

## **The mechanics of secession; secession negotiations; the alternatives to the status quo**

Brexit Seminar Series (Week 1) 16 October 2015, All Souls College

Conveners: Sir Jeremy Lever and Professor Jeremias Prassl

Rapporteur: Eirik Bjorge

Speakers:

- Jackie Minor, Head of the European Commission's Representation in the United Kingdom
- Professor Patrick Minford, CBE, Professor of Applied Economics, Cardiff Business School, University of Cardiff
- Professor Mads Andenas, Professor at the Faculty of Law of the University of Oslo

The meeting opened with Sir Jeremy Lever drawing attention to salient points contained in the Introduction, which is printed immediately before this Report. He observed that anyone who, in ten years time, looked back on these Seminars would probably say, with hindsight: 'They didn't identify the most important point.' The seminars are meant not to be propagandist but rather to enlighten those who come to the seminars as to potential consequences of Brexit.

### **The mechanics of exit**

The Lisbon Treaty laid down for the first time a procedure for exit by a Member State from the European Union. Previously, the situation was governed by the international law of Treaties. Article 50 of the Treaty on European Union now provides that:

‘Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.’

In this connection, it is not clear what the relevant constitutional requirements of the United Kingdom are. We know there will be a referendum. But referenda remain only persuasive, not binding, on the Government. In theory, the Government could choose to ignore the referendum. Will it need to do anything the day after, or will the referendum itself suffice, or will Mr Cameron have to return to Parliament for confirmation of the result of the Referendum? It is thought that the steps taken following on a vote to exit are likely to be wholly within the power of the executive subject to Parliamentary approval of necessary legislative measures. The procedure which follows the serving of the notice under Article 50 TEU (see above) is set out in the second paragraph of the Article:

‘A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a

qualified majority, after obtaining the consent of the European Parliament.’

Under Article 218(3) TFEU, the European Council sets out the framework of withdrawal negotiations on the basis of recommendations by the European Commission. The chief negotiator is then empowered to negotiate the ‘withdrawal’ of the exiting Member State. The assumption is that the Commission would act as negotiator, responsible for conducting technical talks and exchanges of position, leading to final agreement. The terms of the withdrawal are then approved by (i) the 27 non-withdrawing Member States, acting by qualified weighted voting, without the United Kingdom voting, and (ii) with consent, that is, a simple majority, of the European Parliament.

Whereas the procedure lays down that a withdrawing Member State shall not participate in this process, it says nothing of its members of the European Parliament or its Commissioner; it can be assumed that they would be able to participate as they do at present, and that the British Commissioner would remain in charge of his portfolio. There is nothing to suggest that notice of withdrawal would formally affect the status of British MEPs or the British Commissioner prior to actual exit by the United Kingdom

How long is such a process is likely to take? Failing agreement to the contrary, the Treaties cease to apply two years after the giving of the Article 50 notice. The two year period can, by unanimous agreement, be extended. If all the other States and the United Kingdom wanted to continue negotiations, the time could be extended. This is provided for in Article 218(3) TFEU; nonetheless this raises a number of questions to which we do not have the answers.

When the United Kingdom holds the chair of the Council of Ministers in the second half of 2017, it can be assumed that, apart from withdrawal discussions, it will continue to exercise its functions as usual and take the leading role in the European Council.

What happens if one ends up with a ‘no’ vote and but, after the Article 50 negotiations have been concluded, the ‘United Kingdom’ has second thoughts? Can an Article 50 notice, once given, be withdrawn? To this there is no answer in the Treaties: *Qui peut le plus peut le moins?* The text of Article 50 TEU seems to imply that it is a one-way street. There is a two year backstop rule, but it does not suggest that the period could be extended indefinitely. Had this been intended, then the treaty would have said so. Once given, notice is final.

With regard to the scope of the negotiations. Article 50 TEU says that negotiations should take account of the framework of future relationship between the withdrawing Member State and the Union. That makes sense since, if the United Kingdom were to become a member of the European Economic Area (EEA), it would want to preserve a lot of the *acquis* which apply both to members of EU and to those of EEA. It would make no difference to the application of those rules whether the United Kingdom was member of one or another.

