HOUSE OF COMMONS LIBRARY

BRIEFING PAPER

Number 7694, 9 October 2017

Brexit: trade aspects

By Dominic Webb and Lorna Booth

Contents:

Contents

Summary

The UK's future trading relationship with the EU is a key issue, given that nearly half of the UK's trade is with other EU Member States. At the moment, as a member of the EU, the UK is part of the EU single market and the customs union. This means no tariffs or quotas on trade between Member States. It also means elimination of non-tariff barriers, such as differing technical specifications and rules on labelling of products. Given that average tariffs are now low, these non-tariff barriers are considered to be a more important barrier to trade, although tariffs on some individual products are still high. The EU tariff on cars is around 10% and agricultural tariffs are generally higher than those on non-agricultural products.

The key feature of the customs union is that all EU Member States set the same tariffs on goods imported into the EU from non-EU countries. This facilitates trade between Member States by largely removing the need for checks on where products are made. However, being part of the customs union makes it very difficult for a country to negotiate its own free trade agreements.

The Government has said it is seeking an ambitious new economic partnership with the EU. The Government's Brexit White Paper said it was aiming "for the freest possible trade in goods and services between the UK and the EU." The Government's policy is for the UK to leave the single market and customs union after Brexit. Staying in the single market would mean complying with the EU's four freedoms (freedom of movement of goods, services, people and capital) and a continuing role for the European Court of Justice. Leaving the customs union would allow the UK to negotiate its own trade deals but would be likely to mean greater customs checks on UK trade with the EU. Further detail on the customs union was provided in a position paper published by the Government in August 2017.[1] The UK Government also published White Papers on customs and trade in October 2017.[2]

In her Florence speech, the Prime Minister said that the UK was not looking to copy an existing model of relations with the EU and ruled out membership of the European Economic Area (EEA) or an agreement based on the EU's recent trade deal with Canada. The Prime Minister also called for a "period of implementation "lasting for around two years after Brexit. The Prime Minister argued that the UK and EU should have access to each other's markets on current terms during this period.

Two alternatives to the Government's proposals are trading on World Trade Organization (WTO) rules and membership of the EEA. The EEA option would be the closest to EU membership while the WTO option would be the most radical break.

---

1 HM Government, Future customs arrangements: A future partnership paper, August 2017

2 HM Treasury, Customs Bill: legislating for the UK's future customs, VAT and excise regimes, Cm 9502, October 2017. Department for International Trade, Preparing for our future UK trade policy, Cm 9470, October 2017

The WTO option would apply in the absence of a negotiated deal with the EU. In this sense it can be thought of as the default option, although some argue for it on its own merits.[3] This would involve access to the single market on the least advantageous terms. The UK would still have "access" to the EU market in the same way that any other country without a trade agreement with the EU (such as the US) can export to it. Exports of UK goods to the EU would be subject to the EU's tariffs and vice versa. The EU would not be able to set discriminatory tariffs on imports from the UK. The WTO option would mean no contribution to the EU budget and no free movement of people.[4]

Another option would be UK membership of the European Economic Area (EEA). The EEA includes all EU Member States plus Iceland, Liechtenstein and Norway. The EEA option involves considerable (but not complete) access to the single market. It also involves the free movement of people and contributions to EU spending. Non-EU EEA countries are outside the EU customs union.

The Brexit negotiations started on 19 June 2017. The future trade relationship between the UK and EU is not expected to be discussed until the EU considers that sufficient progress has been made on withdrawal issues such as the UK's financial contribution to the EU, the rights of citizens and the Irish border. The EU is expected to take a decision on whether sufficient progress has been made at a meeting of the European Council on 19-20 October. It is generally believed that the EU is unlikely to conclude that sufficient progress has been made on the withdrawal issues to allow trade negotiations to start.

Brexit will also affect trade with countries outside the EU. At the moment, the UK's trade with these countries is governed by the EU. As a result of EU membership, the UK currently has trade agreements with over 60 countries. While the position is not entirely clear, the balance of evidence suggests that the UK will no longer benefit from these deals after Brexit.

After Brexit, the UK will be able to negotiate its own trade deals with other countries. Agreements cannot be concluded while the UK remains in the EU. The Government has said that it is entitled to hold discussions with potential trade partners while the UK remains in the EU. In July 2017, the Government said that 10 trade working groups had been set up covering 15 countries Australia, China, India, Israel, New Zealand, Norway, South Korea, the Gulf Co-operation Council[5], Turkey and the US.

---

3 Tory Eurosceptic MPs revive the case for a 'no-deal' outcome, Financial Times, 5 September 2017

4 The term "WTO rules" has been widely used in the Brexit debate to mean trade in the absence of a free trade agreement. It is important to note, however, that the UK and EU are already subject to the general framework of WTO rules and will continue to be so after Brexit. The EU Member States have gone over and above these in their trade relationship. For more on this, see Peter Ungphakorn, Why the UK is already under WTO rules, and why that matters for Brexit, 15 February 2017

5 The Gulf Co-operation Council has six members: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

1. Introduction

This paper looks at the effect of Brexit on UK trade with both the EU and non-EU countries. The paper is structured as follows. Section 2 describes how UK-EU trade works at the moment while the UK remains an EU Member State. It also describes the UK's relationship with the WTO.

Section 3 sets out the UK Government's preferred option of a new economic partnership with the EU.

Section 4 summarises two alternatives to the Government's position. These are membership of the European Economic Area (EEA), (sometimes described as the "Norway option") and trading on WTO rules.

Section 5 discusses the UK's future trade relations with countries outside the EU.

There are a number of important issues not discussed in detail in this paper. These include the issue of the UK's capacity and expertise to undertake trade negotiations, given that these have been done at EU level for over 40 years. The relationship between Brexit and the devolution settlement is not discussed in detail.

The Queen's Speech announced Bills on trade and customs. The White Papers were published on 9 October 2017.[6]

Separate Library briefings will be published on these Bills after they have been published.

More information on a range of Brexit-related issues is available here.

---

6 HM Treasury, Customs Bill: legislating for the UK's future customs, VAT and excise regimes, Cm 9502, October 2017. Department for International Trade, Preparing for our future UK trade policy, Cm 9470, October 2017

2. Background

2.1 How does UK-EU trade work at the moment?

The single market

The EU single market is an economic area where barriers to trade between its members have been removed. The single market is based on the "four freedoms": free movement of goods, services, capital and people.

The EU forms a single market with no tariffs or quotas on trade in goods between EU Member States. The single market also removes non-tariff barriers to trade, such as differing technical specifications and labelling requirements. The single market is described as follows by L Alan Winters, director of the UK Trade Policy Observatory:

> It is designed to foster competition within the EU by eliminating differences in (a) regulations that segment markets and (b) the terms on which labour and capital are employed in order to ensure a level playing field. It is a 'regulatory union' in which members are bound to adhere to common regulations (except for specific carve-outs – of which the UK already has several – e.g. on working hours), and it is enforced by a strong legal system culminating in the Court of Justice of the European Union (aka ECJ). Because Single Market members apply the same regulations and share the same enforcement mechanism, goods and services that satisfy one member satisfy the rest, and so there is no need to check the conformity of imports with standards at the border.[7]

Tariffs are taxes levied on imports. They are sometimes referred to as customs duties.

Quotas are restrictions on the volume or quantity of goods which may be imported.

The single market also extends to trade in services but it is generally thought that progress towards a single market in services lags behind that in goods with more barriers to trade between Member States remaining.

There has been much debate about "access to the single market". This phrase is used to cover a wide array of trading arrangements. Member States of the EU clearly have access to the single market. But countries like China and the US also export large amounts to the EU so also have a form of "access" to the single market. The key question is the terms on which this access is possible and the costs and benefits imposed by these terms.

Countries outside the single market have access to it in the sense that they can export to the EU but their exports must comply with EU rules and regulations. Imports into the EU from these countries will be subject to any relevant tariffs, quotas or non-tariff barriers, unless these are removed by a free trade agreement with the EU. Countries trading with the EU on these terms are not required to accept free movement of people, make contributions to the EU's finances or be subject to the European Court of Justice.

---

7 L Alan Winters, Disentangling Brexit trade politics and policies, 12 June 2017

"Membership" of the single market (or being "in" the single market), defined as membership of the European Economic Area, means there are no tariffs or quotas on trade between members. Non-tariff barriers are also reduced. Members accept free movement of people, make a financial contribution to the EU and are required to adopt EU legislation on the single market. Non-EU EEA members are subject to the EFTA Court which closely follows the European Court of Justice.[8]

The customs union and rules of origin

The EU Member States also form a "customs union". The key characteristic of a customs union is the common external tariff. All members of the customs union apply the same set of tariffs on goods imported from outside the EU. Goods will therefore be subject to the same tariffs irrespective of which Member State they are imported into. Once inside the customs union, goods can move tariff-free between its members. The customs union is only relevant for trade in goods as there are no tariffs on services.

In 2015, the EU's average tariff was 2.6% for non-agricultural products.[9] This is an average figure: tariffs on some individual products are higher. The EU tariff on cars, for example, is 10%. Tariffs are generally higher on agricultural goods (much higher in some cases). The average EU tariff on sugars and confectionery, and on beverages and tobacco, is around 20%.[10]

Membership of the customs union means EU Member States are severely limited in their ability to operate independent trade policies, for instance by pursuing bilateral free trade agreements with non-EU countries.

The customs union means goods can move freely between EU Member States without the need for checks on the origin of goods as the same tariff is paid regardless of which Member State they were imported into. This is different from a free trade agreement where tariffs are abolished on trade between the parties but they are free to set their own tariffs on trade with third countries.

Exports to the EU from countries outside the customs union are still subject to rules of origin checks even if they have a free trade agreement with the EU. This is to ensure the correct tariff is paid and prevent goods entering the EU via a low tariff country.

