

# **Britain and the EU**

## ***A negotiator's guide***

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## Executive summary

### **Objectives and ambitions**

At this point we do most good by focussing on process and scenarios rather than outcome.

### **Negotiation and referenda**

HMG should give serious thought to raising its game if it wishes to succeed in the conference chamber. Britain's modest experience of referenda holds out some scope for brinkmanship.

### **The strengths and weaknesses of the parties' bargaining positions**

Every argument has its counter. Some are important – sixty years of peace in Europe, the EU's defective institutions, easier trade, the failure of the common market in services. Others are inflammatory – sovereignty, immigration, suspension of contributions or compliance.

### **The best available 'in' and 'out'**

Paradoxically, the UK might well end up with a better deal if it is willing to contemplate life 'out', as EU negotiators are likely to stick to their guns if the UK is determined to stay 'in', whereas departure opens up transitional arrangements.

### ***In extremis*: immediate disruption vs eventual outcome if the UK ends up 'out'**

If the UK leaves the EU, disruption would pose challenges comparable to other adjustments in the country's recent history; the eventual outcome is no cause for gloom but – as ever – depends on good luck and good management.

## 1 Objectives and ambition

*At this point we do most good by focussing on process and scenarios rather than outcome.*

Before we settle on a stance for the forthcoming EU negotiations, we need first to explore the position of the coalition. It looks as though the Tory leadership is not persuaded by the tactical argument that vigorous renegotiation would weaken the lure of UKIP for *Spectator* Tories (and outflank the other parliamentary parties) without undermining the efforts to ‘detoxify’ the Conservative brand.

Fundamentally, the government seems to want Europe to work and to stick with it while avoiding an unacceptable price. It is not clear, however, what ‘unacceptable’ might mean. There is no hint that the leadership is as irked as some junior ministers by EU intrusion in the business of government: certainly nothing has been heard on this score from senior sources. Neither have we heard anything to suggest that the Cabinet is fussed by the failure of a common market in services to emerge; indeed after the financial crisis broke we heard of ‘rebalancing’ towards manufacturing. This all seems to illustrate a cast of mind. Finally, the government may well feel it has enough on its hands without taking on the Foreign Office or the judiciary. So we conclude that the government is not going to commit to vigorous renegotiation, leading to undemanding targets.

The UK government has little control over the timetable of renegotiation. So it will extol the virtues of patience and pragmatism; almost any eventual outcome will be presented as a triumph or at least a perfectly acceptable compromise on any ‘reasonable’ view.

If we were to identify worthwhile UK renegotiation ambitions, then the most constructive approach would be to seek fulfilment for the UK of the EU’s central bargain: a surrender of sovereignty only in return for palpable gains. For the UK this means not so much peace (as for France), or respectability (as for Germany, and for Southern and Eastern European members with only recent history of democracy), or a voice (as for the Low Countries and other smaller nations), but free access to local markets where we have comparative advantage, specifically services. This, however, has been delayed indefinitely: though the Services Directive was negotiated during the good times from 2000 to 2006, it was rendered toothless by vested interests and now stands unenforced. The failure of the EU to deliver on its central bargain with the UK amplifies the grievances about sovereignty.

The natural course would be to revisit the issue with a new timetable. But at present there is no understanding, spending capacity nor political will for the critical reform – dealing with bank balance sheets and the zombie companies they support. In addition, the Euro’s sovereign debt crisis complicates events beyond any hope of timely resolution. So efforts on this score are acutely untimely, with the recession and banking crisis edging us towards greater (rather than lesser) restrictions.

This will leave negotiators unable to address the market in services in a positive spirit. As a result, our delegation will be obliged to engage with the other side of the failed bargain – in other words, to contemplate the repatriation of powers (which famously threatens to inflame attitudes). Do negotiations founder at this point? It depends on how the Government has communicated its ambitions for renegotiation and on public opinion.

Ahead of the Prime Minister’s speech, there seems to be something of an official campaign to depress expectations. This has included the *Sunday Telegraph* interview with the PM himself, articles by senior commentators and a round-robin letter to the *FT* from business leaders. Wednesday’s speech by a senior US diplomat, Philip Gordon, followed by Thursday’s by the chair of Germany’s European affairs committee, Gunther Krichbaum, have pointed up the misgivings of our principal allies about vigorous renegotiations. They also have the effect of defining sovereignty down, such that even calls for a referendum look like bulldog independence.

