ESSAYS IN REGULATION

Brexit and the Single Market

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NS 6.1 July 2016

REGULATORY POLICY INSTITUTE

Essays in Regulation, New Series

Published by the Regulatory Policy Institute
300 Banbury Road, Oxford OX2 3ED, UK
www.rpieurope.org

First published July 2016

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Summary of main points

The UK is currently a Contracting Party to the European Economic Area (EEA) Agreement, and exit from the EU does not necessarily imply exit from the Single Market (i.e. withdrawal from the Agreement). Exit from the EEA would require that extra steps be taken, either unilaterally by the UK or by the other Contracting Parties to the Agreement.

There is no explicit provision in the Agreement for the UK to cease to be a Contracting Party other than by unilateral, voluntary withdrawal, which requires simply the giving of twelve months' notice in writing (Article 127). A commonly held assumption that only EU and EFTA members can be Parties to the EEA Agreement – and hence that the UK has to be a member of one or other of these two organisations to be in the Single Market – is not well grounded, although UK consideration of an application for EFTA membership is an option well worth exploring in its own right.

In the absence of a prior withdrawal notice or of steps by other Contracting Parties to try to force UK exit (of a nature not yet identified and not necessarily feasible in the light of the Vienna Conventions on the Law of Treaties and on Succession of States in respect of Treaties), on Day 1 of the post-Brexit era the default position appears to be that UK would still be a Party to the EEA Agreement.

This has major implications for any future negotiations. For example, with continuing UK participation there would be no requirement for an application for "access" to the Single Market.

Should the UK choose not to withdraw from the EEA there would be need for some textual adjustments to the Agreement, if only to reflect the UK's changed status as a non-EU Contracting Party. The more substantive implications of continuing participation concern the operation of the institutions supporting the non-EU Contracting Parties – Iceland, Liechtenstein and Norway – not the EU institutions. Early discussions with the governments of these three countries are indicated: they need not await Article 50 Notification.

Continued participation in the EEA following Brexit would see substantial repatriation of powers covering the areas of agriculture, fisheries, trade policy, foreign and security policy, justice and home affairs, taxation, and immigration, consistent with the strong desire of many Leave voters to 'take back control'. It would, for example, give the UK freedom to negotiate its own trade deals and set its own tariffs, as well as dispensing with the egregiously protectionist common agricultural policy.

Immigration is the most vexed issue, not least because of the difficulties in establishing a reasoned discourse on relevant matters. The underlying problem concerns the interpretation and application of the principle of *free movement of persons*, in respect of which EU political leaderships tend to favour a rather fundamentalist, 'non-negotiable' position, motivated by the goal of political union.

The EEA Agreement does not treat the 'four freedoms' (of goods, persons, services and capital) as absolutes. In each case it provides for limitations to be imposed when justified by some other aspect of public policy. Importantly, for non-EU Contracting Parties to the EEA Agreement the 'decision maker of first instance' is the relevant State, not the European Commission.

The commercial aim of the EEA Agreement affects the interpretation and application of the free movement principle in consequence of its significance when determining what measures can or can't be justified. A 'political' interpretation and application of *free movement of persons* is not well adapted to the aim of the EEA Agreement set out in Article 1(1). Given this misalignment, *free movement of persons* is almost inevitably a highly contested issue.

Nevertheless, the Agreement provides scope for unilateral action on *free movement of persons* that is not currently possible for the UK as a member state of the EU. Post-Brexit the Agreement would allow scope for at least some degree of re-alignment of interpretation and application of the free movement principle to better fit with commercial policy objectives.

In relation to budgetary payments by the UK, the default position appears to be a zero contribution from Day 1 of the post-Brexit era, if the UK opts not to withdraw from the EEA Agreement. This again affects the negotiating position. If the UK subsequently agrees to make financial contributions it should expect a *quid pro quo*, for example increased influence in the rule-making process for the Single Market and/or more explicit recognition of greater flexibility in the interpretation and application of the *free movement of persons* principle (whilst still pledging allegiance to the principle itself[1]). Such developments would also be of benefit to the other non-EU Contracting Parties, and arguably to EU Contracting Parties as well.

Crucially, the EEA Agreement does not foreclose future policy developments of the types suggested by those who favour immediate exit from the Single Market: it simply leaves those other options available for future consideration and possible adoption, allowing 'market testing' of new policy approaches in the interim. On this basis continued participation in the EEA Agreement can be said to be *sufficient unto the day*.

Such optionality coupled with the faster response speed of the UK governance system amounts to an asymmetric competitive advantage over the EU in policymaking, which serves to counteract the asymmetric disadvantage of smaller market size. The overall imbalance in power in Single Market rule-making is therefore somewhat less than it might appear at first sight.

The aim of the EEA Agreement (set out in Article 1(1)) is highly consistent with the longstanding aims of UK commercial policy, steady and dogged pursuit of which could be a stabilising factor that, *inter alia,* serves to reduce political uncertainty in markets.

[1] By way of analogy, it is not a meaningless exercise when US citizens pledge allegiance to the flag, but it does not entail unanimity in what that pledge might imply for conduct in each and every possible set of circumstances.

George Yarrow[1]

Brexit and the Single Market

Introduction

The outcome of the referendum of 23 June 2016 raises immediate issues concerning the UK's future policies in regard to the European Single Market. In the frenzy of the referendum campaigns and their aftermath there has not been room for much clear, calm and collected thinking about the detail of the new factual context, the relevant public policy trade-offs, or the characteristics of the policy strategies that might be pursued. What follow are some thoughts on these matters.

To put things in some sort of context it is helpful to start by considering the nature of markets more generally. Since the matter has been addressed in detail elsewhere[3] it can be dealt with quickly here. A market is a social/economic institution developed to serve a particular purpose or function: the facilitation of mutually beneficial exchange transactions between buyers and sellers. It is a set of rules, of varying degrees of formality, that govern or regulate commercial conduct in ways that are, or should be, developed to best serve that specific purpose or function (which can be expressed in short-hand as 'facilitation of trade'). A market succeeds or fails according to how well it serves this purpose.

A shared commitment to a market's purpose, facilitation of trade, coupled with an evolving set of market rules whose elements and structures are (and, as contexts change, continue to be) 'fit for purpose' tends to be conducive to economic success. In contrast, attempts to use market rules to achieve other purposes, most usually at the behest of an influential party with partial[4] or partisan interests, tends to degrade market performance. Over time the latter type of conduct discourages market participation and lowers traded volumes, i.e. in a general sense it serves to restrict trade.

The Single Market: key contextual matters

The European Economic Area (EEA) Agreement was developed to expand the European Single Market, whose domain is defined by the relevant[5] territories of the 31 states that are Contracting Parties[6], of which the UK is one. Each Contracting Party was required to ratify or approve the Agreement in accordance with its own constitutional requirements and then lodge

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[1] Chair, Regulatory Policy Institute; Emeritus Fellow, Hertford College, Oxford. This draft reflects and has benefited from a range of comments on earlier versions. Remaining errors and nonsenses are my own.

[3] G, Yarrow, *The political economy of markets*, http://www.rpieurope.org/Publications/Essays_New_Series/Yarrow_Political_Economy_of_Markets_April_2015.pdf

[4] The sense in which the word partial is used here is most easily explained by reference to its antonym, impartial.

[5] See later commentary on Article 126.

[6] The European Union is also a Contracting Party, as was the European Coal and Steel Community when the Agreement was first made.

its instruments of ratification or approval (Article 129(2)). It is by virtue of completing this process that the UK became a participant in the EEA.

If a new Contracting Party to the Agreement is added, the domain of the Market expands: if an existing Contracting Party withdraws, the domain contracts. There is no provision in the Agreement that contemplates the domain of the Single Market being significantly expanded or contracted by any other means, although there is provision for variation in the territory of an individual Contracting Party that lies within the Market's domain. This allows for full or partial exclusion of 'special territories' such as the Faroe Islands or the Isle of Man, and the relevant matters are addressed in Article 126 of the Agreement.[7]

In particular, there is no provision in the Agreement for the termination of Contracting Party status other than by means of voluntary withdrawal, which requires the giving of 12 months' notice to other Contracting Parties (Article 127).