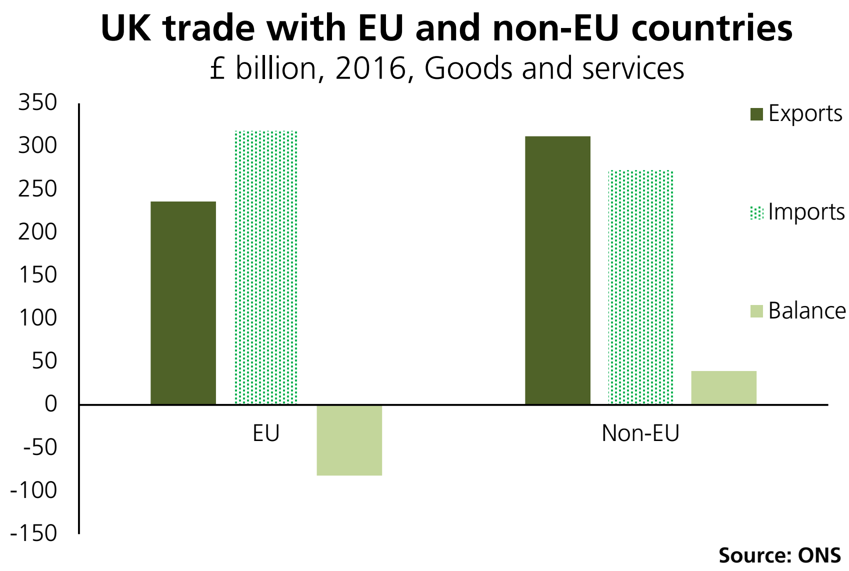
Take the following hypothetical example. The EU tariff on cars is 10%. Suppose country A has a free trade agreement with the EU but sets its own tariff on cars at 5%. Without rules of origin, country B could export cars to country A, pay a tariff of 5% and then export them on to the EU paying no further tariff. Rules of origin are required to prevent this happening and ensure that only goods originating in country A benefit from the free trade agreement.

8 EFTA is the European Free Trade Association whose members are Iceland, Liechtenstein, Norway and Switzerland.
9 World Trade Organization, WTO Tariff Profiles 2017, p82. Trade-weighted average
10 World Trade Organization, WTO Tariff Profiles 2017, p82

Rules of origin can be complex when products are assembled in more than one country and can introduce bureaucracy and delay into cross-border trade.[11]

2.2 Statistics on UK trade

Taken as a group, the EU is by far the UK's most important trading partner. In 2016 it accounted for 43% of UK goods and services exports (£236 billion) and 54% of UK imports (£318 billion). These figures are shown in the chart and table below.



UK trade with EU and non-EU countries 2016
Goods and services

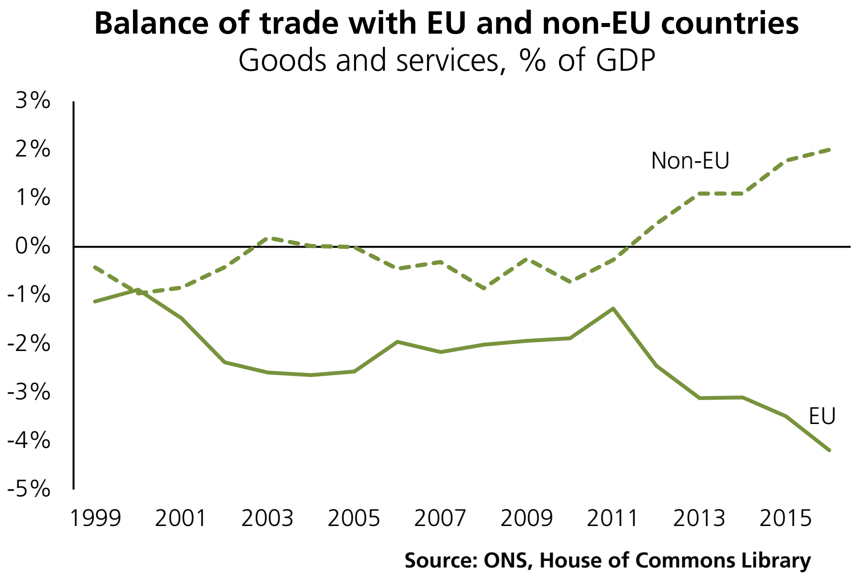
	Exports		Imports		Balance
	£ billion	%	£ billion	%	£ billion
EU	236	43.1%	318	53.9%	-82
Non-EU	312	56.9%	272	46.1%	+39
Total	547	100.0%	590	100.0%	-43

Source: ONS Balance of Payments Stat Bulletin, 29 Sept 2017, Tables B & C

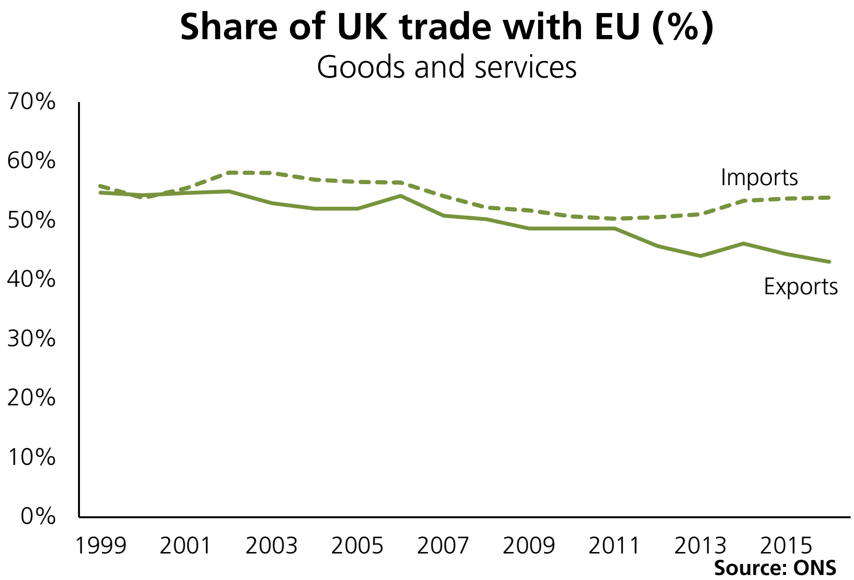
These estimates take no account of the "Rotterdam effect". This is the argument that UK trade with the EU is overstated by these figures. The UK does a large amount of trade with the Netherlands, some of which may ultimately be with countries outside the EU but be recorded as EU trade. There are no official estimates of how big this effect might be, but, even making allowance for it, the EU is still the UK's largest trading partner by a large margin.

The UK imports more from the EU than it exports to it. In 2016, the UK's deficit on trade in goods and services with the EU was £82 billion while the surplus with non-EU countries was £39 billion. The chart below shows the UK balance of trade since 1999 with EU and non-EU countries.

[11] There is more on the customs union at The UK in a changing Europe, The customs union



The share of UK exports going to the EU has declined gradually over recent years. In 2002, the EU accounted for 55% of UK exports. By 2016, this had fallen to 43%. The picture on imports is slightly less clear. In 2003, 58% of UK imports were from the EU. By 2011, this had fallen to 50% but increased slightly to 54% in 2016.[12] More information on the UK's trade with the EU is in another Library note: Statistics on UK-EU trade.



The UK's top 10 trading partners are shown in the table below based on trade with individual countries rather than blocs like the EU. The US is by some way the UK's largest export market. The UK exported £96.4 billion of goods and services to the US in 2015, nearly a fifth of the total. The only other non-EU countries in the top 10 are Switzerland and China. On the imports side, the largest trading partner is Germany, followed by the US and China.

[12] The figures are for trade with the EU as it is now (ie 27 countries, plus the UK) for all years from 1999.

Top 10 trading partners: Goods and services, 2015

	Exports			Imports	
	£bn	% of total		£bn	% of total
US	96.4	18.6%	Germany	70.4	12.9%
Germany	48.5	9.4%	US	59.3	10.8%
France	32.9	6.4%	China	38.4	7.0%
Netherlands	31.8	6.1%	Netherlands	36.9	6.7%
Ireland	25.7	5.0%	France	36.4	6.6%
Switzerland	21.0	4.1%	Spain	25.0	4.6%
Italy	17.7	3.4%	Belgium	23.4	4.3%
China	16.7	3.2%	Italy	20.5	3.7%
Belgium	15.2	2.9%	Ireland	18.7	3.4%
Spain	14.8	2.9%	Norway	14.2	2.6%

Source: ONS

2.3 The World Trade Organization (WTO)

The WTO's website describes its role as follows:

> There are a number of ways of looking at the WTO. It's an organization for liberalizing trade. It's a forum for governments to negotiate trade agreements. It's a place for them to settle trade disputes. It operates a system of trade rules.[13]

The UK is a founding member of the World Trade Organization in its own right.[14] Lord Price, the Minister for Trade, told the House of Lords EU External Affairs Sub-Committee "we do not need to accede to the WTO as we are already a member."[15] As an EU Member State the UK is, in practice, represented by the European Commission at the WTO.[16]

The UK's "membership terms are bundled with the EU's."[17] At the moment, the UK is bound by a number of WTO trade commitments (known as "schedules"). These are for the EU as a whole and are negotiated by the EU.[18] In December 2016, the Department for International Trade said that in unbundling the UK's schedules, it would seek to replicate the UK's current obligations. The Department's statement said:

> The United Kingdom is a founding member of the World Trade Organisation (WTO). In addition to the general obligations of membership, all WTO members undertake specific commitments in their goods and services schedules: WTO members' goods schedules set out upper limits for tariffs and detail any tariff rate quotas, and WTO members' services schedules set out commitments and reservations across all sectors and list specific sectoral commitments and reservations.

