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Brexit: trade aspects

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Summary

The UK's future trading relationship with the EU is a key issue, given that nearly half of the UK's trade is with members of the bloc. So far, the Government has said that it wants to develop "our own British model" and "the best deal for Britain".

At the moment, as a member of the EU, the UK is part of the Single Market. This means no tariffs, customs duties or quotas on trade between Member States. It also means elimination of non-tariff barriers, such as technical specifications and rules on labelling of products. Given that average tariffs are now low, these non-tariffs barriers are considered to be a more important barrier to trade, although tariffs on some individual products are still high. The EU tariff on cars, for example, is around 10%. The Single Market also extends to services although progress here is generally thought to be slower than for goods.

While the Government has said it does not want an off the shelf option, existing trade arrangements provide a starting point for considering what the UK's future trading relationship with the EU might look like. Three options are considered in this note: membership of the European Economic Area (EEA), a free trade agreement (FTA) and trading under World Trade Organization (WTO) rules. All are likely to involve some balancing of a range of factors including terms of access to the Single Market, control of immigration and financial contributions to the EU.

One option would be UK membership of the European Economic Area (EEA). The EEA includes all EU Member States plus Iceland, Liechtenstein and Norway. The EEA option involves considerable (but not complete) access to the Single Market. It also involves contributions to EU spending and free movement of people. Some have suggested this option might be amended in some way for the UK ("EEA minus") or be a temporary stage after the UK leaves the EU.

A free trade agreement between the UK and the EU would be an intermediate option between EEA membership and trading under WTO rules. It is not possible to know with certainty what such a deal would look like as this would depend on the outcome of negotiations between the UK and the EU. While they vary, as a general rule, free trade agreements tend to offer less access to the Single Market but impose fewer obligations. For example, the recent agreement between Canada and the EU gives Canada less good access to the Single Market than the UK currently has as an EU member but Canada will not make contributions to EU spending or be required to accept free movement of people. Other bilateral agreements, such as those between Switzerland and the EU, involve more obligations. Free trade agreements can take a long time to negotiate.

The WTO (World Trade Organization) option would apply in the absence of a negotiated deal with the EU. In this sense it can be thought of as the default option, although some argue for it on its own merits. This would involve access to the Single Market on the least advantageous terms. The UK would still have "access" to the EU market in the same way that any other country without a trade agreement with the EU (such as the US) can export to it. Exports of UK goods to the EU would be subject to the EU's tariffs and vice versa. While tariffs are generally low, they remain high in some sectors. The EU would not be able to set discriminatory tariffs on imports from the UK. There would be less access for the UK to the EU market in services. The WTO option would mean no contribution to EU spending or need to accept free movement of people.

1. Introduction

The UK's trading relationship with the EU post-Brexit is clearly of huge significance given the scale of UK exports to and imports from the EU.

So far, the Government has set out its aims in fairly general terms. For example, on 7 September 2016, in a statement to the House of Commons, the Prime Minister said:

> It is not about the Norway model, the Swiss model or any other country's model—it is about developing our own British model. So we will not take decisions until we are ready, we will not reveal our hand prematurely, and we will not provide a running commentary on every twist and turn of the negotiation.[1]

In a statement to the House of Commons on 5 September 2016, the Secretary of State for Exiting the European Union (Rt Hon David Davis MP) said:

> Naturally, people want to know what Brexit will mean. […] It means getting the best deal for Britain: one that is unique to Britain and not an off-the-shelf solution.[2]

The UK's new trading relationship with the EU is likely to be the product of negotiation. There are a number of existing models of trade between the EU and non-EU countries which provide a starting point for considering how future UK-EU trade relations might work. These existing models can be grouped into three categories:

- membership of the European Economic Area (EEA)[3]
- a free trade agreement between the UK and the EU
- trading under World Trade Organization (WTO) rules.

The EEA option would be the closest to EU membership while the WTO option would be the biggest break. Most economic analyses published before the referendum found that the EEA option would do the least harm to the UK economy with the WTO option having the largest negative impact.

The UK's options are not limited to these three categories. As noted above, the Government has said it does not favour an "off the shelf" model. It is worth pointing out that the UK economy is much larger than any of the non-EU EEA member states or the countries with which the EU has a free trade agreement. It is possible that this may help the UK in its negotiations with the EU. The Treasury Committee has also pointed out that the UK's economic relationship with the EU may be different from these existing models:

> The UK's economic relationship with the EU is unlikely to be identical to that of any other country. As a large European country, the UK will seek, and probably be able to obtain, a unique arrangement. However, the terms of that arrangement

1 HC Deb 7 September 2016 c335
2 HC Deb 5 September 2016 c38
3 The EEA members are the EU Member States, plus Iceland, Norway and Liechtenstein

> would be constrained and conditioned by two forces: the views of other EU Member States and UK domestic opinion.[4]

Variations on existing models have been suggested. For example, Rupert Harrison, former adviser to George Osborne, has suggested "EEA minus". He argues that pure EEA membership is a "non-starter" given the outcome of the referendum. EEA minus would entail some concessions to get a bit more control over immigration.[5]

The renegotiation of the UK's trading relationship with the EU will require a number of considerations to be balanced. These include access to the Single Market, free movement of people, contributions to the EU budget, the extent to which the UK needs to adopt EU rules and the extent of UK influence over those rules. The EU has said that access to the Single Market depends on accepting all four freedoms – including free movement of labour. It has said that "there will be no single market 'a la carte.'"[6]

This paper aims to set out some of the possible options for future UK-EU trade. Section 2 describes how UK-EU trade works at the moment and provides some statistics on its scale. Section 3 then describes three possible scenarios for the post-Brexit relationship: EEA, WTO and a free trade agreement between the UK and EU.

