Cutting the Gordian Knot

A Roadmap for British Exit from the European Union

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Foreword by SIR MARK WORTHINGTON OBE

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FOREWORD

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On June 23, 2016, the British people took a momentous decision. After 43 years entwined within the ever-centralizing structures of the European Union (EU), they chose to set themselves free.

The dire warnings of the Remain campaign—known as "Project Fear"—foretold emergency budgets, tax rises, higher prices, banking meltdowns, companies abandoning Britain, mass job losses, economic collapse, and even the possibility of war! The establishment apologists for Europe left no hyperbole, no matter how hysterical, unused in their attempts to frighten us. But the British people held their nerve.

Of course, it was only to be expected that in the immediate aftermath of the vote there would be a certain degree of instability. The people may have spoken, but would the politicians listen? Would they try to water down or even block the democratically expressed wish of the electorate? And just how could Brexit be achieved?

Now the Prime Minister has made clear that "Brexit means Brexit." With that certainty established, the markets can begin to readjust to a very different reality. It will be a reality not without its uncomfortable moments. Not everyone will be a winner in the short term. But it is the future that the British people have chosen for themselves, one where they are firmly in control.

In their outstanding paper, reissued and updated here, Iain Murray and Rory Broomfield expose the extent to which decision making in Britain has been supplanted over the decades by the institutions of the European

Union. As a result, they show the limitations we have come to accept on our freedom to legislate and regulate for ourselves and on our inability to operate independently with the wider world.

Murray and Broomfield provide us with a blueprint for what comes next. They examine the options available to those now charged with implementing the democratic mandate. They probe the merits and drawbacks of possible alternative trading models in a meticulous and evenhanded way.

There is no underestimating of the difficulties, but the authors show a real grasp of the fresh challenges and opportunities that are open to Britain. There is no sense of insularity here—more a hopeful and positive view that freed from the EU, Britain has a dynamic and exciting future, one which it now controls for itself.

EXECUTIVE SUMMARY

On June 23, 2016, the people of Great Britain decided to leave the European Union (EU). While the result of the vote plunged the United Kingdom into uncharted waters, it is accepted that there is no turning back and that the UK's government must navigate a course out of the EU. It will need to devise a concrete plan to conclude the Brexit process. This will require three main legal actions.

First, the British government will need to invoke Article 50 of the Treaty of European Union and commence negotiations on the terms of UK withdrawal. This must happen fast, in order to avoid problems with Britain being a signatory to the Vienna Convention on the Law of Treaties, because Article 60 of the Vienna Convention allows for immediate sanctions against a party unilaterally breaching a treaty. While it is plausible that informal negotiations could take place before Article 50 is invoked, that will depend on goodwill on the other side of the table.

Second, the Prime Minister will need to present a bill to Parliament, repealing the various laws that have established the UK's membership of the EU and enabled the incorporation of EU law into UK domestic law.

Third, Parliament should review the body of EU law already incorporated into domestic law to ascertain what can be safely repealed and what should be retained. For this process to go smoothly, the streamlined procedures outlined below should be followed.

The second and third actions can be combined into single repeal bill that establishes a Royal Commission on Regulatory Reduction with special powers to present packages of reforms before Parliament to be considered, using streamlined procedures discussed below.

This paper also examines the most important question relating to the invocation of Article 50 and the start of negotiations: whether the UK should attempt to enter into a relationship with the EU like that of Norway (the "Norway option") within the European Economic Area or like that of Switzerland, a looser version of that relationship ("EEA-lite"), or reject those options and pursue an entirely new arrangement.

Considering one of the major reasons many people voted Leave was a desire to regain control over immigration policy, and that following the paths of Norway or Switzerland would restrict the UK's freedom of action in that regard, an entirely new arrangement, whereby the UK remains open to the world, not just the EU, seems like the best option going forward.

This paper outlines various policy issue areas where special measures will be needed, either in the Article 50 negotiations or via separate legislation. Carried out properly, withdrawal from the EU will enable the UK to pursue a new course of action that will provide significant benefits for its people.

The United Kingdom's government faces some tough choices ahead. It needs to be responsive to its voters, acknowledging their decision to leave the EU and their reasons for doing so, while remaining respectful of those who voted to stay. It also needs to ensure that any negative potential economic consequences of leaving an established economic union are mitigated as soon as possible.

Realistically, the UK cannot remain in the EEA. To do so would be to ignore the reasons why people voted to leave, and could leave to significant domestic strife. Nor would remaining in the EEA provide the liberty to make choices that would really benefit the British economy.

But the consequences of leaving the EEA should not be downplayed. The wrong turn, into an isolationist stance that shuts out the rest of the world, would be disastrous.

That is why Britain must declare it is open for business, with unilateral declarations where appropriate, and trade agreements to be concluded as quickly as practicable with those nations who indicate a willingness to do so. At the time of this writing, these include Australia, Brazil, Canada, China, Ghana, India, Mexico, New Zealand, South Korea, and Switzerland.

Similarly, it must regain control over immigration while not turning its back on the benefits immigration and travel bring to a nation. A market-based immigration system may prove to be the best solution to this problem in the long run.

The suite of policies recommend in this essay share this vision of an open Britain, dedicated to the principle that markets make better use of information than government planners.

Overall, the UK will benefit substantially from a reduction in regulation, a better fisheries management system, a market-based immigration system, a free market in agriculture, a globally focused free trade policy, and a shale gas-based energy policy.

By following this road map after leaving the EU, the UK will have set itself on the road to becoming once again a global economic powerhouse.

INTRODUCTION: BRITAIN AND THE EUROPEAN UNION

In 1946, Winston Churchill, Great Britain's wartime leader, gave a speech in Zurich that called for the creation of "a kind of United States of Europe."[1] The Council of Europe he proposed was created in 1949. It continues to this day. However, the institutions that became the European Union (EU) grew out of a separate body, the European Coal and Steel Community (ECSC), founded by the Treaty of Paris in 1951, which aimed to create a single market in coal and steel.

While Britain was a charter member of the Council of Europe, it was not part of the ECSC, which consisted of Belgium, France, Italy, Luxemburg, the Netherlands, and West Germany. The ECSC assembly of parliamentarians soon began work on an enlargement of their common market into other areas (plans for a single defense policy were vetoed by French President Charles de Gaulle).

That enlargement led to the signing of the Treaty of Rome in 1957 and the creation of the European Economic Community (EEC). Its initial aim was customs union. Agricultural prices were fixed across the EEC with the creation of the Common Agricultural Policy (CAP) in 1962. Border tariffs between the member states were abolished in 1968.

It was the potential of this new, huge, tariff-free market that attracted the UK to apply for membership in 1961, along with Ireland, Denmark, and Norway. President de Gaulle again objected, and the applications were suspended. He explained his thinking in 1967, saying France "would not consent to … any association with Britain, which would mean the destruction of the Europe which they had begun to build—a Europe independent of a monetary, political, and financial system which was foreign to her. In sum, before Britain could hope to become a member of the Community, she must undergo a fundamental and radical transformation."[2] He also said that British membership would be "incompatible with the British tradition of obtaining cheap food from all parts of the world."[3]

While Britain was kept out of the nascent EEC, it joined with Austria, Denmark, Norway, Portugal, Sweden, and Switzerland to form the European Free Trade Association (EFTA), which still exists in a different form today.[4] Unlike the EU, EFTA was not a customs union. Its members retained the power to conduct trade agreements on their own, although EFTA may also conduct joint agreements, such as the one between EFTA and the EU that allows some EFTA states membership of the European Economic Area (EEA). Lacking the full features of a common market, it was viewed as inferior to the EEC by British governments of the 1960s and 1970s.

The European Economic Area, an important issue in any Brexit discussion, is an agreement signed in 1994 between the EU member states and the three EFTA states—Iceland, Lichtenstein, and Norway—to establish an area in which the principles of free movement of goods, people, services, and capital would apply.[5] All new EU member states automatically become members of the EEA, though not all EEA or EFTA members are in the EU. Switzerland, although an EFTA state, declined to join the EEA. Membership is open to all EFTA states. Other European microstates besides Liechtenstein, such as San Marino and Andorra, have considered joining, but there has been little progress on these fronts. The EFTA members of the EEA have agreed to incorporate EU directives into their laws in some areas governed by the European Community, including research and development, education, social policy, the environment, consumer protection, tourism, and culture.[6] They do not enact laws in the areas of Common Agricultural and Fisheries Policies, the customs union, common trade policies, foreign and security policies, justice, and home affairs, or monetary union. However, they are part of the Schengen free movement zone via separate agreements.[7]

Following de Gaulle's resignation of the French presidency in 1969, the membership applications of the four countries came back on track. Although the Norwegian people rejected membership in a popular referendum in 1972, and there were significant debates within Britain on the effects on food prices and the future of the Commonwealth of Nations, Britain, Ireland, and Denmark acceded to the EEC in 1973.

Just as De Gaulle had warned, Britain immediately found herself part of a political and financial system foreign to her, one where the executive, the European Commission, has the sole prerogative of proposing legislation and Parliament has to share control over the budget with other institutions—practices contrary to the Anglo-American conception of separation of powers.[8] Moreover, the European Court of Justice had asserted the supremacy of community law over national law in a judgment in 1964,[9] challenging the British principle of parliamentary sovereignty. Despite some initial disquiet with this system, mostly on the British left, UK membership of the EEC was confirmed by popular referendum—the first of its kind—in 1975.

The EEC continued to expand and evolve. It added Greece, in 1981, and Spain and Portugal, in 1986, as members and worked on expansion of its powers through the Single European Act in 1987. This led to the signing of the Maastricht Treaty in 1991, which absorbed the EEC and some other institutions such as the ECSC into a new body, the European Union with its "three pillars"—the European Community, the Common Foreign and Security Policy, and Justice and Home Affairs. The Commission technically had powers only over the Communities, although under its President, Jacques Delors, it worked assiduously to expand them, while the Council of the European Union (formerly the Council of Ministers) oversaw all three pillars. The European Parliament gained a power of "codecision" with the Council on Community matters.[10] This effectively abolished the national veto on Commission initiatives.

The Treaty of Amsterdam, which entered into force in 1999, enabled the free movement of people across much of the EU. This was followed by enlargements, including the accession of much of Eastern Europe in 2004. An attempt to create a European Constitution, with provisions for formal EU citizenship, foundered on the rocks of national referenda, with France and the Netherlands rejecting it in 2005. However, many of the contents of the Constitutional treaty were adopted in the Treaty of Lisbon, which came into force in 2009. The most important of those provisions is probably the Charter of Fundamental Rights, which expands on the non-EU European Convention on Human Rights, administered by the Council of Europe. The Charter significantly expanded individuals' ability to file rights-based legal claims against national governments, due to its equal status with the EU treaties.[11]

As it stands, the European Union has significant supra-national powers, either in the form of exclusive power (or competence, in the EU's language) or shared power with member states over the following issues:

Exclusive

- Customs union;
- Establishing of the competition rules necessary for the functioning of the internal market;
- Monetary policy for euro zone countries;
- Conservation of marine biological resources under the common fisheries policy;
- Common commercial policy;
- Concluding international agreements, including trade agreements.[12]

Shared

- Internal market;
- Social policy for aspects defined in the Treaty;
- Economic, social, and territorial cohesion;
- Agriculture and fisheries, excluding conservation of marine biological resources;
- Environment;
- Consumer protection;

- Transport;
- Trans-European networks;
- Energy;
- Freedom, security and justice;
- Common safety concerns in public health matters for aspects defined in the Treaty.[13]

The EU's Frequently Asked Questions Web page defines "shared" competence thusly: "Shared competence means that both the EU and its member states may adopt legally binding acts in the area concerned. However, the member states can do so only where the EU has not exercised its competence or has explicitly ceased to do so."[14] In other words, if the EU wants to propose laws in these areas, member states may not do so.

THE BREXIT VOTE
WHAT HAPPENS NEXT?

On June 23, 2016, the people of Great Britain decided to leave the European Union (EU). While the turnout of the vote led to fears of instability at first, the path forward for the United Kingdom out of the EU is clear. Following the vote to leave the EU, the United Kingdom's government will need to devise a concrete plan to conclude the Brexit process. This will require three main legal actions.

First, the British government will need to invoke Article 50 of the Treaty of European Union [see Sidebar] and commence negotiations on the terms of UK withdrawal. This must happen first, in order to avoid

THE EUROPEAN UNION INSTITUTIONS

There are seven Institutions of the European Union.

European Parliament
Elected every five years, the European Parliament acts as a legislative decision body, in conjunction with the Council of the European Union, although members do not have the right to initiate legislation. Instead, legislation is introduced by the executive, the European Commission. The Parliament shares budgetary power with the Council, approves Commission membership, and may dismiss the Commission *en bloc* (although the one time this was threatened, the Commission resigned before dismissal).[15] Based in both Brussels and Strasbourg, it maintains facilities in both cities.

