IPPR

BRIEFING

ONE STEP REMOVED?

SIX POSSIBLE FUTURES FOR THE UK'S ECONOMIC RELATIONSHIP WITH THE EU

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July 2016

Institute for Public Policy Research

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IDEAS to
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ACKNOWLEDGMENTS

The author would like to thank Josh Goodman, Marley Morris, Phoebe Griffith and Michael Jacobs for their input into this briefing.

Any errors or omissions are my own.

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Citation

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Colebrook C (2016) *One step removed? Six possible futures for the UK's economic relationship with the EU*, IPPR. http://www.ippr.org/publications/a-progressive-brexit

SUMMARY

It seems likely that the government will soon seek to strike a deal with the EU that no longer allows free movement of people. In return, the EU is likely to require that the UK has less access to the single market.

At this point we cannot know precisely what trade-offs between migration policy and market access the UK will actually be able to make – they will depend on a process of diplomatic negotiation between the UK and the EU. However, progressive policymakers and thinkers need to work out which trade-offs they think would be better than others – and they need to do it soon. Only then can they work out what they think the UK's approach to the negotiations should be.

To help policymakers and thinkers to do that, IPPR has produced two briefing papers. This briefing covers possible options for access to the single market; the other (Morris 2016)[1] covers options for the UK's migration policy.

These briefings are of course not unique – other organisations have published similar products. However, we hope these are somewhat broader in scope.

That is not to say that our two briefings are exhaustive, either – for both migration policy and single market access, there are almost infinite spectrums of options – but we have tried to set out what we think are the *key* options.

We assess the implications of each option against two objectives that policymakers may want to satisfy as they negotiate a deal with Europe:

- ensuring that the living standards of all UK citizens continue to rise
- ensuring that the UK ends up with a greater degree of self-determination.

'Self-determination' in this respect could mean either of two things: the ability to control our own trade policy (sign our own free trade agreements and set our own import tariffs); or to set our own laws where they relate to our tradeable activity, the main types being employment law, consumer protection, and environmental protection.

These two objectives are in tension with each other: retaining as much access to the single market as possible would minimise the negative effect on the UK economy of exit from the EU, but would require us to sign up to EU laws which we would have had no role in designing. We do not attempt in this paper to take a view on the option or options we should be pursuing. We have, however, set out IPPR's initial views on the best options in a separate blog.[2]

1 http://www.ippr.org/publications/where-next-for-free-movement
2 http://www.ippr.org/blog/what-new-deal-should-we-strike-with-the-eu

TABLE A.1

Brexit: A summary of the economic options

Model of relationship	Free trade in goods	Free trade in services*	'Passporting'† rights for financial & insurance services	Customs union	Contribution to EU budget	Participation in CAP‡ & CFP**	Participation in other EU-funded programmes (e.g. research)	Adherence to EU legislation
Status quo: EU membership								
Option 1: 'EU minus'								
Option 2: 'Norway'								
Option 3: 'Norway minus'								
Option 4: 'Switzerland'								
Option 5: 'Turkey'								
Option 6: 'Brazil'								

Key	
Retained	
Partially retained	

Note: *'Free trade in services' refers to the ability to sell a service to a citizen or firm in another country without restrictions or artificial costs. The single market for services within the EEA involves harmonisation of consumer protection and employment law, to ensure a level playing field across countries.

†'Passporting' rights mean that firms can be based in one EEA country and sell financial and insurance services across the EEA, without needing to adhere to each individual country's financial regulations. It is a key motivation for US banks choosing to locate their European baseS in the UK.

‡CAP = Common Agricultural Policy

**CFP = Common Fisheries Policy

TABLE A.2

Brexit: the details of the economic options (and their possible implications for migration policy)

