

Brexit essentials: Alternatives to EU membership

This is the second in a series of briefings covering the essential aspects of the UK's referendum on EU membership, which Prime Minister David Cameron has committed to hold by 2017. This edition discusses the most commonly proposed alternatives to EU membership that have been put forward by advocates of a British exit from the EU.

In the event that the referendum results in a “leave” vote, there are a number of possible scenarios for the UK's future relationship with the EU. The referendum question will decide whether the UK should leave or remain in the EU. However, in the event of a “leave” vote, the public will not have a say into the future relationship between the EU and the UK. At the time of writing, the pro-Brexit campaign has not put forward a united proposal for what form Brexit would take - but various alternatives have been suggested.

Possible exit scenarios

A post-Brexit world will not necessarily resolve the issues that British Eurosceptics have with the status quo. None of the most commonly proposed alternatives would be straightforward to implement; and none presents the “benefits without burdens” scenario that the pro-Brexit lobby has suggested is achievable. Some exit scenarios would see the UK continue to contribute financially to the EU and continue to be subject to EU law.

There are various models for the UK's post-Brexit relationship with the EU, which can be grouped under three main headings:

- Exit the EU but become a member of the EEA and of EFTA, retaining access to the single market (the “Norwegian model”);
- Exit the EU and join EFTA but not the EEA, with EU relations governed by a framework of bilateral agreements and some limited access to the single market (the “Swiss model”); or
- Total exit from the EU and the single market. In this model the UK could seek to join the EU Customs Union (as Turkey has done); access the EU market under the World Trade Organisation (WTO) rules; or negotiate a special deal from scratch under a new free trade agreement.

The EEA and EFTA

EEA: “European Economic Area”, which includes the 28 Member States of the EU plus three of the four EFTA states (Iceland, Norway and Liechtenstein - the fourth being Switzerland). The EEA Agreement covers the adoption of EU legislation in the agreed policy areas including the four freedoms, but not areas including policies such as those relating to agriculture, social and employment law, justice or home affairs.

EFTA: “European Free Trade Association”, which comprises Iceland, Norway, Liechtenstein and Switzerland. EFTA promotes closer economic cooperation and free trade between its member states.

1. The Norwegian model

One option is for the UK to exit the EU but join the EEA, together with Norway, Iceland and Liechtenstein, and EFTA, together with the EEA states and Switzerland, retaining access to the single market.

The pro-Brexit view

“Single market access without ‘political union’ is secured under the EEA option.” **Business for Britain, ‘Change or Go’, 17 July 2015**

This was the approach taken by Norway following its exit in 1994. There is no automatic right for the UK to become a member of EFTA or a party to the EEA Agreement, so existing members would have a veto on the UK joining. For example, Norway has previously vetoed Slovakia’s membership.

Under this model, EU policies not covered by the EEA Agreement would no longer apply to the UK. For example, the UK would no longer be subject to EU rules on agricultural and fisheries policy, the customs union, common trade policy, or common foreign and security policy, and would have the freedom to set its own VAT regime. The UK would be free to set its own laws in these areas, but would no longer benefit from EU policies, for example, EU subsidies in areas such as agriculture.

The EEA Agreement does not cover the area of freedom, security and justice either. The network of information exchange on matters of national security, which the UK has access to as a result of its participation in EU-wide police and judicial cooperation, would likely have to be replaced by a network of bilateral agreements.

Although no longer a member of the EU, as a member of the EEA the UK would be required to retain a wide range of EU legislation, including legislation relating to the EU’s four fundamental freedoms, such as the free movement of people. Over 11,500 EU legal acts have been incorporated into the EEA Agreement as of 2015.¹ Although incorporation can be delayed in the most controversial cases, it normally goes ahead.

¹ EFTA website: <http://www.efta.int/eea-lex>.

The Four Freedoms

The single market is based on four freedoms: the free movement of goods, persons, services and capital.

Goods	Persons	Services	Capital
Internal taxation	Free movement of citizens	Freedom to provide and receive services	Free movement of capital
Free movement of imports	Free movement of workers		Free movement of payments
Free movement of exports	Freedom of establishment		

The key characteristic of the “Norwegian model” is therefore that, while the UK would remain subject to the bulk of EU legislation, it would lose all formal voting rights and ability to influence that legislation. Norway, Iceland and Liechtenstein are able to exert some “soft influence”, but ultimately have no seat around the negotiating table and no voting power. The UK would therefore not be represented in decision-making processes that would have direct consequences for the country, and nor would it have any significant influence on them.