European Council
Summit body of the heads of government of all member states, it sets EU direction and strategy, but has no legislative powers. Not to be confused with the Council of the European Union or the non-EU Council of Europe.

Council of the European Union
Formerly the Council of Ministers from each member state, it shares legislative decision and budgetary power with the European Parliament, but has no right to initiate legislation. It sets policy on common defense and security matters and concludes international agreements. Not to be confused with the European Council or the non-EU Council of Europe.

European Commission
Comprised of 28 Commissioners—one per member state—nominated by the member state governments but bound by office to represent the EU. While it acts as the executive power, it has the sole right to initiate legislation. Based in Brussels, it administers the budget, implements and enforces policy (including bringing lawsuits against member states and private bodies), and negotiates international agreements on behalf of the Council of the European Union.

THE EUROPEAN UNION INSTITUTIONS continued

Court of Justice of the European Union
The EU's judiciary branch. Based in Luxemburg, it ensures that EU law is applied uniformly across the Union, adjudicates disputes between member states as well as private disputes, and has the power to overrule national parliaments in certain areas. Not to be confused with the non-EU European Court of Human Rights.

European Central Bank
Sets monetary policy for the euro zone and works with national central banks. Based in Frankfurt, its primary objective is price stability.

European Court of Auditors
Based in Luxemburg, it audits the finances of the European Union and its institutions, and has signed off on the accounts every year from 2007 to 2015.

problems with Britain being a signatory to the Vienna Convention on the Law of Treaties, because Article 60 of the Vienna Convention allows for immediate sanctions against a party unilaterally breaching a treaty.[16] While it is plausible that informal negotiations could take place before Article 50 is invoked, that will depend on goodwill on the other side of the table.

Second, the Prime Minister will need to present a bill to Parliament, repealing the various laws that have established the UK's membership of the EU and enabled the incorporation of EU law into UK domestic law.

Third, Parliament should review the body of EU law already incorporated into domestic law to ascertain what can be safely repealed and what

ARTICLE 50

Article 50 of the Treaties on European Union states:

> 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. … 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.[17]

Article 50 has never been tested. As a result, there is considerable uncertainty over how it will apply. The EU's executive body, the European Commission, has no formal role in the process.[18] Negotiations are conducted by the European Council (the "Senate" of member states) after obtaining the consent of the European Parliament. The Parliament in turn could theoretically refuse to grant consent to the UK's withdrawal negotiations, leading to the UK being kicked out and the possibility of EEA membership and other association options becoming moot.

Why might the European Parliament withhold its consent? It has already received advice that any form of "partial withdrawal" would require a treaty change rather than the Article 50 process.[19] So if it looked like the UK were approaching negotiations with just such a "partial withdrawal" in mind—in essence, what the European Parliament Research Service called "a new type of à la carte EU membership for the state concerned"—then the Parliament might dig in its heels and demand treaty change instead.[20] This is not an unlikely scenario, given the concerns in Brussels about the UK wanting to have its cake and eat it within the European Parliament.

ARTICLE 50 continued

Assuming the Parliament grants consent, the negotiations will need to be conducted in light of the fact that Article 50 assumes the "end of the application of the Treaties and the Protocols thereto in the state concerned from that point on."[21] Therefore, Article 50 negotiations will need to cover such things as the phasing out of various EU programs, such as the diverse forms of EU financial aid. Other topics of discussion likely will include transitional arrangements for trade with third parties covered by EU agreements and the future of the UK's trade arrangements with the EU itself. However, the most important aspect of the negotiation for many people will be the status of UK and EU citizens resident in the others' jurisdiction.

Under Article 50, if no agreement on these matters is reached by the end of a period of two years after the invocation of the article (which can be extended), then the UK will simply cease to be a member of the EU and could be considered to have been kicked out, with no special arrangements for its future relationship.

should be retained. For this process to go smoothly, the streamlined procedures outlined below should be followed.

The second and third actions can be combined into single repeal bill that establishes a Royal Commission on Regulatory Reduction with special powers to present packages of reforms before Parliament to be considered using streamlined procedures discussed below.

This paper also examines the most important question relating to the invocation of Article 50 and the start of negotiations: whether the UK should attempt to enter into a relationship with the EU like that of Norway (the "Norway option") within the European Economic Area or like that of Switzerland, a looser version of that relationship ("EEA-lite"), or reject those options and pursue an entirely new arrangement. It outlines various policy issue areas where special measures will be needed, either in the Article 50 negotiations or via separate legislation. Carried out properly, withdrawal from the EU will enable the UK to pursue a new course of action that will provide significant benefits for its people.

While this paper attempts to quantify costs and benefits where possible, we must emphasize that this is a highly speculative exercise. In each case, we estimate the relative costs and benefits and rank them along three categories:

- **High:** a significant cost or contribution to the nation's economy that would need to be accounted for in extraordinary ways, either by additional appropriations measures or enabling significant savings to government, such as tax cuts or closing down agencies;
- **Medium:** a cost that would require some adjustment to the ordinary way of doing things or a benefit that would enable savings within a department or such like; or
- **Low:** no appreciable disruption or benefit to the economy or government.

ARTICLE 50 NEGOTIATIONS AND THE NORWAY/ EEA-LITE OPTIONS

The first question British policy makers need to answer is what the UK should set as its negotiating goal. The country faces three main options:

The European Parliament is unique among developed world legislatures in that it cannot initiate legislation.

- Reenter the European Free Trade Area alongside Norway, Iceland, and Liechtenstein;
- Negotiate a deal within the European Economic Area (EEA), similar to that of Switzerland (also a member of EFTA, but with different arrangements discussed below); or
- Leave the EEA entirely and negotiate with the EU as a sovereign entity outside the EEA.

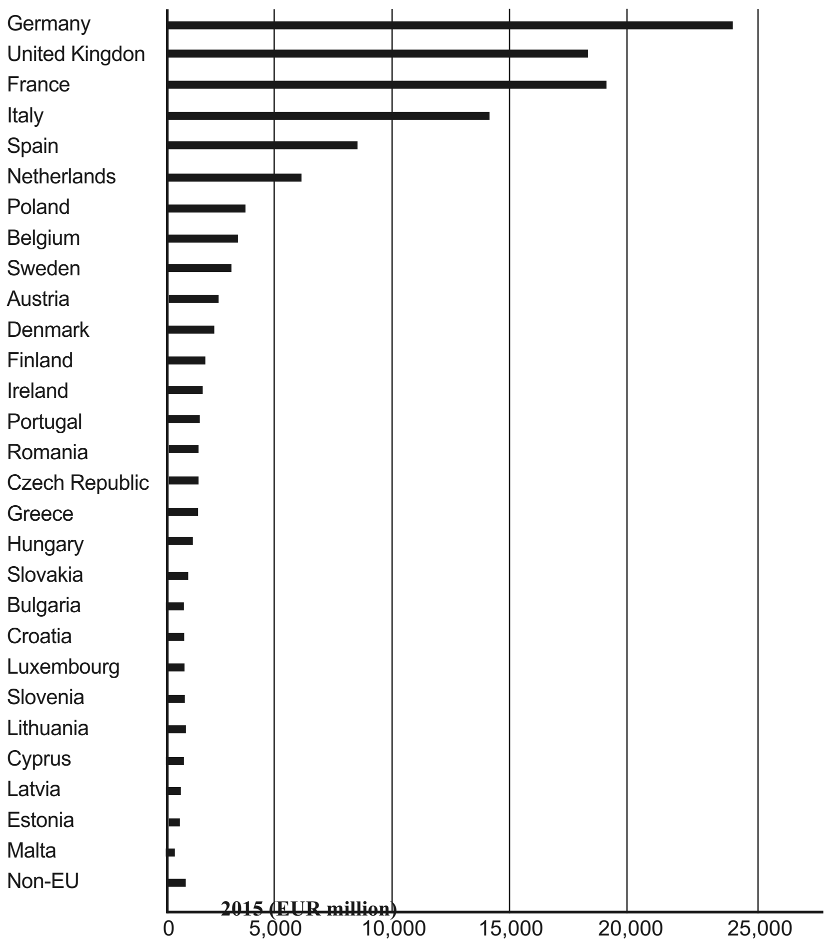
The EEA/EFTA route is unattractive, and would do little to solve the three main reasons for leaving the EU: its democratic deficit, its cost, and its stranglehold over immigration policy.

One of the strongest cases against the EU's governing structure is the "democratic deficit"—the term commonly used to describe the unrepresentative nature of EU decision making. The European Parliament is unique among developed world legislatures in that it cannot initiate legislation. Instead, that lawmaking role falls to the EU's executive branch, the European Commission. [See sidebar] As a result, the Commission—an unelected clique of technocrats—makes policy decisions remotely from the people whom the Members of the European Parliament are supposed to represent. There has been repeated popular discontent across Europe over this problem, from the movement of the "metric martyrs" in Britain, who resented the imposition of a metric measurement-only system on British merchants, to the French rejection of the European Constitution treaty in a referendum in 2005.

This would remain the case if Britain were to enter the EEA/EFTA, but made slightly worse. The laws that govern the functioning of the EEA would still be taken by the same clique in Brussels, only without British input. Whatever little democratic input UK citizens had in the process would be lost. In this respect, the Europhile argument about "having a seat at the table" is true, even if the seat plays a small role. Since the Brexit vote, the Commission has resurrected the idea of a much more interventionist set of policies on "the European pillar of social rights," mostly related to employment regulation.[22] Britain had managed to forestall these policies as a member of the EU, but would be unable to do so as a mere EEA member. While the initial proposal is to apply these initiatives first to the euro zone, it is likely that they will eventually become part of the EU's settled set of laws, known as the *acquis communitaire*, and may in turn become part of the EEA's requirements.

Second, the cost would remain high. EFTA nations are expected to contribute to the EU operational budget according to the relative size of their economies. Their contributions comprised 3 percent of the total EU operations budget in 2015,[23] and pay an extra amount into the administrative budget, negotiated each year for each EU program in which they participate.[24] As Figure 1 shows, the larger economies constitute a significant portion of contributions to the EU budget. As the UK makes up a significant part of the EU/EEA's economy, at 17.5 percent in 2015, its contribution would still rank high on the list.[25]

Figure 1. Contributions to EU Budget



There would be a significant savings to the cost of direct contributions to the EU budget, from some £13 billion[26] ($17 billion using current market exchange rates) down to £2.8 billion (about $3.6 billion) per year, which would place it 10th on the EU list or at about the same level of contributions as Austria.[27] However, those savings would be dwarfed by the significant regulatory burden on the UK economy, which would mean that the savings could amount to as little as 1.6 percent of the total cost of the EU to the UK.

Finally, regaining control of immigration flows was a large part of the argument for leaving the EU, and was influential on many voters' decision to vote Leave. EFTA membership incorporates the principle of free movement of labor within the EEA, which makes it incompatible with the referendum result and therefore politically problematic.

Others have proposed an "EEA-lite" deal, whereby the UK negotiates membership of the EEA on its own terms, similar to that of Switzerland. However, the three arguments above still apply. On February 9, 2014, Switzerland voted by referendum to impose immigration controls on EU citizens. The EU reacted badly to the Swiss decision. According to the *Irish Times*, the EU Commission's reaction to the vote was, "This goes against the principle of free movement of persons between the EU and Switzerland. The EU will examine the implications of this initiative on EU-Swiss relations as a whole."[28] As the newspaper went on to note, "The introduction of quotas on EU immigrants violates existing treaties between Switzerland and the EU" and that, as a result, "focus will turn to what changes the EU will demand in a renegotiated treaty, with many believing it will not tolerate challenges to its free movement laws." This sentiment has certainly been witnessed since the Brexit vote. As the article correctly predicted: "[W]ith anti-immigration feeling on the rise throughout Europe and expected to play a central role in May's European elections, Brussels is also likely to want to take a strong stance on the issue."[29]

A similar reaction can be expected if the UK were to try to renegotiate terms of membership of the EEA. One can imagine what Brussels's reaction would be—"You're either in the club or you're not." This sentiment was illustrated on the day after the Leave vote when Manfred Weber, Chairman of the European People's Party—the largest grouping in the European Parliament—said: "Exit negotiations should be concluded within two years at max. There cannot be any special treatment. Leave means leave."[30] Further, senior EU officials have suggested the bilateral deals governing the Swiss relationship with Europe are "complex, unwieldy to manage," and "have clearly reached their limits."[31] This understanding, given the current issues of the refugee crisis, the euro zone, and now Brexit, has led to the presidents of the European Council, Commission, and Parliament—Donald Tusk, Jean-Claude Juncker, and Martin Schulz, respectively—and the current President of the EU's rotating presidency, Mark Rutte, to say that any delay to the UK's exit would "unnecessarily prolong uncertainty."[32] All this indicates there is little appetite within the EU for another probably far more complex series of arrangements governing access to the EEA on the UK's terms.

