<u>BREXIT CHALLENGE #1</u>

ACCESS TO THE SINGLE MARKET

What is the Single Market?

The European Union is the world's largest borderless marketplace, home to 500 million consumers. The EU started life in 1957 as a Common Market - a free trade area whose members don't charge import tariffs on each other's goods. Today, however, the most important barriers to trade are regulatory. From the mid-1980s, thanks in large part to the leadership of Margaret Thatcher and Lord Cockfield, the EU started to develop a single regulatory system. By 1993 this had evolved into the Single Market.

The Single Market aims to ensure the free movement of goods, capital, services, and people so that trading across the EU is as easy as trading within national borders. To achieve that, common rules and regulations are agreed among members of the EU to allow exporters to sell their products and services to the rest of Europe, and to allow consumers to use them, without having to comply with 28 different regulatory systems.

Why is it important?

Access to this sophisticated trading bloc is extremely valuable to the UK economy. 44% of UK exports in goods and services went to other countries in the Single Market in 2014.

The Single Market allows more trade to take place between the members of the EU than would otherwise be the case. The key innovation is the removal or harmonisation of 'non-tariff barriers'. These range from product and production standards, to licensing requirements, procurement rules, labelling, intellectual property law, environmental standards and employment legislation. The absence of these barriers is the key difference between a free trade area and a Single Market.

Compared to formal tariffs (charges levied on imports), non-tariff barriers are less visible. But they are often far more important, because they govern every aspect of the way that companies operate across borders.

Sometimes these rules make it deliberately difficult for foreign companies to enter the market; sometimes they represent entirely necessary regulation but are nonetheless complicated and expensive for foreign companies to understand and comply with. Even where tariffs are reduced to zero, as they are in many free trade agreements around the world, these hidden obstacles remain.

In the Single Market, these rules are simplified and harmonised by agreement among its members, so that there is a single 'rulebook' for companies to operate from. The idea is "one set of rules in, 28 sets of rules out".

As a member of the EU, the UK has always had a seat at the table for these discussions, and has fought to ensure that the harmonised rules are in the interests of British exporters and the companies that make up their supply chain, while also protecting British consumers and the environment.

In fact, much of the structure of our economy is built upon the non-existence of barriers to the Single Market, with integrated European supply chains and companies locating factories here which mainly export to the continent. This structure has evolved because of the ease of doing business within a barrier-less market. Were we to introduce barriers, the economic incentives to invest here would inevitably diminish.

What has the government said about the Single Market post-Brexit?

Unlike some Leave campaigners who explicitly called for the UK to exit the Single Market, Theresa May and Philip Hammond have said they want to maintain 'access' for British companies while introducing restrictions on the free movement of workers from the continent (one of the key conditions for membership of the Single Market).

So what's the problem?

The key problem is this: if we are no longer members of the EU, "access" to the Single Market comes at a cost.

This cost comes in three forms. First, in order to benefit from free movement of goods, services, and capital, we will also have to accept free movement of people. Second, we will need to make a contribution to the EU budget, as every other member of the Single Market has to. Third, in order to continue to trade freely on the continent, our exporters and their supply chains will have to abide by all of the rules of the Single Market. But crucially, they will have no say over how those rules are written.

The precise way in which free movement and EU budget contributions will impact on the UK is likely to be negotiable to some degree. The fact that we would have to adopt Single Market rules which are made by others is non-negotiable. That is therefore the focus of this paper.

A dramatic loss of sovereignty

Up until now, British diplomats in Brussels have been closely engaged in all the sectoral rule-setting for trade that affects the UK economy (electrical goods, cars, consumer/environmental standards, financial services, etc), while British industry exercised influence over decision-making through Brussels-based lobby groups and professional associations. In addition to our prominent voice in the Council, Britons have also occupied key political and administrative positions in the European Commission and the European Parliament. Once we leave the EU, all of these levers will be lost.

This represents a huge loss of control for a country which is so dependent on trade with the Single Market. It is entirely possible that decisions will be taken by the remaining 27 Member States in future that are not in the interests of the UK. For example, discrimination could take the form of requiring that the UK adapts production processes to European standards where it is disproportionately expensive for us to do so, and where we would previously have fought to secure an opt-out. Or it could take the form of handing privileges to continental competitors who want to see their preferred requirements built into the regulations at the expense of UK businesses.

When that happens, we won't be able to do anything about it: compliance with those rules will be a precondition for our ability to trade freely with the EU.