Model of relationship	Free trade in goods	Free trade in services	'Passporting' rights for financial & insurance services	Customs union	Contribution to EU budget	Participation in CAP & CFP	Participation in other EU-funded programmes (e.g. research)	Adherence to EU legislation	Possible implications for migration policy
Option 1: 'EU minus'	X	X	X	X	X		X	X	Free movement of labour is likely to be a condition.
	Pros Minimal negative impact on the UK's trading relationships with the 27 EU member states plus Norway, Iceland, Liechtenstein and Switzerland. Remaining within the common trade policy would mean continued benefit from EU free trade agreements (FTAs), including those with Eastern Europe and Africa. Would not require the UK to develop own legislative programme in policy areas currently under EU control, or our own trade policy, so no additional public expenditure would be required to develop the necessary expertise.				***Cons*** The UK would have to continue to impose EU tariffs on imports from outside the EEA, which pushes up UK consumer prices. We would not have the ability to make our own trade deals with third countries if we continued to participate in the common trade policy. We would still be bound by a great deal of EU legislation, without having a hand in designing it. It would be unlikely to result in a significant reduction in the UK's contribution to the EU budget.				
Option 2: 'Norway'	X	X	X		X		X	X	Free movement of labour is likely to be a condition (Norway has free movement).
	Pros Minimal negative impact on our trading relationships, as we would retain free trade in goods and services, and passporting rights, within the EEA. Independent trade policy would mean we could sign new FTAs with third countries – in theory this could mean quicker, more advantageous deals (although this may be unlikely in practice). Control over trade policy would mean that the UK could unilaterally reduce import tariffs, saving UK consumers money. At the same time, remaining within the EEA would mean we would not have to pay tariffs on imports from the EU. Given the focus of EU trade policy on lowering both tariff and non-tariff barriers, there is a good chance that the UK's deal with the EU would result in minimal customs borders without our having to be in the customs union.				***Cons*** HM Treasury has estimated that this level of separation from the EU would mean that the UK economy would be between 3.4 and 4.3 per cent smaller, relative to a scenario of continued EU membership, after 15 years. * UK businesses would face customs borders when selling to the EU, including proof-of-origin rules. UK firms or industries could face 'trade defence measures' imposed by the EU if they were judged to have engaged in anti-competitive trade practices. We would still have to adhere to EU legislation where it impacted on trade with it, without a hand in designing it. We would need to develop expertise in negotiating deep and comprehensive FTAs in order to secure reduced trade and customs barriers with trading partners. It would mean only a small reduction in the UK's contribution to the EU budget.				

Model of relationship	Free trade in goods	Free trade in services	‘Passporting’ rights for financial & insurance services	Customs union	Contribution to EU budget	Participation in CAP & CFP	Participation in other EU-funded programmes (e.g. research)	Adherence to EU legislation	Possible implications for migration policy
Option 3: ‘Norway minus’	X	X	(partial)		X		X	(partial)	Both Norway and Switzerland accept free movement, and this option sits between their levels of single market access. However, we would hope to negotiate some restriction in exchange for this reduction in market access.
	Pros We would have continued free trade in goods and services with the EU. Independent trade policy would mean we could sign new FTAs with third countries – this could mean quicker, more advantageous deals. Control over trade policy would mean that the UK could unilaterally reduce import tariffs, saving UK consumers money. At the same time, remaining within the EEA would mean we would not have to pay tariffs on imports from the EU. Given the focus of EU trade policy on lowering both tariff and non-tariff barriers, there is a good chance that the UK’s deal with the EU would result in minimal customs borders without our having to be in the customs union.				***Cons*** In addition to the ‘cons’ of option 2 (above), the loss of our ability to passport certain financial and insurance services into the EU would have a negative impact on those sectors in the UK.				
Option 4: ‘Switzerland’	X	(partial)	(partial)		X		X	(partial)	Switzerland has free movement, but we would hope to negotiate some restriction in exchange for this reduction in market access.
	Pros Continued free trade in goods (only). Independent trade policy would mean we could sign new FTAs with third countries – this could mean quicker, more advantageous deals. Control over trade policy would mean that the UK could unilaterally reduce import tariffs, saving UK consumers money. At the same time, remaining within the EFTA would mean we would not have to pay tariffs on imports from the EU. Given the focus of EU trade policy on lowering both tariff and non-tariff barriers, there is a good chance that the UK’s deal with the EU would result in minimal customs borders without our having to be in the customs union.Would probably result in a much smaller UK contribution to the EU budget. We could in theory develop a much more bespoke relationship with the EU, and would only have to adhere to the EU legislation that applied to our trade with it.				***Cons*** Losing our current level of access to the single market for services – both free trade and passporting – would hurt our ability to trade services, unless we could quickly agree new bilateral treaties. The Treasury estimates that such an arrangement would leave our economy between 4.6 and 7.8 per cent smaller, relative to a scenario of continued EU membership, after 15 years. UK businesses would face customs borders when selling to the EU, including proof- of- origin rules. UK firms or industries could face ‘trade defence measures’ imposed by the EU if they were judged to have engaged in anti-competitive trade practices. We would still have to adhere to EU legislation where it impacted on trade with it , without a hand in designing it. We would need to develop expertise in negotiating deep and comprehensive FTAs in order to secure reduced trade and customs barriers with trading partners. It would take time to build up this expertise, and time to negotiate the deals themselves.				