13 WTO website
14 PQ 2954 8 November 2016
15 House of Lords Select Committee on the European Union, Internal Market Sub-Committee and External Affairs Sub-Committee, Brexit: future trade between the UK and the EU, Evidence volume, 13 October 2016, Q40
16 WTO, European Union - Trade Policy Review, para 2.16, 18 May 2015
17 Peter Ungphakorn, Nothing simple about UK regaining WTO status post-Brexit, International Centre for Trade and Sustainable Development, 27 June 2016
18 Brexit and the WTO option: Key questions about a looming challenge, Financial Times, 12 July 2016

> The UK's WTO commitments currently form part of the European Union's schedules. When we leave the EU we will need UK-specific schedules. In order to minimise disruption to global trade as we leave the EU, over the coming period the Government will prepare the necessary draft schedules which replicate as far as possible our current obligations. The Government will undertake this process in dialogue with the WTO membership. This work is a necessary part of our leaving the EU. It does not prejudge the outcome of the eventual UK-EU trading arrangements.[19]

The UK's schedule can only be adopted if none of the WTO's 163 members object.[20] Views differ on how easy the process of establishing the UK's schedules at the WTO will be.[21] Agriculture is one area which presents particular challenges (see box below). The House of Lords EU Committee concluded:

> Although the Government is confident that this process will be purely technical, a number of political factors could complicate certification. For example, the views of other WTO members, particularly on tariff rate quotas, and on whether the UK and the EU's actions could be considered to be a 'modification' rather than simply a 'rectification' of the EU's schedules, may complicate agreement.[22]

The WTO will be important to UK trade policy even if trade with the EU is not on the default WTO rules basis. For example, the WTO has rules on free trade agreements and customs unions. In particular, these must cover "substantially all trade". These rules have implications for the UK's future trade arrangements with the EU and mean that deals applying only to certain industries might well be open to challenge at the WTO.[23]

Box 1: Agricultural trade

The UK's exports of agricultural goods were worth £20 billion in 2016 of which 60% were to the EU. UK agricultural imports were £43 billion, of which around 70% were from the EU. The main destinations for UK exports were the Irish Republic, the US, France and the Netherlands. The largest sources of UK imports were the Netherlands, the Irish Republic, France, Germany and Spain. The largest category of exports was whisky (£4.1 billion).

Agricultural issues can be a sticking point in trade negotiations. In evidence to the International Trade Committee, Peter Ungphakorn, a former WTO official, said that "agriculture is particularly political in trade issues" and was "particularly difficult to negotiate".[24]

EU tariffs on agricultural products are, on average, higher than on non-agricultural products and, in some cases, very high (although there is considerable variation). Imports of agricultural products from

[19] HCWS316 Written Statement 5 December 2016

[20] Julian Braithwaite (UK Permanent Representative to the WTO), Ensuring a smooth transition in the WTO as we leave the EU, 23 January 2017

[21] The Government has said it intends to follow the WTO rectification procedures (see PQ 58537 13 January 2017). Rectification is for changes which do not alter the scope of concessions. The alternative, modification, is for substantive changes (see House of Lords European Union Committee, Brexit: the options for trade, 5th Report of 2016-17, HL Paper 72, 13 December 2016, para 173). See also, David Allen Green, Brexit and the issue of the WTO schedules, Financial Times 28 February 2017

[22] House of Lords European Union Committee, Brexit: the options for trade, 5th Report of 2016-17, HL Paper 72, 13 December 2016, para 212

[23] For more on this, see Peter Ungphakorn, Why the UK is already under WTO rules, and why that matters for Brexit, 15 February 2017

[24] International Trade Committee, UK trade options beyond 2019, 13 January 2017, HC 817-ii, 2016-17, Q208

least developed countries, and some developing countries, can enter the EU market at zero or reduced tariffs under various EU preferential trade arrangements or free trade agreements.[25]

The EU also has a system of tariff rate quotas (TRQs) which allow a certain volume of agricultural imports into the EU at low or zero tariffs. The EU TRQs will need to be divided between the UK and the EU. This process may well be difficult.[26] TRQs are likely to become the "most contentious issue" for the UK at the WTO, according to Luis González García of Matrix Chambers.[27] In addition, some way of dealing with UK-EU trade will need to be found.[28] [29]

It was reported in October 2017, that the UK and EU had reached a preliminary deal on splitting the TRQs. There would be no expansion of market access for non-EU countries. Quotas would be divided up based on where goods are consumed in the EU. This would mean the UK taking a relatively large share of the quota for New Zealand lamb, for example, due to the large amount consumed in the UK. The UK hopes that its agricultural quotas can be agreed by "technical rectification" (ie without agreement from other countries). The US and others are reported to object to the proposed division of the TRQs and there is also opposition to technical rectification.[30]

There are also rules on subsidising agriculture. Professor L Alan Winters of Sussex University told the House of Commons International Trade Committee that:

> The obligation is not to subsidise above a certain amount, but the EU is well inside the limits that it negotiated in 1994 and therefore allocating subsidies should not be a significantly difficult issue.[31]

The Government has said that it wants "a reciprocal deal that delivers no tariffs on trade between the UK and EU" and that it is "working to minimise burdensome non-tariff-barriers to such trade, while maintaining high standards for food safety, animal welfare and the environment."[32]

There is more information on trade and agriculture in a separate Library briefing, Brexit: Agriculture and Trade.

2.4 The Brexit negotiations

The Brexit negotiations started in June 2017. The first phase of negotiations concerns citizens' rights, the financial settlement, the Irish border and other separation issues. The UK Government is keen for the negotiations to move on quickly to future UK-EU relations, including trade. This will only happen if the EU considers that sufficient progress has been made on phase 1 of the negotiations. The European Council of 19-20 October will give the EU an opportunity to consider whether this has happened. The European Parliament voted 557-92 in favour of a motion saying that insufficient progress had been made on the three phase 1 issues.[33]

---

[25] WTO, Trade Policy Review – The European Union, 18 May 2015, para 4.53

[26] House of Lords European Union Committee, Brexit: the options for trade, 5th Report of 2016-17, HL Paper 72, 13 December 2016, paras 178 and 185

[27] The "WTO Option" for Brexit is far from straightforward, The Economist, 7 January 2017

[28] Peter Ungphakorn, The limits of possibility: splitting the lamb-mutton quota for the UK and EU-27, 6 January 2017

[29] For more detail on the TRQs, see Peter Ungphakorn, Written evidence to International Trade Committee, UKT0052, 21 February 2017

[30] UK and EU strike initial deal on WTO quotas in Brexit breakthrough, Financial Times, 3 October 2017. Trump opposes EU-UK agri-deal in blow to May's Brexit plans, Financial Times, 5 October 2017. For more information, see Peter Ungphakorn, UK, EU, WTO, Brexit primer – 2. Tariff quotas, 7 October 2017

[31] International Trade Committee, UK trade options beyond 2019, 10 January 2017, HC 817-ii, 2016-17, Q208

[32] PQ 908265 19 January 2017

[33] EU Parliament says Brexit talks not made sufficient progress, Financial Times, 3 October 2017

More background on the negotiations is available in a number of Library papers available on the Commons Library Brexit hub.

Box 2: Trade and devolution

Brexit raises particular issues in relation to the Irish border. In particular, how will customs arrangements work, given the desire to avoid a return to a hard border? These issues are discussed in a separate Library paper, Brexit negotiations: the Irish border question. The UK Government published a position paper on Northern Ireland and Brexit in August 2017 and an accompanying paper on Northern Ireland's trade.

A further issue is the role of the devolved administrations in future trade agreements. Trade agreements often include measures on policy areas which are devolved, such as agriculture.

3. The Government's negotiating objectives

3.1 The Government's objectives

The Government's negotiating objectives for the trade aspects of Brexit were initially set out in a speech by the Prime Minister at Lancaster House on 17 January 2017.[34] A White Paper was published shortly afterwards.[35] The Prime Minister also gave a speech on Brexit in Florence on 22 September 2017.[36]The main points are:

- The UK will leave the single market and the customs union.
- The UK wants the freest and most frictionless trade possible in goods and services between the UK and the EU.
- The UK does not wish to adopt an existing model of relations with the EU. Both the EEA option and a model based on the EU's recent trade agreement with Canada are rejected[37]
- An "implementation" period (or transitional period) of around two years.

The Prime Minister said:

> let us not seek merely to adopt a model already enjoyed by other countries. Instead let us be creative as well as practical in designing an ambitious economic partnership which respects the freedoms and principles of the EU, and the wishes of the British people.[38]

The Prime Minister was optimistic that a trade agreement could be reached for a number of reasons, including the fact that the UK and EU are important trading partners, the UK and EU have a shared belief in free trade and a commitment to high regulatory standards.

The Government has also set out its ideas for future relations with the EU in a number of position papers. The paper on customs is discussed in the box below.

---

[34] The Government's negotiating objectives for exiting the EU, Speech by the Prime Minister, 17 January 2017. The Secretary of State for Exiting the EU, Rt Hon David Davis MP, made a statement to the House of Commons on the same date. See HC Deb 17 January 2017 cc792-822.

[35] HM Government, The United Kingdom's exit from and new partnership with the European Union, Cm 9417, February 2017

[36] A new era of co-operation and partnership between the UK and the EU, Prime Minister's speech, Florence, 22 September 2017

[37] The EEA model is rejected as this would mean adopting new EU rules with little influence over them. The Canada option would reduce market access (compared to the situation now) and would fail to take into account the existing close relationship between the UK and the EU.

