Theresa May’s Brexit Speech of 17 January 2017 – Decoding its clarity and ambiguity

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Summary

The speech by Prime Minister Theresa May on 17 January 2017, marked an important step on the way to Brexit, followed by the Supreme Court’s decision on 24 January to require that Parliament authorise the triggering of Article 50, which will lead rapidly now to a short enabling Act. The Prime Minister announced in her speech of 17 January the objective to negotiate a Comprehensive Free Trade Agreement (CFTA), combined with a Strategic Partnership to cover non-trade aspects of the future relationship. This closes the debate about whether the UK would stay as full member of the EU’s single market as in the European Economic Area and the EU’s customs union; the answer being no. A next step in defining the UK’s objective follows immediately, since the aim is still to have maximum ‘access’ to the single market, while the UK also intends on Day 1 of withdrawal to ‘nationalise’ all EU market law into UK law, which would indeed seem to make for a high degree of market access. The issue that arises here is how the UK will want to use its legal freedom to change this nationalised EU law, alongside the predictable requirement from the EU side that the CFTA should be a legally water-tight treaty. This leads into two alternative models for a CFTA: either a Canadian-style (CETA) agreement which makes no reference to EU law, or a Ukrainian-style (DCFTA) agreement which does rely heavily on EU law for defining market rules. There is no indication yet whether the UK will want to tend towards the one or other model, but this will be a major and inescapable choice to make when negotiations begin. An important omission from the Prime Minister’s speech was any indication how the UK may want to control immigration from the EU. In addition the speech says there will no longer be huge payments into the EU budget. Whether these several ingredients can also add up into an acceptable deal for the EU of course remains to be tested. In the event that only a ‘bad deal’ is on offer from the EU, the UK threatens to take aggressive tax and other regulatory measures to strengthen its competitive position, with uncertainties here both as regards the credibility of the threat and the EU’s possible response.

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Prime Minister Theresa May’s speech on 17 January 2017 has set the stage for the triggering of Article 50 before the end of March and the beginning of negotiations. The speech had a considerable amount of content, and her dignified delivery gave an impression of clear determination and deliberation. But on close reading, the text is riddled with ambiguities and silences on major points.

1. Overarching clarity and ambiguity

(a) The positive linchpin of her speech is the idea of making a ‘Comprehensive Free Trade Agreement’ (CFTA) with the EU, which sounds clear.

(b) The text goes on to say that this “cannot mean membership of the single market”, ... but “instead we seek the greatest possible access to it”, and seeks negotiation of a “a completely new customs agreement” ... since “full customs union membership prevents us from negotiating our own comprehensive trade deals”.

(c) The text is more operationally precise in stating that on Day 1 of withdrawal a Great Repeal Act “will convert the acquis – the body of EU law – into British law”, which is very clear, ... “as it makes no sense to start again from scratch when Britain and the remaining member states have adhered to the same rules for so many years”.

(d) But at the same time, the text sets out a formidable set of negatives: no “partial membership”, no “associate membership”, no “half-in half-out”, no “model already enjoyed by other countries”, no “bits of membership”.

The reader of the text may feel that paragraphs (a) to (c) are all about ‘bits’ of membership, or about ‘half-in and half out’, etc., or a set of contradictions, or at the very least of ambiguities. This is notwithstanding the fact that the first of the Prime Minister’s twelve numbered objectives is to establish “Certainty and clarity”.

The present note tries therefore to decode what is being said, and what may happen next. As a first approximation one can regard paragraphs (a) to (c) as having operational meaning of relevance for the forthcoming negotiations with the EU, whereas (d) is maybe more political rhetoric for the domestic audience. It would not be the first time that a political speech has addressed audiences at home and abroad with somewhat divergent messages.
2. On the ‘ins and outs’ of the single market

The UK intends to remain wholly compliant with the EU’s technical regulations and directives for the single market on Day 1 after withdrawal. As mentioned, the plan is to nationalise all the relevant EU _acquis_ as UK law, with some kind of omnibus legislation (to be called the Great Repeal Act) to simply transfer the entire substance of relevant EU legislation onto the UK statute book. The UK would thus ‘leave’ the single market by nationalising and internalising it. In substance nothing changes, except for the major legal point of principle that disputes would not be subject to rulings of the Court of Justice of the European Union (CJEU). This is a highly charged matter politically in the UK, but since the country happens to be the EU member state that abides most strictly to the EU law book as part of its legal-political tradition, this issue might turn out be of relatively minor practical importance.