Some have pointed out that the EEA is a less risky option in terms of the others available. "The Leave Alliance" argues that joining the EEA and adopting the plan authored by Dr. Richard North, known as *Flexcit*, would allow the UK to start the process of freeing itself from the EU with minimal disruption.[33] The argument goes that the EEA option would allow for single market access in a way that would reassure the business community against instability.

Such arguments might be strengthened by the Lord Ashcroft survey published after the vote, which suggested that 43 percent of those who voted to remain in the EU did so because "the risks of voting to leave the EU looked too great when it came to things like the economy, jobs and prices."[34] However, single market access does not necessarily require EEA membership. The EU has 42 different trade deals with countries from Mexico to South Korea to South Africa, and is willing to negotiate based on a case-by-case basis.[35] Thus, the UK would be in a strong position to negotiate its own deal with the EU. Indeed, given the size of the UK economy and the current annual trade deficit with the EU of £63 billion ($82 billion), it would be in a stronger position to negotiate compared with many others with current FTAs with the EU. If a deal were done before the Transatlantic Trade and Investment Partnership (TTIP), it would be the EU's largest trade agreement with an outside nation. And, unlike the trade deals with Mexico and others, the UK already has all the necessary rules in place needed to trade with the EU.[36]

Others, such as Roland Smith[37] and the Adam Smith Institute (ASI),[38] argue that the UK would benefit from EEA membership as it would allow for the UK to retain access to the single market while having an "emergency brake" on immigration. However, the "Norway / Switzerland option" still appears too restrictive as a tool for devising immigration policy. Despite there being potential "safeguards measures" of articles 112 and 113 of the EEA agreement, these articles have conditions.[39] Further, given the approach taken by EU officials after the vote, and considering the reasons why people voted Leave, the implementation of a "Liechtenstein protocol" by the UK, whereby EEA arrangements are guaranteed but free movement of people is suspended, seems ambitious.

Smith, the ASI, and others argue that the EEA would be an interim position at the start of a longer journey. However, this is also optimistic. Given the EU's desire to ensure other member states remain part of the club, it is less likely that the EU would grant any favors to the UK within the EEA but outside the EU, as Brussels seeks to "avoid a chain reaction" of other countries rushing for the exits.[40]

In fact, the European Parliament's own advice on this subject was dismissive of these two options: "Grossly speaking, following the first one (of the 'EEA' or 'Switzerland' kind), the UK would become a kind of a 'satellite' of the EU, obliged to transpose into its law all EU regulations and directives for the single market."[41] Its other advice, that UK entry into the EEA would require treaty change rather than Article 50, seems also to argue against EEA membership as being the easy option envisaged by its supporters. A new treaty could open the floodgates to all sorts of grievances from other nations, and so would be unattractive to the European Institutions.

Therefore, the UK should reject joining the EEA. Instead, its negotiating position should be that of a sovereign country negotiating a free trade agreement. As noted, the EU has free trade deals with 42 countries and is concluding one with the United States. Therefore, it is plausible for the EU to successfully conclude such a deal with the UK and thereby retain access to the large UK market. Moreover, any increased costs associated with a UK-EU trade deal could be mitigated by the UK becoming a leader in other free trade agreements. Some major economies have already expressed willingness to conclude trade agreements with the UK, including Australia, India, and South Korea.[42]

Some major economies have already expressed willingness to conclude trade agreements with the UK, including Australia, India, and South Korea.

This position was taken by the Vote Leave campaign in the EU referendum, in a framework outlined before the vote:

1) A negotiation strategy for the informal talks that will precede the formal negotiations leading to a new UK-EU treaty,
2) Immediate legislation in the current session of Parliament and,
3) A framework for legislation and policy decisions between 2016 and 2020 of which the centerpiece is the repeal by 2020 of the European Communities Act 1972 (ECA). We can also start negotiating new trade deals to promote free trade before we have left the EU.

Vote Leave's proposal of introducing a free trade bill that restores the UK government's control over its own trade policy is a sensible step in the right direction (subject to the limitations of the Vienna Convention). While there would be transitional costs, the benefits of becoming a leader in the free trade movement would outweigh these in the long run. The UK should take this once-in-a-generation opportunity to regain its sovereignty while keeping economic benefits of zero-tariffs with the EU's Single Market and embracing global opportunities. It should invoke Article 50 on those terms.

EUROPEAN COMMUNITIES ACT REPEAL BILL

The first title of the legislation to be presented in Parliament can be simple. All that is required is a clause stating, "The European Communities Act (1972) is repealed."

The bill's second title should be more complex. Regulation has become a major burden on the UK economy and a major source of that regulation

Costs of UK Membership of the EU (2005)

Area of Cost	Cost as % of GDP
Net UK cash contribution	0.4
Costs of Common Agricultural Policy	0.3
EU protection of manufacturing	2.5-3
Regulations	6-25
Bail-out transfers	2-9
Total Costs	11.2-37.7

Source: Minford, Harambe, and Nowell (2005), p.14

is the requirements of the European Commission. Patrick Minford, Vidya Mahambare, and Eric Nowell of Cardiff University found in 2005 that the cost of "harmonization" (as they then termed EU regulation) was between 6 and 25 percent of GDP.[43]

Therefore, EU regulation might be costing the British economy somewhere between £132 billion ($171 billion) and £555 billion ($712 billion) a year—or £5,000 ($6,500) to £22,000 ($33,000) per household. As the typical British family has a disposable annual income of just £16,000 ($21,000), reducing that regulatory should be an economic necessity.

The top 100 EU regulations in terms of cost deplete the UK economy by £33.3 billion ($43 billion) a year.

Open Europe, a think tank based in London and Brussels, finds that the top 100 EU regulations in terms of cost deplete the UK economy by £33.3 billion ($43 billion) a year in 2014 prices, and that the costs outweigh the benefits in a quarter of the cases. Moreover, the benefits claimed are often clearly overestimates. As Open Europe points out: "[T]he stated benefit of the EU's climate targets (£20.8bn) was dependent on a global deal to reduce carbon emissions that was never struck. In fact, Open Europe estimates that up to 95 percent of the benefits envisaged in the impact assessment have failed to materialise."[44]

Of course, not all regulations are subject to the same inflated benefit analyses as climate regulations, but let us take Open Europe's assessment of the cost of the regulations and the potential feasible savings from UK-specific deregulation as a guide. They now estimate that feasible cost savings for these top 100 regulations amount to £13 billion ($17.1 billion) and that a truly deregulatory government could up those savings to £24 billion ($31.6 billion) annually.[45] At savings of 40 percent to 72 percent, these represent a truly significant saving to the UK economy and households.

EU regulation now affects virtually every area of business in the UK, and UK business has adapted to bear the costs in the most efficient way possible. Withdrawing from the European Union will allow the UK to address this burden by abolishing regulations that add cost but few benefits. At the same time, it would be wrong for the UK to revert to the regulatory *status quo ante* of 1972, which was a major factor behind the economic stagnation of the 1970s.

Given that regulations carry the force of law, it should be up to Parliament to debate the appropriateness of each regulation. However, the sheer volume of regulations concerned makes this impractical. Between 1998 and 2004, Germany incorporated 750 directives and 18,187 EU regulations into its legal code.[46] Parliament would be incapable of giving enough weight to the consideration of each regulation to allow for a thorough examination of whether to abolish it, keep it in place, or amend it.

Accordingly, we recommend establishing a Royal Commission on Regulatory Reduction. This commission would be modeled on the successful Bases Realignment and Closure Commission (BRAC) in the United States, established in 1988 and given special legal standing by Congress in the Defense Base Realignment and Closure Act of 1990.

The BRAC has nine commissioners, appointed by the President, who examine the prospect for closing or realigning military bases, free from the pressure of lobbying by Members of Congress eager to keep military bases open in their districts. The commission presents a package of recommendations to Congress to be voted up or down without possibility of amendment. The process has worked successfully, with packages approved in 1988, 1991, 1993, 1995, and 2005.[47] Pentagon officials have asked Congress for another BRAC round soon.[48]

The principle enjoys bipartisan support in the U.S. Sen. Phil Gramm (R-TX) proposed the idea of using the model to reduce regulation,[49] while the liberal Progressive Policy Institute has endorsed a similar idea.[50]

The Royal Commission on Regulatory Reduction would review existing regulations incorporated into law pursuant to the European Communities Act and hold public hearings on their effect. It would also be bound by its terms of reference to consider when regulations had been "gold-plated"—going beyond the original EU intent for UK purposes—and provide recommendations on dealing with those.[51] While gold plating has declined in practice, by the government's reckoning, many gold-plated rules remain on the books.[52] Following review, the Commission would propose an annual package of regulatory revisions to be voted on without amendment by Parliament no later than September 30 (the dates used here are illustrative only of the time scale we consider necessary for due deliberation).

Each government department would transmit recommendations for regulations to repeal or modify to the Commission by April 15.[53] After receiving the departments' recommendations, the Commission shall solicit testimony, conduct public hearings, and submit its recommendations to the Prime Minister by August 15. Recommendations would normally take the form of a package of statutory instruments, subject to the normal negative resolution procedure. Where changes to the regulation concerned are subject to affirmative resolution, or the Royal Commission recommends repeal of primary legislation, the Prime Minister shall refer that recommendation to the appropriate government department for action.

Finally, the Act should amend the Regulatory Reform Act 2001 to ensure that Regulatory Reform Orders under the auspices of that Act can be introduced by recommendation of the Royal Commission, so that Select Committees of the House are not duplicating the work of the Commission.

The Commission would be chaired by a current or former Justice of the Supreme Court of the United Kingdom, nominated by the Prime Minister, and six other members—three chosen by the Prime Minister from each of two lists of 10 candidates, one provided by the governing party, the other by the opposition. Membership of the Royal Commission below the chairman should be term-limited, with each member serving for no longer than two calendar years.

Meetings of the Commission should be open to the public, except where classified information is discussed. All proceedings, deliberations, and information should be open to the Chairmen of Committees of Parliament.

The Chairman of the Commission would appoint a Secretary to the Committee who should be a current of former member of the Senior Civil Service, preferably of Deputy Secretary grade or higher, to assemble a staff drawn from government departments or within a budget agreed with the chairman. In order to constrain costs, the Commission's expenses could be paid for by a prorated budget transfer from government departments according to the amount of EU regulation they oversee.

As CEI's Wayne Crews—a former staffer for Sen. Gramm—has noted regarding the regulatory reform commission process:

> The filtering process of holding hearings combined with the bundling of regulations from across the spectrum of government activity would make the Commission's recommendations more difficult to oppose politically compared with alternatives. As in the base closure model, everybody stands a good chance of getting "hit," thus the bundling provides political cover.[54]

The Royal Commission will probably need several years to conclude its work. The departments with the most onerous body of regulation should be first in the queue.[55]

The costs of a Commission will be low, especially if it is paid for and largely staffed out of existing departmental budgets. The benefits are potentially high. If just a quarter of existing EU regulation is abolished or rolled back as a result of the Commission's work (a lower proportion than the amount Open Europe regards as feasible for the top 100 regulations), the benefit to the UK economy will be an annual saving of £33 billion ($43 billion) to £140 billion ($182 billion), or £1,220 ($1,590) to £5,200 ($6,760) per household. Over 20 years, this will represent between half a trillion and two trillion pounds in savings.

FISHERIES AND TERRITORIAL WATERS

Upon withdrawal from the European Union, British territorial waters will revert exclusively to the UK, and the EU's Common Fisheries Policy will no longer be in effect. The UK should reestablish control over these waters quickly, as this likely will be a particularly contentious element of the Article 50 negotiations. While the British fishing fleet is still quite large by European standards, it is a shadow of its former self. The fishing fleet based in the port town of Grimsby has been reduced in size from 400 vessels in 1970 to just five today (although much of this is as a result of disputes with Iceland).[56] The Grimsby fish market sold 18,000 metric tons of fresh fish in 2012, of which 13,000 tons originated in Icelandic waters.[57]

Given the perilous state of many fisheries—with about 30 percent of fish stocks outside sustainable limits—it will be important to institute a workable fisheries management regime that can help these fish stocks, and the fishing industries they support, fully recover. Cod stocks in particular are at critical levels, according to the Marine Management Organization.[58]

Environmental groups, marine biologists, and free market economists all agree that one of the prime causes of the parlous state of EU fisheries in general is the Common Fisheries Policy (CFP). The CFP actively encouraged a "tragedy of the commons" by mandating "equal access to a common resource."[59] The CFP encourages overfishing, high rates of bycatches—unwanted fish and other marine animals caught during commercial fishing for different species—and discards, and allows for subsidization of fishing fleets.[60] (While there has been some recent reform of this program that went into effect on January 1, 2014, it is far too early to say how beneficial these reforms will be in the long run.)

As the UK territorial waters contain a large amount of fish, most of which is not currently landed by UK fishermen, there will be considerable interest in the fisheries management regime that will be established following withdrawal from the CFP.[61] It provides an opportunity to rebalance industry considerations and environmental quality, in order to allow the best possible management of fisheries to enable sustainable and profitable use by the industry.

