay a higher price, in terms of regulatory cooperation and ongoing contributions than in the best case.

135 The scaling factor = (UK balance of trade with EU) / (UK balance of trade with US) = 488,667 / 134,709 = 3.628 (Data from ONS Pink Book 2013).

136 It should also be noted that the pound costs given in the research paper are for a 2027 baseline. In order to ensure consistency with the figures used throughout the rest of this annex, the fractional GDP figures are instead used and then converted into pounds at a 2012 baseline.

Figure 9: Cost of UK Exit as calculated by comparison with the TTIP

	Benefit of TTIP (%GDP)	Benefit of TTIP (£bn, 2012)	Cost of UK Exit (£bn)
Best Case / 'Basic Modest'	0.14%	2.12	7.67
Most Likely / 'Modified Modest'	0.17%	2.57	9.32
Worst Case 'Modified Ambitious'	0.35%	5.29	19.18

Trade with the Rest of the World

In a similar manner, it is not possible to accurately model all possible combinations of external trade agreements in the different scenarios – particularly as the benefit to the UK would vary dramatically depending on not only the country but the nature of the FTA. Instead, an estimation has been done in a similar manner to the above, by equating possible future trade agreements to the benefit to the UK from the EU-Canada FTA (£1.3bn annually¹³⁷) for FTAs with developed countries and to the benefit to the UK from the EU-Korea FTA (£500m annually¹³⁸) for FTAs with emerging countries, appropriately scaled for their importance as a trading partner to the UK. Although the figures will not be exact, one can be confident that they will be of the right order of magnitude.

In the worst case scenario, it is assumed that not only does the UK not manage to form any new FTAs, but that some of the countries with have signed FTAs with the EU – in the calculations assumed to be Canada and South Korea¹³⁹ – refuse to honour these commitments. In the most likely scenario, it is assumed that existing partners honour their commitments and that the UK also forms news FTAs with a small number of mid-sized¹⁴⁰ trading partners – for calculation purposes, taken to be Australia, India and Brazil¹⁴¹. In the best case scenario, it is assumed furthermore that the UK succeeds in concluding FTAs with two major trading partners, China and Russia, in addition to the FTAs formed in the most likely scenario.

137 <https://www.gov.uk/government/news/government-welcomes-historic-eu-canada-free-trade-agreement>

138 <http://blog.ukti.gov.uk/2010/10/25/why-the-eu-korea-fta-is-a-breakthrough-for-british-business/>

139 The choice of these countries is not intended to imply they are more likely than other partners to renege on their commitments; they are simply a representative pair.

140 In terms of their importance to the UK as trading partners.

141 Again, a representative sample.

Figure 10 sets out the amount that could be gained or lost from each FTA.

Figure 10: UK benefit or loss from selected FTAs			
FTA	Equate to	Scaling Factor	Annual Value to UK (£bn)
South Korea	N/A	N/A	0.5
Canada	N/A	N/A	1.3
Australia	Canada	1.03	1.33
India	South Korea	1.52	0.76
Brazil	South Korea	0.70	0.35
China	South Korea	4.60	2.30
Russia	South Korea	1.67	0.83

Using these values, the worst case scenario results in an annual loss of £1.8bn, the most likely scenario in an annual gain of £2.1bn and the best case scenario an annual gain of £5.6bn.

EU Budget Contribution

The net contribution of the UK to the EU was, in 2012, £10bn annually¹⁴². Under the best case scenario; the UK would cease all payments, a saving of £10bn. The same is equally true under the worst case scenario, as there would be no agreement with the EU. Under the most likely scenario, it is assumed that some residual payments would continue to be required, as a price for certain market access of for participation in certain programmes. This is modelled at 40% of the current payments, or £4bn annually, resulting in a saving of £6bn annually¹⁴³.

Regulatory

The burden of EU regulation is estimated at £7.5bn annually¹⁴⁴. Not all of this regulation will be bad; therefore, one would not expect it to all be eliminated. Nevertheless, a significant economic gain from leaving the EU would be to lighten the burden of regulation.

Under the most likely scenario, it is assumed that the UK is required to

142 House of Commons Library Research Paper 13/43: 'Leaving the EU' (2013)

143 The contribution of Switzerland, an EFTA but not EEA member, is 60% less per capita than that of the UK (Ibid). As this paper proposes a considerably looser partnership with the EU than Switzerland's, a 60% reduction may be considered a reasonable lower bound to the reduction.

