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Thinking ahead for Europe

Which model for Brexit?

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Abstract

The UK government is currently considering its options for its future relationship with the EU, which will inevitably have an important trade policy content. While the Prime Minister, Theresa May, has said that there is no suitable 'off-the-shelf' model available, there are several models under discussion that can serve at least as references in evaluating the pros and cons of various approaches. Each of the models under debate so far (called in shorthand WTO, Norway, Switzerland, Turkey and Canada) has its own respective qualities, but each of them also entails serious drawbacks from the UK's standpoint. There is a new model that has so far been ignored in the debate, namely the Association Agreements, which include Deep and Comprehensive Free Trade Areas (DCFTAs), between the EU and Ukraine, Georgia and Moldova, which came into force earlier in 2016. Like the other models, it is obviously not for outright copying, but it has some important features that are likely to be of interest to the UK.

The plan for Brexit was made a bit clearer by the Prime Minister's announcement on 2 October 2016, that Article 50 would be triggered by the end of next March and that a 'Great Repeal Bill' would, from the moment of withdrawal, retain in the first instance all existing EU law that was relevant as sovereign UK law. The Prime Minister also said that the UK would seek a free trade deal with the EU, but this undoubtedly would be conditional on the UK undertaking, inter alia, legally binding commitments to retain legislation deemed essential for any high degree of access to the single market. For whatever 'bespoke' deal that the UK might seek, the EU side will not accept a package that seems to make the secession process an easy one for others to follow. Moreover, in the event of a negotiating impasse at the end of the two-year period set by Article 50, the 'guillotine' could fall with the risk of imposing greater costs on the UK than on the EU.

In the event that negotiation of a comprehensive Association Agreement is found to be infeasible, a simpler option might be to achieve free trade by staying in the Customs Union, although there would still associated conditions and many other issues to resolve.

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Which model for Brexit?

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The Prime Minister has said that there is no 'off-the-shelf' model suitable for the UK's future relationship with the EU. This is undoubtedly true since there is no precedent for a secession agreement, and all the EU's many complex trade agreements are unique in their precise content. But the process does not start with a blank sheet of paper. There are several 'models' of how the EU can relate to non-member states, which may be instructive for the UK to consider, but not to copy into a formal agreement.

Several of these 'models' are well known and can be summarised for their relevance to the UK, namely and quite briefly:

- World Trade Organisation (WTO)
- European Economic Area (EEA), as for Norway, inter alia
- Customs Union, as for Turkey
- Switzerland, *sui generis*
- CETA, with Canada, as a recent example of an agreement with a non-European country

There is also a recent addition to the collection:

- the new model of Association Agreements between the EU and its close neighbours, recently negotiated with Ukraine, Georgia and Moldova and incorporating Deep and Comprehensive Free Trade Areas (DCFTAs). Although obviously not suitable for wholesale adoption, the model has several features of potential interest to the UK.

One often hears the terms 'hard' versus 'soft' Brexit used in the British debate. Although they have no official definitions, they seem to be understood as meaning the WTO and EEA models, respectively.

1. World Trade Organisation

The UK is and will remain a member of the WTO. There are two major issues to work through here, on the UK's future bound tariff schedule in the WTO, and its schedule of reservations (if any) on trade in services and establishment for individuals and companies engaged in service sectors. With its existing WTO membership renegotiated on these points, the UK will be free to negotiate its own free trade agreements with the EU and any other WTO member, as long as it keeps out of the EU's Customs Union (see below). A first task will be to reconstitute as fast as possible the free trade content of the EU's many preferential agreements with many countries, including some advanced industrial economies, such as Korea, Singapore and

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Canada (the latter still awaiting full ratification by the EU) as well as many developing countries. The second step would be to negotiate agreements with countries with whom the EU has no agreement so far, including major cases that are currently under negotiation (e.g. the US, Japan and India). Advocates of Brexit have argued that the UK could negotiate such deals faster and better on its own, but indications from the US and elsewhere suggest rather that the UK will be 'at the back of the queue'.

The UK's future tariff schedule at the WTO. Since this will have to be agreed with all other WTO member states, the UK will have a strong interest in making this process as easy and speedy as possible. One obvious way of proceeding would be to retain the EU's MFN (most favoured nation) tariff schedule unchanged, or to do this with exceptions only for tariff lines for which it might propose more liberal rates than the EU, including possibly a more liberal tariff-quota regime for agricultural products. But the UK could not expect to persuade the rest of the world to revise its tariffs downwards in exchange. On the contrary, other WTO member states could take the occasion to demand various concessions, since the process requires that the applicant reaches bilateral agreements with each of them. This would apply to the EU itself as well, since its formal WTO commitments on some points will have to be adjusted, and these will have to be agreed with the rest of the WTO.

Services. This will be a highly complicated affair in negotiations with both the WTO and EU. The WTO's General Agreement on Trade in Services (GATS) contains extensive lists of sub-sectors for which member states retain reservations limiting market access. The EU's service markets (internally) are partly subject to EU-level regulation and partly remain a matter of member state competences. As a result there is a double set of reservations at the WTO for the EU as such, and for each of the 28 member states individually. The UK will therefore have to decide what list of reservations it wishes to retain. The UK might choose a relatively more liberal package than the EU's existing reservations, which of course would facilitate agreement. But as in the case of the tariff schedules, this would be done unilaterally by the UK, without any real possibility to persuade the rest of the world to reciprocate.