If the UK made a tariff-free agreement with the EU, and remained compliant with European technical standards, its goods would still pass freely into the EU’s market. A key point here is that for industrial goods technical standards are worked out for the EU by three pan-European technical organisations (comprising 34 member states, not just the 28 of the EU), of which the UK is and will remain a member. There would be nothing to negotiate, and no non-tariff barriers, as long as the UK continues to retain this corpus of EU technical standards. The UK would hardly be leaving the single market for the basic movement of goods, except for the legal point.

But the crucial question that follows is what would happen if the UK gradually stopped being entirely compliant with the many other EU laws governing the single market, whose ‘chapters’ are listed in Annex B.1 and which contain hundreds of individual directives and regulations. The question cannot at this stage be entirely or clearly answered. If the law in question was product- or sector-specific, that product could not be imported into the EU. But if the rule was unrelated to traded products, like the environmental directive for bathing waters, nothing would change. If the rule was relevant to the single market, but of a more horizontal nature (e.g. competition policy), it would depend on what legally binding commitments the UK would take in its CFTA, and what dispute settlement mechanism would be established. The speech did not go into the precise content of the CFTA (on which more below). But on dispute settlement, the aim is clearly to avoid the jurisdiction of the CJEU, and therefore presumably to rely on institutionally neutral arbitration arrangements that are found in various FTAs with countries outside Europe.

Overall this explains how the Prime Minister can say that the UK will be leaving the single market, but still aiming to have access to it. To a degree she is playing with words. There seem to be some ‘bits’ of the EU left here.

3. On the ‘ins’ and ‘outs’ of the customs union

It is clearer that the UK will be leaving the customs union, since it will to cease to apply the EU’s common external tariff, in order to fashion its own FTAs with third countries. But the Prime Minister still seeks some kind of special ‘customs agreement’ to minimise bureaucratic frictions in trade, with the automobile industry being cited as a major concern because of the complexity of its cross-border supply chains. Being ‘out’ of the customs union means that rules of origin will have to be respected with the
necessary supporting paperwork. The ‘customs agreement’ will presumably see the UK continuing to apply the EU’s ‘customs code’, but the idea seems to aim at something more than that. Press reports suggest that the Brexit ministers have been exploring how the customs union formula might apply selectively to some sectors, such as automobiles or pharmaceuticals, which has led one trade policy expert to comment that this is no more plausible than to be half-pregnant. UK officials are said to have been examining how the Norway-Sweden customs border is managed, since Norway is outside the customs union, while being inside the single market. Some bits of the EU, like the customs code, seem likely to remain, but how much is unclear.

4. Control of immigration

This crucial part of the speech is virtually empty, beyond saying that “we will get control over the number of people coming to Britain from the EU...”, and “we will always want immigration...”. The government is considering its options for gaining control, but it does not even say what the options might be.

Maybe this is not such a bad thing. More precisely it remains to be seen whether the pre-referendum polemic surrounding immigration from the EU, and the disagreeable spread of xenophobic discourse and behaviour in the UK, may already be reducing the numbers entering the UK and increasing the numbers returning home. This would greatly ease tensions over the doctrine that all four freedoms have to be taken together, bearing in mind the agreement made by the EU with Switzerland in 1999 for a ‘safeguard clause’ regarding the free movement of people, which was judged to be compatible with very deep integration of goods and service markets.

The Swiss ‘safeguard clause’ of 1999 provided that: “In the event of serious economic or social difficulties, the Joint Committee shall meet, at the request of either Contracting Party, to examine appropriate measures to remedy the situation. ... The scope and duration of such measures shall not exceed that which is strictly necessary to remedy the situation. Preference shall be given to measures that least disrupt the working of this Agreement.” But this clause has never been activated, and so there is no experience of how it might have been applied. It has also been overtaken by more recent developments in Swiss measures regarding migration (which are not relevant here). However in the case of a drastic drop or even reversal of net immigration in the UK case, an adequate measure might be a variant of the Swiss 1999 agreement to cover against a renewed surge of immigration.