We conclude that advocates of any specific outcome – ‘in’ or ‘out’ – will have a hard time getting serious attention from the UK government at the moment. Therefore this paper confines itself to examining process and scenarios, without pronouncing on an outcome.

## 2 On negotiation – 1

*HMG should give serious thought to raising its game if it wishes to succeed in the conference chamber.*

*'...wise policy-makers, while aware of their nation's limits, know that the art of statesmanship is about working as close to the edge as possible, without stepping over the brink.'*

Robert Kaplan, introducing the foreign policy realism of Hans Morgenthau (Kaplan, 2012, p14).

Negotiators celebrate their commitment to 'principled negotiation', building relationships and setting expectations with good manners and consistency of conduct, resolving issues in an orderly fashion, respecting confidences, finding common ground if possible and if not, ensuring that concessions are fairly balanced and reflect good-faith interests. In reality of course, negotiators lose their temper, revisit issues remorselessly, engineer shocks to put the other side off, undermine each other, seek to orchestrate events from outside the room and generally play dirty pool. The question thus becomes, 'how resourceful is the UK government willing to be in prosecuting its objectives?' We may take it that it will be gaming the possible scenarios. But other questions remain, for example:

- **What expertise will HMG deploy in its gaming?** How successful will it actually be in developing fall-back positions? Or in rendering them compelling to the other side?
- **How willing will HMG be to challenge the other side?** To revisit topics formally resolved in the past? To place more rather than fewer issues on the table? To set lines in the sand – either as to substantive issues or as to negotiating conduct ('Her Majesty's Government will not negotiate under duress')? To walk out to make points? To convey the merit of an 'out' to get the best out of an 'in'? To play real hardball?
- **Will HMG be sufficiently tough-minded in the choice of the team it fields?** The fear would be 'Buggins turn' leading to what the Rand Corporation famously called 'educated incapacity' – in this instance, senior diplomats well-versed in EU affairs – but who then see things too much from the other side. Paradoxically, it might be better to field negotiators without EU form.
- **How much resource will HMG devote** to staffing and the overnight research and analysis that was once a great British talent? Is there a commitment to combine this with a 'command communications and control' (C<sup>3</sup>) set-up, providing for direct political control and rapid responses to unexpected events?
- **What preparation will HMG make for the sheer grinding physical toll** of EU negotiations on its team?
- **How successful will HMG be in controlling information?** Will it be able to respond promptly to unexpected events by influencing the commentary at home and abroad?
- **How willing is HMG to incorporate the referendum process or timetabling into its negotiation tactics**, with some commentators already decrying the former?
- **Is HMG willing to use out-and-out cunning?** Will it contemplate ways to wrong-foot or undermine the other side?

Engaging with these matters in the round, a realistic vigorous negotiating schema might embrace:

1. **A clear statement of HMG's objectives.** For example:
  - a. **Preferably, to obtain a settlement** enabling the UK to stay in the EU on terms satisfying our sovereignty and economic objectives within (six months? twelve months?);
  - b. **Failing that, to obtain as much of an orderly and amicable withdrawal** as may be achievable within the following (six months? twelve months?);
  - c. **Putting the deal to a referendum;** or
  - d. **Seeking a mandate for a more vigorous stance if necessary.**