Under prevailing international law, a UK independent of the EU will have three areas of responsibility for marine resources.

1. Exclusive use of an area up to 12 miles from the coast;
2. An exclusive economic zone (EEZ) governing use of resources up to 200 miles from the coast, depending on other nations' maritime borders; and
3. High seas jurisdiction for its own vessels and freedom to fish in the high seas according to international commitments.

A property rights-based fisheries management system is preferable to any of the other solutions for fisheries management within the EEZ. It provides the best incentives possible to proper stewardship and conservation of the system while avoiding the problems that plague politically-managed systems—a phenomenon well explained by economists of the public choice school. However, a property rights system

Failure to define property rights generally results in what ecologist Garret Hardin termed "the Tragedy of the Commons.

must have certain features to work. Case Western Reserve University law professor Jonathan Adler describes them thus:

> For incentives to work, the property right to a resource must be definable, defendable, and divestible. … Even someone indifferent or hostile to environmental protection has an incentive to take environmental concerns into account, because despoiling the resource may reduce its value in the eyes of potential buyers.[62]

The effectiveness of private property rights in promoting good stewardship is only as strong as the weakest element of that "bundle" of rights. For example, if individuals are barred from selling their fishing rights, they will have less incentive to preserve the value of those rights by not overexploiting the resource. If they decide to leave the business and no longer intend on harvesting the resource, they may have an incentive to deplete it. Similarly, if bureaucrats can take away the property right at any time, the right will be less valuable and the attendant incentives for conservation will be diminished.

Failure to define property rights generally results in what ecologist Garret Hardin termed "the Tragedy of the Commons."[63] A tragedy of the commons occurs when no one has any incentive not to deplete a common resource, in the expectation that someone else will deplete it first. This has been the source of the problems that bedeviled the CFP.

In the modern context of commercial fishing, the best way forward is for the UK government to create fisheries access rights similar to private property rights. The most effective solution to date has been New Zealand's Individual Transferrable Quota (ITQ) system, which has resulted in the speedy turnaround in the health of that country's fishing stock.

New Zealand's Individual Transferable Quota System. Individual Transferable Quota systems cap a country or region's total allowable catch (TAC) and guarantee fishers a share or quota, often as a percentage of the TAC. Once the initial allocation is made, fishing rights take on the features of property rights. They may be exploited to the degree allowed by the quota, and may be leased, sold, or transferred to other fishers. Since the shares are owned in perpetuity, fishers have a strong incentive to harvest as many as possible in accordance with the quota without depleting the fish stock. Owners of the most efficient fishing vessels have an incentive to buy quotas from those with older, less efficient vessels, thus reducing the total number of vessels in the long run.

Given the novelty of this form of property right, owners of ITQs are likely to be sensitive to the prevailing regulatory climate. Therefore, in order to maximize the environmental advantages of the system, the government should set up an ITQ market carefully and avoid taxing or interfering with these new property rights.

New Zealand's ITQ arrangement, the most extensive in operation, developed considerably over time. It makes for a useful case study, as

The New Zealand ITQ system behaves as a functioning market should.

it illustrates some of the pitfalls that must be avoided in any effort to introduce private property rights into fishing markets.

New Zealand, beginning in 1960, subsidized the development of fisheries, with the result that stocks were severely depleted by the time the Fisheries Act was passed in 1983. Tradable quotas were created in 1986, but these were only valid for 10 years, and were measured in tonnage, which meant that the Fisheries Ministry had to buy back excess tonnage whenever the TAC was lowered. Also, the fact that the quotas were only good for 10 years reduced their value as a property right. In 1990, the quota was changed from a measure of tonnage to percentage of TAC.[64]

In 1994, the government scrapped both the quotas' 10-year expiration—transforming them into perpetual rights—and levied significant taxes on the quotas. Although fishers technically have a right only to access the fish rather than a right to the fish themselves, their access rights are property rights for all intents and purposes, analogous to the riparian rights of property owners under the common law.[65] Owing to rights guaranteed to native Maori populations under the Treaty of Waitangi (1840), these property rights have a strong element of constitutional protection—hence their grant in perpetuity.[66]

The New Zealand ITQ system behaves as a functioning market should, as confirmed by a 2002 analysis by Motu, a New Zealand-based think tank.[67] The Motu study finds that the markets for quotas are very active, "with more than 120,000 leases and 30,000 sales of quotas as of the end of the 1998 fishing year—an annual average of about 8,700 leases and 2,000."[68] These reforms led to an increase in transactions: "[T]he total number of leases has risen…from 2,000 in 1986 to 14,500 in 1998."[69] Moreover, the study found that:

> [T]he value of fish is positively associated with quota prices, as evident by the result that the elasticity of the quota type with respect to the fish export price is positive and statistically significant in both lease and sale price equations. … Controlling for other factors, there is evidence of increased profitability of the included fisheries since the establishment of the ITQ system.[70]

In a 2008 study published in *Science*, researchers Christopher Costello, Steven Gaines, and John Lynham investigated the effects of all 121 fisheries around the world where ITQs and other catch share schemes exist, comparing them to the 11,000 fisheries without property rights and controlling for confounding factors such as fish species and ecosystem characteristics. They found that the existence of catch share rights not only precluded fishery collapse, but as in New Zealand, often helped reverse preexisting collapse.[71]

Moreover, the authors found that if catch shares had been instituted globally from 1970, the incidence of fishery collapse would have been reduced by two-thirds. Fish stocks would be rising rather than falling. The evidence is clear: ITQs represent the best basis for management of the UK's sovereign fisheries.

Other considerations that need to be established by the management council include:

- A rapid and responsive data collection system;
- A system for the registration of vessels, skippers, and crew;
- A ban on discards—any fish caught that belong to commercial species should be landed;
- Conservation arrangements including permanent and temporary closures;
- A ban on industrial fishing and other damaging fishing methods; and
- A prohibition of fishing or vessel subsidies.

Such a system will enable the successor to the CFP to be responsive to the needs of the UK economy, the fishing industry, and the ecology as a whole.

One final consideration is the management of fish stocks that straddle EU boundaries, such as with Belgium or Denmark. The Article 50 negotiations will need to set up temporary Joint Management agreements based on the "relative stability" allocations of the 1983 agreements to introduce the Common Fisheries Policy that were based on historic practice.[72] The example of a UK ITQ system is likely to prove attractive to environmental groups in the EU and lead to pressure for adoption of a similar system—most environmental groups strongly support catch share systems—and therefore in the long run to the possibility for ITQ-based joint management systems.

The costs of setting up and running an ITQ system can be substantial, but experience in Iceland and New Zealand suggests these costs are considerably lower than the current management costs incurred by the UK.[73] Moreover, research suggests that an optimal ITQ system has the management costs borne by the industry rather than the public.[74] The "cost" to the public purse should be positive in present value terms. Benefits are hard to quantify, but for comparative purposes, the introduction of ITQs in Chile is estimated to have provided $166 million in benefits from 2001-2020.[75] Therefore, one can safely assume that the introduction of ITQs in British sovereign waters will be beneficial to the UK economy as a whole.

TRADE

The United Kingdom has long been a champion of free trade. This position has brought enormous benefits to the UK in the form of increased wealth and innovation and enhanced human welfare. Indeed, free trade's benefits to the working man were recognized by both the Chartists and the British Labour Party, which adopted free trade as its policy in 1904 and clung to it against Conservative opposition for almost half a century. As Oxford economic historian Kevin O'Rourke has noted:

> Economists have shown that this view was correct: the move to free trade, and the globalization of the late 19th century economy, all benefited British labour greatly. … [A]lmost one half of the total real wage gains recorded in Britain in the late 19th century can be attributed to the impact of international

transport cost declines, and the cheap food which they gave rise to.[76]

Therefore, those concerned about the EU's effects on wages should be buoyed by the prospect of the UK becoming once again a champion of free trade, which it would be able to do once freed from the EU's customs union. UK trade policy should aim at eliminating both tariff and non-tariff barriers with its largest trading partners in the post-EU world. It should also consider alternative arrangements for trade associations that would advance the principle of free trade rather than encourage setting up large trade-management bureaucracies or Balkanizing the world into trading blocs.

UK trade policy should aim at eliminating both tariff and non-tariff barriers with its largest trading partners

Eliminating Tariff Barriers. The United States remains the UK's largest non-EU trading partner in terms of both exports and imports, and existing U.S.-EU tariffs remain a burden on both economies. Getting rid of tariffs on both sides of the Atlantic would increase EU exports to the U.S. by up to $69 billion, while U.S. exports to the EU could increase by up to $53 billion. There would be substantial gains in both economies. The EU's GDP could rise from $58 billion to $85 billion, while that of the U.S. could increase from $59 billion to $82 billion.[77]

On a per capita basis, with a population of 62 million out of the EU's 503 million citizens, many of these benefits would accrue to the UK — in the form of at least $3 billion in increased GDP. However, given the

UK's historic trading links with the U.S., the UK can be expected to gain disproportionately compared with Europe as a whole from a relaxation in tariffs between the U.S. and UK.

In a free-trade lesson the UK could learn from, in November 2011 Canada announced that, to help spur the economy, it was eliminating tariffs on imports used by Canadian manufacturers.[78] Tariffs would be cut on about 70 items, the latest in government moves to get rid of all tariffs by 2015. Canada already has abolished tariffs on more than 1,800 items—relief that added about US $423 million annually to its economy.[79] A 2014 study by the Canadian Council of Chief Executives found that unilateral elimination of all tariff barriers would decrease Canadian government revenue by C$4 billion (US$3 billion) but would increase Canadian GDP by C$20 billion (US$15 billion).[80]

Trade agreements should consider trade barriers' impact not only on producers, but also on consumers. Tariffs on imports are in reality added taxes on the foreign goods and services purchased by consumers and businesses. Consumers benefit from imports that reduce prices, increase choices, and provide new technological advances. Eliminating tariffs can provide major "tax cuts" that can help stimulate the economy. Therefore, they should be the focus of any trade deal the UK cuts in a post-Brexit world.

Non-Tariff Trade Barriers. The reduction of non-tariff barriers should also be a priority in any post-Brexit trade deals. Even as tariff barriers to trade have been reduced, non-tariff trade barriers have increased. These barriers can take many forms, including restrictions on food products

Protectionism costs the EU 6 to 7 percent of its GDP annually.

based on their method of production, laws promoting cultural practices, and costly regulatory regimes. The World Trade Organization, for instance, has recognized that sanitary measures that go well beyond what is needed for health and safety can constitute unwarranted barriers to trade.[81]

The EU has proven more willing to introduce such barriers than other countries or trade blocs, and it is certainly plausible that the UK, absent EU trade competence, would be less likely to indulge in such trade barriers than the EU as a whole. For instance, the UK's entertainment industry has much more in common with Hollywood than it does with continental filmmaking. The UK has historically sourced food from countries such as New Zealand that have high food safety standards but less restrictive sanitary regulations than the EU.

Such protectionism is expensive to the EU. According to French economist Patrick Messerlin, protectionism costs the EU 6 to 7 percent of its GDP annually.[82] Kristian Niemietz of the Institute of Economic Affairs has calculated that EU food prices are 17 percent higher than they would be under free market conditions owing to the presence of EU agricultural regulations.[83]

One approach to reducing non-tariff barriers is to apply the principle of regulatory equivalence, whereby two or more parties mutually recognize each other's standards. However, regulatory equivalence can take two very different forms—harmonization and competition.

Under harmonization, regulators attempt to reach common standards applicable in both nations. From being initially equivalent but different in detail, the two regulatory regimes grow more similar. This is the approach currently taken by several global regulators of financial services. The problem is that such harmonization can turn into stagnation, as superior alternatives are not explored for fear of upsetting the applecart. Such stagnant regimes are more vulnerable to economic shocks and disruptions.

Under regulatory competition, regulators allow a discovery process to occur that allows for comparison of the relative merits of different approaches. That comparison incentivizes the adoption of more streamlined, less burdensome regulatory regimes that reduce transaction costs and allow for greater wealth creation.

As CEI's Fran Smith told the U.S. Trade Representative when the idea of a U.S.-EU trade agreement was first floated,

> Providing companies with a choice of regulatory regimes often works better than a single uniform regulatory structure or a harmonized system. Centralized regulators can suffer from limited information and pressures from special interest groups. Dispersed regulatory structures can satisfy different preferences, try varied approaches to regulating, gain information about what works and what doesn't, and provide feedback to learn more about the cost effectiveness of specific rules. Regulatory competition provides these benefits.[84]

By ensuring that regulatory equivalence is included in post-Brexit trade deals, the UK can lower non-tariff barriers and incentivize itself and other countries and trading blocs to continuously improve their regulatory practices.

WHAT MIGHT A POST-BREXIT TRADE DEAL LOOK LIKE?

