



UK trade and the World Trade Organisation

A Brexit briefing for non-specialists

Richard Barfield
September 2018

Foreword

It is firms not governments that win markets and create jobs. As a trading nation the United Kingdom needs to provide effective support to British firms competing at home and globally. How far we continue to access our largest and closest market, the European Union, will have a substantial impact on the UK's prosperity, employment, and the public services we can afford to pay for.

So it is vital that political decisions on our future trade policy are made on the best available evidence, taking account of how business operates and supporting continued wealth creation in this country. Richard Barfield's clear and objective report provides that evidence, drawing on the most recent analysis of trade flows to compare different models.

The report is timely. It highlights the real trade-offs that decision-makers face over the coming months. A disorderly Brexit falling back on the minimalist WTO framework for trade could cost more than a million jobs across Britain and cause lasting damage to our attractiveness as a base for international investment. Remaining in the European Economic Area and Customs Union would offer the certainty of a level playing field in Europe to UK firms, safeguarding jobs and investment here. But it would require continued acceptance of EU single market rules.

By setting out how international trade works today, what the WTO can and cannot do, the impact of geographic proximity on trade flows, and the importance of regulatory convergence for the service sector, the report underlines the depth of our economic relations with the European single market, and why we will never be able to achieve similar depth of market access elsewhere.

There are no simple solutions to the UK's future relations with the European Union. The analysis in this report should help our politicians, and the wider public, to understand the importance of the choices we make for our economic wellbeing in the decades ahead. Decisions now need to be taken urgently, to prevent business planning for the worst outcome turning into a self-fulfilling prophecy of lost jobs and investment. The economic stakes for this country are now very high.

Martin Donnelly

September 2018

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Richard Barfield

Like many concerned citizens, I have followed Brexit closely. As a contribution to the debate, I created an extensive website to provide concise and comprehensive facts on Brexit issues (brexitfactbase.com). I have written this briefing to provide non-specialists (like me) with deeper and wider analysis on trade and the WTO.

Over my career, I have worked with many international businesses. I was finance director for Hertz and Barclaycard and spent over 25 years in the consulting practice of PwC, where I specialised in risk and regulation in financial services. As a business writer, I authored two books on banking regulation after the financial crisis, published by Thomson-Reuters. I am now an independent consultant.

Review panel

This report reflects input from a distinguished review panel, whose contributions have been invaluable.

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Any errors and omissions remain my responsibility.

Contact details are at the end of the document.

Introduction

Brexit has put trade at the centre of the national debate for the first time since the early 1970s. It is not surprising that many politicians and commentators are finding it difficult to deal with the trade issues.

The aim of this briefing is to allow a non-specialist to understand how international trade works, the role of the WTO and the main trade options open to the UK with Brexit.

It is based on publicly available information from reliable sources like the WTO itself, the House of Commons Library, Parliamentary Committees, think tanks, reputable trade specialists and Brexit FactBase. To allow an unconstrained view of the options and their implications, we put the Government's red lines to one side.

The report concludes with a high-level assessment of the consequences of each trade option for the economy and employment.

The briefing has six sections which cover the following topics:

- 1 Overview of trade and the importance of international trade to the economy.
- 2 Trade barriers with a focus on the three most relevant to Brexit: tariffs, customs and regulation.
- 3 The WTO – its purpose in promoting freer global trade, the principles that guide it, its role, how it operates and resolves disputes.
- 4 Trade barriers and the EU - how the EU helps reduce trade frictions for member states through the internal market and trade deals with other countries.
- 5 Trade options for Brexit – consider the implications of various trading model options from Basic WTO to the European Economic Area, including Chequers.
- 6 Impact assessment of the trade options, including opportunities, and effects on the economy.

Executive summary

Trade is the heartbeat of any economy. Healthy trade signifies a healthy economy which creates jobs and funds public services. UK GDP splits 80% services, 10% goods and 10% other and provides over 32 million UK jobs which follow the same split. Seven to eight million of those jobs depend on international trade. The economy is sensitive to changes in trade and if trade falls, the economy suffers.

UK trade benefits from over 40 years of investing in integrating the UK into the world's largest, virtually friction-free market. The value of EU membership to the UK economy runs at about 4% of GDP¹ – worth about £80bn a year (about nine times the UK's annual net contribution). International trade is a major factor in the UK economy with a combined value of imports and exports equal to 63% of GDP in 2017. Half of that trade is with the EU27.

To succeed, international trade must overcome many barriers such as different cultures, languages and legal systems, which increase the cost of trade or restrict market access. The most obvious physical barrier is distance, which introduces transportation costs and delays. As a result, most countries conduct most of their international trade in both goods and services with their neighbours.

In 2017, 49% of UK trade was with the EU27 plus 7% with other European countries and territories (principally EFTA states, UK Crown Dependencies and Gibraltar). The EU has entered into preferential trade arrangements with around 90 other third countries (including those provisionally in place and those pending, such as with Canada and Japan), facilitating trade with EU member states: a further 12% of UK trade was with those countries. The EU is negotiating with several other third countries which accounted for more UK trade.

The UK trade ecosystem is complex with many links and dependencies. Imports and exports are inter-twined. Exports of manufactured products in sectors like automotive and food usually depend on imports of intermediate components and raw materials. UK services and goods depend on each other, for example, restaurants, hotels and supermarkets, depend on food manufacturing. Service sectors are often linked, for example financial services and professional services depend on each other. Technology services are pervasive.

Trade barriers

The trade barriers that are most directly relevant to Brexit are tariffs, customs and regulation. Tariffs are taxes charged to the importer of goods when they are imported. Apart from agricultural and automotive goods, these are typically small. Customs barriers include clearance procedures required at the border (to ensure that correct tariffs are paid, and that taxes such as excise duty and VAT are paid). Tariffs and customs barriers relate to goods; regulatory barriers relate to goods and services. For goods, customs and regulation are usually more important than tariffs. For services trade, it is regulatory barriers that matter.

¹ Institute for Fiscal Studies, The EU Single Market: The Value of Membership versus Access to the UK, Carl Emmerson Paul Johnson Ian Mitchell, August 2016 <https://www.ifs.org.uk/publications/8411>

The purpose of WTO is to help trade flow as freely as possible for the benefit of all. The WTO has succeeded in reducing tariffs globally to minimal levels (with the main exceptions being agriculture and developing countries). WTO members have reduced tariffs and some trade barriers through regional trade agreements such as customs unions and free trade areas. The WTO continues to permit these initiatives, but its main focus is now on assisting its members to lower or remove non-tariff barriers.

Tariffs are easy to measure and average about 3% of UK imports. The cost of non-tariff barriers is harder to estimate, but trade economists agree that they are more expensive than tariffs. The Government assumes that, trading under basic WTO terms, non-tariff barriers would cost the UK the equivalent of a tariff of 5% to over 20%, depending on sector (except for construction, assumed to be zero).

The EU is the global leader in removing trade barriers between countries, principally between its member states. The EU Single Market is unique - complemented by the EU Customs Union, EU customs cooperation and the EU VAT area. Together, these four frameworks allow EU businesses to trade freely in the EU with no tariffs and minimal non-tariff barriers from customs and regulation.

Brexit impact on trade

Brexit increases trade barriers - all Brexit options will impede UK trade with the EU compared to full EU membership, UK exports to the EU will suffer, and imports from the EU will become more expensive². This twin-pronged attack on international trade will reduce UK competitiveness putting jobs and livelihoods at risk and will discourage investment in the UK.

Against these risks, Brexit could bring some benefits to trade. Potential benefits include opportunities to negotiate UK-specific trade deals with non-EU countries and to reduce regulation. However, the regulatory and trade opportunities are unspecified and uncertain, and the Government believes that the benefits to trade of Brexit are likely to be much smaller than the costs.

Long-run estimates of economic impacts are useful to rank Brexit options and compare the consequences. As a rule of thumb a long-run 1% drop in overall UK exports is equivalent to a 0.2% to 0.3% drop in UK GDP, which translates into a similar effect on long-run employment.

We consider how trade barriers could change with Brexit starting with Basic WTO and working up to EEA. The Basic WTO option introduces the highest barriers to trade and the EEA option the lowest. Various studies quantify the estimated impacts of the barriers on UK trade, which we translate into impacts on GDP and employment. Table 1 summarises the results.

The Basic WTO option would mean substantial disruption to supply chains, with new tariffs, regulatory barriers and customs checks applying on day one of Brexit. Even the low ends of the estimate ranges for the other options show that the impacts of

² Economists for Free Trade, a Brexit-supporting think tank, believe that Brexit will benefit the economy in the long-run, but their economic forecasts have been strongly criticised for using unrealistic assumptions.

Brexit on trade and employment would be significant (the estimate ranges reflect uncertainty about the outcomes).

The Basic WTO option would see reductions in overall exports of 12% to 13% (£72bn to £78bn), which would lead to a loss in GDP of 2.4% to 3.9% (£48bn to £78bn). The employment effect would be equivalent to long-run job losses of 0.8 million to 1.3 million (assuming wages and productivity remain unchanged). Average household income for 2017 was £33k, so a 2.4% to 3.9% drop in GDP would translate, in round terms, to a drop of £800 to £1300 in average household income.

Even the EEA option is expected to have a material impact on exports, of £30bn to £48bn with an employment effect equivalent to the loss of 0.3 million to 0.8 million jobs. The trade impact of the EEA option flows principally from the UK's exit from the EU Customs Union. This affects trade in goods, particularly in relation to UK-EU integrated supply chains. There is then a knock-on effect to services trade associated with goods. A similar impact would be seen with a CETA-style FTA (a Comprehensive Economic and Trade Agreement), but it would be more marked because UK-EU services trade would suffer more under a CETA than with an EEA arrangement.

The Brexit option that would limit Brexit trade damage to a minimum would be an EEA arrangement combined with a customs arrangement.

Table 1 Long-run impact of Brexit options on trade relative to EU membership					
	Basic WTO	FTA	Sectoral*	Chequers	EEA
Qualitative features					
Tariffs	High	Low	Low	None	Low
Customs barriers	High	Medium	Medium	Low	Medium
Regulatory barriers	High	High	Medium**	Medium**	Low
Quantitative impact					
Fall in exports	-12 to -13%	-9 to -11%	-7 to -10%	-8%	-5 to -8%
GDP effect	-2.4 to -3.9%	-1.8 to -3.3%	-1.4 to -3%	-1.6 to -2.4%	-1 to -2.4%
Employment effect	-0.8 to -1.3m	-0.6 to -1.1m	-0.4 to -0.9m	-0.5 to -0.8m	-0.3 to -0.8m

*Quantitative impacts interpolated between FTA and EEA **Low for goods, high for services.

Note that the analysis in Table 1 only estimates the Brexit trade effects on GDP. It excludes other impacts of Brexit, such as those on migration and investment, which would reduce GDP and employment further. It also excludes the costs to the public finances of new customs procedures and systems, new regulatory agencies, extra civil servants and so on.

Sectors and regions

The sectors that will bear most of the costs of Brexit due to trade effects are financial services; automotive; agriculture, food and drink; consumer goods; and, chemicals and plastics. The three sectors with the most jobs at risk are administration and support services, wholesale trade, and legal and accounting services.

Regions outside London and the South East are most likely to suffer from Brexit trade effects. These regions have been less resilient to previous economic shocks. The regions expected to be most at risk from trade effects are Cumbria, Hampshire,

Herefordshire, Gloucestershire, Lancashire, Leicestershire, East Riding/North Lincolnshire, Warwickshire and Wiltshire.

Regions with a high proportion of EU exports in the most vulnerable goods sectors include Northern Ireland and Cornwall (food, live animals and manufactures), Northumberland, Tees Valley and Durham (chemicals, machinery and transport equipment) and East Wales (manufactures, machinery and transport equipment).

Opportunities

Over the last two years the Government has not identified significant foreseeable Brexit trade opportunities, so it is unlikely that major opportunities exist. A deal with the US is unlikely because the UK needs to protect its trading relationship with the EU, the UK's biggest trading partner. The Government's own estimates show that the economic value of possible new trade deals is expected to be small compared to the costs shown in Table 1 (even with a US deal). The damage to UK-EU trade will dwarf the trade benefits of deals with other countries.

Similarly, opportunities to deregulate appear to be minimal. The UK is lightly regulated compared to other developed countries and the UK needs to remain aligned with EU rules after Brexit to facilitate trade. In fact, in relation to trade, Brexit will bring more bureaucracy and regulation, not less. Deregulation in other areas like environment and labour standards would be politically challenging.

Unforeseen trade opportunities could arise from Brexit for some UK-based businesses who would innovate and adapt to capture them. Those unspecified opportunities should be weighed against the inevitable loss of future opportunities from full EU and Single Market membership, and the weakening of the UK's competitive and global advantages.

The high-level estimates in this briefing indicate the seriousness of the consequences of Brexit for trade and jobs. The future UK-EU trading relationship needs to be defined clearly before the UK leaves the EU in order to assess and plan for the implications of Brexit for the UK - sector by sector and region by region.

1 Trade and the economy

Trade and the UK economy

Trade is the heartbeat of the economy: buying and selling of goods and services, usually in commercial transactions. As sales grow, production grows, purchases of materials and services grow, and jobs are created.

Healthy trade and investment signify a healthy and growing economy, which in turn permits healthy funding of public services. It is also widely accepted that a country's openness to trade improves productivity.

On the world stage, trade growth is a tool for raising living standards in developing countries. As the UK government notes:

International trade is linked to many jobs; it can lead to higher wages and can contribute to a growing economy by stimulating greater business efficiency and higher productivity, sharing knowledge and innovation across the globe. It ensures more people can access a wider choice of goods at lower cost, making household incomes go further, especially for the poorest in society.³

Output GDP

To measure output GDP, the Office of National Statistics (ONS) conducts extensive monthly surveys of firms.

Each month, ONS collects sales information from businesses, 32,000 private sector firms in production and services, 5,000 retailers and 8,000 construction companies. ONS also surveys government departments covering activities such as agriculture, energy, health and education.

Source: ONS, August 2018

The UK economy thrives on trade internally and with other nations. The principal measure of the size of an economy is Gross Domestic Product (GDP). GDP can be measured in different ways, including economic output, which is the value of the goods and services produced by all sectors of the economy - agriculture, manufacturing, energy, construction, the service sector and government.

International trade is critical to the economic health of developed nations. It is also a

³ Department for International Trade, Preparing for our future trade policy, October 2017
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/654714/Preparing_for_our_future_UK_trade_policy_Report_Web_Accessible.pdf

critical factor in increasing the prosperity of developing nations.

To assess 'trade openness' economists use the ratio of trade (the sum of exports and imports) to GDP. The global average for 2016 was 56%. By including imports and exports, the measure indicates the level of integration of a country with the world economy.

The UK's trade openness ratio in 2016 was 62%, ahead of the US (27%), Japan (31%) and China (38%), but behind most of the UK's European counterparts: Italy (56%), France (61%), Norway (67%), Germany (84%), Ireland (221%) and Switzerland (120%)⁴. Trade openness tends to be higher in developing nations and lower for larger economies. The EU's trade openness ratio was 83%.

Exports contribute to sales which contribute to GDP and employment. To illustrate with a simple example, imagine a Saturday market employing 50 people producing sales of £50,000 month. If demand falls and sales drop permanently to £40,000, employment will eventually drop to 40 (everything else being equal – productivity and wages remaining unchanged).

The EU is the UK's biggest trading partner accounting for £615bn or 49% of UK trade in 2017. Fifty-six per cent of the UK's trade was with European countries (the EU plus principally the EFTA states, UK Crown Dependencies and Gibraltar).⁵

In 2017, the UK's overall trade was £1,258bn, split 65% goods and 35% services (see Table 2). This contrasts with the split of the economy where manufacturing accounts for 10% of GDP and services for 80%. Although the manufacturing sector is a small part of the economy, it contributes a much bigger part of overseas trade.

	Goods (£bn)	Services (£bn)	Total (£bn)	Goods	Services	Total
Exports	339	277	616	55%	45%	100%
Imports	476	166	642	74%	26%	100%
Trade (exports + imports)	815	443	1,258	65%	35%	100%
Surplus/(deficit) (exports – imports)	(137)	111	(26)	-	-	-

Goods imports exceeded exports to create a trade deficit of £137bn; whereas, services exports exceeded imports to create a trade surplus of £111bn. The UK's overall trade deficit in 2017 was only £26bn as result of the trade surplus in services. Financial and business services contributed 77% of the UK's total trade surplus in services.

⁴ World Bank data, <https://data.worldbank.org/indicator/NE.TRD.GNFS.ZS>

⁵ Treasury Pink Book 2018, Chapter 9,

<https://www.ons.gov.uk/releases/ukbalanceofpaymentsthepinkbook2018>

See also the House of Commons Briefing Paper 7851: Statistics on UK-EU trade, 31 July 2018

<https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7851>

The UK trade ecosystem is complex with many links and dependencies inside the UK and with international supply chains, particularly with Europe. In practice, it is more accurate to think of trade as an integrated whole rather than separate compartments.

Imports and exports are inter-twined. Exports of goods in sectors like automotive and food usually depend on imports of components and raw materials. The Institute for Fiscal Studies estimates that over half of goods and services imports from the EU are inputs to the production of goods and services in the UK. Over two-thirds of UK goods and services exports are of intermediate components for overseas producers.⁶ As the IFS observes, the increasingly interconnected nature of global trade means that a country's imports and exports cannot be treated as independent quantities.

Goods and services depend on each other. For example, restaurants, hotels and supermarkets, depend on food manufacturing. The income gained by manufacturers and their supply chains in servicing advanced products like aircraft and medical diagnostic machinery is often about half the total value of a contract.

Service sectors are also interlinked, for example financial services and professional services depend on each other. Technology services are pervasive in all sectors of the economy.