There are a number of important issues not discussed in this paper. It does not examine the process by which trade negotiations between the UK and the EU will take place. The issue of the UK's capacity and expertise to undertake trade negotiations, given that these have been done at EU level for over 40 years, is not discussed. Finally, the important question of the UK's future trade relations with countries outside the EU is not covered.

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4 Treasury Committee, The economic and financial costs and benefits of the UK's EU membership, HC122, 27 May 2016, para 140

5 Rupert Harrison, We now need a proper roadmap to quell corrosive uncertainty, Financial Times, 27 June 2016

6 Remarks by President Donald Tusk after the informal meeting of 27 EU heads of state or government, 29 June 2016

2. Background

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

The EU forms a Single Market with no tariffs or quotas on trade in goods between its members. The Single Market also removes non-tariffs barriers to trade, such as technical specifications and labelling requirements. As tariffs have fallen, non-tariff measures have become more significant as a barrier to trade. A recent estimate suggested that non-tariff barriers could be equivalent to a tariff of 20%. This is much higher than the average actual tariff of around 3%.[7]

The Single Market also extends to trade in services but it is generally thought that progress towards a Single Market in services lags behind that in goods.

The EU Member States also form a customs union with a common tariff applied to goods entering from outside the EU. Member States cannot operate independent trade policies, for instance by pursuing bilateral free trade agreements with non-EU countries. Instead, external trade relationships are co-ordinated at EU level through the Common Commercial Policy (CCP). The European Commission acts as the negotiator in multilateral and bilateral trade talks, with the Council and European Parliament making certain formal decisions regarding the commencement and mandate for the negotiations, and approving their final result. The EU recently completed a trade negotiation with Canada (although this agreement has still to be ratified).

David Cameron made clear in his statement on the outcome of the EU referendum that there would be no immediate change to these arrangements:

> Let me stress that nothing changes in the UK's trading relations with Europe until we actually leave the European Union[8]

He also said:

> The true position is that as long as we are in this organisation—until we exit—all the rules about trade, services, financial passports and access to markets do not change.[9]

7 Steve Woolcock, Playing the game without a say in the rules: how Britain would trade outside the EU, LSE Brexit blog, 24 May 2016
8 HC Deb 27 June 2016 c32
9 HC Deb 27 June 2016 c38-9

Box 1: Customs unions, free trade agreements and the Single Market

Customs union

The EU is a customs union: there is free trade between Member States and a common external tariff on imports from countries outside the EU. In other words, goods coming into the union pay the same tariff irrespective of which Member State they are imported into. The common external tariff allows trade between members of the customs union to take place more easily by removing costly, complex and time-consuming customs controls on trade between its members.[10] Members of a customs union cannot pursue their own individual trade policies. Turkey is in a customs union with the EU but is not a member of the EU.

Single Market

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

There are no customs duties, tariffs or quotas on trade in goods between Member States. The Single Market also aims to create a level playing field by removing non-tariff barriers such as regulations (for example on packaging, labelling or documentation) or technical specifications. As tariffs have generally fallen over time, non-tariff barriers have become relatively more important as obstacles to trade. The Single Market in goods is generally thought to be more developed than the Single Market in services.

Members of the European Economic Area have considerable access to the Single Market. As they are outside the customs union, however, their imports into the EU are subject to customs checks. EEA members are able to negotiate their own trade deals with non-EU countries (there is more on the EEA in Section 3.2 below).

Free trade agreements

A free trade agreement (FTA) is an agreement between countries to reduce barriers to trade between them. FTAs have generally concentrated on trade in goods with less liberalisation of trade in services. Free trade agreements generally do not go as far in removing barriers to trade as the Single Market.[11] A free trade agreement differs from a customs union in not requiring its members to set the same tariffs on trade with countries outside the agreement.

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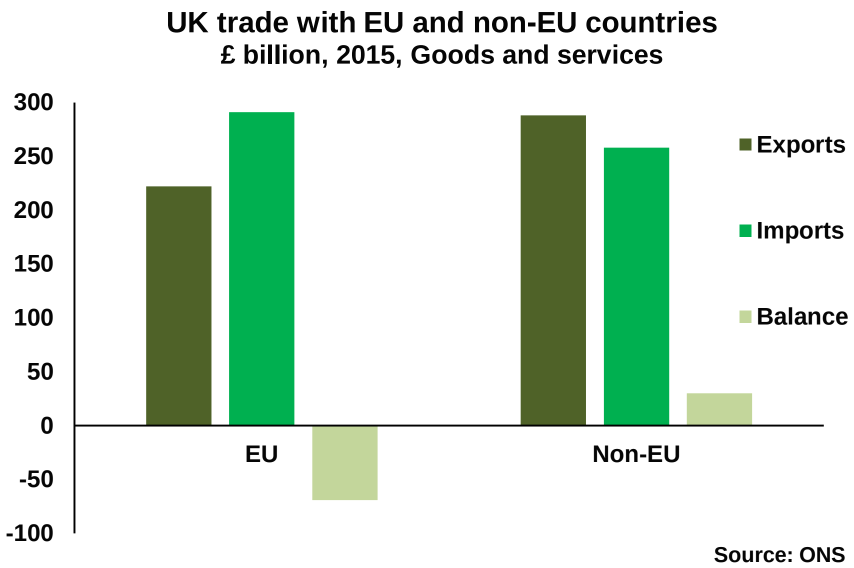
[10] HM Government, Alternatives to membership: possible models for the United Kingdom outside the European Union, March 2016, p25