Article 126(1) is frequently cited as a provision that implies that the UK would cease to be a Contracting Party in consequence of Brexit, but this view depends upon a textual interpolation that itself appears to be based on a misunderstanding of the purpose of the Article: the text as it stands does not lead to the implication claimed. Since the matter has come to acquire some significance in Brexit debates it is examined further in the Annex below. As a general point, however, it can be noted that international law tends, for good and obvious reasons, to be rather conservative in maintaining the rights and obligations of parties to international treaties and agreements: heavy weight is given to the principle of *pacta sunt servanda* (agreements must be kept). Forced withdrawal of those rights and obligations is, therefore, not something that is readily endorsed.

If a country accedes to the EU, it does not automatically become a member of the EEA: it must apply to become a Contracting Party to the Agreement, an application that must be directed to the EEA Council, and it must go through the ratification or approval process. Accession to the EU requires that such an application be made (Article 128).

There are no provisions in the Agreement that restrict the acquisition of Contracting Party status exclusively to member states of the EU and members of EFTA[8], although the Agreement was, as a matter of fact, originally developed as an agreement among Contracting Parties who were members of one or other of those two organisations. The context of that development, which occurred at the end of the 1980s and beginning of the 1990s, was a Europe in flux as communism collapsed and countries in Central and Eastern Europe began their economic, political and social transitions away from the old regimes.

The EU (the EC as it then was) was heavily preoccupied with what can now be seen as the later stages of its central mission, the rehabilitation of Europe from the traumas of the Second World

[7] For quick sight of the special territories involved see https://en.wikipedia.org/wiki/Special_member_state_territories_and_the_European_Union

[8] Article 128 could possibly be interpreted as having an exclusionary intent, again by inferring the word 'only' from the text, but such an approach runs into a number of the difficulties set out in the Annex in relation to Article 126(1). In any event, Article 128 is concerned with new applications to become Contracting Parties, not with the status of an existing Contracting Party, which is the issue here.

War, which it pursued via inclusive and expansionary policies. Whilst the EU's first preference has undoubtedly been for Single Market widening to occur via EU membership, in a situation where market widening might only be feasible via other routes (a matter on which there will have been great uncertainty at the time of the Agreement's drafting) it would have made little policy sense to exclude second-best possibilities that could draw non-members of the EU closer to the EU's member states.

The language of the Agreement reflects its origins in an attempt to include as Contracting Parties all the then members of the European Community and of EFTA. Following a referendum in Switzerland, that country decided not to become a Contracting Party to the Agreement. The EFTA terminology was, however, retained, presumably for administrative convenience in drafting, but it can, unfortunately, be misleading and a potential source of cognitive bias in interpretation.

For example, notwithstanding that Article 2 explicitly states that, for the purpose of the Agreement, "EFTA States" means Iceland, Liechtenstein and Norway, the repeated references to EFTA may give the false impression that bodies such as the EFTA Court and the EFTA Surveillance Authority are institutions that exist to serve EFTA more generally. They are not. Rather they are institutions created specifically for the purposes of facilitating EEA participation by the three aforementioned States. The EFTA website refers to these bodies as EEA EFTA institutions, which is slightly more accurate in that it indicates that they are dedicated to serving the relevant Contracting Parties in relation to EEA issues, not to EFTA issues more generally.

In listing the Contracting Parties, the text of the Agreement splits the countries into two groups (or two sub-lists). First come the states who are members of the European Community (which is listed first among the Contracting Parties), arranged in alphabetical order. The group now includes Austria, Finland and Sweden (previously members of EFTA). This is followed by 'AND', which is followed in turn by the sub-list of other, non-EC Contracting Parties.

The separation of the groups reflects the fact that the governance structure of the EEA has two-pillars[9], one for the EU member states and one for non-EU states, and it is the UK's post-Brexit location in this structure that raises what are probably the only, significant, substantive issues that are immediately created by Brexit.

The first entry on second sub-list (of non-EU Contracting Parties) is [ ]([6]) and footnote ([6]) says *"Austria, Finland and Sweden acceded to the European Union on 1 January 1995."* Given

[9] The EFTA website explains the structure as follows: "*The decision-making process in the EEA Agreement is characterised by its two-pillar structure. Substantive decisions relating to the EEA Agreement and its operation are a joint venture with the EU and in the hands of common bodies. … The EEA EFTA States have not transferred any legislative competencies to the EEA institutions and they are unable, constitutionally, to accept direct decisions by the Commission or the European Court of Justice. To cater for this situation, the EEA Agreement established EEA EFTA bodies to match those on the EU side. The EEA EFTA States take all decisions by consensus as opposed to the EU side where decisions related to EEA legislation are normally taken by majority vote."*

the alphabetical ordering, this is where Austria and Finland once appeared in the lower list. Further down, after Norway is [ ]([7]) and footnote ([7]) says the same thing as footnote ([6]). This is where Sweden once appeared. Thus, on accession to the EU Austria, Finland and Sweden transitioned from one sub-list of Contracting Parties (the non-EU countries) to the other sub-list (the EU members), and hence from one pillar of the governance structure to the other.

These transitions between groupings did not require a political hokey-cokey whereby existing Contracting Parties left the EEA, re-applied and then ratified the EEA Agreement a second time, notwithstanding that the Agreement's text says that *"Any European country becoming a member of the Community … shall apply to become a party to this Agreement"* and could be read narrowly as requiring a re-application. Austria, Finland and Sweden were already Contracting Parties and a process requiring their exit from the EEA at the time of their exit from EFTA would have been costly formalism without benefit.

UK exit from the EU also involves a transition for an existing Contracting Party from one listed group to another, but in the other direction. Although the issues raised by the transition are not identical to those in the Austrian, Finnish and Swedish cases, what is the same is the fact that before the transition the UK was a Contracting Party to the Agreement.

The chief differences between the two cases appear to revolve around:

- Questions raised by possible ambiguities in the text of the Agreement as to the UK's rights to continued participation in the EEA Agreement (see the earlier points made in relation to the interpretations of Articles 126(1) and 128).
- The different features of the two-pillars of the Agreement's governance structure.

As a general matter, the problem of contractual ambiguity is a familiar one in law and economics. A contingency occurs that is not explicitly provided for in a necessarily incomplete contract or agreement and the question is: how is the ambiguity most appropriately resolved? Where the agreement has a declared aim, as the EEA Agreement does, the most obvious answer is that it should be resolved in a way that better advances that aim[10], an answer that appears to command favour with the European Court of Justice and is broadly consistent with the interpretative methods set out in the Vienna Convention on the Law of Treaties, for example in Article 31 ("General Rule of Interpretation", paragraph 1: *"A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and <u>in the light of its object and purpose</u>."* [My emphasis]

The aim of the Agreement is explicitly stated at the outset, in Article 1(1). It opens as follows:

"The aim of this Agreement of association is to promote a <u>continuous</u> and balanced strengthening of trade and economic relations <u>between the Contracting Parties</u> …" [My emphasis]

[10] Assuming that the aim itself does not come into serious conflict with other policy purposes.

Given that the UK is one of the Contracting Parties referred to in this aim – it is an established participant in the EEA – trade and economic relations between the UK and other Contracting parties are material factors in the resolution of ambiguity. A number of immediate questions arise that those who would wish to dance the hokey-cokey, by seeking to end the UK's status as a Contracting Party, would need to answer, including:

- Given the Agreement's aim, what are the benefits of such a significant shrinkage in the domain of the Single Market?
- On what possible basis could it be claimed that the UK's involuntary exclusion from the Agreement would contribute to the strengthening of trade and economic relations between it and other Contracting Parties?
- On what possible basis can it be claimed that the disruptive act of involuntary exclusion would promote a <u>continuous</u> strengthening of trade between the UK and other Contracting Parties?
- By what process would involuntary exclusion be achieved and precisely how would the ambiguities surrounding that exit process themselves be resolved? Wouldn't it be disputatious, costly and time consuming, particularly given that the Agreement itself makes no provision for exit other than voluntary withdrawal?
- Wouldn't the additional market uncertainties likely to be caused by involuntary exclusion themselves hinder both the achievement of the Agreement's specific aim and the achievement of wider policy purposes, including expansion of the Single Market?
- More generally, is there any 'objective justification' for requiring a compliant Contracting Party to withdraw from the Agreement?