5. The possible content of the CFTA

As mentioned, the UK will have at the outset of negotiations to say what it has in mind for a Comprehensive Free Trade Agreement (CFTA). The speech gives little indication. On the other hand, the EU does have clear ideas based on two recently concluded ‘Comprehensive’ deals:

- the Comprehensive Economic and Trade Agreement (CETA), with Canada, and
- the Deep and Comprehensive Free Trade Area (DCFTA), with Ukraine and others, which however are bundled in with the political and other non-trade elements of an Association Agreement.
The Prime Minister says no existing model is good for the UK, and it is obviously true that these complex agreements always differ in much country-specific detail. Nonetheless, as Annexes A and B show, the structural content of ‘Comprehensive’ agreements have much in common. This is because there is a basic corpus of international and/or European trade law that is common currency for all of today’s advanced economies. Moreover, much EU trade and market law is intermingled with international law, for example for technical product standards, intellectual property rights, the regulation of financial services, etc.

While the CETA and DCFTA have similar tables of contents for key trade policy aspects, the two cases have one big and categorical difference. The CETA case does not rely on EU law and is entirely ‘international’, whereas the DCFTA makes heavy use of EU law alongside international law in some chapters. Since the UK will be transferring EU law onto its own statute book on Day 1 of withdrawal, and sees no need to ‘start from scratch’, the DCFTA model may be a more relevant reference than CETA. The list of EU laws contained in the DCFTA is what the EU will have in mind. (Of course the transition periods in the DCFTA for Ukraine and others are irrelevant for the UK that will remain wholly compliant with EU law on Day 1.)

The key difference between CETA and the DCFTA for present purposes may be illustrated by how technical standards for industrial products are to be handled. In the case of the Canadian CETA it is open for either party to present the case that for specific products its domestic regulation is equivalent to that of the other. If this can be proven, it allows for free market access. In the DCFTA case, when Ukraine adopts the corpus of EU technical standards, its products will pass automatically into the EU market, and notably if the DCFTA agreement is followed up as envisaged by an Agreement on Conformity Assessment and Accreditation (ACAA). In this respect the DCFTA provides much better market access that does CETA, and for this the UK would have to do no more than retain the status quo and confirm it with an ACAA.

However, the UK negotiator will then be faced with the question from the EU side whether it intends to remain compliant with EU law over time, since much detail in EU single market law is constantly evolving with amendments or new regulations and directives. The Prime Minister’s speech indicates that “it will be for the British parliament to decide on any changes to that [originally EU] law”. This is clearly a fundamental political point for the UK side. Nonetheless for the EU a CFTA with the UK and EU will have to be a fully specified and legally binding treaty. The EU will look for legal clarity and certainty over the conditions for the whole agreement. At this stage it is unclear how the UK side intends to address this point.

Many other FTAs avoid this problem by being only ‘simple FTAs’, which in practice means scrapping (most) tariffs, while other issues are handled with references to WTO rules and other international conventions, for example for technical product standards, intellectual property rights and labour standards. Services are little liberalised in ‘simple FTAs’. A ‘Comprehensive FTA’ would normally be expected to go way beyond this kind of ‘simple FTA’.

The major question of services is given little attention in the speech, except for the idea of special negotiations over financial services. The UK will presumably retain compliance with the EU Services Directive in order to continue maximum access to service markets, which are so important for its
The EU’s single market is far from complete for services, but it is much more open than the WTO, where the General Agreement for Trade in Services (GATS) allows for many more ‘reservations’ (i.e. restrictions over market access or establishment). For services the Canadian CETA is WTO+ (i.e. provides more market opening than the WTO-GATS), but is much less developed than the Ukrainian DCFTA, which sets the conditions for ‘full internal market treatment’ for various important sectors such as telecommunications and financial services if the EU acquis is fully implemented.