[11] IFS, The EU Single Market: The Value of Membership versus Access to the UK, August 2016, p12

2.2 Statistics on UK-EU trade

Trade with the EU as a whole

Taken as a group, the EU is by far the UK's most important trading partner. In 2015 it accounted for 44% of UK goods and services exports (£222 billion) and 53% of UK imports (£291 billion). These figures are shown in the chart and table below.[12]



UK trade with EU and non-EU countries 2015
Goods and services

	Exports		Imports		Balance
	£ billion	%	£ billion	%	£ billion
EU	222	44%	291	53%	-69
Non-EU	288	56%	258	47%	+30
Total	510	100%	549	100%	-39

Source: ONS Balance of Payments Stat Bulletin, 30 Jun 2016, Tables B & C

These estimates take no account of the "Rotterdam effect". This is the argument that UK trade with the EU is overstated by these figures. The UK does a large amount of trade with the Netherlands, some of which may ultimately be with countries outside the EU but be recorded as EU trade. There are no official estimates of how big this effect might be and, even making allowance for it, the EU is still the UK's largest trading partner by a large margin.[13]

The UK imports more from the EU than it exports to it. In 2015, the UK's deficit on trade in goods and services with the EU was £69 billion while the surplus with non-EU countries was £30 billion. The chart below shows the UK balance of trade since 1999 with EU and non-EU countries.

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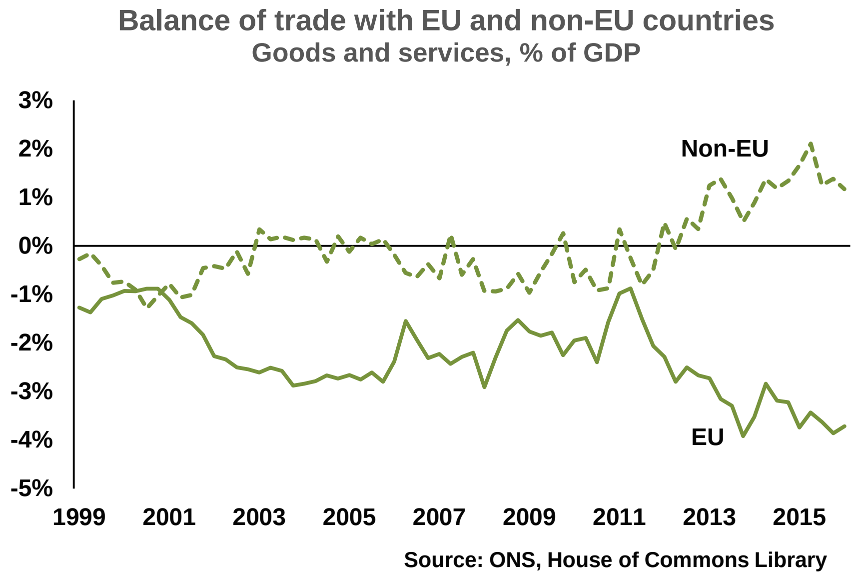
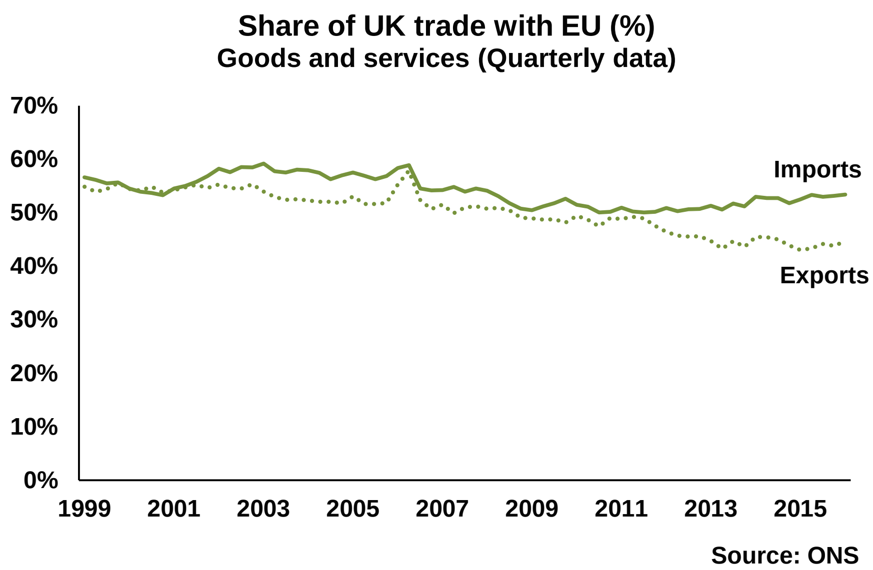
12 ONS Statistical Bulletin, Balance of Payments Jan to Mar 2016, 30 June 2016, Tables B and C

13 There is more information on the Rotterdam effect in another House of Commons Library Briefing Paper: In brief: UK-EU economic relations.