[38] A new era of co-operation and partnership between the UK and the EU, Prime Minister's speech, Florence, 22 September 2017

Box 3: Customs position paper

In August 2017, the Government published a position paper on future customs arrangements.[39] This said:

> As we leave the European Union and therefore the EU Customs Union, the Government seeks a new customs arrangement that facilitates the freest and most frictionless trade possible in goods between the UK and the EU, and allows us to forge new trade relationships with our partners in Europe and around the world.[40]

However, the paper proposed a transition period for the implementation of the new customs arrangements to avoid a "cliff edge". The paper said that:

> The Government is keen to explore with the EU a model for an interim period which would ensure that businesses and people in the UK and the EU only have to adjust once to a new customs relationship. This could be delivered through a continued close association with the EU Customs Union for a time-limited period after the UK has left the EU. This could involve a new and time-limited customs union between the UK and the EU Customs Union, based on a shared external tariff and without customs processes and duties between the UK and the EU. The length of the interim period needs further consideration and will be linked to the speed at which the implementation of new arrangements could take place. We intend to discuss implementation timelines with business as part of our engagement with stakeholders.[41]

The Government envisages being able to pursue new trade negotiations with other countries during this interim period but no new trade deals would be implemented during this period where they were inconsistent with the interim agreement.

In the longer term, the Government proposed two options for future customs arrangements with the EU: "a highly streamlined customs arrangement" and a "new customs partnership":

> **A highly streamlined customs arrangement** between the UK and the EU, streamlining and simplifying requirements, leaving as few additional requirements on EU trade as possible. This would aim to: continue some of the existing arrangements between the UK and the EU; put in place new negotiated and potentially unilateral facilitations to reduce and remove barriers to trade; and implement technology-based solutions to make it easier to comply with customs procedures. This approach involves utilising the UK's existing tried and trusted third country processes for UK-EU trade, building on EU and international precedents, and developing new innovative facilitations to deliver as frictionless a customs border as possible.
>
> **A new customs partnership with the EU**, aligning our approach to the customs border in a way that removes the need for a UK-EU customs border. One potential approach would involve the UK mirroring the EU's requirements for imports from the rest of the world where their final destination is the EU. This is of course unprecedented as an approach and could be challenging to implement and we will look to explore the principles of this with business and the EU.[42]

Any new customs arrangement would have to be negotiated with the EU. The Brexit negotiations will only turn to the future relationship, including customs arrangements, if the EU believes "sufficient progress" has been made on the issues of citizens' rights, the UK's financial contribution to the EU, and the Irish border. The EU will not take a decision on this until October. Michel Barnier, the EU's chief Brexit negotiator said in a speech in July:

> I have heard some people in the UK argue that one can leave the single market and build a customs union to achieve "frictionless trade" – that is not possible.[43]

Open Europe described publication of the paper as a "welcome development" and said the proposals for the interim arrangements were "sensible". With regards to the longer term arrangements, Open Europe favoured the streamlined customs arrangement:

> Of the two long-term models under consideration, Open Europe believes the option for a UK-EU customs facilitation agreement is preferable. This best balances safeguarding barrier-free UK-EU

---

39 HM Government, Future customs arrangements: A future partnership paper, August 2017

40 HM Government, Future customs arrangements: A future partnership paper, August 2017, para 1

41 HM Government, Future customs arrangements: A future partnership paper, August 2017, para 48

42 HM Government, Future customs arrangements: A future partnership paper, August 2017, para 4

43 Speech by Michel Barnier 6 July 2017

> trade with ensuring that the UK is best able to conduct a genuinely independent trade policy once it leaves the EU. It will also likely be easier to negotiate given it follows existing international models for bilateral cooperation in customs procedures.[44]

Peter Holmes of Sussex University was sceptical about the extent to which technology could streamline customs procedures. He said the "first option of a "streamlined" customs arrangement will likely still involve a lot of red tape and delays for businesses, which must prove they meet the EU's standards." The second option of the new customs partnership would require "complex tracking procedures", especially for components and would also need a supra-national body to monitor compliance.[45]

A customs White Paper was published in October 2017.[46]

3.2 Commentary and reaction

Introduction

Michel Barnier, the EU chief negotiator, said that the Prime Minister's Florence speech expressed a "constructive spirit" and showed "a willingness to move forward". He also said, however, that more detail was needed on the UK position.[47]

Open Europe said that the speech was a "sensible way forward".[48] The speech was criticised, however, for lack of detail on the UK's future trade relationship with the EU, with some asking what the transitional period is transitioning to.[49] The "UK in a changing Europe" initiative described the speech as positive in tone but leaving many problems unresolved.[50]

Single market

The Government has said that the UK will leave the EU single market (there is background on the single market in section 2.1 above). The Prime Minister's Florence speech recognised that the single market is based on accepting all "four freedoms" (free movement of goods, services, people and capital). The Prime Minister said:

> The United Kingdom is leaving the European Union. We will no longer be members of its single market or its customs union. For we understand that the single market's four freedoms are indivisible for our European friends.
>
> We recognise that the single market is built on a balance of rights and obligations. And we do not pretend that you can have all the benefits of membership of the single market without its obligations.

---

44 Aarti Shankar, The UK should opt for a customs facilitation agreement with the EU, Open Europe, 15 August 2017

45 Peter Holmes, The UK's plan for post-Brexit customs is more hopeful than realistic, The Conversation, 16 August 2017

46 HM Treasury, Customs Bill: legislating for the UK's future customs, VAT and excise regimes, Cm 9502, October 2017

47 Michel Barnier, Statement, 22 September 2017

48 Aarti Shankar, Open Europe responds to Theresa May's Florence speech, 22 September 2017

49 Iain Begg, May in Florence: renaissance or resistance? LSE Brexit blog, 23 September 2017, Swati Dhingra and Josh de Lyon, Florence speech falls short on the details of a bespoke agreement with the EU, 25 September 2017

50 Anand Menon and Jonathan Portes, Statement in response to Theresa May's speech in Florence, UK in a changing Europe, 22 September 2017

> So our task is to find a new framework that allows for a close economic partnership but holds those rights and obligations in a new and different balance.[51]

Leaving the single market means that the UK will no longer have to accept free movement of people, will be able to depart from the EU's single market rules and would mean a new system (other than the ECJ) for resolving disputes. The Prime Minister said:

> Now in any trading relationship, both sides have to agree on a set of rules which govern how each side behaves.
>
> So we will need to discuss with our European partners new ways of managing our interdependence and our differences, in the context of our shared values.
>
> There will be areas of policy and regulation which are outside the scope of our trade and economic relations where this should be straightforward.
>
> There will be areas which do affect our economic relations where we and our European friends may have different goals; or where we share the same goals but want to achieve them through different means.
>
> And there will be areas where we want to achieve the same goals in the same ways, because it makes sense for our economies.
>
> And because rights and obligations must be held in balance, the decisions we both take will have consequences for the UK's access to European markets and vice versa.
>
> To make this partnership work, because disagreements inevitably arise, we will need a strong and appropriate dispute resolution mechanism.
>
> It is, of course, vital that any agreement reached – its specific terms and the principles on which it is based – are interpreted in the same way by the European Union and the United Kingdom and we want to discuss how we do that.
>
> This could not mean the European Court of Justice – or indeed UK courts - being the arbiter of disputes about the implementation of the agreement between the UK and the EU however.
>
> It wouldn't be right for one party's court to have jurisdiction over the other. But I am confident we can find an appropriate mechanism for resolving disputes.[52]

On the EU side, Michel Barnier has said that it is not possible to leave the single market and keep all its benefits and that opting into the single market on a sector-by-sector basis is not possible.[53]

Customs union

The UK will also leave the EU customs union (see section 2.1 for background). This will enable to UK to enter into its own trade deals. The Government has said that it wishes trade with the EU to be as free and frictionless as possible and set out some ideas on how this could

---

51 A new era of co-operation and partnership between the UK and the EU, Prime Minister's speech, Florence, 22 September 2017
52 A new era of co-operation and partnership between the UK and the EU, Prime Minister's speech, Florence, 22 September 2017
53 Speech by Michel Barnier 6 July 2017

work in a position paper on customs arrangements published in August 2017 (see box above).

On leaving the EU customs union, the border between the UK and the EU will become a customs border. This would be likely to mean more customs controls, potentially involving some increased costs and delays for business.

Economic effects

The economic effects of the Government's plans will depend on a number of factors including the nature of the trade agreement reached with the EU and the UK's ability to take advantage of new trading opportunities with non-EU countries. A trade agreement with the EU is unlikely to give the same level of access to the EU market as membership of the single market and customs union. The Lords EU Committee observed:

> Even the most advanced FTAs do not provide the level of market access for goods that the UK currently enjoys by virtue of membership of the Single Market. We also note that providing equivalent liberal market access for services in a FTA with the EU would be unprecedented.[54]

As noted by the Economist, "Brexit will impose costs and … a hard Brexit will make them heavier."[55] Studies carried out before the referendum generally showed that remaining in the single market was the least economically harmful option.

The Government is seeking, via its proposed trade agreement with the EU, to minimise the costs of leaving the single market. At the same time, it wishes to maximise trading opportunities outside the EU by striking new trade deals. Whether the latter can outweigh the former remains to be seen.

Transition period

In her Florence speech, the Prime Minister proposed an "implementation" or transition period of "around two years". The transition period would give businesses and Government time to adjust and prevent a "cliff-edge" scenario.

