THE FUTURE UK-EU RELATIONSHIP

22.01.2018

With the negotiations on the UK's exit from the EU moving imminently into their second phase, the debate on the future economic relationship is increasing – on both sides of the Channel. The UK's Cabinet has begun discussing in more detail how best to move forward, as the EU27 and European Commission work in parallel to agree a more detailed, united negotiating position. Businesses have spent the last 18 months analysing what is important about the future economic relationship.

The Canadian model, CETA, and Norway's deal have both been proposed for the UK as potential future relationship – but there are big differences between each.

- Firstly, on services. Just as UK firms have today, businesses in Norway have the automatic right to provide any services in the EU and vice versa. In contrast, preferential trade in services in CETA, the most ambitious of the EU's free trade agreements (FTAs), can best be described as patchy. For Canada and the EU, this agreement is an acceptable state of affairs in a way that it would not be for the UK and EU. And while it may well be possible for the UK to negotiate a more ambitious FTA on services trade, it will be an unprecedented and uphill battle.
- Secondly on rules. How rules are managed is what sets Norway's deal and Canada's apart. FTAs such as CETA can make trade easier for business by allowing authorities on either side to enforce the rules of the other, but while helpful this does not provide the much more frictionless trade secured by automatically equivalent rules between Norway and the EU. For the UK, an FTA that managed rules like CETA would inevitably lead to the immediate imposition of non-tariff barriers resulting in extra costs and delays for businesses.

The debate on how best to manage rules is therefore central to finding a model that can manage the challenges of CETA and Norway's deal. For business, there are three simple facts:

- No country has total "sovereignty"
- As well as a trade-off between access and control, there is a trade-off between weight and independence when it comes to rule-making
- To sell to the EU, UK businesses will have to abide by the EU's rules even if there's no deal.

In order to strike this balance between the complicated control and access trade offs, there has been increasing thought given to a hybrid model which might allow a form of participation in the EU single market in some areas, and divergence and the acceptance of trade barriers in others. **For business, this would be an acceptable alternative to single market membership, but serious questions remain about the political feasibility of a model such as this.**

But a new relationship with the rules of the single market is only half the answer to the question of the future economic relationship: a comprehensive customs union is needed. Government has all the right objectives on customs, but – thus far – no proposals have been set forward that can deliver all three in their entirety. Considering the importance of the customs relationship between the UK and the EU, to businesses not just in the UK but across the world, here more than anywhere it is vital to consider the evidence. A customs union with the EU would help facilitate the smooth flow of trade volumes, and facilitate trade and security in Ireland.

A customs union would require trade-offs on achieving an independent trade policy, but the benefits of such are policy are unproven. And while being in a customs union with the EU does place limits on the independence of the UK's international trade policy, it by no means eliminates it. There is much to be done on investment, Industrial Strategy, and on the global stage to deliver a UK that leads the world in trade.

The models on the table

Thus far, the EU has presented the UK with two models for its future relationship: a comprehensive free trade agreement (FTA), modelled on the EU's agreement with Canada (known as CETA for short) or Norway's model of membership of the European Economic Area (EEA).

Exhibit 1: Norway vs Canada, what's the difference?

Norway's deal includes…

- Tariff free trade in all goods and services, excluding certain fish and agricultural products
- Free movement of persons as a fundamental part of the relationship
- A financial contribution to the EU
- Implementation of all EU regulations related to the internal market including employment, consumer protection, environmental, state aid, intellectual property and competition policy

Norway's deal excludes…

- Preferential access to the single market for agriculture and fisheries products
- Participation in current and future EU-third party trade deals
- Common Agricultural Policy participation and funding
- Trade in goods without non-tariff barriers such as export licences and rules of origin
- Participation in monetary union, common foreign and security policy, justice and home affairs policy (cooperation in these areas is possible)

Canada's deal includes…

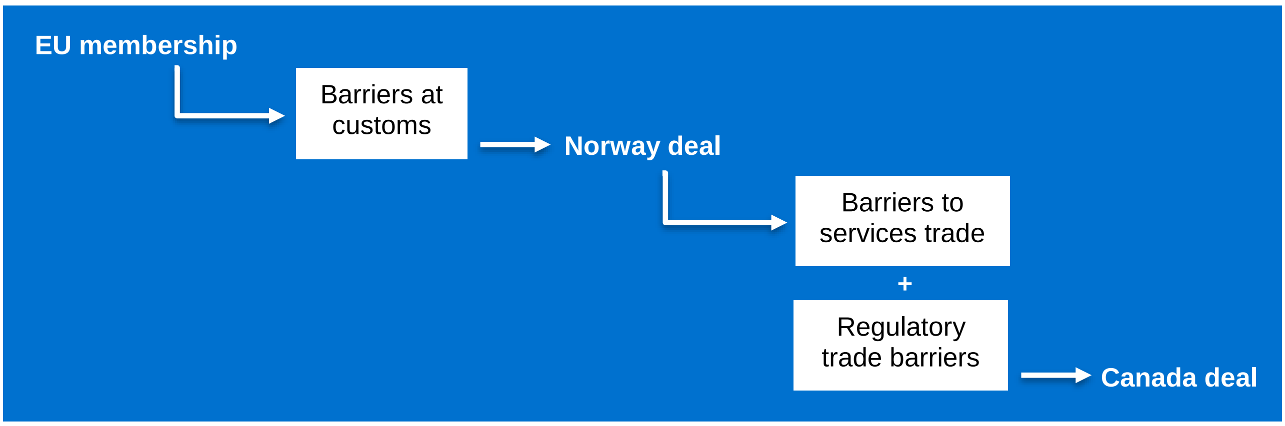
- Comprehensive but not complete tariff free trade in goods
- Limited access to trade in services, including – in some cases – public procurement
- Partial regulatory cooperation, for example on product standards
- Independent free trade policy

Canada's deal excludes…

- Financial contribution to the EU
- Full participation in EU programmes
- Free movement of persons
- Removal of non-tariff barriers such as export licences and rules of origin on trade with EU countries
- Equivalence of UK and EU regulation in domestic areas
- Participation in current and future EU-third party trade deals
- Participation in monetary union, common foreign and security policy, justice and home affairs policy

For business, the difference between the two models is significant, for two main reasons: services trade and the treatment of rules. In addition to this, both models are significantly different to EU membership as neither Norway nor Canada are in customs union with the EU.

Exhibit 2: EU vs Norway vs Canada, what's the difference for business?



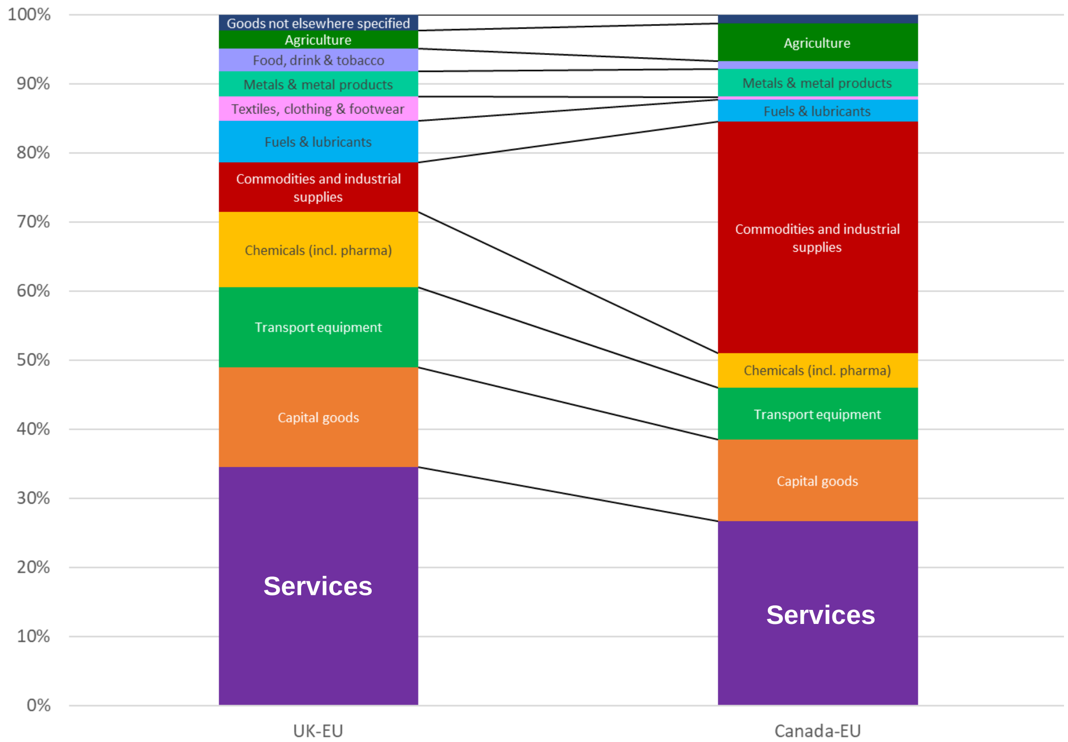
For some vital services, there's a big difference between Canada and Norway

Just as UK firms have today, businesses in Norway have the automatic right to provide any services in the EU and vice versa. This is true for all services, including highly regulated ones. In reality, the EU single market in services is not complete, and some EU countries have a reputation for discriminating in practice against foreign service providers more than others, such as in defence where the UK offered up €17.6billion of contracts to EU27 and equivalent power France offered up just €4.9billion[1]. However, overall this arrangement makes doing business easier, and Norway does 66% of its trade in services with the EU[2].

