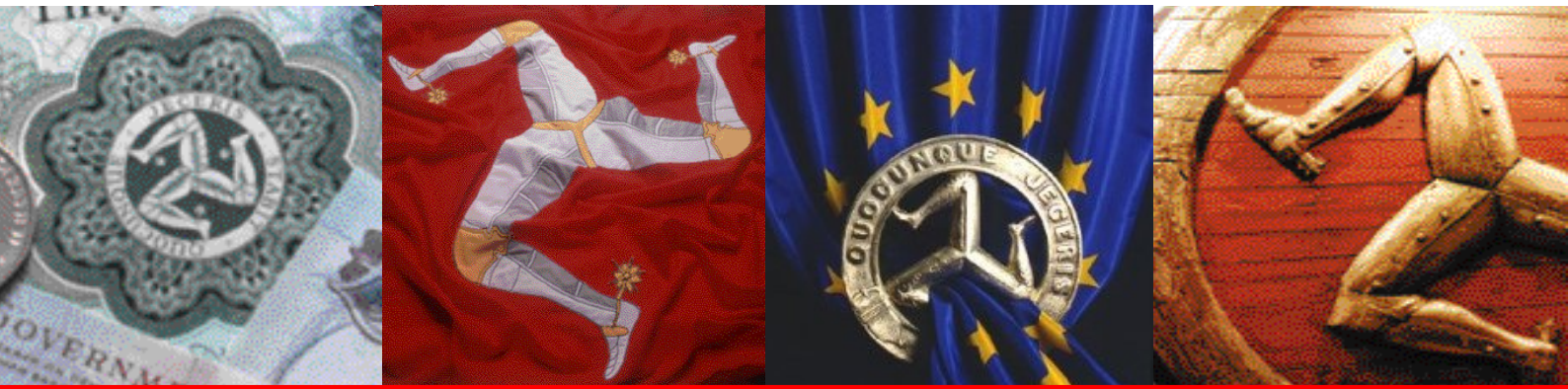




Isle of Man
Government

Reiltys Ellan Vannin



Council of Ministers

UK referendum on EU membership Implications for the Isle of Man

Second Interim Report

Council of Ministers' Second Interim Report on the implications of the EU referendum for the Isle of Man

1 – Chief Minister's foreword

The referendum on the United Kingdom's (UK's) membership of the European Union (EU) will take place on 23rd June. Although the Isle of Man is not part of the UK and is not included within the UK's membership of the EU, if the UK electorate votes to leave the EU, there will be an impact on the Island.

The Council of Ministers published its first interim report on the potential implications of the referendum for the Island, in April 2016.

The first report considered the potential implications for the Island of a vote to remain or leave, as well as setting out several areas for further work, including –

- Engagement with the private sector to identify their views on whether the UK leaving the EU would be good for their business,
- More detailed research into the alternatives to membership, for the UK, and what they may mean for the Island, and also,
- Further political engagement with the other Crown Dependencies to understand their views on the referendum, and its potential impact on them

This second interim report sets out the Council of Ministers findings, and adds to the information already provided for members of the public who may be eligible to vote in the forthcoming referendum. It also expands on the research available for the incoming administration which will, should there be a vote to leave the EU, be responsible for conducting negotiations with the UK and the EU, on behalf of the Isle of Man.

What will happen immediately after the referendum is still difficult to predict; the Leave and Remain campaigns have different views on what will be the likely outcome, but whatever happens, the only certainty is that there will be significant political instability in the UK.

The Isle of Man General Election will take place in September, and although, in the event of a vote to leave, negotiation of the UK's withdrawal agreement may begin relatively quickly, there will also be a need for the UK to negotiate a new relationship with the EU, which may take much longer, and also, numerous bilateral trade agreements with other, non-EU/EEA countries, which may take longer still.

As I have already stated, the Isle of Man Government has not taken a policy position on the referendum, as it is a matter for the people of the UK to decide. Similarly, we cannot

determine at this stage what type of new relationship we might seek with the EU, until we have a clearer view of the UK's intentions.

I would expect to provide further updates following the announcement of the result of the referendum. Should the UK vote to leave the EU, there will be extensive work undertaken to assess the options for the Island's future relationship with the EU.

Hon Allan Bell, MHK

Chief Minister

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2 – Executive Summary

The Isle of Man is not included within the UK's membership of the EU. The Island's limited relationship with the EU is set out in Protocol 3 to the UK's Act of Accession to the EU and allows for free trade in goods. In the event of a UK vote to leave the EU, the Protocol will fall away, and a new relationship will need to be established.

There is a great deal of uncertainty as to what will happen in the event of a vote to leave – not least whether the Prime Minister will remain in post – but it is clear that there may be significant political and economic instability in the UK.

In order to gauge the opinion of local businesses, the Isle of Man Chamber of Commerce was invited to poll its members for their views on the referendum. To the main question 'If you could cast a vote in the referendum which option would you choose?' 66% of all respondents said they felt the UK should remain in the EU. Of the 56% of respondents who export to the UK, that figure rose to 75%, of the 31% who export to the EU (excluding UK), to 85%.

In the event of a vote to leave, the UK Government will have two years to negotiate its withdrawal agreement. It will also have to negotiate a new relationship with the EU and potentially re-negotiate many trade agreements with non-EU countries.

The models for a new UK/EU relationship range from participation in the European Economic Area (and full participation in the Single Market) to bilateral agreements (either a series of bespoke agreements on particular sectors, customs union, or a free trade agreement) or reliance on World Trade Organisation rules.

Each has its own distinct characteristics, and it would appear that should the 'Leave' campaign prevail, then the Free Trade Agreement is the more likely to be pursued.

In the event of a UK vote to leave the EU, the Isle of Man's relationship with the EU will be determined by the UK's new relationship. It may be difficult to replicate the current relationship if, for example, the UK opts to remain outside the EU customs union.

The Isle of Man has taken a neutral stance in relation to the referendum, and the Channel Islands have taken a similarly neutral stance. The Isle of Man will maintain contact with the other Crown Dependencies to ensure they are aligned where possible.

Gibraltar is included within the UK's membership of the EU, and as such, the majority of EU law applies to it. If the UK leaves the EU, this will present significant difficulties for Gibraltar.

Following the announcement of the referendum result, a vote to remain will mean the Isle of Man's position in relation to the EU will be unaltered. A vote to leave, however, will prompt the establishment of a high level government working group, to undertake detailed technical discussions regarding the withdrawal agreement. This work would begin immediately, building on the work set out in the Council of Ministers' reports on the implications of the referendum. The group will report directly to the Council of Ministers, briefing Tynwald on key developments.

Isle of Man Government will also maintain political and official contacts in relation to the developing situation in the UK, and the negotiating stance of the UK with regard to its new relationship.

3 – Introduction

The Council of Ministers' First Interim Report, "UK referendum on EU Membership – Implications for the Isle of Man", set out the potential impact on the Island of a vote for the UK either to leave, or remain, in the forthcoming referendum.

The Report highlighted how the areas of the Island economy which benefit the most from the current Protocol 3 relationship with the EU, would be those most likely to be impacted by a vote to leave, and the subsequent loss of the Protocol. In addition, it was suggested that the free movement of people could be affected, with potential implications for a number of Isle of Man residents who have come to live in the Island from EU countries other than the UK and also for people from the Isle of Man who live and work in the EU. The Report also set out some of the alternatives to EU Membership, should the UK vote to leave.

It also identified where further work might be undertaken, in particular to gauge the views of local industry on the referendum (see Section 4), to assess the position of the other Crown Dependencies (Section 7), and to give some further thought as to the potential for a new relationship between the Isle of Man and the EU (Sections 5 & 6).

The Council of Ministers' second interim report, carries forward some of these themes, and they are considered in more detail below. The following points must, however, be borne in mind.