The UK's negotiation of its services regime with the WTO will go alongside its negotiations with the EU on the same subject. The main point to keep in mind is that while the EU's services market is far from completely integrated, it is incomparably more liberalised than the WTO regime.[1]

Overall, if the UK opted to rely entirely on WTO rules for its future trading relationship with the EU, in the absence of a free trade deal, there would be a sharp reduction of market access for both goods and services. The EU's existing preferential trade agreements with third countries would also cease to apply to the UK, and it would take years for the UK to reconstitute them bilaterally. The potential cost of this loss, including for the UK as a location for foreign direct investment targeting the EU market, is amply discussed in the British debate, and to which this note does not try to add.

[1] Federica Mustilli and Jacques Pelkmans, "Access Barriers to Service Markets – Mapping, tracing, understanding and measuring", CEPS Special Report No. 77, CEPS, Brussels, June 2013.

2. European Economic Area, as for Norway, Iceland and Liechtenstein

This model is clearly defined: the non-member state is treated with regard to the single market exactly as if it were an EU member state. This requires that all EU single market legislation is fully implemented, including new legislation as it becomes effective, or amendments to existing legislation. But it does not entail membership of the Customs Union, thereby permitting EEA/EFTA states to make their own free trade agreements with third countries, which they have done in 31 cases. It also excludes EU agricultural and fisheries policies.

This model also requires respect for all four freedoms on which the EU is based, including the free movement of people.

Significant contributions are made to the EU budget by Norway, and also by Switzerland.

Enforcement is assured by specially created institutions, namely the EFTA Surveillance Authority and the EFTA Court, while this Court is subordinated to the rule that it cannot contradict the case law of the Court of Justice of the European Union.

The advantage of this model is that it is a system that exists, offers legal clarity and actually works. It is the closest among other options to sticking to the status quo in economic terms and it would avoid uncertainty and thereby minimise damage to the UK as a destination for foreign investment aimed at the EU market.

Of all the models one can entertain for the UK, it is the closest to continuing membership, i.e. full inclusion in the single market, but it would not allow the country to have any say in how single market policies are determined.

A detail regarding Liechtenstein is worth noting. In its negotiations with the EU, this very small state secured the right to impose quantitative limits on immigration from the EU; but it is so small that the EU would doubtless say that it does not amount to a relevant precedent.

3. Switzerland

In evaluating the EU-Swiss arrangements as a possible model for the UK's future relationship with the EU, there are two aspects to keep in mind: firstly, how the existing EU-Swiss relationship developed as a set of separate agreements, following its referendum of 1992, which rejected ratification of its negotiated inclusion in the EEA, and secondly how it has handled the free movement of persons.

Swiss model of multiple agreements with the EU. Following its 1992 referendum that rejected accession to the EEA, Switzerland and the EU entered into a long and complex process of negotiating many sector-specific agreements, which had the effect of reconstituting much of the content of the EEA agreement. These were negotiated over many years and were grouped into successive packages. For the first and main package adopted in 1999, the EU insisted that failure to implement any single agreement would lead to automatic suspension of the other components of the package. This was intended to ensure a holistic quality to the whole relationship, since the EU is categorically averse to 'cherry-picking' only those elements of the EU system that the partner state likes. This is why the EU has become highly critical of the status quo regime with Switzerland, and will surely be loath to allow the UK to negotiate something similar. The selectivity and perceived flexibility of the Swiss model are reasons why it has been advocated as a model for the UK. But the UK should have no illusions about the

likelihood that the EU would find this acceptable. The EU will surely insist on a single and comprehensive agreement for its future relationship with the UK. Overall the 'old' Swiss model can be excluded, while the conditions for a 'new' Swiss model have been set out explicitly by the EU Council, which seem to more closely approximate the EEA model.[2]

Switzerland and the free movement of persons. A second and more relevant aspect of the Swiss experience concerns the free movement of people. Switzerland agreed in 1999 to the free movement of people, subject however to a 'safeguard clause', which provided that: "In the event of serious economic or social difficulties, the Joint Committee shall meet, at the request of either Contracting Party, to examine appropriate measures to remedy the situation. … The scope and duration of such measures shall not exceed that which is strictly necessary to remedy the situation. Preference shall be given to measures that least disrupt the working of this Agreement." This clause has never been activated, however, and so there is no experience with how it might have been applied.

In February 2014, it was in any case overtaken politically by a referendum that was passed by a narrow majority of 50.3% 'against Mass Immigration', effectively requiring the government to establish within three years a system of quantitative limits to immigration from all sources, including the EU. This was against a background of immigrants having risen to represent 23.4% of the population, with around 1.3 million from the EU (which is several times higher on a per capita basis than immigration from the EU into the UK).

Given that the Swiss government was obliged under its own law to adopt implementing legislation no later than three years after the referendum, i.e. by February 2017, it proposed in March 2016 new legislation to manage immigration for the EU in the following terms: "The proposed unilateral safeguard clause provides for annual limits to be set by the Federal Council on the number of permits issued to people from EU and EFTA countries if immigration exceeds a certain threshold. When setting these limits the Federal Council will take Switzerland's general economic interests into account as stipulated in the Federal Constitution, and consider the recommendations of a newly established immigration commission."[3] Attempts to reach agreement with this proposal with the EU failed, however, and the proposed bill never passed into law.