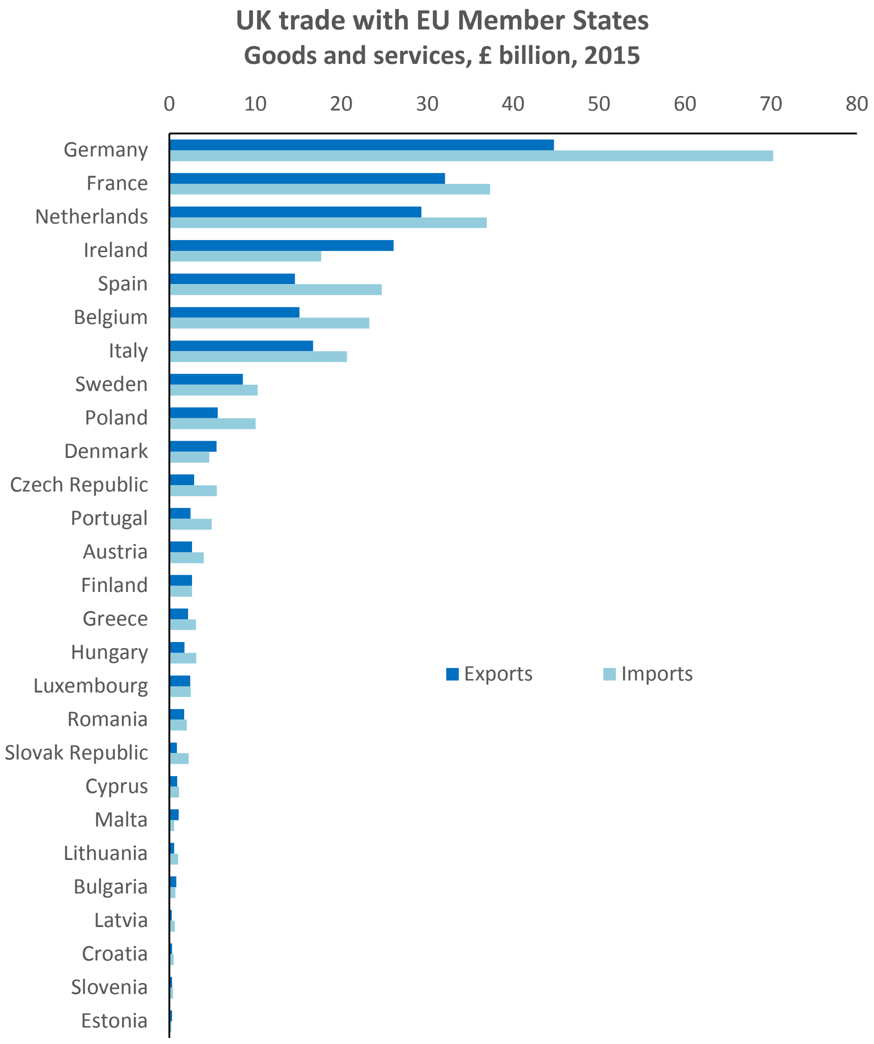


The share of UK exports going to the EU has declined in recent years. In 2002, the EU accounted for 55% of UK exports. This had fallen to 44% by 2015. The share of UK imports from the EU declined from 58% in 2002 to 50% in 2011 before increasing slightly to 53% in 2015.