The Prime Minister said:

> As I said in my speech at Lancaster House a period of implementation would be in our mutual interest. That is why I am proposing that there should be such a period after the UK leaves the EU.
>
> Clearly people, businesses and public services should only have to plan for one set of changes in the relationship between the UK and the EU.
>
> So during the implementation period access to one another's markets should continue on current terms and Britain also should continue to take part in existing security measures. And I know

54 House of Lords European Union Committee, Brexit: the options for trade, 5th Report of 2016-17, HL Paper 72, 13 December 2016, para 163
55 Doing it the hard way, The Economist, 21 January 2017

> businesses, in particular, would welcome the certainty this would provide.
>
> The framework for this strictly time-limited period, which can be agreed under Article 50, would be the existing structure of EU rules and regulations.
>
> How long the period is should be determined simply by how long it will take to prepare and implement the new processes and new systems that will underpin that future partnership.
>
> For example, it will take time to put in place the new immigration system required to re-take control of the UK's borders.
>
> So during the implementation period, people will continue to be able to come and live and work in the UK; but there will be a registration system – an essential preparation for the new regime.
>
> As of today, these considerations point to an implementation period of around two years.[56]

A number of commentators have called for a transitional period. For example, the House of Commons Exiting the EU Committee said:

> A "cliff edge" change in circumstances could be extremely disruptive in some sectors to businesses both in the UK and in the EU 27, whether it be the need to adjust to new provisions for regulatory approval, new customs requirements, or the need to adjust to new costs or restrictions in employing EU workers. The risk of a cliff edge – ie the absence of transitional arrangements – might also push some businesses to pre-empt the result of negotiations and minimise the risks to their business. For some, this could involve re-locating out of the UK or investing elsewhere in future. A period of transition, or adjustment, is a factor in most trade agreements. The Government must make clear from the outset that a period of adjustment to any change in trading arrangements or access to EU markets for UK service industries will be sought as part of the negotiations.
>
> If final agreement is not possible by the time that the UK leaves the EU, it would be in the interests of both sides of the negotiations for an outline framework, with appropriate transitional arrangements, for the UK's future relationship with the EU to be agreed in respect of access to the single market for goods and services and future trade policy.[57]

The House of Lords EU Committee said:

> Brexit will dramatically alter the UK's trading relationship with its biggest trading partner, the EU. The evidence we have heard underlines the importance of establishing transitional or interim arrangements to mitigate the shock that would follow were the UK to leave the EU under the terms of Article 50 without securing agreement on future trading relations with the EU.
>
> A transitional agreement will therefore almost certainly be necessary. We see little evidence that agreeing a transitional arrangement would put the UK's wider interests at risk. Quite the opposite: a transitional arrangement would allow negotiations to be conducted in a less pressured environment, benefiting all

56 A new era of co-operation and partnership between the UK and the EU, Prime Minister's speech, Florence, 22 September 2017

57 Exiting the European Union Committee, The process for exiting the European Union and the Government's negotiating objectives, 14 January 2017, HC815, 2016-17, paras 163 and 164

> concerned. We urge the Government to establish at the outset of negotiations a clear 'game plan' for a future transitional agreement, with specific proposals as to what form it should take.[58]

The proposed transitional period would mean continuing to operate under the framework of "the existing structure of EU rules and regulations".[59] This has been described as a two-year standstill arrangement" [60], as preserving the status quo[61] and keeping the UK in the EU "in all but name until 2021" although the UK will not have a vote in the EU after 2019.[62]

The EU has said that for the UK to continue to benefit from the single market during the transition period, EU rules would continue to apply. Michel Barnier said:

> Today, for the first time, the United Kingdom government has requested to continue to benefit from access to the Single Market, on current terms, and to continue to benefit from existing cooperation in security. This is for a limited period of up to two years, beyond its withdrawal date, and therefore beyond its departure from the EU institutions.
>
> If the European Union so wishes, this new request could be taken into account. It should be examined in light of the European Council guidelines of 29 April 2017: "*Should a time-limited prolongation of Union acquis be considered, this would require existing Union regulatory, budgetary, supervisory, judiciary and enforcement instruments and structures to apply.*"[63]

Some have argued for a longer transitional period. For example, the Trade Policy Observatory at Sussex University has argued for a five to ten year transitional arrangement.[64]

---

58 House of Lords European Union Committee, Brexit: the options for trade, 5th Report of 2016-17, HL Paper 72, 13 December 2016, para 262-63
59 A new era of co-operation and partnership between the UK and the EU, Prime Minister's speech, Florence, 22 September 2017
60 Aarti Shankar, Open Europe responds to Theresa May's Florence speech, 22 September 2017
61 A new era of co-operation and partnership between the UK and the EU, Prime Minister's speech, Florence, 22 September 2017
62 EU gives guarded welcome to May's conciliatory Florence speech, Financial Times , 22 September 2017
63 Statement by Michel Barnier, 22 September 2017
64 Exiting the EU Committee, Written evidence submitted by the UK Trade Policy Observatory (UKTPO), January 2017, paras 3.1 and 3.2

4. Alternative models for UK-EU trade

4.1 Introduction

Two possible alternative models for the UK's future trade arrangements with the EU are trading under WTO rules and becoming a member of the EEA.

These are at the opposite ends of the spectrum in terms of closeness to the EU. The EEA model would be the closest to EU membership with the WTO option being the most radical break. Another option would be a different form of free trade agreement to that proposed by the Government.[65]

4.2 Trading under WTO rules

Under this option, there would be no preferential trade agreement between the UK and the EU. Trade would be based on WTO rules. This is the "default" option – ie the one which would apply in the absence of a preferential trade agreement between the UK and EU.

The WTO option would mean the imposition of tariffs on trade in goods between the UK and the EU. UK exports to the EU would face the EU's tariffs and imports into the UK from the EU would face whatever tariffs the UK decided to impose.[66] This is in contrast to the current arrangements – while the UK is a member of the EU there are no tariffs on UK-EU trade.

There are, however, WTO rules on tariffs which govern how they are applied. The principle of non-discrimination requires WTO members not to treat any member less advantageously than any other: grant one country preferential treatment, and the same must be done for everyone else. There are exceptions for free trade areas and customs unions like the EU, but the principle implies that, outside of these, the tariff that applies to the 'most-favoured nation' (MFN) must similarly apply to all.

In practice, this would prevent discriminatory or punitive tariffs being levied by the EU on the UK, or vice versa. The maximum tariff would be that applied to the MFN. The EU's MFN tariffs have generally fallen over time, meaning that in this particular context the 'advantage' of EU membership has declined. While EU tariffs are low on average, they are high for some sectors, particularly in agriculture.

Trading on these terms would mean many UK exporters to the EU becoming less price competitive, to varying degrees, than their counterparts operating within the remaining EU, and those within countries with which the EU has preferential trading relationships. However, given that the average tariff is low, any loss of competiveness

65 More information on the areas covered by free trade agreements is in the Appendix.
66 As noted above, the Government has said that it intends to replicate the EU's tariff structure as far as possible, at least in the short term.

might well be offset in many cases by the depreciation of the pound which has occurred since the referendum.

The UK would also need to decide the level of tariffs on imports into the UK. Under WTO rules, the UK would not be able to discriminate between imports from different countries, except where there was a free trade agreement. Setting the level of tariffs would involve a trade-off between lower prices for domestic consumers on the one hand, and bargaining power in future trade negotiations on the other. Setting relatively high tariffs would increase prices for consumers but give a bargaining chip in future negotiations. Eliminating or setting low tariffs would tend to reduce prices, but give trading partners little incentive to reduce their tariffs in any future negotiations. The Government has announced that it intends to replicate the EU's tariff structure, as far as possible, at least initially.

Non-tariff barriers to trade include, for example, differing product standards. These might be in the areas of labelling, packaging and sanitary requirements. The terms of WTO agreements limit the circumstances in which such measures can be applied, and in particular uphold the principle of non-discrimination that would prohibit punitive measures against the UK.

Without further negotiation, the UK's trade in services with the EU would be governed by the WTO General Agreement on Trade in Services (GATS). According to researchers at the LSE, "since the WTO has made far less progress than the EU in liberalising trade in services, this would mean reduced access to EU markets for UK service producers."[67]

The WTO option would impose the fewest obligations on the UK. There is no requirement to implement EU legislation although UK businesses would still have to comply with EU rules to in order to export to the single market. Under the WTO option, there would be no obligation to accept free movement of people or make a financial contribution to the EU budget. Studies generally find this option to be the most costly in economic terms.

4.3 The European Economic Area

What is the EEA and what is its trade relationship with the EU?

The European Economic Area (EEA) is made up of the EU Member States plus three other countries: Norway, Iceland and Liechtenstein.[68] EEA membership gives access to the single market with some exceptions in agriculture and fisheries. The EEA countries are outside the EU customs union so can set their own trade policies with countries outside the EEA.

---

[67] S Dhingra and T Sampson, Brexit and the UK economy, LSE Centre for Economic Performance, May 2017, p4

[68] Iceland, Norway and Liechtenstein are also in the European Free Trade Association (EFTA) along with Switzerland. Switzerland is not in the EEA. Its trade arrangements with the EU are governed by bilateral agreements.

The EEA Agreement extends the EU single market and free movement of goods, services, people and capital, together with laws in areas such as competition policy, state aid, consumer protection and environmental policy to include Norway, Iceland and Liechtenstein. In addition, the EEA Agreement covers cooperation in policies such as research and technological development, education, training and youth, employment, tourism, culture, civil protection, enterprise, entrepreneurship and small and medium-sized enterprises.

The Agreement does not cover the following EU policies:

- Common Agriculture and Fisheries Policies (CAP and CFP, although the Agreement contains provisions on various aspects of trade in agricultural and fish products);
- Customs Union;
- Common Trade Policy;
- Common Foreign and Security Policy;
- Justice and Home Affairs (even though the EFTA countries are part of the Schengen area);
- Direct and Indirect taxation; or
- Monetary Union (EMU).[69]

EEA members do not benefit from the EU's trade agreements with other countries. If it were to adopt this model, the UK would be able to negotiate its own free trade deals with other countries. Most of Norway's free trade agreements have been negotiated through EFTA although it does have bilateral agreements with Greenland the Faroe Islands.[70] As they are outside the customs union, exports of goods from non-EU EEA members to the EU must comply with potentially costly customs procedures.