The default position of Britain exiting the EU and the EEA would be for the UK to trade with its partners under World Trade Organization rules. As a WTO member, the UK would be granted Most Favored Nation status by its partners. This would entail the raising of some tariffs by some nations that currently have preferential agreements with the EU, unless the other party was prepared to recognize the UK as a successor to the EU and thereby grandfather in the arrangements for a period. The previous UK government was skeptical that this would be the case.[85]

However, some non-tariff barriers would also go up. UK goods exported to the EU will have to pass certain inspection regimes unless their quality were to certified as meeting EU standards by a mutual recognition agreement.

Therefore, a trade deal should not only reduce tariff barriers; it should include mutual recognition of product standards as well. The trouble is that non-tariff barriers are usually the most contentious and time-consuming part in concluding trade deals. However, the fastest comprehensive trade deal on record, the U.S.-Australia Free Trade Agreement, which came into force in 2005, took only three years and nine months to complete, as it was between two advanced economies with similar legal codes and consumer expectations. Therefore, comprehensive trade deals between the UK and common-law countries like Australia, Canada, and New Zealand could be concluded relatively quickly. Given the current low levels of tariffs between the UK and U.S., and the high trade levels between the two nations, it is also likely that the next American president would negotiate a deal quickly.

A UK-EU trade deal is unlikely to replicate the single market. The mechanism for that is for the UK to reenter the EEA. Therefore, any UK-EU trade deal likely will be more costly to both sides than current arrangements. Open Europe estimates the costs to the UK and EU at 0.9 percent of GDP and 0.1 percent, respectively, by 2025.[86] Ninety-two percent of those costs will be due to the reimposition of border controls and checks, which will happen under any free trade deal the UK might pursue.

SPECIFIC TRADE SECTORS AND TRANSITIONAL ARRANGEMENTS

On invoking Article 50, the UK government will need to calm the nerves of many international investors. In certain industries this should not be a challenge. In financial services, prospects are good for continued market access. Nonetheless, other economic sectors could potentially suffer as a result of the changes in market conditions. In 2013, the Japanese Government submitted evidence to the UK Government's Balance of Competence Review that stated:

> More than 1,300 Japanese companies have invested in the UK, as part of the Single Market of the EU, and have created

> 130,000 jobs, more than anywhere else in Europe. This fact demonstrates that the advantage of the UK as a gateway to the European market has attracted Japanese investment. The Government of Japan expects the UK to maintain this favourable role.[87]

The jobs this refers to have been generated in the automotive industry by companies such as Honda, Nissan, and Toyota, which have significant operations in the UK. The fear that these companies center around two concerns: 1) access to the single market, and 2) potential disruption to their supply chains. Both could have repercussions on the ability for these companies to sell into the European Union and thus help safeguard jobs. Nonetheless, this is based on the assumption that jobs will be safeguarded only through EU membership.[88]

Car manufacturing is a global industry, and siting decisions are made based on car companies' need to find the best business environment. For example, when General Motors relocated some facilities from Detroit to Mexico in the 1990s, it sought a less expensive environment to build its cars that retained access to the American marketplace.[89] The same has been seen in Ford's relocation to Turkey, which provides for cheaper car manufacturing and access to the single market, due to Turkey's position within the EU's Customs Union.

Proposals to solve the problem of leaving the EU but retaining the UK's status within the Customs Union have been proposed by Business for Britain, a major business lobby. While it may seem appealing on its face, given the benefits of single market access, the cumulative detrimental effects of the Customs Union in other areas outweigh the benefits. Indeed, the Customs Union increases consumer prices in the UK.[90] The total costs of the Customs Union and other mechanisms that seek protection of manufacturing amounts to between 2.5 percent to 3 percent of Britain's GDP per year—between £40 billion ($64 billion) and £50 billion ($80 billion) in 2012. UK automotive exports to the EU were roughly £12 billion ($19.2 billion) in 2012.[91]

There are fears that the EU will place barriers on car exports from the UK once the UK has left. This would make the UK less attractive for car manufacturers, the argument goes. But as economist Iain Milne demonstrates, that is highly unlikely, as EU car manufacturers are more dependent on exports to the UK than vice-versa. Although UK car exports to the EU accounted for 661,043 units in 2011, the corresponding flow of cars into the UK from EU countries was well over double that, at 1.65 million.[92]

As Milne also points out, cars produced in Nissan's Sunderland plant—whose surrounding area enjoys high levels of employment—were being sold in Australia, which is certainly not part of the Customs Union. Given the move away from the European market—a shift already under way—British manufacturers will continue to sell their products outside Europe (see graphs 1 and 2). In 2010, UK car exports outside the EU were already worth more, at £9.5 billion (about $14.75 billion in 2010 prices), than UK exports to the EU-26, which stood at £7.8 billion (about $12 billion).[93] This trend is accelerating, with demand for car registrations shrinking in the EU and rising elsewhere in the world.

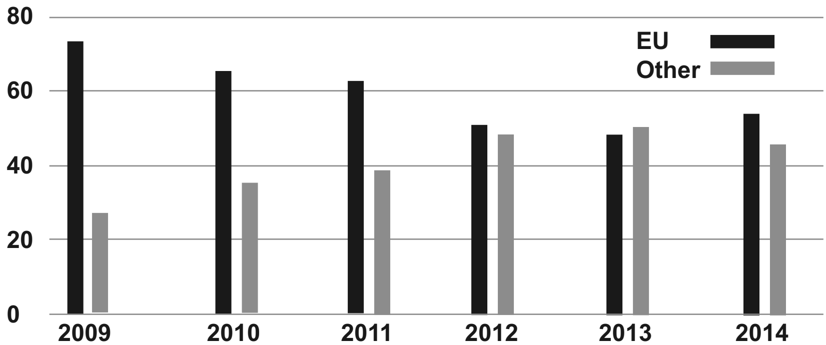
One way the EU could hinder British car exports into the EU would be to place increasingly stringent regulatory standards, such as on carbon emissions. However, as demonstrated by its trading relationship with the UK, Germany, whose auto industry is Europe's largest, maintains an export-oriented approach. Despite a recent fall in export growth, German car manufacturers exported 810,000 cars to the UK in 2015, a third of all cars sold in Britain and representing one fifth of the country's worldwide exports in cars.[94] This growth now means that the UK remains Germany's largest auto export market.[95]

Moreover, the EU would have to contend with imports from other countries being affected in the same way, and possible cases at the WTO over the imposition of targets. In such an instance, the UK would join others in lobbying against protectionist measures, as it would have a seat at this global trade body.

Rules of Origin. Rules of Origin, which are allowed by the WTO, give governments and multinational associations such as the EU the ability to place restrictions on the sale of certain goods if the materials have not been sourced within a defined area. The concern for some car companies, including Nissan, is for contractual arrangements between its British plants and suppliers within the EU to be disrupted, and thus place the supply chain under stress.

A solution for this could be to adopt unilateral free trade. The UK should adopt a no-barriers policy that would allow for goods to come into the UK without any import taxes, coupled with an affirmation by the government to respect the contract and lend short-term subsidies to

Figure 2. Percentage of Total Exports



firms that cannot maintain their previous arrangements. The costs of implementing this policy would not be substantial to British taxpayers, as not every supplier will have an issue with its contracts. Moreover, given that 18 out of the world's biggest 20 automotive suppliers have operations in the UK, and that the UK-based supply chain has the potential to provide more than 80 per cent of all component types required for local vehicle assembly, it can be argued that there is little incentive for automakers to move, as they will retain access to the infrastructure, the workforce, and the global market inside the UK post-Brexit.[96]

Moreover, the UK's global export record and the reduction in prices resulting from less EU regulation—estimated to be at least £9 billion ($14 billion), according to Cardiff University economist Patrick Minford's figures—will help make the UK a more attractive location for manufacturers. That means that the UK could become a beacon for investment in the car industry. Given that 77 percent of vehicles produced in 2013 were exported, and the market for British made cars is growing abroad, car companies will still be in a strong position in the global export market.[97] The average value of cars exported from the UK has doubled over the past decade, from £10,200 ($18,697) in 2004 to £20,640 ($32,280) in 2013.[98] And being outside the EU, car manufacturers will be able to source materials, in volume, from around the world and at global market prices.

FREE ZONES

As a first step to freer trade the UK could immediately expand the use of foreign trade zones or "free zones," which the UK's Revenue and Customs defines thusly:

> A Free Zone is a designated area where non-Union goods are treated as outside the Customs territory of the Union for the purposes of import duties.
>
> This means that import duties (including agricultural charges) are not due provided the goods are not released for free circulation.
>
> Import VAT and Excise duty is also suspended until the goods are removed to the UK market or used or consumed within the Free Zone.[99]

There are currently five free zones in the UK—Liverpool, Prestwick, Sheerness, Southampton, and Tilbury.[100]

Such zones could be established in multiple ports with expanded benefits. Currently, free zones are primarily used for warehousing or distribution.

In the U.S., as of 2014 there are 311 active manufacturing and production operations within foreign trade zones, representing 71 percent of zone activity compared to 25 percent relating to warehousing.[101] Free zones should be expanded to allow for such manufacturing facilities to be set up. This would provide an immediate alternative to abandoning manufacturer tariffs *á la* Canada.

They could provide significant benefits:

- **Duty deferral.** Import duties would be paid only if and when goods are transferred out of the zone and into the UK customs area;
- **Duty elimination.** No duties would be paid on goods exported from the free zone; and
- **Duty reduction.** Free zone users could elect to pay duties at either the rate of the foreign inputs used or the rate applied to the finished product, which could be lower.

Benefits would accrue to the UK in the form of job creation, increased exports, and foreign direct investment. In the U.S., foreign trade zones account for $99 billion of exports, primarily in industries such as petroleum, vehicle parts, and pharmaceuticals.[102]

It might even be possible to include the expansion of free zones in the Article 50 negotiations, as in suggesting that such zones could remain part of the EEA, or least regulated under EEA rules. One intriguing possibility is for areas like the Nissan plant in Sunderland to be designated free zones, thereby significantly reducing the cost of EEA withdrawal. They could be used as part of or complementary to the expanded enterprise zones discussed in the section on Foreign Direct Investment.

FINANCIAL SERVICES

The Globalized Nature of Financial Regulation. London's position as one of the world's leading financial center, alongside New York City, makes its future in a post-Brexit world extremely important not just to the UK, but to the global economy. The case has been made that financial services firms based in London would suddenly find themselves excluded from EU markets and that those firms would have to relocate within the post-UK EU, probably either to Paris or Frankfurt.[103] But that is not necessarily the case. To understand why, we need to look at the globalized nature of financial regulation. After the 2007-2008 financial crisis, the G20 group of nations agreed to harmonize their financial regulations to ensure that the conditions that led to the crisis did not recur.[104]

As a result, much financial regulation is now decided at a supranational level above the EU, and subject to significant international regulatory cooperation. The Financial Stability Board, based in Switzerland, coordinates much of this regulation, such as the Basel Accords on capital standards for financial institutions.[105] (Bank of England Governor Mark Carney currently chairs the Board.[106]) Therefore, UK financial regulation post-Brexit is unlikely to differ much from EU financial regulation.

Indeed, many supposedly European directives on financial regulation simply implement these international regulatory agreements. The Capital Requirements Regulation and Directive implements Basel III at the EU level. The Markets in Financial Instruments Directive (MiFID II) relies to a great extent on the International Standards Organization. Foreign exchange rules are dominated by the Bank for International Settlements Code of Conduct. Other regulations implement agreements made by the International Accounting Standards Board, the International Association of Insurance Supervisors, and other supranational bodies. The UK likely will continue to implement these as a result of its membership of these international bodies.

UK financial regulation post-Brexit is unlikely to differ much from EU financial regulation.

Notably, these international organizations have provided a helpful check on EU regulatory excess. For instance, when the EU started work on developing a financial transactions tax during 2010-2011,[107] the G20 declined to endorse it, owing to opposition from the U.S., UK, and Canada.[108] Since then, French President François Hollande has championed the tax,[109] but opposition from major G20 nations has probably ensured its failure.

The globalized nature of the financial regulatory system means that the EU cannot impose too much overly burdensome regulation without the agreement of major non-EU countries. As the UK is a major member of the G20, its post-EU existence will likely strengthen its hand in these matters.

EU-specific Regulations and Passporting. The EU has introduced regulations on certain financial products that may continue to raise the concerns mentioned in this chapter. For instance, the 2013 Alternative Investment Fund Managers Directive (AIFMD) strictly regulates the activities of hedge funds, venture capital funds, and similar financial firms.

Under the single market, firms operate under AIFMD in different countries via a process known as "passporting." They continue to be regulated by their home country, despite operating in a country with a different financial regulator under the AIFMD recognition that the home country follows its rules. There is concern that leaving the EU and the AIFMD would expose British-based firms to exclusion from EU markets as a result of losing passporting rights.