These questions are sufficient to indicate that, while all manner of things are possible (legal construction not being mechanistic exercise), any case to the effect that ambiguities in the Agreement are best resolved by involuntary exclusion of an existing Contracting Party would be extremely difficult to make. Rather, legal and economic points align in the direction of the conclusion that UK exit from the EU does not imply that the UK ceases to be a Contracting Party to the EEA Agreement.

None of this is to suggest that transitions in the EU status of an EEA Contracting Party is simply a matter of moving a country's name from one sub-list in the Agreement to another. That is clearly not the case. However, the principal, substantive consequences revolve around the pillar of the EEA's institutional structure that is be the pillar of the transitioning Party's *destination* grouping.

For Austria, Finland and Sweden, the destination institutions were in the EU pillar of the governance structure; for the UK they are in the EEA EFTA (i.e. Iceland, Liechtenstein, Norway) pillar. Should it choose to explore the option of transitioning to the status of a non-EU Contracting Party, it would therefore be wise for the UK Government to commerce early discussions with Iceland, Liechtenstein, Norway and with the relevant "EEA EFTA" bodies. This is where the heavy lifting of institutional adjustment would need to be done. In respect

of activities related to the EEA Agreement, the European Commission and European Court of Justice will largely be unaffected, save that their work-loads will be reduced.

It is unfortunate that much media coverage of Brexit seems to be predicated on the assumption that one of the post-Brexit options for the UK is negotiation, *ab initio*, of membership of the EEA (usually referred to as the "Norwegian Option") and that such a negotiation would be exclusively, or almost exclusively, with the EU. That is not the case. *The default ('do nothing') position following exit of the UK from the EU is that the UK would remain a Contracting Party to the EEA Agreement.* Exit from the EEA Agreement requires that concrete, additional steps be taken, either unilaterally by the UK in the event that the Government chooses to withdraw or, via means that are currently unidentified and unknown[11], by the other Contracting Parties.

Should the UK choose to remain a Contracting Party to the EEA Agreement, there would then be "necessary modifications" to the Agreement, the scope of which would be a matter for consideration and negotiation. There is nothing to prevent the immediate commencement of consideration of necessary modifications, particularly given that the pressing issues for a UK transition chiefly engage the interests of Iceland, Liechtenstein and Norway, not the other members of the EU. An early start would be advisable: it does not need to wait on Article 50 notification to the EU.

The relevant, pressing matters concern the implications of continuing UK participation in the EEA Agreement for the EEA EFTA pillar of the EEA's supporting institutions: the EEA EFTA Standing Committee, the EEA EFTA Surveillance Authority, the EEA EFTA Court, the Committee of MPs of the EEA EFTA States, the EEA EFTA Consultative Committee. These are the institution on which the UK would rely if it chooses to remain a Contracting Party to the EEA Agreement: hence the anticipated workings and effectiveness of these institutions are material factors in determining whether or not remaining a Contracting Party is to be the preferred option for the UK.

At this point, it may be well to recall that, in the language, of the Agreement, "EFTA" does not mean EFTA as the acronym is usually understood. The institutions labelled EEA EFTA simply serve the three States that are non-EU Contracting Parties. It is not necessary for the UK to be a member of EFTA (as commonly understood) to be able to participate in or rely on these institutions, although an application for EFTA membership is certainly an additional option that the UK Government should consider. It does, however, require the development of cooperative arrangements with Iceland, Liechtenstein and Norway.[12]

For the Contracting Parties to the EEA who *are* members of the EU, the direct implications of continuing UK participation in the Agreement appear minimal, at least judged in terms of the Agreement's own, stated aims (for those who would wish to 're-purpose' the Single Market things will look somewhat different, which is where the real discomforts will lie). What will

[11] They fall into Mr Rumsfeld's category of known unknowns.

[12] The relative size of the UK economy might suggest that UK participation in EEA EFTA institutions could be a major difficulty, but the consensual mode of operation of those institutions (see footnote 9) speaks against that outcome. Decision making by consensus is a great leveller of power imbalances.

matter more for EU member states are the indirect effects, i.e. those occurring via the implications for intra-EU affairs.

Policy trade-offs

This brings us to the various economic implications of a UK decision whether or not to withdraw from the EEA Agreement. Some of the major issues will be addressed in sequence against a counterfactual of continued EU membership. That is, the discussion is centred on how things might change relative to how things would look if the referendum result had favoured Remain.

The chief interest is on economic effects on the UK, but it can be noted first that there are immediate pluses and minuses for member states of the EU (together with many, uncertain, less immediate effects). For example, post-Brexit, each EU member state will command a higher share of votes when an EU issue is put to the vote (although whether this will translate into greater or lesser influence over outcomes for an individual member state depends not only on the share of votes it itself commands, but also on the pattern of correlation of its own interests with those of other member states, whose voting shares will also increase). On the other hand, there will be a loss to EU members arising from the ending of UK budgetary payments to the EU.

Budgetary Payments

No doubt the EU will seek payments from the UK to make good some of this loss, so as to reduce the magnitudes of consequential hikes in in budget contributions from its members. The expectation of such payments has been used as an argument against the "Norwegian Option" and in the referendum debates such payments have been framed as the price that the EU will demand for "access" to the Single Market. However, the UK is an existing Contracting Party to the EEA Agreement and, as indicated above, it will not automatically cease to be so on exit from the EU.

There should, therefore, be no question of paying for "access". (Here, as on so many other issues, use of language can mislead.) Rather, any financial contributions by the UK should be seen as part of a wider settlement aimed at securing adjustments to the Agreement (and its Annexes and its Protocols) that will better serve the Agreement's aim of facilitating trade. Iceland, Liechtenstein and Norway are central to such a settlement and should properly have voices on these budgetary issues, i.e. financial payments are not exclusively a bilateral UK-EU issue.

A number of other points can also be noted in relation to arguments that have been made about the budgetary costs of the "Norwegian Option":

- A UK budgetary payment benchmarked on Norway's financial contribution as a fraction of GDP would run into billions of pounds, but would still be significantly less than the UK's current contribution to the EU, net of the UK rebate.

- Norway's financial contributions were first set at the time that the EEA Agreement was established when the notion of payment for "access" had greater substance.
- Given the modest levels of commercial activity of the non-EU Contracting Parties relative to that of the EU, e.g. as measured by, say, relative GDPs, there has been a significantly greater disparity in bargaining strengths in the past than there is likely to be in any budgetary negotiations forward, if the UK remains a contracting party.

The second and third of these points serve as a reminder that the economic context now and in the immediate future is somewhat different from what it was in earlier periods.

Loss of control over Single Market rule-making

A recurrent theme in commentary on the "Norwegian Option" is that it would lead to a loss of control over decisions concerning Single Market rules. In one sense that argument is now moot: voters have decided for Brexit and control over Single Market rule-making will necessarily be foregone. It is, however, worth revisiting the issue, because it has some bearing on the future evolution of the Single Market itself.

The first point to make is that the word control invites a binary interpretation: either you have control or you don't have control. The commercial reality is that control comes in degrees[13], and it is probably better to think in terms of degrees of influence (rather than control), to help escape from a binary mind-set. Moreover, influence is exerted in many ways and via many channels.

Notwithstanding this last point, Brexit implies that the UK can reasonably be expected to enjoy a lesser degree of influence in Single Market rule-making. How large the quantum of loss might be is very much an open question, and the eventual answer will be influenced by, among other things, any negotiated changes to the EEA Agreement and its Annexes and Protocols.

Standing back and thinking in general terms, market rule-making is a *co-determination process*, i.e. the rule-set, considered in its entirety and including aspects such as enforcement arrangements and compliance cultures, is the result of the actions and conduct of a multiplicity of economic agents. However, if an individual partial interest or sub-group of partial interests, comes to dominate or monopolise the rule-making process, it is to be expected that there will be a tendency for rule-making influence to be used to serve ends other than the primary purpose of any market (to facilitate trade). Controlling interests will tend to use their economic power to 'rig' the market in their own favour, though there are limits on this process, because when such 're-purposing' occurs the effectiveness of the market itself tends to be degraded.