In contrast, preferential trade in services in CETA, the most ambitious of the EU's agreements, can best be described as patchy. While the EU and Canada have agreed free trade of postal, telecommunications, energy and maritime transport services, and mutual access to public procurement contracts, CETA does not provide anything like free trade for some important sectors. That includes some aviation services, electricity and cultural services. If the UK and the EU were to agree nothing more than the 'global standard of trade deals', it would – in the words of the Secretary of State for Exiting the European Union's special adviser Raoul Ruperal in his former role at OpenEurope – fall "far short" of current or Norway's arrangements[3]. In particular, the UK's 758 exporting TV channels[4], 5,476 UK and 8,008 EU financial service firms[5] would be unable to provide services across border from their current locations.

For Canada and the EU, this agreement is an acceptable state of affairs in a way that it would not be for the UK and EU, because services trade is less important to Canada in general (5% of Canada's output is services exports compared to the UK's 12.1%[6]) and between Canada and the EU in particular. Whereas the UK's top exports to the EU are financial services and business services, Canada's are pearls, semi-precious stones and precious metals.

Exhibit 3: Comparison of UK and Canadian exports to the EU (%)[7]



[1] Exiting the EU Select Committee, Defence Sector Report
[2] UN Comtrade; OECD
[3] European Union Committee, Brexit: the options for trade
[4] European Audiovisual Observatory, Audiovisual services in Europe
[5] Letter from Financial Conduct Authority to Chairman of the Treasury Select Committee
[6] Grant Lewis and Samuel Lowe, Can Global Britain Defy Gravity?
[7] CBI; UN Comtrade; OECD. Note: Services data excludes travel.

The difference between Norway's deal (or indeed the UK's current EU relationship) and a CETA-style free trade agreement is a concern for businesses. Overall estimates of the difference are few and far between, but research by NIESR suggests the reduction in UK-EU trade in services under an FTA would be the same as if the UK and EU traded under WTO rules[8], though goods trade would be more supported. This concern is concentrated in specific sectors more than other, but these are sectors that are particularly important to the UK economy. The concern is also concentrated in particular regions of the UK. While most service exports originate from London and the South East, the North East and West Midlands send about half of their services exports to the EU, making them more proportionally exposed[9].

It may well be possible for the UK to negotiate a more ambitious FTA on services trade, but it will be an unprecedented and uphill battle. The EU's Chief Negotiator Michel Barnier has, for example, stated that "In leaving the single market, they lose the financial services passport" and that "There is not a single trade agreement that is open to financial services. It doesn't exist."[10] If the UK and EU did manage to negotiate a world-leading services deal outside of the single market, it would be a major concession by the EU – not just to the UK but to other countries. For example, the EU-South Korea Free Trade Agreement contains a Most Favoured Nation clause which states that if the EU agrees a more favourable services deal with any other country, the EU must extend those commitments to South Korea as well. While not impossible, this increases the challenge facing UK negotiators if they adopt the CETA route.

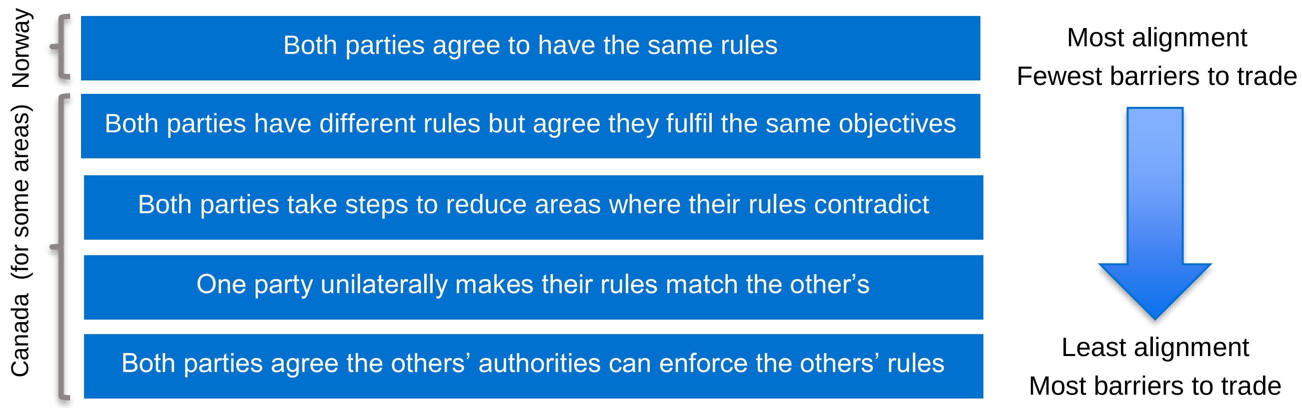
Cooperation on rules in the Norwegian and Canadian deals are different

The biggest difference between a CETA-style free trade agreement and Norway's deal is how the partners in each deal manage their rules. In essence, in CETA there is a Canadian market with Canadian rules for products and an EU market with EU rules for products, separated from one another. While trade deals can lower the walls somewhat around those markets, they never vanish entirely. In contrast, with Norway's deal both partners are inside one market which has only one set of rules. Being part of one market with one set of rules makes trading across countries in that market easier and extends protections for products across the countries in that market. However, it also limits choice: Norway is only one voice in the process for making joint rules, instead of more or less the only voice.

Agreeing rules to make trading across countries easier

There are a number of ways in which cooperation on rules can make trading across borders easier. CETA offers much shallower cooperation than Norway's deal, and in a limited number of areas, which leads to greater barriers to trade.

Exhibit 4: Methods of aligning rules



[8] NIESR, Will New Trade Deals Soften the Blow of Hard Brexit?
[9] UK Trade Policy Observatory, Brexit and Regional Services Exports: A Heat Map Approach
[10] Business Insider, 19th December 2017

For businesses that trade with the EU, or sell to companies that do so, this difference between having the same rules and having different rules is significant. Because the EU and Canada have different laws**,** to sell products both in the EU and Canada, businesses on both sides must – in the main – comply with two sets of rules, get products cleared by two sets of regulators, pay for two sets of licenses and in some instances, even pay for the authorities on the other side to randomly inspect their products before goods can cross the border. To achieve this, they may have to have separate product lines for Canadian goods and European ones. Industries that are highly regulated are most impacted by this doubling of the burden. For example, it is estimated it costs £350,000-£500,000[11] to secure additional type approvals for cars, the Office of Health Economics states it takes 2-3months longer for European-licensed medicines to be cleared for trade in Canada[12], and one machinery manufacturer has reported that getting approvals to sell a single machine to Canada costs £5,600 more than to the EU. None of this complication occurs for businesses in Norway which only have to go through the process once to sell both domestically and to the EU, because both parties agree to have the same rules.

There are very few areas where both Canada and the EU have agreed they have different rules that fulfil the same objective, or regulatory equivalence. One exception to that data, where Canada has implemented rules and enforcement strategies on data protection that the EU has ruled as equivalent to its own, allowing the free flow of data between Canada and the EU. This will be vital for the UK to achieve also, to protect the UK's £240billion data economy. However, even this wasn't part of the CTEA agreement and preceded it by several years. This lack of precedence is a challenge for the UK Government, as wide-ranging equivalence is reportedly a significant part of the deal it wishes to establish with the EU. But, in reality, regulatory equivalence is a core part of how the EU operates: there are two types of rules the EU makes, regulations and directives. Regulations become EU laws and are directly applicable in every member state, whereas member states have – and indeed Norway has – some flexibility in how they implement directives, which have to be transposed into national legislation. This may create some opportunity for the UK to achieve its aims.