Model of relationship	Free trade in goods	Free trade in services	‘Passporting’ rights for financial & insurance services	Customs union	Contribution to EU budget	Participation in CAP & CFP	Participation in other EU-funded programmes (e.g. research)	Adherence to EU legislation	Possible implications for migration policy
Option 5: ‘Turkey’	(partial)			(partial)				(partial)	Free movement is unlikely to be a condition of this level of market access.
	Pros				**Cons**				
	No new customs borders – the UK would continue to trade with the EU without having to meet proof-of-origin rules or other customs requirements. We could in theory develop a much more bespoke relationship with the EU, and would only have to adhere to the EU legislation that applied to our trade with it. We would have an independent trade policy (for services, and for goods not included in the customs union), so could sign our own bilateral deals and set some import tariffs. Under this model we would be unlikely to pay into the EU budget.				As with option 4, we would lose market access for services, including the ability to passport services into the EU – this would hurt our ability to trade services, and worsen our trade balance. With a customs union but not a common trade policy, there would be a risk that whenever the EU signs an FTA with a third country, that country would gain the ability to export goods to the UK duty-free via the EU. We would need to develop expertise in negotiating deep and comprehensive FTAs in order to secure reduced trade and customs barriers with trading partners. It would take time to build up this expertise, and time to negotiate the deals themselves. We would still need to adhere to the EU legislation that applies to our trading relationships with it, without having a say in its design.				
Option 6: ‘Brazil’									Free movement would not be a condition.
	Pros				**Cons**				
	Independent trade policy would mean we could sign new FTAs with third countries – this could mean quicker, more advantageous deals. Control over trade policy would mean that the UK could unilaterally reduce import tariffs. Given the focus of EU trade policy on lowering both tariff and non-tariff barriers, there is a good chance that the UK’s deal with the EU would result in minimal customs borders without our having to be in the customs union. Being outside the customs union would eliminate the risk of third countries avoiding paying UK duties by exporting goods to the UK via the EU (a key risk of option 5). Represents the most significant decoupling of UK and EU legislation. The UK would make no payments to the EU budget.				This option would have the biggest impact on the UK economy as a consequence of reduced access to the single market. The Treasury estimates that it would cause the UK economy to be between 5.4 and 9.5 per cent smaller, relative to a scenario of continued EU membership, after 15 years.* UK firms or industries could face ‘trade defence measures’ imposed by the EU if they were judged to have engaged in anti-competitive trade practices. We would need to develop expertise in negotiating deep and comprehensive FTAs in order to secure reduced trade and customs barriers with trading partners. It would take time to build up this expertise, and time to negotiate the deals themselves. Under the WTO’s ‘most favoured nation’ (MFN) rules, reducing the tariffs that the UK charges on one country’s imports would mean reducing tariffs on imports of those products from *all* World Trade Organization countries to the same degree. This could have a significant impact on domestic producers, particularly in the agricultural sector, If the UK chose not to reduce all third-country tariffs to zero (so that, for example, we have something to bargain with when we enter into trade negotiations), it would mean that we would have to charge tariffs on imports from the EU (again under MFN rules). This would increase costs for UK consumers and firms.				

*Source: HM Treasury (2016)

‘OPTION ZERO’ THE STATUS QUO

While this briefing explores six options for the UK in terms of its future access to the EU single market, there is of course a ‘seventh option’, unlikely as it might be - that of zero change. This section reviews the UK’s trade relationship with the EU as it currently stands, in order to inform the discussions of key options for change the sections that follow.

The UK is currently a member of the single market, which means that it accepts the free movement of goods, services, capital and labour. The ‘single market’ describes a number of elements.

FREE TRADE

The UK is part of a free trade area for goods that encompasses the other 27 EU countries plus Norway, Iceland and Liechtenstein (which together make up the European Economic Area, or **EEA**) and Switzerland (the only member of the European Free Trade Area [**EFTA**] yet to join the EEA or the EU). The UK imposes no tariffs on goods imported from EFTA, and pays no tariffs on goods it exports to EFTA.

The UK is also part of a free trade area for services. A crucial difference between our free trade agreement (FTA) for *services* as part of the single market on the one hand, and that for *goods* on the other, is that the *services* FTA covers only the EEA: Switzerland is excluded.

The integration of services within the EEA extends to ‘passporting’ rights for financial services. This means that UK firms can offer financial and insurance services to any other EEA member without needing to comply with each individual country’s regulations. It is a key reason why non-EEA banks (including those based in the US and Asia) favour the UK as an English-speaking base for their European operations.

CUSTOMS UNION

Free trade agreements define how the countries that are signed up to them trade with each other. A customs union goes a step further: it reduces trade barriers to an even greater extent, by eliminating customs borders (that is, paperwork), and it defines how all member countries trade with the outside world, not just with each other . As an EU member, the UK is part of the EU customs union (**EUCU**), which means:

- no customs duties at internal borders between the UK and EU member states
- the EU negotiates FTAs on behalf of all members, and common customs duties apply to imports from outside the EU

- common rules of origin[3] for products imported from outside the EU, and no obligation to prove the origin of inputs used in products being sold to the rest of the EU
- a common definition of customs value[4] (that is, the way in which that the value of goods is calculated for applying customs duties).