With regard to the treatment, post-Brexit, of financial liabilities, on both sides, although the EU's budget is determined annually, liabilities (e.g. for pensions of EU officials and indebtedness of the Institutions) would have to be equitably apportioned between the departing Member State and the remaining European Union. All of that would take time.

Turning to the question of the acquired rights of companies and individuals, what would be the status of British citizens living elsewhere in Europe, of British companies overseas, the rights of British banks, who currently on the basis of being

established in the City of London are able to do business all over Europe (and in each case, the corresponding position in the United Kingdom of citizens of, and undertakings established in other Member States)? The answer that the Commission has given to that question is ‘we don’t know’, and it is indeed difficult to say what the answer is. It cannot yet be known.

Next the attention may be drawn to Article 50(5) TEU which provides that: ‘If a State which has withdrawn from the Union asks to re-join, its request shall be subject to the procedure referred to in Article 49.’ In a sense, it was pointed out, it is a game of snakes and ladders.

Such an applicant State, like any other, would have to meet all the requirements for membership: democracy, the rule of law, fundamental rights—no doubt, these would not be problematic, but all the opt outs that the United Kingdom currently enjoys are and have been based on continuing membership. If the United Kingdom were to exit and subsequently applied to re-join the EU, would the United Kingdom have to commit to membership of the Euro, and would it enjoy no opt outs from justice and home affairs?

A withdrawal agreement would cover a whole range of issues, but not, first, treaty adjustments necessary to regulate relations between remaining Member States nor, second, the terms of the future relationship of any agreement in relation to trade between the United Kingdom and the EU. Could any of that it be part of a withdrawal agreement? Probably not. Again, this can be known only as negotiations proceed. The kind of agreement for which the United Kingdom might be looking would nevertheless probably require ratification by the European Parliament and by all national parliaments and might require Treaty changes. There might be a declaration that there shall be a trade agreement, but its terms would fall to be negotiated only at a later stage? It would therefore seem that Article 50 negotiations are concerned with the terms on which the existing relationship of the United Kingdom as a Member State of the European Union is terminated (divorce) rather than its future relationship with the European Union (a new cohabitation agreement).

### **Exit to what?**

The Seminar then moved from the mechanics of exit to a consideration of the situation to which the United Kingdom would moving upon exit. Professor Minford's observations were directed primarily to explaining why he believes that the advantages for the United Kingdom in regaining its status as an independent sovereign State are such as to make exit from the European Union desirable. The EU has changed greatly from its genesis as essentially an economic organisation to a single market dedicated to ever closer union across the board. The evolution that the EU is undergoing is causing fractures and is unsustainable, at least so far as the United Kingdom is concerned. If British history shows one thing, it shows that the British are very independent-minded. If anyone had told the British in 1973 that they would be becoming part of a European State, they would not have agreed. The British like to decide for themselves.

The EU and the United Kingdom have much in common and, if the United Kingdom decides to exit the EU, they will surely negotiate a sensible new relationship. One can start from the assumption that the existing Treaties are needed by other countries and that changes of the EU Treaties therefore cannot be changed sufficiently to assuage the United Kingdom's concerns as a Member State. For that reason, there has got to be a new relationship—a new treaty between the United Kingdom and the EU. The Eurozone crisis is an important element in this. One worries about the degree of protection sought by the Eurozone countries. If the United Kingdom were to remain

within the EU, it would have to join the Euro. That is the logic of the ever closer union.

Will the United Kingdom leave? It is widely argued in the 'Yes' camp that the United Kingdom will 'cling on to nurse, for fear of worse'. But how rational is nurse? If she is mad, she might do a lot of damage. The United Kingdom is a moderately liberalised economy; the EU is a socialist or social-ish protectionist customs union. The differences will intensify. That could create uncertainty for the United Kingdom, more uncertainty than being outside.

Any assumption that the EU is a free market nirvana is to be questioned. Rather, it is a customs union and it is protectionist. The EU has anti-dumping rules, it has tariffs and it has a sprawling system of protection of agriculture.