Free trade agreements such as CETA can make trade easier for business by allowing authorities on either side to enforce the rules of the other, and while helpful this does not provide the much more frictionless trade secured by automatically equivalent rules as with Norway. In theory it means that, for example, a manufacturer in Canada producing a child's toy for the EU market can send it to a local conformity assessment body or notified body which will ensure it meets EU consumer protection standards, the EU's Toy Safety Directive and other relevant rules. The notified body provides the Canadian firm with an examination certificate and allows it to stamp a CE mark on the product. This allows Canadian goods to pass through customs more quickly, but the EU and Canada have only agreed this for a limited number of sectors. Additionally, this conformity assessment is valid only for the EU. If the company wants to sell to Canadian consumers as well, it must go through the process again, fulfilling different requirements, and is required to pay to do so. This contrasts with Norway, where conformity assessment from a Norwegian body allows it to be sold both domestically and across the EU, saving time and money. And not only does this liberalisation only apply to a limited number of sectors, in reality the EU has so far only agreed one Canadian notified body is permitted to

Exhibit 5: Industries covered by conformity assessment provisions in CETA

- Electrical equipment like TVs and phones
- Radio and telecommunications terminal equipment
- Toys
- Construction products
- Machinery
- Measuring instruments
- Hot-water boilers
- Equipment for use in explosive atmospheres
- Equipment for reducing noise emissions
- Yachts and others recreational craft

[11] Automotive Council
[12] Office of Health Economics, Public Health and Economic Implications of the United Kingdom Exiting the EU and the Single Market

issue European conformity assessments, and this only in radio equipment[13]. Canada has agreed 25 conformity assessment bodies in the EU able to judge to Canadian standards[14]. This is in direct contrast to Norway, which alone has 25 bodies able to provide assessment for joint standards for both Norway and across the EU[15]. The UK has 181, though not all of them are active[16].

Compared to Norway's deal, the difficulties of trade between a country like Canada and the EU, even with an FTA, are most keenly felt by businesses when rules diverge and so partners try to use FTAs to reduce areas where this happens. Within the EEA, Norway's businesses only experience the downsides of divergence when there are delays to implementing the EU's rules. For example, the Confederation of Norwegian Enterprise has reported that, when there was a delay updating to a new directive on salmon, Norwegian trucks were stopped at the EU border. And when it seemed Norway was hesitating over the implementation of REACH regulations, investment in the Norwegian chemicals sector stalled.

However, between the EU and Canada there are lots of areas where rules diverge. Often, to ensure products meet multiple sets of divergent standards, companies conform to the highest. For example, if the EU rules say businesses must offer a 2-year guarantee to people who buy their products, and another country the firm sells to says the guarantee must last 18 months, the firm will often offer 2 years to everyone so it only has to have one set of paperwork that accompanies the product. This is inconvenient but manageable.

The challenges occur when rules say contrasting things. A simplified example would be if the EU's rules said a label had to be red and Canadian rules said a label had to be blue. That would require a business to make products for the EU with red labels and products for Canada with blue labels. This increases costs and reduces flexibility for the manufacturer. CETA does establish forums to discuss how to stop this happening, but these are expressly forbidden from designing legislative changes, falling far short of the automatic process that ensures barriers are reduced between Norway and the EU.

One way to reduce unhelpful contradictions and duplications for its businesses is for one side to act unilaterally to make its rules match the other's. This is a limited form of regulatory alignment and only acts one way: it has benefits because producers do not need to operate separate processes in these areas, and the partner aligning its rules can agree to let products into its market more easily, but the other partner is under no obligation to do so and there are therefore barriers to trade in that direction. Canada has chosen to do this in a number of areas, including making changes to its laws on patents, food and medicines, creating greater access for EU businesses. This form of voluntary alignment can be expected to be a feature of UK policymaking whatever the relationship between the UK and the EU after Brexit. But without the other side of the relationship accepting the rules and their enforcement as equivalent, this unilateral alignment is a long way from the ease of the Norway relationship.

In both Norway and Canada's relationships, the EU's greater economic heft means the balance of power when it comes to adopting rules sits with the EU. Even before CETA, Canada had encouraged its companies to adopt EU chemicals regulators, as the gold standard. In CETA itself, however, the EU did not agree to change a single technical standard, whereas Canada has had to make legislative changes. And Norway adopts the EU's rules automatically not the other way around. Though Norway's agreement allows for temporary departure from the rules in special circumstances, Norway has never used this power. In the deal the UK and EU agree, it will be important to find a form of influencing those rules that will still be applying in future.

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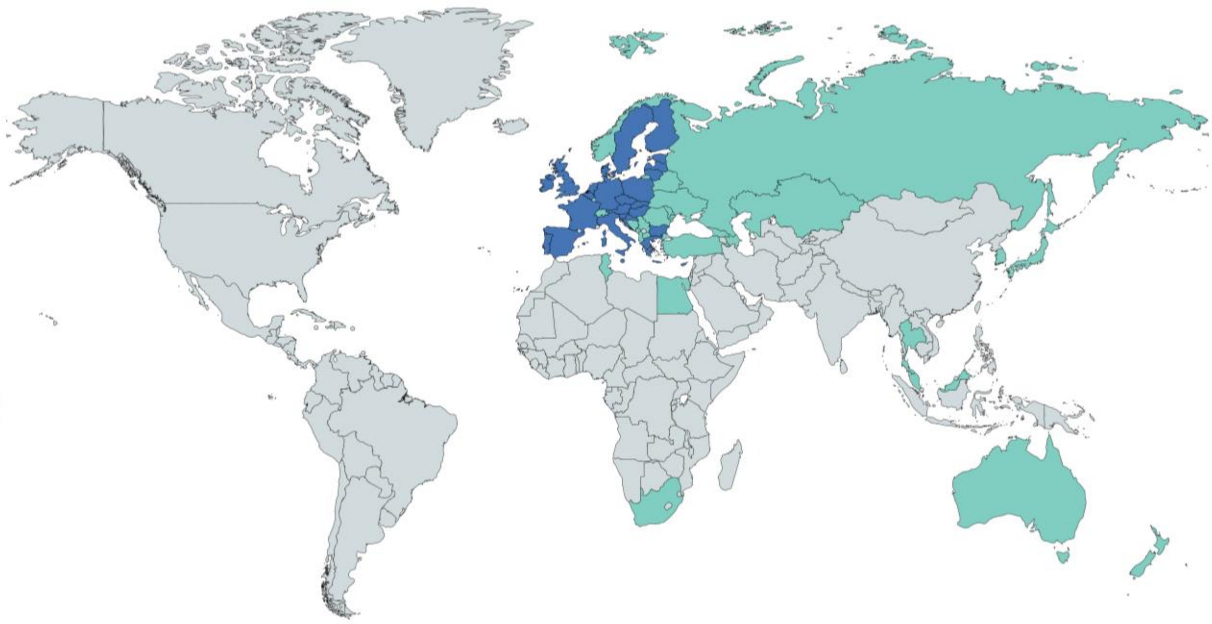
[13] NANDO, Canadian designated conformity assessment bodies
[14] NANDO, EU designated conformity assessment bodies
[15] NANDO, Notified bodies - Norway
[16] NANDO, Notified bodies – United Kingdom

Exhibit 6: An example of non-EU countries adopting EU rules: signatories to the Euro VI Heavy duty requirements



For the UK, a free trade agreement like CETA would inevitably lead to non-tariff barriers resulting in extra costs and delays for businesses. An ambitious deal that negotiated mutual recognition of a wider range of conformity assessment bodies could likely be achieved and tackle some behind the border non-tariff barriers. And either side could choose to keep its rules aligned with the others', unilaterally deciding the other sides' rules are equivalent to its own. But this is most likely to involve the UK adopting EU rules, not the other way around. Wherever the EU and UK did not negotiate a form of equivalent rules, UK companies would have to go through many procedures twice over. Inevitably, an FTA like Canada's would lead to the immediate imposition of non-tariff barriers as well as increasing barriers over time as the UK and EU's rules drifted apart. And these non-tariff barriers are a real and legitimate concern for businesses: with a deal, non-tariff barriers could be twice as costly to businesses and consumers as tariffs are[17]. In contrast, (customs aside) regulatory trade barriers between the UK and EU if the UK joined the EEA would hardly rise.

Agreeing rules that protect particular products

Both the CETA and Norwegian relationships provide firms with certain levels of protection for their goods – through rules on intellectual property, including trademarks and geographical indicators. As with rules that make trade easer, the protections in Norway's relationship with the EU are more far-reaching than Canada's, though both fall short of EU membership and the current trading relationship between the UK and the EU.