More recently, the Swiss parliament's lower house adopted on 21 September 2016 a new law favouring the recruitment of local residents for new vacancies, including already established EU residents, in an effort to reach a compromise solution with the EU. The Swiss believe that this should be acceptable to the EU, and that the referendum of 2014 will now be overtaken by this law if passed by the upper house. European Commission President, Jean-Claude Juncker, has said that in his view the EU could be satisfied with this new law.

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[2] Council of the EU, Council Conclusions on a Homogenous Single Market and EU Relations with Non-EU Western European Countries, 16 December 2014. Extract, para. 44: "A precondition for further developing a bilateral approach remains the establishment of a common institutional framework for existing and future agreements through which Switzerland participates in the EU's internal market, in order to ensure homogeneity and legal certainty in the internal market. The Council welcomes the opening of negotiations on such a framework in May 2014, expects further efforts in order to progress with these negotiations and reiterates that without such a framework no further agreements on Swiss participation in the internal market will be concluded."

[3] See www.sem.admin.ch/sem/en/home/aktuell/news/2016/ref_2016-03-04.html

Finally, in a further twist to this Swiss affair, a petition is being circulated to hold a second referendum to annul the one of February 2014, and it has apparently already gained 100,000 supporters. While this number is sufficient to justify calling for a new referendum, it remains to be seen whether the petition is now dropped in view of the new law.

The new law appears to be a soft measure aimed at ending the confrontation with the EU. After a couple of years of reflection, the Swiss seem to have judged it to be in their interests to make a concession rather than let the 2014 referendum inflict major damage on their economy. This may not solve the British problem, but as a case study in Swiss management of the referendum process, it gives the UK food for thought.

4. Customs Union, as with Turkey

This model would mean retaining the EU's common external tariff (as bound at the WTO as its MFN tariff schedule) and also the import conditions imposed under the EU's many free trade or preferential trade agreements. The big advantage is that exports pass freely into the EU without being subject to customs controls or administratively costly 'rules-of-origin' documentation.

As regards the EU's free trade or preferential agreements with the rest of the world, the UK would have to negotiate bilaterally with these countries in order to gain preferential access to their markets, but in general it would be plausible for the UK to secure the same preferential terms as the EU, although this would not be automatic. While the UK would not be free to do free trade deals with other countries ahead of the EU, it is notable that the EU has ongoing negotiations with major trading nations, including the US, Japan and India. As and when these negotiations result in new free trade agreements for the EU, then the UK should in principle be able to follow through on the same terms. Moreover, some of these countries, including the US, say that in any case the UK (outside the Customs Union) would be 'at the back of the queue'.

Staying in the customs union would also have the important political advantage of avoiding renewal of custom controls at the Northern Ireland/Ireland frontier. Abolition of those frontier controls was one of the signal achievements of the Good Friday Agreement of 1998, which ended 30 years of violent conflict. Nobody wants to destabilise that agreement.

It is fair to say that both the EU and Turkey find the Customs Union to be an uncomfortable arrangement, because of the constraints imposed on Turkey's own trade policy and resulting tensions. It is worth noting that Turkey sought but was refused participation in the EU's negotiations with the US over the Transatlantic Trade and Investment Partnership (TTIP).

Nevertheless, the Customs Union option for the UK would have the great merit of being a much simpler route for maintaining free trade for goods than the other models described in this paper. A question would arise over associated conditions that the EU side would require, beyond compliance with the customs code and procedures. As pointed out (in section 6

below), however, it is highly likely that the UK will retain conformity with European technical standards.[4]

5. The CETA with Canada

This (still unratified) Comprehensive Economic and Trade Agreement (CETA) is an advanced model of a quite deep trade agreement, except that it is very limited in the services sectors. It is comprehensive in coverage and is the most up-to-date example of a free trade agreement between advanced economies that applies comparably high regulatory standards. The EU's free trade agreement with Korea is another but somewhat older example in the same category. The relevance of this model for the UK, however, is much reduced, since it ignores the large amount of EU market law that the UK will most likely retain in order to maximise its access to the EU single market. The CETA could be a useful template to expedite future UK negotiations of its own bilateral trade agreement with Canada and other advanced economies, but not with the EU.

6. The new Association Agreement model with neighbouring countries

The new Association Agreements that came into force in 2016 with Ukraine, Georgia and Moldova have several interesting features for the UK, which have been curiously ignored so far in London.[5] These concern their comprehensive structure and high degree of inclusion in the single market for three of the four freedoms (free movement of goods, service and capital, but not people). The reason for the exclusion is not explained in the Agreements, but is surely because the EU was worried about the prospect of large flows of migrants, a point that coincides with a prime UK interest for itself. This is a departure from the doctrine that all four freedoms always come together in an indivisible package, a doctrine that applies to the EU itself and the EEA, but not necessarily now between the EU and other close neighbours. Going further afield, the EU's free trade agreements with the rest of the world invariably exclude the free movement of people.

These Agreements set out in legally precise terms the entire agenda for defining the relationship with the EU, sector by sector, for almost all EU competences. This structure is more or less used in many of the EU's association or partnership agreements with third

[4] The EU also shares its Customs Union with some European micro-states such as Andorra, and currently the EU seeks to bring these states into much more extensive alignment on EU law, as explained in Council of the EU, op. cit.