## 2 On negotiation – 2

2. **Negotiating team.** The following requirements seem wise:
  - a. **A chain of command to PM/cabinet sub-committee** via C<sup>3</sup> set-up; see (3) below.
  - b. **Intensive training** including scenarios, war-gaming, role-play and familiarity with the C<sup>3</sup> set-up.
  - c. **Carefully selected** during training for aptitude, stamina and commitment.
  - d. **None with EU form.**
  - e. **Tag-teams to withstand prolonged sessions**, with IT supporting hot-transfer.
  - f. **A shadow support team** of authors/presenters of media material.
  - g. **Iron discipline:** written commitment of all in the team – including those sifted out during training – to agreed conduct, in particular:
    - **compliance** with the chain of command;
    - **confidentiality** as to tactics, etc; and
    - **adherence to PR channels;** ie, no unauthorised briefings or even informal conversations with pals.
3. **C<sup>3</sup> set-up, also providing staffing, back-office and IT:**
  - a. **Drawn from best** in civil, foreign, military and intelligence services.
  - b. **Inter-disciplinary expertise** in law, economics, EU politics, negotiating psychology and strategy.
  - c. **Supporting hot-transfer** between tag-teams.
  - d. **Providing real-time control** of tactics and analyses of
    - other side's stance, dynamics and tactics
    - other side's proposals and options for counter-proposals
    - shifts in domestic and international setting.
4. **PR campaign:**
  - a. **Based on decision-tree of events.**
  - b. **Dominating the news cycle** with instant rebuttal/origination for press, TV and new media.
  - c. **Think pieces** for weekly and specialist press, some ostensibly placed by third parties.
  - d. **Unattributable briefings** from different informed sources.
  - e. **Social media campaign** embracing (eg) real-time tweets from (d) above.
5. ***In extremis*, 'gamesmanship':**
  - a. **Applying consistent or random shocks** to condition/wrong-foot the other side (eg pressuring deadlines).
  - b. **Encouraging splits** within the other side's negotiating team or supporters.
  - c. **Weakening** individual negotiators.
  - d. **Cranking up domestic sentiment.**

### 3 On referenda

*Britain’s modest experience holds out some scope for brinkmanship.*

Parliamentarians and officials famously hate referenda, as they impair incumbents’ freedom of manoeuvre. In this country, they assume the mantle of Burke, pointing to the UK’s constitutional commitment to ‘representative democracy’. They also point to Europe’s unhappy experience of referenda outside Switzerland and the excesses of America’s ballot initiatives, and to populist governments.

Referenda may serve many purposes. In the UK they have served the purpose of endorsing constitutional changes, but they may also:

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| - Serve as Hague's ‘new mandate for Europe’. | Was he being disingenuous to mollify his department? It would be best to assume not.   |
| - Bind negotiators.                          | This may be a novelty, and negotiators will see such an approach as a two-edged sword, but overall it could strengthen the UK’s position.  |
| - Reinforce deadlines.                       | A specific instance of the objective above with similar comments applying.   |
| - Constrain future parliaments.              | Reduces the risk of foot-dragging by the other side in contemplation of a change of government. Another novelty, but nothing else is likely to prevent future parliaments u-turning on referenda and timetables. |

In the UK’s single experience of a referendum on Europe, the electorate was led by a united political leadership. Would the converse apply? For example, were cabinet ministers or other big beasts to bolt a party line, splitting other opinion-formers, would this legitimate the vote against government recommendations which has happened elsewhere in Europe on such topics?

It would seem that opinion is being conditioned for a referendum regime that maximises HMG’s discretion and supports an unambitious approach to renegotiation. To gain most from renegotiation, however, a more fruitful approach might be a regime encompassing two referenda. It should explicitly contemplate a failure of negotiation, making it clear that the UK would take such a failure as a trigger to seek a mandate to embolden its stance. Specifically, we suggest:

1. **An initial referendum**, possibly coinciding with the European parliamentary elections in June 2014, seeking a mandate for:
  - amicable negotiations on the presumption of staying ‘in’ for a stated period, say a year; followed by
  - amicable negotiations with the threat of going ‘out’ for a stated period, say a further year, and promising
  - one and one only referendum to approve the outcome at the end of this period, in this example two years.
2. **A second referendum** at the end of the stated period, recognising the outcome at that point and
  - If negotiations are complete, seeking approval for the outcome; or
  - If negotiations are incomplete, seeking approval for such bolder measures as suspension of contributions or compliance.

Such an approach sits well with the foreign policy realism advocated by Robert Kaplan, ‘working as close to the edge as possible, without stepping over the brink’.

#### 4 The strengths and weaknesses of the parties’ bargaining positions – 1

*Every argument has its counter. Some are important – sixty years of peace in Europe, the EU’s defective institutions; easier trade, the failure of the common market in services. Others are inflammatory – sovereignty, immigration, suspension of contributions or compliance.*

The analyses in this and the following two sections are a faint reflection of the intensive programme of scenario testing and gaming to be expected in Brussels, London and elsewhere.