This Report:–

- does not seek to go over ground covered in the first Report, and must be read in conjunction with it; and
- It addresses further some of the implications of a vote to leave the EU. (The implications of a vote to remain, so far as they can be predicted, are set out in full in the first report).

In addition, it has to be emphasised that the UK Government has not, at this stage, announced what might be termed a "Plan B". It is campaigning to stay in the EU, and Government and the Remain campaign as a whole do not view any of the alternative models identified so far, as being a better option than remaining in the EU, with its special status (i.e. with certain opt outs, opt ins, and reforms). The 'Leave' campaign, although not entirely explicit, would appear to support the negotiation of a Free Trade Agreement.

This Report is part of the ongoing work being undertaken in advance of the referendum, to ensure that, Tynwald, the business community and members of the public have a clearer

understanding of how the referendum, and the possibility that the UK will leave the EU, may affect the Isle of Man.

It is worth noting once more, that much is still unknown, and the full impact of the UK leaving the EU, on both the UK itself, and the Isle of Man, may not be known for many years.

4 – Isle of Man Chamber of Commerce survey

One of the recommendations of the Frist Interim Report was that the views of Isle of Man industry on the referendum be sought. Since then the Isle of Man Chamber of Commerce has been invited to consult its members on the potential impact on their business of a vote to leave, or a vote to remain in the EU.

In line with the British Chambers of Commerce (BCC), the Isle of Man Chamber of Commerce has taken a neutral view over whether the UK should remain or leave the EU. However, the BCC does poll its members regularly in what is termed an 'EU barometer'.

It was agreed that it would be sensible to replicate the questions used in the BCC EU Barometer in the UK, in order to be able to compare the findings of the Isle of Man survey with the most recent UK poll. In addition, some further questions were put to the Isle of Man respondents, in order to build up a clearer picture of their business e.g. size, sector and markets for their goods and services and also, to determine whether this impacted on their views on the UK remaining in or leaving the EU.

Survey Questions

The following questions were included to ascertain the types of respondents, and how they would vote in the referendum, if they were able to do so.

- 1 – Which sector do you represent?
- 2 – How many people do you employ? (15 or fewer, 16 or more, 100 or more)
- 3 – How old are you? (under 35, over 35)
- 4 – Do you provide – goods, services, or goods and services?
- 5 – If you could cast a vote in the referendum, which option would you choose? (Remain or Leave)
- 6 – Where do you sell your goods or services? (Isle of Man, UK, EU (excluding UK), Rest of the world)

45 Members responded, and overall, whichever way the results were analysed (by sector, age, number of employee or goods/services), the results were very similar.

To the main question '**If you could cast a vote in the referendum which option would you choose?**' 66% of all respondents said they felt the UK should remain in the EU. Of the 56% of respondents who export to the UK, that figure rose to 75%, of the 31% who export to the EU (excluding UK), to 85%.

In answer to question 6, on where the respondents do business, the results were –

71% sell in IoM

56% export to UK

31% export to EU (excluding the UK)

47% export to the Rest of the world

The responses for the questions 7 and 8 are set out in the tables below. Included are some of the headline figures from the most recent (Q1 – 2015) survey undertaken by the BCC.

Question 7	Answer	IOM	UK¹
Which scenario will have the biggest negative impact on your business?	UK withdrawal	44%	63%
	UK withdrawal with a new trade deal	2%	
	UK remains in EU but transfer powers back	0%	
	UK integrates further	18%	
	No change	9%	
	I don't believe I have enough information to make a decision	27%	

Question 8	Answer	IOM	UK
Which scenario will have the biggest positive impact on your business?	UK withdrawal	11%	
	UK withdrawal with a new trade deal	11%	
	UK remains in EU but transfer powers back	16%	55%
	UK integrates further	9%	
	No change	29%	
	I don't believe I have enough information to make a decision	24%	

Question 9	Answer	IOM
What impact do you believe the UK's renegotiated terms for its relationship with the EU will have on	Positive	16%

¹ British Chambers of Commerce Business EU Barometer Q1 2015
<http://www.britishchambers.org.uk/Q1%202015%20Business%20EU%20Barometer.pdf>

your business?			
	Negative	11%	
	No impact	62%	
	Don't know	11%	

Conclusion/summary

The results point to the view that on the whole Isle of Man businesses would appear to be in support of the UK remaining in the EU. They also appear to more supportive if they do business with the UK and/or the EU, rather than if they deal exclusively with the Isle of Man or the rest of the world. There does not appear to be a significant difference in terms of size of business, or sector.

When polled by BCC in April 2016, UK businesses were less inclined to vote to remain in the EU than their Manx counterparts, with 54% for remain, compared with 66% in the Isle of Man.

The Isle of Man survey was relatively small – 45 responses received – but perhaps reflected a more pragmatic view taken by Isle of Man businesses (as was reflected in some of the comments received) in that they could not influence the outcome, and would be reliant on the voters in the UK, and indeed on the new relationship struck by the UK, if there was a vote to leave.

One reason why Isle of Man businesses may appear to be more in favour of the UK remaining in the EU than their UK counterparts (the small sample notwithstanding) could be because Isle of Man businesses currently have access to the EU market for their goods (manufactured and agricultural), but are not constrained by some EU regulation in terms of, for example, employment and other social legislation.

In addition, work permit legislation means that there is more flexibility in terms of regulating the inflow of workers, who can be employed in areas where there are shortages of suitably skilled workers locally.

5 – What happens next?

The Day After

On 24 June, the result of the referendum will be announced.

If the result is that the UK is to 'remain', then the reforms negotiated by the UK and agreed in February will be brought into effect (although this will not happen immediately). If there is a vote to leave, then it is likely that the Prime Minister will call a meeting of the Cabinet, to agree what will happen next.

The UK will need to communicate to the President of the European Council the UK's wish to withdraw from the EU but again this does not need to happen immediately.

There is a reasonable expectation that there will be calls for the Prime Minister (and Chancellor) to resign. This would lead to new leadership of the Conservative Party, presumably, drawn from within the 'Leave' campaign (or indeed someone who can command support across the party) supported by a significantly different Cabinet. It is unclear when this would take place, and whether the UK's notice to leave the EU would be lodged before or after this had happened.

It is the subject of some debate between the two sides of the referendum campaigns, but it can be assumed that in the event of a vote to leave the EU, there will be significant political and economic/financial turmoil in the following days and weeks.

The European Council is due to meet on 28th June, the week after the referendum. The result of the referendum will be discussed by EU leaders, and these discussions will give a strong indication of the direction the EU will take in its subsequent negotiations with the UK.

Does a vote to leave mean the UK will definitely leave?

There are two key questions which sit under the question of whether or not a vote to leave would definitely mean the UK will leave the EU. These are –

- Could a vote to leave be used to negotiate a better deal?; and
- Could a vote to leave prompt 'Remain' MPs to force the holding of a general election which could, were it fought on the issue of EU membership, potentially overturn the referendum?

Of the two questions, the answer to the first is, 'unlikely', and to the second, 'possibly'.

The referendum question asks whether the UK should 'remain' a Member of the EU, or 'leave'. If 'leave' prevails, then the UK is very unlikely to 'remain' as a Member with renegotiated terms of Membership. To do so would be ignoring the result of the vote.

It is possible that a vote of 'no-confidence' in the Government be instigated, or indeed, that the Government itself calls for a general election. As has already been mentioned, a vote to leave the EU takes the UK into uncharted territory, and as such, there can be no certainty as to what may happen.