EEA members accept free movement of people, although there are some rights to suspend this in certain limited circumstances. EEA members make a financial contribution to the EU. EEA members must also incorporate much of EU law into their domestic legislation in return for access to the EU market:

> 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.[71]

Liechtenstein, Norway and Iceland have no representation in any of the EU institutions and only indirect influence – including the right to be consulted – on EU proposals affecting them.

The Government has ruled out EEA membership even as a transitional option. In oral questions on 7 September, David Davis said:

> The simple truth is that membership of the European Free Trade Association, for example, which would be one way to retain EEA membership, would do exactly that: it would keep us within the

69 EFTA website
70 European Parliament Research Service, Free trade agreements between EFTA and third countries: an overview, April 2016, p1
71 HM Government, Alternatives to membership: possible models for the united Kingdom outside the European Union, March 2016, para 3.12

> acquis, and it would keep us within the requirements of free movement, albeit with some limitations, but none of those have worked so far. In many ways, it is the worst of all outcomes. We did consider it—I gave it some considerable thought, maybe as an interim measure—but it seemed to me to be more complicated, more difficult and less beneficial than other options.[72]

Advantages and disadvantages of EEA option

Some commentators have written in favour of this option. For example Wolfgang Münchau, writing in the Financial Times, argued that EEA membership was the most sensible option for the UK. This model had the advantage of existing already so would not need to be invented and would minimise the economic costs of Brexit. He noted that it would mean accepting free movement of people and would entail contributions to the EU budget.[73] A leader in the Economist said the "Norwegian option would do the least damage to the economy."[74] Most studies of the economic impact of Brexit found this option would lead to lower economic losses compared with other options.[75] A Financial Times leader said "the government may not like it but permanent membership of the European Economic Area is the best way of safeguarding Britain's future as a trading power.[76]

There are drawbacks to the EEA option. Open Europe set these out as follows:

> However, a Norway-style relationship is unlikely to be a viable long-term option for the UK. Firstly, it is a poor fit when set against the Leave side's key arguments during the referendum campaign: restoring full control over UK immigration policy, restoring UK sovereignty over lawmaking including vis-à-vis the European Court of Justice, eliminating the UK's financial contribution to the EU, and reducing the burden of EU legislation on business. Secondly, and perhaps just as importantly, it is unlikely that such an EU-satellite status would satisfy the national self-image of a major G7 economy with deeper trade and foreign policy links across the world, such as the UK.[77]

4.4 Staying in the customs union

One option which has been suggested is that the UK might stay in the customs union, possibly as a transitional arrangement after Brexit. The main features of the customs union are described in section 2.1 above. The main advantage of a customs union arrangement is that it would reduce the costs associated with rules of origin. The main disadvantage is that it would severely constrain the UK's ability to conclude its own agreements on trade in goods. It has been argued that as the customs

---

72 HC Deb 7 September 2017 c286
73 "Brexit: The Norway option is the best available for the UK", Financial Times, 28 June 2016
74 "Adrift" [leader column], The Economist, 2 July 2016
75 IFS, Brexit and the UK's public finances, IFS Report 116, May 2016, p35
76 Welcome sense from UK on the customs union, Financial Times [leader column], 20 December 2016
77 Open Europe, As the UK searches for a post-Brexit plan, is the EEA a viable option? 4 August 2016

union applies only to goods, a customs union arrangement with the EU might allow the UK to pursue free trade deals covering services.[78]

Turkey has a customs union agreement with the EU (but is not strictly a member of the EU customs union). This agreement does not cover all goods: industrial goods and processed agricultural goods are covered. There is more information on customs unions in chapter 4 of the House of Lords report, Brexit: options for trade.

The UK's Government's position on the customs union was set out in a paper published in August 2017[79] (see Box 3 above for more detail). The Government published a customs White Paper in October 2017.[80]

[78] New customs union with EU after Brexit is still an option, analysts say, Guardian, 2 July 2017

[79] HM Government, Future customs arrangements: A future partnership paper, August 2017

[80] HM Treasury, Customs Bill: legislating for the UK's future customs, VAT and excise regimes, Cm 9502, October 2017

5. Trade with non-EU countries

5.1 Introduction

Even as an EU Member State, the UK does slightly more trade with non-EU countries than with the rest of the EU. The share of UK exports accounted for by non-EU countries is rising: from around 45% in 1999 to around 57% in 2016.[81] The UK's single largest export market is the US. The US and China are the second and third largest source of UK imports.

As an EU member state, the UK cannot operate its own independent trade policy. As noted above, the UK is a member of the EU customs union which means all EU Member States have the same tariffs on goods imported into the EU from non-EU countries.

Trade agreements are negotiated by the EU. Individual EU Member States cannot negotiate their own separate agreements. Trade deals are negotiated by the European Commission on behalf of, and in consultation with, the Member States. The European Parliament has to give its consent to trade agreements and in some cases the parliaments of Member States do as well.[82]

5.2 Which countries does the UK have a trade agreement with as a member of the EU?

The EU has trade agreements in force with over 60 countries (see table below). The EU's partners in these agreements range from large economies, such as Canada and South Korea, to very small economies such as Dominica and St Vincent & the Grenadines. The EU does not have trade agreements in force with a number of the world's largest economies, such as the US, Japan, China and India. The EU is in negotiations with Japan over a trade agreement. The EU has also been in negotiations with the US over the Transatlantic Trade and Investment Partnership (TTIP), although the outlook for this agreement is highly uncertain.

The list of trade deals includes a number of Economic Partnership Agreements (EPAs). These are trade and development agreements between the EU and African, Caribbean and Pacific countries. EPAs aim to contribute to sustainable development and to reduce poverty. EPAs open up EU markets fully and immediately while permitting the partner countries a longer period to open up their markets.[83]

The list does not include countries with whom the EU is currently negotiating a trade agreement.

81 Both figures based on current composition of the EU.
82 European Commission, Trade negotiations step by step, September 2013
83 European Commission, Economic Partnership Agreements

List of EU trade agreements

Albania	Lesotho
Algeria	Liechtenstein
Andorra	Madagascar
Antigua and Barbuda	Mauritius
Bahamas	Mexico
Barbados	Moldova
Belize	Montenegro
Bosnia and Herzegovina	Morocco
Botswana	Namibia
Cameroon	Nicaragua
Canada	Norway
Chile	Occupied Palestinian Territory
Colombia	Panama
Costa Rica	Papua New Guinea
Cote d'Ivoire	Peru
Dominica	San Marino
Dominican Republic	Serbia
Ecuador	Seychelles
Egypt	South Africa
El Salvador	South Korea
Faroe Islands	St Kitts and Nevis
Fiji	St Lucia
FYR Macedonia	St Vincent and the Grenadines
Georgia	Suriname
Grenada	Swaziland
Guatemala	Switzerland
Guyana	Syria
Honduras	Trinidad and Tobago
Iceland	Tunisia
Israel	Turkey
Jamaica	Ukraine
Jordan	Zimbabwe
Lebanon	

Sources: European Commission, WTO

5.3 Will the UK continue to benefit from EU trade agreements after Brexit?

It seems unlikely that the UK will continue automatically to benefit from the EU's trade agreements after Brexit, although the situation is not entirely clear. The House of Lords EU Committee recommended that the Government confirm the position in respect of these agreements. The Committee said:

> On the balance of evidence, we conclude that the UK is unlikely to be able to retain access to the EU's FTAs with third countries

> following Brexit, whether they are mixed agreements or not. We urge the Government to confirm that this is the case.[84]

In response, the Government has said:

> We are seeking to achieve continuity in our trade and investment relationships with third countries, including those covered by existing EU Free Trade Agreements. As the Prime Minister has said, we want to avoid a cliff-edge and to provide certainty where we can. We are exploring ways to achieve this with our trade partners so as to deliver maximum continuity and certainty for businesses once we leave, as well as to ensure continued preferential arrangements for developing countries.[85]

In evidence to the International Trade Committee, the Secretary of State, Dr Liam Fox, said he wished to see a "transition" of the EU's trade agreements to the UK. He told the Committee:

> On the transitional adoption, we have made it very clear to countries that we would like to see a transition of their agreements to a UK agreement at the point that we leave the EU. So far, we have not yet had a country that did not want to do that. That is a lot easier as a process than negotiating a new FTA because it simply means changes to the current treaty framework, in other words, removing references to EU institutions, for example, but also disaggregating any quotas that exist within that. We think that from our initial contacts with countries that they are likely to do so.[86]

On a visit to Japan, the Prime Minister said she wanted the UK to be able to take advantage of existing EU trade agreements after Brexit such as the EU-Japan deal currently being negotiated.[87] The Financial Times reported, however, that Japan was placing higher priority on the deal with the EU and was not in a rush to sign an agreement with the UK.[88]

The International Trade Committee also called on the Government to seek clarification on the extent to which the grandfathering of EU trade agreements is legally possible.[89]

5.4 Can the UK negotiate new trade agreements while still in the EU?

The Government has said that it is not possible for the UK to negotiate or conclude free trade agreements with non-EU countries while it remains an EU Member State.[90]

---

84 House of Lords European Union Committee, Brexit: the options for trade, 5th Report of 2016-17, HL Paper 72, 13 December 2016, para 163

85 Department for Exiting the EU and Department for International Trade, Brexit – the options for trade: Government response, 28 February 2017

86 International Trade Committee, UK trade options beyond 2019, 1 February 2017, HC 817-ii, 2016-17, Q454

87 Theresa May wants Britain to 'piggyback' on EU trade deals after Brexit, The Times, 30 August 2017

88 UK hopes dashed for swift Japan trade talks, Financial Times, 28 August 2017

89 International Trade Committee, UK trade options beyond 2019, 1st report of Session 2016-17, HC 817, 7 March 2017, para 202

