

**Leaving the EU  
without agreement:  
possible  
consequences**



# Leaving the EU without agreement: possible consequences

## Introduction

Since the EU referendum in June 2016 there has been considerable speculation about the outcome of the UK's negotiations under Article 50 of the Treaty on European Union. It has been suggested that the UK could decide to leave the EU without reaching any form of agreement with the remaining 27 EU Member States (the EU27). Indeed, it has been claimed by the previous government prior to the 2017 general election that such an approach would be better than the United Kingdom negotiating "a bad deal" with the EU27, although the term "bad deal" has not been defined.

This paper considers the consequences of the UK leaving the EU without an agreement. In doing so it focuses mainly on the legal and practical consequences, rather than the political ramifications of such an eventuality. It should be noted that leaving the EU without an agreement also means leaving the European Economic Area, the area governed by Single Market rules (which excludes agriculture and fisheries) that includes Iceland, Liechtenstein and Norway as well as the EU. It would also mean that the UK would cease to have a preferential relationship with Switzerland as a result of no longer being party to the EU-Swiss agreements. And it would mean the UK losing the benefits of all the EU's agreements with third countries.

## The current legal situation

On 29 March 2017 the Prime Minister, Theresa May, wrote to the President of the European Council, Donald Tusk, notifying him that the United Kingdom wished to leave the European Union.<sup>1</sup> By doing so, Mrs May triggered the provisions of Article 50, which provide for a period of two years to negotiate the terms of withdrawal once a Member State has given notice that it wishes to leave. At the end of the two-year period, whether or not an agreement has been reached, the withdrawing country leaves, unless the Member States agree unanimously with it that the negotiating period should be extended.

In domestic terms, the UK is a member of the EU by virtue of the European Communities Act 1972 (as amended) and that Act would need to be repealed to make withdrawal valid. The Government has announced its intention to repeal this Act and to re-enact existing EU legislation in the UK prior to the UK's withdrawal.<sup>2</sup> On this basis the 1972 Act would be repealed at the same time as the UK's withdrawal.

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<sup>1</sup> See HM Government, *Prime Minister's letter to Donald Tusk triggering Article 50*, 29 March 2017

<sup>2</sup> The details are set in HM Government, *Legislating for the United Kingdom's withdrawal from the European Union*, Cm 9446, 30 March 2017

## **The consequences for individual rights**

The most immediate impact for ordinary people would be the loss of their individual rights as EU citizens. This could impact in many ways. For example, UK citizens travelling in the EU/EEA and Switzerland would no longer have the absolute right to do so; unless special arrangements are made, they could be stopped and either detained or deported if they had no valid Schengen or other EU Member State visa.

For UK citizens living and working in an EU Member State the situation would be more serious as their right to live, work, study or retire in the EU would fall away with the UK's departure (i.e. their free movement rights). UK citizens living in the EU would automatically become third country citizens under EU law and would have diminished entitlements, for example, for access to local healthcare or employment.

In the UK, legislation would be needed to cater for the changed status of EU nationals working in UK as they too would have lost free movement rights.

The impact would be particularly serious on the border between Northern Ireland and the Irish Republic. The UK-Ireland Common Travel Area (CTA) would be difficult to sustain and the Irish Government would be obliged to introduce border and customs controls at ports and airports for UK travellers as well as on the land border with Northern Ireland.

## **Trade and economic consequences**

There would be multiple impacts on trade and the UK economy. Various specific aspects and sectors are considered below but a general list of consequences includes:

- the end of tariff-free trade with the EU, requiring UK exporters and importers to pay normal third country duties as the UK fell back on World Trade Organisation rules (WTO) for its trade with the EU;
- disruption at ports and airports because of the need to apply customs duties, health and other rules consequent on introducing WTO rules but with little capacity to do so;
- consequent disruption to manufacturing businesses with complex supply chains, and to key imports such as food supplies;
- loss of regulatory certainty with potential knock-on effects on contract certainty, insurance cover, trade finance and other inputs critical to business continuity;
- loss of services exports as WTO rules have limited service sector coverage; the impact would be particularly severe in financial services (see below);
- a probable fall in the value of sterling;
- the loss of preferential trading rights with over 50 countries which have free trade or other such agreements with the EU;<sup>3</sup>