The Leaving Process

The process by which a Member State might leave the EU is set out in Article 50 of the Treaty on European Union (see the First Interim Report and the UK Cabinet Office report "The Process for Withdrawing from the EU"², for more detail). Broadly speaking, however, the process of leaving the EU can be broken down into three elements –

- The mechanics – the legal and administrative changes which must be made to the Treaty, to EU law, and to domestic/UK law, to give effect to the change of status from EU Member State to 'third country', and to address so-called residual rights of citizens
- The new relationship – the UK is unlikely to be totally detached from the EU, and will want to maintain some form of trading relationship with it at least
- Trading relations with third countries – which, up until this point, have been covered by EU trading agreements

The three elements are linked, in that the withdrawal agreement may cover more than simply the arrangements for leaving, and can cover the new relationship. However, this in turn depends on what kind of new relationship is envisaged, and whether that would cover trade with other third countries.

The Isle of Man – What Happens Next?

If the UK votes to leave the EU, then the Isle of Man's current relationship with the EU will cease, as it is included within the UK's Treaty of Accession which would itself be rescinded. This will not, however, happen straightaway.

²

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/503908/54538_EU_Series_No_2_Accessible.pdf

Each of the three stages of withdrawal and renegotiation will need to be dealt with, from an Isle of Man perspective.

Withdrawal – the mechanics

Isle of Man officials will discuss with their UK counterparts how the mechanics of leaving will be carried forward, and will also brief UK officials on the implications of the UK leaving the EU for the Island. Detailed work on the mechanics of leaving will be carried out by the Her Majesty's Attorney General's Chambers, the Customs and Excise Division of the Treasury, and the Crown and External Relations Directorate in the Cabinet Office which will include Passport, Immigration and Nationality. The Department of Environment, Food and Agriculture, and the Department for Economic Development would also need to assess in more detail the implications for industry, and provide guidance for businesses/employers in the Island, once the new arrangements become clearer.

In terms of the political process, addressing the mechanics of the UK leaving the EU would not require political mandate from Isle of Man Government, as the decision to leave would already have been taken (by the UK). The Isle of Man European Communities Act³ would require repeal, and many pieces of Isle of Man law where there is reliance on or reference to EU law/rules would also require amendment, and of course, these changes would require the approval of Council, and Keys/Legislative Council or Tynwald (for primary and secondary legislation respectively). In addition, the residual rights of non-British EU citizens living in the Isle of Man would need to be addressed.

New relationship

In respect of the UK's new relationship with the EU, the Council of Ministers will assess the options available to the Isle of Man, within the framework of its relationship with UK, as they emerge. As has already been discussed in the First Report, the Isle of Man will not have *carte blanche* in terms of its own future relationship with the EU, and must look in the first instance at that which the UK manages to secure for itself. This would need to be undertaken on an ongoing basis; in other words as the UK develops its own negotiating position, the Isle of Man will need to make clear which elements it would wish to see extended to cover the Island. A new relationship between the Isle of Man and the EU would need to be agreed by the UK, by the EU (Council in unanimity, and in the European Parliament), and ultimately sanctioned by Tynwald.

³ European Communities (Isle of Man) Act 1973, AT 14 of 1973

Whilst there is a great deal of uncertainty around this question, it is clear that the UK's position, and therefore the Isle of Man's potential options may not emerge until after the general election in the Isle of Man, when there will be a new Council of Ministers and new Tynwald.

Trading relations with third countries

The UK may wish to begin trade negotiations with non-EU/EEA countries, in order to ensure that they maintain favourable trading conditions. The Isle of Man will also need to monitor and input into these discussions, assessing how it might be included within the scope of these agreements, if it is deemed beneficial for the Island to do so.

A new UK/EU relationship – what does the UK want?

In order to determine what relationship the UK is likely to seek, and without indulging in potentially wasteful speculation and conjecture, it is necessary to look at what the current Government, and what the 'Leave' campaign are suggesting would be their preferred relationship with EU. Putting aside the rhetoric, it is possible to determine the following key elements which may underpin the UK's position when it sets out to negotiate with the EU – both its leaving agreement, and its new relationship.

Government view

The UK Government's stated position is that there is no 'Plan B', and that it is not preparing for any form of new relationship with the EU. The 'Remain' campaign, similarly, does not suggest that any alternative relationship would be an improvement on membership – with carve outs and 'opt ins' – that the UK has negotiated.

Clearly, to advocate any new relationship would undermine their campaign, and so this position is understandable. The Prime Minister has, however, stated that if the result of the referendum were to leave the EU, then he would not attempt to remain inside the Single Market, as it requires the UK maintain free movement of people, and adheres to a great number of EU rules.

The 'Leave' Campaign view

The Leave Campaign does not set out a particularly clear vision of what it would seek instead of EU membership, but it has stated its views on the following key issues –

Immigration

The Leave campaign advocates controlling migration into the UK from the EU. This cannot be done if the UK is a full participant in the Single Market, whereby the 'four freedoms' – free movement of goods, people, capital, and services – are protected. This would appear to rule out the option of joining the EEA (European Economic Area) and, therefore, of full participation in the Single Market.

Sovereignty

Sovereignty is a key issue for the Leave campaign, and so it is unlikely that a 'Leave' government would wish to participate in the EEA Agreement, as there is no representation/participation in the decision-making process for non-EU Member States.

Budgetary contribution

Much is made by the Leave campaign that the UK is a net contributor to the EU, and that it does not wish to continue to pay in to the budget, when it feels these funds could be better used domestically. In short, the Leave campaign does not wish to – as they see it – for example subsidise farmers or poorer cities or regions in other parts of Europe.

Trade

The Leave campaign envisages tapping into new growth areas across the globe, signing agreements and trading with emerging economies, as well as negotiating a separate trade deal with the EU. It would appear, therefore, that the Leave campaign would not envisage that the EU would continue to negotiate such agreements on the UK's behalf.

What does this mean for the UK's future relationship with the EU?

Although there is no formal statement or model for a new relationship with the EU from either side, each of the points from the Leave camp set out above add up to the rejection of a Norway/EEA style-agreement certainly, and preclude full participation in the Single Market. They point towards the wish to negotiate a separate Free Trade Agreement with the EU, or perhaps to membership of the EU's Customs Union, but that in turn could complicate the UK's ability to negotiate its own trade deals with other countries (see below).

It leaves, potentially, a separate agreement or series of agreements with the EU on trade, and possibly for visa-free travel.

However, and this is a significant point, there is broad support in Westminster for retention of the ability to participate in the Single Market, and so it could be that this option could be pursued as a compromise, albeit the Prime Minister has ruled this option out. In addition, it could also be envisaged that a 'staged' leaving process might be undertaken, whereby participation in the EEA may be sought prior to fully leaving, in order to minimise the economic shock. How this might be achieved politically, is difficult to envisage.

6 – Alternatives to EU Membership – the different models for a new relationship

Numerous studies, position papers and opinion pieces have been published which set out the alternatives to EU membership, which could be negotiated by the UK, should it vote to leave the EU.

The UK Government published a paper entitled 'Alternatives to Membership – possible models for the United Kingdom outside the European Union'⁴, in March 2016, which sets out the following alternatives –

- The Norway model – in the European Economic Area (EEA) but not in the EU
- Negotiated bilateral agreements, including –
 - The Swiss model – a series of bilateral agreements
 - The Turkish model – customs union
 - The Canadian model – A Free Trade Agreement
- World Trade Organisation (WTO) membership – reliance on WTO rules to set limits for trade barriers/tariffs

Whilst it can be helpful to consider the relationships other countries have with the EU, it is important to remember that none of these has previously been an EU Member, and that if the UK leaves the EU it may well choose to negotiate a new/bespoke relationship, rather than mirror existing models.

Similarly, the Isle of Man will need to consider what options are available to it, and to do so, this section sets out some of the key characteristics of a potential future trading relationship

4

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/504661/Alternatives_to_membership_possible_models_for_the_UK_outside_the_EU_Accessible.pdf

between the UK and the EU, and how these characteristics may suit the Isle of Man's requirements.

