

# BREXIT POLICY BRIEFING

## STAYING IN THE EU SINGLE MARKET AND A CUSTOMS UNION UNTIL A NEW DEAL IS IN FORCE

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The business community has accepted that the UK is leaving the EU and, since the referendum, has been focusing on how to make a success of Brexit. Companies are offering their ideas, evidence and expertise to policy makers to secure the UK's new relationship with the EU. The CBI and its members are committed to working in partnership with the government to grow our economy and deliver prosperity in our regions and nations, throughout negotiations and beyond.

The complexity of the task of negotiating a free trade deal between the UK and the EU cannot be underestimated. The UK and the EU have a deep relationship, built on 40 years of economic integration. Reflecting that will require both parties to commit to seeking the most ambitious free trade deal ever signed. There is a real possibility that – with the best political will in the world – that deal will not be agreed, ratified and in force by the deadline provided by Article 50.

But both the UK and the EU have prioritised “a smooth exit” in their objectives – and that objective is shared by business. In order to have the confidence required to continue investing, and generating jobs and growth, companies need the process of the UK's exit from the EU to be as smooth as possible, and to avoid a damaging “cliff-edge” scenario where the UK-EU relationship is governed by WTO rules.

To provide the certainty that businesses need, transitional arrangements will be required. As far as possible, those transitional arrangements should replicate as much of the economic relationship that is in place between the UK and the EU at the moment. The simplest way of achieving that would be for negotiators to agree that the UK should remain in the single market and a customs union until a new deal is in force. Agreement of this would secure continuity for business operations, protect ease of trade between the UK and the EU, and give negotiators the time they need to make Brexit a success for both sides

### **The negotiation of transitional arrangements would increase certainty and is an urgent priority for businesses**

There is an urgent need for clarity in the Brexit debate. Since the vote to leave the EU took place, businesses across the country have proved themselves resilient, investing and creating jobs throughout the UK. But with negotiations on the horizon and political uncertainty at home, the need for clarity on what our new relationship with the EU might look like is growing. While firms will continue to invest in their plants, innovation and training, uncertainty is beginning to hit their ability to recruit and retain talent, and impact major decisions in the boardroom – with investments on significant projects like innovation centres and logistics hubs on hold.

The best possible way for negotiators to reduce uncertainty and provide further clarity to business is to agree transitional arrangements. This is an urgent priority. Current proposals from the UK government to secure an implementation phase will not sufficiently provide the level of reassurance that businesses are seeking at this time.

Should it be possible to negotiate both the UK's withdrawal from the EU and a comprehensive free trade deal before March 2019, an implementation phase will be required to bring the new deal into force. This implementation phase would provide a period a time for businesses and regulators on both sides of the Channel to adapt to any changes required by the provisions of the new deal. Assurance that they will have

this period of time to change would be welcomed by business. This is illustrated in Scenario 1 in the box below.

### Scenario 1



However, businesses have very real concerns that negotiators will not be able to agree both the UK's withdrawal from the EU and a comprehensive free trade deal within this time frame. If no deal is agreed within the time allowed by Article 50, and the time allowed is not extended, the UK will automatically drop out of EU membership and the economic relationship between the UK and the EU will be governed by WTO rules. This would create an abrupt and sudden change - a "cliff-edge" which would be seriously disruptive for the governments, regulators, businesses and the economies of both the UK and the EU.

To avoid this disruption, transitional arrangements are required in any interim period between the end of the time allowed by Article 50 and the implementation of a free trade deal. This is illustrated in Scenario 2 in the box below.

### Scenario 2



## The UK should remain in the single market and a customs union during any period of transition

Businesses are seeking as much continuity as possible during any period of transition. However, the economies of the UK and the EU are so closely integrated, and the relationship so complex, that negotiating arrangements that provide sufficient continuity is an enormous challenge. Maintaining the benefits of both the single market and customs union until a deal is in force will be crucial. There are a number of ways negotiators could explore achieving continuity during any period of transition, including:

- Signing a bespoke interim arrangement for the period of transition, committing to continuity on each economic matter in turn. It is hard to see how this could be negotiated in time and it may not provide a sufficient legal basis for business continuity in many sectors.
- Remaining in the single market for the period of transition through a bespoke legal agreement between the UK and the EU. This would mitigate much disruption for business but a special deal such as this will require strong political will.
- Remaining in the single market for the period of transition by joining the EEA. This would require the UK to seek a separate negotiation to secure agreement from the other EEA countries and there would be some companies this would not achieve continuity for.