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<sup>3</sup> The EU has 50 free trade and other agreements covering approximately 65 countries:  
[http://ec.europa.eu/trade/policy/countries-and-regions/agreements/index\\_en.htm#\\_other-countries](http://ec.europa.eu/trade/policy/countries-and-regions/agreements/index_en.htm#_other-countries)

- a rise in prices as imports would be more expensive (because of the imposition of customs duties);
- potential food and other shortages caused by the delays at ports and airports;
- a loss of foreign direct investment, including the potential reversal of previously agreed FDI decisions;
- loss of access to essential workers for businesses and public services; this could lead to skill shortages, consequent higher prices and potentially the closure of some businesses altogether; significant parts of the public services (the NHS for example) could be unable to fill key vacancies and might face shortages as EU citizens returned home because of doubts over their status in the UK.<sup>4</sup>

The extent of the economic damage can be partly gauged by looking more specifically at trade in general and then at some individual sectors.

Some Leave supporters suggest that other major trading partners trade with the EU on “WTO terms” and that the UK would have no trouble doing likewise. In fact few major countries do so. The US, for instance, has a whole series of equivalence agreements with the EU (on financial services, veterinary issues, mutual conformity of assessments, and the like). The UK would need these too - both with the EU and the US (and other relevant countries) - in order to maintain its trade at the existing level. But leaving the EU without agreement, with obligations unmet, would not be a promising basis for seeking them.

### Trade in goods

Leaving without agreement would create three significant problems immediately:

1. as already noted, the sudden introduction of tariffs on UK exports and on imports from the EU as we fall back on WTO rules. It is sometimes suggested that we could avoid this by adopting zero tariffs on imports from the EU but this would be contrary to WTO most-favoured nation (MFN) rule; while the average of EU duties is low (around two per cent), some individual rates are very high, for example on meat and dairy products.<sup>5</sup> The effects of this would be a sharp fall in exports abroad and a rise in prices at home.<sup>6</sup> The Government has announced that the UK would adopt the EU's existing tariffs when the UK leaves the EU, although it could be amended later;<sup>7</sup>
2. the introduction of customs controls would be a significant problem as 14,000 trucks a day, for example, enter and leave the UK; these would need to be subject to the usual third country border controls, i.e. checking the documentation of the driver and that for the load in the vehicle, searching the vehicle in at least some cases, and collecting any duties that are owed; the UK has not had any customs controls with the EU since 1993 and does not have the capacity to introduce such

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<sup>4</sup> There was a fall of 96 per cent in the number of EU citizens joining the nursing register in the UK between July 2016 and April 2017; new rules on language skills may have been a factor in this, in addition to the June 2016 referendum result: see 'EU nurse applicants drop by 96% since Brexit vote', Nick Triggle, *BBC News*, 12 June 2017

<sup>5</sup> The “Most-favoured nation” principle means that countries cannot discriminate between their trading partners: see World Trade Organization, 'Principles of the trading system', 13 July 2017

<sup>6</sup> EU non-agricultural tariffs averaged 2.3 per cent in 2015: World Trade Organization, *World Tariff Profiles 2016*, 5 March 2017, p. 81

<sup>7</sup> This is not a unilateral process and would require the consent of other WTO member countries: see Senior European Experts, *The UK & the EU Customs Union: Issues and Questions*, 19 February 2017

controls quickly;<sup>8</sup> in addition, the UK is reliant on France and Belgium for the operation of juxtaposed immigration controls, which enable UK Borders staff to check passports at Belgian and French ports and officers from those countries do the same in the UK; there is no certainty that these controls would survive the UK leaving suddenly or that Belgium and France would be willing to increase the number of staff to deal with what would be a chaotic situation at ports, railway stations and airports;<sup>9</sup>

3. customs officers, supported by port health officers and other personnel would need to enforce public health rules (e.g. for food imports), those for plant health, and address the complex problem of rules of origin (see under automotive below for an explanation of the latter); and
4. a lack of infrastructure to cope with the changed set of circumstances; for example, new IT systems to process a greater number of customs and other border formalities; vehicle parks for lorries; customs warehouses where goods could be held during formalities; offices and vehicle examination facilities.

