

Plaid Cymru: Alternatives to EU Membership

The trade models and what they mean for Wales

Context

- The UK's decision to leave the European Union will change its terms of trade with the other EU27.
- A Government amended Opposition motion was passed on 7 December 2016 agreeing that Article 50 will be triggered by 31 March 2017, and that the UK Government would publish a plan before doing so. So far, little has been offered to the public in terms of the Government's negotiating position.
- Since 24 June 2016 Plaid Cymru has been clear and consistent in its approach to its preferred model for a United Kingdom exiting the EU.
- Our single, overriding concern is to protect Wales's national interests and that means prioritising the economy.
- That means retaining membership of the European Single Market and staying within the Customs Union.
- This paper assesses the possible future trading frameworks the UK Government will have to consider when formulating its plan before invoking Article 50 and explains the thinking behind our position.
- The possible models range from retaining, or renewing our membership of the European Economic Area, retaining membership of the Customs Union with the EU, negotiating a bespoke Free Trade Agreement with the EU or reverting to a trading relationship based solely on World Trade Organisation rules.

Plaid Cymru's position

- Plaid Cymru has been clear and consistent in its approach to its preferred model for a United Kingdom exiting the EU.
- Our single, overriding concern is to protect Wales's national interests and that means prioritising the economy.
- With careful consideration, Plaid Cymru has come to the conclusion that retaining membership of the **European Single Market** and maintaining our membership of the **Customs Union** is the least damaging option for Wales and we urge the UK Government to proceed with EU negotiations in a way that will honour Welsh interests.

1. EEA – Membership of the European Single Market

What is it?

- When exiting the European Union, the UK could join the European Free Trade Area (EFTA) and become a signatory to the European Economic Area Agreement (EEA).
- This model is what is referred to as a 'soft Brexit'. It would allow the UK to have to remain a member of the European Single market. This means the continued freedom of movement for trade, services, investment and labour.
- All countries who sell to the EEA have 'access', it is only through membership that tariff-free trade can be guaranteed.
- It is the least damaging option for the Welsh economy.

Why does it matter?

- 200,000 jobs in Wales are supported by our trade with the Single Market¹. International companies choose to base themselves in Wales because it is seen as a gateway to a lucrative European market.
- Wales exports £5 billion² more worth of goods than it imports, meaning it relies heavily on trade with the EU. If this trading process is hampered through tariff or non-tariff barriers, then Wales could see a decline in businesses willing to invest there.
- The possibility of leaving the Single Market is already causing concern for companies based in Wales:
 - The Federation of German Industry in the UK, which represents German companies in the UK and is based in Gwynedd, has expressed concern about this loss of confidence in the UK market.
 - Airbus employs 6,000 at its Broughton site in Flintshire and could easily move its operations to Europe.³
 - Ford employs 1,800 people in Bridgend and has announced its intention to cut its production of new petrol engines by half.⁴
 - The Chinese company Longhua has abandoned a deal with FieldMaster Tractors in Betws, near Ammanford which promised 40 new jobs because of the uncertainty surrounding future trade with Europe.

Is it an easy process?

- Remaining in the EEA would mean being part of an existing structure for engagement, already enjoyed by Norway, Liechtenstein and Iceland, and which would provide greater certainty for businesses and citizens and is more likely to be negotiated and ratified within the set time period we face.

Are there any downsides?

- Non-EU EEA countries have no formal powers over decision making in any of the EU's institutions.
- Under the EEA agreement there is also limited access to the Single Market for agricultural and fisheries goods and the arrangement excludes the Common Agricultural Policy. In order to pursue this model successfully, careful thought must be given to developing an agricultural policy that will safeguard our farmers.

2. Membership of the EU's Customs Union

What is it?

- Similar to the EU Single Market, the EU Customs Union is a type of free-trade area.
- Within a customs Union two or more countries agree to abolish restrictions on mutual trade. They also agree set up a common system of tariffs and import quotas on goods from countries outside of the customs union – what is known as a 'Common External tariff'.
- Under the EU Customs Union, goods coming into the UK from outside the EU are subject to the Common External Tariff. Goods leaving the UK and going to the EU do not incur the additional tariff costs as the UK is inside the EU Customs Union free-trade area.

