



## **BREXIT AND TRADE SCENARIOS**

### **BACKGROUND PAPER**

#### **Introduction**

Around 44 per cent of the UK's goods are exported to the EU, and 54 per cent of imports to the UK come from the EU.

As members of the European Union, the UK is a member of the single market and the customs union:

- Single market rules require the free movement from one EU member country to another of goods, people, services and capital (the so-called 'four freedoms'). It removes barriers to trade and harmonises, or unifies, national rules at EU level.
- The customs union is a type of free-trade area. Two or more countries agree to abolish restrictions on mutual trade, and to set up a common system of tariffs and import quotas that apply to non-members. In the jargon, they have a "common external tariff" (CET).

#### **Government red-lines**

The Prime Minister has committed to withdrawing the UK from the EU in March 2019.<sup>1</sup> The Prime Minister's Mansion House speech outlined a deep and comprehensive free trade agreement (FTA) with the EU after Brexit based on the following principles:

- We start from a place where our regulators already have deep and longstanding relationships
- It may make sense for British courts to look at the appropriate ECJ judgments
- We don't want to see the introduction of any tariffs or quotas
- We will want to explore with the EU, the terms on which the UK could remain part of EU agencies (for example European Medicines Agency, EURATOM)

Four red-lines in the government's negotiating position have also emerged:

- ending free movement of people;
- ending the authority of the European Court of Justice (ECJ) over British law and maintaining regulatory autonomy;

---

<sup>1</sup> May, Theresa, "I am determined to give our country the best possible Brexit", Telegraph, 9 November 2017. Retrievable [here](#).



- ending the UK's contribution to the EU budget<sup>2</sup>; and
- ensuring the UK can pursue its own international trade policy, ruling out participation in any customs union with the EU.

As adopted at the European Council summit 22-23 March, the EU and the UK have confirmed the agreement of a transition period which will last until December 2020 during which the UK will continue to meet its obligations under the single market and the customs union. This includes the continuation of freedom of movement.<sup>3</sup> This agreement is one component of the overall Withdrawal Agreement to be ratified by the end of the year.

## Scenarios for UK-EU trade relationship after Brexit

### 1. Cliff edge: trading under the rules of the WTO

World Trade Organisation (WTO) rules are relevant to trade with the EU if there is no overall trade agreement following Brexit. Under the WTO rules, customs duty would be imposed on 90%<sup>4</sup> (by value) of UK goods entering the EU and subject to tariffs, import VAT and the customs clearance process including 'rules of origin' checks,<sup>5</sup> and preferential trade regulations as currently applied to non-EU countries.

WTO "Most favoured nation" (MFN) terms would offer the UK protection against tariff barriers being applied by the EU on British goods post-Brexit. MFN requires that concessions offered to trading partners should be applied to other partners, for example if a tariff is cut for one partner, it should also be cut for all others. But WTO rules can be over-ridden, where a group of countries set up a free trade agreement, as the EU has done with the single market and the customs union.<sup>6</sup>

The non-discrimination terms are an important component of the WTO General Agreement on Trade in Services (GATS). While trade in goods is a relatively simple idea to grasp, trade in services is much more complex, and as result, the rules are more flexible and less well defined. The European Union has only been partly successful in removing the all the barriers to trade in services internally.

### 2. The Norwegian and Swiss models and a bespoke UK-EU Free Trade Agreement (FTA)

Norway is not in the EU, or in the customs union, but it is part of the European Economic Area (EEA), which allows access to the Single Market. Switzerland has partial access to

---

<sup>2</sup> HM Treasury, "Customs Bill: legislating for the UK's future customs, VAT and excise regimes", October 2017 p. 7 Retrievable [here](#).

<sup>3</sup> Politico, "EU and UK reach Brexit transition deal", 19 March 2018. Retrievable [here](#).

<sup>4</sup> Confederation of British Industry, [http://www.cbi.org.uk/global-future/case\\_study06\\_wto.html](http://www.cbi.org.uk/global-future/case_study06_wto.html)

<sup>5</sup> These checks ensure that goods are produced in the exporting country and not simply re-routed from another country that is subject to higher tariffs. Read more at <https://www.gov.uk/guidance/rules-of-origin>

<sup>6</sup> Read more about the most-favoured-nation rules at [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/fact2\\_e.htm#seebox](https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm#seebox)



the Single Market through a series of bilateral agreements with the EU that are not overseen by European institutions. Neither of these options are favoured by the UK government as continued Single Market access carries obligations: such as budget contributions; ECJ oversight; and free movement obligations, which cut across red-lines and would relegate the UK to ‘rule-taker’ of EU legislation, where, to date, we have been rule makers.<sup>7</sup>

The UK government has said it intends to negotiate a bespoke deal that allows market access like that of Norway and Switzerland, although with the limited obligations of the FTA with Canada, this has sometime been described as a Canada + deal.<sup>8</sup>

### 3. Customs Union

The customs union creates a common external tariff on goods coming from countries outside the EU and applies to member states only. No country outside the EU, other than Monaco, is a member of the customs union. The UK could negotiate “a” customs union agreement with the EU, Turkey has set a precedent in this regard.

Remaining within a newly negotiated customs union has certain advantages. It prevents raising tariffs on goods traded with Europe and it partly resolves the issue of a hard border in Northern Ireland. A customs union not only avoids the need to collect tariffs, but also the administration of documentation such as proof of origin for goods covered by the customs union.

However, regulatory checks for compliance would continue to be necessary, therefore alongside the customs union, the UK would need to establish a means of regulatory cooperation. The EU has strict requirements on controlled goods like food, chemicals and any electrical goods before they enter the EU market. These rules are especially burdensome for countries that are not part of the Single Market. For example, where Turkey does not follow EU rules for the production, labelling, movement and storage of these goods, it still faces border checks for compliance, ranging from document checks to testing product samples.

A customs union would restrict the government’s ability to set independent trade policy, which is a red-line. If the EU grants preferential tariff reductions to a country, the UK would have to follow under a common external tariffs policy. The EU would partly dictate UK trade policy, as the UK would not be present in negotiations that directly affects its market.

---

<sup>7</sup> Owen, Joe et al, “Trade after Brexit: Options for the UK’s relationship with the EU”, Institute for Government, December 2017, p.1

<sup>8</sup> Politico, “UK wants bespoke Brexit deal with EU”, 19 December 2017. Retrievable [here](#).