EU strengths	UK strengths or counter-arguments
<p>1. The EU has been a great success in fostering European <b>peace and prosperity</b>. The political impulse for union following WW2/end of Cold War remains powerful if not insuperable.</p>	<p>The EU’s problematic history/current operations including:</p> <ol style="list-style-type: none"> <li>a. <b>Democratic deficit</b> – climate of elite decision making.</li> <li>b. <b>Defective institutions</b> – accounts unapproved for 18 years.</li> <li>c. <b>Failure to deliver</b> promised common market in services.</li> <li>d. <b>The Euro crisis</b>, also weakening and distracting national members and EU bodies.</li> </ol>
<p>2. Renegotiation and its outcome are <b>disruptive</b> (see section 6); treaty abrogation trashes international reputation and may trigger international (and at worst, domestic) litigation; hostilities are unthinkable. Absent unexpected events, the UK will be committed to orderly renegotiation. The judiciary and FO are particularly committed to treaty structures; possibly impairing the inclination of the latter to press for a hard bargain.</p>	<p>The UK <b>has to agree</b> to any new EU treaty. If <i>in extemis</i> it comes to treaty abrogation, HMG would be able to seek legitimation by <b>referendum</b> and the constitutional doctrine of sovereignty of ‘Queen in Parliament’ would apply, ie, new legislation would bind the UK courts.</p>
<p>3. The EU is many; the UK is one – it is easy to engineer a sense of <b>isolation</b>.</p>	<p>There is a <b>divergence of member states’ views</b> as between Federalists (small/weak states) and Confederalists (bigger states, in particular France and until recently/maybe still Germany). The EU ought to have difficulty developing joint lines, as well as keeping to them under pressure, though in practice this seems to be well under control. As an example of a ‘divide and conquer’ counter, the UK could offer direct access to its waters for EU fishing fleets.</p>
<p>4. The UK faces <b>50 years of EU precedent</b> – it is easy to engineer a sense of fighting uphill. The precedents of the deals struck with Norway and Switzerland are also said to be unhelpful.</p>	<p>The UK is a substantial <b>gross and net financial contributor</b> to the EU’s budget, whereas Norway and Switzerland make tiny payments. Contribution of the UK to the EU budget is particularly salient during Euro-crisis. Note, our annual contributions are hard cash, whereas (eg) new ECB guarantees are commitments that may never be called.</p>

## 4 The strengths and weaknesses of the parties’ bargaining positions – 2

EU strengths	UK strengths or counter-arguments
<p>5. The status quo is favoured by</p> <ol style="list-style-type: none"> <li>The UK’s industrial (and possibly financial) exporters (amplified by implied or express HMG commitments to sources of FDI, eg, Nissan, GS, etc.), as <b>EU customers are the UK’s major purchasers</b>.</li> <li><b>Opinion-formers</b> retaining affiliation with EU ideals/objectives, eg, the BBC.</li> <li>Those whose political status has been elevated, in particular the <b>legal profession and the judiciary</b>.</li> <li>Those favouring the <i>aquis communautaire</i>, that is the <b>public services and unions</b> in general.</li> </ol>	<p><b>The UK buys more</b> from the EU than it sells and is the largest customer for EU suppliers.</p> <p>The <b>UK market for EU exports</b> is set for premium growth, with population expected to grow faster than our neighbours.</p> <p>The <b>EU’s market for UK exports shows growth below</b> much of the rest of the world.</p> <p>The <b>EU has become unpopular</b> in the UK electorally and with selected politicians.</p> <p><b>The CAP</b> – still the largest cost head – has never been popular and raises the UK’s food prices.</p>
<p>6. Concessions to the UK give <b>precedents for concessions to others</b> elsewhere which threaten the free market which we value.</p>	<p>There is scope to invoke <b>WTO obligations</b> against the EU to enforce non-discrimination and demolish/abate non-tariff barriers.</p>
<p>7. <b>The City could be damaged</b> by retaliatory or simply indifferent policies from the EU’s ‘banking union’.</p>	<p><b>The EU needs the City</b>, to retain access to international capital markets – most economically through the City. The UK is in a unique position to maintain/maximise local liquidity for EU sovereign and corporate capital issues; and co-operate over measures to ameliorate/rectify the current international banking/fiscal crisis.</p>
<p>8. Weakening our support for the social or cohesion fund (ie, for Southern and Eastern Europeans) – almost as large as the CAP – is <b>retrograde and inconsistent</b> given HMG’s vigorous defence of foreign aid.</p>	<p><b>The EU has other commitments</b> to third parties, eg, Francophone Africa, though this could become as much a two-edged sword as the social/cohesion funds.</p>
<p>9. Recent remarks by the US Assistant Secretary of State for European and Eurasian Affairs, Philip Gordon, confirm that the <b>US wants the UK to stay in</b>. So do our other pals.</p>	<p><b>Our friends are realists and would adjust</b>. Think how much we annoyed the Commonwealth on accession.</p> <p>We learn all we need to about fundamental relationships from the composition of the Echelon club for sharing electronic intelligence: the US, the UK, Australia, Canada, and New Zealand.</p>
<p>10. The reality is that many <b>critics’ objections originate beyond the EU</b>. ‘Health and Safety’ excesses go back to the Heath government’s HSA and may well be embodied in ILO obligations; and the EHRC is outside the EU.</p>	<p>Even so, <b>much intrusion</b> comes from the EU itself.</p> <p>Departure of the UK weakens any national or other interests with free market agenda and ultimately the EU itself.</p>
<p>11. The UK’s popular hostility to the EU embraces disreputable (and possibly self-destructive) hostility to immigration.</p>	<p>Calls for careful handling, but many <b>other EU countries have been far less welcoming to immigrants</b> (for example, when Eastern European countries were admitted).</p>