The view from Norway

“We [Norway] are fully integrated into the EU single market as members of the EEA, but what we don’t have is the right to vote on those regulations that are incorporated into our law when they are made by the council of ministers.” Vidar Helgesen, Norwegian Minister for Europe

“If you want to run the EU, stay in the EU. If you want to be run by the EU, feel free to join us in the EEA.” Nikolai Astrup, spokesperson on European Affairs for the Norwegian Conservative Party

“The irony is that if we followed the model of Norway, Europe’s political interference in our country could actually grow, rather than shrink. [...] The single market has rules. We will not always get what we want from those rules. But we have more influence over them from inside the EU, where those rules are actually made.” Prime Minister David Cameron, 10 November 2015

The UK would continue to benefit from access to the single market - although as this would entail free movement of people, this model would be no solution to immigration concerns. In addition, the single market benefits may not be equivalent to those the UK currently enjoys as a member of the EU.

The UK would have access to the single market for trade in goods under the Norwegian model. However, the EEA is currently making slow progress in incorporating EU legislation on financial services; as a result of the differences in regulation, access in some parts of the financial services sector is limited. The EEA Agreement does not cover the work of the European Supervisory Authorities (ESAs), which may leave the UK financial services sector isolated.

The impact of Brexit on financial services is important because they account for c. 8% of UK output and around 3.5% of employment, and are a key sector for the UK.² More foreign banks operate in the UK than any other EU country, and more than half of the world’s largest financial firms have their European headquarters in the UK.³ The City of London also accounts for a high proportion of the EU’s financial services activity - 74% of the EU’s foreign exchange trading and 40% of global trading in euros.⁴ There is a real risk that losing access to provide financial services in the single market would greatly diminish the position of the City of London as a global financial hub and a bridge for foreign business to the EU.

If the UK doesn’t have a seat at the table in crafting financial regulation, it is likely that the rules themselves will favour other financial services markets. Even in areas where the UK does have some access for financial services, it may find itself at a disadvantage in a market where the rules have been designed to favour the EU’s own financial centres.

Timely access to the single market for UK businesses depends on how quickly other EEA States process EU legislation: there is currently a delay of 6-24 months. If standards are not the same, due to the failure of other EEA States to incorporate EU legislation, access to the single market may become limited - for example, for products that do not meet higher EU standards.

“While they pay, they don’t have a say. They don’t have a seat around the table”.
Prime Minister David Cameron on the “Norwegian option”, 28 October 2015

² Speech given by Mark Carney, Governor of the Bank of England, “The European Union, monetary and financial stability, and the Bank of England”, 21 October 2015.

³ *Ibid.*

⁴ CBI, “Our Global Future: The Business Vision for a Reformed EU”, November 2013.

To continue to benefit from access to the single market, the UK would also still be required to contribute financially to the operation of the EU, through a separate EEA Grant. Although the “Norwegian model” would reduce the UK’s financial contribution to the EU compared with the status quo, given its size, the UK would still be required to make significant contributions. Norway, for example, is currently the tenth highest contributor to the EU, despite not being a member: it pays per capita contributions of £106 in 2011, compared with the UK’s £128.⁵ The House of Commons Library has estimated that if the UK left the EU and instead contributed to the EU budget on the same basis as Norway, its contributions would fall by around 17%.⁶

In terms of trade with third parties, the UK would no longer be covered by trade agreements entered into by the EU (such as the TTIP agreement in negotiation with the US), but could join the existing EFTA trade agreements.

2. The Swiss model

An alternative model would be for the UK to exit the EU and join EFTA, but not the EEA. UK-EU relations would be governed by a framework of bilateral agreements and include some limited access to the single market.

The pro-Brexit view

*“Our objective, when we leave the EU, should be to aim for a Swiss model, based on bilateral accords.” British Conservative MEP Daniel Hannan, 15 December 2012, in *The Telegraph**

Switzerland, a member of EFTA but not the EEA, has a unique relationship with the EU that is the result of a significant body of bilateral agreements, through which it has partial access to the single market. This means that Switzerland can trade freely with the EU but is not automatically subject to EU legislation - although it is required to comply with certain single market rules in return for access.

Under such a model the UK would enjoy some access to the single market, although only in areas where it could negotiate bilateral agreements. Switzerland, for example, does not have an agreement in respect of financial services, which are of substantial importance to the UK economy. As a result, a number of Swiss banks need to operate through subsidiaries in the EU - at present, in London.

To gain access to the single market, Switzerland was also required to accept the EU principle of freedom of movement (although it could cap migration until 2014). This model would therefore not be attractive to those wishing to reduce intra-EU migration. It seems highly unlikely that a State outside the EU would be granted access to the free movement of goods, services and capital, without the accompanying free movement of persons.