What happens if the United Kingdom leaves? Will the EU apply its external tariffs to imports from the United Kingdom? The tariffs create an external wall and the United Kingdom will be outside that wall; but it should not be forgotten that in this situation the United Kingdom will not have an external wall against the rest of the world. Given the reforms that the United Kingdom has undergone since 1973 it is competitive, has liberalised its economy and would be able to withstand the normal forces of international competition. The United Kingdom could turn that to its advantage, by reorientating its economy towards global free trade at world prices

In this vein the meeting was told that the United Kingdom would get rid of a 10 per cent tariff equivalent on both agriculture and manufacturing (services are currently not affected by EU tariff or equivalent policies). There would be no reason at all for the United Kingdom to leave the EU and then impose a lot of tariffs. The point in getting out of the EU would be to get rid of those tariffs; it would be the last shoe to drop for the United Kingdom to become a nation that is shaped by its own advantages, not by the protectionism of the EU. The United Kingdom would become a normal nation in the world; it would join the WTO. But is it so cold out there? New Zealand, Japan—many countries are doing well out there.

Against that background, what will happen if the United Kingdom leaves? Professor Minford believed that consumer prices will fall by 8% and that manufacturing and food prices will fall by 10%; prices of services will fall by 2%, because of a reduction in costs. Leaving the EU would mean a reorientation of the economy. The part of manufacturing that is based on intellectual input will probably expand. That would be good for the economy, as one should concentrate on what one is best at. There will be a rise in consumer welfare.

On this view, the United Kingdom would not become another Norway; it would become a normal, self-governing nation. It will have good relations with the EU, though will no longer be ruled by the Euro elites, the modern equivalent of King John in the time of Magna Carta. The United Kingdom will become like New Zealand or Japan. New Zealand is interesting because of the way in which Roger Douglas liberalised the New Zealand economy; Mr. Abe of Japan is trying now to do the same thing. In practice, therefore there will be a welter of new trade agreements. Since the United Kingdom liberalised its economy while in the EU, it is now ready to leave the EU and compete freely on the world stage.

Sir Jeremy Lever here suggested that, although this narrative was one of no complications, the picture may in fact be more complicated.

Professor Andenas, with his Norwegian background, stressed that good solutions would need to be sought in the 'cold climate' of secession and the 'even more brutal world' of trade negotiations. The stronger dictate the terms to the weaker partner; it is worlds apart from internal negotiations within the EU. The United Kingdom leaving the EU would put the former in an extreme situation; it would enter into a half

way house regime. It is interesting to compare the post-Brexit position of the United Kingdom with regimes that do not aim at permanent solutions. These are of a particular nature, as they aim at membership. The European Economic Area agreement is the only agreement which gives full access to the internal market. EFTA was at one time bigger than the EU; the United Kingdom was a member of EFTA. The last States to leave EFTA to join the EU were Sweden, Finland, and Austria. Switzerland had a referendum on whether or not to join the EEA, and the outcome was negative. Switzerland instead opted for a bilateral agreement with the EU. Norway voted 'no' to joining the EU and stayed, as a relative super-power, in the EEA, with Liechtenstein and Iceland as its two partners. Under the EEA, Norway, Liechtenstein, and Iceland find themselves in an institutional arrangement under which the three States adopt automatically every single legislative measure which the EU adopts if it is of relevance to the EEA. Norway has to accept it all, so long as the EU says it relates to the EEA.

Professor Andenas believed that a British return to EFTA is not possible. The United Kingdom is not trusted in the EU, where it is viewed as an unreliable partner. The EEA would not want to 'be in business' with Britain. For that reason the United Kingdom could not join the EEA, even if it wanted to.

With reference to the examples of New Zealand and Japan given earlier, it was said that one has to cast the net wide in looking at possible models. In connection with the restructuring of the New Zealand economy, the point was made that there will be a lot of disorder and urban poverty in the United Kingdom if it were to go through the New Zealand process. Japan and New Zealand are not free trade economies; and Japan still at the other end of the scale. In that sense, they are unhelpful examples. If one wants models, one needs to look for better models.

The EFTA–EEA is not much better as a model. The example of Norway starkly illustrates the limitations that were given. With its five million inhabitants, Norway follows everything that comes from the EU with relevance to the Internal Market except agriculture and fisheries. Norway—in common with Switzerland—is a party to Schengen. Norway contributed to the Greek crisis arrangements, and will to the refugee settlement. There was in Norway recently a government review which went through every aspect of the EEA. There are Eurosceptics in Norway too. And who very much want to leave the EEA; they are far left of Jeremy Corbyn and have limited credibility. Vidar Helgesen, Norwegian Minister for Europe, observed not long ago that what sets Norway apart from EU members is only the fact that Norway does not have the right to vote. Mr. Helgesen spoke of the importance of TTIP: he saw the problems for Norway in the sense that it has no mechanism for joining the agreement. He cited Nick Clegg who had called Norway's relationship with the EU 'telefax diplomacy'.