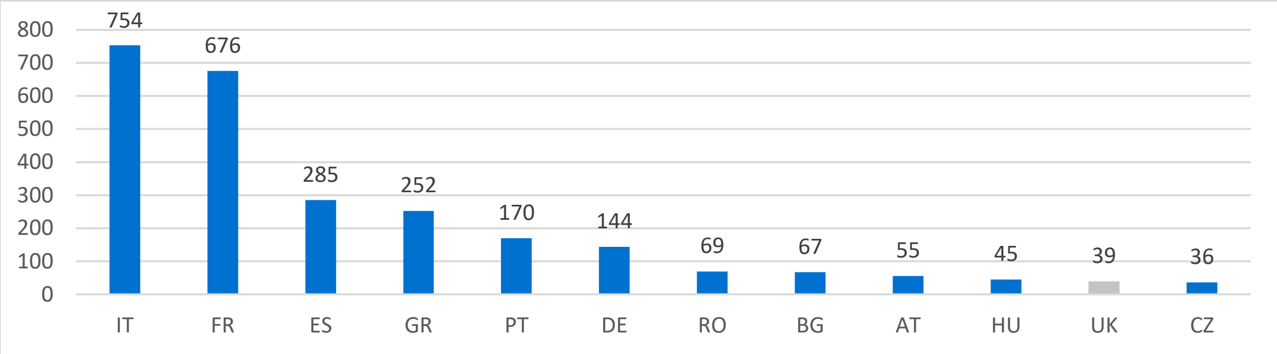
One of the most controversial ways that these cross-border protections are offered is through rules on geographical indications (GIs) – rules which state that certain products sold across both markets can only be made in a specific location. Classic examples are Scotch Whisky, Parma Ham and Champagne. The EU has an extensive register of GIs that has developed over time, and states – among other things – that Cornish pasties sold in the EU must be made in Cornish bakeries, and that Anglesey sea salt sold in the EU countries must have come from the waters of North Wales. In total, the UK has 84 foods that are protected in this way[18].

Norway's relationship with the EU offers less protection for the goods of either side through GI rules, but goes further than the protections offered by Canada's relationship with the EU. All wines and spirits that are geographically protected in the EU are also geographically protected across the EEA

[17] CBI, Trade Costs of a No Deal Scenario
[18] Department for Environment, Food and Rural Affairs, Protected food name scheme: UK registered products

countries, including Darnibole wine produced in the Camel Valley in Cornwall and Somerset Cider Brandy. However, negotiations to increase this list to other geographically protected goods fell apart in 2017, and the EU has instead had to approach these talks country-by-country. Negotiations with Norway have been ongoing since November 2013, and talks with Iceland concluded in 2015 when Iceland agreed to protect 1,150 EU agricultural products and foodstuffs[19]. This relationship covers a much greater range of goods than Canada's: in CETA, the EU and Canada agreed to protect just 145 products covered by geographical indicators[20].

Exhibit 7: Geographical Indications by EU country in 2010[21]



It is likely that the EU and UK could agree comprehensive protections for each other's products through geographical indicators under either kind of model, but this is one area where the UK has arguably greater leverage than the EU. For years, UK businesses have lagged behind other EU countries in taking advantage of the protections offered by geographical indicators. This is illustrated in Exhibit 8.

However, the UK businesses which have taken advantage of the EU's geographical indications scheme do gain a disproportionate advantage from it and are therefore particularly exposed. Of all EU GI products sold in 2010, UK spirits and agri-food made up 10% of the value across the entire EU. Yet overall, given the size of the UK's consumer market and appetite for European goods – 30% of food products on the shelves of UK supermarkets come from the EU[22] – the EU has most to lose in an item-by-item discussion of geographical indications. One exception might be discussions on the geographical indication covering Irish cream, used in Baileys, and Irish whiskey – where the geographical protection extends to products made in both Northern Ireland and Republic of Ireland, making both sides of the island intensely interested in its future.

Agreeing to make rules together

The debate on how best to "take back control" has been central to discussions on the future relationship between the UK and the EU. At its heart, there is a trade-off between access and control. The more "independent" Britain is, the less preferential access it can expect to the European market. But the trade-offs are much more complicated than often implied.

For business, there are three simple facts:

- **Firstly, that no country has total "sovereignty",** except perhaps North Korea. Every other nation pools sovereignty in order to make decisions collectively to some extent. At the UN, countries work together to build and enforce rules on everything from shipping regulations to environmental laws. Countries come together to write rules for food safety at the Food and Agriculture Organization and World Health Organization, and to write rules at on financial services at the Basel Committee. Standards are collectively written at three separate international standards bodies, while the international rules of trade are written by countries coming together at the World Trade Organization. The UK sits on each of these.

[19] European Commission, Press Release, 18th September 2015
[20] European Commission, CETA - Summary of the final negotiating results
[21] European Commission, Value of production of agricultural products and foodstuffs, wines, aromatised wines and spirits protected by a geographical indication (GI)
[22] Department for Environment, Food and Rural Affairs, Food statistics in your pocket 2017

This collective decision making at an international level is vital in a world that grows closer every day. But it also means a country sometimes accepting rules that it disagrees with – a loss of "control".

- Secondly, as well as a trade-off between access and control, **there is a trade-off between weight and independence** when it comes to rule-making. At present, the EU has a seat on these international bodies as well as the member states: the UK is represented both independently at the OECD's work on chemicals as well as by the European Chemicals Agency for example, and both independently and by the European Patent Organisation at the World Intellectual Property Organization. Being an independent voice in these international organisations does not necessarily mean having a bigger voice.
- **And finally, to sell to the EU, businesses will have to abide by the EU's rules even if there's no deal.** This is the case for every other country and will be the case for the UK. The debate is therefore whether the benefits of "control" over laws for sectors that do not trade with the EU are worth the ceding of influence over laws for companies that do not trade with the EU, or are not in the supply chains of companies that trade with the EU. This price is in addition to the cost of non-tariff barriers and divergence that those companies will face if the UK exercises that control.

Exhibit 8: Norway vs Canada: cooperation on rules

Norway has influence over the EU's rules through…

- Participation in European Commission regulation and programme committees
- Submission of written comments to EU legislative and other policy initiatives
- Placement of national experts in key policy units of the European Commission
- Participation in EU agencies
- Intergovernmental cooperation

Norway does not have…

- Members of the European Parliament
- Members of the Council or Commissioners
- Voting powers in all EU agencies

Canada will be able to co-operate with the EU over rules through a Regulatory Cooperation Forum which will…

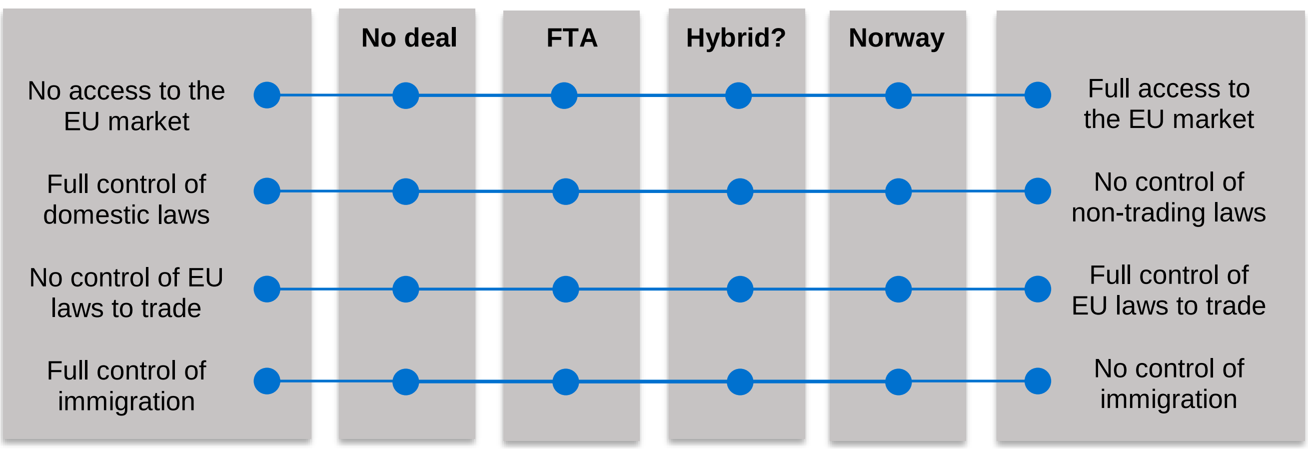
- Enable regulators to exchange experiences and information
- Help identify areas where regulators could work together
- Provide help and make suggestions to regulators and legislators

The Regulatory Cooperation Forum won't…

- Be able to change existing regulations
- Develop new legislation
- Have any decision-making powers
- Restrict the decision-making power of regulators in the EU or Member States

The most important choice the UK has to make in the negotiations on its future relationship with the European Union is where on this spectrum it wishes to fall.