The Prime Minister’s speech also goes way beyond trade matters, seeking cooperation with the EU on the fight against crime and terrorism, and foreign and defence policy. Provisions for these activities would have to be defined and included in an agreement. The question will be whether to bundle everything into a comprehensive agreement that would include not only the CFTA, but also this broad range of security and foreign policy issues. The EU’s preference is to make all-encompassing agreements at one time, rather than have successive packages of agreements. The Swiss model of the past is the example of successive and separate packages, which the EU now wishes to avoid under the so-called ‘cherry-picking’ objection. By contrast the EU’s Association Agreement with Ukraine is all-encompassing. It includes the DCFTA for trade policy, but also includes the complete range of political, security and foreign policy cooperation. The Prime Minister speaks against an ‘association agreement’, but in favour of a ‘strategic partnership’, which the EU reserves for very important partners. However this again may be playing with words, and the choice of name is the least of the problems. The idea of a ‘Strategic Partnership Agreement, including a Comprehensive Free Trade Agreement’ would seem to have the right tone.

A related issue is what the UK will want to do in relation to the EU’s many agencies and programmes that are open to third-country participation, as listed in Annexes B.2 and B.3 (from the Ukraine agreement). While the Prime Minister wishes to avoid replicating any existing model, these lists are objective realities. The UK has to make up its mind in which agencies and programmes from these lists it wishes to continue to participate. The speech only went as far saying that “there may be some specific European programmes in which we might want to participate. If so, and this will be for us to decide, it is reasonable that we would make an appropriate contribution”. This language (“there may be some...”) seems implausibly weak from any objective reading of UK interests. The agencies and programme amount to crucial networks for technical cooperation in many fields of vital interest to the UK, including not only scientific research (the only sector mentioned, implicitly Horizon 2020), but also higher education with Erasmus+, the European Defence Agency, the Aviation Safety Agency, Europol and many others. When the UK has worked out what it would like to participate in, the EU side will want to establish at least the framework rules to govern these possibilities, which is another ingredient for a possible all-encompassing agreement (i.e. a Strategic Partnership that includes a CFTA). The rules for ‘appropriate contributions’ to EU agencies and programmes by non-EU member states already exist, in many cases being made proportional to GDP.

Notwithstanding its strong objection to ‘cherry-picking’, the EU is seen to allow for some flexibility in the making of various complex sector-specific agreements alongside and apart from its comprehensive agreements, except for cross-references. The DCFTAs contain provisions for some such cases, for example Civil Aviation Agreements for the single European sky (CAA), Agreements for Conformity Assessment and Accreditation (ACAA) as mentioned above, the Horizon 2020 agreements, etc.
6. The budget question

The key language here is “... because we will no longer be members of the single market, we will not be required to contribute huge sums to the EU market”. This begs the question what the EU will require to make a CFTA. It runs straight into the contrary position stated by various EU leaders that the UK will have to ‘pay’ for access to the single market. The scene is set for debates over graduations of ‘access to’, versus the absolute ‘membership of’ the single market, with a view to framing the extent of required budgetary contributions.

With the UK’s withdrawal, the EU is likely to face a €9 billion ‘hole’ in its annual budget, being the estimated amount of the UK’s net contributions at the present time. If the EU demands a contribution as a condition for a CFTA, one reference amount could be the contribution that Norway makes, scaled up for the size of the UK economy. This gives about €3.5 billion, which might be considered the outer limit or beyond for the UK, since it will not be a member of the single market like Norway in the European Economic Area.

If on the other hand there is no CFTA, and the UK has simply a WTO-based relationship with the EU, then the EU budget would receive additional tariff revenues, estimated at roughly €4.5 billion. Interestingly this amount is not so different from the ‘Norwegian’ calculation. So in both cases the EU would recuperate around a third to half of its loss of UK contributions.

This so far has concerned only regular current budget matters. But there also emerges the issue of ‘legacy costs’ of the divorce. There has been considerable public mention of this, including from the European Commission, with figures in the range of €20-40 billion sometimes cited. However, there has been no definition so far of what such costs would consist of, beyond, for example, remarks about commitments made before the UK’s withdrawal which will be paid only after its withdrawal, and about pension liabilities for retired EU staff. There has been so far no listing of the EU’s assets and liabilities, including contingent liabilities such as loan guarantees, nor explanation of the legal basis for this or that claim that the EU might make.