There are huge forces pushing the EEA apart; it is difficult to hold it together, which is possible only by excessive subservience on the part of the smaller countries. With any kind of free trade model, one is almost bound to encounter some of the problems that Norway has encountered. Even a regional power such as the UK will find that the arrangements will serve the stronger party, the EU, and that the centrifugal forces in such arrangements will work in the disfavour of the weaker party, the UK. There is, simply put, no such thing as a polite trade negotiator.

Against this background it was observed that there is, therefore, no model that the United Kingdom can follow. Professor Andenas then turned to the question of costs. The impact on financial services is important. Currently, this causes real problems to Norway. None of the newly adopted banking or financial services directives with capital adequacy or passport rules have been through the EEA process. They are waiting for a solution to the constitutional solutions for the new financial market

regulator bureaux; and in the meantime the passporting rules do not apply for those new services that are included, such as those related to clearing house activities. Norwegian finance firms are currently not operating in the internal market, but nor are they operating as complete outsiders that can benefit for the regime for third country undertakings. A permanent feature of the EEA makes Norway subject to antidumping actions. If some industry in the EU can benefit from something, however small advantage, it may call upon the EU's anti dumping regime, and in many instances the consequences for the Norwegian competing sectors have been numbing.

The whole of the transitional period after the United Kingdom's notice under Article 50 TEU would be one in which the United Kingdom would have little or no influence on the EU. After Brexit the United Kingdom would have no influence on the application by the EU of any rules that had been agreed for application during any transitional periods; the idea that the United Kingdom could make good its independent position and protect UK business in that period has no foundation. Brexit would leave it a victim of fortune during that period.

Professor Andenas was also of the view that one should have no illusions that the United Kingdom could expect any preferential treatment. Not from the EU, and not from any other part of the world. Any idea that the United Kingdom on its own could make advantageous deals in the selfish world of international trade negotiations would be wrong. The costs and uncertainties will be great. One has to have more to show than Japan and New Zealand; it is so obvious that the United Kingdom is in Europe and that that is the reality of the position of the United Kingdom.

Sir Jeremy Lever asked whether, post-Brexit, the United Kingdom could expect to be in a similar institutional position in relation to the European Union as it would be in relation to the United States of America or would it continue to have an institutional relationship with the EU that gave it special rights and imposed upon it special obligations.

Professor Andenas believed that Professor Minford had concentrated excessively on benefits of leaving, whilst not wanting to engage with the possible costs of leaving: Minford had simply added up the transfers from the UK to the EU as net benefits in a Brexit. In that regard, Professor Minford believed that it is impossible to quantify, in economic terms, the effect of Brexit on world trade, as there are no good parameters. All the estimates are orders of magnitude. The United Kingdom would move to specialise more. It is wrong to think that the United Kingdom would be like Norway, as the United Kingdom trades more with the rest of the world than with the EU. The United Kingdom is a global player. Had the United Kingdom still had the Empire, it would have had problems; but the point of this in trade terms is the importance of being unimportant. The United Kingdom is small; it does not have a problem selling at world prices. That is the essence. The United Kingdom needs to look after its own interest and to be free to adjust to developments in the light of its individual position. One speaker made the point that statistics are bandied around with gay abandon. For example it had been said that less than half of the United Kingdom's exports go to the EU, but that is partly because overall world trade has increased. Geography is not going to change; the United Kingdom will remain an island State. The biggest export market will continue to be the countries of the EU. If the United Kingdom removes itself from Europe, the problem is that the barriers to export of services are not tariffs—they lie behind the border barriers. That is for example the case with financial services. If the City of London is to remain a major international financial centre (and it is advantageous to Europe for there to continue to exist within Europe the international financial centre that London constitutes) there will need to be

some kind of agreement between the EU and the United Kingdom.