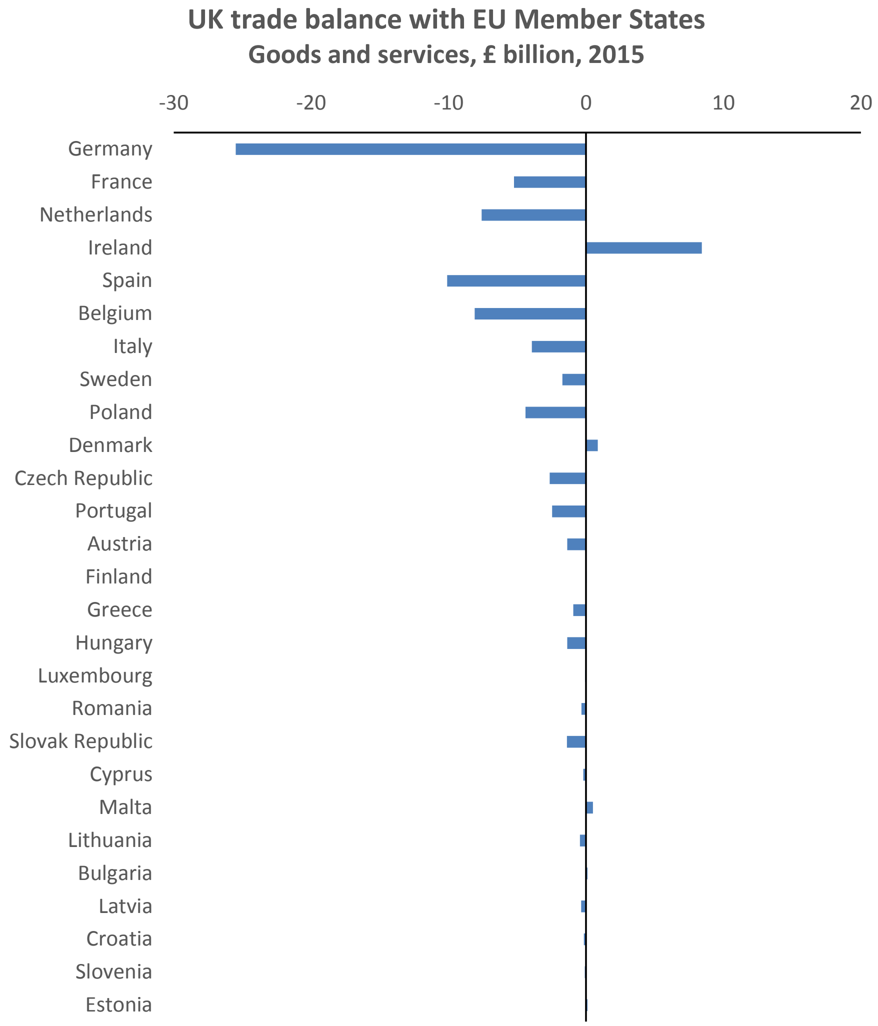
Trade with individual EU Member States

Trade between the UK and each of the other EU Member States is shown in the charts below. The first chart shows that only a few countries account for most of the UK's trade with the EU. The top 5 EU trading partners (Germany, France, the Netherlands, Ireland and Spain) account for two third of the UK's trade with the EU.



Source: ONS Pink Book 2016, Table 9.3

The chart below show the UK trade balance with each Member State. In 2015, the UK had a surplus with 5 countries, a deficit with 21 and was broadly in balance with one country (defined as a deficit or surplus of less than £50 million). The largest deficit was with Germany (£25 billion) and the largest surplus was with Ireland (£8 billion).



Source: ONS Pink Book 2016, Table 9.3

3. Possible models for UK-EU trade

3.1 WTO option

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

Tariff barriers

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

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

In practice, this would prevent discriminatory or punitive tariffs being levied by either the EU on the UK, or vice versa. The maximum tariff would be that applied to the MFN. The EU's MFN tariffs have generally fallen over time, meaning that in this particular context the 'advantage' of membership has declined. In 2013, the EU's trade weighted average MFN tariff was 2.3% for non-agricultural products.[14] This is an average figure: tariffs on some individual products are much higher, however, especially on agricultural goods. The EU tariff on cars, for example, is 10%. The average EU tariff on sugars and confectionery is nearly 30% and on beverages and tobacco over 20%.[15]

This would mean many UK exporters becoming less price competitive, to varying degrees, than their counterparts operating within the remaining EU, and those within countries with which the EU has preferential trading relationships. However, given that the average tariff is low, any loss of competiveness might well be offset in many cases by the depreciation of the pound which has occurred since the referendum.

The UK would also need to decide the level of tariffs on imports into the UK. Under WTO rules, the UK would not be able to discriminate between imports from different countries. At the moment, it is not clear

[14] World Trade Organization, WTO Tariff Profiles 2015, p75
[15] HM Government, Alternatives to membership: possible models for the United Kingdom outside the European Union, March 2016, p36, based on WTO data

whether the UK could simply "inherit" the EU tariff and apply these to UK imports (including those from the EU). [16] Setting the level of tariffs would involve a trade-off between lower prices for domestic consumers on the one hand, and bargaining power in future trade negotiations on the other. Setting relatively high tariffs would increase prices for consumers but give a bargaining chip in future negotiations. Eliminating or setting low tariffs would tend to reduce prices, but give trading partners little incentive to reduce their tariffs in any future negotiations.

Non-tariff barriers

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

Just as important in a trade context, however, are the standards required of products imported from outside the EU. All UK businesses must comply with these standards already but withdrawal from the EU raises the prospect of (possibly costly) divergences between the UK and EU product standards. On the other hand, some proponents of withdrawal argue that leaving the EU means only exporters to the EU would have to be bound by the EU's product standards, leaving other businesses free to operate under a UK regime.

Services trade

Without further negotiation, the UK's trade in services with the EU would be governed by the WTO General Agreement on Trade in Services (GATS). Under this agreement, EU Member States (and other parties to the agreement) have chosen which sectors they are prepared to liberalise, and the time scale over which they wish to do so. As with trade in goods, GATS also operates on the principle of non-discrimination, meaning broadly that outside preferential agreements, restrictions on market access must be applied uniformly across all countries.

Barriers to services trade are usually in the form of non-tariff barriers, such as domestic laws and regulations, also known as 'behind the border' measures. In general, services markets are more highly regulated than the market for goods. Often, regulation is intended to meet social objectives, or to correct failures in supply, rather than directly to restrict foreign suppliers, but the effect on market access for foreign companies can in some cases be highly restrictive. EU Member States retain considerable national discretion over services regulation and supervision. Just as a fully level playing field in services trade does not exist within the EU, so exporters from outside the EU face different levels of market access in individual Member States. However, the level of market access would generally be far more limited for UK exporters under a GATS arrangement than it is currently.

[16] "Brexit: Silence from leave camp leaves options in the air", Financial Times, 27 June 2016

As well as affecting cross-border trade in services, these restrictions could also have implications for UK companies providing services through a commercial presence (effectively outward direct investment) in other Member States.[17] The EU Treaties require that a service provider from one Member State be legally free to establish in another, while continuing to be regulated by the authorities of its home country. A UK company that provides services through establishments in other Member States may find, when the UK is no longer a member of the EU, that it has to comply with the requirements of a foreign regulatory authority.