The UK's top 25 trading partners account for over 80% of UK trade (see Appendix D). The US is the largest individual country accounting for 14.5% of trade. Except for the US and Hong Kong, 23 of the top trading partners are either in the EU (11); have EU preferential trade agreements in place, applied or pending (9); or, are involved in trade negotiations with the EU (3). The US and China both have a number of bilateral trade agreements with the EU, which we discuss later.

EU trade policy

One of the EU's founding principles is free trade among its members. The four freedoms (goods, services, capital, people) were established in the Treaty of Rome which came into force in 1958. The EU was the world's biggest trader in goods and services in 2016, accounting for 18% of the world's imports and exports (followed by the US and China)⁷.

The EU is committed to liberalising world trade to increase prosperity and to open and grow new markets (see panel below). Central to this are EU trade agreements with third countries (i.e. non-member states), which are made within WTO rules

The EU may have laudable trade goals, but its trade policy is not without criticisms including⁸⁹:

⁶ Institute of Fiscal Studies, Firms' supply chains form an important part of UK-EU trade: what does this mean for future trade policy? 8 January 2018, <https://www.ifs.org.uk/publications/10302>

⁷ Eurostat, World trade in goods and services - an overview, https://ec.europa.eu/eurostat/statistics-explained/index.php/World_trade_in_goods_and_services_-_an_overview

⁸ WTO, Trade Policy Review of the EU, July 2017 https://www.wto.org/english/tratop_e/tpr_e/s357_sum_e.pdf

⁹ Overseas Development Institute, The next decade of EU trade policy: Confronting global challenges? 2012, <https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/7727.pdf>

- EU agriculture remains highly protected compared to other countries and the EU is a significant user of trade defence measures for agriculture.
- EU is in danger of moving towards protectionism in relation to its trade with countries that do not have FTAs with the EU.
- EU tends to adopt a sub-optimal defensive position on the role of trade in tackling global challenges like climate change and food security.
- EU uses trade as a blunt instrument to assist developing countries and could target its support better, for example on policies and institutions for good governance, industrialisation and diversification, regional integration efforts and trade-related systems.
- In some cases, EU requirements can increase the cost of doing business for its member states.

The EU and its member states are all important members of the WTO and the development of the EU's policies, politics, and economy affects many other countries. Therefore, the EU's trade and investment policies are important to other countries and the multilateral trading system.

The WTO as a whole is very interested in how the EU addresses current challenges including Brexit.

EU trade policy¹⁰

Trade - a global system

World trade is founded on rules laid out by the World Trade Organisation that help ensure that trade agreements and obligations between countries are open and fair.

EU trade policy is made exclusively at EU level. The Commission negotiates agreements on behalf of the EU within WTO rules and works closely with national governments and the European Parliament to maintain the global system and enable it to adapt to worldwide changes.

Trading as a world leader

The EU is the world's biggest exporter of manufactured goods and services, and it is the biggest import market for over 100 countries. It is also the world's largest Single Market area. Both European and international consumers and investors enjoy the many benefits of a simplified system – in an area where people, goods, services and money can move freely.

Building a fair and open playing field

The EU negotiates agreements through its world-wide network of trade relations. It engages with a huge range of partners, mostly through free trade agreements.

These partnerships seek to create growth and jobs for Europeans by opening new markets with the rest of the world. Transatlantic markets, for example, represent transactions worth around 2 billion euros every day.

EU trade policy also aims to reduce child and forced labour, environmental destruction and price volatility. Schemes which ensure transparency and traceability in supply chains are one example.

For the world's poorest countries, EU trade policy looks to combine trade and development. Allowing lower duties, supporting small export businesses, and advising on improvements to governance are just some of the ways trade and development can work hand in hand to ensure the neediest benefit from trade-led growth.

¹⁰ European Union, Trade https://europa.eu/european-union/topics/trade_en

2 Trade barriers

Trade barriers can make it difficult for businesses to compete in foreign markets. Exporters face two categories of trade barrier: tariffs and non-tariff barriers. Tariffs apply to goods but not services, whereas non-tariff barriers apply to both.

Tariffs are less of a barrier than non-tariff barriers. The majority of goods attracts low average tariffs globally, but tariffs remain high in some sectors, particularly the agricultural, food, and automotive sectors.

The evolution of historical trade patterns gives insights into the effect of reducing or removing trade barriers. Trade economists use the results of these analyses to gauge the impact of increasing barriers under Brexit.

The main barriers affected by Brexit are: tariffs, customs barriers and regulatory barriers. We discuss these below after considering distance and other trade barriers.

Distance

The most obvious barrier to trade is distance. This is true even within the UK - a manufacturer in Cornwall finds it a lot easier to sell goods to a customer based in Devon than in Aberdeen.

Trade statistics show that countries trade the most with their neighbours. The UK's top ten trading partner countries are all in Europe except for the US and China, which have much bigger economies than the UK. As an individual country, the US is the UK's top trading partner, but, although its economy is similar in size to the EU, UK-US trade is much smaller than UK-EU trade.

The mathematical relationship between trade, size of economy and distance is similar to the relationship between gravity, mass and distance. This gives rise to 'gravity models' of trade between countries. Gravity models have been criticised, but trade specialists and academics point to the models' proven predictive power, which shows that they are robust (the true test of any model). As a rule of thumb, trade between economies halves with a doubling of distance.

For example, the value of the UK's trading relationship with Ireland (trade value in 2016 - £47.5bn) is greater than the value of UK trade with Italy (£39.9bn) or Spain (£42.6bn), even though Ireland's economy is much smaller. Similarly, the UK trades with distant New Zealand (£2.5bn) and Australia (£13.1bn) much less than it trades with two nearby EU economies of similar size, Greece (£5.3bn) and Spain (£42.6bn).

The gravity effect applies to services as well as goods,¹¹ but trade in services is only possible if regulatory barriers have been addressed and alignment achieved.

¹¹ See PwC's analysis of over 100 gravity models. ['The gravity model', PwC, 2017.](#)

Other barriers

There are many other trade barriers that hamper trade with or without Brexit. Although the paper does not discuss these barriers, it is important to consider them in the context of international trade:

- Bureaucratic or political hurdles
- Language barriers
- Legal uncertainty
- Discriminatory tax
- Risks of bribery and corruption
- Currency fluctuations
- Risk of bad debts

If businesses have competitive products or services that foreign customers want and can afford, they can succeed in international markets, but it takes time, requiring specialist skills and long-term investment, typically over many years.

Businesses usually find it easier to trade with countries with a common language, established cultural ties and similar legal systems. In the UK's case this applies to Commonwealth nations, but distance remains a barrier.

Tariffs

A tariff is a border tax or a customs duty – a levy imposed on goods crossing from one customs territory to another, usually expressed as a percentage of the value of the product. When people talk about tariffs, they usually mean import tariffs, because export tariffs are rare.

Tariffs require customs authorities to identify imports and their source of origin so that the correct taxes can be levied. Rules of origin are criteria to define where a product was made, and thereby ensure that the correct tariffs and other regulations are applied. In particular, any free trade agreement between WTO members to reduce or eliminate tariffs between them will apply only to goods from the countries concerned. Where a complex product has partly been made in one country and partly in another (for example, where components are made in country A, but the finished product is assembled in country B) complex rules determine whether country B is to be treated as the country of origin of the goods. The process of applying rules of origin results in administrative costs and delays.

The importer pays the border tax. A UK importer of goods with a tariff has to pay the tariff to Her Majesty's Revenue and Customs (HMRC) before taking possession of the goods. As a member state, HMRC passes the tariff revenue from the importer to the European Commission, after deducting a 20% fee to cover collection costs.

Although the importer is legally liable to pay the tariff, the question of who actually bears the economic burden of the tariff is more complicated. Depending on the competitive position, sometimes the importer is able to pass the burden on to the final customer, sometimes it is born by the external producer, and sometimes it is shared between them.

In 2017, when President Trump proposed a 20% tariff on Mexican imports to the US to pay for the wall, few realised that it would be US consumers who would be paying

for the wall¹². The likely result was that US importers would put prices up for their end-customers. If the US importers put pressure on Mexican suppliers to reduce their prices, the suppliers would turn their attention to other markets.

Similarly, if the UK introduces tariffs on imports from the EU as a result of Brexit (which it has to do under WTO rules unless there is a free trade agreement with the EU or unless the UK decides to eliminate all tariffs on all imports), it is likely that it will be the consumer (or intermediate manufacturer) who will pay, at least in part.¹³

EU and UK tariffs

In 2015, the average trade-weighted tariff that the EU applied to its goods imports was 3% compared to 4.4% for China and 2.4% for the US.¹⁴

The majority of EU trade is in non-agricultural products which carried a tariff of 2.6%. Agricultural products carried a higher average tariff of 7.8%.

The average EU tariffs include product categories with average tariffs ranging from zero to over 35%. Within the categories, individual products can carry much higher tariffs, but most tariffs are low or zero. Preferential trade arrangements with other countries meant that, in 2015, about 70% of EU imports were at zero or reduced tariff rates¹⁵.

Adjustments to existing tariffs would need to be considered carefully. For example, tariffs on South African oranges are often referred to as an EU tariff that the UK might wish to reduce after Brexit. However, for much of the year (including during the peak South African growing season) tariffs on South African exports of oranges to the EU are zero under the EU/South Africa free trade agreement (many other African countries benefit from zero tariff arrangements on exports to the EU including oranges). If the UK decided to eliminate all such tariffs, it could disrupt other developing countries which the UK seeks to support, such as the West Indies. The UK has traditionally supported banana tariffs on imports from outside the West Indies as a way of supporting the economies of small Commonwealth countries in that region.

The mix of UK imports differs from the EU average and, in 2016, the average applied tariff for UK imports was 2.8% (including the benefit of zero tariffs within the Single Market)¹⁶. See Appendix C for analysis of UK tariff rates by sector. Table 3 lists the UK import categories that face above-average applied tariffs.

¹² Forbes, Memo to Trump - 20% Mexican Import Tariff Means Americans Pay for The Wall

<https://www.forbes.com/sites/timworstall/2017/01/27/memo-to-trump-20-mexican-import-tariff-means-americans-pay-for-the-wall/>

¹³ Economists for Free Trade assume that the entire burden of any tariffs imposed by the UK on EU exports will fall on the EU exporter – but that assumption depends on the highly implausible claim that there is perfect competition between EU and other countries' exports. Any more plausible assumption results in a finding that UK consumers bear a large part of the burden.

¹⁴ WTO, World tariff profiles, 2017

https://www.wto.org/english/res_e/booksp_e/tariff_profiles17_e.pdf

¹⁵ Eurostat, International trade in goods, May-June 2017

https://ec.europa.eu/eurostat/statistics-explained/index.php/International_trade_in_goods_-_tariffs

¹⁶ Institute for Fiscal Studies, The Customs Union, tariff reductions and consumer prices, March 2018

<https://www.ifs.org.uk/uploads/publications/bns/BN225.pdf>

Import category	Average applied tariff
Live animals and animal products	23.4
Prepared food	12.2%
Oils and fats	9.3%
Footwear	8.3%
Vegetable products	5.6%
Textiles	5.6%
Plastics	3.5%
Transport equipment	3.3%
Leather products	3.1%

Customs and regulation

There are two types of non-tariff barrier that Brexit affects: regulatory barriers (such as conformity with local law and technical standards) and customs barriers (such as rules and certificates of origin and rules to ensure that VAT is paid at the border).

The direction of travel of commercial society has been towards harmonisation of standards and regulations. In England, it goes back to King Edgar in the 10th century, who legislated to standardise weights and measures across the country. Divergences in market rules create barriers to trade (or higher costs of trade) across those markets.

Regulatory barriers arise when different countries have different laws and regulations for areas such as health and safety, animal health and environmental standards. Traded items might also meet different technical standards. Importing countries need to check that their standards are met (such as purity of medicines, quality of raw materials or qualifications to provide services). Even when countries have the same standards, certificates are necessary.

Some conformity checks may be performed at the border, others may take place before. For example, exporters to the EU need to provide evidence of conformity with EU-approved standards. Inspectors may undertake some checks at, say, a factory or a farm before the goods make their way to the border. However, for advance checks to work, the EU must recognise the inspectors and approve of the standards that are applied.

The height of non-tariff barriers varies with trade arrangement, the highest being found in WTO most-favoured-nation terms, the lowest in the EU Single Market. The UK is subject to its own trade regulation, EU regulation and other international regulation. It is important to note that the EU is subject to international regulation,

so not all EU trade regulation starts with the European Commission – it starts with other international bodies (for examples see the later section on the EEA option).

Interestingly, in taking a wider view of regulation, the National Audit Office noted that the OECD found that the UK is one of the more lightly regulated of nations (see panel)¹⁷. The OECD maintains a comprehensive database on international regulation.

OECD view of regulation in the UK

Interestingly, Britain has one of the most lightly-regulated economies in the OECD. In 2013, the OECD assessed the extent of regulation in 47 countries. The OECD analysis showed that the UK has low levels of regulation compared with other OECD member states.

OECD splits its analysis into network sectors (telecoms, electricity, gas, post, rail, air passenger transport, and road) and a series of product markets.

According to the OECD, the UK has:

- the most deregulated network sectors when considering criteria such as barriers to entry, extent of public ownership, vertical integration and market structure;
- low barriers to competition in product markets compared with most other OECD nations, and less prescriptive 'command and control' regulation;
- comparatively complex regulation relative to other nations.

The cost of NTBs is difficult to measure and estimates vary. Most estimates show NTBs to be significantly more expensive than tariffs. Earlier this year, the UK government estimated the cost of NTBs in terms of a tariff cost equivalent by industry sector (see Table 4)¹⁸.

The tariff cost equivalents are average indicators for the sectors. Within sectors, the costs for particular products or services can be significantly higher or lower. The paper by Berden and Francois provides a comprehensive summary of studies into the tariff cost equivalents of NTBs¹⁹. As Table 4 show, average NTBs are significantly higher than average tariffs of 2.8%. This means that, when negotiating new preferential trade agreements, policy-makers should focus on customs and regulatory cooperation rather than on tariffs.

¹⁷ National Audit Office, A short guide to regulation, September 2017

<https://www.nao.org.uk/wp-content/uploads/2017/09/A-Short-Guide-to-Regulation.pdf>

¹⁸ EU Exit Analysis, Cross-Whitehall Briefing, January 2018

¹⁹ For a review of the literature and summary by sector, see Quantifying Non-Tariff Measures for TTIP Koen Berden and Joseph Francois, Paper No. 12 in the CEPS-CTR project 'TTIP in the Balance' and CEPS Special Report No. 116 / July 2015

<https://www.ceps.eu/system/files/SR116%20Barden%20and%20Francois%20NTMs.pdf>

Table 4 Tariff cost equivalents of non-tariff barriers		
Goods sectors	Service sectors	Tariff cost equivalents
-	Retail and wholesale trades	>20%
Agriculture Food and drink	Defence, education and health	>15% - 20%
Chemicals, rubber, plastics Motor vehicles and parts Other manufacturing	-	>10% - 15%
Machinery, equipment, energy	Business services Financial services ¹ Other services	>5% - 10%
-	Construction	0 - 5%

Reducing tariff barriers

There are three ways to reduce trade barriers:

- Reduce or eliminate tariffs.
- Cooperate on customs arrangements (so that systems, data and paperwork interconnect smoothly).
- Apply common regulatory standards and recognise each other’s regulatory regimes.

Tariffs can be reduced or eliminated through preferential trade agreements such as regional free trade areas and customs unions. Customs unions also reduce some border checks but leave most in place. Trade agreements may also specify cooperation on customs arrangements, but otherwise, they tend not to address non-tariff barriers (though many recent free trade agreements contain provisions seeking to tackle them in some areas). Free trade agreements have also tended not to cover services, though some recent agreements reduce some barriers to trade in services, but in a limited way. The major barrier to trade is now regulation.

There are two ways to recognise standards and regulatory regimes:

- Mutual recognition, which involves both sides in a trading relationship recognising each other’s standards or regulatory regimes. The rulebooks may differ, but both parties agree that they deliver the same outcomes.
- Equivalence, where only one side recognises the other’s standards and/or regulatory regimes.

Outside the EU, the only example of broad mutual recognition is the Trans-Tasman Mutual Recognition Agreement between Australia and New Zealand. It (in essence) works by integrating New Zealand into Australian frameworks that seek to deal with

non-tariff barriers between different Australian states (in federal states, such as the US, Canada, and Australia, there are often significant non-tariff barriers between the various provinces/states, especially in services).

Equivalence is riskier than mutual recognition. For example, if the EU27 granted equivalence to the UK in a specific sector, later the EU could decide unilaterally to withdraw it. Alternatively, the EU could threaten to withdraw it unless the UK makes changes in line with the EU's wishes.

A case in point is Swiss stock exchanges, which have benefited from equivalence to gain access to EU markets. Recently the EU unilaterally indicated that it was worried about increasing divergence and said it would only recognise equivalence for another 12 months unless the Swiss market rules were changed. This has put the Swiss under pressure and caused major controversy, making it difficult for businesses to plan ahead.

As the EU is the world's largest trading bloc by some margin, many countries choose voluntarily to align with parts of its system, in order to facilitate trade. For example, South Korea chose to copy the EU REACH regulations for chemicals (Registration, Evaluation, Authorisation and restriction of Chemicals), rather than a US or bespoke alternative. Similarly, the EU's competition law regime has been fairly widely copied around the world.

If the UK chose to abandon the REACH system (it is significantly tougher than the US system), the divergence would not just be with the EU or the EEA, it would also be diverging with South Korea. The increase in barriers to trade caused by the divergence would not just be confined to UK-EU trade, it would affect other trading relationships, too

3 World Trade Organisation

Overview and purpose²⁰²¹

The WTO's overriding stated purpose is to help trade flow as freely as possible for the benefit of all. It does this by helping trade to flow as freely as possible within agreed rules and disciplines. Successive rounds of international negotiations since 1947, initially under the WTO's predecessor, the General Agreement on Tariffs and Trade (GATT), have sought to liberalise world trade and make the rules more relevant.