A follow-on from this, Professor Andenas claimed, was that the case made for leaving the EU would apply equally to leaving the WTO and other international agreements. The arguments for leaving, if taken seriously, attack the structure of international trade. Should one really bet ones future on that? The element of risk would be huge. No one country provides an example. The WTO is developing a regime for services, but it is doing so slowly. For the United Kingdom to depend on that WTO system, which is so weak, would be dangerous.

Professor Minford believed that seeing things that way was to see them like a trade lawyer: it was fallacious, as it failed to remember markets. There is no world regime for financial services; the City has sold its services to the world market. The City owes nothing to the WTO. There is no organisation of services, and nonetheless the City is so successful, without any international trade lawyers needing to be involved. However, it was then pointed out that the City is the most highly regulated area of business in the world, and it is regulated by EU regulations.

The meeting was invited to consider the New Zealand model, and the point was made that one ought to be cautious in opting for such a course. There are differences between the United Kingdom and New Zealand. New Zealand is much smaller, with only four million inhabitants; its economy is centred on agriculture and tourism. New Zealand did not leave a customs union; it liberalised and removed tariffs and subsidies. The result was extremely high suicide rates amongst farmers and unemployment en masse. Great social disruptions were the outcome. There are, therefore, many counter-arguments, as reforms might have been done differently. New Zealand has not moved into a world of free trade. Rather it has engaged in other agreements, it is neither a paradise of free trade, nor a country with burdensome tariffs.

Singapore, though small, and Japan were then mentioned by Professor Minford as other possible models. The meeting was asked how Brexit would benefit the average British citizen and the increasing number of people on the margins? The answer given was the United Kingdom would get the benefit of ridding itself of tariffs. The outcome would be then that prices would fall. It must be noted that the idea of any particular country being a 'model' is not the issue; no two countries are the same but the similarities lie in being self-governing, not within an overall super-state. The point is simply that this is quite possible and for the UK would create large net benefits which would no doubt in practice be diluted if it did not adhere totally to the free market model assumed.

The issue of foreign direct investment (FDI) in the United Kingdom was mooted. The United Kingdom is one of the countries that attracts the most FDI in Europe; it is arguable that US businesses invest in the United Kingdom because they get access to the EU internal market—what will be the effect of Brexit on that?

In the model relied on for the case for Brexit, the assumption had been made that if the United Kingdom left the EU it would not subsidise farmers at all. That scenario was described as completely unrealistic. The answer given to that was that if you look back at the history of British farming the common feature had been fiscal transfers.

The question was repeated, Would there or would there not be subsidies for British farmers after Brexit? That remains an open question but it seems likely that help would be provided to UK farmers selectively and via fiscal transfers ('deficient payments') as in the past, which cause very little cost. Finally, two important issues will need to be resolved. First, what, if any, changes negotiated by Mr. Cameron before the holding of the Referendum, will enable the Government to coalesce behind a

recommendation that the United Kingdom should remain a Member State of the European Union? Secondly, when voters cast their votes in the Brexit Referendum, if they vote in favour of exit from the EU, what will be the alternative for which they are, in effect, voting. The Norwegian model costs nearly as much as EU membership, per head, in terms of money transfers by Norway to central EU funds; however, it encompasses almost all aspects of a single market, with the advantages and disadvantages of that position but with no say with regard to the rules that govern that market; and it includes the benefit—and burden—of free movement of persons. Alternatively, how about the Swiss model? It is somewhat more flexible, but in reality not that much different. Moreover, Brussels does not care for the Swiss model either. What is left is, perhaps, some ad hoc arrangement, governing the supply and acquisition of particular goods and/or services. Some have, it was said, confidence in the United Kingdom as trade negotiators, assuming that the United Kingdom will get a good deal; it should be noted that the Minford costing assumes no trade agreements at all, merely the reassertion of world prices in place of EU protected prices. One alternative is that the United Kingdom becomes simply an Unassociated Third Country in relation to the European Union. However, as the EU sells large amounts to the UK unmatched by UK exports to the EU, the EU has most to lose from failing to reach a trade compromise. Those who favour Brexit have yet to express any concluded, let alone unanimous, view about the alternative that they envisage as a result of Brexit. But if the gains are as high as Minford says, there is plenty of scope for deviation in practice from assumed free trade for there still to be substantial gains.

Dr Eirik Bjorge  
*Rapporteur*