Fewer states are members of the EUCU than of the free trade area – only the 28 EU member states are members of it at present; it is extended to a further three non-EEA countries, but only for some goods.[5] This means that, although EEA countries can, as a rule, trade tariff-free with the EU, the EU can impose 'trade defence instruments' (such as tariffs) on Norway, Iceland and Liechtenstein (and vice versa) for unfair trade practices such as dumping.[6] In practice, however, the EU has only made use of these powers once – it imposed tariffs on Norwegian salmon in 2006.[7]

Proof-of-origin requirements impose a 'non-tariff barrier' (in the form of extra paperwork) on countries outside the EUCU. The customs union requires firms importing into EUCU countries to define the origin, or economic 'nationality', of the goods being sold in order to ensure that they pay the correct tariffs – the EU applies different import tariffs depending on the trade deal it has with the exporting country. Firms within the EUCU do not face this requirement.

ADHERENCE TO EU LEGISLATION

The EU's legislative programme is based on the principles and objectives set out in the EU treaties,[8] and policy objectives are achieved through a mixture of three types of binding legislation: directives, regulations and decisions. The table below explains the differences between them.

The UK has opted out, fully or partially, of some areas of EU policymaking:

- the Schengen agreement, which abolished border controls (along with Ireland)
- economic and monetary union (along with Denmark)
- the Charter of Fundamental Rights of the EU, which allows European courts the power to rule on issues related to the Charter (along with Poland)
- freedom, security and justice, which includes police and criminal justice legislation (along with Denmark and Ireland).

3 The UK has to apply the same customs procedures to imports as does the rest of the EU. This means that once goods are inside the EUCU, they can move without any customs barriers. See https://www.gov.uk/guidance/rules-of-origin

4 http://ec.europa.eu/taxation_customs/customs/customs_duties/declared_goods/index_en.htm

5 Turkey, Andorra and San Marino: http://ec.europa.eu/trade/policy/countries-and-regions/agreements/index_en.htm#_customs-unions

6 http://ec.europa.eu/trade/policy/accessing-markets/trade-defence/

7 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:015:0001:0023:EN:PDF

8 http://europa.eu/scadplus/constitution/objectives_en.htm#OBJECTIVES

TABLE 0.1

Types of binding EU legislation

Type of legislation	How it is applied in national law	Would it automatically continue to apply?	Example
Regulation	Applies in its entirety across the EU once passed. Does not have to be transposed into national law first.	No	Regulation on common rules for imports
Directive	Sets out a goal that all EU countries must achieve. Applies at the member-state level, which means that EU countries must then choose how to change their own domestic laws in order to implement it.	Yes	The Consumer Rights Directive; the EU Emissions Trading System; the VAT Directive*
Decision	Applies to a specific country or individual company rather than to the EU as a whole, and applies immediately, without the need for transposition.	No	Some counter-terrorism work with specific organisations.

Source: EU, no date
*Note: VAT is the only domestic tax currently guided by EU law. The 'common system of VAT' aims to ensure that 'similar goods and services bear the same tax burden'. See http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32006L0112&from=en

Harmonisation of laws across the EU related to tradeable activity – consumer protection, employment law and environmental protection in particular – is a core element of single market access, as it means no firm in one country can undercut those in another by having less regard for their workforce, for the environment, or for the quality of their product. Countries that have a deep economic integration with the EU, such as those within the EEA, must adopt all such EU legislation as a condition of their access to the single market.

CONTRIBUTIONS TO EU BUDGET

The EU undertakes its own public spending, funding programmes across the EU in order to further its objectives. Its expenditure is broken down into five categories.

1. **Smart and inclusive growth:** includes research and innovation grants; employment and social policy; and funding for education and training:
2. **Sustainable growth: natural resources**, including the Common Agricultural Policy (CAP) and the Common Fisheries Policy (CFP)
3. **Security and citizenship:** justice and home affairs; border protection and immigration policy
4. **Global Europe:** covers all external action/ foreign policy interventions)
5. **Administration:** all running costs of the EU institutions, including pensions and schooling.

The EU's expenditure is funded through a combination of revenues from customs duties, and contributions from EU member states which are based on VAT revenues and states' ability to pay (measured by gross national income). The UK's contribution in 2015 amounted to 12.6 per cent of the EU budget, or £12.9 billion (HM Treasury 2015: table 3.A).[9]