[5] The AA-DCFTA text for Ukraine in the Official Journal of the EU runs to 2,000 pages of legal and technical matters, which is the main reason why its essence is not easily understood. With the aim of making these complex texts more accessible, CEPS decided to write shorter explanatory books, which have recently been published. See Michael Emerson and Veronika Movchan, *Deepening EU-Ukraine Relations – What, why and how?*, CEPS and Rowman and Littlefield International, 2016. This text is freely downloadable at: www.ceps.eu/publications/deepening-eu-ukrainian-relations-what-why-and-how, with a short guide available at: www.ceps.eu/publications/ukraine-and-europe-%E2%80%93-short-guide. Comparable books are published on the EU's similar agreements with Georgia and Moldova, accessible at www.ceps.eu.

countries. If the UK chose to go for a deep and comprehensive future relationship, the EU would probably want to work along the lines of the same structure:

I. General principles – *(easily satisfied, about common values, but not relevant here)*
II. Foreign and security policy – *(important possibilities for the UK, but not relevant here)*
III. Justice, freedom and security *(important issues for the UK, but not relevant here)*
IV. Trade and trade-related matters (i.e. the DCFTA – *see below)*
V. Economic and sector cooperation – *see below*
VI. Financial cooperation – *see below*
VII. Institutional provisions – *see below*

An organisational advantage of this structure and its content is that it provides clear and explicit listings of all the EU directives and regulations that are considered relevant, numbering over 300 in the case of Ukraine (listed in the annexes to the agreement), with another 300 food safety regulations added subsequently.

7. Towards a bespoke Association Agreement for the UK

In this section the standard structure of an advanced Association Agreement is followed, adapted to British circumstance and interests.

To begin with, the speech by the Prime Minister on 2 October 2016 at the Conservative Party conference went some way towards explaining how the government intends to handle the stock of EU laws, with reference to a forthcoming 'Great Repeal Bill'. The Bill appears to be based on the idea that this law will, on the day following secession, retain all relevant EU legislation as sovereign UK law unchanged in the first instance. In so doing, the distinction between the EU's *directives* and *regulations* is of major practical importance. The point here is that all directives, which are implemented by national legislation, are already, as a result, fully part of sovereign UK national jurisprudence, and thus for these nothing changes. While the UK will no longer be bound to the EU by these directives as such, its implementing legislation will continue to stand as a matter of sovereign UK law, unless explicitly repealed. Regulations have the opposite logic, being directly applicable in the member states without any further supporting national legislation. Upon secession, since all EU law will cease to apply, the substance of regulations will cease to apply unless the UK takes the step to re-install their content in national legislation. This poses the important need to avoid an unintended legal void, which would be especially important for some sectors such as food safety. Since there are hundreds of such regulations with much technical and scientific content, the UK will have to work out how to devise some short-cut legal technique for 'copying and pasting' various blocks of EU regulations into UK law, either to avoid a legal void as a temporary measure, or to assure continued market access in various sectors for the foreseeable future. The idea of the Great Repeal Bill seems precisely to avoid the legal void.

The UK would then take its time to carefully consider which directives or (newly nationalised) regulations to repeal or replace. Public debate in the UK often suggests that a lot of EU law is unnecessary 'red tape'. However the largest number of legal texts are product-specific technical standards produced by the European standards organisations, which are pan-European rather than EU institutions, and of which the UK will surely remain a member, because it is vital for market access.

For EU laws that it proposes to keep, the UK will need to decide what to do with the continuous flow from Brussels of amendments and replacements to existing laws. Will the UK keep its stock of EU laws up-to-date? If not, there will be a break in legal homogeneity, with the risk of reduced market access.

For each piece of EU legislation that the UK may decide to drop, it will have further to decide whether:

- to have a legal void (i.e. total de-regulation) or
- to define new UK laws and standards. If the latter case is adopted, the issue will then be whether the UK standard is to be more or less 'safe' than the existing EU standard, or whether it can be just 'smarter', and whether it will lead to denial of access to the EU market.

The Brexit minister, David Davies, is reported as saying that most existing market legislation will be retained. The evidence compiled in the UK government's Balance of Competence Review, completed in 2014, suggests that the desired excisions may not be very substantial. The government may therefore proceed by selective subtraction from the corpus of EU law. This would avoid the otherwise highly implausible prospect of immediate and wholesale replacement of masses of EU law with new British law with different content. So far, the advocates of Brexit have not been specific on what they would want to replace, beyond political generalisations about cutting 'red tape'.

However, there is a serious constraint limiting the otherwise attractive idea of keeping open when and what subsequent deletions of EU laws to make. The Prime Minister has said she would like a free trade deal with the EU. The EU will be willing to engage in negotiation on this, but it will have its conditions, which will be all about which blocks of EU market law the UK would commit to retain. The following paragraphs offer therefore a preliminary view of how the UK might want to relate to the core content of a possible DCFTA, together with various chapters under the heading of 'Economic and Sectoral Cooperation' that appear in the Association Agreement model.

Core trade policy conditions of a DCFTA. The core constituent parts of a 'deep' free trade area (listed in Annex 1) are in institutional terms the subject matter for which the EU has exclusive competences, and the Commission's Directorate-General for Trade primary responsibility. These make for a primary package of conditions for a free trade agreement, but there will be further conditions (under the heading of Economic and Sectoral Cooperation – see further below). Some comments are offered below on how the UK and the EU might handle the inevitable chapter headings.