¹ http://www.jillevans.net/eu_membership_benefits_and_challenges_for_wales.pdf

² <http://gov.wales/statistics-and-research/welsh-exports/?lang=en>

³ <https://www.ft.com/content/77e6e934-c571-11e6-8f29-9445cac8966f>

⁴ <http://www.bbc.co.uk/news/uk-wales-politics-37295554>

- Goods imported into the Customs Union area would also need to follow 'rules of origin' – the requirement to determine where a product and its parts were produced in order to ensure that the correct import tax is paid.

Why does it matter?

- For many businesses in Wales, being outside the Customs Union would mean tariffs being imposed multiple times, for parts imported from the EU and again for the final products assembled in the UK to be exported to the EU.
- The Japanese Government, in its open letter to the UK and the EU on Brexit, said its first priority was maintenance of the current tariff rates and customs clearance procedures.⁵
- 45 Japanese companies operate in Wales supporting 6,000 jobs⁶. This includes companies such as the automotive industry's Mitsui Components in Ammanford, employing 250 people.
- Manufacturing is worth £9billion to the Welsh economy, putting this at risk would be irresponsible.
- Membership of the EU Customs Union also ensures that businesses are not subject to large amounts of red-tape or 'non-tariff barriers'. This could be as much as 4%-15% of the cost of goods – costs that might even exceed the external tariff that otherwise would be applied.⁷
- Applying 'rules of origin' by exiting the Customs Union could cost 1-1.2% of GDP.⁸
- As the UK has been a member of the EU Customs Union and its forerunners since 1973 all of its free trade deals since then have been negotiated as a bloc. Leaving the Customs Union would mean losing access to the EU's 56 trade deals with other key countries.

Is it an easy process?

- Like the EEA, the Customs Union already exists as a construct and it is made up of EU Member States, and includes the Isle of Man, the Channel Islands and, following the opening of its accession negotiations in 1995, Turkey.

Are there any downsides?

- The main criticism levelled at continued membership of the Customs Union is that a Member State loses its ability to formulate its own external trade policy. This would mean the UK could not pursue free trade agreements with other countries without the support of the EU. However, continued membership of the Customs Union would mean that all of its members would negotiate as a bloc, meaning greater clout in negotiations.

3. Free Trade Agreement

What is it?

- A Free Trade Agreement (FTA) is a bespoke trade agreement between two countries.
- Rather than providing for complete free trade, FTAs provide preferential market access relative to a situation where no agreement already exists. This would mean that there would potentially be lower tariffs than those prescribed by the WTO, but higher than those already offered under Single Market Membership.

Why is it not a preferred model?

⁵ <https://www.ft.com/content/98dd4eb4-729f-11e6-bf48-b372cdb1043a#axzz4JOdSKxA>

⁶ <http://gov.wales/about/cabinet/cabinetstatements/previous-administration/2015/japanvisit/?lang=en>

⁷ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/271784/bis-14-512-trade-and-investment-balance-of-competence-review-project-report.pdf

⁸ <http://openeurope.org.uk/today/blog/post-brexit-leaving-customs-union-no-brainer/>

- A potential FTA deal will not guarantee the levels of free trade enjoyed under EU Single Market nor Customs Union Membership.
- FTAs are complex and slow moving. Before seeking to open formal negotiations, there would need to be a planning phase, with wide and thorough consultation.
- The UK's complex existing relationship with the EU means it is difficult to see any FTA could be reached in time for the UK's exit from the EU. FTAs take years to complete and according to the UK Government's timetable it would need to negotiate the UK's exit from the EU in tandem with an FTA by March 2019 – something most experts agree would be impossible.
- We already know that uncertainty means businesses are pulling out of investing in Wales. The last report of the FSB's UK Small Business Index⁹ showed that for the first time in four years, more businesses were negative than positive about the future. This was the third quarter in a row in which there has been a downturn in confidence. Wales cannot afford the luxury of time.

Is it an easy process?

- No. Even once the UK has decided on a negotiating strategy for an FTA with Europe, the process is long. From the perspective of the EU, recommendations are drafted by the Commission which will then need the mandate of the Council. The Commission then uses this mandate to negotiate with the UK. It is likely that the FTA will be a 'mixed agreement', infringing on areas of EU Member State competence, meaning that the agreement must be separately authorised by each of the Member States. This process of consultation and ratifying is multi-layered and requires consensus at every level making it long and drawn-out.
- One model being considered as a possible FTA is the Comprehensive Economic and Trade Agreement (CETA) – Canada's deal with the EU. After almost ten years of negotiations, a compromise has finally been agreed. The European Parliament is yet to approve the deal and the vote is expected in February 2017.
- Similar to the more widely known 'TTIP' agreement, CETA could lead to big Canadian corporations being as powerful as the UK Government, suing it for not giving access to certain areas in the market and putting our public services at risk of privatisation.¹⁰

Are there any positives?