This concern is misplaced. Passporting is policed by the European Securities and Markets Authority (ESMA), which can also grant passporting rights to non-EU firms on the basis of "regulatory equivalence." In July 2016, ESMA recommended that passporting be extended to firms from the United States, as well as from Australia, Canada, the Cayman Islands, Guernsey, Hong Kong, Japan, Jersey, and Switzerland.[110] Given this, it is inconceivable that passporting rights will not also be extended to UK firms on the basis that UK and EU law will differ little on the details of regulation. For ESMA to reach a different decision would likely result from political vindictiveness rather than evidence-based decision-making.

AIFMD and ESMA's use of regulatory equivalence and mutual recognition is preferable to regulatory harmonization, as it allows for a degree of regulatory competition within an overall framework of regulatory cooperation. If a Singaporean or British firm is able to offer a superior product based on the nature of its regulatory system, then one must hope that the EU will recognize that superiority and adjust its regulations accordingly. Moreover, MiFID II specifies that the passport only requires an investment firm to be authorized and supervised by an EU regulator, not that it be based in the EU. So, the Irish regulator could authorize and supervise a firm, allowing it to get an EU passport. Facebook, for example, has an Irish electronic banking license. Post-Brexit, other American and British firms could do likewise.

The UK's World Leadership Role. The City of London has a role far wider than just the EU. It recently overtook Singapore as the second largest trading center for Renminbi.[111] It is a center of Islamic banking,[112] and a world leader in the FinTech revolution (London-based firm TransferWise is valued at over $1 billion[113]). As such, it is well suited to remain the world's largest financial center. With free trade deals already being discussed with other large modern economies, it is certain that financial services will play a leading role in these discussions. Assuming that the UK retains passporting rights as discussed above, it is probable that the UK's role as a global financial center will be enhanced as a result of Brexit.

Brexit offers an opportunity for the financial services sector, especially in terms of regulation and new product offerings. Former UK Chancellor of the Exchequer George Osborne courted China seeking to secure London's position as the leading trading center for Renminbi when it becomes a free-floating currency.[114] As other economies around the world open up and develop, there could be further opportunities for new business—and a need for the UK to retain its position as a global financial hub.

If the UK is to remain a global financial player it needs to send a strong signal to investors that its regulatory authorities are the best around. To do so, the UK needs to bolster the role of the Financial Conduct Authority (FCA), a UK regulatory body funded by fees charged to its financial industry members that operates independently of the government. As the majority of financial transactions in Europe go through the City of London, the FCA is currently heavily involved in implementing MiFID II, along with other EU directives. After the LIBOR and FX scandals of recent years, however, the FCA needs to prove its competency. This means dedicating more financial resources in order to allow the FCA to perform its role more effectively and legislation to ensure its transparency and reporting standards are world beating. In particular, it should look to maintaining an innovation-friendly environment for FinTech, which is where the future of finance may well lie.

For instance, in January 2016, the British government released a study, known as the Blackett Review, on the potential of distributed ledger technology known as the Blockchain, which concluded:

> The UK is not alone in recognising the importance of distributed ledger technologies. Other countries, large and small, are already moving quickly to adopt distributed ledgers—and the case study of Estonia shows how quickly a small country with an effective digitally-aware leadership can progress. However, there is still

> time for the UK to position itself within this leading group—indeed, it is essential for it to do so, given the importance of the financial and services sector to the UK economy.[115]

For the UK, establishing global leadership in this area will be a priority. Similar opportunities present themselves in payment systems and crowdfunding. No longer being tied to the EU's system of collective action represents a tremendous opportunity. If these goals can be achieved, the UK could continue to provide an example of best practices to ensure a more competitive and innovative global regulatory environment.

The EU's Lack of Capacity and Infrastructure. The flipside to the UK's leadership in these areas is the EU's failure to develop either the capacity or the infrastructure for a successful financial services industry absent UK firms. While trading venues feature prominently in MiFID II, there are few aside from national stock exchanges outside the UK or Switzerland. Foreign exchange, rates, and credit trading are all handled primarily in the UK, so for the EU to rule that UK regulations are not good enough for them could provoke a crisis in these markets.

Similarly, co-location services and high-frequency trading are also based in London, as are the firms that are the main players in these activities such as Citadel Securities. It is difficult to see the EU acting in a protectionist manner to exclude British-based firm as there is no domestic EU industry to protect.

Modern business requires access to modern financial services. Whether the EU likes it or not, those services are based in the UK, U.S., and Switzerland. In the near future, none of these will be an EU member, and only Switzerland will be part of the EEA. It is plausible that some UK business may relocate to Switzerland, but given the UK's strength in global financial markets, it is likely that those firms will offer mostly locally oriented services.

A Note of Caution on Global Regulatory Cooperation. It is debatable whether the actions taken by the G20 since the financial crisis really tackled the issues that caused the crash.[116] Moreover, there is a real concern that the move toward regulatory cooperation may intensify the effects of any future crash that results from the regulation itself, as there will be no major safe harbor. As Matthew Sinclair of the UK-based Taxpayers Alliance and Dalibor Rohac of the American Enterprise Institute warned in 2010:

> The increased internationalisation of financial regulation risks amplifying future global booms and busts. Global regulations lead to global crises as organisations are encouraged to hold similar assets and respond in similar ways when things go wrong. As a result, the new regulation could increase the systemic risk to the world economy.[117]

Therefore, it would be prudent for the UK government and the country's financial institutions to promote regulatory competition, rather than direct regulatory cooperation, where possible. Much like America's system of competitive federalism, in which states are free to promote their own regulation subject to certain federal rules, a less stringent set of global financial regulations might allow for greater experimentation to improve best practices. Mutual recognition of regulatory equivalence should remain the goal, without setting off a "race to the top" in terms of regulatory stringency.

FEASIBLE MULTILATERAL TRADE FORMULATIONS

Given the size of the British economy and its similarities with that of the U.S., a UK-U.S. bilateral free-trade deal is likely to be finalized, though there might be concern in the UK that such a deal would be dominated by the American side—something negotiators should bear in mind and work to assuage. Accordingly, it is worth considering scenarios whereby the UK and the U.S. might both be members of a multilateral trade agreement. Three such possibilities are a North Atlantic Free Trade Area (NAFTA2), a Global Free Trade Association (GFTA), and unilateral free trade.[119]

North Atlantic Free Trade Area. In 2000, a U.S. Senate report commissioned by then-Sen. Phil Gramm (R-TX) concluded that UK entry into the North American Free Trade Agreement (NAFTA) would be beneficial to the UK. The study found that the UK economy could increase its exports on net by a value of over $2.5 billion (2000 prices).[118] Reaction in the U.S. to the report was generally favorable, while it was dismissed as "barmy" by then-UK Foreign Secretary Robin Cook.[119]

However, it is now feasible to consider a NAFTA2. Icelandic economists have proposed that the Icelandic government should adopt the Canadian dollar as a national currency, given the close relationship in industries and business cycles between the two countries.[120] It would not be too great a step for NAFTA to expand to include Iceland. Once that occurs, the continental identity of the current NAFTA would no longer apply, and a precedent would be set for the inclusion of other developed North Atlantic countries, including the UK. Therefore, it would be plausible to imagine a NAFTA2 with membership including Canada, Greenland, Iceland, Mexico, Norway, the United Kingdom, and the United States. Ireland might even find such an arrangement preferable to the EU. Such a free trade area would incorporate 30 percent of world GDP and constitute a major step toward breaking down trade barriers worldwide.[121] Former Canadian Prime Minister Brian Mulroney has also floated the possibility of Australia and New Zealand joining NAFTA.[122]

Global Free Trade Association. Another potential idea is for the world's freest economies to come together to form a global free trade association. Eligibility for membership would be determined by reaching an appropriate score in an index of economic freedom, such as those compiled each year by the Heritage Foundation in partnership with *The Wall Street Journal* and by Canada's Fraser Institute in partnership with various think tanks around the world. These economies are by nature committed to free enterprise and free exchange of goods and services.

The GFTA would be a rules-based organization, according to its progenitor, John Hulsman, who came up with the idea while working at the Heritage Foundation.[123] Membership would depend on countries meeting certain indexed standards in four main areas:

- Open trading policies;
- Transparent and open foreign investment policies and capital flows;
- Minimal regulations designed not to impede business and trade; and
- Secure property rights.[124]

Initial enthusiasm for the idea from a number of smaller countries when it was first floated in the early 2000s was dashed on the rock of the EU's sole authority to negotiate trade agreement on behalf of its members. With the UK regaining control over its international trade policy, the idea will become viable again.

As Hulsman points out, the GFTA need not be a treaty. Instead, it would be established by act of Parliament, allowing access to the UK's market with the lowest possible barriers to ensure reciprocal standards. The GFTA could be seen as a sophisticated version of unilateral free trade, and could be adopted as the UK's preferred version of it. As such, it could represent a challenge to the entire system of regulated trade, including the EU's system of MRAs and border controls. It might even inspire some EU nations that qualify for GFTA membership to leave the customs union for the prospect of freer trade.

According to Hulsman, the following countries would currently qualify for membership in a GFTA: Australia, Canada, Iceland, New Zealand, Singapore, the UK, and the U.S., and EU members Denmark, Estonia, Finland, and Iceland. Other countries could obtain membership with small changes to their laws in only one of the categories mentioned above: Botswana, Chile, Israel, Japan, South Korea, Taiwan, and Uruguay, from the EEA, Switzerland and Norway, and from the EU, Austria, Belgium, Germany, the Czech Republic, the Netherlands, and Sweden.

Unilateral Free Trade. Another option, as discussed in the section on the automotive industry, would be for the UK simply to drop all tariff barriers and trade freely with the rest of the world. This would be a simple return to the principle of comparative advantage first expressed by David Ricardo in 1817 that helped inspire British free trade in the 19th century.[125]

The benefits to the British economy would be more affordable imports and raw materials, better allocation of resources, lower prices for consumers, and a spur to innovation that should quickly offset the loss of economic activity in previously protected sectors. This would doubtless be politically unpopular, but it would transform the British economy as radically as the reforms of the Thatcher era, and should provide similar benefits. The Open Europe model, which focuses purely on trade and tariff reduction, calculates a benefit to the UK economy from the policy of 0.66 percent by 2025, offsetting the losses from trade with the EU (assuming a free trade deal is finalized) by more than two thirds.[126] Yet this figure, by Open Europe's own admission, maybe an underestimate, as it does not take into account the dynamic effects of freer trade.

Accordingly, were the UK to take such an approach to trade policy, we could see a similar economic trajectory as that of the 1980s—an initial slump, with possible significant unemployment and accompanying disquiet, followed by a very quick rebuilding of the economy as resources moved to more productive uses, leading to a sustained boom. Therefore, we estimate initial costs to be moderate to high, depending on how quickly new arrangements could be put in place, followed by sustainable moderate to high benefits as time wears on.

IMMIGRATION

When considering the immigration issue, it is important to remember that the vast majority of the UK's non-native born population comes from countries outside the EU (see table 2). Of the top 10 non-native population segments in 2011, only two of them were from EU countries (see figure 4). Therefore, the immigration issue is not primarily an EU issue. However, owing to the principle of free movement of labor, non-EU immigration policy has become hopelessly interlinked with EU free movement policy, meaning that withdrawal from the EU allows the possibility for rethinking UK immigration policy as a whole.