Exhibit 9: The trade-off between access and control is complicated



A hybrid model?

In order to strike this balance between the complicated control and access trade offs, there has been increasing thought given to a hybrid model which might allow participation in the EU single market in some areas, control and the acceptance of trade barriers in others. In the Prime Minister's Florence Speech, in September 2017, she provided the first hints at what this "bespoke" agreement might look like.

"We will need to discuss with our European partners new ways of managing our interdependence and our differences, in the context of our shared values.

There will be areas of policy and regulation which are outside the scope of our trade and economic relations where this should be straightforward.

There will be areas which do affect our economic relations where we and our European friends may have different goals; or where we share the same goals but want to achieve them through different means.

And there will be areas where we want to achieve the same goals in the same ways, because it makes sense for our economies."

Since the Prime Minister's speech in September, two prominent think tanks have devised models on how the relationship between the UK and the EU set out in the Florence Speech could be managed.

Exhibit 10: IPPR[23] and IfG[24] proposals for potential hybrid models

IPPR writes about the potential creation of a "shared market"

This would be a new type of arrangement with the EU that aligns the UK's and the EU's regulations while giving the opportunity for future divergence over time.

At the centre of the model IPPR proposes would be continued alignment with most aspects of the single market. With the exception of the free movement of people, the agreement would stipulate that continued regulatory alignment is required in order to access the benefits of the single market.

The agreement would manage this possibility of divergence. It would include a divergence mechanism that would suspend access to the single market in the case of misalignment, with the extent of the suspension depending on the extent of the misalignment.

It would have specific provisions for managing divergence in Northern Ireland.

It would have a new mechanism for managing disputes, with a new "Court of Justice" for the UK to enforce the agreement and a new "UK Surveillance authority" to monitor the agreement, much as exists in EFTA.

IfG writes about the potential creation of a "EU-UK regulatory partnership"

This would be a unique type of arrangement - a process for managing the UK's regulatory divergence from the EU Single Market.

The IfG sets out three approaches to regulatory alignment:

- 'Core tier': areas of regulation where the UK continues to achieve the same goals as the EU and continues to meet them in the same ways
- 'Mid tier': areas of regulation where the UK could diverge from EU rules to achieve the same regulatory goals or outcomes by different means
- 'Outer tier': areas of regulation where the UK would be free to diverge from EU rules from the start with no consequences for market access

Divergence would be managed using a test for regulatory parity, as defined by experts on a joint committee. Each side would have to inform the other of rules changes to avoid surprises.

It requires a court and joint expert committees, as well as potentially a dispute resolution mechanism.

[23] IPPR, The Shared Market: A New Proposal for a Future Partnership between the UK and the EU
[24] Institute for Government, Trade After Brexit: Options for the UK's relationship with the EU

The advantages for business of a UK-EU hybrid model are clear – it would be an acceptable alternative to single market membership. As long as the UK Government made the right decisions about which areas to diverge in, access to the single market through a hybrid model would allow business to continue operating without disruption. Such a model would reflect the size and importance of the UK economy, and build on 40 years of integration instead of forgetting the past and starting from scratch. Yet the model would recognise that if future divergence from the EU made economic sense, the UK could do so, making an informed decision about the costs of loss of access to the EU market in comparison to the gains of domestic reform. Similarly, the EU would not be constrained from continuing to legislate as it chose, knowing that if the UK chose not to go through the process of dynamically updating its own rules In turn, the costs would not be greater for the EU than they would have been under a classic FTA.

While on balance, this model may be technically and legally feasible, and economically satisfactory from both sides, and lead to much faster agreement than the negotiation of a classic FTA, **serious questions remain about the political feasibility of a model such as this**, from the perspectives of both the UK and the EU side. But it may well be possible in a model like this to reach a compromise for the UK and deliver it while fulfilling the Government's aims for greater control of immigration, rules and money.

Controlling immigration from within the "hybrid model" relationship

Immigration was a defining issue of the EU referendum campaign and restoring public confidence that migration is being controlled effectively is a central pillar of delivering on the vote to leave the EU. Business understands that free movement of people will not continue as it has before. Restoring public confidence is about demonstrating control and establishing that those who come here are contributing to our economy and society A recent nationwide ICM poll of 4,000 people found 56% of the public favour greater control versus 36% who prefer a reduction in numbers.[25] CBI believes that greater controls on immigration are achievable while having a close relationship with the single market through a hybrid model.

Firstly, greater control of the movement of people is possible through more rigid implementation and enforcement of the existing rules regulating free movement. The UK could, for example, make a registration process compulsory for EEA nationals residing longer than 3 months, as is the case in an overwhelming 27 out of 31 EEA countries. It is already UK law that to stay beyond this period an EEA national must either be a worker, self-employed, jobseeker, student or financially self-sufficient. But the lack of registration or obligation for EEA nationals to prove this makes enforcement of existing law more difficult. For example, in Belgium within three months of arrival EEA nationals must register in person at their local authority requiring documentary proof of residence, health insurance and either their employment contract, proof of study or level of income. Failure to do so can occur a €200 fine and EEA nationals are required to carry their registration certificate at all times.

Secondly, the UK should be ambitious in upcoming negotiations and look to secure reforms to free movement that allow greater control over migration. Both the UK and EU must prioritise mobility for economic purposes and remain open to all solutions required to preserve this. While movement of people is one of the indivisible four freedoms that the UK should not ask the EU to undermine, there is precedent for reform. There are a number of examples of these reforms negotiated by countries like Switzerland, and the UK should negotiate its own reforms, including an emergency brake if it chose the hybrid model.

Controlling rules from within the hybrid model relationship

A hybrid model would secure the UK and EU a more nuanced relationship on cooperation over rules. It could provide a way for the UK to negotiate greater input into the trading rules its businesses will be governed by, as well as greater choice over the areas of rules it wanted to remain aligned with or otherwise.

There are a number of ways that the UK could seek to influence the rules of the EU market it would be applying on a direct basis as part of this model. For example, the UK could seek to negotiate

[25] Open Europe, Beyond the Westminster Bubble: What people really think about immigration

membership of the EU agencies and bodies that set technical requirements and contribute to the EU's policymaking process. This would also meet some of the UK's business community's concerns about a drop off in control over rules firms will be complying with whatever the deal after exit. More detail on the EU bodies that most concern businesses can be found in the CBI's report In the Room Where It Happens. Similarly, the UK could negotiate many of the ways Norway influences EU rules and would expect to do so more effectively given the UK's comparable economic heft. A number of EU member states that share the UK's way of thinking on many regulatory issues would support a step such as this.

Ultimately, a hybrid model would give the UK more choice over where it wanted alignment and where it chose to suspend preferential market access. The biggest question is whether the EU would accept such a flexible relationship with the single market. One area that the UK Government must ensure continued influence or control is over employment law. UK firms want to avoid accepting employment laws over which they have no influence. They are not seeking widespread change of EU-derived employment legislation after Brexit, and are instead primarily concerned about the changes to regulations that might be made in the future. UK influence has previously changed EU rules that when initially drafted would have been a bad fit for the UK's labour market. The UK must be able to continue to do so, or to diverge over time on this issue. An important aspect of the post-Brexit relationship will need to be ongoing discussion about core employment legislation where equivalence is necessary for a smooth trading relationship with the EU combined with a recognition that the UK will seek to diverge in other areas for the sake of efficiency, competitiveness, and legislative clarity.

Controlling money from within the hybrid model relationship

As the UK would only partially be participating in the single market as part of the hybrid model, it would be contributing less to the EU budget. The amount the UK would be paying would be a matter for negotiation. However, some factors to be considered come from the precedent that the EEA countries set. The UK would be expected, for example, to have to contribute to maintain the institutions that support the agreement, just as the EEA countries have a budget to fund the EFTA Court, EFTA Surveillance Authority and other required bureaucracy. Similarly, Norway contributes funds to a number of EU countries to support their development through "Norway grants", paid to the countries that are recipients for the EU Cohesion Funds. This is part of the "price" that Norway pays for its preferential trading relationship with the EU. Norway has a significant degree of control over how this money is spent in EU countries: country-specific priorities and programmes are negotiated between Norway and the beneficiary states, and only around half are paid directly to the EU member state governments: 63 of 150 programmes that Norway was funding in 2015 were benefiting public authorities and institutions, charity organisations and businesses[26].