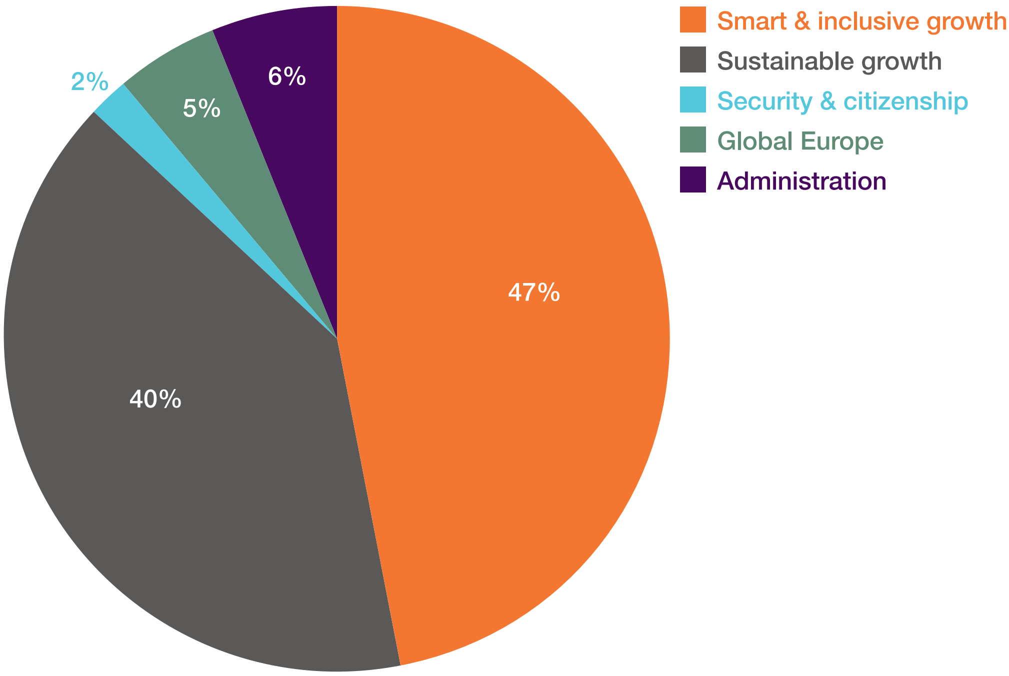
9 Figures for 2015 are estimates.

Overall, the UK is a net contributor to the EU budget – it gets back around 40 per cent of its contribution, through EU spending on programmes in the UK.[10] However, poorer regions *within* the UK are net beneficiaries from EU regional development programmes and the common agricultural policy. The UK is also the third-highest recipient of EU research and innovation funding (Dhingra and Sampson 2016).

FIGURE 0.1

How the EU spends its budget

Payment appropriations by budget heading in the 2015 EU budget



Source: adapted from HM Treasury 2015: 9

FREE MOVEMENT OF CAPITAL

The EU is committed to the free movement of capital (such as foreign direct investment flows, investments in assets such as shares and property, and loans and other transactions between countries). This extends to third countries in all but exceptional circumstances.[11]

FREE MOVEMENT OF LABOUR

Finally, the UK accepts free movement of labour as an EU member. See the concurrent IPPR briefing by Marley Morris (2016) for a detailed discussion of this issue.

10 Net of the rebate, and including EU spending that goes to both the UK public and private sectors (which is an estimate, rather than a precise figure) – for more details see HM Treasury (2015).

11 http://ec.europa.eu/finance/capital/framework/treaty/index_en.htm#excepttreaty

OPTION 1
‘EU MINUS’
EEA-LEVEL FREE TRADE IN GOODS AND SERVICES; CUSTOMS UNION

WHAT DOES IT MEAN?

If the UK, having chosen to leave the EU, were to pursue a trading relationship with the EU that approximated as closely as possible the current arrangements, it might include the following elements.

Free trade

The UK would continue to trade goods and services tariff-free with the EEA. We would also continue to passport financial services.

Customs union

We would remain within the EUCU, which would mean no new customs borders with the EU. Full retention of this arrangement would mean that the UK would continue to contract-out trade negotiations to the EU, and could not sign its own bilateral deals. It would also mean that the UK would continue to implement EU tariffs on all imports.

Adherence to EU legislation

To retain the same level of goods and services market integration with the EU, the UK would, in all likelihood, have to abide by all of the binding legislation that the EU brings into force that applies to its tradeable activity, including that on consumer protection, product market regulation and customs rules. It isn’t clear at this stage exactly what proportion of EU legislation the UK would have to continue to implement but, as an indication, Norway is currently less integrated with the EU than this option would imply, and has incorporated around 75 per cent of all EU legislative acts into domestic law (House of Commons 2013a).

Participation in EU programmes

Countries that are members of the EEA, who have access to the single market, who are not EU members, pay two types of contributions:

- a contribution to economic development programmes, which could be considered a ‘fee’ for single market access
- contributions to the programmes in which they participate.

Norway contributes to reducing economic and social disparity across the EU via the EEA and Norway grant scheme[12], to programmes (such as Horizon 2020 and Erasmus+) in which it participates, and to reflect its cooperation on justice and home affairs policy (including its membership of the Schengen area).[13]

12 http://eeagrants.org/
13 http://www.eu-norway.org/eu/Financial-contribution/#.V3JWB-srLcs

The scale and nature of the UK's contributions to the EU if it chooses to pursue this option for its relationship with the EU is therefore likely to depend on two things:

- the level of involvement it retains in the EU's programmes (which we may or may not continue to play a role in shaping)
- more political considerations regarding the fees that the remaining member states judge is appropriate in return for the UK's continued access to the single market.