Given that the UK will be an established Contracting Party, not a new Contracting Party seeking "access", it would be better to think of any future budgetary negotiations as involving, for example, payments for greater participation in and greater influence on the Single Market rule-making process. That is, contributions should be linked to reform of the EEA governance

[13] A dictionary definition is "the power to influence or direct people's behaviour or the course of events." The amount of power enjoyed by a party is obviously something to be measured along a continuum, i.e. it is not a binary variable.

structure in the direction of strengthening the participation of non-EU Contracting Parties with the intent of giving the EEA a more balanced, less partial governance structure. Such strengthening would be of benefit not just to the UK, but also to Iceland, Liechtenstein and Norway and to those EU member states whose commercial policies are reasonably well aligned with those of the non-EU Contracting Parties. Indeed, a less asymmetric distribution of rule-making power could be expected to be favourable to the development of the Single Market as a whole, by increasing the resistance to discriminatory 're-purposing' of the market and by helping keep all Contracting Parties focused on the Agreement's primary aim (facilitation of trade).

As to what the possible adjustments to Single Market governance might be, that will be a matter for detailed consideration as negotiations progress.

Response speeds and asymmetries of power

Even if the UK is willing to pay in order to secure adjustments to arrangements that would enhance the influence of non-EU EEA members in Single Market rule-making, there are risks that EU institutions will subsequently be able to 'chisel' by progressing self-interested rule-change in small increments. This after all is a natural tendency in collective agreements of many types, and it is to be remembered that the EU has (heavily weighted) political as well as commercial objectives and has shown a proclivity to use market rules to achieve political objectives, the creation of the euro being the outstanding example.

In such circumstances, economists tend to ask immediately about the strength of incentives to behave in this way, and accumulated learning on cartel behaviour and collusion identifies a number of factors that may affect such incentives. One of these is the degree of homogeneity in the interests of the cartel members. In this case the interests of 27 Contracting Parties to the EEA Agreement who will remain members of the EU diverge to significant degrees. Rules that would favour the partial interests of some combinations of EU member states, but would be inimical to the general aim of the EEA Agreement, would almost necessarily be contrary to the partial interests of at least some other EU member states. Whilst this might not prevent rule-creep driven by partial interests, it would likely slow the process down.

A second identifiable factor is the relative response speeds of different Contracting Parties in the face of unwanted conduct by others, i.e. the speed with which they can adjust their own policies in reaction to unwanted conduct by others. A fast response speed is a distinct advantage to whoever can command it. If the possessor is a dominant economic agent, it tends to reinforce the asymmetry of power and provide greater incentives for the use of that power; if the possessor is a weaker economic agent, it tends to mitigate the asymmetry of power and give rise to weaker incentives to use that power in the first place.

The UK's governance arrangements can, when needed[14], be remarkably speedy by international standards: the system has what might be called a *low inertia mode* that can be

[14] The qualification is important: there are obviously many examples of UK Government decision making where inertia appears to be much higher, airport runway capacity expansion in the South East being an obvious current example. If the proposition about a low inertia mode is correct, an inference that might be drawn from

switched on when circumstances dictate. In contrast, EU rule-making is a relatively cumbersome and slow process, which is unsurprising and difficult to avoid in a structure with so many members with differing interests.

Thus, while in a post-Brexit EEA there would be asymmetries in population numbers, sizes of GDPs, etc. between the EU and non-EU Contracting Parties, and while the latter may have significantly less direct influence on rule-making, there would also be asymmetries the other way arising from differences in speeds of response and in freedom for unilateral action. To focus only on the first gives a misleading impression of the likely balance of forces.

Sufficient unto the day *(alternatively, step by step) policy-making*

The high-level principles of economic policy can often be simply expressed. What is required now is that immediate issues be addressed quickly, among other things to avoid any unnecessary persistence of damaging uncertainty. *Sufficient unto the day is the evil thereof* is a useful guide, and what should count as sufficiency might be divided into three elements:

- Political acceptability in the light of the referendum result.
- Early reduction of avoidable uncertainty, in particular to mitigate potential falls in investment and possible recession.
- Not foreclosing options for adjustments and developments that might be desirable in the future, but the merits of which are currently uncertain.

The "Norwegian Option", i.e. continued participation in the EEA Agreement, can be assessed against these *desiderata*.

The second and third are the more easily addressed. Continued participation in the Single Market implies minimal disruption to existing trading arrangements with the other Contracting Parties, including with Iceland, Liechtenstein and Norway, not just EU member states. As yet no very clear, alternative shorter-term strategies have been developed in any detail or, *a fortiori*, tested for feasibility and effectiveness. There is talk of "sunlit uplands", but romantic imagery is not a good substitute for concrete policy strategy: even if the uplands exist, paths to get there need to be identified and careful consideration given the risks that they could lead into a marsh or over a cliff. Absent a clearly identified and carefully examined strategy, unilateral withdrawal from the EEA Agreement can be expected to magnify and prolong many of today's uncertainties.

Crucially (and it is difficult to overemphasise this point) the "Norwegian Option" does not foreclose shifts to alternative options in the future: withdrawal from the EEA Agreement requires only the giving of twelve months' notice in writing to the other Contracting Parties (Article 127). If things proceed co-operatively and the EEA works broadly as it is intended to

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the airports case is that a decision on capacity expansion has not been of sufficiently high priority to flick the switch, i.e. not 'needed'. Supporting evidence for the inference is to be found in the substantial, unused capacity at Stansted and the availability of a Gatwick option with a shorter construction lag. Heathrow may be the least cost option in the longer term, but the perceived cost advantages have not (up to the time of writing, but possibly not for very much longer) been considered sufficiently high as to trigger a very large, long-term commitment that would, in effect, foreclose other options.

work, i.e. serves its purpose in facilitating trade, it can continue to be supported and developed. If, on the other hand, it turns out that rule-making continues to be 're-purposed' in ways that have material, adverse effects on the UK, there could be relatively quick withdrawal at a later time.

It is at this point important to recognise that the EEA Agreement does not, unlike membership of the EU, preclude non-EU Contracting Parties entering into other trade arrangements, as Iceland, Norway and Liechtenstein have done via EFTA. EFTA is itself built on a trade agreement, but EFTA also has a number of trade arrangements with other countries around the world. The EFTA website currently reports 27 free trade agreements (FTAs) with 38 countries and 9 FTAs currently under negotiation, including with Russia and India.

The UK would, therefore, be free to develop such arrangements and thereby participate in the facilitation of trade more globally. The EU on the other hand is, and always has been, a customs union with a common external tariff that is set collectively, thereby precluding initiatives by individual member states (the latter obviously cannot, unilaterally, offer potential partners a lower tariff).

The first of the *desiderata*, political acceptability, is the one on which the substantive objections to the "Norwegian Option" tend to be concentrated. Critics have claimed that continued membership of the EEA would be only marginally different from continued membership of the EU, although it is an unfortunate feature of the referendum debate that substantiation of this proposition was notably lacking: all too often it was simply assumed to be the case. If the 'only marginally different' proposition were true and generally recognised to be true, a vote to Leave the EU could indeed reasonably be interpreted as a vote to leave the not-at-all-very-different EEA Agreement also, but is it true?

The EFTA website nicely summarises the information required to answer this question, in a succinct section headed "What is not covered by the EEA Agreement". It says:

The EEA Agreement does not cover the following EU policies:

- *Common Agriculture and Fisheries Policies (although the Agreement contains provisions on various aspects of trade in agricultural and fish products);*
- *Customs Union;*
- *Common Trade Policy;*
- *Common Foreign and Security Policy;*
- *Justice and Home Affairs (even though the EFTA countries are part of the Schengen area);*
- *Direct and Indirect Taxation; or*
- *Economic and Monetary Union."*

The UK has an opt-out from Economic and Monetary Union and from Schengen (which is not part of the EEA Agreement, but in which the three, existing non-EU Contracting Parties choose

to participate, via individual, bilateral agreements). Brexit would therefore not affect these matters.

For the rest it is difficult to argue that the listed differences are economically or politically unimportant. They figured prominently in the referendum campaigns and were consistently given as areas of policy where the UK should leave the EU in order to 'take back control'. In relation to the first bullet point alone, notwithstanding that many of them favoured Remain the great majority of economists hold the view that the Common Agricultural Policy is egregiously protectionist, has harmful consequences for UK consumers (which fall disproportionately heavily on lower-income households), has harmful consequences for farmers in developing countries, and significantly distorts land-use patterns, frequently in ways that are environmentally damaging.