Exhibit 11: EEA contributions 2009-2014

Beneficiary state	Amount (million EUR)
Poland	578.1
Romania	306.0
Hungary	153.3
Czech Republic	131.8
Bulgaria	126.6
Slovakia	80.8
Lithuania	84.0
Latvia	73.0
Greece	63.4
Portugal	58.0

Of course, the UK Government may wish to make the choice to continue contributing to the EU budget for access to specific programmes. For example, the UK business community is keen to see the UK to continue participation in the Framework Programmes that support innovation and research and development across Europe, and would have to contribute to do so. The UK has benefitted significantly from its involvement in each of the EU's Framework Programmes since their inception over 30 years ago – including the current programme, Horizon2020. While the funding Framework Programmes provide is an important benefit, the access to collaborative opportunities – with companies and researchers from across the EU – is even more highly prized by business. These links lead to more successful innovation and can even foster exporting relationships. Furthermore, participation in Framework Programmes enables the UK to

[26] Norwegian Ministry of Foreign Affairs, Norway and the EU – partners for Europe

engage and influence the international development of regulations and the harmonisation of data standards. Enabling UK businesses to continue to play a role in the early stages of regulatory development can ultimately help them to sell innovations into the EU.

Much of the returning EU funding is ear-marked for the NHS, but it is also important that growth in the UK's regions and nations does not lose out as the UK takes control of formerly-EU supplied structural funds. The CBI believes a joined-up approach for this funding is important, and that it should be administered alongside the Government's vision of a modern industrial strategy, which aims to tackle the UK's productivity problem. This is important because the UK's productivity currently lags major competitors such as the US and Germany by well over 20% and has one the most uneven regional distributions of incomes among Western economies[27]. It is critical to create a level playing field for all UK regions to deliver the industrial strategy and should there be any additional capital available following the UK's departure from the EU, the Government should seek to address these regional imbalances.

There are two key areas through which this regional growth should be achieved. Firstly, the National Productivity Investment Fund. Coordination of this fund with sector deals will be important to continue to unlock the value businesses can add to a region through strong supply chain leadership. Government should appoint an independent commissioner to ensure the areas that haven't got devolution deals can compete competitively to obtain this funding. Secondly, the Shared Prosperity Fund as set out in the Conservative Party manifesto. This funding should – among other things – be used to encourage firms with the skill and the will to find and adopt tried and trusted technologies and management practices that the best businesses showcase. The impact achieving this aim could be a £100billion plus uplift in the economy and a narrowing of income inequality by 5%[28].

[27] ONS international comparisons of productivity
[28] CBI, From ostrich to magpie

But a new single market relationship is only half the answer: a comprehensive UK-EU customs union is needed

The Government has set itself three objectives to achieve with a new customs relationship with the EU, outside of the EU customs union:

- Ensuring UK-EU trade is as frictionless as possible
- Avoiding a 'hard border' between Ireland and Northern Ireland or between Northern Ireland and Britain
- Establishing an independent international trade policy[29]

Business supports these objectives and all are important, however – thus far – no proposals have been set forward that can deliver all three in their entirety. Considering the importance of the customs relationship between the UK and the EU, to businesses not just in the UK but across the world, here more than anywhere it is vital to consider the evidence.

The evidence to consider

A customs union with the EU would help facilitate the smooth flow of trade volumes

The importance of the UK-EU relationship to the British economy is such that trade that is frictionless as possible must be pursued to protect jobs and living standards. Achieving 'frictionless trade' with the EU is vital for prosperity. The facts are clear:

- **The EU is the overwhelmingly the UK's most important trading partner:** it provides the UK's single largest export market for goods in 2016, accounting for 48% (£145 billion), or 7.4% of GDP,[30] as well as the source of 55% (£241 billion) of the UK's imports of goods in 2016[31]
- **The EU is currently business' preferred market for trade:** 78% of UK exporting companies, for instance, sell into the EU[32], leveraging its 446 million consumers. The vast majority of these companies (96%) are SMEs[33]
- **UK infrastructure has been built to support easy EU trade.** The Port of Dover deals with the equivalent of 17% of UK trade, with a record 2.6mn freight trucks passing through the port in 2016.[34] At the same time, the Eurotunnel moved over 1 million small parcels per day and transported £100 billion in trade between the UK and the EU[35]

The UK's current membership of the EU customs union, alongside membership of the single market, has created a frictionless trading relationship, one that has helped support these close ties, small businesses and trade volumes.

Exhibit 12: Average EU MFN tariffs

Category	Approximate tariff rate
Dairy products	36%
Sugars and confectionery	Nearly 30%
Beverages and tobacco	Over 20%
Clothing	Over 10%
Cars	10%
Textiles	Over 5%
Chemicals	Nearly 5%
Coffee and tea	Over 5%
Electrical machinery	Over 3%

One of the important things the UK's current membership of the EU customs union provides for is the removal of tariffs chargeable on goods traded between members of the union. Leaving the EU customs union creates a risk that these will be payable. The CBI has estimated the potential costs of tariffs on UK exports to the EU carried out under WTO Most Favoured Nation terms to be on, average, around 4%. If this were applied to total UK goods exports to the EU – the increase in tariff costs would be between £4.5-6 billion per year. Some exports would face tariffs a lot higher

[29] Treasury Select Committee, Letter from the Chancellor to the Chair
[30] Office for National Statistics, Who does the UK trade with? 2018
[31] UK Balance of Payments, The Pink Book 2016
[32] Department for Business Innovation & Skills, UK SMEs in the Supply Chains of Exporters to the EU 2016
[33] HM Revenue and Customs, UK Trade in Goods by Business Characteristics 2015
[34] Dover Harbour Board, Annual Report & Accounts: Port of Dover 2016
[35] Eurotunnel Interview

than the average rate: meat would face a tariff of 26%, for example, while the competitiveness of UK car exporters would also be seriously affected.[36] A trade agreement between the UK and EU could agree to zero tariffs on trade, a customs union is not required for this. However, even with a free trade agreement that is more comprehensive than any other, outside of the EU customs union firms could well find themselves paying tariff charges anyway through rules of origin, a complication that it is very important negotiators find a solution to.

Exhibit 13: Rules of origin case study

A product is made with parts from factories in the UK, Mexico, Poland and South Korea. Each factory makes ~25% of the final product. The UK, Polish and Mexican factories export their parts to South Korea where the final product is assembled. As 75% of the final product comes from the EU or South Korea, which has a trade agreement with the EU, this product can be sold tariff-free.

However, after Brexit, only 50% of the final product will come from within the EU and South Korea and it will face tariffs. This is because, according to the rules of origin in the EU-South Korea trade deal, 60% of the product must be from the EU or South Korea for it to be tariff-free.

The customs relationship between the UK and EU is important to business for more reasons than just tariffs however. UK's existing membership of the EU customs union also currently exempts goods flowing between the UK and EU member states from customs checks, and creates a total exemption from EU Rules of Origin requirements. The lack of paperwork, audits and other red tape has helped businesses on either side of the channel minimise the burden of regulatory compliance and maximise the efficiencies of non-stop movement of goods. Conversely, imports from outside the EU customs union face burdensome and costly administrative procedures to establish the nature of the product, its origin, its value, and duties paid.

Businesses are very concerned about the costs and delays that will arise from leaving the EU customs union. Even with the negotiation of some easier processes, UK-EU trade will be subject to most of the same procedures as non-EU countries, and customs enforcement infrastructure will need to be put in place at the border to manage this. Businesses exporting goods between the UK and the EU, would need to complete Rules of Origin documents on both components and finished goods. For the 135,000 businesses who currently only export to the EU, this would be a huge and unprecedented administrative challenge, while companies of all sizes would incur significant costs. Government has previously estimated that these would range from 4% to 15% of the cost of the good.[37] Meanwhile, an OECD study found that documentation and customs compliance requirements, lengthy administrative procedures and other delays can increase transaction costs by between 2%-24% of the value of the good.[38]

The sort of border necessitated through exiting the EU customs union would take years to develop and huge amounts of resource to manage. Current expectations are for up to 5,000 new HMRC staff required to manage the volume of declarations and checks.[39] Ports such as Dover, where over 99% of all trade is with the EU, would see increases in customs declarations of over a hundredfold.[40] This multiplication of the burden at the border would lead to disruption, marring the flow of trade volumes.

A comprehensive customs union between the UK and the EU after exit would go a long way towards minimising the additional infrastructure requirements, paperwork and the tariffs the EU, delivering trade that is as frictionless as possible to protect trade with our closest partner. While the Government has sought to put forward proposals to manage some of these burdens from outside a customs union with the EU, these plans rely on the EU agreeing an unprecedented range of 'negotiated facilitations'. Even if the UK achieved all of those, businesses will face additional burdens, major infrastructure changes will be required to handle customs declarations, and there will absolutely be 'friction'. Regardless of the UK's

[36] CBI, Eyes Wide Open lecture
[37] Institute for Government, Implementing Brexit: Customs
[38] Trade Committee, OECD, 2013
[39] HoC Treasury Committee: Oral Evidence: HMRC Annual Report and Accounts
[40] Institute for Government, Implementing Brexit: Customs

new relationship with the single market, some level of additional friction is inevitable, but that friction would be much reduced by a customs union between the UK and the EU.