Since this level of access to the single market would go beyond that offered to non-EU countries within the EEA, our contribution is likely to be at least as high as that of Norway, Iceland or Liechtenstein.

It is unlikely that the UK would continue to participate in the CAP or CFP upon exiting the EU – no non-EU member states currently do.

Free movement of capital

This aspect of market access is not dependent upon membership of the EU, and would not change upon exit.

Free movement of labour

With complete retention of economic access, we would in all likelihood be required to agree to continued free movement of labour. This is discussed in greater depth in the parallel IPPR briefing by Marley Morris (2016).

IMPLICATIONS OF THIS LEVEL OF ACCESS

For living standards

- This option would ensure that UK businesses could continue to sell goods and services to the EEA, with no new trade barriers impeding their access to the single market.
- It would also have no negative impact on our trade with countries and regions that the EU has trade agreements with, including those in Eastern Europe and Africa.
- Remaining within the common trade policy would mean that the UK remains tied to the EU timetable for agreeing new FTAs, which could – at least in theory – impede our progress in terms of exporting to new markets,[14] but would also mean that there is no need for the UK to develop its own trade negotiating expertise.
- We would still have to apply EU import tariffs (the EU currently imposes a tariff of 12.8 per cent on imports of beef, for example[15]). This imposes costs on UK consumers, and may make UK producers less competitive.
- Our agricultural sector would lose the direct subsidy of the CAP (70 per cent of the £3 billion CAP budget the UK receives goes towards supporting the incomes of farmers[16]), although remaining within the customs union would mean the sector would continue to be protected by the EU import tariff wall. Further, analysis of the

14 http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf

15 https://www.gov.uk/trade-tariff/commodities/0201100010

16 For the size of the UK's CAP Budget: table D7 of this paper see HM Treasury (2015), and for the proportion spent in direct subsidy, see House of Commons (2013b).

CAP data has found that wealthy landowners (including the Royal family) are among the biggest beneficiaries of the policy[17].

- This level of market access is likely to go hand-in-hand with significant payments into the EU budget, without any offsetting transfers to the UK from EU programmes.

For self-determination

- The UK would have to adhere to EU legislation as a condition of our continued access to the single market, without having a say in its development.
- We would remain within the common trade policy, and could not sign our own bilateral FTAs.

17 http://www.newstatesman.com/blogs/politics/2012/09/revealed-how-we-pay-our-richest-landowners-millions-subsidies

OPTION 2
‘THE NORWAY OPTION’
EEA-LEVEL FREE TRADE IN GOODS AND SERVICES; NO CUSTOMS UNION

WHAT WOULD IT MEAN?

If the UK wanted to loosen its ties with the EU further, the next step could be to leave the customs union, and instead establish a relationship with the EU similar to those that Norway, Iceland and Liechtenstein – the remaining members of the EEA – have. This would leave our free trade arrangements for both goods and services unchanged. We would also retain passporting rights for financial and insurance services.

Being outside the customs union would mean we could sign our own FTAs with third countries, and set our own import tariffs (within World Trade Organisation [WTO] rules). Our exporting firms would not pay tariffs when selling to EU countries, since the UK would still be in the EEA, but they would be subject to proof-of-origin rules.

Our contribution to the EU budget probably would not be reduced a great deal under this option. For example, EEA member Norway’s contribution is around £106 per capita, compared with the UK’s contribution of £128 per capita (Dhingra and Sampson 2016) – so clearly, being outside the EU doesn’t save Norway much money in terms of ‘membership fees’.

IMPLICATIONS OF THIS LEVEL OF ACCESS

For living standards

- Exit from the customs union would mean that UK businesses would face customs borders when selling to the EU. This would, in all likelihood, reduce our exports. However, the EU is currently pursuing a trade policy that seeks to lower customs borders as well as tariffs (which are already fairly low globally).[18] This means that we may be able to agree minimal customs borders even while remaining outside of the EUCU.
- We would still be able to passport financial and insurance services into the EEA, meaning our position as a global financial hub would be preserved.
- We could sign new FTAs with third countries. In theory this could mean quicker, more advantageous deals, given that we wouldn’t need to negotiate with 27 other member states as well as the third country. However, just to complete bilateral equivalents for the 50 FTAs that the EU already has would be an extremely lengthy process, let alone the 67 deals it has under negotiation (HM Treasury 2016).