6.1 – Characteristics of a new trading relationship

Some of the terminology is set out below, followed by a discussion of which elements may ultimately form the basis of the UK's new relationship with the EU.

6.1.1 – Customs Union

A Customs Union is an agreement between two or more countries to remove customs barriers and reduce or eliminate external customs duties on mutual trade. Customs unions generally impose a common external tariff (CET) on imports from non-member countries. A tariff is a tax or duty imposed on a particular class of imports or exports (and those tariffs can vary, depending on the class of goods).

The Isle of Man is in customs union with the UK and currently, through Protocol 3, is a part of the EU's Customs Union. Goods pass freely between the Isle of Man and the UK in trade, and onwards to the EU.

6.1.2 – Common External Tariff

A common external tariff must be introduced when a group of countries forms a customs union. The same customs duties, import quotas, preferences or other non-tariff barriers to trade apply to all goods entering the area, regardless of which country within the area they are entering.

For this reason, the Common External Tariff is applied to goods imported into the Isle of Man from outside the EU.

6.1.3 – Rules of Origin

Rules of Origin are the criteria needed to determine the national source of a product. They matter because duties and restrictions often depend upon the source of imports. The complex supply chains of the global economy mean that this is not always straightforward to determine. The bureaucracy involved is a cost for businesses.

Many goods manufactured in the Isle of Man – and this will apply especially in relation to the aerospace and high-precision engineering sector – are components destined for inclusion within other products. As such, if the UK and Isle of Man are both outside the single market, the likelihood is that certificates of origin will be required for UK/Isle of Man products destined for the EU, and may ultimately be subject to tariffs, quotas etc.

6.1.4 – Non-tariff barriers

A non-tariff barrier is a form of trade barrier other than a tariff. Non-tariff barriers include quotas, levies, embargoes, sanctions and other restrictions.

6.1.5 – The Single Market

The Single Market, created in the 1980s, makes the European Union the world's largest economic zone. It works by treating the EU's Member States as a single economic area. In particular, it promotes the free movement of goods and services beyond the scope of a Customs Union, within the EU in three key ways, by:

- removing import duties on goods, known as tariffs, and removing quotas;
- creating a single customs area for the movement of goods without the bureaucracy and paperwork of customs checks; and
- developing a level-playing field by removing other barriers to free trade such as differing regulations or technical specifications, known as 'non-tariff barriers'.

This opens up both goods and services markets, which ensures that companies are treated in a fair and non-discriminatory way.

6.1.6 – Pass-porting

Pass-porting entitles a financial services firm authorised in a European Economic Area (EEA) state to carry on permitted activities in any other EEA state by either exercising the right of establishment (i.e. setting up a branch and/or agents), or providing cross-border services. These rights are subject to the fulfilment of conditions under the relevant Single Market directive.

6.1.7 – 'Pass-porting' and Financial Services

The EU's financial services 'passport' means that financial services firms authorised in the UK can provide their services across the EU, without the need for further authorisations. The passport also means that the main regulatory responsibility for UK firms' activities across the EU/EEA remains with UK regulators rather than moving to other EU/EEA regulators.

The passport does not currently apply to businesses established in the Isle of Man, as it is categorised as a third country. If the UK were to leave the EU, it would no longer qualify for 'pass-porting' and would itself be treated a third country.

6.1.8 – Negotiating trade deals outside the EU

UK companies currently have preferential access to many external markets thanks to EU trade agreements covering 53 markets. Combined with the 27 other countries in the Single Market, and the countries in the EU Customs Union and EFTA, this is effectively more than 80 trade deals – covering over a third of the world’s economy.

Were the UK to leave the EU, without new arrangements in place, British companies would immediately lose preferential access to all these markets. This would continue until the UK was able to negotiate bilateral deals with these countries.

The Isle of Man benefits from the provisions of these trade deals within the scope of Protocol 3, so it can trade in goods and agricultural products, but not in services, on these preferential terms.

6.2 – Alternative models for a new relationship with the EU

(edited extract from UK Cabinet Office paper “Alternatives to Membership: possible models for the United Kingdom outside the European Union”⁵)

The UK Government has set out the key characteristics of several models for a future relationship with the EU, and these are elaborated below. (This section draws on the UK report on Alternatives to Membership. It focuses on the trade related elements, as it can be assumed that the UK will not, for example, participate in the Schengen area or the Euro, as it has already opted out of these areas)

6.2.1 – The Norway model

Market access

The Norway model brings less access to the EU market than the UK currently enjoys in three ways:

- it is outside the EU’s Customs Union for all goods;
- it has limited access to the Single Market for agriculture and fisheries;
- and it does not benefit from the EU’s external trade agreements.

5

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/504661/Alternatives_to_membership_possible_models_for_the_UK_outside_the_EU_Accessible.pdf

Being outside the EU's Customs Union means that all trade in goods between Norway and the EU is subject to customs procedures, and companies must be able to prove the origin of the components in their exports (see rules of origin). To benefit from preferential rates, Norwegian exporters have to provide documentary evidence proving that their products are either made inside the EEA, or that they comply with over 500 product-specific rules.

In practice, were the UK to adopt the Norway model, it would mean that UK companies that sought to take advantage of preferential tariff rates would need to submit forms for many goods transported across all UK borders (including the border between Northern Ireland and Ireland). This would impose significant administrative costs.

Being outside the EU's Customs Union also means that restrictions would have to be reintroduced on goods that consumers wanted to transport across borders, making them more expensive.

Norway is outside the Single Market for agricultural produce. This means that it does not trade products in these sectors freely with the EU. 64 per cent of the UK's fish exports and 73 per cent of vegetable exports go to the EU. Under an arrangement like Norway's, a number of these would be liable to tariffs.

Norway must conclude its own trade and investment deals with countries outside the EU. Norway has the right to do this on its own, but all of its current agreements have been negotiated through the European Free Trade Association (EFTA), which comprises Norway, Switzerland, Iceland and Liechtenstein. EFTA has so far negotiated 25 Free Trade Agreements (FTAs), covering 36 countries compared with 53 markets for the EU. In addition, agriculture and fisheries are not covered in these FTAs.

Norway is obliged to accept free movement of people from both EU and EEA countries as part of the EEA Agreement.

Costs and Obligations

Norway is required to ensure its domestic law complies with any EU legislation that forms part of the EEA Agreement. An independent study commissioned by the Norwegian Government in 2012 calculated that, in return for its access to the EU market, Norway has had to incorporate approximately three-quarters of all EU laws into its own domestic legislation. Norway is also required to comply with EU legislation in areas not directly related to the Single Market, including elements of social policy, consumer protection and environmental standards. This includes the Working Time Directive, Agency Workers Directive and Renewables Directive. Norway is obliged to accept the free movement of people from both EU and EEA countries.

EEA and EU nationals moving to Norway to work or find a job are entitled to be treated on the same basis as nationals. This means that they have the right to access benefits, including unemployment allowances, sickness benefit and housing benefit. In 2014 more than 6 per cent of the population resident in Norway were nationals from other EU countries, a higher proportion than in the UK.

Norway makes a significant contribution to EU spending. Norway pays grants to poorer EU Member States each year and also makes spending contributions to a number of EU programmes, including those on research and education in which it participates. In describing Norway's contributions to EU spending, the former Norwegian Minister for Europe said that "our financial contributions are on a par with comparable EU Member States".

Influence and Sovereignty

Norway has no representation and no vote in deciding EU law. The Norwegian Prime Minister does not attend the European Council. Norway does not participate in the Council of Ministers, has no Members of the European Parliament (MEPs), no national member of the European Commission, no judge of the European Court of Justice (ECJ), and its citizens do not have the right to vote in EU elections or to work in EU institutions. This means that Norway has limited influence over decisions made by the EU.