The general point is that, if a question were to be posed to the public asking whether to Withdraw from the EEA Agreement or Stick with the EEA Agreement – and that becomes the relevant question once the EU-Brexit question is settled – many of the most forceful arguments made in the referendum campaign for leaving the EU have no relevance. The UK's decision-making capacity in relation to agriculture, fisheries, tariffs and trade, foreign and security affairs, justice and home affairs, and taxation would not be very substantially affected by the decision (to Withdraw or Stick with the EAA). For non-EU Contracting Parties to the EEA Agreement all these matters fall to national parliaments, not to the EU.

Given these points, it can be safely concluded that EU-Brexit coupled with continuing participation in the EEA Agreement would see a substantial repatriation of decision making powers to the UK.

Immigration and the free movement of persons

This brings us to the vexed question of immigration, a matter on which it has been difficult to establish sustained, reasoned, political discourse. There has been substantial immigration from the EU over the past few years, but also immigration from outside the EU, so relevant policy issues are not confined to the EU aspects. Attention here, however, is focused on the latter, in particular on the principle of *free movement of persons*, one of the four freedoms both enshrined in EU law and entailed by the EEA Agreement (Article 1(2)).

The 'four freedoms' terminology echoes President F.D. Roosevelt's four freedoms speech of an earlier period. There is a major difference between the two, however: Roosevelt's four freedoms (of speech, of religion, from want, from fear) were clearly policy *ends/aims*. The EU's four freedoms on the other hand are, at least in the way they are formally set out in the EEA Agreement, policy *means*. The Agreement *"entails"* them, but only *"in order to attain the objective"*.

Speaking generally, *broad* policy ends tend to be more enduring than policy means or, put another way, means tend to be more *context-dependent* than broadly specified ends. There

may be an enduring objective of "improving the material well-being of all sections of UK population", but the policies that are best calibrated to achieving it can be expected to change as circumstances (i.e. social, economic and political contexts) change.

One of the current problems to be faced is that the social, economic and political contexts have, over the past few years, changed significantly in respect to migration flows. The response to be expected from a policy system that is committed to its general objectives is early re-examination of at least some of the means that have been adopted in the past. That has not happened: the EU has, for one reason or another, become obstinately attached to a particular means: a particular view of the meaning and implications of *free movement of persons*.

One interpretation of this obstinacy is that it reflects a view that *free movement of persons,* as interpreted by the EU institutions, is a high value end in itself. In some circumstances this view can be aligned with public attitudes. Probably few in Britain would deny that the freedom to move about the country has substantial value over and above the economic benefits that it gives. But in other circumstances/contexts, things can look very different. Would EU decision makers be content to strike Free Movement Agreements (FMAs) with countries around the world? The evidence suggests not, and the reason why not is easy to identify: because of their implications, some FMAs would have adverse effects on the capacity to achieve other important policy objectives.

Such observed context-dependence in the application of the *free movement of persons* principle could be interpreted as reflecting different resolutions of the different policy trade-offs that occur in different sets of circumstances, but the stubbornness with which differences in the trade-offs facing individual EU member states are met with attempted uniformity of application of the principle indicates that other factors are at work. The more convincing explanation of EU interpretation of *free movement of persons* is that it is indeed a means to an end (as the EEA Agreement implies), but a means of pursuing an end that is different from the aim of the Agreement. More specifically, the interpretation is driven by the aim of creating "A Country Called Europe", i.e. of achieving a high degree of political integration. Since this is not the aim of the EEA Agreement, what we observe when an EU view of *free movement of persons* is mapped into an EEA context is an exercise in the 're-purposing' of markets.

To fill out the details, in the EEA Agreement the ends/means distinction is made explicitly at the start (in Article 1), as is the commercial nature of the Agreement. Paragraph 1 sets out the aim:

1. The aim of this Agreement of association is to promote a continuous and balanced strengthening of trade and economic relations between the Contracting Parties with equal conditions of competition, and the respect of the same rules, with a view to creating a homogenous European Economic Area, hereinafter referred to as the EEA.

The specified aim is in accord with the primary purpose or function of elements of the wider set of economic institutions that we call markets[15], i.e. with the facilitation of exchange transactions. There is no suggestion here of an intent to promote political integration. Article 1 Paragraph 2 then says:

2. In order to attain the objectives set out in paragraph 1, the association shall entail, in accordance with the provisions of this Agreement:

(a) the free movement of goods;
(b) the free movement of persons;
(c) the free movement of services;
(d) the free movement of capital;
(e) the setting up of a system ensuring that competition is not distorted and that the rules thereon are equally respected; as well as
(f) closer cooperation in other fields, such as research and development, the environment, education and social policy.

On the face of things, then, the appropriate interpretation of *free movement of persons* should be determined by the specified commercial objective and the context in which it is pursued. The appropriate interpretation can be expected to be generally different from that which is most appropriate if the aim is the pursuit of political integration.

Two economic points can serve to illustrate the different perspectives (commercial and political):

- There is no very rigid connection between *free movement of persons* taken in a literal sense and achieving the aim in Article 1(1). To see this, consider the issue in the less emotive context of trade between regions of a country. *Free movement of persons* might simply lead to the depopulation of a region, which in turn would tend to weaken trade between that region and other regions and also tend to lead to unequal conditions of competition across regions, there being few things more conducive to monopoly than a thin market.
- Movement of persons is liable to cause uncompensated third-party effects, i.e. impacts of transactions between employers and employees that have effects on other parties that are not taken into account when transaction decisions are made. At an international level the magnitudes of such effects depend upon a whole host of factors, including things such as the structure of social security systems, how health services are paid for, how education is paid for, whether road use is priced or congestion charges are used, housing policies, the voting system adopted, and so on. The standard economist's response to uncompensated third-party effects is to explore options to 'price' them in one way or another, so that they *will* be taken into account by the transacting parties, but that would run foul of the political interpretation of *free movement of persons* in

[15] References to conditions of competition is not a deviation from the focus on trade: competition policy is itself directed against 'restrictions of trade' of various sorts.

that it would most likely be classed as discriminatory: putting a price on 'movement' is to treat movers (migrants) differently from stay-putters (natives).

The general problem has been noted by Paul Krugman in his New York Times 'The Conscience of a Liberal' blog, in an entry entitled "Brexit: The Morning After" [16] in which he categorises *free movement of persons* as one of three major, recent EU policy mistakes (the others are the adoption of the euro and the framing of the euro crisis as a morality tale in which the villains are irresponsible southerners). The mistake was: *"the establishment of free labor mobility among culturally diverse countries with very different income levels without careful thought of how that would work"* [my emphasis]. Krugman's sentiments here are Keynesian, in that Keynes was witheringly critical of the preoccupation of the European elites of his time with their own political projects and of their accompanying indifference to the consequences of those projects for the welfare of the peoples of Europe.

Returning to the EEA Agreement, what we find is a document that explicitly recognises that the creation of a Single Market involves making (a) trade-offs among ends that, particularly when we move from very broad aims to more specific objectives, can come into varying degrees of conflict with one another, (b) trade-offs among means available to achieve those ends, and (c) periodic adjustments to means to reflect changes in social, economic and political contexts so as better to achieve ends/aims in changing circumstances.

For example (and possibly surprising to those who haven't read it) Article 13 of the EEA Agreement dealing with free movement of goods states that quantitative restrictions, i.e. imposition of quotas on imports of goods, exports of goods and goods in transit are not precluded if

"… justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between the Contracting Parties."

Here we immediately see recognition of the possibility that the objectives of public policy can come into conflict – the public policy justification in the list is particularly broad in scope – and that *this can provide justification for over-riding the principle of free movement of goods.*

The provisos at the end of the citation are not particularly restrictive of good practice policy-making. An example of arbitrary discrimination might be a system of quota allocations that was more generous to one source of imports (of the same type of good) than to another; an example of a disguised restriction might be the use of quotas that are more stringent than is necessary to achieve the best resolution of the trade-offs between competing ends. These are

[16] http://krugman.blogs.nytimes.com/2016/06/24/brexit-the-morning-after/

characteristics of policy measures that would be in violation of best practice regulatory guidelines endorsed by the UK, the EU and other OECD countries.