Obligations under WTO option

The WTO option would impose the fewest obligations on the UK. There is no requirement to implement EU legislation although UK businesses would still have to comply with EU rules to in order to export to the Single Market. Under the WTO option, there would be no obligation to accept free movement of people or make a contribution to EU spending. The WTO option would give the UK no say over EU decisions.[18]

How easy would it be to negotiate the WTO option?

Before the referendum, Roberto Azevedo, the Director-General of the WTO, warned that the UK would face "tortuous negotiations" over the terms of its WTO membership. He said "pretty much all of the UK's trade [with the world] would somehow have to be negotiated". The UK joined the WTO as a member of the EU. Mr Azevedo said the UK would not be allowed simply to cut and paste those terms. The WTO has never been through this kind of negotiation with an existing member and even the procedures for doing so are unclear.[19]

The Government's paper on the process for leaving the EU, published before the referendum, also said that even the WTO route might not be quick or easy:

> In the event that we leave the EU, we would need to update the terms of our WTO membership where the commitments taken have previously applied to the EU as a whole. This would not be a straightforward process as, if we leave the EU, then we would need all other WTO Members to agree how the UK will take on the rights and obligations which we have formerly taken as a part of the EU. This would mean negotiating and agreeing updated UK schedules of commitments with all 161 WTO members. And until our schedule of commitments was updated, there could be questions surrounding our rights to access WTO members' markets, and our ability to enforce those rights.[20]

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17 This is recognised as a form of services 'trade' under GATS, but is not measured in trade statistics, which are intended to record *cross-border* trade.

18 HM Government, Alternatives to membership; possible models for the United Kingdom outside the European Union, March 2016, paras 3.70-71

19 WTO warns on tortuous Brexit trade talks, Financial Times, 25 May 2016

20 HM Government, The process for withdrawing from the European Union, Cm 9216, February 2016, p15

An article in the Financial Times set out some of the issues involved in negotiating the WTO option. This concluded that "the legal processes and paperwork are likely to take years".[21]

Commenting on some of the issues involved for the UK in attaining WTO membership in its own right, Charles Grant of the Centre for European Reform said:

> The fourth deal that May needs to strike is attaining full WTO membership. Britain is currently a member via the EU. Full members must deposit 'schedules' of tariffs, quotas, subsidies and other concessions on market access with the WTO. The UK will have to negotiate its own schedules, initially with the other 27. The tariff negotiation could be simple, if the British followed what the EU currently does. But dividing up quotas, on say New Zealand lamb imports, would be more complicated. And then the new British schedules would need the approval of all 163 WTO members, since the organisation's decisions require consensus. So if one member (for example, Argentina or Russia) wanted to create difficulties, it could block the British schedules. British officials hope that such difficulties do not arise, but reckon that it will be hard work to sort out WTO membership within the two years of the Article 50 negotiation.[22]

Andrew Tyrie MP, chairman of the Treasury Select Committee, has described the WTO option as "a back-stop, were negotiations to go disastrously awry" and argued that reliance on WTO rules alone "doesn't appear to provide a desirable blueprint for the UK's economic relationship with the EU in the early years after Brexit."[23] Others, however, appear to be more in favour of this option. Writing in the Financial Times Lord Lawson, the former chancellor of the exchequer, referred to a "futile and wholly misguided attempt to secure a trade agreement with the EU."[24]

3.2 The "Norwegian option": the EEA

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

The European Economic Area (EEA) is made up of the EU Member States plus three other countries: Norway, Iceland and Liechenstein.[25] EEA membership gives access to the Single Market with some exceptions in agriculture and fisheries. The non-EU EEA countries are outside the EU customs union so can set their own trade policies with countries outside the EEA.

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[21] "Brexit: Britain's WTO challenge looms", Financial Times, 12 July 2016. See also, Peter Ungphakorn, Nothing simple about UK regaining WTO status post-Brexit, 27 June 2016

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

[23] Andrew Tyrie MP, Giving meaning to Brexit, Open Europe Briefing 09/16, September 2016, p4

[24] Lord Lawson, "Brexit gives us a chance to finish the Thatcher revolution", Financial Times, 2 September 2016

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

Signed in 1992 and operational from 1994, the EEA Agreement extends the EU Single Market and free movement of goods, services, people and capital, together with laws in areas such as competition policy, state aid, consumer protection and environmental policy to include Norway, Iceland and Liechtenstein. In addition, the EEA Agreement covers cooperation in policies such as research and technological development, education, training and youth, employment, tourism, culture, civil protection, enterprise, entrepreneurship and small and medium-sized enterprises.

The Agreement does not cover the following EU policies:

- Common Agriculture and Fisheries Policies (CAP and CFP, although the Agreement contains provisions on various aspects of trade in agricultural and fish products);
- Customs Union;
- Common Trade Policy;
- Common Foreign and Security Policy;
- Justice and Home Affairs (even though the EFTA[26] countries are part of the Schengen area);
- Direct and Indirect taxation; or
- Monetary Union (EMU).[27]

EEA members do not benefit from the EU's trade agreements with other countries. If it were to adopt this model, the UK would be able to negotiate its own free trade deals with other countries. Most of Norway's free trade agreements have been negotiated through EFTA although it does have bilateral agreements with Greenland and the Faroe Islands.[28] As they are outside the customs union, exports of goods from non-EU EEA members to the EU must comply with potentially costly customs procedures.