Norway is subject to complex arrangements to ensure compliance with EU law. For EU Member States, the ECJ adjudicates in disputes over compliance. Norway is subject to the jurisdiction of the EFTA Court, based in Luxembourg, comprised of judges from the EFTA countries. In the vast majority of cases, the EFTA Court follows the principles in the ECJ's rulings.

6.2.3 – The Swiss model

Market access

Switzerland has a relationship with the EU based on a series of bilateral agreements. In the mid-1980s, the European Community and the EFTA states (including Switzerland) started discussions aimed at establishing a new trade bloc that would expand the scope of the Single Market. This eventually became the European Economic Area (EEA). But in 1992 the Swiss electorate voted against EEA membership. This meant that, unlike Norway, Switzerland had no right to access the Single Market. As a result, Switzerland adopted a different approach. Over the last two decades, it has painstakingly negotiated over 100 individual agreements with the EU, covering market access in different sectors.

Switzerland has only partial access to the Single Market. It has most access to trade in goods. The bilateral agreements include various provisions to reduce practical barriers to cross-border trade. However, agriculture is not comprehensively covered by these agreements, so some agricultural products remain subject to tariffs.

Switzerland has limited access to trade in services. The bilateral agreements only provide partial coverage, with only some sectors covered, such as some types of insurance and public procurement. But Switzerland has limited market access for professional services, including accountancy, auditing, and legal services. And Switzerland has no general access to the EU market in financial services. It is not part of the pass-porting system that minimises the regulatory, operational and legal barriers to the provision of financial services across the EU. Because Switzerland does not have a bilateral agreement with the EU on banking, Swiss banks need to establish a subsidiary in an EU/EEA country, such as the UK, in order to obtain financial services pass-porting rights. UK banks would need to do the same inside EU countries if we were to leave the EU.

Costs and Obligations

The Swiss agreements are static in nature. While Norway is required to ensure its domestic law complies with any EU legislation that forms part of the EEA Agreement, Switzerland does not have the same direct obligation. But if it fails to introduce domestic legislation reflecting certain EU rules, the EU can block Switzerland from access to the related parts of the Single Market. To avoid this, Switzerland chooses in most cases to align with new EU laws as they are adopted. This, in practice, means Switzerland has a similar position to Norway –and has to comply with large numbers of EU laws, but without any say over those laws and without full access to the EU market.

Switzerland is outside the Customs Union and can conclude its own trade agreements with other parts of the world. Switzerland has 29 such agreements, covering 41 countries (by comparison, the EU has agreements covering 53 markets). Switzerland has similar arrangements to Norway on borders and police cooperation. In 2008, Switzerland chose to join the Schengen border-free area. It takes part in EU arrangements for asylum seekers, under the Dublin Regulation.

Representation

Switzerland has no representation in the EU's institutions and no role in the EU's legislative processes. Switzerland has no right to be consulted on laws drafted by the European Commission. It has almost no opportunity to shape EU legislation.

Costs and obligations

Switzerland makes a contribution to spending in the EU. As part of the bilateral agreements, it makes contributions to the EU. These contributions take various forms. Switzerland has made significant grants to Member States that have joined the EU since 2004. It also contributes to various programmes funded by the EU budget. These include EU research, education and satellite navigation.

The EU and Switzerland are currently in dispute over the terms of their relationship. The key issue is migration, which has become a politically sensitive issue in Switzerland. In 2015 almost 16 per cent of the population resident in Switzerland were nationals from other EU countries, a higher proportion than in the UK.

In February 2014, the Swiss voted in a referendum to introduce quotas for immigration of these nationals to Switzerland. The EU has made clear that this is a breach of the EU-Switzerland bilateral agreements, which contain a requirement for free movement of people. In response, the Council of the European Union made its view on this issue clear in December 2014: 'the free movement of persons is a fundamental pillar of EU policy ... the internal market and its four freedoms are indivisible'. In response to the Swiss vote, the EU has reduced Swiss access to EU educational programmes and research funding. The EU has also suspended negotiations on further access to the EU market. If migration quotas were introduced, the EU could remove Switzerland's privileged access to the EU Single Market.

6.2.4 – The Turkey model

Market access

Turkey's relationship with the EU is based on both an economic agreement and its candidacy for EU membership. The EU and Turkey have had a trade-and-economic-based Association Agreement since 1963 (known as the Ankara Agreement). In addition, Turkey has participated in a Customs Union with the EU since the end of 1995. It has also been a candidate country for EU membership since 1999. Accession negotiations began in 2005, and are on-going. They are likely to take a long time.

Turkey has partial access to the EU Single Market. The arrangements cover industrial goods and processed agricultural goods, which means that customs checks are not required for these products. However, arrangements do not cover raw agricultural goods or services. In areas where Turkey has access to the EU market, it is required to enforce rules that are equivalent to those in the EU. This includes competition, product, and environmental rules. Turkey is also

required to align rules on State Aid (government support to businesses) with EU rules. The Agreement with Turkey provides some limited migration rights for Turkish nationals to reside in the EU.

Costs and obligations

While Turkey can agree trade agreements with countries outside the EU, as part of the Customs Union, Turkey's external tariffs must be aligned with EU tariffs. This limits the trade deals that Turkey can agree. When the EU signs a trade agreement with a third country, such as South Korea, Turkey must give that country access to its own market on the same terms. But this obligation is not reciprocal. The third country is not required to open its market on the same terms to Turkish exports. Instead, Turkey has to negotiate separate trade deals with these countries.

Influence and sovereignty

Turkey has no role in EU decision-making. It does not contribute to the EU budget. As a candidate for membership it is a recipient of EU funding which supports reforms in such areas as the rule of law and civil society.

6.2.5 – The Canada model

Market access

Free Trade Agreements involve a more detached relationship with the EU. This means fewer obligations, but less access to the Single Market. Countries agree market access and tariff levels with the EU, and set quotas for trade between them. Exporters who wish to sell to the EU Single Market are required to comply with Single Market rules in the same way that exporters from Norway and Switzerland do.

The EU has trade agreements with 53 markets. These agreements provide varying levels of market access. For the EU, they are negotiated by the Commission, on behalf of the EU and its Member States. The agreement must then be approved by Member States, and the European Parliament.

The agreement between the EU and Canada goes further than any existing EU trade deal. Negotiations between the EU and Canada took seven years and were concluded in 2014.

Before the agreement can enter into force, it must be approved by the EU (including the Council and the European Parliament). Once it comes into force, the agreement provides for phasing out all tariffs on industrial and most agricultural goods entering the EU.

This deal addresses a number of other directly discriminatory measures such as quotas and subsidies for industrial goods.

Nevertheless, the EU-Canada Trade Agreement offers significantly less access to the Single Market than the UK currently enjoys under its special status in the EU. In particular:

- **Rules of Origin.** Trade between the EU and Canada is bound by Rules of Origin. This means that Canadian companies have to prove that a sufficient proportion of the product was originally made in Canada in order to qualify for preferential tariff rates. Complying with these rules creates an extra burden for businesses.
- **Enforcement.** At present, a UK company operating in the Single Market can bring an action against discriminatory or anti-competitive practices using the domestic courts of the Member State where the infringement took place. The UK Government or the European Commission can also bring a case to the European Court of Justice (ECJ) to protect companies' interests. By contrast, under the EU-Canada Agreement, a Canadian company trading in the EU would have more limited options to defend its interests.
- **Financial services.** Inside the EU, financial firms based in the UK can sell their services directly to other EU countries through pass-porting. Such provisions are not included in the EU-Canada, or any other EU Free Trade Agreements. Instead, Canadian financial firms, such as banks and insurance companies, have to establish local subsidiaries inside the EU market and operate under EU regulations and any local requirements in order to access the passport. Similar requirements could be a substantial restriction on UK companies compared to current pass-porting arrangements.
- **Services –** The EU-Canada Trade Agreement offers more limited liberalisation. The EU will open its market in services significantly for Canadian firms. But a number of key sectors are not included, such as audio-visual and the majority of air transport. In 2014, the UK enjoyed a surplus of £17 billion on trade in services with the EU.