The WTO was founded on 1st January 1995 to provide a global framework for trade policy. The Geneva-based WTO is an international body that provides the overarching legal and institutional framework for the world trading system. It currently has 164 members, who accounted for 98% of world trade in 2017. The EU is a member on behalf of the member states, but the UK and the other member states are all WTO members in their own right.

Although 98% of world trade is conducted under WTO rules, practically all of it is subject to additional agreements, governed by WTO rules, that countries have agreed between themselves - either multi-country customs unions and regional trade areas, such as the EU or the North American Free Trade Area, or bilateral agreements, such as those between the US and Australia, and the EU and South Korea. The WTO provides a framework, governments negotiate trade agreements.

The WTO's international trade treaties provide stability to global trade. To be a WTO member, a country must sign up to all the treaties, which govern five main areas:

- Trade in goods - General Agreement on Tariffs and Trade (GATT)
- Trade in services - General Agreement on Trade in Services (GATS)
- Intellectual property - Trade-related Aspects of Intellectual Property Rights (TRIPS)
- Disputes – the WTO's Dispute Settlement Understanding (DSU)
- Trade policy reviews (TPRs)

The treaties are supported by subsidiary agreements and annexes. In all there are about 60 WTO agreements and annexes that create the framework for global trade. A few of these apply only to a sub-set of members, such as the WTO Government Procurement Agreement.

WTO operating model

The WTO is run by its members whose decisions are by consensus, meaning no-one dissents. If one member opposes, a decision cannot be passed²². This is the members' preferred option – voting is allowed but they never want to use it. A

²⁰ World Trade Organisation, https://www.wto.org/english/thewto_e/thewto_e.htm

²¹ This section draws on the House of Lords Library Note: Leaving the European Union: World Trade Organisation, 28 March 2017 <https://researchbriefings.parliament.uk/ResearchBriefing/Summary/LLN-2017-0017#fullreport>

²² What is the WTO? And is it undemocratic?, Peter Ungphakhorn, <https://tradebetablog.wordpress.com/2018/08/17/whats-wto-is-it-undemocratic/>

nominated Director-General (currently Roberto Azevêdo of Brazil) leads the WTO, but he only has the power to make decisions about the Secretariat's management, not about the WTO as a whole. He has no decision-making power over the WTO's trading system. The WTO is 164 governments working together to run the world's international trading system based on agreed rules. The Secretariat provides the bureaucracy that supports the 164 members as they run the trading system. Its role is administrative and advisory. Similarly, there is no executive body with delegated authority to take decisions on behalf of the members.

The WTO's style of operating is quite different to that of many international organisations (and in particular the EU). Its consensus style, involving 164 members in most decisions, means that negotiations usually take years and rarely lead to big changes. It also means WTO does not express a view unless its members agree one by consensus or if there is a legal ruling on the subject. This is quite different to other international bodies, such as the International Monetary Fund, that delegate some powers to an executive board, headed by a managing director (so that the IMF can and does take a view on economic issues of the day). By contrast, the WTO cannot impose anything that the member countries have not agreed – and it makes no sense to talk of a “WTO view”.

The members meet in councils, committees, working groups, etc. These forums form the legislature of the WTO. Each forum accommodates representatives from the full membership, chaired by a member country (usually an ambassador). The top committee is the Ministerial Conference where trade ministers from all members meet every two years. In practice, the larger trading nations and groups tend to have greater influence. Recently, the most influential members have been China, the EU, the US, Brazil and India. Groups like ASEAN and MERCOSUR carry little weight because they do not unified positions. Other groups of members come together to pursue a common agenda on a particular issue such as the G-33 on agricultural trade for developing countries.

In these forums, WTO members discuss trade issues, negotiate to change or expand trade agreements, monitor one another's compliance with them, and settle disputes. The WTO Secretariat of about 650 staff is there to support these discussions and the activities of its members in running the global trading system.

An important WTO body is the Dispute Settlement Body (DSB), which consists of all WTO members. Without a means of settling disputes, the rules-based system would be less effective simply because the rules could not be enforced. The WTO's procedure underscores the rule of law, and it makes the trading system more secure and predictable. Appeals based on points of law are possible²³.

The Appellate Body hears appeals on dispute rulings and consists of seven specialist judges supported by a separate, small secretariat. They meet in groups of three to hear appeals in legal disputes.

There are two forums which are exceptions to the ‘full-membership’ rule. Two committees (Trade in Civil Aircraft and Government Procurement) deal with “plurilateral agreements” - those which only some members have signed. The

²³ Understanding the WTO: settling disputes, WTO website, https://www.wto.org/english/thewto_e/whatis_e/tif_e/disp1_e.htm

committees comprise the signatory countries.

Members contribute to the WTO's budget based on a formula that considers their share of world trade. The contributions for 2018 total £156 million of which the UK pays £6 million (3.8%). The other EU member states contribute 30% of the budget, compared to 11.4% for the US and 9.8% for China. The EU does not make budget contributions.

WTO principles

WTO agreements may be long and complicated, but the WTO's underlying principles are clear and easy to understand. The principles can be grouped under five headings:

1. *Freer trade*

The WTO seeks to minimise tariffs and other trade barriers, and to discipline them where they are needed.

WTO Trade Facilitation Agreement

A recent development is the WTO Trade Facilitation Agreement which came into force on 22 February 2017. The aim of the TFA is to reduce red tape for cross-border trade in goods.

The TFA contains provisions for expediting the movement, release and clearance of goods through harmonisation of processes, information transparency, automation and e-services. It has special provisions for developing countries to assist them to implement the changes.

Some of its substantive provisions (particularly those to do with streamlining) are subject to qualifications (such as "where practicable"). These make it very difficult or impossible to establish whether a breach has occurred.

Other important provisions are stronger, such as the need to announce new regulations in advance and provide an opportunity to comment.

2. *Predictable and stable trade*

General trade rules are just as important for predictable and stable trade as the binding commitments on market access and farm subsidies. Specific details are agreed through negotiations between WTO members.

WTO members commit to a schedule of tariffs, quotas and other matters that will apply to imports from other countries. These commitments are binding. They can only be changed by renegotiation with the WTO members. The WTO monitors compliance of members' trade policies but has no power to initiate

actions to correct behaviour. Actions can only be initiated by a member complaining.

3. Non-discrimination – most-favoured-nation

WTO members should not discriminate between trading partners. This principle is known as most-favoured-nation (MFN) treatment and means that if a country decides, for example, to lower a tariff for one WTO member it must do so for all.

Some exceptions are allowed. For example, countries can negotiate free trade agreements which might give preferential access to a country or group of countries (such as the EU) with whom the agreement is negotiated. The WTO uses the term Regional Trade Agreements (RTAs) to cover FTAs and customs unions and Economic Integration Agreements to cover agreements on trade in services. Economists and trade specialists tend to use the term preferential trade agreements (PTAs) for the same things.

Another common exception to the MFN principle is discrimination in favour of developing countries.

A member may also discriminate against a country that is dumping in its market. WTO rules have anti-dumping provisions (to prevent exporting at below cost to increase sales and market share) and anti-subsidy provisions. The rules allow countries to defend themselves against countries that subsidise their exporters unfairly or distort a market by flooding it with falsely cheap exports. WTO remedies include additional import duties that may be imposed by members to counter such unfair competition so as to protect domestic producers (these are called “trade remedies”).

4. Non-discrimination - national treatment

National treatment is an important example of non-discrimination. To promote fair competition, the WTO has rules on ‘national treatment’. These require members to treat foreign-produced and local goods, services and intellectual property equally with their domestic equivalents, once they have entered a national market (and any import tariff has been levied). As with MFN, numerous exceptions are allowed.

5. Encourage development

WTO permits members to discriminate in favour of developing countries but does not require it. WTO agreements include special and differential treatment for developing countries, which allows less liberalisation and longer time periods.

Developed countries are expected to play their role. One example is Generalised Systems of Preferences (GSPs), which are programmes by developed countries that grant preferential tariffs to imports from developing countries. The EU’s policy of “Everything but Arms” is an example of a GSP. All imports to the EU from the least-developed countries are duty-free and quota-free, with the exception of armaments – this policy applies to 49 developing countries, 34 of

which are in Africa²⁴.

WTO schedules

The WTO rules of trade consist of general rules that apply to all members, and the specific commitments of individual member governments which are listed in 'schedules of concessions'. WTO members have schedules that relate to goods and services.

WTO schedules are legal instruments that describe the treatment a member must provide to the trade of other WTO members. They are an important WTO tool to ensure transparency, security, and predictability for world trade. Although practitioners and commentators often refer to "the" WTO schedule, this is shorthand for several separate legal instruments.

The schedules include commitments to open services markets, and, for some countries (including the EU and UK), a separate schedule for opening government procurement markets. The EU has a single set of schedules for all its member states, but with many member-specific exceptions.

Goods

All goods schedules include "bound duties", i.e. maximum tariffs that can be applied by a member for a particular product, tariff rate quotas and special safeguards. They also reflect members' commitments limiting subsidies for agricultural products. Goods schedules are regularly updated to reflect, for example, changes to tariff classifications or negotiations with other members.

WTO rules on goods are extensive, covering multilateral agreements on the 12 topics listed in Table 5²⁵.

Table 5 WTO rules on trade in goods	
Agriculture	Subsidies and Countervailing Measures (SCM)
Anti-dumping	Safeguards
Customs Valuation	Sanitary and Phytosanitary Measures (SPS)
Import Licensing Procedures	Technical Barriers to Trade (TBT)
Pre-shipment Inspection (PSI)	Textiles and Clothing
Rules of Origin (RoO)	Trade-Related Investment Measures (TRIMS)

²⁴ European Commission, Everything but Arms, list of countries benefitting, accessed 24 August 2018 http://trade.ec.europa.eu/doclib/docs/2017/july/tradoc_155840.pdf

²⁵ WTO legal texts, https://www.wto.org/english/docs_e/legal_e/legal_e.htm#GATT94

Separate bilateral agreements (not necessarily under WTO rules) between trading partners are needed to address other non-tariff barriers.

In relation to Brexit, important WTO rules are tariffs, quotas, rules of origin, measures of support, rules on standards and regulations in goods. The commitments on goods include the maximum tariff levels by type of product, as well as tariff-rate quotas (which allow for a product to be imported at a lower tariff, up to the quota), limits on export subsidies and limits on some kinds of domestic support. Tariff-rate quotas are normally set for products with a high tariff, the quota tariffs being zero or very low.

Rules of origin (RoO) are criteria to define where a product was made, and thereby ensure that the correct tariffs and other regulations are applied. There are two types of RoO:

- Non-preferential under WTO rules – outside a customs union, exporters have to declare the origin of their goods to the customs authority of an importing country.
- Preferential under a preferential trade agreement such as an FTA - binding RoO that specify how an exporter needs to define the origin of exported goods under the terms of the FTA. For example, the FTA's rules may include thresholds defining what proportion of a product determines the product's nationality.

Members must notify the WTO of their rules of origin. The UK currently applies the EU rules of origin. Importers present proof of origin to the customs authority, in line with that country's rules. The WTO requires that members administer these rules consistently and impartially. To do this, WTO members must set-up border procedures and customs controls that are non-discriminatory, unless the border is within a free trade area and a customs union.

A refusal to check goods coming in over one particular border (for example, between the UK and Ireland) would infringe the WTO MFN principle (though some experts in WTO law believe that, in this example, there might be some flexibility in the very short term).

Services

The General Agreement on Trade in Services (GATS) is the WTO agreement governing trade in services. All WTO members are signatories to GATS and assume commitments in individual service sectors. GATS applies, in principle, to all service sectors, except "services supplied in the exercise of governmental authority" and services directly related to the exercise of air traffic rights.

GATS consists of an overall framework which sets out the principles, rules and a schedule for each WTO member listing its specific commitments and any exemptions. There are three overarching principles of GATS: market access, MFN treatment and national treatment.

The three principles are applied to trade in services, across four WTO-defined modes of supply:

- Cross-border supply — non-resident providers supply services cross-border into the member's territory.

- Consumption abroad — a member's residents purchase services in the territory of another member.
- Commercial presence — foreign service suppliers establish, operate or expand a commercial presence in the member's territory, such as a branch, agency, or wholly-owned subsidiary.
- Presence of natural persons — foreign individuals stay temporarily in the member's territory of in order to supply a service.

For market access, WTO members choose the sectors to which they are prepared to grant access and set it out in detailed schedules. There is no presumed right of market access outside the schedules.

In terms of non-discrimination in the context of services:

- MFN treatment prohibits discrimination between 'like' services and service suppliers from different WTO members. The purpose is to ensure equality of opportunity for services and service suppliers from all WTO members. MFN exceptions are an important part of services schedules. However, unless an exemption applies, a WTO member must treat service suppliers from all other WTO members equally.
- The national treatment obligation prohibits WTO members from treating services and service suppliers of any other WTO member less favourably than it treats domestic services and service suppliers. Unlike GATT, in GATS, national treatment applies only where WTO members have committed to grant it for specific service sectors. The commitments are often made subject to conditions, qualifications and limitations, which are set out in the schedules.

In most WTO services schedules, the sectors are listed in order corresponding to the GATT Secretariat classification which lists twelve broad sectors²⁶:

1. Business	7. Financial
2. Communication	8. Health
3. Construction and Engineering	9. Tourism and Travel
4. Distribution	10. Recreation, Cultural, and Sporting
5. Education	11. Transport
6. Environment	12. Other

Note that there are no EU-wide GATS commitments. EU member states have their own schedules detailing market access and national treatment for each service sector. In the financial services sector, for example, this means that there are restrictions on cross-border supply and establishing commercial presence that vary by EU member state.

²⁶ WTO, Trade in Services https://www.wto.org/english/docs_e/legal_e/legal_e.htm#GATT94

Leaving the Single Market means UK access to EU services markets would be governed by the much more restricted access in WTO services schedules (and vice-versa).

Dispute resolution

Dispute resolution is a core part of a well-functioning trade system. Members are expected to be open with one another about where their trade policy might be disrupting or altering trade. Disputes are handled by the 164 members in the DSB, where members are able to raise concerns, seek information, ask questions about how policies work in practice and receive feedback. Any of the above may be sufficient to resolve the issue without the need for a formal legal dispute. Sometimes the process may name-and-shame members into obeying the rules.

If there is a dispute, countries must first attempt to resolve their dispute by themselves. If the consultations fail, the complainant country can request the DSB to appoint a panel to consider the dispute. Since 1995, over 550 disputes have been brought to the DSB and over 350 rulings have been issued.

The sides involved submit legal arguments to a panel and the panel meets each side to ask questions. The panels consist of three trade specialists. Sometimes, evidence from experts will be heard if the dispute raises scientific or technical matters. Third countries may also attend if they have a legitimate interest.

If one side is found to have breached the WTO agreements, the panel will ask the country to comply. Action means an instruction to desist or to find a way to demonstrate compliance. If members disagree with the panel's ruling, they can take the dispute to appeal at the Appellate Body. Most panel rulings have been subject to appeal. Judges then evaluate the matters of law (not fact) and decide on the correct interpretation or whether a member is in breach. The DSB has the final say in panel rulings and appeals.

After the panel or the appeal, the possible next steps are as follows:

- If the WTO determines a rule continues to be broken, it allows the aggrieved member to retaliate proportionately. If asked to, the same or a new panel looks at the proposed retaliation and assesses whether it exceeds the damage to the member's trade caused by the rule-breaking. They then authorise the member to raise tariffs or retaliate in some other way against the rule-breaker up to the value of the damage.
- An alternative to retaliation is to negotiate with the plaintiff to determine acceptable compensation. If an agreement on compensation cannot be reached within 20 days, the WTO can grant permission to retaliate. This could take the form of, say, blocking imports or raising tariffs.

There are around 20 new disputes a year varying in complexity – aside from the complexity of the issue, a dispute may involve just two countries or several. The average time to resolve a dispute is around two years, some taking much longer.

On 22 June 2018 the Appellate Body chair, Ujal Singh Bhatia, said the body experienced an “extraordinarily strenuous year” in 2017 and now faces “unprecedented challenges” arising from the increasing number and complexity of appeals filed and unfilled vacancies.

The seven Appellate Body judges serve a four-year term and three positions are currently vacant. The US is blocking the appointment of new judges which is slowing down the resolution of disputes and putting the system under strain. The chair has urged WTO members to engage in constructive dialogue in order to address these challenges as a matter of priority. This is a key issue. If WTO dispute settlement becomes unworkable, it will have a corrosive effect on the world trade system and slow down other negotiations and developments.²⁷ Consultations are taking place behind the scenes among some WTO members and are sometimes organised by the chair of the DSB.

Compared to the EU's enforcement procedures, those of the WTO are weaker and slower:

- WTO rules operate only at international level and cannot be relied on in either EU or UK courts (except as a guide to interpretation). On the other hand, EU rules bind national governments and courts directly and can be invoked by individuals and businesses. If governments breach EU rules, then businesses and individuals can require national courts to uphold those rules and in some cases to award damages.
- The Commission acts as an enforcer of EU rules and can act against member states that breach EU rules (for example against France in relation to the post-BSE beef ban or Spain when it attempted to prohibit UK-manufactured chocolate from being marketed as chocolate). There is no WTO equivalent.
- WTO dispute procedures mean that domestic industries affected by a breach have no recourse unless they can persuade their government to start a procedure. In the EU, businesses and individuals can act themselves in the relevant national court or complain to the Commission.
- Under the WTO, affected businesses have no right to compensation. WTO dispute resolution results in a declaration that the losing state must change its rules or practices and permission to other states to act if it does not. This can result in one state compensating another. In contrast, EU procedures result in a judgment that has immediate effect at national level, which can often lead to a right to compensation for affected businesses that can be enforced by fines against the defaulting state.
- WTO dispute resolution procedures take years, whereas EU procedures can resolve urgent cases in months.