Access to the EU market for goods (elimination of almost all tariffs). The UK wants this as a priority, and the EU has an interest here too, but the question will be on what conditions, which involves many of the following headings.

Ability to make own free trade deals with the rest of the world. The UK wants this also as a high priority, and it would be able to do this in all circumstances bar joining the Customs Union.

Trade remedies (e.g. anti-dumping duties). The EU generally relies on basic WTO rules here, which the UK would automatically comply with by virtue of its WTO membership.

Customs procedures (including rules of origin). The UK would want to remain compliant with the EU's basic customs codes, but will inevitably have to introduce customs clearance procedures and 'rules of origin' paperwork if it leaves the Customs Union.

Technical standards for industrial goods. The UK will surely wish to remain a full member of the European standards organisations, which are pan-European rather than EU institutions. However these bodies define technical standards for industrial products, which amount to around 5,000 in number, at the request of the European Commission.[6] As one British minister supporting Brexit (C. Grayling) has said, "There is no point in defining new British standards for the safety of lawnmowers" – an argument that is valid 5,000 times over.

There is provision in the DCFTAs for making Agreements on Conformity Assessment and Acceptance of Industrial Products (ACAA), as long as EU technical standards are respected, upon which "[t]he ACAA will provide that trade between the Parties in goods in the sectors that it covers shall take place under the same conditions as those applying to trade between the Member States of the European Union" (Article 57.2 of the Ukraine DCFTA). This is a matter of major economic significance.

In addition, European technical standards are mostly 'voluntary' in the sense that manufacturers remain free to produce according to other standards for supplying foreign markets, and also for the domestic market as long as they meet the "essential requirements" of the EU's framework directives. This means that the EU regime is in practice more flexible than some observers suggest.

Food safety regulations. The same broad arguments apply here as for the technical standards above. The UK will want to avoid non-tariff barriers for agri-food products, and so will see the value of retaining EU product regulations here too. The UK might want to deviate from EU regulations in exceptional cases.

Services. This is a fiendishly complex field in which there remain considerable restrictions on cross-border services provision within the EU itself, but these are much less onerous than all other models (WTO, Canada) except for the EEA.[7] The UK would presumably want to remain compliant with the 2006 Services Directive in order to get the best possible market access.

For the important *financial, transport and electronic communications services*, however, the DCFTA has special provisions for 'internal market treatment' on condition that relevant EU legislation is fully implemented,[8] which, under these conditions, more closely resembles the EEA model.

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[6] CEN (European Committee for Standardisation), CENELEC (European Committee for Electrotechnical Standardisation), and ETSI (European Telecommunications Standards Institute).

[7] See Mustilli and Pelkmans, op. cit.

[8] See the AA-DCFTA with Ukraine at Article 124 on p. 61, and Annex XVII, Article 4, on "Regulatory Approximation", pp 1725-1729 of the *Official Journal of the EU*, L161, Vol. 57, 29 May 2014. Internal market treatment is defined as: "No restrictions on the freedom of establishment of juridical persons of the EU or Ukraine in the territory of either of them and that juridical persons formed in accordance with the law of an EU Member State or Ukraine and having their registered office, central administration or principal place of business within the territory of the Parties shall, for the purposes of this Agreement, be treated in the same way as juridical persons of EU Member States or Ukraine. This shall also apply to the setting up of agencies, branches or subsidiaries by juridical persons of the EU or Ukraine established in the territory of the other Party; and — no restrictions on freedom to provide services by

This means that for City interests in *financial markets* in particular, the DCFTA model suggests in principle a possible route to retain access to the EU's financial market, if the UK remains fully compliant with EU legislation in this area. This compliance, however, has to be 'dynamic' in the sense of updating for amended or new EU legislation in the field, as illustrated by the decision on 30 September 2016 for the EEA states such as Norway to adopt a large package of 31 new EU laws in the financial market domain in order to continue to assure legal homogeneity with the EU. The main features of this extremely complex field, including 'passporting' provisions, are explained in an article by Karel Lannoo.[9] In the Bank of England's document defining passporting, the key language is identical to that found in the DCFTA.[10] This suggests that the DCFTA offers in principle the possibility of passporting, but of course there has been be no testing of these provisions yet so far, and there may be further secondary legal complications for this to be done in practice.

Civil aviation. The UK would be interested in negotiating a Common Aviation Area (CAA) Agreement to retain access to the single European sky, for which the UK is wholly qualified in terms of regulatory standards.

Public procurement. The DCFTA relies largely on WTO provisions in this area, but it goes further towards full market access as long as EU legislation is fully implemented. Presumably the UK would be interested in this.

Intellectual property rights (IPRs). Again there are basic WTO provisions in this area, but EU law goes deeper in various ways that the UK has been keen to advance, and presumably would want to retain.

Competition policy. The UK has been a major driving force for sustaining a rigorous EU competition policy for both anti-trust and subsidies. The British government's general ideology seems unchanged here, and in any case the EU would require continued consistency with this block of policy as one of the sure conditions for tariff-free trade.

Trade-related energy. EU law excludes subsidised or dual pricing for energy inputs into industry, and the UK would have no problem in remaining consistent with these rules.