Crucially, under the EEA Agreement the decision to impose an import or export quota falls to the Contracting Party. *It is a decision that can be taken unilaterally.*

Similarly Article 43 of the EEA Agreement sets out contexts where a Contracting Party can place restrictions on the free movement of capital. For example:

"If movements of capital lead to disturbances in the functioning of the capital market in any EC Member State or EFTA State, the Contracting Party concerned may take protective measures in the field of capital movements."

Similarly,

"Where an EC Member State or an EFTA State is in difficulties, or is seriously threatened with difficulties, as regards its balance of payments either as a result of an overall disequilibrium in its balance of payments, or as a result of the type of currency at its disposal, and where such difficulties are liable in particular to jeopardize the functioning of this Agreement, the Contracting Party concerned may take protective measures."

When it comes to the section of the Agreement devoted to free movement of persons we find no equivalent, *specific* provision for the introduction of protective measures. One explanation of this is that the construction of the Agreement was more responsive to the supplications of business and financial interests than of workers. An alternative explanation is that it reflects a higher EU weight on *free movement of persons* than on free movement of goods and capital, derived from the perceived[17] contribution of *free movement of persons* to the objective of political integration. The two explanations are not mutually exclusive.

Taking things more broadly however, the EEA Agreement does provide for context-dependent variations in the application of the principle of *free movement of persons*. First, Article 28(3), which sets out in specific detail what free movement of workers entails, opens with the words:

"It shall entail the right, <u>subject to limitations justified on grounds of public policy, public security or public health</u>: ..." [My emphasis]

There is nothing in that to unduly concern a UK Government: it explicitly recognises that there can be trade-offs between free movement principles and other, important policy objectives. The issue for the UK is not, I think, the free movement principle in its abstract form, rather it is to do with the much more concrete question: how is the question of what limitations are justified to be decided? That is, the issue is one of *control* or the degree of control. Non-EU Contracting Status would, in effect, shift control away from the EU institutions, which is not

[17] Whether or not there is actually a positive contribution is a matter of controversy. In today's context, there are reasons for believing that it is contributing to political disintegration.

to say that the UK would have a completely free hand in the matter.[18] Rather it would become the decision maker of first instance, subject to oversight by EEA, not EU, authorities who themselves should be guided by the aims and terms of the EEA Agreement, not of the EU Treaty.

Second, the EEA Agreement contains a whole (albeit short) Chapter (Chapter 4) devoted to Safeguard Measures that can be unilaterally imposed by a Contracting Party. The use of safeguard measures is constrained to tackling problems of a regional or sectoral nature, but this is a broad category. Concerns about immigration show significant regional and sectoral patterns, as reflected for example in the voting patterns in the referendum, and these map into categories of labour that might be used in, say, a points-based system of immigration controls, e.g. based on different points for finance sector workers destined for London than for agricultural workers destined for the East of England.

Given the political salience of immigration issues, it is worth citing Chapter 4 in its entirety to illustrate the possibilities and limitations of the safeguard measures provided for in the Agreement.

CHAPTER 4 SAFEGUARD MEASURES

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 <u>unilaterally</u> take appropriate measures under the conditions and procedures laid down in Article 113. [My emphasis]

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.

[18] In any event, a fundamentalist view of control of immigration is about as Utopian as a fundamentalist view of *free movement of persons.* Governments can legislate, but they cannot fully control the consequential outcomes of legislative change. Indeed, the study of economic policy is not short of examples of cases where the effects of legislation have been in a direction opposite to that intended.

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. [My emphasis]

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.

A number of points can be made about these provisions:

- For EU Contracting Parties, the decision maker is the Commission (see Article 113(3)).
- For non-EU Contracting Parties, the decision maker is the national government and, crucially, *the decision can be taken unilaterally* (see Article 112(1)).
- The conditions in Article 112(2) are again no more than an insistence on best practice policymaking and are not particularly restrictive for a government trying to comply with its own best-practice guidelines.
- Article 113 is concerned with process issues and the requirements are broadly in line with good policy practice in the areas of consultation and information sharing, except for the "every three months" provision. For measures that are considered to be of great significance to a Contracting Party the additional administrative costs of three-monthly reporting are likely to be considered trivially small relative to the benefits arising from any measures likely to be deemed to be warranted. For other Contracting Parties involved in monitoring the implementation of safeguard measures the cost-benefit balance can be expected to be less favourable. However, particularly if a safeguard measure is expected to endure for an extended time period, it can be expected that actions will be taken, in the cause of administrative expediency, to reduce the frequency of reporting and this is what happened in the case of Liechtenstein, via the Agreement's Annexes and Protocols. Liechtenstein has implemented restrictions on immigration since it first joined the EEA in 1995.

What this all amounts to is that Brexit, coupled with maintenance of the UK's status as a Contracting Party of the EEA Agreement, implies a shift in control in relation to immigration

issues, although one that is less dramatic than in policy areas such as agriculture and trade policy. Nevertheless, the shift is not a trivial one. As of now the EC Commission is the decision maker for the UK: "*For the Community, the safeguard measures shall be taken by the EC Commission."* Post Brexit, if the UK maintains its Contracting Party status, this will effectively become *For the UK, the safeguard measures shall be taken by the UK.*

For example, if it wanted to, the UK Government could (unilaterally) introduce time-limited (sunset) controls on numbers and use the intervening time to develop a more market-based approach to *free movement of persons*.[19] When the sun sets on the initial controls, a proposed, more permanent alternative might be challenged, but that is a challenge that could be prepared for, and well-designed economic mechanisms have a good defence record. The EU might also itself have started to adjust its own approaches to free movement issues by then, so that securing amendments to the EEA Agreement to allow more permanent arrangements to be embedded might be feasible. Or, if embedding is still resisted, the permanent arrangements might be sustainable as a sequence of 'temporary' safeguard measures. Or the issue may have fallen down the list of priorities because of changed circumstances, and such arrangements might no longer be considered necessary by the UK. Or, if there was a still a major problem and prospects for resolution looked bleak, that might be time for the UK to give notice to withdraw from the EEA Agreement.

The main point is simply that there is optionality all down the track, giving time for policies like the widely touted global search for trade deals to be market-tested and evaluated and enabling policy trade-offs associated with alternative strategic policy options to be resolved on the basis of future information about their effectiveness that is less speculative than current information.

Concluding comments

The "Norwegian Option" or, to put it more accurately, continuation of the UK's existing status as a Contracting Party to the EEA Agreement has a number of attractive features, but there have been two, major objections to it. The first is that it is little different from existing membership of the EU and is therefore at variance with what the electorate voted for in the referendum. Examination of the provisions of the EEA Agreement indicate that, considered generally, the 'little difference' proposition is incorrect. The Option is consistent with achieving a substantial repatriation of powers to the UK. For example, among other things it would restore the UK's ability to seek out new trade agreements across the globe – a *desideratum* that was much emphasised by the Leave campaigns – whilst not unduly disturbing current free trading arrangements with EU partners.

[19] Existing immigration control arrangements around the world, including points systems, tend to be based on inefficient administrative mechanisms, and it is near certain that superior arrangements are feasible. Not so very long ago it was considered impossible to price such things as radio spectrum or reactive power (in AC electric systems, power that does no work), nowadays exchange transactions in each are routine. The UK has been a pioneer in addressing this type of problem and has some of the world's leading 'market designers' in residence.

The second objection is much more specific. It is that the "Norwegian Option" is little different to EU membership in relation to the principle of the *free movement of persons*, which is entailed by both the EU Treaty and the EEA Agreement. If true, the weight to be given to the point depends upon the relative weight given to immigration issues, and that is clearly a matter for individual preferences and judgments.

In making those judgments, however, care should be taken not to be fooled by words and abstractions. Movement is never 'free' in an economic sense: like all human actions, it comes with costs. What is to be meant by *free movement of persons* is necessarily a matter of interpretation and of application of the principle, and appropriate interpretations and applications are generally context-dependent, i.e. they tend to change as circumstances change.

Even in the EU, the interpretation and application of *free movement of persons* is a contested matter and continued participation in the EEA would open up two, new fronts on which the struggle could be pursued. First, the aim of the EEA Agreement (which is largely commercial in nature) is very different from the aim of creating a Country Called Europe. It entails *free movement of persons* as a means to achieve a much less ambitious, largely commercial end, and this in itself provides a solid rationale for a difference in interpretation and application (from an approach motivated by the aim of political integration).