⁵ House of Commons Library (2013), “The Economic Impact of EU membership on the UK”, page 25.

⁶ *Ibid.*

As for any third country wishing to trade with the EU, the UK would be required to comply with certain single market rules in return for access. For example, there is no automatic mutual recognition of regulation - so the UK would have to meet the regulatory requirements of the EU in order to sell its goods and services there.

Following the “Swiss model”, the UK would face the same problem of losing influence over EU rules that it would under the “Norwegian model”: in practice it would have to comply with EU regulation in return for single market access, but would not be represented in decision-making. This problem would be worse under the “Swiss option” than under the “Norwegian option”, as there are fewer institutional structures in place to exert “soft influence” in the EU decision-making process.

“Around the table, there were the 28 member states, plus Norway and Switzerland. The 28 member states got to talk and the other two only got to listen, which brings a lot of warnings for my own country.” **British Conservative MEP Vicky Ford, commenting on a European policy meeting**

There is also no mechanism for automatically updating the Swiss bilateral agreements as EU regulation develops. As a consequence, Switzerland must continually amend and adopt legislation that is the same as that in the EU, so that its businesses can continue to have access to EU markets.

However, the UK would likely make a significantly smaller financial contribution. Switzerland does not contribute to the EU budget, but does take part in other EU financial initiatives, such as research programmes. If the UK paid the same per capita rate as Switzerland, its net contribution would fall by 59%.⁷

The Swiss position was devised in a very unique context - it was intended to be a transition into the EU for Switzerland. That transition never occurred and the EU considers this model to be highly imbalanced and not viable on an ongoing basis. It is therefore highly unlikely that there would be appetite to replicate the Swiss model.

“[...] the approach taken by Switzerland to participate in EU policies and programmes through sectoral agreements in more and more areas in the absence of any horizontal institutional framework, has reached its limits and needs to be reconsidered.” **Council of the European Union, December 2012**

⁷ House of Commons Library (2013), “The Economic Impact of EU membership on the UK”, page 26.

3. Total exit from the EU and the single market

There are various scenarios that could arise on a “total exit” basis, depending on the level of bilateral arrangements that the UK is able to negotiate.

The pro-Brexit view

“We’d have more influence, not less. By regaining our seat on the WTO, which we gave up in 1973 on joining the EEC, we would have more say in global trade talks.” Richard Tice, 31 March 2015, writing in City A.M.

For example, the UK could seek to join the EU’s Customs Union, as Turkey has done. Customs Union countries operate under a common trade policy, common rules of origin and a common external tariff. No duties are imposed on goods that are traded with the EU, in return for compliance with single market regulation.

The Customs Union covers all industrial goods but does not address services, so financial services (which, as highlighted above, are very important to the UK economy) would not be covered.

Furthermore, under such a “Turkish option”, the UK would have no vote or influence on the trade deals that the EU pursues; external trade policy would effectively be outsourced to the EU. Again, the UK would not have a say in how the rules of the single market are made. Turkey must comply with many EU single market regulations and all EU trade arrangements, but has no influence on their composition.

“It would not be in the UK’s interest to be a silent partner in the EU’s trade policy, allowing other countries to set the tone for Europe’s openness to the world and the details of its trade deals, which would define the daily framework for the UK’s global trade. The UK needs to be at the table setting the mandate and approving the final agreement.”
CBI, *‘Our Global Future: The Business Vision for a Reformed EU’*, November 2013

As with the Swiss arrangements, the Customs Union with Turkey was established as a precursor to EU membership; it is not clear that there would be appetite within the EU for extending a similar arrangement to the UK.

Alternatively, the UK could seek access to the EU market under the WTO rules, which apply to all WTO members.

The WTO rules follow the principle of non-discrimination, which requires members not to treat any trading partner less advantageously than any other, unless covered by a separate free trade agreement. In relying on the WTO rules, therefore, the UK would not have access to trade in the EU on terms any more advantageous than third countries that do not have free trade agreements with the EU. UK businesses would be subject to the EU Common External Tariff, meaning that they would be less competitive compared with competitors from the EU or from countries with a free trade agreement (which will soon

include the US). Tariffs would be imposed on around 90% of the UK's goods exports to the EU.⁸ A further obvious disadvantage to relying on the WTO rules is that financial services would not be covered.

This is important because the EU is the UK's biggest trading partner: over the 18 months to September 2015, the EU accounted for between 41-51% of UK exports and 49-55% of UK imports.⁹ The UK is also a beneficiary of significant foreign direct investment from the EU: since the establishment of the single market in 1992, the UK has been its top recipient of foreign capital.