90 Some have taken an different view, such as Andrew Lilico, Yes, we can legally sign a US trade deal before Brexit – no matter what the EU thinks of it, Daily Telegraph, 23 January 2017

Lord Price told the House of Lords:

> We are clear that, while we are a member of the EU, we cannot negotiate or sign free trade agreements but we can have exploratory discussions, which we are having at the moment. Once we leave, we will be free to negotiate and sign free trade agreements for the United Kingdom.[91]

Dr Fox told the European Scrutiny Committee on 26 October 2017:

> To be clear, we are not entitled to undertake trade negotiations while we are part of the European Union. We take our obligations to that seriously, under Common Commercial Policy and under our duty of sincere co-operation with that. We are, however, quite reasonably entitled to hold discussions about further liberalisation. We are also entitled to hold discussions about our WTO position, and it is reasonable for us to scope out future agreements.[92]

However, preparation for future trade deals is already underway. In response to a Parliamentary Question on future trade deals with non-EU countries, the Government said:

> We cannot negotiate and conclude trade agreements while we are a member of the EU, but we can have discussions on our future trading relationships. We have already announced working groups and dialogues on our future trading relationships with seven markets: Australia, China, India, New Zealand, Norway, South Korea and the Gulf Cooperation Council, which comprises six countries. As the Prime Minister has said, we want to build a truly Global Britain—a great, global, trading nation that is one of the firmest advocates for free trade anywhere in the world.[93]

The House of Commons International Trade Committee has asked the Government to clarify its position on how far it can go in negotiating new trade agreements prior to Brexit.[94]

Some have cast doubt on how willing non-EU countries might be to engage in serious trade negotiations with the UK, when the UK's future relations with the EU and situation at the WTO have not been settled. For example, Charles Grant of the Centre for European Reform, wrote in July 2016:

> In any case, countries like the US, New Zealand or China will simply not want to negotiate an FTA with the UK until they know what Britain's relationship with the EU is likely to be. Which bits of the single market, if any, will the UK be in? Which parts of EU competition law will apply to the UK? Once Britain has left the EU's customs union, what 'rules of origin' will Brussels apply, so that other countries cannot use the UK as a way of circumventing EU restrictions on their exports? Would regulatory harmonisation between the EU and the UK make convergence between the UK and other countries impossible?[95]

---

91 HL Deb 19 December 2016 c1465

92 European Scrutiny Committee, Oral evidence on Parliamentary scrutiny of EU Trade Deal: EU Comprehensive Economic and Trade Agreement (CETA), 26 October 2016, HC792, Q26

93 PQ 60711 27 January 2017

94 International Trade Committee, UK trade options beyond 2019, 1st report of Session 2016-17, HC 817, 7 March 2017, para 201

95 Charles Grant, Theresa May and her six-pack of difficult deals, Centre for European Reform, 28 July 2016

The Trade Policy Observatory (TPO) at the University of Sussex has also said that "other partners will want to know what UK-EU relations are before they commit to an FTA".[96] The TPO also noted that, given the limited capacity of the UK Government to negotiate trade agreements, transitional arrangements with third countries would help spread the load of negotiating new agreements.

5.5 What are the Government's priorities for new trade agreements outside the EU?

Leaving the EU, and in particular, the customs union, allows the UK to forge its own free trade agreements. While operating independently means the UK will no longer be part of the large EU trade bloc, it will mean that the UK can pursue its own interests rather than have to negotiate a common position with other EU Member States.

The Government has said the UK "will be champions of free trade driving forward liberalisation bilaterally, as well as in wider groupings". The Government also supports the international rules-based system which supports free trade.[97] The Government's aim is "to increase significantly UK trade with the fastest growing and most dynamic export markets in the world".[98] In June 2017, the Government appointed Crawford Falconer, a former New Zealand Ambassador to the WTO, as Chief Trade Negotiation Adviser with a remit to seal agreements with the UK's key trading partners.[99]

Ten working groups with 15 trade partners have been announced (as of July 2017):

- Australia
- China
- Gulf Co-operation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates)
- India
- Israel
- New Zealand
- Norway
- South Korea
- Turkey
- US[100]

---

[96] Exiting the EU Committee, Written evidence submitted by the UK Trade Policy Observatory (UKTPO), January 2017, para 3.3

[97] HM Government, The United Kingdom's exit from and new partnership with the European Union, Cm 9417, February 2017, p51

[98] HM Government, The United Kingdom's exit from and new partnership with the European Union, Cm 9417, February 2017, p52

[99] Department for International Trade Press Release, DIT appoints Crawford Falconer as new Chief Trade Negotiation Adviser, 16 June 2017

[100] Department for International Trade, UK Department for International Trade marks its first anniversary, 13 July 2017

The House of Lords EU Committee recommended that the Government prioritise agreements where the EU already has a trade agreement. The Committee said:

> We welcome the Government's efforts to engage with non-EU countries to lay the groundwork for future FTAs. However, trade negotiations are time consuming and complex, and it is important that the Government focus its efforts where they can deliver maximum benefit. In particular, the Government should focus on countries where the EU already has FTAs in place, with a view to securing the current level of market access enjoyed by UK businesses. The terms of the EU's existing FTAs and those under negotiation are likely to form a useful starting point for future UK agreements with these countries.[101]

The Committee also recommended that the Government considered negotiating access to the EU's preferential trade arrangements with non-EU countries for a transitional period.[102]

Some think tanks have made suggestions about future priorities for UK trade agreements. For example, the Institute for Government argued that priority ought to be given to carrying over existing EU trade agreements, especially those with Canada, Singapore, South Korea, Switzerland and Turkey. In terms of new agreements, it said:

> Australia and New Zealand offer the UK an opportunity to build experience by negotiating with like-minded, medium-sized economies. The UK should avoid sinking resources into negotiations with the BRIC countries (Brazil, Russia, India and China) or the USA. The experience of other nations suggests that trade negotiations with Brazil, India or China would consume large amounts of precious negotiating resources, with little prospect of reaching an agreement. The USA can be a swift negotiator, but tends to move most quickly when its partners adopt a strategy of capitulation masquerading as negotiation. The UK needs to deploy its resources strategically – it will be more productive to return to such negotiations in the future.[103]

The Institute for Government also commented that there is more to trade policy than trade deals and that other policy measures might be more effective at boosting trade. It also said that it would be realistic to run 4 or 5 trade negotiations at any one time.

Open Europe suggested that India, Canada, Israel and China should be priorities.[104] Open Europe made a number of other recommendations including not focusing exclusively on free trade agreements (as other types of agreement are possible), exploiting the UK's deep historical connections with other countries ("soft power") and prioritising exports of services.

---

[101] House of Lords European Union Committee, Brexit: trade in goods, 16th Report of 2016-17, HL Paper 129, 14 March 2017, para 261

[102] House of Lords European Union Committee, Brexit: trade in goods, 16th Report of 2016-17, HL Paper 129, 14 March 2017, para 263

[103] Oliver Ilott, Ines Stelk and Jill Rutter, Taking back control of trade policy, Institute for Government, 17 May 2017, p4

[104] Henry Newman et al, Global Britain: Priorities for trade beyond the EU, Open Europe 25 April 2017

Box 4: Trade with the Commonwealth

The inaugural Commonwealth Trade Ministers' Meeting took place in March 2017. Dr Liam Fox, Secretary of State for International Trade, said:

> It is the government's intention to make Britain a leader in free trade, working with our friends and allies in the Commonwealth to remove barriers and liberalise the global trading environment. The trade ministers' meeting is an important step towards realising this vision and I'm looking forward to strengthening foundations today for our trading future.[105]

52 countries are members of the Commonwealth. Their combined population is 2.4 billion, 60% of which is under 30.[106] Commonwealth countries vary greatly in size from India with a population of over 1.2 billion to the Pacific island of Nauru with a population of around 10,000. The Commonwealth countries also vary greatly in their level of economic development. Singapore and Australia have GDP per capita of around $50,000 while a number of Commonwealth countries have GDP per capita below $1,000.[107]

In 2015, UK exports of goods and services to the Commonwealth were £47.4 billion (9.2% of the total). UK imports from the Commonwealth were £45.5 billion (8.3% of the total). Trade with the Commonwealth is much lower than trade with the EU and also lower than trade with the US.

While there are 51 other countries besides the UK in the Commonwealth, the UK's trade is heavily focussed on a small number of countries. Five countries (Australia, Canada, India, Singapore and South Africa) accounted for 70% of UK exports to Commonwealth countries and 65% of UK imports from the Commonwealth in 2015.

The table below shows the 10 largest Commonwealth export markets for the UK in 2015. Australia was the largest single market. UK exports to Australia were £8.6 billion in 2015, 18.1% of all UK exports to the Commonwealth and 1.7% of UK exports to all countries. Canada was the second largest market followed by Singapore.

UK's top 10 Commonwealth export markets

Goods and services, 2015	£ billion	% of exports to Commonwealth	% of all exports
Australia	8.6	18.1%	1.7%
Canada	7.3	15.3%	1.4%
Singapore	7.1	14.9%	1.4%
India	6.6	14.0%	1.3%
South Africa	4.1	8.7%	0.8%
Malaysia	2.3	4.9%	0.5%
Nigeria	2.3	4.9%	0.4%
New Zealand	1.0	2.2%	0.2%
Cyprus	1.0	2.1%	0.2%
Malta	0.9	2.0%	0.2%
Commonwealth total	47.4	100.0%	9.2%
Total UK exports	517.4	n/a	100.0%

Source: ONS

The equivalent data for imports are shown in the table below. The UK imported more from India than any other Commonwealth country in 2015. UK imports from India were £9.5 billion, nearly 21% of all UK imports from the Commonwealth and 1.7% of all UK imports.