- Remaining in a customs union for the period of transition, continuing to adhere to the Common External Tariff and Common Commercial Policy. This would mitigate much disruption for business but a special deal such as this will require strong political will.

The simplest way to achieve continuity until a deal is in force is for the UK to remain within both the single market and a customs union during any period of transition.

Staying in the single market and customs union for the duration of a transition period does not prevent the UK from leaving the EU. Should the UK secure these transitional arrangements, it will still be leaving the EU. The UK will cease to be a member of the EU once the Article 50 deadline expires, whether transitional arrangements are in place or not. The UK will be independent politically, no longer represented by the European Council. The UK will be independent on the global stage, and in international fora. The signal sent to the rest of the world will be one of the UK poised to move into a position of full independence.

## 1. Securing continuity for business operations by remaining in the single market until a deal is in force

### **Remaining in the single market until a free trade agreement is in force is the simplest way to secure continuity for business operations**

The EU single market is a constantly updating set of rules – regulations and directives which operate across 32 countries. If the UK is not sufficiently prepared to leave the EU, and a sufficiently comprehensive trade agreement is not in place, companies will face inoperabilities, legal confusion and – in many cases – will have to overcome multiple sets of regulatory hurdles in order to function normally. Some examples of these are featured below.

**Independent cosmetics company:** This business is based in the UK and sells cosmetics products to the EU. The packaging of all cosmetics products sold in the EU must list an address for the company that produced it. That address must be in the EU and must be a staffed office. If the UK leaves the single market without a deal, this company has a choice: the costs of a new office is not justifiable, so they may stop exporting to the EU, or they may sell their IP rights for their products to larger companies with European offices.

**Importing technology company:** Currently, this business' European branch ships the specialist products it makes in the EU directly to customers in the UK. However, the goods it produces outside the EU have to be shipped to one of the company's UK sites, where workers remove the VAT paperwork that comes attached to products produced in non-EU countries. If the UK leaves the single market without a deal, this paperwork would accompany all EU products, so thousands of extra packages would have to go through UK offices first. This company would need additional warehousing, alongside extra staff and machinery. Estimated order times would also have to be increased as it would take longer for products to reach customers.

A transitional arrangement that is capable of taking into account the complexities of the UK's integration within the single market will be incredibly complex to negotiate. The simplest way of achieving continuity across all aspects of business during a transition period is for the UK to remain in the single market.

### **Steps would need to be taken to ensure continued UK influence over new rules**

The EU single market undergoes incessant adjustment, and in order to remain within it during a transition period, the UK would have to accept and implement new rules and European court judgements for that period of time. While the business community acknowledges this could come with challenges, steps could and should be taken to mitigate these downsides.

There are, for example, many ways in which the UK can ensure a form of continued – though reduced – influence over the rules affecting it. Outside the EU, the UK will have reduced input into the rules of the

single market. Without MEPs, Commissioners or representation in the Council, there is a risk that the UK could become a “rule taker” for the transition period. However, to reduce this, the UK government should seek to ensure that the UK can maintain maximum representation of regulators and agencies possible in European bodies. For example, ensuring the British Standards Institute can maintain its membership of the European standards bodies, and that the UK’s Information Commissioner’s Office represents the UK on the European Data Protection Board. Mechanisms should also be agreed by which the UK could challenge any legislation it felt was designed to disadvantage the UK. Additionally, the UK business community should take its own steps to increase its influence in the European Union – investing increased resource in private sector responses to new EU regulations, directives and processes throughout the legislative cycle.

**Once a deal is in force, there will be opportunities for more flexibility around regulation – but there are many now**

If the UK remains in the EU single market for the period of transition, there will still be opportunities to review existing regulation from the EU and its effect on the UK’s competitiveness. While the UK will need to implement and abide by EU rules during this time, it can still look at the way in which it implements those rules. There are many instances of the UK “gold-plating” EU legislation, which could be reviewed and changed while the UK remains a member of the EU single market.