## 5 The best available ‘in’ and ‘out’ – 1

*Paradoxically, the UK might well end up with a better deal if ‘out’ than if ‘in’, as the EU is likely to stick to its guns if the UK wants to stay, whereas departure opens up transitional arrangements.*

Item	General comment	HMG starting and subsequent positions	EU response and most likely (best available) conclusion of negotiation if ‘in’	Most likely (best available) conclusion of negotiation if ‘out’
1. Generally.	<p>The test of HMG’s seriousness about renegotiation will be a move towards a strategy along the lines set out in sections 2 and 3, in particular:</p> <ul style="list-style-type: none"> <li>i. To <b>announce two referenda</b>: the first asking if there should be renegotiation and promising a single referendum to recognise the outcome within (say) two years; the second referendum recognising the outcome at that point, and if negotiations are uncompleted seeking a mandate for a more vigorous negotiating stance.</li> <li>ii. To <b>declare a timetable</b> linking referenda, suspension of payments or compliance, and a deadline for negotiations for a good-faith ‘in’ such that if these fail, the UK then negotiates only for an ‘out’.</li> <li>iii. To <b>put more rather than fewer items on the table</b>, subject to discussions at 4 and 8 b and e below; and</li> <li>iv. To <b>field diplomats without EU form</b>, so as to avoid appeals along the lines of ‘you agreed to see things this way last time’.</li> </ul>	<p>HMG needs to <b>marshal an armoury</b> of opening, fall back and hardball negotiating tactics. To support this it needs to cultivate lay and expert opinion, domestically and internationally.</p>	<p>EU negotiators may incline to drag their feet <b>anticipating a change of government</b>. A deft referendum regime should pre-empt such a course.</p>	<p>Generally, the <b>transitional arrangements</b> described below are only available in an ‘out’ scenario.</p>