Similar terms to the EU-Canada Agreement would have an adverse impact on this balance as trade would be affected. For example, UK low-cost airlines currently benefit from full access to a liberalised EU air services market, which has created an environment in which routes have increased between European cities and which has brought down the cost of travel.

- **Agriculture.** Tariffs are eliminated in most areas, but not all. Certain sensitive areas remain protected. Initially, Canada will only be allowed to export limited quotas of processed shrimp and frozen cod, beyond which tariffs of 20 per cent and 7.5 per cent respectively will be

applied. EU tariffs on fish products will be phased out over seven years. Quotas are introduced for export of other products, such as beef and pork.

- Investment. Despite some concessions, for example in uranium mining, the EU-Canada trade deal will maintain investment restrictions in a number of sectors, such as banking and aerospace.

Costs and Obligations

All trade deals involve difficult choices. Reaching agreement between the EU and Canada required both sides to make concessions. If the UK were involved in similar negotiations with the EU, it would need to be prepared to offer concessions. Negotiators seek to gain access to each other's markets, in return for conceding access to their own market. Economic weight matters in these negotiations. The EU economy is ten times larger than Canada's. This greater market size helped the EU in negotiations. The UK is a larger economy than Canada, but it is still only about a fifth of the size of the rest of the EU economy.

Setting and complying with the rules.

In the EU, common regulations apply to products sold across all 28 Member States. These protect consumers and ensure that our industries are not unfairly penalised. Toys and electrical products, for instance, must comply with EU safety rules. Each national authority assesses whether they do so, and these assessments are recognised by other Member States. This makes it easier for firms to do business. The UK can both influence the setting of rules and judge whether they are met or not. Moreover, as the EU covers a quarter of the global economy many countries voluntarily adopt EU rules to make trade easier. For example, Australia bases vehicle emissions regulation on EU rules. Under the EU-Canada Agreement, the EU has recognised Canadian assessments in only a minority of product categories. This leaves many Canadian products, such as medical equipment, dependent on approval by EU authorities before they can be sold in the Single Market. If the UK were to trade with the EU on similar terms as Canada, this would place many of our companies at a disadvantage.

6.2.6 – WTO-only arrangement

Market access

Countries which have a relationship based on WTO terms alone have much less favourable access to the EU Single Market. The EU imposes a common external tariff on countries outside, except those that have negotiated preferential trade agreements with it. For example,

there is a 10 per cent tariff on car imports, and in the agricultural sector, dairy tariffs averaged 36.1 per cent in 2014. Without a preferential trade deal, there would be no scope to vary these rates for the UK. Under WTO rules, the EU is required to apply a 'common external tariff' in line with the 'Most Favoured Nation' principle, which means that WTO members must offer the same terms to all 161 other WTO members.

Obligations

The WTO-only model involves the fewest direct obligations to the EU. WTO countries which do not have preferential trade agreements with the EU are not required to implement EU legislation. They are not subject to decisions from the European Court of Justice. They are not required to contribute to the EU budget, or to accept the EU's free movement of people rules. However, UK businesses would still have to comply with EU rules, such as on the environment or safety, in order to trade with the Single Market.

Influence and Sovereignty

A WTO arrangement would give no say at all over EU decisions. Some limited, indirect influence might be possible both through diplomatic contact and indirectly through other international organisations such as the G20, IMF and UN. But, of all the models described in this paper, a WTO arrangement would involve the most definitive break with the EU.

In terms of trade negotiations, as a member of the WTO, the UK would be one among 162 members. At crucial stages in multilateral trade rounds, the largest players – the United States, China and the EU – usually command the greatest negotiating weight.

The WTO provides much more limited arrangements to handle trade disputes than the Single Market. Businesses cannot directly enforce their rights under WTO rules. Only Governments can bring cases on behalf of businesses. The WTO dispute-settlement process is burdensome, both in time and resources.

6.3 – The implications and options for the Isle of Man

The Isle of Man is not considered to be part of the metropolitan territory of the United Kingdom for the purposes of ratification and scope of international agreements entered into by the UK, and so any new agreement negotiated by the UK setting out its relationship with the EU would not automatically extend to cover the Island.

In addition, because the Isle of Man is not sovereign it cannot enter into an agreement with the EU in its own right.

The effect of these two factors is –

- firstly, to give the Isle of Man a choice as to whether it agrees to inclusion within the scope of the UK's new relationship with the EU, and
- secondly, to limit the Island's own potential relationship with the EU, to either being the same as, or covering certain parts of, the UK relationship (subject to this being feasible and agreed by all parties). In other words, it is difficult to envisage how the Isle of Man could have a deeper or closer relationship with the EU, than the UK

This does, then, bring into focus the Island's options for its future relationship with the EU, which must be viewed in the context of the path which the UK itself chooses to follow.

The UK – Isle of Man relationship

As discussed in the first report, the UK is the Island's most important trading partner, and free movement of goods and people between the two is of utmost importance. In addition, the Isle of Man is in currency union with the UK.

There is nothing to suggest that a Brexit would have an impact on the underlying constitutional relationship between the Isle of Man and Crown/United Kingdom.

In addition, it is anticipated that the Customs and Excise Agreement with the UK, albeit in a potentially modified form, may continue, and the rights of Isle of Man residents to British citizenship would not be affected, should the UK leave the EU. The rights, however, of those British citizens to live and work in the EU, would be subject to negotiation.

The first priority, therefore, is to maintain the existing open trading relationship with the United Kingdom.

The alternative models – what do they mean for the Isle of Man?

Each of the alternative models will have a different impact on the Isle of Man, as they reflect different characteristics to the Island's current relationship with the EU, as set out in Protocol 3.

These are assessed from an Isle of Man perspective below:

The Norway model

If the UK joined the EEA, the Isle of Man would be in a similar position as it was when the UK joined the EU. It would need to decide whether to be included in the UK's membership, whether it should stay essentially outside, or, whether to seek a compromise position, as it did with Protocol 3.

To enter with the UK, the Island would be required to accept the majority of the EU's *acquis communautaire* (or body of EU law), and this relationship would be far deeper than that currently enjoyed by the Island under Protocol 3. The Island would find itself in a position where a great deal of legislation adopted by the EU would be directly applicable in the Isle of Man, but Isle of Man Government would have no representation within the decision making process, and neither would Isle of Man residents elect an MEP. **In addition, Norway's relationship does not allow for inclusion within the Customs Union, nor, for free trade in agricultural and fisheries products. It does not, therefore, replicate Protocol 3.**

It can be assumed, that the level of access to the Single Market which the Norway model would bring, however, would not come without certain conditions attached and it is a possibility that the Island may be required to contribute to EU funds if it was part of the EEA. The Island may also come under the jurisdiction of the EFTA court, which would seek to ensure relevant EU law was correctly applied in the Island.

Whilst it is not possible to be entirely certain how this option would affect the Isle of Man, it can be said that,

- Inclusion in the EEA requires the implementation of approximately 75-80% of EU law, without any chance of influencing how it is made
- There may be a requirement to pay in to the EU budget

- Some areas are not covered by the agreement – such as agriculture and fisheries

The UK Prime Minister has publicly rejected the possibility of the UK becoming a member of the EEA, and it would seem that the need to allow for free movement of people may be a barrier to the UK pursuing this option, if it were to vote to leave the EU.