105 Department for International Trade Press Release, Liam Fox looks forward to "strengthening foundations" at first ever Commonwealth trade ministers' meeting, 9 March 2017

106 Commonwealth website

107 Figures at market exchange rates

UK's top 10 Commonwealth import sources

Goods and services, 2015	£ billion	% of imports from Commonwealth	% of all imports
India	9.5	20.8%	1.7%
Canada	7.6	16.7%	1.4%
Australia	4.9	10.7%	0.9%
South Africa	4.0	8.8%	0.7%
Singapore	3.9	8.5%	0.7%
Malaysia	2.3	5.1%	0.4%
Bangladesh	2.3	5.0%	0.4%
Nigeria	1.8	3.9%	0.3%
Pakistan	1.6	3.4%	0.3%
Sri Lanka	1.4	3.2%	0.3%
Commonwealth total	45.5	100%	8.3%
Total UK imports	547.2	n/a	100.0%

Source: ONS

5.6 Trade agreements and developing countries

Many developing countries are eligible for tariff-free or low tariff imports under current EU rules.

If the UK is not in a customs union with the EU following Brexit, it will need to decide what tariff regime it wants to put in place for developing countries, subject to WTO rules, and agree any of its own trade deals. A UK approach could be more favourable to developing countries than the current EU schemes or could be less favourable. The value of the current arrangements for developing countries in tariffs on imports to the UK is substantial.[108]

Least Developed Countries – 'Everything But Arms'

The Government has said it will continue to give the Least Developed Countries duty-free and quota-free access when the UK leaves the EU.

The Least Developed Countries[109] currently have duty-free and quota-free access to all products, except for arms and ammunitions, under the EU's 'Everything But Arms' initiative.[110] The Government has pledged to continue this arrangement when the UK leaves the EU.[111]

Other developing countries

The Government has said it will maintain trading arrangements with certain other developing countries and explore options to expand on current arrangements.

Low and lower-middle income countries other than Least Developed Countries, are currently eligible for the EU's standard 'Generalised Scheme of Preferences (GSP)' or 'GSP+' schemes. These involve the partial or entire removal of tariffs on two thirds of all product categories. Of the two, the GSP+ scheme offers greater advantages – removing tariffs on essentially the same product categories – in exchange for a country taking certain actions to support sustainable development and good governance.[112] Some developing countries also have individual or collective trade agreements with the EU.[113]

The Government has said it will "explore options to expand on relationships with developing countries such as Jamaica, Pakistan and Ghana – all of which currently benefit from a mixture of reduced or zero tariffs on the goods they export to the UK – as well as maintaining existing trading arrangements and avoiding costly tariffs".[114]

[108] Overseas Development Institute (ODI) & UK Trade Policy Observatory, The impact of the UK's post-Brexit trade policy on development: An essay series, September 2016
[109] The group of Least Developed Countries is defined by the UN. They are low-income countries confronting severe structural impediments to sustainable development; they are highly vulnerable to economic and environmental shocks and have low levels of human assets (based on indicators of health and education).
[110] European Commission, Generalised Scheme of Preferences (GSP)
[111] Department for International Trade, Department for International Development and Prime Minister's Office, Government pledges to help improve access to UK markets for world's poorest countries post-Brexit, 24 June 2017
[112] European Commission, Generalised Scheme of Preferences (GSP)
[113] HMRC, UK Trade Tariff: preferential trade arrangements for countries outside the EU has a list of countries showing which schemes each is currently eligible for.
[114] Department for International Trade, Department for International Development and Prime Minister's Office, Government pledges to help improve access to UK markets for world's poorest countries post-Brexit, 24 June 2017

Appendix: Free trade agreements

What is a trade agreement?

A free trade agreement is an agreement between countries to reduce barriers to trade between them. [115] Some trade agreements are between two countries – bilateral agreements – and others involve more countries – for example regional deals.

One traditional focus of trade agreements was the reduction of customs duties faced by certain goods when imported. This might be accompanied by deals on quotas, for example setting out the quantities of goods to which certain tariffs applied. There might be agreements on 'rules of origin' – the criteria used to work out which goods count as coming from a certain country, which can be important in determining which goods are eligible for reduced tariffs. Trade agreements also commonly contain agreements on customs arrangements and mechanisms for the resolution of disputes.

While tariffs remain a common part of trade agreements and are important for certain countries and sectors (such as agriculture), they are however becoming less of a focus overall, partly because the average tariffs faced by goods have been falling.[116]

Trade agreements that mostly deal with border measures, such as tariffs and customs arrangements, are often called "shallow" agreements. In contrast, agreements that include rules on other domestic policies are referred to as "deep" agreements – this type of agreement has become more common.

Modern deep trade agreements often cover areas such as technical barriers to trade[117], services[118] and trade-related investment measures. Other common topics include competition policy, intellectual property rights, investment and movement of capital. Some agreements cover issues such as environmental laws, labour market regulations and measures on visa and asylum.[119]

Despite the move towards deeper trade agreements, these agreements generally do not go as far in removing barriers to trade as the EU single market.

---

[115] A free trade agreement differs from a customs union in not requiring its members to set the same tariffs on trade with countries outside the agreement.

[116] World Bank, Tariff rate, applied, weighted mean, all products (%) and World Integrated Trade Solution (WITS) World Product MFN Weighted Average (%)

[117] For example different technical standards and regulations that must be met in different countries – such barriers can be reduced by agreements that countries will have the same standards (harmonisation) or that they will recognise each other's standards (mutual recognition).

[118] Services account for nearly half of UK exports to countries outside the EU.

[119] World Trade Organisation, World Trade Report 2011

Box 5: What's in a trade agreement? CETA as an example

The chapters of the EU-Canada trade deal (CETA) agreement give a sense of the scope of a modern trade agreement:

0. **Preamble**

1. **General Definitions and Initial Provisions**

2. **National Treatment and Market Access for Goods** – includes removal of tariffs for goods

3. **Trade Remedies** – reconfirms World Trade Organization rules that allow members to counteract the negative effects of unfair trade practices on their domestic industry, for example if another member 'dumps' goods on its market at below the cost of production, or subsidises production of those goods

4. **Technical Barriers to Trade** – includes voluntary cooperation on technical regulations for testing and certifying products

5. **Sanitary and Phytosanitary Measures** – covers food safety and animal and plant health

6. **Customs and Trade Facilitation** – aims to streamline customs procedures and make them more efficient

7. **Subsidies** – increases transparency around government subsidies to companies, and includes agreement not to subsidise exports of agricultural products to each other's markets

8. **Investment** – includes measures to open up investment between the EU and Canada and sets up a new Investment Court System to enable investors to resolve investment disputes with governments

9. **Cross-Border Trade in Services** – includes commitments to ensuring fair, equal access to each other's services markets (with some exceptions)

10. **Temporary Entry and Stay Of Natural Persons For Business Purposes**

11. **Mutual Recognition of Professional Qualifications**

12. **Domestic Regulation** – ensures that licensing and qualification requirements and procedures in the EU and Canada are publicly available, easily understandable, and reasonable

13. **Financial Services**

14. **International Maritime Transport Services**

15. **Telecommunications**

16. **Electronic Commerce**

17. **Competition Policy** – includes agreement that the EU and Canada will prohibit and sanction practices which distort competition and trade, including cartels, abusive behaviour by companies with a dominant market position and anti-competitive mergers.

18. **State Enterprises, Monopolies and Enterprises Granted Special Rights or Privileges**

19. **Government Procurement** – sets out when EU and Canadian businesses can provide goods and services to each other's public sectors

20. **Intellectual Property** – includes copyright, trade marks, geographical indications, designs and patents

21. **Regulatory Cooperation** – encourages voluntary cooperation between regulators

22. **Trade and Sustainable Development** – includes agreement to ensure economic growth supports social and environmental goals

23. **Trade and Labour** – includes various commitments and prevents either side from ignoring or lowering labour standards to boost trade

24. **Trade and Environment** – prevents either side from relaxing their laws to boost trade

25. **Bilateral Cooperation and Dialogues** – includes agreement agree to work more closely with each other in areas such as science and forestry

26. **Administrative and Institutional Provisions**

27. **Transparency**

28. **Exceptions**

29. **Dispute Settlement** – provides a system for resolving disputes, including a formal mechanism and mediation.

30. **Final Provisions**

The full text of CETA has more detail.

A FTA is an intermediate category between the WTO and EEA options. It is less clearly defined than the other options – as its scope would depend on what the EU and UK were able to agree. A FTA would be likely to mean reduced access to the single market, especially in services, compared with EU or EEA membership, but would mean no need to accept free movement of people or make financial contributions to the EU budget. A free trade agreement would allow the UK to make its own trade agreements with non-EU countries.

A free trade agreement with the EU would also need to comply with WTO rules. In particular, free trade agreements must cover substantially all trade. The House of Lords EU Committee report explains this as follows:

> Importantly, the GATT and the GATS stipulate that such customs unions or free trade agreements must liberalise "substantially all the trade" in goods or have "substantial sectoral coverage" for trade in services. This means that sectoral agreements (those covering just telecoms, for example) are not legal under the rules of the WTO. We note that these conditions have rarely been raised in dispute settlement procedures at the WTO, have been poorly enforced, and there is considerable uncertainty over the definition of "substantially all". Nonetheless, the UK Government is a member of the WTO and thereby bound by the rules laid out in the GATT and the GATS, which restrict the parameters of the deal the Government will be able to negotiate with the EU.[120]

[120] House of Lords European Union Committee, Brexit: the options for trade, 5th Report of 2016-17, HL Paper 72, 13 December 2016, para 45

BRIEFING PAPER
Number 7694
9 October 2017