So the fundamental dilemma faced by the government is how to square the need for untrammelled access to the single market - from the “passport” rights for UK financial services to the technical specifications of mechanical goods - with the promise to “take back control”.

There is no off-the-shelf solution

There are a number of different potential models for our future relationship with the EU, from Norway to Switzerland to Turkey.

While joining Norway and Iceland as a member of the European Economic Area (EEA) would have the advantage of preserving our membership of the single market, neither this nor any of the other models on offer provides an optimal blueprint for the UK. Those countries that have meaningful access to the Single Market have no say over the rules, and at the same time they are required to accept free movement while making financial contributions to the EU budget. Those countries that have greater autonomy have far more limited access to European markets.

The reality is that any Brexit model that retains significant access to the Single Market also involves a loss of sovereignty. There is no example of a significant economy that has both market access and sovereignty, which is what the Leave campaign promised.

We could, of course, attempt to negotiate a bespoke free trade deal that gave us partial access to the Single Market. The Canada agreement might appear to be a precedent here. But that agreement still includes some tariffs for manufactured goods, it excludes many key service sectors, and it still requires Canada to comply with EU rules when exporting to the EU, with no say in how the rules are written. For the UK, where we are so dependent on services and so closely tied to our neighbours on the continent, it is not a satisfactory answer.

Finally, we could accept life outside the Single Market with no privileged access. In that case, all UK products would be subject to import tariffs and to certification to ensure conformity with EU rules. This would be a costly and time-consuming process that would impose significant burdens on British business, especially in relation to complex manufactured products with many component parts (e.g. cars), and on businesses with complex supply chains that criss-cross the UK/EU border.

Which option is best?

The EEA / Norway model is the best of a bad series of options outside the EU, but it remains hugely problematic for UK interests. In addition to having to accept a rulebook written by other countries, Norway is outside the EU’s Customs Union. This allows them to sign their own trade deals with third countries, but it also means that all Norwegian exports to the EU have to pass through strict customs checks that include extensive paperwork to demonstrate that Norwegian products are either made inside the EEA, or that they comply with over 500 product-specific rules. This would mean more form-filling for British exporters.

The questions that need to be answered

1. Will the government be up front about the fact that there is a fundamental trade-off between continued access to the Single Market and sovereignty over the rules?

2. Does the government distinguish between ‘access’ to the Single Market and ‘membership’ of the Single Market? If so, what is the distinction?

3. If the UK ends up formally outside the Single Market, does the government envisage that we will simply attempt to mimic the harmonised rules adopted by the remainder of the EU, in order to facilitate exports to the continent?

4. EU migrants living in the UK contribute more to the economy through their taxes than they ‘take out’ by using public services. The PM has said she wants the Single Market without free movement, yet free movement is a precondition of membership of the Single Market. How much market access is the the government willing to give up in order to secure concessions on immigration?

5. How will the government preserve the vital ‘passporting rights’ that allow UK banks and other businesses to offer their services across Europe from their base in the UK? Does the government accept that loss of 'passporting rights' (allowing banks and other businesses to offer services across Europe from a UK base) would drive business out of the UK?

6. Services make up 78% of the UK economy. From banking to the creative industries to accounting and legal services, the UK has a massive £15bn trade surplus in services with the EU. Services are not, typically, covered in Free Trade Agreements. Does the government agree that it will be essential to retain this lucrative export market, with continued UK participation in the rules that govern it?

7. The European Court of Justice is an essential part of the Single Market, resolving disputes and ensuring the fair application of European law to Member States. How will the government ensure that the UK can continue to benefit from the protection of the ECJ in upholding the law to guarantee our market access once it is no longer a member of the EU? How will the UK persuade the European Commission to bring actions against Member States who block the UK's access to their markets?

8. The UK has a large stake in the completion of the Digital Single Market, the Single Energy Market, further deepening of the Single Services Market and the Single Capital Market. Government research suggests that full liberalisation of all areas where there are significant non-tariff barriers could increase UK GDP by 7%. How will the government maintain the UK's voice and influence in these important negotiations? If it loses its voice, how would this not represent a loss of control?"

9. Many foreign companies that invest in the UK and set up service ‘hubs’ here have done so because of explicit promises by the Government that they would have tariff-free access to the single market within a framework of EU-wide rules. They were told that the UK would defend their interests in the EU. Why should such companies choose to stay here, or to invest in the UK, once we leave the EU?

10. Countries like Norway, Iceland and Switzerland which have access to the Single Market also have to make significant financial contributions to the EU budget. How much would the government be prepared to pay for the privilege of maintaining access to a market which it can no longer shape to its advantage?