Overall on core DCFTA chapters. The important conclusion from this summary review of core trade policies is that the UK could not only easily remain consistent with these prerequisites for free trade with the EU, but it would in all likelihood want to do so as a matter of policy choice.

Economic and Sectoral Cooperation chapters

Of these chapters of EU policies (as listed in Annex 2) some are also hard-core elements of the EU market regulatory policies, such as for the energy, environment and climate domains. But for other areas that are less directly, or not at all trade-related, there might be agreement over a selective approach to continued commitment to EU law.

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a juridical person within the territory of the other Party in respect of persons of EU Member States and Ukraine who are established in the EU or Ukraine".

[9] Karel Lannoo, "EU Financial Markets after Brexit", *Intereconomics*, Vol. 51, No. 5, September 2016.

[10] This is the same wording as that reproduced in footnote 8. The Bank of England source can be found at: www.bankofengland.co.uk/pra/Pages/authorisations/passporting/default.aspx

Energy cooperation. The UK took a leading role in framing EU policies in this area, including the 3rd Energy Directive, which requires the de-monopolising or 'unbundling' of energy supply networks. It is plausible that the UK would wish to remain at least broadly in line with these EU policies, although there may be questions over forthcoming EU energy legislation under the label 'Energy Union'.

Environment. Here there is much extremely important trade-related regulation (e.g. emissions standards for industrial enterprises), alongside other elements that are not at all trade-related or without cross-border spillover impacts (e.g. the quality of bathing water or nature reserves). Here, as under other chapters, as and when the UK seeks to lighten the extent of EU regulations, the key criterion must be to separate those that do, or do not, have trade-related and cross-border spillovers.

Climate. The EU's Emission Trading System (ETS) lies at the heart of EU climate policy, and the UK took a leading role in getting it established. The UK is now of course party to the Paris Agreement of December 2015, at which the EU took commitments that were only incompletely disaggregated by individual member states. The UK will surely wish to remain faithful to the Paris Agreement, but in principle it could do so by retaining its own ETS alongside that of the EU, or remaining fully integrated with the EU system with the aid of a new Protocol.[11]

Agriculture. The UK would not be under pressure from the EU to continue to apply various instruments of EU farm policy.

Fisheries. There will necessarily be a need to negotiate afresh over access to territorial waters both with the EU as well as with Iceland and Norway.

Labour market and social policies. The Brexit minister, David Davies, is reported to have observed (quite correctly) that EU law in this area, although controversial in the UK, has not prevented the UK from having one of the most flexible labour markets in Europe, and therefore these directives could be retained. If this were the government's choice, it would be an important argument for heading off objections in the EU to free trade with the UK on grounds of 'social dumping'.

Movement of persons. To regain control over immigration from the EU has been the single-most powerful driving force for secession. It is not yet known, however, how the UK will define its policy in this area, and the government says it is looking at various options, including work permits. While the political imperative to act here is evident, it is equally clear that many sectors of the British economy are crucially dependent on migrants from the EU (financial services, health services, higher education, construction, farm workers, etc.). The search is therefore on for the least-damaging means of achieving the objective of lower immigration numbers. The Swiss experience here is worth noting, both for the 1999 safeguard clause, which was accepted by the EU but never activated, and for how its 2014 referendum led after more than two years to a different solution that was finally acceptable to the EU (see above on Switzerland). It is possible that there may soon be a spontaneous reduction of immigration numbers into the UK from the EU, due to the uncertainty factor now created, as well as the

[11] For further details on this complicated question see Milan Elkerbout, "Brexit and climate policy: Political choices will determine the future of EU-UK cooperation", CEPS Commentary, CEPS, Brussels, 15 July 2016.

unfortunate spread of xenophobic attitudes and behaviour that emerged with the referendum campaign, for which there is anecdotal evidence.

For the future UK-EU relationship, some 'grandfathering' of the acquired rights of EU citizens resident in the UK, and vice versa, may be expected. However, there seems to be no hard legal basis or obvious precedent for this.

Other areas, including company law, consumer protection, public health. Some parts of these chapters are strongly related to market access, such as for labelling of consumer products and for public health (e.g. technical regulations for pharmaceuticals and medical equipment). For this category, continued compliance by the UK would be plausible. But there are other elements of these chapters that are not so closely market-related, and where the EU would not pose conditions.

Macroeconomic cooperation would be established via soft 'dialogue', without binding obligations towards the quantitative norms of the Stability Pact. On *taxation,* however, continued use by the UK of the value-added tax would be a prerequisite for free trade.

Agencies and programmes. There are explicit provisions for the participation by the non-member state in many of the sector-specific agencies and operational programmes of the EU, including some of great importance for the UK, such as Horizon 2020 for scientific research, the Erasmus programme for higher educational exchanges and the European Defence Agency, to name just three. These programmes and agencies are listed in Annexes 3 and 4. There is a standard formula for pro-rata GDP financial contributions. Participation in these agencies and programmes has to be governed by specific agreements.

For some of the programmes, notably in the fields of scientific research and higher education (Horizon 2020 and Erasmus), it is already apparent that key UK interests are being damaged by the Brexit uncertainty factor, with the undermining of existing research and university networks. It is therefore a matter of urgency for the UK that agreements are reached permitting full participation in these cases.