## 5 The best available ‘in’ and ‘out’ – 2

Item	General comment	HMG starting and subsequent positions	EU response and most likely conclusion of negotiation if ‘in’	Most likely conclusion of negotiation if ‘out’
2. <b>Relief from financial contribution.</b>	The <b>UK is the third largest contributor</b> , with €4.7bn net pa, €13bn gross pa, the latter representing c10% of the EU’s annual budget for 2013. This should turn out a crucial negotiating counter, also distinguishing us from the position of the Swiss and the Norwegians who make tiny contributions.	Early relief starting (eg) with <b>reduction or suspension of payments</b> attributable to the CAP (one third of the total – more if fisheries are included). If playing hardball, immediate diversion of all contributions to an escrow-holder. Fall-back would be a transitional period to run down contributions.	Although the sums involved are small by modern standards of fiscal bookkeeping, this will be <b>inflammatory</b> in the extreme, giving rise to bitter complaints of bad faith. Very hard to see more than one or two piecemeal concessions.	<b>Transitional period</b> to reduce/abandon contributions.
3. <b>Relief from past legislative intrusion</b> , that is, parts of the Social Chapter (plus aspects of <i>aquis communautaire</i> ) not covered by opt-outs.	This is the most strongly felt issue among the <b>UK Euro-sceptics</b> , generally articulated as ‘sovereignty’ or ‘repatriation of powers’. But note that regulation is a key part of official life and is defended by incumbents.	A blanket objection specifying unacceptable intrusions and declining discussion of which are to be seen as ‘single market’ issues, pleading their <b>toxic reputation with the UK</b> and deploring the implicit threat of sanctions. If playing hardball, unilateral suspension in whole or part, after notice. Fall-back would be a transitional period linked to the transitional period to run down financial contributions.	Much of the objectionable intrusion <b>comes from outside</b> , including obligations under the EHRC, other non-EU treaties, or emulation of practice elsewhere (eg, OSHA → HSA). At most, one or two piecemeal concessions, paraded as an element in ‘variable geometry’	<b>Transitional period</b> to rectify intrusions, linked to transitional period to run down financial contributions.
4. <b>Relief from future legislative intrusion</b> (eg, defence, taxation, foreign policy, justice etc).	Although these are nominally many issues they are <b>easily agreed</b> , so it may be best tactically to treat them as one, resisting any argument from officials that piecemeal efforts satisfy the tactic of placing many items on the table.	A <b>blanket objection</b> . Depending on overall tone of the negotiations, might be worth provoking push-back to justify hardball tactics elsewhere.	<b>Many highly publicised concessions</b> (easily offered as cost-free) already produce ‘variable geometry’	<b>If out, no intrusion threatens.</b>
5. <b>Relief from obligation to admit EU residents</b> and treat as though UK nationals.	Probably the <b>second most strongly felt issue</b> . But note that this is the <b>converse of the rights of the UK emigrants</b> to the EU; and the obligation to treat residents aliens as though UK nationals comes from the EHRC, which is not an EU body.	<b>Country by country visa renegotiations</b> with reciprocity. Avoid hardball for fear of inflaming domestic sentiment.	Much of the objectionable intrusion comes from <b>obligations under non-EU obligations</b> , eg, the EHRC as noted plus the 1951 UN Refugee Convention. But as it happens, concessions are possible as there have been precedents elsewhere, and concessions would be relatively cost-free and serve as a seductive Trojan horse.	Negotiation can <b>cut the cake by nationality</b> (eg, Germans preferred to Romanians), by class of migrant (eg, skills or capital preferred to unskilled indigents), or by time/ transitional arrangements, all mitigated by grandfathering provisions.
6. <b>Relief from CAP agriculture commitments.</b>	<b>Potentially inflammatory issue domestically</b> , as bears upon food prices. Could be a wedge between France and Germany.	<b>Early relief</b> . If playing hardball, unilateral suspension after notice. Fallback would be a transitional period linked to the transitional period to run down financial contributions.	If still a <b>deal breaker for France</b> , then very inflammatory and hard to see any concessions whatever.	<b>Transitional period</b> to abandon regime, linked to transitional period to run down financial contributions.
7. <b>Relief from fishing policies.</b>	Not so inflammatory, but <b>would animate fishing interests</b> in some marginal constituencies	<b>As above.</b>	Obviously a <b>big issue with Spain</b> , around whom others would congregate in cost-free solidarity. Maybe piecemeal concessions.	<b>As above, plus possible bilateral deal with Spain.</b>