In summary, WTO rules and rulings have no direct impact on a country's own laws. By contrast, EU member states (and businesses and individuals) are obliged to adhere to EU law and regulation where they apply.

²⁷ World Trade Organisation, https://www.wto.org/english/news_e/news18_e/ab_22jun18_e.htm

Dispute example: US steel and aluminium tariffs 2018

The US has recently invoked national security as a justification for imposing tariffs on imports of steel and aluminium – but this exception is highly controversial, and its use is being challenged by a number of WTO members affected.

The EU, Canada, Japan, Mexico and Switzerland have all initiated dispute settlement proceedings against the US at the WTO in response to the Trump administration's imposition of import tariffs of 25% on steel and 10% on aluminium from 1 June 2018. |

In line with WTO rules, the EU has also taken proportionate retaliatory measures by imposing additional tariffs on imports of a long list of selected US goods.

4 Trade and the EU

Trade between EU members

Economic cooperation between member states is a core objective of the EU. Barrier-free trade is at the centre of EU economic cooperation, both within the EU and with its trading partners. Removing trade barriers increases trade, improves efficiency and reduces the cost of doing business, leading to improved quality and lower prices. The EU is the global leader in removing trade barriers from the trade between its members.

One of the major benefits of EU membership is near-frictionless trade of goods and services in the Single Market and the EU Customs Union, supported by the EU VAT area and strong customs cooperation between member states.

- The **EU Customs Union** is comprehensive and means that all trade within the EU is free from tariffs, which helps keep costs down for producers and prices down for consumers. The EU Customs Union, supported by regulatory alignment in the Single Market, eliminates customs controls for goods flows across borders within the EU. Removal of administrative checks and delays at customs reduces costs and helps manufacturers to get the most out of modern techniques such as “just-in-time” production.
- The **Single Market** is based on common regulatory and technical standards that apply across the EU plus mutual recognition in many sectors. This means that a product made in a member state can be sold anywhere in the EU without additional regulatory checks. The same applies to the manufacture of intermediate components, which can go into a manufacturing process anywhere else in the EU.

The EU reduces regulatory barriers by harmonising legislation and creating a common rulebook. Mutual recognition plays an important role. In sectors where there are still differences, it minimises the effects of the differences. Member states recognise the equivalence of the other 27 national authorities’ domestic regulations, thereby allowing products and services that can lawfully be sold in one country to be sold in other member states. The EU recognises that it still has work to do to remove some remaining barriers to trade in services. Member states may, for example, have different local laws that affect trade in some services sectors. However, in areas where the UK is strong – such as financial and legal services – the EU rules give EU service providers unparalleled access to customers across the EU with minimal regulatory barriers.

The European Commission, EU regulatory bodies and domestic regulatory agencies conduct checks to ensure the rules are followed (and check that the checks are carried out!). Unresolved disputes over the interpretation of rules or compliance with them can be escalated, if necessary, to the European Court of

Justice for a decision. In principle, all EU citizens and businesses have access – they do not need to rely on their governments to act for them in disputes.

- The **EU VAT area** means that VAT does not need to be paid on imports from within the EU of, say, raw materials and intermediate components, until the end of the relevant accounting period (rather than immediately on importation). This provides an important cash-flow benefit to suppliers, many of whom are small and medium-sized enterprises (SMEs) – and also means that there is no need to set up checks at the border to ensure that VAT is paid on importation. It also means that consumers can order goods from anywhere in the EU without having to worry about additional VAT being imposed on importation causing delays and inconvenience.

If an import is from a non-EU country, the importer must pay the VAT before the goods are released from customs – and in the case of postal deliveries to consumers the parcel will not be handed over until the consumer has settled the VAT paid. (This means that all EU countries have to inspect imported goods from non-EU countries, including parcels, in order to apply the correct rate of import VAT).

The system depends on extensive and unparalleled exchanges of information between the member states' tax authorities, as well as very substantial, though not complete, harmonisation of VAT rules.

- The framework for strong **EU customs cooperation** between member states is found in the Union Customs Code, which is an essential instrument of the Single Market. It defines all the formalities that must take place in the movement of goods between the EU member states and third countries, including import–export procedures, data requirements, tariff classifications, and common risk criteria. Common interpretation of those rules is necessary to avoid, for example, differences in tariffs charged by different member states as a result of different tariff classifications of the same goods. The Union Customs Code also mandates greater use of information technology between member states' customs authorities to allow for real-time information sharing. Many of these features are included in the recent WTO Trade Facilitation Agreement.

The EU is an ideal environment for integrated supply chains that involve different member states and use just-in-time management. Please see the case study on auto manufacturing at the end of this section.

Trade with third countries

The supply chains within the EU extend around the world. It is the largest trading partner of both China and the US.

To stimulate trade and lower barriers to trade with other countries the EU has negotiated and put in place preferential trade agreements with 36 countries; a further 7 countries' agreements are pending (awaiting ratification or parliamentary approval). Another 40 countries have agreements that are partly in place and provisionally applied.

Appendix D lists the UK's top 25 trading partners, which account for over 80% of UK trade. Twenty-three of these partners are either in the EU (11); have EU preferential

trade agreements in place, applied or pending (9); or, are involved in trade negotiations with the EU (3).

The Trade Directorate of the European Commission has a team of over 700 staff to negotiate and monitor the implementation of EU trade agreements. Globally, the greatest depth and breadth of experience in negotiating trade deals rests with this team.

EU trade agreements are not always Free Trade Agreements. There are three main groups of EU preferential trade agreement with different purposes:

- Customs Unions: eliminate customs duties in bilateral trade and establish common import tariffs.
- Association Agreements, Stabilisation Agreements, (Deep and Comprehensive) Free Trade Agreements and Economic Partnership Agreements: remove or reduce customs tariffs and non-tariff barriers in bilateral trade.
- Partnership and Cooperation Agreements: provide a general framework for bilateral economic relations but leave customs tariffs as they are.

As at September 2018, the EU had trade and partnership agreements with 119 countries in place or in progress²⁸:

- 36 with in-force agreements, including Mexico, South Korea, Switzerland (5 of which are being updated). Of these, 3 countries have EU customs unions: Turkey, Andorra and San Marino (different to the EU Customs Union);
- 34 with agreements partly in place and provisionally applied to enhance trade. These include Canada (still to be ratified) and several other Commonwealth countries in Africa and the Caribbean;
- 8 with agreements partly in place but not yet applied;
- 20 with pending agreements, including Japan, Singapore and Vietnam;
- 21 in negotiations for agreements (8 of which are paused or suspended).

The EU has also been negotiating Trade in Services agreements with 23 WTO members accounting for 70% of global trade in services, but the negotiations are currently suspended.

In terms of UK's top 25 trading partners in 2017, seven have existing or pending agreements: Japan, Turkey, Canada, Singapore, South Korea, Russia, South Africa.

Smaller UK trading partners that have existing agreements with the EU include: Mexico, Israel, Egypt, Morocco, Chile, Serbia and Montenegro, Albania and Ukraine.

The EU's current negotiations include three countries in the UK's top 25: China (for an investment agreement), Australia and India. In addition, the EU is in negotiations with smaller UK trade partners, including: New Zealand, Thailand, Malaysia, Indonesia, Philippines, Argentina, Brazil and Uruguay.

²⁸ European Commission, http://ec.europa.eu/trade/policy/countries-and-regions/negotiations-and-agreements/#_in-place

Case study Auto manufacturing - 'just in time'

Modern manufacturing uses techniques like "just-in-time" (JIT) to make the production process as efficient as possible. The Single Market is an ideal environment for tightly-managed supply chains that require certainty of rapid delivery, clarity of technical standards, low transport costs and an ability to provide unified support services in data analytics, design and maintenance. JIT techniques and integrated supply chains tend to be found in competitive industries that are high-volume and low-margin.

In the car industry, for example, a car manufacturer will place orders automatically and digitally into its suppliers who will make and deliver components to the factory at the time and the place that they are needed in the production process. This depends on the manufacturer being confident that the supplier is meeting technical standards (e.g. engineering tolerances) and regulatory standards (e.g. safety and environmental standards) so that the final product conforms.

In order to achieve economies of scale, specialist component producers will service many manufacturers. In the EU, the supply chains criss-cross member state borders benefitting from frictionless trade. Of the 30,000 components in modern vehicles, each one may contain 30 sub-components and have passed through 15 countries during the course of its production, according to Clepa, the European supply chain organisation²⁹.

EU auto manufacturing is not exclusively an EU process and some components may come from global suppliers, often from a country benefitting from an EU trade agreement.

JIT provides many benefits, including:

- No need to stock parts in advance or maintain large warehouses to house them
- Lower rent and insurance costs
- Reduced inventories throughout the supply chain mean lower working capital requirements and lower costs of production

However, JIT also has disadvantages:

- The system depends on on-time delivery and there is little room for error
- Small delays from one supplier can disrupt a whole production schedule
- Low stocks may mean that unexpected orders cannot be met immediately, but JIT is responsive

²⁹ Brexit triggers a great car parts race for UK auto industry, Financial Times, 30 July 2017
<https://www.ft.com/content/b56d0936-6ae0-11e7-bfeb-33fe0c5b7eaa>

5 Brexit trade options

All Brexit options will reduce UK-EU trade. Brexit increases frictions for trade between the UK and the EU compared to the arrangements that both enjoy with the UK as an EU member state.

As the European Council President, Donald Tusk, put it:

“Our agreement will not make trade between the UK and the EU frictionless or smoother. It will make it more complicated and costly than today, for all of us. This is the essence of Brexit”³⁰.

It is redundant to say that the UK could trade on WTO terms after Brexit. All international trading arrangements will be under the umbrella of the WTO treaties. For example, if the UK succeeds in agreeing an FTA with the EU, the FTA will need to meet the WTO requirements for an acceptable preferential trade agreement.

Commentators sometimes uses the term ‘WTO terms’ incorrectly and to mean different things.

In this section we look at three options in detail:

- **Basic WTO.** In this option, the UK trades solely under most-favoured-nation terms, either in March 2019, if there is no Withdrawal Agreement, or in January 2021, if there is an agreed transition period but not an agreed future relationship. This paper assumes that it occurs in an orderly fashion in January 2021. We do not discuss the chaotic implications of ‘no deal’.
- **Sectoral agreements.** This option is Basic WTO plus multiple bilateral sectoral agreements with the EU. The agreements would be negotiated during the transition period and come into effect in January 2021. This option has been rejected by the EU, but usefully illustrates the building blocks involved for the UK in negotiating trade agreements with the EU and other countries.
- **Free Trade Agreement.** Instead of multiple sectoral agreements, this option involves a UK FTA with the EU complemented, in the fullness of time, with FTAs and other agreements with other UK trading partners. Relevant reference points are the Canadian and Japanese Comprehensive Economic Trade Agreements (CETAs).

We also consider, at a higher level, the Chequers proposal, EFTA membership and EEA membership.

To allow an unconstrained view of the options and their implications, we put the Government’s red lines to one side.

³⁰ President’s statement, 7 March 2018

<http://www.consilium.europa.eu/en/press/press-releases/2018/03/07/statement-by-president-donald-tusk-on-the-draft-guidelines-on-the-framework-for-the-future-relationship-with-the-uk/>

Basic WTO

The UK becomes a third country and trades with the EU, its largest trading partner, on the same terms as other third countries like the US and China.

UK-EU trade would be under WTO rules on a most-favoured-nation basis, but with no bilateral deals between the UK and the EU (or between the UK and anyone else). In its own right, the UK would remain a signatory to several international treaties and be a member of several international organisations, like the WTO.

Basic WTO would represent a dramatic change from the UK's status as a member of the Single Market and the EU Customs Union. The new arrangements for UK-EU trade would seriously disrupt UK-EU trade and would be significantly inferior to EU membership. This would not represent discrimination by the EU against the UK - the EU would simply be treating the UK the same as any other third country without an EU preferential trade agreement.

On 19 July 2018, the UK submitted its proposed schedule for goods to the WTO for certification. The process allows WTO members to raise objections so that these can be resolved. The schedule, received by the WTO on 24 July, covers import tariffs on goods, reflecting the concessions and commitments applicable to the UK as an EU member. A member may object if it believes the UK's proposed schedule acts to its detriment or if the UK is violating the terms of its schedule for a particular product. In practical terms, the UK could operate the schedule while the certification process proceeds, even if objections are raised.

Certification should be achievable but there are some tricky areas, such as negotiating the UK's share of the EU's existing tariff-rate quotas (there are around 100 tariff-rate quotas, which makes this a complicated and time-consuming task). The Director-General of the WTO, Roberto Azevêdo, thinks it would be very ambitious to complete the process by March 2019. As an experienced trade negotiator, he observed on the BBC Radio4 Today Programme on 24 August 2018:

"The moment that other countries sense an opportunity to increase a market share or a quota here or there, they're going to go for that".

Key implications of Basic WTO are:

- The four freedoms of movement of goods, services, capital and people, which underpin the Single Market, no longer apply.
- The UK has no trade agreements with the EU or other countries (the UK would become the only developed country in the world with no trade agreements).
- UK exports to the EU are no longer tariff-free. EU27 importers would be charged tariffs on UK exports as described in the EU's schedule at the WTO.
- UK imports from the EU are no longer tariff-free. The UK would charge import duties on all of its imports (including those from countries with EU trade agreements) respecting the ceilings set out in the proposed schedule of 'bound' tariffs. The UK would charge duties at the rates currently charged by the EU. This would raise UK prices for consumers and costs for producers.

For example, UK import tariffs on EU agricultural goods would result in higher costs for food manufacturers and higher prices in the supermarkets.

- The UK could apply lower tariffs on certain products if it wanted to, but it would need to apply these to all imports of those products. If the UK wanted to reduce its tariffs systematically, it would probably do this over several years to avoid disruption and sudden job losses in industries like farming and manufacturing. (To illustrate: under the EU's agreement with Japan, it will take seven years for tariffs on EU imports of finished cars from Japan to reduce from 10% to zero).
- The UK drops out of the EU's many trade agreements with third countries and will no longer benefit from these or future EU agreements. UK exports to these countries become less competitive than comparable exports from the EU27 (except to the extent that any fall in sterling compensates).

Services trade with the EU

Service sectors would be seriously affected. Being in the EU's Single Market means the UK is much more closely integrated into the EU's services markets than would be possible as a non-EU member accessing through the EU's WTO commitments on services and the application of WTO services rules.

Trade in services would revert to the WTO rules on services (the General Agreement on Trade in Services) and the EU's GATS schedule that details access to the EU for third countries. This would result in a significant deterioration in access for UK services compared with Single Market membership.

To take a couple of examples (among many): UK law firms would no longer have the right to operate an office in an EU member state (and some EU member states very significantly restrict the operation of non-EU lawyers); and UK musicians would have to seek work permits before playing at a concert or gig in the EU27 – meaning that, in many cases, the work would go to an EU27 national.

The UK would need to negotiate access on services with all individual EU member states as well as with the Commission. The EU does not have a uniform policy for all services. Some sectors have largely uniform rules across the EU, such as insurance and banking, but others vary by sub-sector and member state, such as those that determine how foreign legal firms may have a commercial presence to provide legal services.

Under GATS, UK firms can provide services to EU27 customers in four different ways (or 'modes of supply'):

- 1 Cross-border from the UK (e.g. City banking services to Paris-based company);
- 2 EU customer coming to the UK (e.g. Spanish patient visiting a Harley Street specialist);
- 3 Commercial presence in the EU (e.g. UK-owned bank branch or subsidiary in Italy);
- 4 People from UK going to the EU to supply services there (e.g. a consulting project on-site in Germany or a UK musician playing in a concert in Vienna).

EU members can deliver a high proportion of services to each other with Mode 1, but this becomes more difficult to do for a third country, as relevant rules may require services to be supplied by an EU regulated body (for example, EU member states' company laws may require a company's auditor to be regulated in an EU member state). In many cases, UK-based suppliers would need to set up a commercial presence in the EU – Mode 3 – requiring additional costs and investment. Mode 4 provision would not be covered at all without an agreement with the EU and could well be significantly disrupted by requirements to seek work permits or visas, depending on the rules of the member state concerned.

Some services like aviation are not covered by GATS but would still require changes. For example, access to the single EU aviation market requires headquarters and majority shareholdings to be located within the EU so that it can have regulatory oversight on safety. EasyJet has already announced it is setting up an Austrian subsidiary to allow it to continue to fly intra-EU routes after Brexit.

Examples of impacts on financial services

- Loss of passporting rights for financial services, as well as reduced access for other service providers like legal and accountancy services, means that firms need to find other ways to access EU27 markets
- Banks with a UK presence have acquired or are acquiring banking licences in EU27 member states and are beefing up their operations in Dublin, Frankfurt, Paris or elsewhere. This results in additional costs and capital requirements, and job transfers from the UK to the EU27.
- A substantial part of UK-based EU-related banking activity is at risk (some estimates at 40-50% of activity), with knock-on effects to related professional services.
- Loss of jobs and associated tax revenues.

Tariffs

The average MFN tariff, based on 2016 goods imports, would be 4.6%³¹. This would cost UK consumers and producers about £15bn extra if it was applied to UK imports from the EU (£318bn in 2016) - assuming no other changes. The value of UK imports affected would be higher than this because it would include imports from third countries that have EU trade deals.