Financial cooperation. No doubt the question of financial contributions from the UK to the EU budget will arise in the course of negotiations, with the precedents of Norway and Switzerland surely to be cited by the EU. The outcome of such negotiations cannot be anticipated, but it will undoubtedly relate to the degree of access to the single market that would be negotiated. It is already clear that the EU will not want the overall package to appear to be so favourable to the UK that it might be interpreted in other member states as an attractive secession model.

Institutional provisions. There are standard models in the EU's external agreements. It may be anticipated that a ministerial-level Cooperation Council would be created for the UK, supported by an array of sector-specific committees and sub-committees of officials. As in the case of the EU's 'strategic partnerships', there would be provision for the whole process to be guided by summit-level meetings between the British Prime Minister and the Presidents of the Commission and European Council.

The powers of the Association Council will need to be carefully defined. In the case of the new Association Agreements, the Association Council has some limited powers to amend the Agreement, not the main text, but the annexes, which define much of the detail of the legal obligations. This links to the issue of updating of the future UK-EU agreement for new

legislation by the EU. Such updating is automatically required for the EEA and is enforced directly by the 'EFTA Court' if necessary. For the Association Agreements there is a provision for updating, but this has to be decided jointly by the Association Council, which on political grounds would presumably be viewed more favourably by the UK.

Dispute settlement. The Association Agreements have two regimes. The first mechanism of general application relies on the Association Council to settle disputes by agreement. For the DCFTA part of the Agreement, however, there is a system of binding arbitration that draws largely on the WTO model of dispute settlement, consisting of three arbitrators, one each from the two parties, and a third from another country as chairperson. There is also a role here for the Court of Justice of the European Union (CJEU), where issues of interpretation of EU law are at stake – a highly sensitive issue for both sides. The Great Repeal Bill would put all EU law under strictly British jurisdiction and the Prime Minister has stressed the political objective to escape the authority of the CJEU. In any comprehensive agreement between the UK and the EU, however, there would have to be a strong dispute settlement system, and the EU side will want to retain a role for the CJEU to assure legal coherence with EU jurisprudence. The EEA, for example, has a special 'EFTA Court', which is obliged not to deviate from case decisions of the CJEU.

Negotiation process under Article 50. Now that the end-March 2017 deadline for triggering the Article 50 procedure has been decided, the clock has started ticking for the negotiations to reach an agreement within two years by end-March 2019. Complex trade and cooperation agreements typically take several years to complete, normally longer than two years (even assuming that the UK-EU negotiations for their future trade regime can proceed in parallel with the separate withdrawal agreement, but this is still unclear as of now).

Two years later, if there is no agreement defining future UK-EU relations, the guillotine falls, meaning that the UK will be 'out', all EU law will cease to apply to the UK, and its relations with the EU will for trade purposes be governed essentially by the terms of WTO membership. In the absence of an agreement, this means introducing tariffs at the level of their WTO MFN levels.

The two-year period can be extended if there is unanimous agreement by all member states to do so, but this might well be difficult to achieve if the failure to reach an agreement on time reflected a period of harsh negotiations. The Great Repeal Bill, entering into force on the day of withdrawal, only covers against the risk of legal void within the UK.

Since the Prime Minister's speech on October 2nd, the prospect of the negotiations has taken a sharper profile. While there is little publicly known about the government's intended negotiation strategy, and indeed it is probably not yet decided, there is much speculation in the media that the government may be willing to go for a 'hard Brexit'. This has immediately played into political statements suggesting a 'hard' response from the EU, notably from the President of France.[12] It may be regretted that the process has already reached this point, even before Article 50 is triggered, but it necessarily means that the negotiators have to think through what their respective bargaining positions would be if there were still an impasse as the two-year period approached its end. There is a paramount need for correct evaluations of

[12] See *Financial Times*, "Hollande demands tough Brexit negotiations" and "French president seeks to avoid contagion and protect principles of single market", 7 October 2016.

each other's likely bottom-line positions. Here there seems to be some risk of miscalculation on the British side, to judge by various 'hard Brexit' statements. In particular, there is the frequently heard argument that because the EU has a trade surplus with the UK, it will have a compelling interest in making a tariff-free trade deal. This argument is an incomplete assessment, for two reasons. First the prospect of UK withdrawal has ignited serious interest in the rest of the EU in gaining market share from the UK for both foreign direct investment in manufactured goods aiming at the EU market (e.g. Japanese car producers), and of course also for financial markets, with the 'red carpet' already being rolled out in other EU financial centres. Secondly, as the French President already said explicitly, the remaining EU will have a strong and indeed existential interest in preventing "disintegration contagion", meaning that the terms of UK withdrawal should not appear potentially attractive to others. Moreover it is already clear that financial markets are highly sensitive to the perceived risks of a 'hard Brexit', and these sensitivities are bound to grow when the Article 50 clock really starts ticking. Since the UK government has not yet stated its negotiating objectives, there is still some room for shepherding the process on to less dangerous lines.

At the technical level, it may be noted that the Association Agreement model has two potentially useful features. First, much of the technical legal drafting could be carried over if a similar structure were adopted, thus shortening the time needed to assure the technical adequacy of the legal drafting. Second, the Association Agreements provide for a very large degree of 'provisional application' (indeed for all the DCFTA provisions) from the moment of signature, without waiting for the necessary ratification of the full treaty text by all EU member states and the European Parliament.