A customs union between the UK and EU would facilitate trade and security in Ireland

An open and frictionless border has been vital to the prosperity of the all-island market in Ireland. Unlike Scotland, England and Wales, Northern Ireland shares a direct land border with the Republic of Ireland. This geographic proximity, combined with membership of the European Union, has led to ever increasing economic integration throughout the island. Over 37% of Northern Ireland's total exports, for instance, go to the Republic of Ireland (ROI), equivalent to £3.4bn per annum.[41]

Meanwhile, many Northern Irish businesses operate on an all-island basis with entrenched supply chains across the entire island. In 2015, over 5,000 businesses in Northern Ireland exported goods to the Republic of Ireland (one and a half times as many as sold goods to Great Britain).[42] This means that parts, materials and finished goods cross the border constantly.

- 177,000 HGVs and 208,000 light commercial vehicles cross the border between Northern Ireland and the ROI each month.
- Almost 13,000 border crossings are made each year to produce Guinness.
- More than one quarter of Northern Irish milk is processed at plants in the Republic.[43]

Unless a unique solution can be found, leaving the EU customs union and the single market will inevitably lead to the imposition of physical customs infrastructure at the Irish border, as well as a wide range of import and export procedures which will frustrate movement across the border. This would threaten the prosperity generated by all-island economic integration, slowing down trade, increasing administrative costs, and disrupting supply chains, with serious consequences for critical sectors such as agri-food and construction. In this case, Irish businesses across both countries will need to comply with certificate of origin requirements. According to one estimate, this would add over €458 to the cost of shipping every consignment of goods across the border.[44] Even for an SME sending just 2,200 batches of goods across the border in a year (6 or 7 each day), this raises an additional cost of over €1 million.

Exhibit 14: Northern Ireland's economic recovery is fragile

- Northern Ireland is one of the least well-off regions of the UK: income per head is 73% of the UK national average
- Poverty levels in Northern Ireland are among the highest of all UK regions: low-income individuals make up 20% of the population
- Estimates of regional Brexit impacts show Northern Ireland to be heavily exposed: one average shows Northern Ireland's GDP 2.8% lower after a decade, compared with 1.8% lower for the UK overall
- In 2017, the Northern Ireland economy is expected to expand by a sluggish 1.4% - three times slower than the forecasted 4.9% growth in the Republic of Ireland

Businesses agree with the Prime Minister that it is vital to avoid a return to the 'borders of the past', for reasons that are more than economic. The introduction of the European Single Market in December 1992, alongside the existence of the EU customs union, eliminated the need for the customs controls that had been in place since 1923.[45] Membership of both contributed to the eventual removal of a hard border with the signing of the Belfast Agreement in 1998. The economic and social progress attained by the citizens of Northern Ireland since then must not be compromised. The business community recognises that peace and prosperity are highly correlated. Both are underpinned by free movement of people, services and goods between Northern Ireland and the Republic of Ireland, and between Northern Ireland and Great Britain. Businesses are clear: there can be no 'hardening' of either border.

[41] NISRA, Broad Economy Sales and Export Statistics
[42] HM Government, Additional Data Paper: Northern Ireland Trade Data and Statistics, August 2017
[43] DG Internal Policies of the Union, Smart Border 2.0
[44] DG Internal Policies of the Union, Smart Border 2.0
[45] DG Internal Policies of the Union, Smart Border 2.0

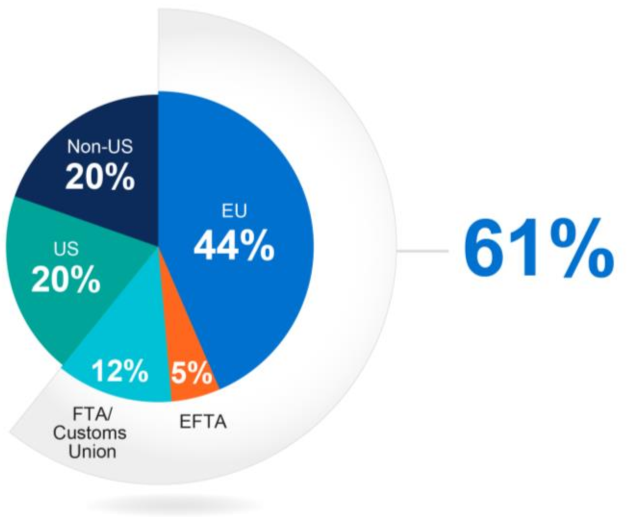
A comprehensive customs union between the UK and the EU, while not the entire answer to the border quest, is part of the answer. A return to the borders of the past must be avoided and the successful running of all-island businesses protected. This is even more important in the context of the slow recovery of the Northern Irish economy, which is in stark contrast to the rapid growth of its nearest neighbour, as in Exhibit 14[46 47 48 49]. The solution is not moving the border to the Irish Sea, as exports between Northern Ireland and Great Britain are 4 times that of exports to the Republic of Ireland[50]. So far, none of the proposals put forwards by the Government will deliver its objectives for Northern Ireland. A customs union would help it to.

A customs union would limit the UK Government's independent trade policy, but the benefits of such a policy are unproven

The main benefits of leaving the EU customs union are the possibility of new trade opportunities and the ability to deviate from the common external tariff. This is the tariff that is applied to all third-country businesses trading into the customs union that ensures consistency of treatment. There has been much discussion about which countries the UK would like to negotiate new free trade agreements with, with the Government setting up over 14 bilateral working groups.

However, the business case for sacrificing the UK's frictionless trading relationship with the EU in order to negotiate new agreements has not been proven. Recent research from the National Institute of Economic and Social Research estimated that the increases to UK trade from concluding FTAs with the USA, Canada, Australia and New Zealand combined are less than 3% of current total trade in goods and services. Meanwhile, the estimated trade increase from concluding FTAs with the BRIIC (Brazil, Russia, India, Indonesia, China and South Africa) countries combined is even smaller, at just over 2%. In contrast, the evidence shows that leaving the single market would lead to a long-term reduction in total UK trade of between 22% and 30%.[51] Exhibit 15 shows how the majority of the UK's trade is already covered by its EU relationships – through the EU membership, EFTA and EU free trade agreements[52].

Exhibit 15: The UK's percentage trade by arrangement



In addition to questions around the relative economic benefits of signing FTAs with other countries, there are also serious questions over the practicalities of negotiating high numbers of trade deals in order to match the current benefits of UK-EU trade. The vast majority of non-EU FTAs currently in existence are relatively poor at breaking down non-tariff barriers, which are vital for the UK's thriving services sector. Meanwhile, comprehensive trade deals - of the sort that would be most beneficial to the UK - take a long time to complete and require vast resources.

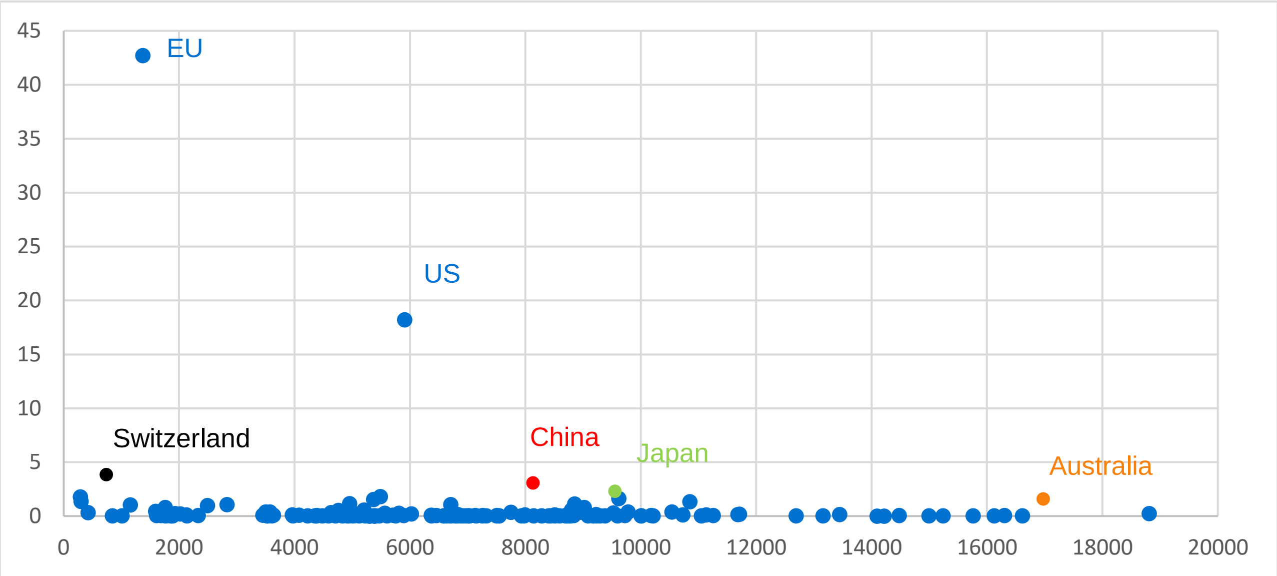
Successfully developing and negotiating the types of agreements that would deliver real economic benefit takes time, staff, and knowledge. While it is possible to negotiate and implement an FTA in a relatively short space of time – on average the US takes 3 and a half years to move through negotiations