EEA members accept free movement of people. The Government's March 2016 report on the alternatives to EU membership noted, however, that there was a right to suspend free movement of people in certain limited circumstances. This could only be done in a reciprocal way, so for example, if Norway used it this would remove the right of Norwegians to move to the EU.[29]

EEA members make a financial contribution to the EU. EEA members must also incorporate much of EU law into their domestic legislation in return for access to the EU market:

> An independent study commissioned by the Norwegian Government in 2012 calculated that, in return for its access to the EU market, Norway has had to incorporate approximately three-quarters of all EU laws into its own domestic legislation.[30]

[26] EFTA is the European Free Trade Association
[27] EFTA website
[28] European Parliament Research Service, Free trade agreements between EFTA and third countries: an overview, April 2016, p1
[29] HM Government, Alternatives to membership: possible models for the United Kingdom outside the European Union, March 2016, para 3.16
[30] HM Government, Alternatives to membership: possible models for the United Kingdom outside the European Union, March 2016, para 3.12

Liechtenstein, Norway and Iceland have no representation in any of the EU institutions and only indirect influence – including the right to be consulted – on EU proposals affecting them. The EFTA website explains how EEA members can influence EU legislation:

> The EEA Agreement does not grant the EEA EFTA States formal access to the decision-making process within the EU institutions. However, the EEA EFTA States can participate in shaping a decision at the early stages of preparing a legislative proposal. The EEA Agreement provides for input from the EEA EFTA side at various stages of the preparation of EEA-relevant legislation:
>
> First, representatives of the EEA EFTA States have the right to participate in expert groups and committees of the European Commission. They participate extensively in the preparatory work of the Commission and should be consulted in the same manner as EU experts. The Commission may seek advice from the EEA EFTA experts by phone or by correspondence, or in meetings. The experts may also be associated with the preparatory work through regular committee meetings.
>
> Second, the EEA EFTA States have the right to submit EEA EFTA comments on upcoming legislation.
>
> While the EEA EFTA States use these opportunities to contribute to the legislative process, they can neither sit nor vote in the European Parliament or the European Council.

More information on this subject may be found in the EFTA Bulletin (2009) on Decision Shaping in the European Economic Area.[31]

On leaving the EU, the UK would no longer be a member of the EEA. It would have to seek to rejoin EFTA and apply to join the EEA.[32] Continued UK membership of the EEA would require the agreement of all EEA members, including Iceland, Liechtenstein and Norway.[33]

Advantages and disadvantages of EEA option

Some commentators have written in favour of this option. For example Wolfgang Münchau, writing in the Financial Times, argued that EEA membership was the most sensible option for the UK. This model had the advantage of existing already so would not need to be invented and would minimise the economic costs of Brexit. He noted that it would mean accepting free movement of people and would entail contributions to the EU budget.[34] A leader in the Economist said the "Norwegian option would do the least damage to the economy."[35] Most studies of the economic impact of Brexit found this option would lead to lower economic losses compared with other options.[36]

Professor Richard G Whitman, writing on the Chatham House website, described the EEA option as "tried and tested" and said "it would also

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31 EFTA website

32 House of Commons Library Briefing Paper, Brexit: how does the Article 50 process work? p33

33 HM Government, Alternatives to membership: possible models for the United Kingdom outside the European Union, March 2016, para 2.4

34 "Brexit: The Norway option is the best available for the UK", Financial Times, 28 June 2016

35 "Adrift" [leader column], The Economist, 2 July 2016

36 IFS, Brexit and the UK's public finances, IFS Report 116, May 2016, p35

ease the UK's crushing political and diplomatic burden of simultaneously seeking to renegotiate its trade relationship with the EU and all its other trade partners."[37]

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

> However, a Norway-style relationship is unlikely to be a viable long-term option for the UK. Firstly, it is a poor fit when set against the Leave side's key arguments during the referendum campaign: restoring full control over UK immigration policy, restoring UK sovereignty over lawmaking including vis-à-vis the European Court of Justice, eliminating the UK's financial contribution to the EU, and reducing the burden of EU legislation on business. Secondly, and perhaps just as importantly, it is unlikely that such an EU-satellite status would satisfy the national self-image of a major G7 economy with deeper trade and foreign policy links across the world, such as the UK.[38]

As EEA members are outside the EU customs union, exports to the EU must comply with customs procedures and Rules of Origin.

Others have questioned whether this model is better than EU membership. For example, writing in the Financial Times, Martin Wolf said "…leaving the EU and seeking to retain current access to the single market, while accepting free movement of labour, would be mad. If the UK were willing to accept all this, it should stay inside the EU, since it would continue to possess a voice in the single market regulations that would affect it."[39]

Rupert Harrison, formerly an advisor to George Osborne, suggested the idea of a "European Economic Area minus" arrangement. This would involve "a bit more immigration control and a bit less single market".[40] Harrison argued that pure EEA membership was probably not an option for the UK, given the result of the referendum but noted that "the devil will be in the detail" of an EEA-minus arrangement.[41]

A temporary EEA option?