The extra cost of £15bn would be concentrated on the consumers and users of products with the higher tariffs. The eight sectors that would have above-average MFN tariffs of UK imports are listed in Table 7. These sectors account for about 35% of UK imports, but would account for over 80% of the tariff burden (£12bn of the £15bn) and would be particularly affected.

³¹ Institute for Fiscal Studies, The Customs Union, tariff reductions and consumer prices, March 2018
<https://www.ifs.org.uk/uploads/publications/bns/BN225.pdf>

Some sectors that are involved with international supply chains, where components move back and forth several times between the UK and the EU, would be vulnerable to the cumulative cost of multiple tariffs in the production process.

Import category	Average MFN tariff
Live animals and animal products	32.2%
Prepared food	18.4%
Oils and fats	12.7%
Footwear	11.0%
Vegetable products	11.1%
Textiles	10.7%
Plastics	5.5%
Transport equipment	7.1%

Customs barriers

While the UK is in the EU, its products are not subject to border checks because they already qualify as being compliant with EU rules and regulations. This changes under a Basic WTO option and UK exports to the EU would be subject to a battery of checks. These will cause additional costs and delays.

UK exports to the EU would be subject to the same customs checks that the UK and EU currently carry out on imports from third countries. When the UK leaves the EU Customs Union, producers will need to meet whatever origin regime is put in place. These include complying with RoO, which will create a new administrative burden for exporters.

All UK exporters would need to complete:

- Single Administrative Document (SAD)
- Entry Summary Declaration (ENS)
- Additional specialist documentation required for highly-regulated goods
- Transport permits and insurance certificates

The SAD consists of 54 boxes with eight parts, which must be completed and submitted for every declaration.

UK exporters would no longer have access to current EU-wide e-customs systems that reduce the need for lengthy paper-based procedures for declaring goods. One of the most important is the New Computerised Transit System (NCTS) which permits paperless customs clearance and takes on average about 30 minutes off processing time.

Regulatory barriers

Exporters from the UK would have to be able to prove that goods meet EU standards, and this could involve border inspections.

Without mutual recognition agreements or the EU granting equivalence, UK products could not enter the EU without further checks at the border. Over time, if

there is divergence between UK and EU standards, UK businesses would be unlikely to produce two different product lines - one for the UK market and one for the EU – as this would increase costs and complexity. Exporters and UK suppliers to exporters would almost certainly maintain one product line to the higher standard (UK or EU).

To facilitate trade with third countries, the EU has equivalence provisions in many of its sector regulations, ranging from financial markets to data adequacy. However, the regulations for several important sectors, such as chemicals, do not have them.

Conformity assessment

Conformity assessment involves testing, inspection and certification. The certificate would be required at the border before a good can be placed on the EU market. In many sectors, product conformity can be self-certified, but shippers may be stopped at customs and asked to provide technical documents as proof³².

- For highly regulated sectors, such as the automotive and chemical sectors, accredited certification is needed. A conformity assessment body (known as a ‘notified body’) undertakes the relevant inspections and issues certification of technical compliance. UK-based companies would no longer be able to rely on UK accreditations from Defra, BEIS or other agencies and would therefore face checks at the border.
- The rules of the Union Customs Code stipulate that, without an agreement, only EU licences and certificates certifying conformity with EU regulations are valid for third-country goods. This could mean week-long delays while they are physically inspected, and samples are obtained to be sent to an approved testing house. There are also costs involved.

These new barriers would put at risk over half of the total exports from the chemicals, food and beverages and textiles sectors and at least a quarter of the total exports from other sectors. If exports did not cease due to the practicalities of implementing the checks, compliance costs would reduce trade and profitability.

Summary - Basic WTO	
Tariffs on imports from EU	High
Tariffs on exports to EU	High
Services trade	Barriers created
Customs barriers	High
Regulatory barriers	High

Most plausible studies (such as the World Bank study on the integration of UK and EU trade) suggest that the Basic WTO option would lead to a long-run drop in bilateral trade between the UK and the EU of 40-60%, with services affected worse than goods³³. Even if these estimates are out by a half, the damage to trade, the economy and jobs would be huge.

³² Institute for Government, Frictionless Trade? What Brexit means for cross-border trade in goods, 17 August 2017, <https://www.instituteforgovernment.org.uk/publications/frictionless-trade-brexit-august-2017>

³³ See, for example: World Bank, Deep Integration and UK-EU Trade Relations, January 2017, p19 Table 6, <http://documents.worldbank.org/curated/en/853811484835908129/pdf/WPS7947.pdf>

Sectoral agreements

In this model, the UK augments its Basic WTO agreement with the EU with bilateral agreements. The UK agrees multiple bilateral trade agreements with the EU during the transition period and they come into effect in January 2021. This is similar to the way in which Switzerland has developed its relationship with the EU and how some other countries enhance their basic WTO relationships with the EU.

In Switzerland's case, it has achieved deep integration on much of its goods trade with the EU, but not on services. Switzerland's agreements with the EU began with an overall agreement on trade in goods in 1972, pre-dating the Single Market. To give an idea of scale that could be involved in using bilateral agreements there are about 100 separate agreements between Switzerland and the EU, many of them sector-specific (see Appendix A for details). These define the Swiss-EU relationship in trade and many more areas.

For sectoral agreements to meet WTO requirements to cover 'substantially all' trade in goods, under GATT, or substantially all sectors (determined by number of sectors, volume of trade and modes of supply) under GATS. As far as WTO rules are concerned, sectoral agreements must cover enough sectors to satisfy those provisions, although what is "enough" remains an open question.

The EU treaties database lists 70 agreements between the EU and the US (six of which are multilateral) and 18 between the EU and China³⁴. Many of these cover topics related to trade such as:

- China - customs cooperation, trade and economic cooperation, scientific and technical cooperation, maritime transport, textiles and clothing.
- US - customs cooperation, aviation safety and air transport, security cooperation, peaceful use of nuclear energy, application of competition laws and, cooperation on intellectual property. They also cover, government procurement, sanitary measures to protect health in the trade in animals and animal products, and trade in bananas, cereals, oil seeds, rice and wine.

The EU does not like the Swiss model, which it sees as ad hoc, cumbersome and time-consuming to maintain. The EU prefers a comprehensive approach rather than sectoral agreements and would like the Swiss to enter into an FTA. On the other hand, the Swiss believe that a sectoral approach serves their economy well.

The UK will be faced with negotiating agreements with many other countries in addition to the EU. On Brexit, Britain will be excluded from EU arrangements with third countries, entering the equivalent of a legal vacuum in key parts of the UK's external commercial relations.

The Financial Times analysed the EU treaty database and found 759 separate EU bilateral agreements with potential relevance to the UK³⁵. Of these, 295 relate to trade. In addition to rolling over EU preferential trade agreements or negotiating

³⁴ European Commission website: <http://ec.europa.eu/world/agreements>

³⁵ After Brexit: the UK will need to renegotiate at least 759 treaties, Paul Mclean, Financial Times, 30 May 2017 <https://www.ft.com/content/f1435a8e-372b-11e7-bce4-9023f8c0fd2e>

new trade agreements, Brexit opens a further 464 time-pressured mini-negotiations worldwide with non-EU countries. Additional UK agreements, outside the EU framework, may also need to be revised because they refer to EU law. And, of course, many of the negotiations are inter-dependent. Overall, the FT estimated that the UK would need to approach 160 countries.

The scale and complexity of the renegotiations involved is huge. The agreements cover aviation, nuclear materials, customs, fisheries, trade, transport and regulatory co-operation in areas such as antitrust or financial services. Successful negotiations will require technical expertise, commercial awareness and international trade negotiation experience.

As Lord Hannay, Britain's former EU ambassador said:

*"We are talking about an enormous number of complex acts that we rely on today. The challenge of replacing them falls in the same category as Alice in Wonderland running furiously to stand in the same spot."*³⁶

Summary – Sectoral arrangements	
Tariffs on imports from EU	Low
Tariffs on exports to EU	Low
Services trade	Unlikely to be addressed
Customs barriers	Medium
Regulatory barriers	Medium

Given the EU's unwillingness to pursue a 'Swiss-style' option, this option is not on the table, but it serves to illustrate the breadth of the negotiations involved. The sectoral model is complex to create and to administer but would deliver a high degree of free trade in most goods sectors and some liberalisation of services. Customs Union membership is not part of the arrangement.

³⁶ *ibid*

Free Trade Agreement

An FTA is an agreement which aims to abolish tariffs and quotas between its members. Its main advantage over the Basic WTO option would be to remove these barriers from UK-EU trade: goods trade between the UK and the EU would become tariff-free.

Costly and inconvenient non-tariff barriers would remain. For example, UK exports to the EU would still be subject to customs checks (in order to check origin and to levy import VAT). Most other regulatory barriers and checks would remain. This would mean that physical infrastructure would be required at the Irish border.

Examples of FTA customs impacts and costs

- More than half of the UK's 300 000 plus traders trade only with the EU. At least 130 000 of those have no current dealings with Customs authorities. The number of customs declarations is projected to increase fivefold, from 50 million to 250 million.
- Any FTA requires RoO certificates for cross-border trade to ensure that there is sufficient domestic content to justify tariff free status. One UK car company estimated that it would need some 15,000 rules of origin certificates, at a minimum cost estimated at £15 each.
- UK supermarkets relying on just-in-time food imports could need 80 000 separate import declarations annually, costing large businesses £25 each and smaller ones without economies of scale around £50 each.
- Similar challenges apply to food exports. Around 70% of UK food and drink trade takes place within the EU and would be subject to customs checks.

An FTA is a small step up from Basic WTO, but a big step down from the near-frictionless trade of the EU Single Market. A practical indicator of the depth of a trade agreement is the number of legally enforceable policy areas that it contains. A study by the World Bank found that the EU's relationship with its members includes 44 legally enforceable areas whereas a typical FTA only has 14.

There are two types of FTA: shallow and deep. The Government is seeking a deep FTA with the EU.

- *Shallow FTAs* deal with border measures, such as tariffs and customs arrangements for goods.
- *Deep FTAs* include rules on other relevant domestic policies that affect trade. There is a trend towards deeper FTAs – such as the EU's Comprehensive Economic and Trade Agreements (CETAs) with Canada and

Japan. A deep trade agreement might include policies on:

- Competition, intellectual property rights, investment and movement of capital;
- Environmental laws, labour market regulations and measures on visa and asylum.

General features of FTAs include the following:

- FTAs typically relate to goods but some modern FTAs include an element of services.
- Unlike a customs union, FTA members do not have to set the same tariffs on imports from countries outside the FTA. The members are free to negotiate their own trade deals with other countries.
- Modern FTAs try to address some NTBs, but most remain in place for both goods and services. This is the big disadvantage of an EU FTA for the UK compared to Single Market membership.
- An FTA can involve more than two countries, such as:
 - EFTA FTAs on behalf of Iceland, Liechtenstein, Norway and Switzerland;
 - North American Free Trade Agreement (NAFTA) –Canada, Mexico, US;
 - Association of South East Asian Nations Free Trade Area FTA (ASEAN FTA) – Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand plus Cambodia, Laos, Myanmar and Viet Nam;
 - EEA Agreement covering the EU28 and three EFTA countries.

Case study – broadcasting under an EU FTA

The UK creative services sector exports over £4bn to the EU, with more than half of fashion, graphic design, film and video exports going to EU countries.

Pan-European broadcasters are required to base themselves in an EU member state; and current EU FTAs do not cover broadcasting and programme production rights.

The UK could no longer be the hub for pan-European broadcasting it has become since the audio-visual market was opened up.

CETA as an example of a deep FTA

The Canada-EU CETA (which is already being applied in most areas but still needs to be ratified by EU member states) is an example of the type of the deep FTA that the UK Government has said that it is seeking³⁷.

A UK-EU CETA is likely to reflect important differences between the Canada and the

³⁷ Can CETA-Plus solve the UK's services problem? Briefing Paper 18, UK Trade Policy Observatory, March 2018 <http://blogs.sussex.ac.uk/uktpo/publications/can-ceta-plus-solve-the-uks-services-problem/>

UK. For example, the EU accounts for only 10% of Canadian trade but about half of UK trade; the UK is a neighbouring state with a large services economy and well-established, closely-integrated trade flows with the EU27.

There are strong advocates of a “Canada+++” trade deal. So, what does the Canada CETA do that an ordinary FTA does not? Appendix B lists the 30 chapter headings of the 1400-page EU-Canada CETA), which include The main points to note are as follows.

As in other EU FTAs, the CETA removes tariffs on trade in industrial goods between Canada and the EU. Most have already been removed, and all will be within seven years. Tariffs on most agricultural products have also been removed (which represents extensive liberalisation).

There are however quotas principally in relation to Canadian agricultural exports³⁸. It also removes all barriers to investment for EU investors in Canada and allows EU companies to bid for public procurement contracts in Canada.³⁹

Like other third countries with an EU FTA, Canada still faces other barriers in trading with the EU. Checks take place at the border to make sure Canadian goods meet EU regulatory standards, and there is a higher degree of paperwork involved.

The main difference is that the CETA includes some liberalisation of trade in services. The EU’s commitments in CETA go further than its commitments under the WTO’s General Agreement on Trade in Services (GATS). However, CETA still follows the GATS schedule closely, so that the most protected sectors in GATS remain the most restricted in CETA (including financial services). There are a few areas of mutual recognition in relation to services. Some EU services sectors are effectively completely open under CETA (in mining, energy, environmental services and some professional services), but other sectors that are important to the UK, such as financial services and transport services, remain very restricted.

To pursue a CETA with wider access to services markets, the UK and the EU would need to conduct separate detailed negotiations for each services sector. The EU would be reluctant to open up some services sectors to the UK. This is because the Canada CETA contains an MFN clause, which means that if the EU agrees better services commitments with another country (such as the UK), then those benefits need to be extended to Canada. For example, this could limit the EU’s willingness to offer more favourable terms to the UK on financial services.

The EU seems unlikely to offer the UK more than a few concessions more than Canada. Even if a Canada+++ deal was possible for the UK, it would still fall a long way short of the services access that the UK enjoys as an EU member. This is because such a piecemeal deal, negotiated sector by sector, lacks the ‘architectural’ – the over-arching – aspects of the Single Market which are of particular importance

³⁸ Canadian chamber of Commerce, So what's in the Canada-EU Trade Agreement (CETA)? http://www.chamber.ca/membership/131018-So-whats-in-the-Canada-EU-Trade-Agreement-CETA/131018_CETA_Analysis.pdf

³⁹ House of Commons Library, CETA: the EU-Canada free trade agreement, 26 June 2018 <https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7492>

in services trade – the unified court system, the free mobility of labour and the mobility of data.

On the other hand, the EU is likely to want commitments and obligations from the UK, as a large neighbouring economy, to maintain a level playing field with the EU. The EU has flagged that it is likely to seek these commitments from the UK in relation to tax, labour standards, environmental and social protections and state aid. The EU will interpret the “+++” differently to the UK.

The integrity of the Single Market is a core principle for the EU, and the member states would not want to see it violated by granting too much flexibility to the UK. If the UK wants to optimise its services access, it might lead more naturally to some fine-tuning of the EEA agreement – a ‘Norway+’ option, which comes with many of the architectural aspects.

Summary – UK-EU FTA	
Tariffs on imports from EU	Low
Tariffs on exports to EU	Low
Services trade	Partially addressed
Customs barriers	Medium
Regulatory barriers	High

The World Bank study estimates that an ‘ordinary’ FTA would reduce UK-EU trade by over 40%, with services affected more severely than goods. The trade impact of a UK-EU CETA would not be so severe but would still be material (benefitting primarily from some increased services access). Most tariffs on goods would be eliminated but there would be no customs union.

Chequers proposal

The Chequers proposal can be seen as an FTA with a customs arrangement, but no detailed services commitments.

The Chequers proposal addresses tariffs on goods and customs facilitation. It proposes a free trade area with the EU on goods and customs arrangements, which operate like the EU Customs Union for UK-EU trade but permit the UK to set its own tariffs for third countries and to negotiate its own trade deals. The UK would follow the common rulebook with the EU for goods and would remain harmonised with the EU in the future but would retain a right of veto over future changes, with attendant reduced market access.

The Chequers proposal makes high-level recommendations for services. The UK proposes to retain regulatory flexibility in return for reduced market access to the EU. As a result, the UK accepts that mutual recognition is not an option and that equivalence will be used to reduce regulatory barriers. The proposal makes no detailed recommendations regarding regulatory barriers for services.

The European Commission welcomed Chequers as the first detailed proposal from the UK Government on the future UK-EU relationship. However, the Commission has welcomed the proposals, which cover more than trade, but has said that it is concerned about proposals for trade (economic cooperation) go against the core principle of the Single Market of the indivisibility of the four freedoms.

The Chequers proposal differentiates the treatment of goods and services, but the Commission points out that trade in the two is closely inter-related. The Commission has also raised major concerns particularly that the UK's customs facilitation proposal is bureaucratic, not legally-robust and impractical⁴⁰.

Summary – Chequers	
Tariffs on imports from EU	None
Tariffs on exports to EU	None
Services trade	Not addressed
Customs barriers	Low for UK-EU goods trade
Regulatory barriers	Low for goods High for services

Tariff-free trade on goods and agriculture and a customs arrangement lead to near frictionless trade on goods, but the customs arrangement introduces new bureaucracy. Regulatory barriers in relation to services remain to be addressed. The Irish border issue would be resolved, if the customs arrangement worked.

⁴⁰ Michel Barnier, Press statement, 20 July 2018 http://europa.eu/rapid/press-release_STATEMENT-18-4626_en.htm

European Free Trade Association

The European Free Trade Association (EFTA)⁴¹ promotes free trade and economic integration between its Member States (Iceland, Liechtenstein, Norway and Switzerland), within Europe and globally. There is a free trade area between the four members but not a customs union.