## 5 The best available ‘in’ and ‘out’ – 3

Item	General comment	HMG starting and subsequent positions	EU response and most likely conclusion of negotiation if ‘in’	Most likely conclusion of negotiation if ‘out’
8. <b>Trade renegotiation</b> , embracing tariff and non-tariff regime applicable to: a) UK imports of goods from the EU.	Hannan and others argue that the <b>large and growing size of the UK’s market</b> adds to our bargaining position on (d). There is something in this.	Declare <b>principle of reciprocity</b> with (d) below and seek proposals. If playing hardball, make <b>referral to the WTO</b> . Fallback would be a transitional period to new regime linked to the period to run down financial contributions.	Attempt to link to ‘single market’ legislative intrusions, with threat of <b>tariff or non-tariff barriers</b> .	<b>Transitional period</b> to new regime at third-party levels, linked to transitional period to run down financial contribution, subject to piecemeal renegotiation under aegis of WTO.
b) <b>UK imports of services from the EU</b> .	Following the watering down of the EU Service Directive, <b>no common market in services is in prospect</b> , so no agreement is possible, enabling the topic to serve as a <b>tactical opportunity</b> to put many topics on the table for subsequent withdrawal.	<b>Itemised proposals for free trade in services</b> , with as much detail as possible, with a view to wearing down the other side. If playing hardball, make referral to the WTO. Fallback would be a graceful withdrawal as other items come out the right way.	Talk of ‘watering down’ is disingenuous: first drafts invariably lead to second thoughts. As passed, the <b>EU Service Directive balances legitimate interests</b> , not least those advocated by British unions. Proposals to revisit are untimely if not mischievous, given the still unresolved international banking crisis. In short, nothing substantive is likely to be offered, though no doubt attempts will be made to confuse with (9).	<b>Nothing to be expected.</b>
c) <b>UK imports from third parties</b> .	Possibly <b>country by country</b> , if not class by class.	<b>As (a) above</b> with reciprocity with (f).	<b>As (a) above</b> , subject to current concessions for Francophone Africa balanced with – if applicable – Commonwealth countries.	<b>As (a) above.</b>
d) <b>UK exports of goods to the EU</b> .	The item most likely to <b>excite producer interests</b> and their cheerleaders among opinion formers. HMG will need to check the files to rebut claims of express or implied commitments to Nissan, GS etc. A preliminary campaign of newspaper articles, speeches etc essential.	<b>As (a) above.</b>	<b>As (a) above.</b>	<b>As (a) above.</b>
e) <b>UK exports of services to the EU</b> .	As (b) above. But very <b>likely to be confused</b> among opinion-formers and those directly concerned with (9 )below.	<b>As (b) above.</b>	<b>As (b) above</b>	<b>As (b) above</b>
f) <b>UK exports to third parties</b> .	<b>As (c) above.</b>	<b>As (c) above.</b>	<b>As (c) above.</b>	<b>As (c) above</b>
9. <b>Relief from regulation of financial services</b> in a manner injurious to the City of London	It is <b>not clear that the EU either can or would want to injure the City</b> as this would add to the cost of funding of their own sovereigns and corporates.	Declare that at present, HMG sees <b>no reason to injure the supply of capital to the EU via London</b> . Tricky for either side to play hardball, as cuts off nose to spite face, though the UK could drag feet on banking/regulatory co-operation.	<b>Piecemeal intrusions to be expected</b> , but probably not effective.	<b>Removal of the City from EU legislation</b> over a possible transitional period, and subsequent operation as an offshore centre for issuers and investors.

**6 *In extremis*: immediate disruption vs eventual outcome if the UK ends up ‘out’ – 1**  
*If the UK leaves the EU, disruption would pose challenges comparable to other adjustments in the country’s recent history; the eventual outcome is no cause for gloom but – as ever – depends on good luck and good management.*

Topic	Immediate disruption	Eventual outcome
1. Definition.	<b>Disruption defined as effects over ‘period of adjustment’</b> , so (say) two to five years.	<b>Outcome defined as conditions after ‘period of adjustment’</b> , so (say) after two to five years.
2. Historical comparison.	Adjustments the UK economic model: <b>alteration in the destination of exports</b> , generally accomplished within a year or two; and <b>alteration in the composition of FDI</b> , historically a slower process. For example: a) processing raw materials and exporting simple manufactures, generally to and from <b>colonies</b> ; to b) buying and selling complex manufactures and semi-manufactures, generally to and from <b>OECD markets</b> , to c) adding <b>entrepôt activities</b> in services (in particular financial services), to d) adding investments in and imports from <b>emerging markets</b> .	It is unrealistic to expect a return to the UK’s nineteenth-century <i>imperium</i> or even some sort of sweetheart deal with the US along the lines of an expanded NAFTA. But how realistic might be a model of an <b>offshore (relatively) free-trade zone</b> <i>a la</i> HK/Shenzen vs China? Note that since 2007/8 protectionist pressures have tended to intensify in the OECD. This creates an international climate that may be propitious for such a zone.
3. Relations with immediate neighbours.	<b>Ireland would have to undergo severe adjustment</b> , (something for which it seems to have an infinite and admirable capacity). It is hard to parse the effect upon the appetite for <b>Scottish independence</b> .	Irish exceptionalism makes it <b>unlikely that Ireland would join</b> the UK in leaving the EU. The EU has made it clear that it would insist upon <b>Scottish renegotiation</b> if it leaves the UK. How much more so if the UK leaves the EU?
4. International relations generally.	<b>Uncertainty</b> over the transitional period. Out-and-out <b>treaty abrogation is unattractive</b> as the UK would wish to conduct itself in an orderly fashion both to cultivate international reputation and minimise local disruption. So there would some sort of legitimation by <b>referenda</b> plus <b>transitional arrangements</b> , possibly extending over a decade or so. Departure from EU would open up a cascade of requirements for <b>piecemeal renegotiation of trade deals</b> inherited from past decades of EU membership, as well similar piecemeal renegotiation with EU itself to take account of the effects of such alteration in our arrangements with the international community.	We have already noted that although we are told that the Americans and other allies prefer to have us in, they are also <b>realists</b> . In addition, it is likely that <b>relations with our European neighbours will improve</b> once we cease to be the ghost at the feast.
5. Consumer confidence and domestic political sentiment.	Depends on the immediate <b>political climate</b> ; there is a balance between dialling down the domestic temperature to avoid populist excesses and cranking it up to convey to the other side our inability to give way. Otherwise, <b>little positive</b> , though there might be immediate good news in <b>agriculture</b> – see (6) below. On the downside, <b>consumer spending might abate on uncertainty</b> , with some political, economic and possibly social turbulence; abated to the extent of restraint from inflammatory conduct and commentary.	Depends upon <b>good luck and good management</b> , in particular well-chosen and effectively-articulated direction of travel.