The Swiss model

If the UK were to pursue the Swiss model, then it may offer the Isle of Man the flexibility to seek some form of agreement which might allow for free trade in goods and agricultural products, but again, this would not include customs union. It may also allow the UK the flexibility to pursue trade agreements with other countries.

Access to the Single Market for Financial services – and in particular, pass-porting – are not included within the Swiss model, and although this might not mean any changes to the Island's status as a third country, the loss of the ability of banks with branches in the UK to 'pass-port' into the EU could indirectly affect local businesses.

As is noted above, the EU and the Swiss have encountered difficulties in the way in which their relationship is functioning, and in particular, the obligation to accept free movement of people has caused significant problems.

The Turkey model

With inclusion of Customs Union and free movement of people (subject to limitations) the Turkish model would appear to be the arrangement which would most closely match that of the Island's current Protocol 3 relationship. This model would, however, limit the opportunities for the UK to conduct trade negotiations with other countries with a free hand, as it would be bound by the Common External Tariff, which it would be bound to apply in respect of all countries with which the EU had negotiated a trade deal.

The Canada model

A Free Trade Agreement (FTA) may contain elements which would be beneficial to the Isle of Man, but this would largely depend upon the ability of the UK to negotiate a favourable deal

with the EU. Customs barriers would remain, and it would not be possible to benefit from the trade deals the EU has with other countries.

World Trade Organisation

As outlined in the UK position, this would represent the minimum relationship between the UK and the EU. The UK's membership of the WTO was extended to include the Isle of Man, but this status may require clarification if the Island were to rely on WTO rules to allow for trade with Europe and the rest of the world.

Discussion/Conclusion

The Isle of Man is not entirely free to choose what relationship it has with the EU. It may seek to benefit from all or part of the provisions negotiated by the UK, but at this stage, what those might be, are very far from clear.

In addition, it is also not clear what the EU might seek in terms of concessions from the UK or from the Isle of Man. The EU is currently assessing how it might incorporate requirement for third countries to meet its criteria for 'tax good governance' in order to trade with the EU, and so provisions relating to taxation may well form part of such an agreement.

It cannot be said with any certainty at this stage how the Isle of Man might preserve its current trading relationship with the EU, and maintain its inclusion within the EU common customs area. The characteristics of the UK's new trading relationship with the EU may not include UK membership of the customs union, and so the Isle of Man will need to assess how it can protect and preserve free trade with the EU, within the framework of any new relationship.

The UK referendum will, without doubt, cause uncertainty amongst businesses which rely on exporting their goods to the EU.

The UK's line in negotiations with the EU is unlikely to be made public, and will be influenced by the shape of what may be a new cabinet, following the referendum. The Isle of Man will remain in contact with the UK Government through political contacts and officials, immediately following the referendum.

7 – Smaller jurisdictions

7.1 – The Crown Dependencies

In line with the recommendations for further work set out in the Council of Ministers' First Interim Report, the Chief Minister met with his counterparts from Jersey and Guernsey to discuss the potential impact, and response, to a 'Brexit'.

The Crown Dependencies (CDs) have an identical legal relationship with the European Union, with each jurisdiction covered by Protocol 3 to the UK's Treaty of Accession. There are, however, differences in the manner in which each of the CDs interacts with the EU, in a legal and practical sense.

The Isle of Man has a Customs and Excise and VAT-sharing agreement with the UK which sets it apart from the other CDs, and means that the Isle of Man is effectively part of the fiscal territory of the EU.

In addition, differences in provision of health care, and pensions and social security mean that the Isle of Man is more closely aligned with the UK – and through many social security bilateral agreements signed prior to the UK's accession to the EU, and extended to include the Isle of Man – and with other EU Member States.

In addition, the Isle of Man's economy is more diverse. The areas of agriculture, fisheries and manufacturing which are covered by Protocol 3 are more significant in the Isle of Man. The Isle of Man has maintained a neutral stance on the referendum, but the Council of Ministers has emphasised that there would be significant impact on the Island, particularly in terms of fisheries, agriculture and manufacturing, if the UK was to vote to leave the EU and Protocol 3 was to fall away. Jersey and Guernsey have also maintained a neutral stance on the referendum.

The Crown Dependencies agreed to maintain contact in the run-up to the referendum, and immediately afterwards.

Do the Crown Dependencies need to have the same 'new' relationship with the EU?

The simple answer to this question is 'no'. The relationship between the Isle of Man, Jersey and Guernsey and the UK are similar, but not identical – the key similarity being that each is linked for historical reasons to the British Crown (the Monarch), rather than being part of the UK itself (the sovereign state). In addition, the economies of the Islands are similar, but not identical. It is not necessarily the case, therefore, that the same post-Brexit relationship has to be the same for all three CDs. In addition, the Overseas Territories will have a different

perspective, and in particular Gibraltar has a different set of immediate concerns and priorities (see below).

There are, however, considerations of practicality and pragmatism in respect of whether the UK would be willing to take a different negotiating position for different Crown Dependencies and Overseas Territories and furthermore whether the EU would be willing to accept this. For this reason, the Crown Dependencies will remain in contact in order that each can understand the others' position.

7.2 – Gibraltar & the Overseas Territories

Of the 14 British Overseas Territories, only Gibraltar and the sovereign airbases in Cyprus are located in continental Europe, with the rest located in either the Atlantic or the Caribbean.

When the UK joined the EU, Gibraltar became part of the EU under Section 227(4) of the Treaty of Rome 1973 and the (UK) Act of Accession of the same year. Gibraltar is not a Member of the EU in its own right, but is included within the UK's Membership. (Like the Isle of Man, Gibraltar does not conduct its own international relations, and cannot sign international agreements in its own right).

The EU Treaty does not apply to Gibraltar in its entirety, and Section 227(4) defines how Gibraltar was able to negotiate some derogations from the Treaty, namely the Common Customs Tariff, Value Added Tax, and the Common Agricultural Policy.

In essence, therefore, Gibraltar's position is the opposite of the Isle of Man's – they are 'in' with the exception of Common Customs Tariff (and VAT and CAP), and the Isle of Man is 'out' with the exception of the Common Customs Tariff (the Isle of Man voluntarily applies VAT, because of its agreement with the UK, and is in effect part of the EU's VAT territory but it does not participate in the CAP).

Gibraltar residents also vote in the EU Parliamentary elections as part of the Southwest constituency (after a court case of 2004), and will have a vote in the forthcoming referendum.

As the UK's membership of the EU applies to Gibraltar, it is obliged to enact legislation to comply with EU Directives and all EU Directives apply to Gibraltar. Thus, EU Directives are transposed into Gibraltar law (such as Financial Services and Tax Directives) This, combined with improvements in the Regulatory regime, enabled Gibraltar to secure its passporting rights

in Europe for financial services. Thus, financial services operating from Gibraltar enjoy the “freedom of establishment” and “freedom of services” elsewhere in the EEA without having to go through separate licensing procedures in each member state (i.e. “passporting”).

Gibraltar and the referendum

The Gibraltar Government and its people (as polls have demonstrated) are committed to remaining in the EU. In particular, their concerns are that if the UK left the EU, then border controls would make it difficult for the 10,000 or so Spanish residents who cross the border each day to work in Gibraltar, and this would have a significant impact on the economy. They believe that there is a very real prospect that the border could be closed. Furthermore, it could reignite Spanish claims of sovereignty.

In addition, Gibraltar’s economy, which is reliant on financial services, e-gaming and tourism relies on the existing close ties with the EU and the ability to sell to customers in the single market. Barriers to the ability to trade freely would have a significant impact on the Gibraltar economy.