7. The transition question

The need for a ‘transition’ after the end of the Article 50 two-year period has been much aired in debate in the UK, without its possible content being at all clear. The speech did specify that a “phased process of implementation” would follow an agreement made before the end of the two-year period. The reaching of agreement within this time delay is itself considered highly unlikely in Brussels circles, and as mentioned it would take unanimity to extend the negotiation period. But the transition concept being explored is not about this.

2 Ibid.
3 The most detailed material published so far appears in the Financial Times, “UK faces Brexit divorce bill up to €20 billion”, 12 October 2016.
What might the transitional arrangement be about? The UK starts by being wholly compliant with EU law, and says that it would take its time to work out what of this to drop or change. So in this respect the UK controls its own transition towards being less complaint with EU law, if that is what it wants.

There are some transitional mechanisms that the EU is familiar with, notably for the phasing in of EU laws for accession states or close neighbours over a number of years, but that is irrelevant for the UK.

There is the ‘provisional application’ model, which allows for parts of the EU’s international agreement to be implemented after the signing, but before ratification is completed, such as in the case of the DCFTA for Ukraine. The usual delays for ratification by all member states amount to several years, and this point seems not yet to be surfacing in the UK debate.

There are also precedents for including in all-encompassing agreements summary references to various sector-specific agreements that can be negotiated separately and later, such as for civil aviation or research programmes, or as the speech suggests, possibly for immigration, customs, criminal justice or financial markets.

The speech talks of such arrangements in order to avoid ‘cliff-edge’ nightmares. However the main prerequisite for avoiding precisely this scenario is to reach the main agreement within the two years, or to negotiate its extension.

8. Bluffing to play hard ball?

The feature of the speech most noted by the media came at its end with reference to “some voices calling for a punitive deal that punishes Britain and discourages other countries from taking the same path”. This echoes the ‘punishment’ language heard in the UK debate and relates to the balance of power that will prevail at the end of the two-year negotiation period if no agreement will have been made: the guillotine will fall with the UK out with no deal at all, unless the EU27 agree unanimously to extend the negotiation period.

The UK will indeed be in a highly vulnerable position tactically in that case. In order to strengthen the UK’s bargaining position, the speech says that “no deal for Britain is better than a bad deal for Britain”. This is followed by the threat to engage in tax and regulatory competition to offset the competitive disadvantage resulting from the EU’s application to the UK of its WTO most-favoured nation (MFN) tariffs. Going further still, the speech declares that “we would be free to change the basis of Britain’s economic model”.

Is this serious, or is the Prime Minister bluffing? There are three points to be taken, one by one.

First on corporation tax, the Chancellor of the Exchequer said in his November budget statement that the UK’s already low rate of 20% will be cut to 17%, to have the lowest rate of all G20 economies. So that is going to happen in any case, and therefore loses bargaining leverage.

Second, on regulatory arbitrage (i.e. to gain market share through imposing lower regulatory burdens than competitors), the question would be what regulations would be lightened, given that the UK is already at the light end of the spectrum among European countries. The Prime Minister is defining her domestic agenda in terms of being fair to working people and protecting and even enhancing their
employment rights, while curbing excesses of corporate greed. So ‘social dumping’ seems not to be envisaged. To take another sectoral example, the UK would hardly want to renege on its Paris climate change commitments.

This leaves still the case of financial services, where the City will be losing its European single market ‘passport’ rights, but where the UK regulator might fight back with specific regulatory measures to gain or retain market shares in international finance. It has some experience here, starting in the 1960s when it created a favourable regulatory environment for the Eurobond market, winning for London the prime site for what became a huge market, initially from New York and then Paris. This part of the threat is more plausible. For a contemporary hypothesis, the UK might drop out from compliance with EU’s recent legislation limiting bonus payments in financial institutions, to stem the flow of emigrants from Canary Wharf. But this also would sit uneasily alongside the Prime Minister’s call for a fairer society.