**6 *In extremis*: immediate disruption vs eventual outcome if the UK ends up ‘out’ – 2**

Topic	Immediate disruption		Eventual outcome	
	Positive	Negative	Positive	Negative
6. <b>Agriculture.</b>	The cheers of <b>fishing interests</b> would raise the rafters.	A move to world prices and the end of subsidies would <b>shake up agriculture</b> at least as much as accession in the seventies. Transitional arrangements would delay such benefit as might arise for fishing interests.	Food at world prices, so presumably <b>cheaper</b> . <b>Revived fishing industry.</b>	<b>None seen.</b>
7. <b>Manufacturing industry.</b>	<b>Greater freedom</b> to set labour etc laws. <b>Freedom from risk of destructive tax harmonisation</b>	<b>International interests</b> (eg Japanese and Indian motor manufacturers) would hold capital expenditure pending a view of the outcome. So too possibly <b>local interests.</b>	International interests would <b>respond to the transitional deal</b> we strike on exit. Where exporting ex EU (eg Tata/JLR), little effect. Local interests would <b>adjust to new markets relatively promptly</b> , with revised export and FDI policies.	Compliance with EU standards would be no more <b>onerous</b> than exporters’ current obligations to comply with those of the US or other third-party territories. Arguments that we would have to incorporate ‘single market’ intrusions are far-fetched. So <b>after adjustment, none.</b>
8. <b>Migration.</b>	A poisoned chalice, with much scope for <b>populist enthusiasm</b> , but as much risk of <b>loss of economic benefits</b> and some risk of social dislocation.		<b>More domestic control</b> might improve the scope to cultivate social solidarity.	If populist controls prevail, <b>loss of benefits</b> of skilled (and cheap unskilled) migrants; impairment of <b>freedom of UK migrants</b> to settle in the EU.
9. <b>Financial services.</b>	<b>Greater freedom to set regulations.</b>	<b>International interests</b> would hold capital expenditure pending a view of the outcome.	<p><b>Not much.</b> The EU Service Directive was watered down to virtual nullity and – with EU political attention very much elsewhere – is now unenforced. So there is <b>no EU common market in the financial or any other service industry</b>. There is a fledgling regime of ‘passporting’, which eases the operation of EU banks in other EU territories, but this is in close to <i>de facto</i> abeyance since the squalls after 2007.</p> <p>Recent chatter has suggested that either (a) international banks would move elsewhere or (b) European regulators would make it tough for London to keep its share of business.</p> <p>As to (a), banks locate according to a number of criteria of which regulation is just one.</p> <p>As to (b), it is not clear that the European regulators either could or would wish to cut off their sovereigns, companies or banks from liquid capital markets. So issuing and trading would probably not be affected. As to corporate finance, M&amp;A activity is already closely regulated at the European and national level.</p>	