In the medium-term trade in goods would be adversely affected as well by the development of non-tariff barriers to trade. The central success of the Single Market has been to reduce those non-tariff barriers (such as regulatory standards for goods and services, requirements for particular qualifications etcetera), which are a bigger obstacle to trade in the twenty-first century than (in most cases) tariffs. With the UK no longer in the EU, it would have no influence over the constantly evolving Single Market rule book, it would not be able to object effectively to changes that would be harmful to UK interests.

### Trade in services

For trade in services the consequences of leaving without an agreement would be potentially even more serious:

1. services are hardly covered by WTO rules and so the loss of access to the Single Market would have a greater impact on British exporters of services than of goods; as services are the largest part of the UK economy (almost 80 per cent) and the UK is a large net beneficiary from the export of services, the economic impact would be high;
2. some specific parts of the service sector, financial services are the most significant example, would be very badly hit because of the loss of mutual recognition arrangements, legal doubts about the regulation of the service being provided and the concomitant loss of free movement of persons rights, which are an essential part of many service exporters' businesses;
3. the absence of the mutual recognition of professional qualifications and/or regulatory requirements, could mean some British service providers going out of business overnight if their host country declined to recognise their qualifications

<sup>8</sup> 14,000 trucks a day: see 'Brexit Britain has a long way to fall before it touches the bottom', Will Hutton, *In Facts*, 7 June 2017

<sup>9</sup> The first arrangements for juxtaposed border formalities were introduced by the 1991 Sangatte Agreement and then extended for France by the 2003 Treaty of Le Touquet: *Treaty between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the French Republic concerning the Implementation of Frontier Controls at the Sea Ports of both Countries on the Channel and North Sea*, Treaty Series No.18 (2004), 4 February 2003

or regulatory approvals any longer (which they might be tempted to do for protectionist reasons);

4. other legal consequences, including issues about the jurisdiction under which the service provided would come, enforcement of judgments and the protection of intellectual property and data.

### Financial services

The UK is the world's largest exporter of financial services and insurance. Around £40-£50 billion of the UK's £200 billion revenues in this sector comes from EU business. Approximately 2.2 million people in the UK work in financial services as a whole, the majority outside London. This sector contributes over seven per cent of UK GDP.<sup>10</sup> The immediate consequences of leaving without an agreement would be:

- loss of access to the financial services and insurance Single Market on privileged terms;
- likely non-recognition of some UK businesses because their regulatory arrangements would no longer be compliant with EU rules (i.e. they would not have a valid "passport" allowing them to operate across the EU without additional regulation);<sup>11</sup>
- non-recognition would mean that UK businesses could not lawfully trade in at least some aspects of financial services in the EU; those with an operation already established and regulated in the EU might be able to move business there but UK exports would fall sharply;
- UK clearing and settlement businesses would be particularly affected;
- there is also a debate about whether there would be financial instability in the EU27 if the supply of financial services from the UK was impacted, particularly the hedging market, where the UK provides a major service to EU businesses; EU officials argue that in those circumstances EU businesses could turn to the New York market as its standards are deemed to be equivalent to those of the EU.<sup>12</sup>

An interim solution to address some of these problems might be temporary recognition by the EU of UK standards (which are currently those of the EU), as being equivalent for a year or so while the EU market adapts.

### Automotive

The automotive sector would be particularly badly hit because it would be affected in multiple ways. First by the introduction of tariffs on vehicles and components, secondly because of the delays caused by the requirements of rules of origin, and thirdly because of the disruption to just-in-time supply chains that would come both from the first two issues but also from the disruption at ports and airports. In the short-term the sector would be likely to see a fall in exports because of the imposition of a 10 per cent duty on British-made cars exported to the EU. In the longer-term there would be questions both about the sustainability of cross-border supply chains and whether or not to remain located in a UK which was outside the Single Market.

<sup>10</sup> See House of Lords European Union Committee, *9th Report of Session 2016–17: Brexit: financial services*, HL 81, pp. 5-6

<sup>11</sup> The passporting rules are explained in *ibid.*, p. 9, para 13 *et seq.*

<sup>12</sup> Discussed in John Springford & Simon Tilford, *Why no deal would be much worse than a bad deal*, Centre for European Reform, 24 May 2017

Rules of origin are a major issue for exporters of manufactured goods. The concept is that before a country (or the EU in this instance) can decide the appropriate duty on an imported item, it needs to know what percentage of that item was manufactured in the country from which it is being exported. This is a bureaucratic process that might make exporting uneconomic for smaller companies. For the larger companies in the automotive sector it is a problem because more than half the components in a British-built car will have been imported. Individual parts can cross the Channel multiple times as a result of the way supply chains now work.<sup>13</sup>