18 See http://ec.europa.eu/trade/policy/countries-and-regions/agreements/index_en.htm

- We would gain the freedom to set our own import tariffs with third countries, while continuing to trade tariff-free with the EEA. Unilaterally lowering import tariffs could have benefits for UK consumers and producers, but it could also hurt our bargaining position as we pursue new FTAs with third countries.
- The EUCU uses trade defence instruments in cases in which it identifies unfair trading practices. This means that, in theory, UK firms or industries could become subject to tariffs from EU members if they were judged to have engaged in such practices. However, as noted above, this has only happened once in recent years.[19]
- Overall, the Treasury estimates that the UK economy would be between 3.4 and 4.3 per cent smaller after 15 years under an arrangement of this sort, relative to a scenario of continued EU membership (HM Treasury 2016).

For self-determination

- We would still have to adhere to EU legislation where it impacted on trade (as noted above, Norway has incorporated around 75% of all EU legislative acts into domestic law) (House of Commons 2013a).
- We would have an independent trade policy.

19 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:015:0001:0023:EN:PDF

OPTION 3
'NORWAY MINUS'

EEA-LEVEL FREE TRADE IN GOODS AND SERVICES; NO CUSTOMS UNION; SOME PASSPORTING

WHAT WOULD IT MEAN?

Members of the EEA, such as Norway, have full passporting rights for services. The UK could offer to accept a more piecemeal approach to agreeing which financial and insurance services we have the ability to passport into the EU, using bilateral treaties as Switzerland has done, while retaining EEA-level free movement of goods and services more broadly. This would put our level of integration somewhere between that of Norway (which has full free movement of goods and services and full passporting) and that of Switzerland (which has only partial access to the single market for services, and some passporting rights, both based on bilateral treaties with the EU).

We would ideally decide on the services for which we retained passporting rights based on:

- their value to the UK economy
- their degree of integration with other activities based in the UK.

IMPLICATIONS OF THIS LEVEL OF ACCESS

For living standards

Under this option we would lose our ability to passport certain financial or insurance services into the EU. Passporting rights are a key incentive for non-EU financial institutions to base their European operations in the UK. We could therefore expect the loss of this ability to have a negative impact on financial market activity in the UK, as it is likely that we would lose some of these activities to alternative bases inside the EEA. This would ultimately lead to lower tax receipts, and a hit to economic growth.

For self-determination

- This option could result in the UK having more control over financial regulation for those services that would no longer be passported.
- We would still have to adhere to all other EU laws related to our tradeable activities, without having a hand in their design.
- We would have an independent trade policy.

OPTION 4
'THE SWITZERLAND OPTION'
EFTA-LEVEL FREE TRADE IN GOODS; PARTIAL FREE TRADE IN SERVICES; SOME PASSPORTING; NO CUSTOMS UNION

WHAT WOULD IT MEAN?

The global liberalisation of trade in services is at an earlier stage than that for goods. While goods market liberalisation is now a 50-year-old project,[20] the first international agreement for trade in services, the General Agreement on Trade in Services (GATS), was only introduced in 1995.[21] The EU is unusually advanced in offering its members – and the wider EEA – free trade in services. The level of integration diminishes significantly for countries outside the EEA, however.

If we were to exit the EEA and join Switzerland in the EFTA, we would face diminished integration of services. We would no longer be able to export all services, or passport financial services, into the EEA without negotiating bilateral agreements and being able to prove that our regulations are equivalent to those of the EU (House of Commons 2011). A trade in services agreement (TiSA) is currently being negotiated between 23 members of the WTO, including the EU and the US, to further open up trade in services, although no end date has been set and it could be years before any deal is concluded.[22]

Under this option we would still, in all likelihood, be required to contribute to the EU budget, although to a lesser degree than the other options discussed above. In per capita terms, Switzerland contributes around 40 per cent of what the UK pays into the EU – £53 per head – in order to gain access to the single market in goods (House of Commons 2013b).

IMPLICATIONS OF THIS LEVEL OF ACCESS

For living standards

- The UK would be outside of the single market for services, which would have a significant impact on a key area of export strength. We have run a services trade surplus with the EU since 2005: UK services exports to the EU have risen by 63 per cent over the last decade, compared with imports growth of 28 per cent (author's calculations using ONS 2016).
- We would lose the ability to passport financial and insurance services into the EEA without signing bilateral agreements. This would prompt at least some firms within the financial and

20 https://www.wto.org/english/tratop_e/serv_e/gats_factfiction2_e.htm
21 http://www.unesco.org/education/studyingabroad/highlights/global_forum/gats_he/basics_gats.shtml
22 http://ec.europa.eu/trade/policy/in-focus/tisa/index_en.htm

insurance sectors to move operations into the EEA in order to continue to trade on the same terms.

- Overall, the Treasury estimates that the UK economy would, under an arrangement of this sort, be between 4.6 and 7.8 per cent smaller after 15 years, relative a scenario of continued EU membership (HM Treasury 2016).