However, a bizarre sentence in the speech warns that there could be measures that “would mean a loss of access for European firms to the financial services of the City of London”. And what does that mean? Is it that the City would turn away clients from the EU. Or is it that the EU would prevent its firms from using the City? The drafting here is lacking in legal clarity and commercial credibility.

Finally, on the prospect of Britain changing its ‘economic model’, which presumably would mean going for large-scale reforms to lighten or abolish business taxation and regulation, this sounds rather hollow, given the points made above on the UK’s starting position as an already relatively lightly taxed and regulated economy, and one where the Prime Minister is promoting a social contract of enhanced fairness for all parts of society. There seems to be little political market in the UK for further eroding the tax base to the point, for example, of making the funding of the national health service even more difficult than it is today.

Moreover, have the advocates of aggressive tax and regulatory competition by the UK assessed the likely response from the EU side? Since the UK is planning an ultra-competitive corporation tax rate in any case, there will be voices on the continent saying that this actually strengthens the case for the EU to allow the Article 50 two-year guillotine to fall with a hard Brexit, i.e. with the introduction of WTO-level tariffs and limited, single market access for goods and services.

9. Conclusions

The speech has supplied some clarity on the fundamental choice, namely to go for a Comprehensive Free Trade Agreement (CFTA), combined with a Strategic Partnership.

But a huge ambiguity hangs over the next level for defining the content of a CFTA, notably over how the UK will want to use its freedom to change its nationalised EU law, while at the same time wanting to make a legally binding agreement to have maximum access to the single market. The EU for its part will surely want to make a legally precise, durable and comprehensive agreement.

There are major matters where the speech anticipates the case for coordination, including over foreign and security policy, terrorism and crime, and various technical agencies and programmes. For these,
the EU side is likely to want an all-encompassing agreement; thence the idea of a Strategic Partnership, going beyond but including a CFTA.

But there is zero information still on how the UK proposes to regain control over immigration from the EU.

It is said that on leaving the single market there will be no requirement to pay huge sums into the EU budget, but this will presumably become an issue for negotiation.

There is finally the scenario where for the UK “no deal would be better than a bad deal”, leading to the idea of competitive tax and regulatory measures to offset the competitive disadvantages of “no deal”. But this seems not that credible beyond the tax measures already planned.
Annex A. EU-Canada Comprehensive Economic and Trade Agreement (CETA)

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Trade remedies
Technical barriers to trade (TBT)
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Customs and trade facilitation
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Intellectual property
Investment
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Labour
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Science, technology
Dispute settlement

N.B. The above is a simplified version of the official text.
Annex B. EU’s Association Agreements, including Deep and Comprehensive Free Trade Areas (DCFTAs) with Ukraine, Georgia and Moldova

Annex B.1. Table of Contents

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Chapters on legal and institutional provisions
- Dispute settlement
- Institutional provisions

N.B. The above is a somewhat simplified and edited list of chapters.
Annex B.2. Agencies of the EU open to participation by non-member states

European Agency for Safety and Health at Work (EU-OSHA)
European Fisheries Control Agency (EFCA)
European Monitoring Centre for Drugs and Drug Addiction (EMCDDA)
European Union Institute for Security Studies (EUISS)
European Centre for Disease Prevention and Control (ECDC)
European Aviation Safety Agency (EASA)
European Defence Agency (EDA)
European Foundation for the Improvement of Living and Working Conditions (EUROFOUND)
European Union’s Judicial Cooperation Unit (EUROJUST)
European Agency for the Management of Operational Cooperation at the External Borders (FRONTEX)
European Environment Agency (EEA)
European Asylum Support Office (EASO)
European Chemicals Agency (ECHA)
European Police College (CEPOL)
European Maritime Safety Agency (EMSA)
European Food Safety Authority (EFSA)
European Institute for Gender Equality (EIGE)
European Police Office (EUROPOL)
European GNSS Agency (GSA)
European Network and Information Security Agency (ENISA)

Annex B.3. Programmes of the EU open to non-member states

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Internal Security Fund
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Pericles 2020, Programme for the protection of the euro against counterfeiting
SESAR JU, Air Traffic Management modernisation
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