EFTA is an inter-governmental organisation that negotiates trade deals on behalf of its members but does not enter into the agreements itself (unlike the EU). The four states are parties to the agreements negotiated, each signing on its own behalf.

The four EFTA states take decisions by consensus (like the WTO), EFTA states are also free to negotiate their own deals with third countries.

EFTA's preferential trade agreements comprise 28 FTAs covering 39 countries and territories outside the EU. EFTA members tend to negotiate as a bloc, because it gives them a negotiating advantage. Third country agreements are in the minority (see below).

The trade agreements typically eliminate import duties on industrial goods and fish, but not agriculture. Over recent years, EFTA has added rules and commitments on services, investment and public procurement. Since 2010, EFTA been introducing provisions on sustainable development in new negotiations and reviews of existing FTAs. These address environmental and labour standards relating to trade and investment.

Trade between the EU and the EFTA states, excluding Switzerland, is subject to the European Economic Area (EEA) Agreement – EFTA's trade agreement with the EU⁴². As a result, EEA-EFTA members are obliged to adopt EU legislation relevant to the Single Market. As the EU accounts for about 70% of EFTA's total trade, EU rules and regulations play a major role in the EFTA states' trade relations. This has tended to restrict all EFTA members' trade policies towards third countries. Within these constraints, EFTA members are free to decide those trade policies.

Individual EFTA members have signed bilateral FTAs with some third countries.

- The Iceland-China FTA of 2013 was China's first with a European country
- Norway has signed two bilateral FTAs (with the Faroe Islands and Greenland) and is negotiating one with China.
- Switzerland, which is in a customs union with Liechtenstein, has concluded bilateral FTAs with two countries and one territory – China, Japan, and the Faroe Islands.

Acting as a group of four, EFTA states can often negotiate agreements more quickly than the EU, which must cater to the interests of 28 nations. If one EFTA nation wishes to move faster, it can decide to negotiate with a third country on its own. This can have the advantage of piloting an EFTA template. There is ongoing dialogue

⁴¹ European Parliament: Free trade agreements between EFTA and third countries: An overview [http://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_BRI\(2016\)580918](http://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_BRI(2016)580918)

⁴² EFTA, Frequently asked questions on EFTA and the EEA <http://www.efta.int/fag>

between EFTA and the EU, so, EFTA can in theory also act as an advance party for the EU, for example with China.

To ensure consistent application of EEA rules, the three EEA-EFTA states established the EFTA Surveillance Authority and the EFTA Court, which correspond to the European Commission and the CJEU. Note that the EFTA Court is not subordinate to the CJEU. The EFTA Court does not seek actively to diverge from the CJEU, but it can and has done so. Similarly, the CJEU regularly follows precedent in EFTA Court case law. This relationship was described in 2017 as “a symbiotic one marked by mutual respect and dialogue” by a former CJEU President.⁴³

EEA-EFTA involvement with EU

We discuss EEA in more detail below, but it is worth noting here how EEA-EFTA members interact with the EU.

Within the EU, EEA-EFTA members participate in committees hosted by the Commission, engaged in the preparation of legislation or in managing programmes. EEA-EFTA members also submit written contributions and resolutions. This participation is not limited to legislative acts but also covers broader EU policies or non-legislative policy instruments and expert groups.

The EEA Agreement provides for EEA-EFTA participation in three main types of committees – programme committees, expert groups, and comitology committees – as well as certain other committees. It includes participation in the EEA-EFTA “social partners in the EU social dialogue, relations with the European Parliament and the EEA Joint Parliamentary Committee”. It also covers formalised involvement of non-governmental actors in the decision-shaping process in the EEA and the EU.

- In programmes, the Commission is required to take note of EEA-EFTA member views, on the same basis as those from EU member states.
- The EU’s expert groups provide a key channel to influence and contribute to emerging EU policies and legislation. Participants gain access to important information from the Commission and can communicate national positions at an early stage. Those who participate in them have equal status, whether from EU or EEA-EFTA member states.
- EEA-EFTA states can participate in comitology committees, although they have no voting rights. These committees assist the Commission in drafting and adopting implementing measures where the Council has delegated authority. EFTA experts are co-opted on the same basis as national experts from the EU member states.

When EU legislation and regulations are being finalised, EEA-EFTA member states are invited to provide written comments.

⁴³ Cited by Carl Baudenbacher, How the EFTA Court works, 27th August 2017, <http://blogs.lse.ac.uk/brexit/2017/08/25/how-the-efta-court-works-and-why-it-is-an-option-for-post-brexit-britain/>

European Economic Area

The European Economic Area (EEA) option offers Single Market membership and the four freedoms. It covers most goods (the main exclusions being agriculture and fisheries) and services. It does not require membership of the EU Customs Union.

The EEA was established in 1994. Its objective is to extend the Single Market of the EU to the participating EFTA states, creating a homogeneous European Economic Area, comprising the 28 EU member states and the three EEA-EFTA states – Iceland, Liechtenstein and Norway. Switzerland, the largest EFTA economy by far, is not an EEA member.

All relevant EU Single Market legislation is integrated into the EEA Agreement so that it applies throughout the EEA. The core of these rules relates to the free movement of goods, capital, services and persons. As the EEA agreement changes, EEA members incorporate relevant rules into their domestic law (if they refuse to do so, and if agreement cannot be reached on divergence, then the EU can impose a proportionate restriction on access to the Single Market).

The EEA Agreement is wider than an FTA and covers:

- Horizontal areas such as social policy, consumer protection, environment, company law and statistics;
- Competition and state aid rules of the EU Treaties;
- Participation in EU programmes such as those for research (Horizon 2020) and education (Erasmus).

However, the EEA Agreement is narrower than full EU membership. It does not cover:

- EU common agriculture and fisheries policies, although it contains provisions on trade in agricultural and fish products.
- Customs union, nor a common trade policy, common foreign and security policy, justice and home affairs, harmonised taxation or the economic and monetary union.
- Schengen. However, all four EFTA states participate in Schengen through bilateral agreements and apply the provisions of the relevant EU law.

The three EEA-EFTA States make no mandatory contributions to the EU budget (or the Common Agricultural Policy), however:

- The EEA Agreement requires them to sign up to contributions to development programmes in less prosperous EEA member states (the 'Financial Mechanism'), but they negotiate and administer the forms of those programmes themselves (the EU does not specify them). The nearest equivalent is direct international aid (not routed via the EU).
- They can also choose to join EU joint programmes, in which case they participate and pay a share of the programme costs based on GDP. The EU member states do not have this choice, which has an option value: the EEA EFTA states can choose to join schemes from which they expect a net benefit and opt out of those they expect are not net beneficial.

Given that the EEA Agreement incorporates most Single Market regulations and mutual recognition, most EEA-EFTA exports to the EU do not undergo regulatory checks at the border. Membership of the Single Market precludes regulatory

convergence with other countries (such as the US) other than that pursued by the EU itself.

The EEA-EFTA countries have sometimes criticised their limited participation in the EU's decision-making process, given that in practice they have to adopt all EEA-relevant legislation in order to maintain access – something they say amounts to a 'democratic deficit'. It is true that the EEA EFTA States have no vote in the EU Parliament and Council, but their influence is significant, and only appears small because they are small countries.

The making of an EEA rule proceeds through five stages

- 1 the construction of the regulation
- 2 the voting
- 3 the determination of 'EEA relevance'
- 4 adjustment and amendment, including the possibilities of derogation and equivalence
- 5 veto ('rights of reservation') with the possibility of retaliation, although limited by considerations of proportionality.

EEA-EFTA states have more or less open access to stage (1). lose stage (2), but gain stages 3, 4 and 5 (the EU authorities are involved in these decisions, but not the individual EU member states). In practice, the absence of voting is not as important as it might seem. (1) is the most influential stage, with (2) in second place.

The UK is much larger in trade terms than the EEA-EFTA countries, so the UK would be in a much stronger position (as an EEA-EFTA member) to influence stages 1, 3, and 4 and still be able to refuse to carry over EU legislation to which it objects. And, as observed above, the UK will in practice need to follow the EU model in areas like chemicals regulation or data protection in order to maintain access to the EU market. This means that the EEA mechanism for carrying over such rules can be seen as simply formalising what in many cases the UK would have to do anyway, but with the added benefit of being able to influence EU regulation.

EEA-EFTA countries such as Norway also have influence, upstream, in terms of international standard setting that drives EU policy and through involvement in EU committees (as discussed under EFTA).

International standards

International bodies often determine the thrust of international regulation before it is adopted by the EU and translated into EU rules by the Commission. These international bodies may be treaty-based (such as the WTO) or established to focus on particular issues (such is the International Accounting Standards Board). This gives countries the opportunity to influence global and EU regulation upstream⁴⁴.

⁴⁴ See Bruges Group, The Norway Option, Richard North, 2013

https://www.brugesgroup.com/images/issues/alternatives_to_the_eu/the_norway_option_pdf.pdf

Case study – Basel Committee international standard setting

The Basel Committee on Banking Supervision sets global standards for the prudential regulation of banks and provides a forum for regular cooperation on banking supervisory matters.

The Basel Committee's standards do not have the force of law but are adopted globally in local laws and regulations, including by the EU. For example, the EU's Capital Requirements Directive and the associated regulation are based on Basel Committee standards.

When the Basel Committee is developing standards, the Committee receives submissions from central banks, regulators, industry bodies, and, sometimes individuals and businesses, which gives opportunities to influence from non-members.

Norway is not a member of the Basel Committee, but participates in some of the working groups through representatives of the Nordic finance ministries.

The UK (through the Bank of England and industry submissions) is an influential member of the Basel Committee and plays an active role in the development of the standards.

In areas closer to its economic interests, Norway has the opportunity to make its voice heard in the relevant international standard-setting bodies. There are many such bodies, and we do not have the space here to describe them all. Examples of bodies and standards in relation to food and agriculture include:

- The UN Food and Agricultural Organisation (FAO) takes the lead on agriculture, forestry, fisheries and rural development, feeding into WTO negotiations. Norway is an active member in the FAO in its own right.
- Two other international bodies (the IPCC and Codex) formulate international food standards. These standards are recognised by the WTO Sanitary and Phytosanitary (SPS) Agreement, which is the main driver of EU policy. Separately a third body (OIE) sets standards for animal health controls, which also drives EU policy. Norway and the EU member states are all members of the three bodies. EU member states rely on the EU to represent them and provide input through the Commission's committees and task forces. In Codex, Norway hosts the Fish and Fisheries Products Committee.
- Rights and responsibilities of nations in their use of the world's oceans, establishing guidelines for businesses, the environment, and the management of marine natural resources, are dealt with by the UN

Convention on the Law of the Sea (UNCLOS), within which the EU and Norway must comply.

Summary – EEA-EFTA	
Tariffs on imports from EU	Low*
Tariffs on exports to EU	Low*
Services trade	Low barriers
Customs barriers	Medium
Regulatory barriers	Low

*Assuming the Norway version of EEA with tariffs on agriculture and fisheries.

The EEA option would deliver deeper trade integration for the UK with the EU than any other arrangement for a third country. The benefits to trade of the four freedoms of movement of goods, services, capital and people would apply. However, the EEA option would still fall some way short of the trade integration that flows from full EU membership because the UK would not be in the EU Customs Union. This affects goods trade (particularly in integrated supply chains) and the associated services trade. The World Bank estimates that the EEA option would reduce UK-EU trade by around 10%, although other estimates are higher.

6 Impact assessment

Overview

The UK currently enjoys the deepest possible trade deal in the world as member of the EU. Over the last 45 years the UK economy has become highly integrated with the EU economy and both UK and EU industries benefit from significant accumulated investment in this integration.

As we move to a much less elaborate deal and 'de-integrate' from the EU, it will have a detrimental impact on many firms, industries and the jobs that they create.

- UK-based firms that are competitive internationally because they operate to scale in the EU's large internal market and benefit from its considerable efficiencies, may well lose their competitive edge as a result of Brexit. The UK's position in global supply chains is under threat.
- Brexit creates greater costs and bureaucracy for the UK's trade capability but with no obvious cost gains from deregulation, which as yet are unspecified. (Though advocates of a "WTO-only" arrangement often refer to gains from deregulation, they tend to be circumspect about the deregulation they have in mind. Indeed, very few businesses are clamouring for deregulation. There are obvious political difficulties associated with deregulation in the labour market, health and safety, product safety, and the environment. As explained above the UK is likely in practice to want to retain much EU regulation in order to maximise access to the EU market and to provide certainty to business.
- Small and Medium-sized Enterprises (SMEs) will feel the additional costs acutely as they do not have the in-house skills to deal with them. For example, SMEs will no longer be able to export without the costs of complying with guaranteeing payment of VAT, customs duty, tariffs, proof of regulatory compliance, rules of origin, labelling regimes and so on. See Appendix E for three real-life case studies of the impacts on SMEs.
- UK-based exporters may benefit from a weaker pound, but that effect is much less important than it once was given that so much UK manufacturing is now a part of a multinational supply chain – a weaker pound increases the cost of imports leading to little gain for these exporters. Household budgets are squeezed by the weaker pound and more expensive imports.
- Local and regional impacts of Brexit vary, depending on the size and location of industry sectors and their reliance on the EU for trade, skills, workforce and investment. Sector and regional impacts are not independent of each other and there will be knock-on effects.

The complex nature of the trade ecosystem means that impacts on one part will affect others in ways that cannot be foreseen. There may be opportunities to strike independent trade deals, but very few businesses have identified benefits from Brexit - most are concerned about risks and costs.

Trade and economy

Brexit increases trade barriers. All Brexit options will impede UK-EU trade compared to full EU membership. UK exports will suffer (not just with the EU), and imports will become more expensive. This twin-pronged attack on international trade will reduce UK competitiveness - putting jobs and livelihoods at risk and will discourage investment in the UK.

The Office of Budget Responsibility expects UK GDP growth rates to be at between 1.3% and 1.5% in real terms for the next few years⁴⁵. The OBR projections do not include the effects of any specific Brexit scenario, because it is not yet clear what will be agreed between the UK and the EU. However, the forecast of low single-digit 'pre-Brexit' growth performance means that the UK economy has limited capacity to absorb the shock to trade of Brexit.

To compare options, our analysis looks at the long-run implications of Brexit, ignoring the costs of transition. The method used for estimating impacts works as follows:

- The starting point is the impact on UK-EU exports and on overall trade for each option. We use the quantitative analysis of trade impacts by the National Institute of Economic and Social Research (NIESR), which is based on their review of other studies and use of the well-regarded NiGEM model. The fall in trade is not just due to new trade barriers, it also includes the effect of a weaker pound and reduced investment.
- Exports are around 30% of GDP and 23% of total final expenditure (which also includes imports). Based on these figures, it is reasonable to suggest that, as a rule of thumb, a 1% drop in total exports would cut UK GDP by 0.3% to 0.2%. This is in the middle of the range of other projections by independent economists. (GDP currently runs at £2 trillion a year and disposable income at £33k per household⁴⁶, so 1% of GDP is worth £20 billion or £330 per household). Economists for Free Trade, a Brexit-supporting think tank, believe that Brexit will benefit the economy in the long-run, but their economic forecasts have been strongly criticised for using unrealistic assumptions.⁴⁷
- In the long-run it is reasonable to expect overall wages to move in direct proportion to GDP. If GDP falls, but wage rates and productivity remain unchanged, jobs will be lost. Some employers could choose to reduce wages to protect some jobs, or they may accept reduced productivity. For the purposes of simplicity, we ignore these considerations and look at the effect on employment in terms of a jobs-equivalent effect.

⁴⁵ March 2018 Economic and fiscal outlook, [Office of Budget Responsibility](#), 13th March 2018

⁴⁶ ONS, Household disposable income and inequality in the UK: financial year ending 2017; mean household income - £32,676; median household income - £27,310.

⁴⁷ Economists for Free Trade assumptions include: (i) Unilateral abolition of all trade barriers and much EU regulation would boost Britain's trade. (ii) The gravity effect does not apply to UK trade and any fall in trade with the EU will be made up automatically elsewhere. (iii) All price differences are caused by protection through tariffs and non-tariff barriers (not differences in quality or customer requirements). For a critique, see, for example: L. Alan Winters CB, Will eliminating UK tariffs boost UK GDP by 4 percent? Even 'Economists for Free Trade' don't believe it! <https://blogs.sussex.ac.uk/uktpo/2017/04/19/will-eliminating-uk-tariffs-boost-uk-gdp-by-4-percent/>

- There are over 32 million in work in the UK, so a long-run 1% drop in GDP would result in a theoretical long-run drop in employment equivalent to over 320,000 jobs. The number of jobs lost through reduced exports may in practice be lower, because the UK could lose a disproportionate number of higher-value, more productive jobs (for example in manufacturing and financial services).

Applying this method to the Basic WTO option, the results are as follows⁴⁸:

- Total exports drop by 12-13%, which, based on 2017 trade figures of total exports of £600bn would be worth, in round figures, £72bn-£78bn a year.
- The resulting long-run economic impact would be 2.4% to 3.9% of GDP, which translates into a GDP impact of £48bn to £78bn a year.
- A change of 2.4% to 3.9% in employment would be equivalent to a loss of 0.8 to 1.3 million jobs (assuming wages and productivity do not change).
- Average disposable household income for 2017 was £33k, so a 2.4 to 3.9% drop in GDP would translate, in round terms, to a drop of £800 to £1300 in average disposable household income.

Table 8 summarises the long-run impacts of the Brexit options on trade. The analysis excludes the costs to the public finances of new customs procedures and systems, new regulatory agencies, extra civil servants and so on.

Given the flexibility of the UK labour market, the employment loss is likely to be at the lower end of the ranges. However, there would be a consequential reduction in real wages (as the labour market adjusts) so households would be squeezed in a different way.