The UK would also be subject to non-tariff barriers to trade in the EU. To continue dealing with EU customers and suppliers, UK businesses would be required to continue to comply with EU technical specifications and safety standards, but would not have influence over their formulation and development.

Each WTO member operates with a schedule of agreed tariffs. The UK's goods and services schedules are currently incorporated into those of the EU. On leaving, the UK would need to negotiate a new set of tariffs. The same is true for agricultural commitments under the WTO Agreement on Agriculture.

As a third alternative, the UK could seek to negotiate a new free trade agreement (FTA) with the EU from scratch. Under this model, access to free trade in the EU, including for financial services, would depend on the agreement negotiated. The extent to which the UK would be subject to the rules on freedom of movement, in exchange for receiving freedom of capital, goods and services, would also depend on the deal negotiated.

There is no guarantee that a new FTA could be negotiated, or how long it would take. For example, the EU's FTA with Canada (CETA) took more than five years to negotiate and sign; ratification is expected to take another two years. FTAs with key countries typically require ratification from all Member States through their national parliaments.

"If you believe Britain could negotiate a trade deal that preserved all the advantages of the single market without any of the costs of membership, don't count on it." Radek Sikorski, Polish Foreign Minister, The Times, 25 September 2012

In terms of international trade, the UK would be free to conclude its own bilateral trade agreements with third countries; the free trade agreements between the EU and those other countries - of which there are over 50 - would no longer apply (including those with Korea, Mexico, South Africa, Colombia, and those in progress such as those with Japan and the US). This would need to be balanced against the risk of not being able to do so satisfactorily, as a smaller global player, as well as the risks posed by the period of uncertainty that this would entail.

For example, the United States has ruled out a separate trade deal with the UK if it leaves the EU, although New Zealand has said that the UK could likely replicate any EU trade deals it has with the country post-Brexit.

⁸ House of Commons Library (2013), "Leaving the EU", page 27.

⁹ HM Revenue & Customs Overseas Trade Statistics, 6 November 2015. Available at https://www.uktradeinfo.com/Statistics/OverseasTradeStatistics/Pages/EU_and_Non-EU_Data.aspx.

“I think it’s absolutely clear that Britain has a greater voice at the trade table being part of the EU, being part of a larger economic entity.”

“We’re not particularly in the market for FTAs with individual countries. We’re building platforms that other countries can join over time. We have no FTA with the UK so they would be subject to the same tariffs - and other trade-related measures - as China, or Brazil or India.” Michael Froman, United States Trade Representative, October 2015

Under any variation, the key feature of total exit is that, in exiting entirely from the single market, the UK would no longer contribute to the EU budget.

The UK would also cease to benefit from EU funding. Although the UK is a net contributor to the EU, many regions are net recipients, such as Wales. The CBI has estimated that Wales would lose around £207 million in structural funding and £290 million in agricultural funding following Brexit.¹⁰

The extent to which the UK government would seek to repeal EU legislation that has been transposed into UK law is not clear; much of it is broadly supported, but there may be pressure from businesses to remove certain laws such as those implementing the Working Time Directive.

From the standpoint of those who wish to curb immigration into the UK, a clear advantage of total exit is that the UK would not be subject to the rules on freedom of movement and would have full control over its own borders (depending on the results of the negotiation of any new FTA). However, British people would equally lose the right to work, live and travel freely across the EU. British people are the EU’s biggest beneficiaries of the freedom of movement; there are more British people living in other EU countries than any nationality. Losing the benefit of freedom of movement would also increase the difficulty for British business in attracting and retaining global talent; particularly in sectors which employ a large share of EU migrants such as financial services (6%) and information & communications technology (5%).¹¹

The exit process

The exit process governed by the Treaty on European Union requires:

1. notification of an intention to withdraw to be given to the EU Council; and
2. a withdrawal agreement to be negotiated between the withdrawing state and the EU Council. In practice this would entail a long negotiation period to unravel the complex relationships currently in place; for example, removing the UK as a signatory to free trade agreements; and agreeing the logistics of phasing out the UK’s budget contributions and EU funding to UK regions.

The withdrawing state would cease to be bound by the EU treaties from either the date provided in the withdrawal agreement or two years after the notification of the intention to withdraw. It is unclear in practice what the sanction would be for a Member State that ceased to observe the treaties earlier than the specified two-year period.

¹⁰ Based on 2009 data. CBI, “Our Global Future: The Business Vision for a Reformed EU”, November 2013.

¹¹ House of Commons Library, “The economic impact of EU membership on the UK”, September 2013.