It has been suggested that temporary membership of the EEA might be an option for the UK. This would allow the UK to leave the EU while maintaining access to the Single Market. It would also give time for trade arrangements with both the EU and non-EU countries to be worked out. Temporary membership of the EEA would mean accepting free movement of people. Restrictions could only be brought in once the UK's temporary membership of the EEA had finished.[42] Open Europe have pointed that this option, which might not involve formal

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[37] Richard G Whitman, The EEA: a safe harbour in the Brexit storm, Chatham House, 27 June 2016

[38] Open Europe, As the UK searches for a post-Brexit plan, is the EEA a viable option? 4 August 2016

[39] Martin Wolf, "Britain's best hope is to keep Europe waiting", Financial Times, 29 June 2016

[40] https://twitter.com/rbrharrison/status/747027379730653184

[41] Rupert Harrison, "We now need a proper roadmap to quell corrosive uncertainty", Financial Times, 27 June 2016

[42] "The interim European Economic Area option", Financial Times, 25 July 2016. See also Adam Smith Institute, The case for the (interim) EEA option

EEA membership, but an agreement which "mirrors" the substance of the EEA's relations with the EU, could have some problems, such as ensuring it really was temporary and "managing the domestic politics". They argued that these obstacles could be overcome if the UK and EU were able to set out what the eventual final settlement would look like.[43]

3.3 A free trade agreement with the EU

The third option is a free trade agreement (FTA) between the UK and the EU. The EU's relations with Switzerland are governed by a series of bilateral agreements. The EU has recently finished negotiating a trade agreement with Canada (although this has yet to be ratified or implemented).

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

We do not know how keen the rest of EU would be to enter into a FTA with the UK or what the terms of such an agreement might be. A comprehensive economic and trade agreement between the UK and the EU would probably need the agreement of all EU Member States' governments (and some parliaments of EU Member States).[44] The UK is, however, an important market for the rest of the EU. The rest of the EU has a trade surplus with the UK (just under £70 billion in 2015). In 2015, 21 of the other 27 EU member states had a trade surplus with the UK. Germany's surplus was £25 billion. These commercial considerations might lead to pressure for a UK-EU free trade agreement. Also, negotiations would start from a position of close integration between the EU and the UK. The aim of the negotiations would be to loosen this to some extent. As the Treasury Committee note, this is different from most trade negotiations which aim to increase economic co-operation.[45] On the other hand, some EU countries may have domestic political incentives to drive a hard bargain with the UK to disadvantage their own anti-EU parties.

A free trade agreement might take a long time to negotiate. The EU's trade agreement with Canada took seven years to negotiate and has yet to be ratified. A trade agreement with the EU would need to be approved by the European Parliament and might need approval by each

[43] Open Europe, As the UK searches for a post-Brexit plan, is the EEA a viable option? 4 August 2016

[44] Treasury Committee, The economic and financial costs and benefits of the UK's EU membership, HC 122, 27 May 2016, para 141

[45] Treasury Committee, The economic and financial costs and benefits of the UK's EU membership, HC 122, 27 May 2016, para 149

Member State. Also the UK has not negotiated a trade agreement while it has been in the EU. The UK's experience and capacity to negotiate trade deals is likely to be limited at the moment. It is currently recruiting trade experts to deal with this problem. A free trade agreement would mean the UK would be outside the customs union meaning UK exports to the EU would be subject to customs checks and rules of origin.

4. Statistics on UK trade with EU Member States

UK trade with EU Member States, Goods and services, 2015

	Exports		Imports		Trade balance
	£ billion	% of all UK exports	£ billion	% of all UK exports	£ billion
Austria	2.6	0.5%	4.0	0.7%	-1.4
Belgium	15.1	3.0%	23.3	4.2%	-8.1
Bulgaria	0.8	0.2%	0.7	0.1%	0.1
Croatia	0.3	0.1%	0.5	0.1%	-0.2
Cyprus	0.9	0.2%	1.1	0.2%	-0.2
Czech Republic	2.9	0.6%	5.5	1.0%	-2.6
Denmark	5.5	1.1%	4.6	0.8%	0.8
Estonia	0.3	0.1%	0.2	0.0%	0.1
Finland	2.7	0.5%	2.6	0.5%	0.0
France	32.1	6.3%	37.3	6.8%	-5.2
Germany	44.8	8.8%	70.2	12.8%	-25.5
Greece	2.2	0.4%	3.1	0.6%	-0.9
Hungary	1.8	0.3%	3.1	0.6%	-1.4
Ireland	26.1	5.1%	17.7	3.2%	8.4
Italy	16.7	3.3%	20.7	3.8%	-3.9
Latvia	0.3	0.1%	0.6	0.1%	-0.4
Lithuania	0.5	0.1%	1.0	0.2%	-0.5
Luxembourg	2.4	0.5%	2.5	0.5%	-0.1
Malta	1.1	0.2%	0.6	0.1%	0.5
Netherlands	29.3	5.7%	36.9	6.7%	-7.6
Poland	5.6	1.1%	10.0	1.8%	-4.4
Portugal	2.5	0.5%	4.9	0.9%	-2.5
Romania	1.7	0.3%	2.0	0.4%	-0.3
Slovak Republic	0.9	0.2%	2.3	0.4%	-1.4
Slovenia	0.3	0.1%	0.4	0.1%	-0.1
Spain	14.6	2.9%	24.7	4.5%	-10.1
Sweden	8.5	1.7%	10.3	1.9%	-1.7
Total EU28	222.4	43.6%	291.0	53.0%	-68.5

Source: ONS Pink Book 2016, Table 9.3

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