### Pharmaceuticals, medical devices, chemicals and nuclear

These sectors are heavily dependent on EU regulation and the EU is the UK's largest export market. In the case of chemicals, three-quarters of imports are from the EU and 60 per cent of UK exports go there.<sup>14</sup> The chemicals and pharmaceuticals sectors would face problems because they would lose their ability to sell new products in the Single Market without approval. In the case of pharmaceuticals in particular, it would be in the interest of the EU to grant such accreditations but there would inevitably be a delay.<sup>15</sup>

The nuclear industry, which is to a considerable extent regulated by Euratom, presents different problems which would be seriously complicated by leaving without an agreement.

### Agriculture & Food

More than 70 per cent of the UK's trade in food and beverages (exports and imports) is with the EU.<sup>16</sup> This is vulnerable because the EU charges high duties on some food products. The average tariff on dairy products is 35.5 per cent but as high as 87 per cent on frozen beef. In the case of manufactured foods, there are duties of 25 per cent on confectionery and 15 per cent on cereals.<sup>17</sup> The levying of these tariffs would put up domestic food prices and sharply reduce UK food and drink exports. In addition, the food sector has complex cross-border supply chains that would be subject to tariffs, rules of origin procedures and public health rules; these would add to costs and particularly impact the agriculture and food sector in Northern Ireland. UK food producers would need to be authorised, for example, to export animal-based products to the EU.<sup>18</sup> UK importers would lose access to inspections of food producing establishments in third countries by the EU's agencies. There could also be shortages of some products in the UK because of the delays at the border ports.

### Civil aviation

The UK has the largest aviation sector in the EU and the third largest in the world. It is worth £55 billion to the UK economy and employs almost a million people.<sup>19</sup> The EU regulatory framework governing civil aviation covers not only flights to European destinations but also those from the UK to the US.

<sup>13</sup> See House of Lords European Union Committee, *16th Report of Session 2016–17: Brexit: trade in goods*, HL 129, p. 38, para 107 *et seq.*

<sup>14</sup> *Ibid.*, p. 33, para. 87

<sup>15</sup> See John Springford & Simon Tilford, *supra* n. 12; see also the CBI's list of 10 possible pitfalls for UK businesses from leaving without a deal, published in 'The ten ways Britain's businesses will LOSE without a deal with the EU: CBI boss on why we need a good Brexit', *Mail on Sunday*, 4 March 2017

<sup>16</sup> Food & Drink Federation cited in House of Lords European Union Committee, *op cit.*, p. 35, para. 94

<sup>17</sup> House of Lords European Union Committee, *op cit.*, p. 35, para. 96

<sup>18</sup> See the European Commission, 'Non-EU Countries Authorised Establishments: Non-EU country establishments database', 17 July 2017

<sup>19</sup> See House of Lords European Union Committee, *18th Report of Session 2016–17: Brexit: trade in non-financial services*, HL 135, 22 March 2017, ch. 7

There is real uncertainty about whether aircraft would be able to fly between the UK and the EU (and vice versa) as there is no fall back to WTO rules in this sector. Some sort of emergency arrangement would be needed to avoid chaos across Europe, with passengers and goods stranded. British-based airlines would lose their rights to operate flights between destinations within the EU as these derive from the Single Market. For example, easyJet flies between Paris and Toulouse and between Milan and Paris. As with other service companies, British airlines will need to have a subsidiary inside the Single Market in order to take advantage of its benefits.

Flights to non-EU countries would also be affected. For example, flights between the UK and the USA are governed by the EU's Open Skies agreement with the US, which would no longer be applicable. This would mean falling back on less advantageous (to UK airlines) previous bilateral agreements, assuming the US was willing.<sup>20</sup>

### Aerospace

The UK has the largest aerospace industry in Europe, sending £27 billion of exports annually to the rest of the EU. It is particularly at risk from Brexit because the EU's Aviation Safety Agency (EASA) certifies aircraft, engines and their components, and pilot training. In addition, the industry depends on complex cross-border supply chains that would be disrupted by the imposition of customs controls. It is also a significant beneficiary of free movement of skilled labour and often moves key personnel around the EU at short notice to meet demand.