Second, the EEA Agreement provides significantly greater scope for *unilateral* action by the non-EU Contracting Parties in relation to decisions about movement of labour and persons, just as it does in relation to the application of the principles of *free movement of goods* and *free movement of capital*.

Whilst the significance of these differences is again a matter for individual judgment, sound judgments should, at a minimum, take account of their existence, i.e. not ignore some real differences. Moreover, a judgment that the differences are too small to be acceptable on an enduring basis should not be considered in and of itself determinative of an answer to the question of whether or not to withdraw from the EEA Agreement at the moment of Brexit. Non-withdrawal today leaves open the option of withdrawal tomorrow. It is a just a case of taking one step at a time.[20]

Remaining a Contracting Party to the EEA Agreement might be described as a 'soft landing' from Brexit, although that should not be read as implying that the jump is a small one, only that the mattress has substantial depth and resilience. Having landed, there will be ample time to consider how next to proceed. Policymaking is an ever-continuing exercise in plotting a

[20] One of the best illustrations of the step-by-step policy approach is the programme of privatisation, market liberalisation and regulation that was implemented in the 1980s and early 1990s. Step-by-step is not always the best approach however: in 1990 the Polish Government opted for comprehensive and immediate deregulation of prices, rather than a more gradual adjustment path. The two contexts were different, and each strategy was effective in its own context. What is being suggested in this section is that the Brexit context points to gradualism rather than trying to resolve all major issues at the outset, not least on the basis of the underlying rationale of the original expression of *sufficient unto the day*: the alternative would divert substantial amounts of time, attention, resources and cognitive effort away from other, immediately important matters.

course, not in making sharp jumps to some end destination. The latter are rarely feasible, but if they are the destination almost invariably turns out not to be the end of the journey: events occur, contexts change and the end turns out to be just another beginning, e.g. because events have conspired to make it an uncomfortable place to stay.

It is true that the EU has sought to 're-purpose' the EEA Agreement. Examples include: (a) insinuating that reduction in regional disparities is one of the Agreement's objectives (rather than, as the Preamble to the Agreement suggests, an expected effect of achieving its Article 1(1) aim), (b) introducing, in its Protocols and Annexes, a financial transfer mechanism, and (c) interpreting and weighting the principle of *free movement of persons* in a way that is motivated by political objectives that should play little or no role in this type of Agreement. Here again, however, care should be taken to avoid an unduly Utopian view of policy-making: feasible imperfection is better than impossible perfection. 'Re-purposing' of markets is a general phenomenon that is always with us and to which liberal commercial policies will always be opposed. The Single Market is just one of the many fronts on which this wider struggle plays out.

There is an immediate short-term issue of policy uncertainty arising from the referendum vote and an early declaration that the Government has no intention of withdrawing from the EEA Agreement, i.e. no intention of triggering Article 127, would do much to reduce that uncertainty. It would in itself be a game changer. It is, however, possible to go further.

First, subject to the outcomes of early discussions with Iceland, Liechtenstein, Norway and the non-EU ("EEA EFTA") institutions supporting the non-EU ("EEA EFTA") pillar, it might be possible to move much more quickly to Brexit than could be expected to be the case in the event that trading arrangements with the EU were negotiated from scratch. The EEA Agreement is an existing document and the "necessary modifications" that would be required to reflect the new realities appear to be modest in scope. "Necessary modifications" would leave scope for further improvements, but these could be considered over a longer period by way of the processes set out in the Agreement itself, based on discussions, negotiations and ultimately agreement among Contracting Parties who share the Agreement's aim.

Second, it could be explicitly recognised and stated that, in the face of sharp or rapid changes in economic context or environment, policy certainty is not well promoted by clinging to rules/regulations/laws-as-they-are. Rigid adherence to rules that no longer serve their intended purposes creates institutional fragility, usually ending in a crisis, crunch or collapse that then gives rise to further, major uncertainties. What can potentially stabilise things in periods of change when rules are being rewritten is a clear sense of an enduring policy purpose (facilitation of trade) coupled with a commitment to stand in opposition to those pressures that would hinder its advancement (the ever present partial interests who seek to 're-purpose' markets). Simple, repeated reassurance that the referendum result is not to be interpreted as a shift to new and unfamiliar UK policy purposes – and indeed can be seen as a re-commitment to traditional positions in relation to things such as parliamentary democracy and liberal, global commercial policies – could help here.

This should not be beyond the capacity of a British government comprised of politicians who may have an interest in their own electoral prospects. There is strong, popular support in the country for the purpose that markets[21] serve, facilitation of exchange transactions, although the grounds of that support are not usually very clearly articulated: the purpose is taken as a given of a commercial culture. The vast majority of us depend heavily on these institutions in our quotidian lives and have a strong interest in seeing them work well, whether the markets are local, national or international in scope. Continued participation in the Single Market, via the EEA Agreement, would simply be an aspect of a very traditional UK commercial policy and it would serve as a very clear signal that the central features of that policy remain intact.

The remarkable thing about the (*sufficient unto the day*) policy strategy outlined is its simplicity. It has only three, indispensable components: (a) do nothing, i.e. don't voluntarily withdraw from the EEA Agreement, (b) let everyone know that the intention is to do nothing, i.e. that the UK does not intend to withdraw voluntarily from the EEA Agreement, and (c) enter early discussions with the Governments of Iceland, Liechtenstein and Norway and with the EEA EFTA institutions. The first may come about by default: the second and third would require active, modest steps by Her Majesty's Government.

[21] Note that the word market needs no qualifying adjective such as 'free' or 'social'. When used, the import of such adjectives is almost invariably unclear and a good rule of thumb is that, when a qualifying adjective appears, the motivation is frequently to be found in an attempt to 're-purpose' (although of course it may also just reflect a lack of understanding of the nature of markets).

Annex

Article 126 of the EEA Agreement: a butterfly effect? [22]

The interpretation of Article 126 of the EEA Agreement may look like a small matter, but it has very large potential consequences for the Brexit negotiations and their outcome. It therefore merits some careful thought.

In discussions of the proposition that UK exit from the EU does not imply UK exit from the EEA – and hence that it does not imply that the UK, should it wish to remain part of the Single Market, will have to apply for and negotiate "access" – the most frequent objection elicited from lawyers is that this is to ignore Article 126 of the Agreement. Their argument is a simple one and goes as follows.

The text of Article 126(1) is:

"The Agreement shall apply to the territories to which the Treaty establishing the European Economic Community is applied and under the conditions laid down in that Treaty, and to the territories of Iceland, the Principality of Liechtenstein and the Kingdom of Norway."

Post-Brexit, the UK will not be a member of the European Economic Community (now the EU) and the UK obviously isn't Iceland, Liechtenstein or Norway. Ergo the Agreement shall not apply.

Response

An error of logic

The first point to note is the logical error. The deduction would be correct if the Article opened with the words *The Agreement shall <u>only</u>* apply … . Without the word 'only' there is nothing to indicate that the Agreement cannot also apply to countries that do not satisfy the conditions set out in Article 126(1). *A fortiori* there is nothing to indicate that the Agreement ceases to apply to one of its own Contracting Parties which, by dint of circumstances, no longer satisfies one of the conditions specified.

A possible counter-response is that the word 'only' can reasonably be inferred from the surrounding text, the economic and political context in which the Agreement was made, the original intentions of the Contracting Parties to the Agreement, and so on. If that point is made, it goes without saying that there is a burden of proof to be discharged by those who would argue for it, and in this case I think the burden is a heavy one, because this particular flap of a

[22] The butterfly effect refers to a phenomenon in which a very small difference in the initial or starting position (the 'boundary conditions' in physical systems, the 'context' in social and economic systems) of a dynamical system leads to very large differences in the system's later states. The naming comes from Edward Lorenz who illustrated the (previously known) phenomenon by pointing to the possibility that that one flap of a butterfly's wings could give rise to changes in the course of subsequent, major weather systems. In the current context the wing-flap is the interpretation of Article 126.

butterfly's wings would have obvious, very major consequences: it would *compel* UK exit from the Agreement.