- FTAs provide preferential market access relative to a situation where no agreement already exists. Of course, we are starting at a point where we have full membership of the Single Market, so any step away from this would jeopardise Welsh trade, jobs and even public services.

4. World Trade Organisation

What is it?

- The World Trade Organisation (WTO) aims to liberalise trade by lowering tariffs and reducing or eliminating other barriers to trade.
- In order to create a consistent global trading system, the WTO applies non-discrimination rules, meaning that they cannot discriminate between trading partners and members are obliged to apply the same tariffs and offer the same market access to all WTO members. This applies to both trade in goods and services.
- The WTO's rules do not apply if a Free Trade Deal or Customs Union has been agreed.

⁹ <http://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-sbi-q3-2016.pdf?sfvrsn=0>

¹⁰ <http://www.unitetheunion.org/news/workers-uniting-condemns-eu-canada-trade-agreement/>

Why is it not a preferred model?

- Tariffs or barriers to trade under WTO rules would, of course, mean an increase in cost, relative to Single Market and Customs Union Membership. This would ultimately hit the cost of living and jobs because businesses would have to increase prices to compensate for increased tariff costs.
- For instance, the EU imposes an average tariff of around 14% of agricultural imports from non-EU countries, with higher rates on individual items. Outside the Single Market, dairy exports could attract a 36% tariff, and beef exports could see a tariff of between 58% and 70%.¹¹
- If we left the Single Market and had to rely on World Trade Organisation rules, the extra cost of exporting beef could be £240million a year, with an extra £90million added to the cost of exporting lamb.¹²

Is it an easy process?

- No. Contrary to what some politicians are saying, the UK cannot simply ‘fall back’ on WTO rules.
- The UK is a member of the WTO in its own right. However, it does not currently have individual ‘schedules and concessions’ because it is a part of the EU which currently represents the UK at the WTO. In leaving the EU, the UK will have to separate its schedules from the EU, and its new schedules will be subject to approval by all WTO members.¹³
- Before negotiating its ‘schedules’ with WTO members, the UK will have to negotiate separating out its tariff rate quotas from the other EU Member States. These tariff-free quotas provide lower duties for some imports and agreeing these quotas will not be easy.
- Having agreed on the sharing of tariff rate quotas, the UK would then be in a position to present them to other WTO members. Reaching an agreement with the WTO members is likely to be problematic as some countries are likely to demand better terms of access to the UK market now it is not a member of the EU.
- WTO members may also insist on knowing the outcome of wider trade negotiations between the EU and the UK before certifying the UK’s schedules. For instance, it could demand lower UK import tariffs to compensate for the fact that goods exported from the UK to Europe may be subject to tariffs.
- Each of the WTO’s 163 other members is able to veto the UK’s proposals.

Are there any positives?

- Falling back on WTO rules would then allow the UK to formulate its own FTAs.

Appendix – Table of options

Provisions included in each framework	1. EEA	2. Customs Union	3. Free Trade Agreement	4. World Trade Organisation
Trade with the Single Market	Full membership of the Single Market in	Almost full membership of the Single Market in goods,	Depends on scope and depth of FTA.	Based on EU schedules of concessions at the WTO, applied on a

¹¹ http://www.jillevans.net/agriculture_eu_factsheet.pdf

¹² http://www.jillevans.net/agriculture_eu_factsheet.pdf

¹³ <https://www.ft.com/content/5741129a-4510-11e6-b22f-79eb4891c97d>

	services, partial market access for trade in goods.	no market access for trade in services.		Most Favoured Nation basis.
Participation in the EU's customs union	No.	Yes.	No.	No.
Accept the principle of free movement of persons	Yes.	No.	No.	No.
Budget contributions	Yes.	No	No.	No.
Autonomy over trade policy	Yes, although not able to change standards or regulations.	No, although FTAs can be sought on aspects not covered by the customs union arrangement.	Yes.	Yes.
Dispute resolution	Through the EEA Joint Committee and the EFTA Court.	N/A	Through state-to-state dispute resolution mechanisms.	State-to-state use of the WTO dispute settlement process.