144 British Chamber of Commerce 'Burden Barometer', 2010

accept approximately 2/3 of the *acquis*¹⁴⁵, which is modelled as 2/3 of the cost of regulation, a saving of £2.5bn. Under the best case scenario, it is assumed that the UK only needs to accept the regulation it wishes to, which is estimated at around half – a saving of £3.75bn. Under the worst case scenario, as there would be no agreement with the EU, the UK again only needs to apply the regulation it wishes to, so the saving is again calculated as £3.75bn.

FDI

At £790bn in 2012, the UK has the second largest stock of inward investment in the world, behind the United States, with average net inflows of £44.5bn over the three preceding years¹⁴⁶. It is very difficult to say how much of this is as a result of the UK's membership of the EU – many other factors such as a favourable business climate, language and flexible labour law will play a strong part. Equally, it is hard to estimate how much difference measures that could only be put in place as a result of leaving the EU, such as reduced regulation, could compensate for any negative impacts of a UK exit. The evidence is equivocal: 72% of companies interviewed in North America and 66% of those in Asia thought reduced integration with the EU would make the UK more attractive as a destination, against 38% of those interviewed in Western Europe¹⁴⁷.

In the most probable scenario, this will therefore be modelled as no change in FDI: essentially assuming that, after the transitional periods, the positives will balance the negatives. In the best case scenario, it is assumed that the UK becomes even more attractive, with FDI increasing by 10%. In the worst case scenario, a recent survey by the CBI found that 35% of firms would decrease their own business investment in the case of a UK exit¹⁴⁸. It is notable that the benefit of EU membership cited most frequently by these firms (76% of them) was the ability to buy and sell products without taxes and tariffs on trade flows in EU markets and only in the worst case scenario would this no longer be the case. It is therefore assumed that, in the worst case scenario, FDI decreases by 35%.

145 In line with members of the Eastern Partnership.

146 Figures taken from International Monetary Fund Coordinated Direct Investment Survey - <http://cdis.imf.org/> - last accessed 06/01/2014

147 Ernst and Young UK Attractiveness Survey (2013). Across the whole world, 47% considered it would make the UK more attractive and 47% that it would make it less attractive.

148 YouGov/CBI Survey (2013) <http://www.cbi.org.uk/media-centre/press-releases/2013/09/8-out-of-10-firms-say-uk-must-stay-in-eu-cbi-yougov-survey/> – last accessed – 07/01/2014

The impact of FDI on GDP is complex and can vary dramatically depending on the nature and sector of the investment. However, given the openness of the UK to FDI and the mobility of global capital, it is possible to simplistically model FDI as simply part of the Investment component of the GDP equation¹⁴⁹. Drops or increases in FDI are therefore modelled simply as drops or increases in GDP, giving a best case impact of £4.5bn, a most probable impact of 0 and a worst case impact of -£15.6bn.

Debt Interest

Under a worst case scenario, in which a UK exit went badly leading to a crisis of confidence in the international markets' confidence in the UK's ability to service its debts, the cost of interest on the national debt would rise. This is modelled as a 1.5% rise in interest rates. Taking national debt as 75.9% of GDP in 2018/19¹⁵⁰, a 1.5% rate increase would cost £17.2bn at 2012 prices.

Under the best case and most likely scenarios it is assumed that such a crisis is avoided and so the cost of this effect is zero.

149 $GDP = \text{private consumption} + \text{gross investment} + \text{government spending} + (\text{exports} - \text{imports})$,

150 Office for Budget Responsibility: Economic and Fiscal Outlook (December 2013) – <http://cdn.budgetresponsibility.independent.gov.uk/Economic-and-fiscal-outlook-December-2013.pdf> – last accessed 05/01/2014

Conclusion

Summing the above effects, the total impact in each of the three scenarios is set out in Figure 11.

Figure 11: Impact on GDP of the Best Case, Most Likely and Worst Case Scenarios			
	Best Case	Most Likely	Worst Case
EU Trade (£bn)	-7.7	-9.3	-19.2
External Trade (£bn)	5.6	2.1	-1.8
Budget Contribution (£bn)	10.0	6.0	10.0
Regulatory (£bn)	3.8	2.5	3.8
FDI (£bn)	4.5	0.0	-15.6
Debt interest (£bn)	0.0	0.0	-17.2
Total Gain or Loss (£bn)	16.1	1.3	-40.0
Total Gain or Loss (%GDP)	1.1%	0.1%	-2.6%

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