Once the new UK-EU free trade agreement is in place, the UK business community will be able to help the UK government seek opportunities for more domestic flexibility in regulation, particularly in domestically focused sectors. These opportunities for changes will have to be in areas that do not put up additional barriers to trade, or conflict with the UK-EU free trade agreement. However, being able to explore these opportunities after a free trade deal has been agreed would enable conversations about opportunities to be more effective because the areas that cannot be changed will be clear.

## **2. Protecting ease of trade by staying in a customs union until a deal is in force**

**Staying in a customs union until a deal is in force is the simplest way to protect ease of trade**

A customs union is a trade agreement which covers all industrial and manufactured goods and processed agricultural products. Members of a customs union apply the same tariff and import procedure to all goods coming from outside the union territory, but no tariff on goods travelling within the area. The EU customs union requires that participants align to the EU’s external trade policy and look to implement or align with EU regulations in relations to goods.

If the UK is not sufficiently prepared to leave its customs union with the EU, and sufficiently comprehensive trade agreement including a customs arrangement is not in place, companies will face tariffs, quotas, delays and new levels of regulatory barriers – both on trade between the UK and EU, and on trade between the UK and markets with which it currently has trade agreements. Some examples of these are featured below.

**Manufacturing company:** This UK business supplies components which make up 25% of a final product, to be assembled in South Korea. Factories in Mexico, Poland and South Korea also all make 25% each. As 75% of the final product currently comes from the EU or South Korea, which has a trade agreement with the EU, this product can be sold tariff-free. However, if the UK is outside of the EU customs union, only 50% of the final product will count as “local product” – falling below the threshold of 60% local product required for it to be tariff-free. The UK factory is therefore concerned that it will be excluded from this supply chain in future.

**Bread factory:** A major bread company has a single factory for all its bread on the island of Ireland. In the early hours of each morning, lorries load with bread for distribution to retailers across the island. If the UK is outside of the EU customs union, the bread will face a tariff – the average tariff on food and drink products is 22% - and the supply chain will be disrupted, with the potential for delays and the reintroduction of border checks.

At present, it is very difficult to see how the UK will be prepared to deliver such a significant change in its customs procedures by the time the UK leaves the EU. Additionally, transitional arrangements that are capable of ensuring ease of trade is protected while allowing the UK to leave the EU customs union will be incredibly complex to negotiate. The simplest way of protecting ease of trade across all aspects of business during a transition period is for the UK to remain in a customs union with the EI.

### **The UK could use any time provided by a transitional arrangement to secure current FTAs and build capacity**

While staying in a customs union until a new deal is in force would curtail the UK's ability to formally negotiate independent trade deals for the time being, it would not stop British business from capitalising on trade opportunities or frustrate the work of the Department for International Trade (DIT) as the UK transitions.

Firstly, business has been clear that there is much within current EU free trade agreements which the UK should seek to replicate outside of the EU. Through a transition period, business would continue to enjoy the same benefits of current EU FTAs, such as that with South Korea which has boosted exports by more than £3billion since 2011, while the government can devise a clear plan to carry over the substance of the agreement for when the UK does exit the EU customs union. Moreover, there are recent deals on the table which the UK has meticulously helped to craft, such as those with Canada, South Korea and Colombia, and are now primed with opportunities worth billions for British business to fully utilise during the transition period.

Secondly, while staying in a customs union would necessitate acceptance of current EU trade policy on free trade agreements and the setting of tariffs, quotas and regulatory cooperation with third countries for the duration of the transition, the important work of deepening trade ties with global markets could continue. Officials and business are already hard at work in a number of markets including the US to China, agreeing iterative changes to market access issues and regulatory burdens which slow our exporting efforts, particularly in services sectors which benefit less from free trade agreements. Further collaboration with third countries to scope areas of mutual interest over the transition period will unlock immediate solutions for exporters and act as ideal preparation for potential future free trade agreements which benefit from proper intensive preparatory work before formal negotiations begin.