Overseas Territories

The other Overseas Territories are not included within the UK’s membership of the EU, and the result of the referendum will not, therefore, directly impact upon them. However, Anguilla, the British Virgin Islands, the Cayman Islands, Montserrat, and the Turks and Caicos Islands, together with other Overseas Territories, have jointly commissioned a study on the subject. This will not only review the issues that would arise should the British electorate vote to leave, but will also consider whether there might be alternative options in relation to the Overseas Territories status with both the UK and the EU; potentially opening the way for longer term change, irrespective of the outcome of the vote.

7.3 – The Faroe Islands – similar but different

The Faroes are a dependency of the Danish Crown and have, from a constitutional perspective, many similarities to the Isle of Man, but also some important differences.

The Faroes resemble the Isle of Man in that they are non-sovereign, and rely on the Danes for their international representation. In addition, when the Danes joined the EU, the Islanders chose not to follow, as the Isle of Man chose not to follow the UK.

Here, however, the similarities end. The Faroese economy is significantly different from the Manx economy, with the Faroese relying heavily on the export of fish and fish products – both farmed and caught from the wild.

In addition, the relationship between the Faroes and Denmark differs from that of the Isle of Man and the UK. The Faroes position is clearly set out in statute, with two key Acts, one setting out the Islands' delegated powers and right to self-determination, and another setting out where it might negotiate and sign international agreements in areas for which it has competence (although these agreements are ultimately signed by the Faroes and the Danes in right of the Faroes).

In addition, the Danes provide financial support to the Faroes, and the Faroes have an MP who sits in the Danish national parliament.

The Faroese Government⁶ states that when Denmark joined the European Economic Community in 1973 the Faroes had the option to remain outside. Like other fisheries dependent communities, the Faroese did not find it their interest to become subject to the Common Fisheries Policy. As a result, the Faroes is regarded as a third country in the context of the EU. The formal relationship between the parties is regulated by two bilateral agreements:

- Free Trade Agreement
- Bilateral Fisheries Agreement

The first Free Trade Agreement between the Faroes and the EC was made in 1991 and later revised in 1996. After negotiations between the parties, Protocol I on market access was replaced in 1998. With this revision, many of the original restrictions were removed, enabling the Faroes to export most of its fish products to the EU market. There remain nevertheless, quantitative restrictions on some areas of vital importance for the Faroese industry.

In 2001, the Faroes and the European Union finished negotiations on a Veterinary Protocol, that is part of the Trade Agreement. In 2005 the Faroes also joined the System of Pan-Euro-Mediterranean Cumulation.

Other Trade Agreements

The Faroes has Free Trade Agreements with three EFTA countries - Norway, Iceland and Switzerland. In addition to these agreements the Faroes used to have free trade agreements

⁶ Faroe Islands Ministry of Foreign Affairs website <http://www.government.fo/foreign-relations/>

with Poland and Estonia, in order to facilitate trade with Central and Eastern Europe. However, since the accession of Poland and Estonia in the European Union, these agreements have been annulled.

7.4 – The EU and Andorra, Monaco & San Marino

In March 2014, the European Commission agreed to the opening of negotiations with Andorra, Monaco and San Marino on these countries' participation in the single market. These negotiations are ongoing, and at present envisage an 'umbrella agreement', between the EU and the three 'micro-states' to cover general principles, and three individual agreements, to cover the detail.

Each of the micro-states has already entered into an agreement with the EU on the automatic exchange of tax information, and each, in addition, also uses the Euro as its currency.

Andorra

Customs union and cooperation

The EU customs union with Andorra is based on the 1990 Agreement establishing a customs union (covering industrial goods) and its Protocol on customs security measures. The 2004 Cooperation agreement provides a framework for cooperation on the environment, transport, culture, regional policy, veterinary matters (Veterinary protocol) and other areas.

Monaco

Customs and trade

Through its special relationship with France, Monaco is part of the EU customs territory and located within the external borders of the Schengen area. The 2003 Trade agreement with Monaco covers the field of medical products, cosmetics and medical devices.

San Marino

Cooperation and customs union

The 1991 Co-operation and Customs Union Agreement established a customs union with San Marino and provided for cooperation in several areas.

7.5 – Liechtenstein

Liechtenstein joined the EEA in 1995. The EEA Agreement covers most aspects of its relations with the EU, including:

- the EU single market – all relevant laws, except those dealing with agriculture and fisheries, apply to Liechtenstein
- EU Agencies and programmes – Liechtenstein participates in a number of them, albeit with no voting rights
- social & economic cohesion in the EU/EEA – Liechtenstein contributes financially
- regular political dialogue on foreign policy issues at ministerial and expert level

Travel (and asylum)

Since December 2011, Liechtenstein has been an associate member of Europe's border-free Schengen area and fully participates in the Dublin system for dealing with asylum claims.

Taxes & duties

The EU has bilateral agreements with Liechtenstein on taxation of savings. Negotiations on EU-Liechtenstein co-operation on combating fraud and exchange of information on tax matters are ongoing.

Relations with Switzerland

Liechtenstein has had a customs and monetary union with Switzerland since 1924 and is strongly integrated in the Swiss economy.

Summary

The table at the end of this report sets out the relationship each of the small states and dependencies has with the EU. It must be noted that the Isle of Man cannot negotiate an agreement with the EU in its own right, as it is not sovereign.

7 – Conclusions

The scope for the Isle of Man to determine its own relationship with the EU is limited. In the event of a vote to leave the EU, the UK will negotiate its own future relationship with the EU, and it is through the UK that the Isle of Man may have its own relationship with the EU. None of the models currently identified as representing a potential template for the UK's new relationship with the EU entirely replicates Protocol 3, and the Isle of Man will need to ensure that it stays abreast of discussions between the UK and the EU to ensure that what is agreed is adapted to apply to suit the Island, maintaining contact with the other Crown Dependencies.

Appendix 1 – Small non-EU European jurisdictions and the EU

	ANDORRA	MONACO	SAN MARINO	LIECHTENSTEIN	FAROE ISLANDS	GIBRALTAR
Constitutional status	Principality	Principality	Republic	Principality	Self-governing nation	Overseas Territory
Key "large country" relationship	France / Spain	France	Italy	Switzerland	Denmark	UK
Population (000s)	70	36	32	37	48	30
Size (km²)	468	2	61	160	1400	7
Currency	Euro	Euro	Euro	Swiss franc	Danish krone	Sterling
EU Customs Union	Y	Y	Y	N	N	N
Single Market: Goods	N	N	N	Y	N	N
Single Market: Services	N	N	N	Y	N	Y
Single Market: Capital	N	N	N	Y	N	Y
Single Market: People	N	N	N	Y	N	Y
Schengen	N	N (but heliport and port are Schengen points of entry)	N	Y Participates in Dublin system as well as in asylum matters	N (Schengen point of entry/external border)	N
Taxation of Savings Agreement with EU	Y	Y	Y	Y	N	Y
Monetary Agreement for use of Euro as legal tender	Y	Y	Y	N	N	N
Core Treaty with EU	Customs Union and Cooperation Agreements (environment, transport, culture, regional policy)		Customs Union and Cooperation Agreements	European Economic Area (EEA) Agreement, Schengen and Dublin Association Agreements	TFEU Article 355, 5 a) – "The Treaties shall not apply to the Faroe Islands"	TFEU Article 311(a)
Other agreements with EU	Veterinary	Trade Agreement (medical products, cosmetics and medical devices)		Free Trade Agreement and Agricultural Products Agreement (together with Switzerland) Various Agreements with EU Agencies under the EEA or under Schengen And Dublin	Trade Agreement (goods) Veterinary, Research, Fisheries	
Eligibility for EU funds	Cross border cooperation			Only indirectly through participation in EU programmes (e.g. on R&D)	Cross border cooperation + FP7 (pay own contribution)	



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