### Other sectors

There would be consequences in all sectors because of the legal uncertainties but there might be particular difficulties in energy. This is because of the inter-connectors between the UK and other European countries which allow the countries involved to exchange electricity and gas supplies to meet temporary pressures on demand.

If we left without an agreement, UK businesses would no longer be eligible to bid for public procurement contracts in the EU.

### **Security and justice consequences**

The immediate consequences would be serious because the UK would lose access to a series of essential tools used daily by the police and security agencies to protect our borders, to fight terrorism and to bring criminals to justice. In particular we would:

- lose access to the vital Schengen Information System database, used in border controls and for the checking of suspicious people and vehicles;
- lose access to the Europol database, which contains police intelligence from across Europe;
- face the collapse of the European Arrest Warrant system for the UK, with uncertainty about the validity of warrants already issued and the lawfulness of detaining those already in custody;

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<sup>20</sup> See 'Will Brexit complicate landing rights for UK flights?', Paul McClean & Alex Barker, *Financial Times*, 12 February 2017

- have to return to old extradition arrangements, which took nine months to a year in each case and which would only apply to some EU Member States as many of them have repealed past legislation;
- lose the co-operation arrangements for police, prosecutors and judicial authorities that operate via Europol and Eurojust and of which the UK currently makes great use.

In addition, the UK would lose the goodwill of many involved in the fight against terrorism and cross-border crime in Europe who might see a British walkout as at best irresponsible.<sup>21</sup> Taken together, these amount to a sudden and dramatic loss of capacity at a time when we face serious threats to our security.

In the longer-term we would lose any ability to influence evolving EU policy in the fields of security, crime and justice as we would no longer be attending EU meetings, proposing new EU policies or be actively involved in the EU's crime and justice agencies.

### **Other consequences**

The UK's budget contribution would not cease to be an issue even if we left without meeting any obligations. It would be likely to be pursued through international courts for the recovery of monies to which the UK had been committed as a member and it would be open to the EU to take other forms of retaliatory action.

The UK is the third largest recipient of EU funding for research and innovation. The loss of funds would be immediate and it would be accompanied by a further loss of opportunities to participate in important cross-border research projects (this has started since June 2016). In addition, there would be a further loss of skilled staff in research and universities because of uncertainties about their prospects in the UK.

Finally, the UK would lose influence over and involvement in the EU's foreign and security policies. This would bring with it risks to UK security and trade and the serious risk of a global loss of influence in the medium to long-term.

### **Analysis: the wider consequences**

#### Impact on UK national standing

The most immediate effects of withdrawal without any agreement would be economic and personal – as explained above – but the UK would have done something it has hitherto never done before: walked away from treaty obligations without meeting its responsibilities.

The UK has long been a state that has sought to promote a rules-based international order in the world; its own abandonment of that approach would be a fundamental change of direction that would affect how the UK is perceived for decades to come. Relationships with the EU Member States – individually and collectively – would be soured and the UK's attractiveness as a trade and investment partner would be reduced.

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<sup>21</sup> The implications for security and justice of Brexit were discussed in the Senior Experts paper, *Brexit: The Implications for Justice & Home Affairs*, 27 April 2017

### Opportunity costs

Leaving the EU without agreement would have significant opportunity costs in the sense that public resources would have to be diverted to deal with multiple urgent problems. There would be a major impact on parliament, on the civil service and on other public services, including the NHS and the police. Resources would have to be diverted from the frontline to administration, for example to issue and manage work permits, to build a far bigger customs service, to perform a wide range of regulatory roles previously conducted by the European Union, to draw up and adopt new laws, to negotiate over 700 treaties with other countries and to promote new trade arrangements.

The likely reduction in the size of the economy, at least in the short to medium-term as a result of the fall in trade, would mean lower tax revenues and therefore reduced sums available for public spending. Industry and commerce would be diverted from growing businesses to maintaining existing business. For some companies, leaving without agreement would mean closure.

### **Conclusion**

The consequences of the UK leaving the EU without an agreement would be far-reaching. Not all the negative consequences would be felt by the UK alone; the Republic of Ireland would be hard hit but there would also be trade and other losses elsewhere in the EU. That does not mean that the risks of leaving the EU without an agreement are evenly balanced; the UK would be by far the biggest loser and the consequences would be with us for decades to come.

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