Retaining the Free Movement Principle? Remaining in the European Economic Area, either as a member of EFTA or with some other affiliation (the "Norway/Switzerland option"), requires adhering to the EU's principle of free movement of labor. This would mean that one of the main concerns expressed by the British public in the Brexit vote would remain. It also means that, like Switzerland, the UK would be required to maintain stricter controls on non-EU/EEA immigration in order to keep overall immigration levels down. These controls have led to a severing of traditional ties with Commonwealth countries as well as causing difficulties for the financial services industry as the ability to move staff between the UK and U.S. has decreased. The prime purpose of

Table 2. Total Population

Fiscal Year	Panel A Total Population				
	Natives	EEA	Non EEA	EEA, 2000 on	Non EEA, 2000 on
1995	52,172,016	885,367	3,920,502	—	—
1996	52, 053,113	823,820	4,409,663	—	—
1997	52,024,832	953,449	4,178,270	—	—
1998	52,044,969	1,044,056	4,258,364	—	—
1999	52,198,811	1,065,211	4.294.403	—	—
2000	52.167,122	1,054,930	4,509,258	—	—
2001	52,254,626	1,124,239	4,577,880	105,815	334,841
2002	52,221,725	1,161,818	4,762,303	157,264	611,803
2003	52,346,927	1,229,381	4,819,508	205,220	836,533
2004	52,384,909	1,282,428	5,010,460	301,420	1,116,979
2005	51,580,064	1,411,814	5,216,225	469,053	1,345,442
2006	52,191,015	1,677,650	5,543,197	658,519	1,697,557
2007	52,054,165	2,271,159	5,436,642	969,502	1,928,921
2008	52,115,726	2,373,601	5,702,679	1,070,076	2,260,517
2009	52,331,186	2,432,699	5,800,989	1,139,307	2,450,912
2010	52,333,130	2,763,560	5,987,809	1,462,313	2,656,915
2011	52,360,031	2,847,289	6,146,430	1,562,028	2,924,529

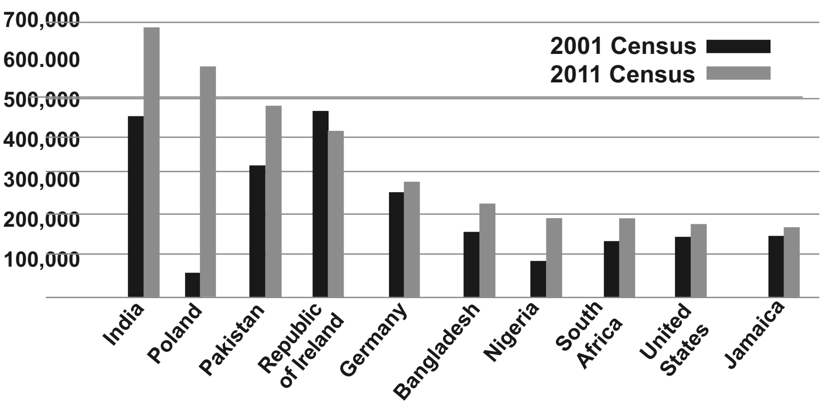
Source: Dustmann and Frattini 2013

immigration policy should be to maintain the best possible pool of labor for the nation, and the firms that use that pool are best placed to decide its make-up without artificial geographic restrictions. In a global economy, the best person to add value to a firm's activities, or to the nation's culture for that matter, might be a graduate of an Indian technical college rather than a Polish university.

Transitional problems will abound, however. The extraction of the UK from the EEA's labor mobility requirements without adequate replacement in the labor supply, wages in many businesses could rise very quickly, resulting in job losses and even businesses closing. Therefore, it is essential that the UK retain access to a pool of highly motivated affordable labor beyond the UK's native population.[127] Initially, this could be maintained by an expansion of the current points-based visa scheme for non-EEA nationals allowing those EEA nationals currently employed in the UK to continue to work providing they meet certain standards.[128] Skilled workers could be accommodated using the already existing Tier 2 provisions of the points-based system. Low-skilled workers could be accommodated by means of reactivating the currently-suspended Tier 3 of the system. Tier 1 (General) could also be reactivated to allow for a quick influx of new highly skilled workers from outside the EU.

Moreover, in order to avoid unnecessary anguish and fear among EU citizens currently resident in Britain, Whitehall should declare that all

Figure 4: Top 10 Countries for non-UK born residents in England and Wales, 2001 and 2011



Source: Regent's University 2013

EU citizens resident in the UK before the date of the referendum, June 23, 2016, retain the right to remain in the UK under any transitional arrangements made as part of the Article 50 negotiations. While this might be regarded as "showing one's hand" in the negotiations, we believe it is necessary for humanitarian reasons, and that the EU negotiators will see it as such. These residents would retain the same right to seek British citizenship as any other residents. Consideration could be given to expedited granting of citizenship for those who have been in the UK for more than 10 years or who have demonstrated they have started a family with every intention of remaining in the country.

These measures would come at some cost. More staff and computing capacity would need to be hired to enable the one-off glut of applications to be handled fairly and expeditiously. This could be handled by establishing a temporary executive agency that would exist for a maximum of five years outside the Home Office, seconding staff from the Home Office's UK Border Agency.

The Article 50 negotiations will need to focus on arrangements on a reciprocal deal at the European level for British residents who wish to remain resident in the EEA similar to the transitional arrangements described above. Currently, there are 70,000 Spaniards resident in the UK but 390,000 Britons resident in Spain.[129] Having them suddenly left high and dry regarding to their status in Spain would be unjust and could lead to significant burdens on the UK taxpayer if a substantial proportion were to be forced to repatriate.

Ireland is a special case. It has long had little restriction on its labor mobility with the UK. There is no reason for this not to continue. The Common Travel Area (CTA) between the two countries was established in 1922 and should continue to apply. The CTA would continue to be compatible with EU law after British withdrawal from the EU/EEA, according to University of Leicester law professor Bernard Ryan.[130] As Ryan also notes, there would be concerns about EU/EEA residents in Ireland and how they could be differentiated within the CTA. The answer to this appears to be simple: The UK should allow visa-free travel by EU/EEA residents into the UK, and should suggest this be reciprocated by EU/EEA countries in the Article 50 negotiations. While this may appear to be a case of the cart leading the horse, it would demonstrate to the world that Britain remains an open, international nation. In any event, an update to the arrangements for the CTA (which is not a Treaty, but a non-binding joint agreement between the UK and Ireland) would be prudent.

Going forward, it would be advantageous for the UK to quickly reestablish close labor mobility arrangements with Commonwealth countries such as Australia, Canada, and New Zealand. However, it is important that Commonwealth discussions should not confine themselves to the "white" commonwealth. As Tim Hewish of the Royal Commonwealth Society said in his Brexit Prize paper, "The process of viewing those from Commonwealth nations: white, black, or Asian as alien has had a profound effect on the UK's national psyche and trading position in the world. Britain's global identity had been diminished in favour of a solely European one."[131] If the Commonwealth is to be embraced, it should be for the glorious diversity of an extended family.

A first step, as Hewish recommends, would be to reinstate the Commonwealth Working Holiday visa, allowing all Commonwealth nationals aged 17-27 to visit and reside in the UK for two years with a work permit.[132] For older professionals, the current Tier 1 scheme may prove too cumbersome for Commonwealth countries with whom we could expect to conclude a trade deal quickly.

One new way to solve this problem would be to offer "sojourner" status to citizens of these countries. Such a status could allow, subject to a background check and medical examination to exclude potential terrorists, criminals, and those carrying communicable diseases, legal residency for a period of five to 10 years without the restrictions of the points-based scheme.

In addition, the UK should establish a more competitive visa scheme for entrepreneurs than the current Tier 1 (Entrepreneurs) scheme, which guarantees residence to any entrepreneurs able to demonstrate adequate capital backing for a business they wish to establish in the UK. Only 462 such visas were granted in 2012.[133] A good example to follow is Canada's successful entrepreneur visa program, which requires funding of C$200,000 (US$150,000) or just C$75,000 (US$56,000) from an accredited Canadian angel investor.[134] That is below the UK requirement of £200,000 (US$260,000). The Canadian lower tier category is also slightly lower than its UK counterpart, which requires £50,000 ($65,000), if the enterprise is financed by a UK Trade and Investment-endorsed seed funding competition, a business expansion loan from a UK government department, or a UK Financial Conduct Authority-registered venture capital firm.[135]

Finally, the UK should consider moving toward a simple, nationality-neutral immigration tariff. Many immigrants already pay substantial amounts of money to gain the opportunity to work in a dynamic economy like the UK's. Sadly, many more pay considerable sums to human traffickers and are then forced to work in near-slavery conditions—including sex work—to pay off their traffickers. An immigration tariff, as suggested by Nobel Laureate Gary Becker[136] and by the Cato Institute's Alex Nowrasteh, would not only turn this criminal income into a government revenue stream, but would also virtually eliminate the exploitation of would-be immigrants by criminal traffickers.[137] It would also significantly reduce the bureaucratic costs of the points-based system and allow for a reduction in the size of government spending accordingly.

The formula for setting the immigration tariff is a significant exercise beyond the scope of this paper, but some guiding principles should apply. A tariff schedule could be established, ensuring that those with less ability to contribute pay more, but not more than they would pay to immigrate illegally. Several studies have found that the wage premium of working legally in a developed country is significantly large, which provides an incentive for potential migrants to afford a tariff when possible. Migrants are able to accumulate surprisingly large amounts of money to pay traffickers to take them to their desired destination, for example by pooling village resources. Workers who have paid a tariff are also less likely to accept the lower wages offered by the black market over legal work. Studies have found that minimum wage provisions increase illegal immigration, so an overhaul of the immigration system to introduce a tariff might include abolition of the minimum wage as a contradictory incentive.[138]

A tariff schedule would look something like this, assuming similar NPVs to the U.S.

Table 3. Proposed UK Immigration Tariff Schedule

Education	Age	Rate (in £)
Less than GCSE	Less than 18	5,000
	18-21	10,000
	22-27	20,000
	28-35	35,000
	36+	50,000
GCSE equivalent	Less than 18	N/A
	18-25	7,500
	26-35	15,000
	36-45	22,500
	46+	37,500
College degree	Less than 18	N/A
	18-30	3,750
	31-40	7,500
	41-50	11,500
	50+	15,000

In 2015, net inward migration to the UK was 333,000 people.[139] If that level of migration holds true and the immigrants paid an average of £15,000 ($20,000) each, then an annual income stream of around £3 billion ($4 billion) could be achieved, more than enough to pay for immigration costs and immigrants' use of the welfare system. Assuming a tariff scheme took two and a half years to develop, the net present value of the income from such a scheme from 2018-2028 would be just under £20 billion ($26 billion).[140]

Finally, one important and valuable feature of the UK's membership of the EU has been its involvement in the Erasmus educational exchange program.[141] The UK should continue its participaiton in the program, with appropriate rights to seek work after completion of study, an important objective of the Article 50 negotiations. Moreover, the UK government should consider working with British universities to set up similar programs with its potential trade partners as part of or parallel to its future trade deals.[142]

AGRICULTURE

Like other economic sectors, British agriculture has become increasingly influenced by the involvement of the European Union. Since the UK joined the EEC, the regulatory influence from the EU has grown to comprise over 40 per cent of all UK agricultural regulation.[143] That has changed agricultural practices in the UK with subsidies (now called payment entitlements) for programs such as the Basic Payment Scheme (formerly the Single Payment Scheme).

These subsidies will be in question once Article 50 is invoked. Over the budget period 2014-2020, the UK was expected to receive £17.8 billion ($23.15 billion) in EU direct payments and market investment tools for

> *New Zealand's subsidy reforms have been so successful that farmers in that country now no longer want subsidies.*

direct support for farmers and £1.84 billion ($2.4 billion) for environmental preservation and rural development. Understandably, proposals to end this level of subsidy have been met with resistance. Some Euroskeptic economists, such as Lee Rotherham, have suggested that the UK might keep the respective subsidies in place for a period of up to 10 years, in which time the respective legislation could be changed.[144] The UK would save money in this scenario, as it would not be funding the Common Agricultural Policy for other nations. However, it could lead to higher levels of taxpayer subsidies, despite the farming community adapting in the face of increased price competition from abroad.

Instead, the UK should instead follow the example of New Zealand, which has demonstrated that subsidy reductions can lead to a more competitive, larger, and successful agricultural industry. New Zealand's subsidy reforms, made throughout the 1980s, have been so successful that farmers in that country now no longer want subsidies.[145] New Zealand farmers now recognize that subsidies are a form of government intervention into their industry. Indeed, the abolition of subsidies has allowed agricultural firms to become leaders in the New Zealand economy as the owners prove themselves to be agile entrepreneurs. There is no reason for farmers in the UK, after leaving the EU, not to follow a similar path. Indeed, the finance ministers from opposing parties who reformed New Zealand, Roger Douglas and Ruth Richardson, demonstrate that true leadership can convince a nation to make short-term sacrifices to achieve long-term goals.[146]

However, some critics, such as National Farmers Union President Peter Kendall, argue that ending subsidies would "devastate" the UK farming sector.[147] Such arguments are based on the assumption that businesses are unable—or unwilling—to adapt to changing market conditions. New Zealand has shown that is not the case. As a result of effectively ending the subsidies in the 1980s, agricultural firms in New Zealand now make up over 10 per cent of New Zealand's top 100 companies.[148]

Nonetheless, Kendall highlights other concerns that include access to the EU's single market — the argument that, given current WTO tariffs on agriculture, UK exports to the EU would suffer. However, the scenario of existing tariffs applying to the UK-EU trading relationship post-Brexit is far from being a certainty. This potential scenario was addressed by Cardiff University's Patrick Minford, who noted that if the UK were to declare unilateral free trade, there would be no incentive for the European Union to impose taxation on UK farmers.[149]

Kendall argues that if the UK wished to lower its tariff barriers with the rest of the world, it would not be able to apply higher barriers to the EU under WTO rules. However, as New Zealand has shown, a freer market environment will bring great rewards to those farmers most willing to adapt. Moreover, exiting the Customs Union and allowing the UK to buy food at world food prices—from a range of countries tariff free—

could only help develop a more competitive market and, given increased choice at tariff free levels, lower prices for consumers.