What about remaining in the EU?

The advantages of remaining in the EU will depend on the success of the Prime Minister's renegotiation, which is now expected to take place largely at the next meeting of the European Council on 18/19 February 2016. If his demands are accommodated, the advantages may also include guaranteed safeguards for the UK's financial interests outside the eurozone and increased controls on migration. In particular, the Prime Minister has advocated for a three to four year ban on EU migrants claiming benefits.

The obvious advantages of remaining are that the UK would continue to benefit from access to the single market and the "four freedoms". The Governor of the Bank of England, Mark Carney, has noted that the UK has been the leading beneficiary of the four freedoms of movement of goods, services, people and capital, and that EU membership has made the UK economy stronger and more dynamic.¹²

"Cross-border integration of goods, services, labour and capital markets increases an economy's dynamism through increased specialisation, enhanced competition, and greater possibilities for diversification and risk-sharing." Mark Carney, Governor of the Bank of England, October 2015

Through continued representation and voting rights at the European Council, Council of the European Union and European Parliament, the UK will retain its ability to shape EU rules and the direction of the EU's development. The UK has the joint highest number of votes at the European Council and the third highest number of members at the European Parliament (73, the same as Italy, after France's 74 and Germany's 96); it has therefore played a key role in shaping EU rules.

¹² Speech given by Mark Carney, "The European Union, monetary and financial stability, and the Bank of England", 21 October 2015.

The EU Institutions

European Parliament: the EU's law-making body. Its 751 MEPs are directly elected by EU voters every five years. Shares power over EU budget and legislation with the Council of the European Union.

European Parliament Seats per Member State from 2014:

Germany	96	Netherlands	26	Austria	18	Lithuania	11
France	74	Belgium	21	Bulgaria	17	Latvia	8
Italy	73	Czech Republic	21	Denmark	13	Slovenia	8
United Kingdom	73	Greece	21	Finland	13	Cyprus	6
Spain	54	Hungary	21	Slovakia	13	Estonia	6
Poland	51	Portugal	21	Croatia	11	Luxembourg	6
Romania	32	Sweden	20	Ireland	11	Malta	6

European Commission: the EU's executive body, responsible for proposing and implementing EU laws and the day-to-day running of the EU.

Council of the European Union: comprises government ministers from each EU country, according to the policy area to be discussed. Together with the European Parliament, it is the main decision-making body of the EU, as the ministers have the authority to commit their governments to actions agreed on in the meetings.

European Council: comprises the heads of state or government of each EU Member State, plus the European Commission President and the High Representation for Foreign Affairs and Security Policy. It does not pass laws, but decides on the EU's overall direction and political priorities. It also deals with complex or sensitive issues that cannot be resolved at lower levels of intergovernmental cooperation (e.g. the UK's proposals for renegotiation of its relationship with the EU will be discussed at a European Council summit).

Indeed, the UK has had a strong track record of influencing EU policy in the past: for example, it succeeded in introducing a requirement that banking regulation of the European Banking Authority must be agreed by a "double majority"; it championed recent cuts in the EU budget; and it was a key advocate for the Eastern enlargement of the EU in 2004. The UK has also had success in challenging EU law (which, as highlighted above, could affect British interests regardless of membership) at the European Court of Justice: for example, the UK successfully challenged the European Central Bank's policy for the location of clearing houses.

"There are things we get out of Europe, no doubt about it. We are a trading nation. We don't just want access to Europe's markets. We need a say over the rules. That is what we get sitting round that table." Prime Minister David Cameron, October 2015

What about the EU without the UK?

As a key trading partner and geopolitical neighbour, how the EU develops without the UK as a member is not irrelevant to British interests. Were Brexit to occur, the EU Member States that are in favour of liberal free trade would lose a vocal and powerful member. There is therefore a possibility that the direction of the EU's development would shift.

There are also wider political considerations for the UK itself, as well as for its relationships with its neighbours. Brexit can be expected to have an impact on the likelihood of Scotland leaving the UK and the devolution settlement to the Scottish, Welsh and Northern Irish regions. Were Brexit to take place, Northern Ireland would be left as the only part of the UK to share a land border with the EU, which would affect the openness of the border, Anglo-Irish relations and stability within the island of Ireland.

“Ireland regards the prospect of the UK leaving the EU as a major strategic risk [...] the EU has been an important, perhaps underestimated, enabler of peace in Northern Ireland [...] Common membership of the EU project is part of the glue holding that transition process together.”
Irish Taoiseach Enda Kenny, 9 November 2015

To read the first briefing in this series, visit [Brexit essentials: UK proposals for EU reform](#)