[46] ONS, via Haver
[47] DWP via "Poverty in the UK: statistics", House of Commons.
[48] Oxford Economics, The Economic Implications of UK exit from the EU for Northern Ireland
[49] EY Economic Eye, December 2017
[50] ONS
[51] National Institute of Economic and Social Research, Will New Trade Deals Soften the Blow of Hard Brexit?
[52] Making Brexit Work for British Business, Peter Sands et al.

and conclude implementation – agreements which provide wider and deeper benefits take far longer to secure.[53] CETA, the EU-Canada agreement, took seven years to complete and it is not yet fully implemented. Yet this is closer to the type of agreement that the UK would need to negotiate to cut customs duties, open up new procurement contracts, and to ease access to telecoms and other service sectors. It is not currently feasible for the UK to negotiate lots of these agreements simultaneously. Building up a new portfolio of trade agreements would take decades.

Leaving the EU customs union to strike free trade agreements with far-flung countries may sound exciting, but the reality is that distance still matters to trading businesses. Analysis by PwC of more than 100 previous studies showed that proximity has only become more, rather than less, important to trade in goods. Halving the distance to a market roughly doubles the volume of exports.[54] This is demonstrated by the UK's existing patterns of trade. For instance, at present, the value of the UK's trading relationship with Ireland is greater than its trade with Italy or Spain, even though the total size of Ireland's economy is much smaller.[55] Businesses emphasise this anecdotally, with many small firms stating they venture into trading with the EU first as a springboard to the rest of the world, and larger firms explaining they have the resource to have production in markets abroad, and therefore do not need to trade with them from the UK.

Exhibit 16: Distance still matters, Percentage exports against distance (km from UK)[56]



With so many questions as to the value and practicalities of focussing on new markets across the globe, there is simply not enough existing evidence to warrant endangering the existing frictionless trade of £145billion in goods to the EU.[57] There are certainly a number of specific, high tariff products that stand to gain from the UK having the independence to strike trade agreements, but for the economy as a whole it would be wrong to put international trade before frictionless trade with the EU and a soft border in Ireland.

[53] Peterson Institute for International Economics, How Long Does it Take to Conclude a Trade Agreement with the US
[54] Financial Times, The Post-Brexit Trade Deals that Britain Needs to Prioritise
[55] Office for National Statistics, Who does the UK trade with? 2018
[56] ONS, Who does the UK trade with?, Grant Lewis and Samuel Lowe, Can Global Britain Defy Gravity?
[57] UK Balance of Payments, The Pink Book 2016

How could staying in a customs union with the EU work in practice?

When the UK ceases to be a Member State of the European Union the country will also automatically exit the EU Custom Union. As only Member States can be a member of the EU's customs union, the UK will likely have to agree a separate customs union agreement with the EU, which would be a matter for negotiation.

At present the EU has customs unions with 3 countries: Turkey, Andorra, San Marino. Turkey's customs union with the EU is not comprehensive. It covers industrial goods, but not primary goods, agriculture, service-related goods or public procurement. However, there are proposals to expand the remit of this arrangement as of December 2016. These proposals are based on the perception that Turkey is moving closer to EU rules and regulations over time.

Given that this is the case, and with the UK's existing levels of complete regulatory alignment with the EU, it would be reasonable to expect the UK to be able to negotiate a fully comprehensive customs union agreement with the EU, which would include all goods, agriculture, service-related goods and public procurement. This fully comprehensive arrangement remains the only existing model which could closely preserve the current efficiencies of frictionless trade with EU member states.

The choice to enter into a comprehensive customs union with the EU would necessitate ongoing protection of the integrity of the market covered by the EU customs union where goods flow freely. To do this, and avoid differences in the point of entry to the customs area, the UK would need to copy the external trade regulations implemented by EU member states – namely the Common External Tariff (CET) and the Common Commercial Policy (CCP).

- The Common External Tariff sets a uniform set of duties levied on goods entering the customs area from countries outside the customs area. This ensures that there is no competitive advantage to entering the customs area from one point because of lower duties.
- The Common Commercial Policy applies uniform principles in the fields of movement of goods, trade in services and the commercial aspects of intellectual property which could be subject to trade negotiations with markets outside the EU (with a few exceptions). This policy requires consistent application of EU trade policy to ensure that the EU can guarantee the provisions of its trade agreements with third countries across its entire customs area.

Making a success of being in a customs union

While being in a customs union with the EU does place limits on the independence of the UK's international trade policy, it by no means eliminates it. Indeed, the importance of a robust and ambitious Government strategy to boost exports and attract FDI grows exponentially. Many countries excel at exports from within the EU customs union – for example, Germany sells 4.7 times more to China than the UK does[58], without a free trade agreement.

Firstly, the UK would also retain significant areas of influence over its trade and investment performance, providing key services to promote investment opportunities and encourage business into export activity. Given the substantial current trade deficit and untapped export potential across every region of the UK, this area of Government activity and focus will be key to future economic growth regardless of the outcome of the EU negotiation.

There is much that the Government could be focusing on:

- The whole of Government could devote more resources to our presence in markets abroad, ensuring commercial diplomacy is used to maximum effect in fast-growing overseas markets
- The Department for International Trade could redouble its efforts to address every area where its predecessor UKTI did not succeed in narrowing the exports gap

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[58] CBI; Haver; ONS; Deutsche Bundesbank.

- Much work remains to ensure that the new Industrial Strategy delivers real change on the sector-specific needs for breaking into new markets and a consistent approach to new markets
- As part of the Industrial Strategy, Government and business should be looking to embed best practice across business export support in regional Local Enterprise Partnerships (LEPs)
- More should be done to mirror the successes of comparable third-country government initiatives in areas like export credit finance and trade missions
- The Government could also expand the current model of formal bilateral government-to-government dialogues to new markets to help identify opportunities for improving market access conditions and regulatory cooperation
- Much work could be done through partnership with business to achieve a joined-up whole of Government approach to the “global Britain” agenda, with policies on industrial strategy, skills, infrastructure and immigration all aligned behind a shared objective of market openness and enhancing overseas trade opportunities

As an independent member of the WTO, the UK would have the ability to influence the international trade agenda at the WTO. Focusing efforts here on topics such as the ground-breaking proposals on e-commerce currently being progressed has effect not just in one country but in over a hundred, as the ‘Most Favoured Nation principle’ means any successes negotiated at the WTO are effective across all markets at once. Equally, even when not all countries in the WTO agree to a proposal, the UK is well placed to lead the way on plurilateral cooperation at the WTO. For example, the UK can increase its impetus behind the current Trade in Services Agreement negotiation, to provide the UK with a platform to gain preferential access for key sectors in multiple markets simultaneously.

And while the UK would have a more limited scope for its independent trade policy with regard to trade negotiations, the UK would be free to negotiate bilateral agreements with those countries the EU has already completed negotiations with. The UK would have limited leverage and would be unable to negotiate trade agreements with third countries on issues of tariffs, non-tariff measures, customs cooperation, or regulatory recognition which the EU Commission has within its competence. But it would be able to hold third-party negotiations on areas not covered by the CET or CCP or outside formal trade remits, such as audio-visual services, visa cooperation and recognition of professional qualifications, to help further the reach of the UK’s world-leading legal services sector for example.

One of the issues the UK Government will have to tackle in negotiations of a customs union is that UK would have to provide the same preferential access that EU member states provide to third countries, but lack the reciprocal third country preferential access or any influence on the negotiation of the terms due to being outside the EU. That may be a necessary cost of prioritising frictionless trade with the EU and a soft Irish border, but it may also be possible to negotiate a solution to this. **The UK should seek to learn the lessons of other countries,** including the precedent that Turkey was attempting to set with the EU, in order to find a solution to this.

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