For self-determination

- This means less integration of our services with the EEA relative to option 3, and would mean that the proportion of EU legislation the UK would be obliged to adopt would be smaller.
- As with both the ‘Norway’ and ‘Norway minus’ options (2 and 3 respectively), under this option we would have an independent trade policy, and so could sign bilateral FTAs with third countries.
- We would still have to adhere to all other EU laws related to our tradeable activities, including employment law and consumer and environmental protection, without having a hand in their design.

OPTION 5
'THE TURKEY OPTION'
PARTIAL FREE TRADE IN GOODS AND SERVICES; PARTIAL CUSTOMS UNION

WHAT WOULD IT MEAN?

Turkey is an example of a country with partial access to the EU single market, including membership of the EUCU for most goods.[23] It means that not all goods and very few services are traded freely between Turkey and the EU, and customs borders are not completely eliminated. This means that Turkey faces some 'non-tariff barriers' when selling into the EEA. Turkey has an independent trade policy, and is able to sign its own FTAs, although it must agree to impose EU tariffs on imports.

The UK could adopt such an approach if it exited the EFTA altogether and negotiated a set of bilateral FTAs with the EU.

It is unlikely that the UK would need to make a contribution to the EU budget under this option, although there would be a cost to the public purse in terms of developing the domestic trade negotiating expertise that we would need in order to secure such agreements.

IMPLICATIONS OF THIS LEVEL OF ACCESS

For living standards

- By remaining within the customs union for most goods, the UK would not have to deal with proof-of-origin rules or other customs barriers to trade.
- We could sign FTAs with third countries, potentially speeding up integration with extra-EU markets.We would be able to sell fewer services to the EEA, unless we quickly agreed a series of bilateral agreements, including for the passporting of financial services.
- If our customs union had the same scope as Turkey's, we would have to continue to apply EU tariffs to our goods imports – with the notable exception of non-processed agricultural goods, coal and steel. Conversely, our agricultural, coal and steel sectors would no longer be protected by the EU tariff wall.
- With a customs union but not a common trade policy, any country that signs an FTA with the EU could export goods to the UK duty-free via the EU, while the UK would not have the same rights to export to that country.

23 Non-processed agricultural goods, coal and steel fall outside the customs union. See HM Government (2013): Annex A.

For self-determination

- It would allow a more bespoke approach to our trading relationships with the EU, as we would decide our level of participation through bilateral treaties.
- For the market access we did want to retain, however, we would still have to sign up to EU legislation without having a say in its design, including employment law and consumer and environmental protection.
- The UK would in charge of its own trade policy.

OPTION 6
‘THE BRAZIL OPTION’
WORLD TRADE ORGANISATION (WTO)
TRADING RELATIONSHIP

WHAT WOULD IT MEAN?

If the UK fails to cut a deal with the EU on the nature of its relationship to it within two years of article 50 being invoked, the UK will automatically default to a WTO relationship with the EU.

Crucially, all WTO members must apply ‘most favoured nation’ (MFN) status to all other member countries unless they are already in a trade deal or a customs union with them. This means they apply the same tariffs to goods imports from all member countries, and do not give advantageous treatment to any one trading partner (by offering a reduced tariff, for example). The tariffs that the UK has applied to its exports to other WTO members besides the EU would therefore not go up (or down) under MFN rules. However, the UK would begin paying tariffs on its exports into the EU and, unless we were to set all import tariffs to zero, we would have to start adding import tariffs to our imports from the EU.

This option would require no contribution to the EU budget, although, as with the previous option, the UK would need to build up considerable expertise in trade and other areas of policy that are contracted out to the EU at present.

IMPLICATIONS OF THIS LEVEL OF ACCESS

For living standards

- As discussed above, global trade in services remains much less liberal than trade in goods. There are more trade barriers between WTO members that apply to services than apply to goods, and so the UK would find itself limited in terms the proportion of its tradeable services that it could sell into EU markets.
- We could reduce import tariffs, which would benefit consumers and firms, but would present the same problems as the option 5 (above) for our agricultural sector, which currently benefits from both the EU tariff wall and the CAP. Furthermore, with WTO status we would have to charge the same tariffs on imports from any country that we don’t have an FTA or customs union with. This means that unless we were to set all tariffs to zero, we would face higher prices for our imports from the EEA, which we currently buy tariff-free.
- Once outside the customs union, we would not face the risk of third countries exporting goods to the UK tariff-free via the EU.

- Overall, the Treasury estimates that the UK economy would be between 5.4 and 9.5 per cent smaller after 15 years under an arrangement of this sort, relative to a scenario of continued EU membership (HM Treasury 2016)

For self-determination

- This option offers the most comprehensive decoupling of UK and EU legislation, although the same condition would apply as for the previous options – namely that we would have to align our laws with those of the EU if we wished to increase our economic integration and trade more easily with it.
- The UK would be in charge of its own trade policy.

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