In fact, the arguments for the wing-flap are weak. There is nothing in the rest of the Agreement's text that provides a clear pointer to an intention that membership of either the EU or EFTA was an essential characteristic for Contracting Parties, and the EU's broad policy goals in the period 1989-1992 were to bring countries together, not to create new barriers to participation in the Single Market.

De facto the Contracting Parties were, and to date have been, members of the EU or of EFTA, but it is hard to see that this reflects anything other the fact that, in the period 1989-1992, this was an Agreement that would not only contribute in and of itself to the EU's wider policy goals of the time, but also was feasible within a relatively short time period and could serve as a first, significant step in a more comprehensive programme of economic co-operation.

Another argument for the inclusion of 'only' is that without it Article 126(1) is simply descriptive, conveys no information, and *therefore* would not have appeared in the Agreement at all, but this too is unconvincing. The 'therefore' is itself questionable, relying on implicit, auxiliary assumptions to the effect that re-statement, or stating the same thing in a different way, can have no value and that drafters will never ever be inclined to state the obvious. However, the main reason that this argument can be discounted is that Article 126(1) is not informationally redundant: it serves a specific, additive function, and its interpretation and implications should be assessed on the basis of this function.

Inconsistency with principles of international law

Next, consider the argument that an 'only' can reasonably be inferred from an interpretative maxim such as *expressio unius est exclusio alterius* (to express one thing is to exclude another, alternative thing).

The difficulty then is inconsistency with the general intent of the Vienna Convention to protect and preserve as much as is feasible of international co-operation in the face of extraneous political events, illustrated for example by the discrepancy between this maxim and the Convention's own guidance on interpretation.

To illustrate, if the EU were a fully-fledged political union and had entered into a multilateral agreement with Iceland, Liechtenstein and Norway, Brexit would have the effect of creating two successor states, the UK and the EU minus the UK. The Vienna Convention on Succession of States says, in Article 34, that: *"1. When a part or parts of the territory of a State separate to form one or more States, whether or not the predecessor State continues to exist: (a) any treaty in force at the date of the succession of States in respect of the entire territory of the predecessor State continues in force in respect of each successor State so formed; …"* In the hypothetical circumstances, therefore, the multilateral agreement would still apply to the UK.

These are not, of course, the actual circumstances. The UK is a Contracting Party to the EEA Agreement in its own right, having signed it and ratified it, factors that serve only to *strengthen*

the case against any forced exclusion. The point is simply that, given the Convention's approach to successor states, it would be extraordinary to over-ride its purposes and intent via recourse to an interpretative maxim such as *expressio unius est exclusio alterius.*

Oddities as signifiers

To elaborate further, consider the situation if the word 'only' were somehow conjured into the text. There would then be a number of oddities.

First, the question of who can and cannot be a Contracting Party is an important one. Why then is it not set out much earlier in the Agreement where most of the substantive content is to be found? As it stands it is the 126th of 129 Articles, in the final part, Part IX, of the Agreement which is entitled GENERAL AND FINAL CONDITIONS and which can reasonably be said to be focused on tidying up a number of loose ends.

Second, why do the words *"under the conditions laid down in that Treaty"* appear in Article 126(1)? What do they mean? Could they not be omitted?

Third, most of the text of Article 126 comes in its second paragraph, which is its only other paragraph. Article 126(2) states that:

Notwithstanding paragraph 1, this Agreement shall not apply to the Åland Islands. The Government of Finland may, however, give notice, by a declaration deposited when ratifying this Agreement with the Depositary, which shall transmit a certified copy thereof to the Contracting Parties, that the Agreement shall apply to those Islands under the same conditions as it applies to other parts of Finland subject to the following provisions:

> *(a) The provisions of this Agreement shall not preclude the application of the provisions in force at any given time on the Åland Islands on:*
>
> > *(i) restrictions on the right for natural persons who do not enjoy regional citizenship in Åland, and for legal persons, to acquire and hold real property on the Åland Islands without permission by the competent authorities of the Islands;*
> >
> > *(ii) restrictions on the right of establishment and the right to provide services by natural persons who do not enjoy regional citizenship in Åland, or by any legal person, without permission by the competent authorities of the Åland Islands.*
>
> *(b) The rights enjoyed by Ålanders in Finland shall not be affected by this Agreement.*
>
> *(c) The authorities of the Åland Islands shall apply the same treatment to all natural and legal persons of the Contracting Parties.*

The Åland Islands lie in the Baltic Sea between Finland and Sweden. The inhabitants, who number around 28,000, are Swedish speakers, but the islands are part of the territory of Finland. The islanders enjoy a significant degree of autonomy.

The question is: why should these provisions relating to the Åland Islands be bundled together, in the same Article, as a proposition that can, so it is argued, be determinative on such an important matter as entitlement to participation in the EEA Agreement?

Examination of such oddities can often be informative, and in this case it certainly is.

States and territories

The EEA Agreement is an agreement among governments, who are the Contracting parties and of which the UK is one. However, membership of the EU does not require that the whole *territory* of a State be subject to the EU Treaties. In relation to the Kingdom of Denmark, for example, Greenland and the Faroe Islands are 'contracted out'.

Similarly, what can be termed 'special member state territories' may be 'contracted in' to the EU, but with certain conditions applied. For example, the Spanish enclaves of Ceuta and Melilla are part of the EU, but they are excluded from the common agriculture and fisheries policies.

The EEA Agreement necessarily has to address issues arising from these special territories, of which there are a significant number, including overseas territories that became attached to Europe in the age of empires: they are a kind of fossil record of European history. UK examples are the Channel Islands, the Isle of Man and Gibraltar. The reason for this necessity is Article 29 of the Vienna Convention on the Law of Treaties, which states that: *"Unless a different intention appears from the treaty or is otherwise established, the treaty is binding on each party in respect of its entire Territory".*

The issues are therefore addressed in Article 126, which expresses the intention of the Agreement in respect of the territories to which it is to apply. *It takes the set of Contracting Parties as a given* and then, in effect, defines the parts of their territories (generally all or the great bulk of the territories) that are to be covered by the Agreement, applied either in its entirety or subject to special provisions. The relative policy significance of the matter, which reflects the small, relative economic sizes of the special territories, explains its late occurrence in the text of the Agreement.

The potentially complicated exercise of 'geographic market definition' for EEA purposes is simplified by the fact that the EU had already gone through this exercise for those of the Contracting Parties who were its own members at the time. The Agreement therefore simply adopts the outcomes of that earlier process – "*The Agreement shall apply to the territories to which the Treaty establishing the European Economic Community is applied …".* Further, as noted, certain territories may be 'contracted in' to the EU Treaties, but subject to certain conditions. This explains the words *"… and under the conditions laid down in that Treaty".* Any conditions in the EU Treaty that are relevant to the operation of the Agreement are simply

mapped from the EU Treaty into the EEA Agreement, and a potentially time consuming, administrative exercise is avoided.

The same, administratively expedient option was not available for those Contracting Parties who were not members of the EU, and hence these had to be dealt with separately, country by country. Fortunately, these countries, which originally included Austria, Finland and Sweden as well as Iceland, Liechtenstein and Norway, do not have appeared to have raised 'special territories' issues, save in the case of Finland.

Finland was the only country with a special territories issue that was a Contracting Party of the EEA before joining the EU. This explains why the matter of the Åland Islands, uniquely among special territories, needed be addressed in the EEA Agreement, and it is so addressed in Article 126(2).

Brexit would imply that that there would need to be "necessary modifications" to the Agreement, but this doesn't mean that the special territories issue needs to be re-opened in a way that would lead to significant administrative burdens. For example, the text of Article 126(1) could be adjusted to read: *"The Agreement shall apply to the territories to which the Treaty establishing the European Economic Community is or has been applied …*". That would map the UK arrangements at the time of Brexit into the EEA Agreement without further ado.

Conclusion

The perceived oddities exist only as a result of misinterpretation and the conclusion from all this is simple: there is no case for conjuring the word 'only' into the text of Article 126(1). Article 126 was not intended to be, and as it stands is not, determinative of the ability of a country to participate in the Agreement. It is not exclusionary, either by intent or by effect. The purpose of the Article is, *starting with the territories of the Contracting Parties*, to make negotiated, generally marginal adjustments that take account of the interests of the inhabitants of a number of special territories.