Table 8 Long-run impact of Brexit options on trade relative to EU membership					
	Basic WTO	FTA	Sectoral*	Chequers	EEA
Qualitative features					
Tariffs	High	Low	Low	None	Low
Customs barriers	High	Medium	Medium	Low	Medium
Regulatory barriers	High	High	Medium**	Medium**	Low
Quantitative impact					
Exports to EU	-59 to -65%	-44 to -52%	-34 to -46%	-40%	-23 to -39%
All trade	-24 to -26%	-18 to -22%	-15 to -19%	-17%	-11 to -16%
Fall in exports	-12 to -13%	-9 to -11%	-7 to -10%	-8%	-5 to -8%
GDP effect	-2.4 to -3.9%	-1.8 to -3.3%	-1.4 to -3%	-1.6 to -2.4%	-1 to -2.4%
Employment effect	-0.8 to -1.3m	-0.6 to -1.1m	-0.4 to -0.9m	-0.5 to -0.8m	-0.3 to -0.8m

* Quantitative impacts interpolated between an FTA and EEA **Low for goods, high for services.

⁴⁸ The trade impacts are based on three NIESR publications: The Long-Term Economic Impact of Leaving the EU Monique Ebell and James Warren, May 2016,

<https://www.niesr.ac.uk/sites/default/files/publications/National%20Institute%20Economic%20Review-2016-Ebell-121-38.pdf>

How much would a 'White Paper Brexit' cost the UK economy? August 2018

<https://www.niesr.ac.uk/blog/how-much-would-'white-paper-brexit'-cost-uk-economy>

Assessing the impact of trade agreements on trade, Monique Ebell, November 2016

<https://www.niesr.ac.uk/publications/assessing-impact-trade-agreements-trade>

In the EEA option, the UK exits the EU Customs Union. This affects trade in goods, particularly in relation to integrated supply chains. There is then a knock-on effect to the services trade associated with goods trade. An FTA would lead to similar effects, but UK services trade would suffer more under an FTA (even a CETA) than under an EEA arrangement. (The wide range of estimates for the EEA option is due to the small number of countries on which the trade effects are based (the EEA-EFTA countries), which increases uncertainty).

The Brexit option that would minimise trade damage would be an EEA arrangement (with the four freedoms) combined with a customs arrangement. This would also avoid the need for physical infrastructure at the Irish border.

It is important to note that the overall impact of Brexit on the economy would be greater than the trade impacts shown in Table 8. The overall impact would include additional Brexit effects, particularly: reduced migration, lower productivity and reduced foreign investment. These additional factors would increase the fall in GDP and amplify the employment effect.

Including these factors, the Government's analysis⁴⁹ of a range of forecasts cited an average, mid-range GDP loss of 1.6% for an EEA-style agreement and 4.8% for an FTA-style agreement. Other studies show an average long-run loss of 7.7% GDP for the WTO option. The estimated employment effects on a simple pro-rata basis would be 0.5 million (EEA), 1.5 million (FTA) and 2.5 million (WTO). For the reasons discussed above, long-run job losses may be lower than these indicative figures.

Sectors and regions

The big picture impacts of Brexit on the economy are potentially devastating. However, it is hard to imagine the effects without translating them into sector and local impacts. In this section we summarise the conclusions of several studies that have looked at these effects.

Local Brexit trade impacts depend on the size and type of industry, its reliance on the EU27 for trade, workforce and investment, sector-specific effects of tariff barriers and the complex relationships between different businesses (for example between those that export and those that do not, between manufacturing businesses and their services partners, and so on).

Studies that have assessed regional and sector impacts of Brexit trade barriers, often use different methodologies and Brexit scenarios⁵⁰. Methodologies may consider:

- The proportion of local EU27 export sales to domestic sales
- Regional trade flows
- Foreign investment and EU grants
- Mitigating actions that businesses might take.

⁴⁹ [EU Exit Analysis, Cross-Whitehall Briefing](#), January 2018

⁵⁰ See this report for a useful summary of existing studies: Morris M (2018) *An equal exit? The distributional consequences of leaving the EU*, IPPR. <http://www.ippr.org/research/publications/an-equal-exit>

Sectors

In March 2018, the House of Commons Committee for Exiting the European Union published the Government's cross-Whitehall briefing on EU exit analysis. This included a provisional high-level view on the impact of Brexit on UK industry sectors under three Brexit scenarios (WTO, FTA, EEA). The impact was measured based on the impact on EU27 exports and the resulting drop in each sector's contribution to the economy.

The Government's analysis found Brexit would be damaging under all scenarios for all industry sectors but one. The worst affected would be:

- Chemicals
- Food and drink
- Clothes
- Manufacturing and automotive
- Retail

The analysis found that there could be a potential small upside for agriculture under the FTA option.

A more sophisticated study⁵¹ estimated that 70 percent of the extra costs arising from trade barriers will be incurred by five sectors:

- Financial services
- Automotive
- Agriculture, food and drink
- Consumer goods
- Chemicals and plastics.

For in-depth impact analysis on four sectors please see the House of Commons enquiry into "Brexit and the implications for UK business inquiry"⁵² reports for:

- Automotive
- Processed food and drink
- Aerospace
- Civil nuclear sector

Translating Brexit sectoral impacts into jobs, the University of Birmingham found that 2.5 million UK jobs are at risk due to the trade effects of Brexit. The three sectors with the most jobs at risk are administration and support services (slightly less than 500,000 jobs), wholesale trade (275,000), and legal and accounting services (170,000).⁵³

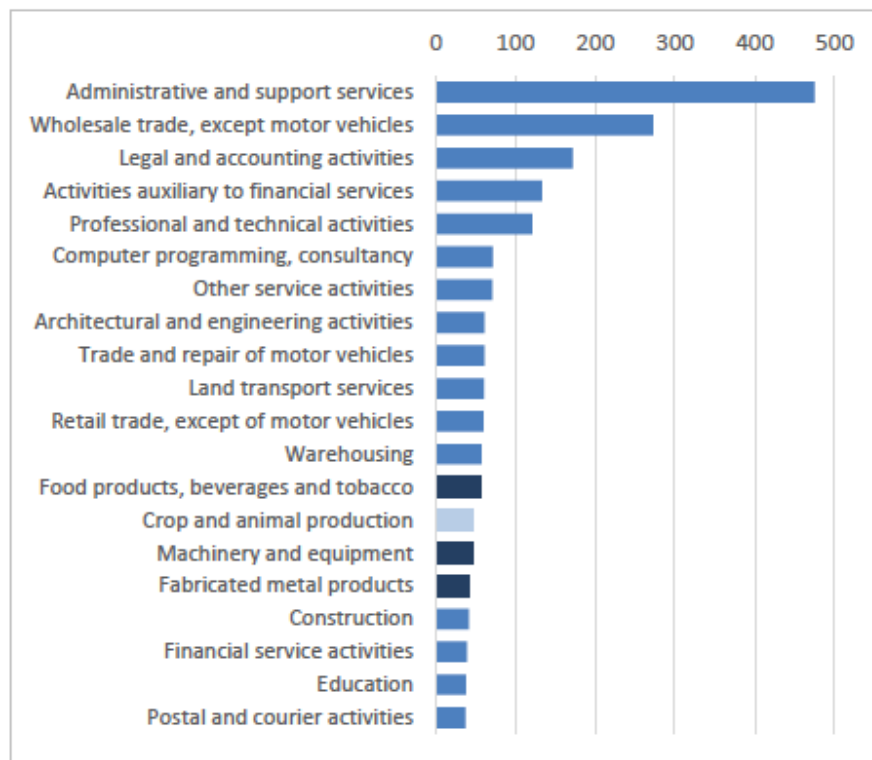
⁵¹ Oliver Wyman and Clifford Chance, The Red Tape Cost of Brexit, March 2018

https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2018/march/Oliver-Wyman_Clifford-Chance-The-Red-Tape-Cost-of-Brexit.pdf

⁵² House of Commons, Brexit and the implications for UK business enquiry

<https://www.parliament.uk/business/committees/committees-a-z/commons-select/business-energy-industrial-strategy/inquiries/parliament-2017/brexit-and-the-implications-for-uk-business-17-19/>

⁵³ University of Birmingham, An Assessment of Brexit Risks for 54 Industries: Most Services Industries are also Exposed, https://blog.bham.ac.uk/cityredi/wp-content/uploads/sites/15/2018/01/City-REDI-Briefing-Template_Sectoral-Analysis.pdf



Source: University of Birmingham⁵⁴

Regions

Country-level export and import figures hide local trade flows in raw materials, parts and components and business services that are typical of integrated supply chains. Fortunately, these local flows can now be assessed using input-output data at regional level⁵⁴.

Most studies suggest that in the long run it is areas outside London and the South East that are most likely to suffer from Brexit. This is mainly because London and the South East have proved more resilient to previous economic shocks than the rest of the country.

Several regions have a high proportion of EU exports, in the most vulnerable goods sectors. Table 9 lists the most exposed regions for four vulnerable goods sectors. These include:

- Northern Ireland and Cornwall (food, live animals and material manufactures)
- Northumberland, the Tees Valley and Durham (chemicals, machinery and transport equipment)
- East Wales (material manufactures, machinery and transport equipment)

The University of Birmingham went a step further and linked regional trade flows to regional labour income⁵⁵. This provides a readily-understandable measure of the risk

⁵⁴ Input-output data describe the sale and purchase relationships between producers and consumers within an economy. They show flows of final and intermediate goods and services defined according to industry or product outputs.

⁵⁵ For a summary article, see <https://theconversation.com/how-brexit-will-hit-different-uk-regions-and-industries-91287>. For more detail, please visit <https://onlinelibrary.wiley.com/doi/full/10.1111/pirs.12334>

of Brexit to local workers and economies. The study found that the Brexit risks to labour income are:

- Greatest in:
 - Cumbria
 - Lancashire
 - Leicestershire
 - Warwickshire
 - East Riding/North Lincolnshire
- High in:
 - Hampshire
 - Herefordshire
 - Gloucestershire
 - Wiltshire
- Lowest in:
 - Highlands and Islands (Northern Scotland)
 - North-eastern Scotland
 - Merseyside
 - London

Table 9 Regions with highest shares of EU exports for four vulnerable goods sectors

Region	Percentage of exports going to EU			
	Food and live animals	Chemicals	Material manufactures	Machinery and transport equipment
Northern Ireland	90%		84%	
Cornwall & Isles of Scilly	90%		69%	
Shropshire and Staffordshire	89%	68%		
Cheshire	86%		69%	
West Wales & Valleys	86%			
Outer London - South		77%		
Northumberland and Tyne & Wear		70%		62%
Lincolnshire		69%		
Tees Valley and Durham		65%		61%
East Wales			77%	84%
East Yorkshire and Northern Lincolnshire			69%	
Bedfordshire and Hertfordshire				70%
North Yorkshire				61%

Case studies – impact of Brexit on SMEs

Please see Appendix E for “*Ready for Brexit*” interviews with directors at three SME companies to see what Brexit means for them.

Opportunities

Are there trade opportunities and benefits to counter the risks and costs of Brexit? The Government has not published an 'opportunity audit' to identify which UK-based industries would benefit from Brexit. Businesses are not, in general, demanding access to untapped global trading opportunities or freedom from regulatory constraints.

Unforeseen trade opportunities would arise from Brexit for some UK-based businesses who would innovate and compete to capture them. These unspecified opportunities would need to be balanced against the inevitable loss of future opportunities from full EU and Single Market membership, and the competitive and global advantages that it brings to the UK.

Trade

There are no specific examples of advantageous trade deals that the UK is seeking, and it is widely recognised that new trade deals will take years to negotiate. The planned roll-over of existing EU deals with third countries is principally an important defensive move to mitigate damage to EU-related trade from Brexit.

The Government's assessment is that the economic impact of UK trade deals with other countries would be small compared to the losses from lower trade with the EU. Preliminary Government analysis shows that a trade deal with the US would benefit GDP by only about 0.2% in the long term⁵⁶.

An early trade deal with the US is unlikely, because it is in the UK's economic interests to prioritise its much bigger relationship with the EU. The US will want to see what is agreed with EU before it committing to a serious deal. They have already expressed the view that, if the UK keeps aligned with the EU, there would be little scope for a UK-US deal. The US authorities are also mandated under US law to include provisions in trade agreements that would be difficult for UK public opinion to accept (for example, on food standards) and which would also be difficult to reconcile with UK commitments in any likely UK-EU FTA.

The Government assesses that trade deals with other non-EU countries and blocs, such as China, India, Australia, the Gulf states and Southeast Asia would add, in total, a further 0.1- 0.4% to GDP.

In most sectors, such as automotive, financial services and medical supplies, the evidence is that the risks of Brexit outweigh the opportunities. The food sector is often identified as a potential area of opportunity. However, when the Lords Select Committee on the European Union examined in detail the opportunities for new trade deals to import cheaper food, it concluded that the opportunities are limited:

"We note that some witnesses, including the Minister, feel opportunities for new trade deals are limited. Given that and given the Government's commitment to ensuring imports meet UK standards, it seems unlikely that imports from outside the EU will have much effect on the price or availability of food."⁵⁷

⁵⁶ [EU Exit Analysis, Cross-Whitehall Briefing](#), January 2018

⁵⁷ European Union Committee, [Brexit: food prices and availability](#), 10 May 2018
<https://publications.parliament.uk/pa/ld201719/ldselect/lddeucom/129/129.pdf>

Regulation

The Government is assessing the opportunities, but it has no immediate ambitions to reduce regulation that affects trade, because the UK wishes to remain aligned with EU rules and standards to facilitate trade (with the EU and third countries), and to maintain high domestic social and environmental standards.

Deregulation may have benefits in terms of increasing competition and stimulating innovation, but it is difficult to achieve. Market rules come as sets of interdependent rules, whose effects interact. For complex rulebooks, it is difficult to deregulate in a piecemeal fashion. Major business interests often lobby for deregulation to get rid of specific rules to favour their own lines of business, business models or target markets. Piecemeal deregulation may satisfy a narrow interest but tends to cause incoherence in the rules as a whole.

When it comes to international trade, the UK faces the challenge that it needs to comply with international regulations and standards, the EU included, in order to trade. This means that deregulation could only be achieved by either reaching prior agreements with other countries or by acting unilaterally. Unilateral divergence from international standards would put UK trade at risk but could create some opportunities.

Large-scale deregulation would need to be approached with great care. Botched deregulations in financial services have been the sources of considerable harm to wider society, such as the US savings and loan crisis of the late 1980s and the global financial crisis of 2007/8. And, it is politically difficult (even if you consider it to be right) to deregulate labour market rules, product safety standards, health and safety at work, and environmental standards.

The regulatory challenge for the UK is likely to come from the other direction. In light of the extra red tape for UK trade that we discussed earlier, the UK will want to avoid additional UK regulatory bureaucracy. There are already 90 regulatory bodies in the UK. In addition, there are 34 EU regulatory agencies whose frameworks affect the UK⁵⁸. If the 34 were duplicated in the UK, it would add to the administrative burden on UK-based firms seeking to export.

Diverging from the current EU regulatory regime where it is satisfactory (for example in medicines, chemicals, intellectual property, telecoms, energy and other sectors) would add unnecessary cost, complexity and uncertainty to businesses faced with double regulatory standards (domestic and European). Many sectors would voluntarily follow EU rules, regardless of the domestic rules. The dominant view from industry is to keep things simple and certain by remaining as aligned as closely as possible.

⁵⁸ National Audit Office, A Short Guide to Regulation, September 2017 <https://www.nao.org.uk/wp-content/uploads/2017/09/A-Short-Guide-to-Regulation.pdf>

Appendices

- A Swiss agreements with the EU
- B EU-Canada Comprehensive Economic Trade Agreement
- C UK tariff rates by sector
- D UK top trading partners and sectors
- E SME case studies

A Swiss agreements with the EU

The Swiss-EU contractual framework comprises around 20 main and 100 subsidiary agreements⁵⁹. These fall into two main groups:

- Bilaterals 1 are mainly market-opening agreements which provide Switzerland with extensive access to the EU Single Market. They strengthen the competitiveness of Swiss companies against with their EU28 competitors.
- Bilaterals 2 cover additional economic interests, for example, those of the food industry, the financial centre and the tourism sector. Their main purpose is to extend the existing cooperation to political areas such as asylum, security and the environment.

Bilaterals 1 - 2002	Bilaterals 2 - 2005
1 Free movement of persons: opening of the labour markets	9 Schengen/Dublin: easier travel, improved cooperation in security matters, coordinated asylum policy
2 Technical barriers to trade: easier approval of products	10 Taxation of savings: cross-border taxation of savings income
3 Public procurement: extended access to the European procurement market	11 Fight against fraud: combating crimes such as smuggling
4 Agriculture: easier trade with specific products	12 Processed agricultural products: removal of customs duties and export subsidies for food industry products
5 Overland transport: opening the markets for road and rail transport,	13 Environment: participation in the EU Environment Agency
6 securing the road-to-rail transfer policy	14 Statistics: harmonisation and exchange of statistical data
7 Civil aviation: reciprocal access to the air transport market	15 Media: access to EU subsidies for filmmakers
8 Research: Swiss participation in the EU research framework programmes	16 Education: participation in EU education programmes
	17 Pensions: removal of double taxation

Most of the agreements are contracts in their own right and can be terminated separately at any time. The Bilaterals 1 agreements are an exception. They were

⁵⁹ Bilateral agreements, <https://www.eda.admin.ch/dea/en/home/bilaterale-abkommen.html>

concluded as a package. Termination of one of them automatically results in all ceasing to apply.

Bilateral agreements are based on intergovernmental cooperation, i.e. no sovereignty rights are transferred to a higher instance (such as the EU institutions). Implementation of the agreements is the sole responsibility of the contract partners.

Most agreements require updating in order to adapt to changing regulations. Other agreements are renewed at regular intervals.