Again, New Zealand is instructive. Since the end of subsidies in 1984, New Zealand farms have increased productivity and income in multiple sectors. There are more and bigger lambs, the cost of milk production is the lowest in the world, and horticultural exports have increased in terms of both volume and diversity.[150]

According to New Zealand government statistics, when subsidies were removed, farmers diversified, improved efficiency, and sometimes subdivided the land to make hobby farms. It also allowed the government to spend more money elsewhere. The environment was better protected and family farms still make up the majority of farms in New Zealand. Rural population increased by 4.6 percent between 1981 and 1986.[151] If population growth is deemed an indication of success, following the New Zealand example would not put UK farmers at immediate risk.

Kendall's argument concedes that even if the remaining EU member states wanted to increase their own internal market share at the expense of the UK, WTO rules would prohibit import restrictions on the grounds of the production or processing method, unless a product is objectively different and harmful.[152] That means there is little chance of British products being refused entry into the single market. Nonetheless, there will still need to be national safeguards on food quality once Britain is outside the EU. This can be achieved by the current bodies set up to monitor this. And with oversight from Parliament, there can be a greater level of transparency and responsiveness.

With exiting the EU, the UK could expect to see a higher rate of smaller farms. Although it may not have a substantial effect on production volumes, given the size of the marketplace, it will help to lower costs for the consumer and lead to greater variety of local products by abandoning a Common Agricultural Policy licensing practice that disincentivizes smaller producers from farming by effectively requiring farmers to prove *that they are, in fact, farmers*.

Without EU subsidies, British agriculture could become a lot more adaptive and reactive to market changes.

The lowering of food prices could present British farmers with an opportunity. Like New Zealand did with branding of New Zealand butter and lamb, the UK can continue to do the same with British beef and other foods that are renowned globally for their quality.[153] In doing so, UK producers would be able to enhance their competitive advantages in producing certain products at a lower cost. The net result of this could be a higher consumption rate of particular goods both domestically and abroad. While there may be greater price competition in the UK market, farmers could benefit from increased volumes and price premiums for their exports to reflect their renewed reputation.

Fears that the UK farming industry could not stand without government subsidy are misplaced. Without EU subsidies, British agriculture could become a lot more adaptive and reactive to market changes. Like New Zealand, the UK can take advantage of changing market conditions while increasing both consumer choice and reducing costs.

ENERGY, ENVIRONMENT, AND TRANSPORT

These three policy areas have become inextricably linked in recent years as the global warming alarmist movement has largely driven debate. That is important to bear in mind as there is an argument that UK national policy on these issues would not be much different from EU policy. However, in freeing itself from the EU straitjacket, the UK will have some leeway in a number of areas to introduce greater flexibility to craft policy based on the country's circumstances, rather than dictates from Brussels.

Energy

Current UK energy policy is in large part driven by the EU's Emissions Trading Scheme (ETS), which is based on the principle that a cap can be placed on total carbon dioxide emissions and that firms that need to emit carbon dioxide can trade permits, establishing a market price for emissions. The scheme was set up in 2005 at a time when it looked like the price of a permit would rise inexorably.

The ETS has repeatedly collapsed since the financial crisis as businesses that should have helped spur the price rise have gone bust or reduced activity as a result of the economic contraction. Leaving the EU provides an opportunity to leave the ETS and EU-wide renewable energy targets and rethink the longer-term strategy.

Rather than switch over to an expensive and wasteful wind-powered economy, the UK should look to the example of the U.S., where technological innovation in horizontal fracturing ("fracking") of oil and gas has revolutionized the U.S. energy supply without any government intervention—and led to a significant reduction in carbon emissions to boot.

Fracking's success is largely based on subsurface property rights. Property rights combine the incentive of profit—from the exploitation of the right—with the incentive of conservation—to ensure the right does not become worthless. In the U.S., landowners retain property rights to subsurface oil, gas, and other minerals. Therefore, any energy company that wants to exploit those resources has to negotiate with the owner.

The result has been the widespread adoption of lease agreements in which energy companies pay royalties to the property owners, who receive a steady income stream where none existed previously. Many lessors live in some of the poorest areas of the country. Local and state revenues have received a considerable boost in tax payments. Previously depressed areas have seen an influx of high-paying jobs. Local industries have benefited as a result, multiplying the effect.[154] Meanwhile, the price of energy has dropped sharply, providing a boon for consumers.

Moreover, as a result of the increase in supply, the U.S. has turned from a $100 billion annual importer of natural gas to being a significant exporter.[155] The UK should follow America's lead and not only permit fracking but alter the provisions of the Petroleum Act 1998 that vest the subsurface rights to oil and gas in the Crown, thereby returning to the status quo ante before the Petroleum Act of 1928 usurped the people's subsurface property rights. Allowing property owners to enjoy full rights to the oil and gas that lie beneath their land will spur development of the industry and secure an income stream for citizens. It can also provide a new revenue stream for the Treasury to offset the costs associated with devolving the Crown rights to the people.

The UK is due to shut down over seven gigawatts of capacity in coal-fired power plants by 2016. Replacing these quickly with lower-emission natural gas plants will enable Britain to reduce carbon emissions considerably while keeping the lights on.

It should be noted that so far the UK, along with Poland, has successfully blocked any EU directives aimed at reducing fracking's use. Now that it has decided to leave the EU, the prospect of EU rules banning fracking has receded, and therefore the new government should make fracking a centerpiece of its energy policy. According to the Bowland Shale Gas Study, the UK has around 1,300 trillion cubic feet (tcf)[156] of shale gas reserves (and possibly up to 2,200 tcf), much of it in the north of England and Northern Ireland, areas that could well use the benefits of a new fracking industry.[157] In 2015, the entire U.S. industry produced 29 tcf , meaning that UK reserves could produce that amount for almost 50 years, solving the energy problem for the near future.[158] Current U.S. prices are around $3 per thousand cubic feet, valuing the UK's reserves at an astonishing $3.75 trillion.[159]

At a household level, the U.S. currently benefits to the tune of $1,200 per household annually from the results of fracking, simply in terms of savings on school expenditures.[160] While a UK industry may not provide the same level of benefits, those benefits are still likely to be substantial. Other EU energy regulations—such as the Large Combustion Plants Directive, which requires limits on emissions from power plants, refineries, and steelworks or the Industrial Emissions Directive, which played a large part in increasing costs on the UK steel industry—can be addressed through the Royal Commission on Regulatory Reduction.[161]

Environment

Most of the environmental regulations imposed by the EU, such as the Environmental Liability Directive, Water Framework Directive, and Ambient Air Quality directive, can be addressed through the Royal Commission on Regulatory Reduction.

One rule Westminster should do its utmost to repeal is the directive on Registration, Evaluation, Authorization and Restriction of Chemicals (REACH), the most wide-ranging and restrictive in the world on chemical innovation and use. It requires chemical companies to prove their products are safe, rather than requiring governments prove they are harmful. A 2006 study by Angela Logomasini of the Competitive Enterprise Institute found that its "benefits are highly dubious and the costs to economic freedom and development—even if mitigated by reducing REACH's scope—are likely to remain substantial."[162] Repealing REACH will allow the UK, a nation with a long and proud history of chemical development, to reclaim its position as a major innovator and producer in this field.

In order to prove that chemicals that have long been in use are safe, chemical companies have been required to produce test results, the vast majority of which have been conducted on animals. According to the European Coalition to End Animal Experiments: "REACH will require 13 million to 54 million animals for tests conducted between 2009 and 2018, and REACH testing will continue beyond 2018."[163]

Animal testing is necessary in certain conditions, but a huge number of tests required by REACH are unnecessary, as the chemicals being tested have been in use for years without demonstrable harm. In order to spur innovation in the chemicals industry, to provide competitive advantage for the UK industry over its EU competitors, and to promote animal welfare, a separate bill should be introduced into Parliament after the Brexit Bill to repeal the effects of REACH and return industry regulation to its pre-2006 levels.

Unfortunately, products that would be exported to the EU would still require REACH certification, but the spur to innovation generated by the lifting of REACH requirements should still provide considerable benefits for UK industry in the global market. If beneficial chemicals became available in the UK and its new trading partners, there would also likely be pressure from EU companies that could benefit from these chemicals to lift REACH restrictions in Europe, which would be a further boost to animal welfare there.

Transportation

In large part, the regulations governing international transport, with respect to road, rail, and sea travel are governed more by international treaty than by EU rules. As former Department of Transport undersecretary Handley Stevens has noted:

> Since 1985 the EU has developed extensive common transport policies. Where these do little more than implement in EU law the terms of international agreements and conventions which the UK has signed as an independent sovereign state (e.g. in road and sea transport), the costs arising from any renegotiation or even withdrawal from the EU would be minimal. The consequences for rail transport would be particularly small,

> since EU policy is less developed, and there are so few direct rail links.[164]

Thus, these regulations can be addressed via the Royal Commission on Regulatory Reduction.

Air travel is another matter. Internal European air travel is completely governed by EU regulation, and the system of bilateral air travel rights with non-EU countries is being replaced by a series of agreements with the EU, the most important of which is with the U.S. In recognition of the difficulty involved in extricating the UK from these arrangements, the UK should position itself as a world leader in the "open skies" movement, promoting a global initiative to liberalize access to air space.

As Fred Smith and Braden Cox of the Competitive Enterprise Institute have noted, a global industry like airlines would be better served by a form of free trade in airline services that allows airlines from one country to work in other countries, with rights of establishment (setting up new airlines) and cabotage (operating domestically within other countries).[165] By meeting all International Civil Aviation Organization standards, the UK as an "open skies" leader would not face any issues with non-standard safety or air traffic communications requirements.

It is likely that disruption to the airline industry would be one of the biggest costs to the UK as a result of withdrawal should the EU not prove cooperative. In particular, budget airlines like EasyJet might be so badly hit that they might consider relocating. It is incumbent on UK representatives, during Article 50 negotiations, to prioritize the continuation of current arrangements long enough for acceptable UK-EU and UK-U.S. air travel deals to be ironed out. The prominence of Heathrow as "the world's favorite airport" and the attraction to foreign airlines of not needing to pay ETS-related fees should be strong arguments in favor of cooperation between the UK and EU.

CONCLUSION

The United Kingdom's government faces some tough choices ahead. It needs to be responsive to its voters, acknowledging their decision to leave the EU and their reasons for doing so while remaining respectful of those who voted to stay. It also needs to ensure that any negative potential economic consequences of leaving an established economic union are mitigated as soon as possible.

Realistically, the UK cannot remain in the EEA. To do so would be to ignore the reasons why people voted to leave, and could leave to significant domestic strife. Nor would remaining in the EEA provide the liberty to make choices that would really benefit the British economy.

But the consequences of leaving the EEA should not be downplayed. The wrong turn, into an isolationist stance that shuts out the rest of the world, would be disastrous.

That is why Britain must declare it is open for business, with unilateral declarations where appropriate, and trade agreements to be concluded as quickly as practicable with those nations that indicate a willingness to do so. At time of writing, these include Australia, Brazil,[166] Canada, China,[167] Ghana, India, Mexico New Zealand, South Korea, and Switzerland.[168]

Similarly, it must regain control over immigration while not turning its back on the benefits immigration and travel bring to a nation. A market-based immigration system may prove to be the best solution to this problem in the long run.

The suite of policies recommend in this essay share this vision of an open Britain, dedicated to the principle that markets make better use of information than planners.[169]

Overall, the UK will benefit substantially from a reduction in regulation, a better fisheries management system, a market-based immigration system, a free market in agriculture, a globally focused free trade policy, and a shale gas-based energy policy.

By following this road map after leaving the EU, the UK will have set itself on the road to becoming once again a global economic power-house.

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Article 112:

1. If serious economic, societal or environmental difficulties of a sectorial or regional nature liable to persist are arising, a Contracting Party may unilaterally take appropriate measures under the conditions and procedures laid down in Article 113. 2. Such safeguard measures shall be restricted with regard to their scope and duration to what is strictly necessary in order to remedy the situation. Priority shall be given to such measures as will least disturb the functioning of this Agreement. 3. The safeguard measures shall apply with regard to all Contracting Parties.

Article 113:

1. A Contracting Party which is considering taking safeguard measures under Article 112 shall, without delay, notify the other Contracting Parties through the EEA Joint Committee and shall provide all relevant information. 2. The Contracting Parties shall immediately enter into consultations in the EEA Joint Committee with a view to finding a commonly acceptable solution. 3. The Contracting Party concerned may not take safeguard measures until one month has elapsed after the date of notification under paragraph 1, unless the consultation procedure under paragraph 2 has been concluded before the expiration of the stated time-limit. When exceptional circumstances requiring immediate action exclude prior examination, the Contracting Party concerned may apply forthwith the protective measures strictly necessary to remedy the situation. For the Community, the safeguard measures shall be taken by the EC Commission. 4. The Contracting Party concerned shall, without delay, notify the measures taken to the EEA Joint Committee and shall provide all relevant information. 5. The safeguard measures taken shall be the subject of consultations in the EEA Joint Committee every three months from the date of their adoption with a view to their abolition before the date of expiry envisaged, or to the limitation of their scope of application. Each Contracting Party may at any time request the EEA Joint Committee to review such measures.

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