The transition period also strengthens rather than diminishes the position and direction of DIT. Just as business needs time to adjust to the trading arrangements outside the EU, so officials in DIT will need adequate time to recruit, research, build process and engage stakeholders in preparation of inheriting the full breadth of trade policy from the EU. As a new department, the task of crafting a legislative basis for trade, a platform for formal negotiations, and a policy framework to deliver across all types of goods and services in our economy is exceptionally demanding. A transition period under the status quo enables DIT to continue its excellent work in promoting our exports and the UK as a primary destination for international investment, as well as add time to build capacity on a strategy for Britain to seize all opportunities that exist within fully independent trade policy.

### **Business is excited about international trade, and ready to fully seize those opportunities after completing a new arrangement with the EU**

British business supports the Government's vision of making a success of Brexit by forging a path for the UK as a great free trading nation. The immediate priority must be the formation of a national trade strategy to secure our current international commercial relationships and practically grasp the new international

opportunities outside the EU. A transition period under a customs union and in the single market ensures that both business and government have the time necessary to build on their foundations and adapt their approach. With this time, the UK can form an unprecedented partnership between business and government that will forge an ambitious and practical strategy to deliver benefit to all consumers, sectors and communities of the UK.

## **The UK may be required to accept continued free movement until a deal is in force**

The EU has made clear on numerous occasions that membership of the single market and free movement are inseparable “freedoms”. To secure continuity for the economy, the UK may be required to accept continuation of free movement during any period of transition.

The UK government should take any additional time provided by a transitional arrangement as an opportunity to get any future system for controlling EU migration right. Continuation of free movement during a transitional period, if necessary, could act to grant the UK government any time it needs to navigate the complexities of getting the future system in place.

### **Business stands ready to help ensure a long-term approach that meets economic needs and enjoys public support**

Access to the skills and labour needed for growth is essential to our economy. Firms understand that free movement will not work as it has before after the UK leaves the EU, and that the public need to have confidence in any new system. This balance can only be achieved through a pragmatic, demand-led system rather than driven by a simplistic, top-down target and a cap. Firms welcome the opportunity to work with government in the months ahead to develop a new immigration system which allows skilled workers with a job offer free access to the UK and offers work permit-based access to address labour shortages in key sectors where the evidence supports this.

CBI members are reporting that uncertainty around future access to skills is already having a detrimental impact on investment decisions. Continuation of free movement during the transitional phase could help to alleviate this. So too would guaranteeing the rights of those EU citizens already here. But without clear signals on the direction of travel around Britain’s long-term immigration policy within the next few months, long-term damage may be done.

## **Achieving these transitional arrangements would give negotiators the time they need to make Brexit a success for both sides**

### **Business does not seek to delay the process of leaving the EU, but to expedite it**

Companies want to see the negotiation and agreement of such a comprehensive trade deal as soon as possible. Transitional arrangements are just one of a large number of complex issues that negotiators will grapple with once talks begin. By seeking to remain a member of the EU single market and a customs union during this phase, the UK will make transitional arrangements as simple as they can possibly be, and agreement will be reached much more quickly. Additionally, early agreement of transitional arrangements such as these will remove the “cliff-edge” from the table, and as such negotiators will be able to focus on other complex, political issues.

### **These arrangements would make a successful exit much more likely**

Business remains clear in its objectives for the UK-EU trade deal negotiators should seek to agree: a barrier-free relationship between the UK and the EU, which recognises the importance of the EU as our closest,

more important trading partner. It will require the negotiation of deep regulatory cooperation across a range of sectors, and of a customs arrangement that ensures integrated global supply chains can continue to operate without disruption. The UK will also have to take steps to establish an immigration system which gives companies access to the people they need to grow while meeting the needs of the public. Business and government will have to work together to design new systems of funding in areas like agriculture and our regions and nations, and to establish an ambitious global trade agenda.

Securing stability through these transitional arrangements will give negotiators the time they need to work through all these complex issues, and agree the most comprehensive trade deal the EU has ever struck. It will also allow the UK government any time it might need to manage its response domestically, to adapt to any changes required whether in customs systems, immigration systems or legal systems.

**The European business community would support a deal that provides continuity and certainty**

Ensuring that the UK's exit from the EU is a smooth process is an absolute priority for the European business community. In the long-term, it's also important to secure a close economic partnership between the UK and the EU. The CBI expects that mechanisms to achieve that would be welcomed by companies in Europe, as it is in the real financial interest of firms on both sides of the Channel.