Conclusion

All five of the familiar models have their qualities, but each suffers from one defect or another for the UK, which validates the 'no off-the-shelf model' remark of the Prime Minister. Simple WTO membership would mean serious damage to access to the EU market for both goods and services; the EEA regime is incompatible with the wish to control immigration; staying in the Customs Union would limit the possibilities to conduct free trade with the rest of the world; the Swiss model would not be acceptable for the EU; and the Canadian model is not really relevant for a future UK-EU trade deal, but more for third-country cases. There is a new sixth model for the Association Agreement with neighbouring countries, including the DCFTA formula for trade. This model is also not suitable for wholesale copying, but it offers some features of potential interest to the UK: a structure to frame the forthcoming UK-EU negotiations, a high degree of single-market inclusion for three of the four freedoms (goods, services, capital, but not labour), and other legal and institutional features that the UK would find not inappropriate.

In her speech on 2 October 2016, the Prime Minister went some way towards clarifying how the government wishes to proceed. Article 50 will be invoked before the end of March 2017. A 'Great Repeal Bill' is planned, in which all relevant existing EU law will be transferred onto the UK sovereign statute books on the day of withdrawal in order to avoid a legal void, and to give adequate time to work out what should subsequently be kept or repealed. The UK will also seek a free trade deal with the EU, for which the EU will surely set conditions, consisting of continued compliance with much trade and single market law. The EU may be expected to request contributions to the EU budget. This means that in order to minimise delay and

uncertainty over a possible free trade deal, the UK must promptly work out (beyond the ultra-simple and temporary terms of the Great Repeal Bill) what EU law it is willing to retain over the long term as part of a free trade deal. The outline of a bespoke Association Agreement has been sketched above, indicating what the UK interests might plausibly be.

Whether the EU would be willing to engage in something like this is not known. Several EU leaders, however, have already staked out political markers, some very recently in the light of Prime Minister May's speech of October 2nd. The two main points being made concern the indivisibility of the four freedoms and the need to avoid a British solution that would risk encouragement by contagion for other member states to escalate disintegration, which, as mentioned earlier, is a concern of existential proportions for the EU as a whole.

If the conditions for an ambitious Association Agreement become too difficult for one side or the other to accept, a simpler alternative for damage limitation could be to go for free trade through staying in the Customs Union, although there would still associated conditions and many other issues to resolve.

For the time being, however, the general view on the continent is likely to be, as at the battle of Fontenoy in 1745, that it is for "*Messieurs les Anglais, tirer les premiers!*".

Annexes

Contents of the EU's new model Association Agreements, including Deep and Comprehensive Free Trade Areas (DCFTAs), as for Ukraine, Georgia and Moldova

Annex 1. Chapters of the DCFTA (selected) in Title IV

Market access for goods (elimination of almost all tariffs)
Trade remedies (e.g. anti-dumping duties)
Customs procedures (including rules of origin)
Technical standards for industrial goods
Food safety regulations
Services (notably financial services, transport, electronic communications, etc.)
Payments and capital movements
Public procurement
Intellectual property rights (IPRs)
Competition policy
Trade-related energy

Annex 2. Chapters of Economic and Sectoral Cooperation (selected) in Title V

Macroeconomic cooperation
Taxation
Energy cooperation (excluding trade-related)
Environment
Agriculture
Fisheries and maritime policy
Company law
Consumer protection
Information society
Employment and social policy
Public health
Agencies and programmes
Space
Cross-border cooperation

N.B. There is a somewhat confusing overlap between the chapters Titles IV and V, with various services appearing under both headings, which is here eliminated for simplicity.

Annex 3. Agencies of the EU open to participation by non-member states

European Agency for Safety and Health at Work (EU-OSHA)
European Fisheries Control Agency (EFCA)
European Monitoring Centre for Drugs and Drug Addiction (EMCDDA)
European Union Institute for Security Studies (EUISS)
European Centre for Disease Prevention and Control (ECDC)
European Aviation Safety Agency (EASA)
European Defence Agency (EDA)
European Foundation for the Improvement of Living and Working Conditions (EUROFOUND)
European Union's Judicial Cooperation Unit (EUROJUST)
European Agency for the Management of Operational Cooperation at the External Borders (FRONTEX)
European Environment Agency (EEA)
European Asylum Support Office (EASO)
European Chemicals Agency (ECHA)
European Police College (CEPOL)
European Maritime Safety Agency (EMSA)
European Food Safety Authority (EFSA)
European Institute for Gender Equality (EIGE)
European Police Office (EUROPOL)
European GNSS Agency (GSA)
European Network and Information Security Agency (ENISA)

Annex 4. Programmes of the EU open to non-member states

Competitiveness of Enterprises and SMEs (COSME)
Asylum, Migration and Integration Fund
Copernicus, European Earth Observation Programme
Erasmus+
Creative Europe, Programme for the cultural and creative sectors
Customs 2020
European Maritime and Fisheries Fund
European Statistical Programme
European Territorial Cooperation
Health for Growth
Fiscalis 2020
Galileo and EGNOS Programmes
Global satellite navigation system
Horizon 2020
Hercule III, Anti-fraud
Internal Security Fund
Life Programme, Environment and climate change
Pericles 2020, Programme for the protection of the euro against counterfeiting
SESAR JU, Air Traffic Management modernisation
European Union Civil Protection Mechanism

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