In terms of content, the agreements are based on EU law. Some regulate the recognition of the equal status of Swiss and European legislation (e.g. the reciprocal recognition of product regulations) or refer to the applicable EU law. Others deal with cooperation between Switzerland and the EU within the framework of EU agencies and programmes (e.g. in joint research).

In order to preserve the advantages of these contractual rulings (e.g. unrestricted market access), it is sometimes necessary to adapt the agreements to new legal developments. Problems can also arise in certain countries in terms of application. The so-called mixed committees are responsible for questions of this nature. These are bodies made up of representatives from Switzerland and the EU. Most important agreements are monitored and administered by a mixed committee.

B EU-Canada Comprehensive Economic Trade Agreement

The 30 chapters of the EU-Canada Comprehensive Economic Trade Agreement (CETA) give a sense of the scope of a modern trade agreement⁶⁰. The Canadian agreement is over 1400 pages long.

- 1 **General Definitions and Initial Provisions**
- 2 **National Treatment and Market Access for Goods** – includes removal of tariffs for goods
- 3 **Trade Remedies** – reconfirms WTO 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
- 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 govts.
- 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,

⁶⁰ CETA chapter by chapter, European Commission, <http://ec.europa.eu/trade/policy/in-focus/ceta/ceta-chapter-by-chapter/>

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, trademarks, 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**
- 30 **Final Provisions**

Annexes

C UK tariff rates by sector

The table below from the Institute of Fiscal Studies shows tariffs for UK imports of different types of good in 2016⁶¹. Column 2 shows the EU’s most-favoured-nation (‘MFN’) tariffs that the UK importers would pay under WTO rules – overall weighted average: 4.6%.

The MFN tariff is the tariff the EU currently applies to nations that do not have preferential trade agreements. These are the tariffs that the UK is planning to apply to its imports under the WTO option as shown in its proposed schedule of concessions submitted to the WTO. Note that within the categories, sub-categories of good may carry higher or lower tariffs than the category average.

Column 3 shows the effective tariff rates applied by the UK in 2016. The lower rates reflect the benefits of tariff-free EU trade and the trade agreements that the EU has negotiated with other countries.

Type of goods	1	2	3
	Imports	Average tariff	
	£bn	MFN %	Applied %
Live Animals; animal products	9.2	32.2	23.4
Prepared food	22.6	18.4	12.2
Oils and fats	1.3	12.7	9.3
Vegetable products	12.3	11.1	5.6
Footwear	5.5	11.0	8.3
Textiles	23.8	10.7	5.6
Transport equipment	71.8	7.1	3.3
Plastics	16.3	5.5	3.5
Leather products	2.8	4.4	3.1
Ceramics	4.5	4.0	2.8
Arms and ammunition	0.1	2.9	2.0
Base metals	20.2	2.6	1.6
Chemicals	45.7	1.9	1.2
Wood articles	5.0	1.8	1.1
Misc manufactures	14.4	1.7	1.4
Electrical equipment	99.0	1.5	1.0
Optical equipment	14.7	1.0	0.8
Mineral products	31.3	0.7	0.6
Precious metals	52.4	0.2	0.1
Pulp of wood	7.7	0.0	0.0
Works of art	2.8	0.0	0.0
Unknown	8.0	NA	NA
	<u>471.3</u>	4.6	2.8

⁶¹ Institute for Fiscal Studies, The Customs Union, tariff reductions and consumer prices, March 2018
<https://www.ifs.org.uk/uploads/publications/bns/BN225.pdf>

D UK top trade trading partners and sectors

D1 UK top trading partners

UK top 25 trading partners - 2017 trade (exports + imports)					
		Goods	Services	Total	% total EU PTA* status
		£m	£m	£m	trade
1	United States of America	90,594	91,989	182,583	14.5% Suspended
2	Germany	105,857	29,070	134,927	10.7% EU27
3	Netherlands	62,723	23,254	85,977	6.8% EU27
4	France	51,703	29,489	81,192	6.5% EU27
5	China	61,590	5,948	67,538	5.4% Negotiation (investment agreement)
6	Ireland	34,797	21,025	55,822	4.4% EU27
7	Spain	26,803	20,614	47,417	3.8% EU27
8	Belgium	39,538	7,418	46,956	3.7% EU27
9	Italy	28,927	13,952	42,879	3.4% EU27
10	Switzerland	14,407	16,285	30,692	2.4% EFTA
11	Japan	16,186	11,508	27,694	2.2% Pending
12	Norway	22,785	4,651	27,436	2.2% EEA-EFTA
13	Hong Kong	15,638	5,185	20,823	1.7%
14	Sweden	12,309	7,921	20,230	1.6% EU27
15	Poland	15,448	4,222	19,670	1.6% EU27
16	Turkey	15,251	2,913	18,164	1.4% Agreement in place
17	India	12,148	5,676	17,824	1.4% Negotiation (FTA)
18	Canada	11,329	5,863	17,192	1.4% Agreement provisionally applied
19	Australia	7,216	8,825	16,041	1.3% Negotiation (FTA)
20	Singapore	8,493	6,260	14,753	1.2% Pending
21	South Korea	10,865	2,383	13,248	1.1% Agreement in place
22	Denmark	7,522	5,405	12,927	1.0% EU27
23	Russia	8,935	3,507	12,442	1.0% Agreement in place
24	Czech Republic	7,623	1,737	9,360	0.7% EU27
25	South Africa	5,422	3,721	9,143	0.7% Agreement in place
		694,109	338,821	1,032,930	82.1%
	Percent of top 25 trade	67.2%	32.8%		

The top 25 include 9 third countries with EU PTAs accounting for 13.6% of trade (9% excluding EFTA Switzerland and EEA-EFTA Norway). 49 other smaller UK trading partners listed in the Pink Book or ONS** have EU PTAs and accounted for 3.4% of trade. EU's negotiations include 12 UK trading partners which account for a further 10.1% of UK trade.

*EU PTA = EU Preferential Trade Agreement
 ** For smaller countries not listed in Pink Book, based on ONS interactive tool for goods and services trade (latest available data is 2016).

D2 UK trade with Europe

UK trade with Europe - 2017				
	Goods	Services	Total	% total
	£m	£m	£m	trade
EU27	423,226	191,754	614,980	48.9%
EFTA	38,060	22,100	60,160	4.8%
Other Europe	18,592	13,121	31,713	2.5%
Europe total	479,878	226,975	706,853	56.2%
Rest of the world	335,312	215,541	550,853	43.8%
World total	815,190	442,516	1,257,706	100.0%

1. Other Europe covers: Gibraltar, Crown Dependencies (Guernsey, Jersey, Isle of Man) Andorra, San Marino, Bosnia & Herzegovina, Vatican City, Faroe Islands, Macedonia and Moldova.
UK trade with 'other Europe' is mainly with the Crown Dependencies and Gibraltar.

2. UK GDP in 2017 was £2,004 billion (ONS). Trade to GDP ratio = 63%.

D3 Services trade by sector

Services trade by sector - 2017						
	Exports	Imports	Trade	% of trade	Surplus/(deficit)	% of surplus
	£m	£m	£m		£m	
Financial services	59,624	15,256	74,880	16.9%	44,368	39.8%
Other business services	80,342	38,735	119,077	26.9%	41,607	37.3%
	139,966	53,991	193,957	43.8%	85,975	77.1%
Insurance & pension	18,329	1,827	20,156	4.6%	16,502	14.8%
Telecoms, computer & information	20,189	11,524	31,713	7.2%	8,665	7.8%
Transportation	30,071	22,056	52,127	11.8%	8,015	7.2%
Intellectual property	16,197	9,349	25,546	5.8%	6,848	6.1%
Manufacturing	2,643	1,201	3,844	0.9%	1,442	1.3%
Maintenance and repair	1,171	530	1,701	0.4%	641	0.6%
Construction	2,178	1,612	3,790	0.9%	566	0.5%
Personal, cultural and recreational	3,807	3,278	7,085	1.6%	529	0.5%
Government	2,697	4,609	7,306	1.7%	(1,912)	-1.7%
Travel	39,791	55,500	95,291	21.5%	(15,709)	-14.1%
Total services	277,039	165,477	442,516	100.0%	111,562	100.0%

D4 Goods trade by sector

Goods trade by sector - 2017						
	Exports	Imports	Trade	% of trade	Surplus/(deficit)	% of deficit
	£m	£m	£m			
Machinery & transport equipment	137,629	180,993	318,622	39.1%	(43,364)	31.5%
Miscellaneous manufactures	47,249	74,151	121,400	14.9%	(26,902)	19.6%
Chemicals	58,451	60,151	118,602	14.5%	(1,700)	1.2%
Material manufactures	31,388	52,298	83,686	10.3%	(20,910)	15.2%
Fuels	29,913	45,474	75,387	9.2%	(15,561)	11.3%
Food & live animals	15,048	38,958	54,006	6.6%	(23,910)	17.4%
Crude materials	7,428	10,300	17,728	2.2%	(2,872)	2.1%
Beverages & tobacco	7,789	8,049	15,838	1.9%	(260)	0.2%
Unspecified goods	3,449	4,398	7,847	1.0%	(949)	0.7%
Animal & vegetable oils & fats	527	1,547	2,074	0.3%	(1,020)	0.7%
Total	338,871	476,319	815,190	100.0%	(137,448)	100.0%

E SME case studies

In this appendix there are three real-life SME case studies, published with the permission of *Ready for Brexit*⁶², relating to CYCL, Penny Hydraulics Group and Rex London.

SME case study 1 – CYCL (London)

Luca Amaduzzi's innovative bicycle safety company CYCL successfully negotiated a deal in the venture capital TV show *Dragons' Den*, but to keep his business on the winning track post-Brexit he is seriously considering relocating it to his native Italy

Can you give us some background on CYCL?

We are a start-up that was set up three years ago. We design innovative bicycle products, such as direction indicators for bicycles. My business partner and I are Italian and we are a very international company with an international workforce, but the company was founded in the UK and based in London. We design in the UK and we manufacture in China.

When did you first notice that Brexit would have an impact on your company?

Immediately after the referendum when the pound to dollar exchange rate dropped massively. We pay our manufacturers in dollars, so that had a huge impact and forced us to raise prices. And it hasn't got any better. The exchange rate now is even worse.

Do you export much to Europe?

Yes. The UK market makes up about 25% of our business and the European market takes up about 60% of our export business. If there is no deal and tariffs are introduced and delays occur at customs we will have to move the stock abroad.

Are you seriously considering relocating?

Yes. We will relocate and open a separate company in the EU to sell from there. If we did move to the EU, Italy would be the country we would be most likely to relocate to. I used to have a company there and I know how the legal system works. I have a temporary company there that I can use if necessary. If we have to, we will move the company to Italy in January and move our stock there too so that we can serve Europe. Europe is a bigger market for us than the UK. Although we are based here and are happy here, the reality is we are considering whether to move so that we can continue to access the European market.

What do you think the UK Government should do to help keep small companies like yours operating here?

They should definitely stay in the Customs Union. Instead of our goods going straight through at the border, goods will have to stop at customs, which will lead to delays and extra paperwork, which is not good for business.

⁶² Ready for Brexit is a private sector organisation that helps businesses understand the challenges and opportunities that Brexit will create. <https://readyforbrexit.co.uk>
<https://readyforbrexit.co.uk/interview-dragons-den-winner-luca-amaduzzi-says-brexit-may-force-him-to-move-his-cycle-safety-company-cycl-abroad/>
<https://readyforbrexit.co.uk/interview-robin-penny-managing-director-of-penny-hydraulics-is-upping-his-stock-in-preparation-for-a-no-deal-brexit/>
<https://readyforbrexit.co.uk/interview-taig-karanjia-rex-london/>

SME case study 2 – Penny Hydraulics Group (Derbyshire)

Robin Penny managing director of Derbyshire-based lifting equipment manufacturer Penny Hydraulics Group says the prospect of a no-deal Brexit has led him to increase his stocks in preparation for border delays

When did you first notice that Brexit would have an impact on your business?

About a month ago when the negotiations got to the point where no deal looks to be a distinct possibility. I think that up until then everybody thought that there was going to be some sort of a deal and that there would at least be a two-year transition period, but it's getting very close to March now and people are placing orders for things, quite a lot of which are on three-month lead times. It's getting to the point where if there is going to be a hard Brexit we need to start overstocking.

How much trade do you do with Europe?

We only export about 15%, but when you look at all the components we use, virtually everything is imported whether it's the steel or the plastic or the fittings, everything comes in from somewhere to start with. We do get a large number of items from the Far East, but I would say that 75% is from Europe or Eastern European, which is going to be affected by any border controls down at Dover and Calais.

What are you doing to prepare for Brexit?

The possibility of there being no deal will cause tremendous hold-ups at the borders. So we are planning to overstock. We are looking at renting extra warehouse space so that we can overstock just to keep our customers serviced. That will probably give us a couple of months grace, by which time hopefully something has happened and goods start to flow again. I can see there being a problem for a month or more down at our borders, where normally stuff comes through without any checks.

So you have had to make a considerable investment in space and extra stock?

Yes, that's what we are doing now. We are also ringing our suppliers to ask what they are doing about it. We are going out to see a supplier in Italy in November to see how they are going to supply stuff to us and what their plan is. We are starting to get a plan together to mitigate the problems because I think now that whatever happens there will be some sort of disruption. Even if there is a two-year conversion point then all we're doing is pushing that back. This could just be a trial run for two years' time, but at some point, there's going to be a problem.

What is the reaction from your European suppliers to Brexit?

They think that it's our problem, so we're going to firmly tell them that it's also their problem. If they can't get stuff here, then we are not going to be buying from them. For stuff coming in from China, there are established routes. There is somewhere to put the containers while they go through customs. That supply route is sorted out, but for stuff coming in from Europe there is no infrastructure, there is nobody to check it, there is nowhere to park the vehicles.

What do you think the Government should be doing to help SMEs through the Brexit process?

There's a lot of information on Government websites about what we should be doing, but none of it is very constructive. There needs to be somewhere to park lorries coming in from Europe and going to Europe and it's just not going to be there. I think that businesses are starting to realise that there is going to be one almighty cock up in March no matter what happens. I am losing any hope that they are going to sort it out and if they do buy two years, we are only putting it off and then there will be an almighty cock up in two years' time.

SME case study 3 – Rex London (London)

Taig Karanjia, chief operations officer of gifting business Rex London is creating a base on mainland Europe to minimise any disruption to his trade with EU nations post-Brexit

Has Brexit had an impact on your business to date?

So far no. We do some trade shows in Paris and Frankfurt, the two biggest ones in Europe, and interestingly just after the referendum, we saw a different reaction from the French and the Germans at those shows. The Germans were acting like we'd lost a relative and were saying we had big problems and were quite concerned about how they were going to trade with us. Whereas the French didn't seem to mind at all and were oblivious to it.

Aside from that, we haven't seen an impact. Our exports have grown in the last year and a half, but that's up until now. We have four trade shows in January and February, three of which are abroad and if things are quite tense and undecided by then I think that's when you might have some severe ramifications, because people are unlikely to want to order thinking 'well am I going to have to be paying tax on this or import duties?'

Have you made any changes to your business in preparation for Brexit?

Yes. We design our products and we have them made in China, so we import everything into the UK from China. Then we export from the UK. Currently, 45% of our turnover is export and the majority of that is direct to Europe. We do export to Japan and Australia as well, but it's Europe – France, Germany, Spain and Belgium – that is our key market. We have no alternative, but to create a base in Europe. Unlike some companies where they might have a handful of products and customs clearance would be quite straight forward, our product range goes to 2,700 lines, all of which will be liable to different types of regulations and will all have commodity codes as well.

As a result of Brexit, we've had to broaden out our options and we've set up a warehouse presence in Holland. We have warehouse space in Venlo and we have another warehouse that is being set up this week just outside of Amsterdam. From the warehouse close to Amsterdam we will sell directly to the Dutch and the Venlo warehouse is for our German business, as it's right next to the border.

We also have a business address in Amsterdam so that we can set up a company very quickly, which will be the next step.

Why have you chosen Holland as your base on the European mainland?

We chose Holland because of its geographical location for distribution throughout Europe. Also, from a point of view of setting up companies, Holland is a good deal easier than somewhere like France where the administration is quite arduous.

We are probably going to hold off until December before we set up the Dutch subsidiary company. At the moment we are setting up the structure so that we have the relationship with two different warehouses, then we have the facility to register our business and we can start that in December once it looks like it's going to be absolutely necessary. We will then have to take larger warehouse space so that we can export our goods into Holland and only go through one set of customs clearances.

Our selling point to our customers is that we deliver within five working days. That is one of the reasons that we do well, and we export very well. Not only do they like our products,

they like that we are quick on delivery. That is a quick supply, particularly if you're a business wanting to sell goods on, knowing when you're going to get a delivery is important to you.

What support would you like to see the Government give to SMEs like yourself to help with the Brexit process?

I don't think that there is anything that they can do because they are bound by their own interests and by much larger businesses. They are much more interested in the huge businesses like the services and the automobile industries than giftware companies. We are one of the many small businesses that fall outside the huge amount of pressure that the larger organisations put on the Government. They don't have the time to deal with or be interested in small businesses.

Do you see anything positive coming out of Brexit?

Not in the industry that we are in. We already export to places like Japan and we're very aware of the different regulations that are required to export to countries around the world.

For example, we sell a packet of four paper straws and they come in four different colours – yellow, orange, purple and red – and we cannot export that to Japan because they don't accept anything with a purple or red dye, which is related to food. There are little things like this which different countries have that mean when you are exporting the product lines like we are it becomes problematic.

For a company like ours a big market is good for us, it's easy to deal with and it's very simple to trade with. The only option for us as a company is to go and have a presence in Europe and trade from Europe, because we can't practically trade into Europe with this many products.

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