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Brexit (2): The New Deal: Future trade relations between the UK and the EU after withdrawal from the EU: What are the best options?

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To withdraw from the European Union, the EU and the UK will need to negotiate a “divorce agreement” (see our first post [here](#)). Following this, a so-called Second Agreement could be negotiated between the EU and the UK. This new agreement will deal with trade relations between the EU and the UK. In this post we will discuss the various options available, along with their pros and cons.

What needs to be kept in mind is that the UK will aim to maintain its access to the Single Market, free movement of goods, services and capital. The free movement of persons and the freedom of establishment are potential problem areas for the UK^[1], as well as the contribution it currently makes to the EU. By the end of this post we will have argued why the Swiss model would be in the best interest of the UK, and the EEA-model (with the UK also being part of the EFTA) in the best interest of the EU.

European Free Trade Association (EFTA)-model

First of all, the UK could become part of the EFTA. Iceland, Lichtenstein, Switzerland and Norway are already part of it. The EFTA is an intergovernmental organization between Iceland, Lichtenstein, Switzerland and Norway. Founded in 1960 with the conclusion of the EFTA Convention, it consisted also of members that would later join the EU (as for instance the UK, that joined it in 1960, but would leave it to become part of the EC (EU) in 1973). The general aim is free movement of goods between its members (which means no duties and customs). There are also provisions on State aid (referring to the WTO framework) and competition law that set conditions all EFTA-members need to apply. The free movement of persons (including right to work, entry and residence) is also dealt with under the Convention, allowing for some exceptions for Liechtenstein and Switzerland in an Annex to the Convention. The EFTA as an organization manages the compliance of the members itself as party to the EFTA Convention. Besides being part of the Convention, three particular EFTA-members (Liechtenstein, Norway and Iceland) have become party to the EEA-agreement (which will be discussed in the next paragraph). Additionally, there are some EFTA Free Trade Agreements with third countries to which all members of the EFTA are automatically party. In relation to third countries (other than those which are included under the EFTA Free Trade Agreements) the individual EFTA-members may create their own policy and impose their own customs and duties. The EFTA, as an international organization, upholds the management of the EFTA Free Trade Agreements itself but also the membership of Liechtenstein, Norway and Iceland to the EEA.[2]

EFTA-membership itself would not provide any guarantee for the UK in its trade relations with the EU since it is only an agreement between non-EU countries. The Norwegian minister of European Affairs, Elisabeth Vik Aspaker, has not been very positive about the UK rejoining the EFTA.[3]

European Economic Area (EEA)-model

The UK could also become part of the European Economic Area (EEA). This membership could be additional to membership in the EFTA and possibly alternative to it, although at present all non-EU members of the EEA are also EFTA-members. The EEA Agreement is a treaty between EFTA-members and the EU (Switzerland not being part however). It includes access to the Single Market, the free movement of goods and services, the free movement of persons and the

freedom of establishment. EU rules on the Single Market would need to be accepted, and the UK would no longer have a say in the substance of legislation that is made at EU level. Also, costs would not be significantly reduced, given that the price the UK would pay is 83% of its current EU spending.[4] There would be no joint foreign policy with the EU, and the EEA is not a member of the EU customs union. Trade agreements with third countries could be agreed upon independently from the EU.

Jean-Claude Juncker has ruled out any concessions by the European Commission on the free movement of persons.[5] This makes the EEA less attractive for the UK, since it would have to accept the free movement of persons, as well as abiding by EU legislation without having any say in it. Thus, the EEA option would be most in the interest of the EU, and not in that of the UK (at least not if it does not want to maintain the free movement of persons). Nevertheless, some scholars in the UK also have suggested that short-term membership with the EEA would be a safe, but not permanent, option for the UK and would allow for transition of EU-UK trade relationships to yet another model.[6]

The Swiss model

Switzerland is an example of a country that is part of the EFTA, but has not become part of the EEA. Instead, Switzerland has individually negotiated and enacted a number of agreements with the EU on various aspects of trade. These treaties, taken together, are substantially similar to EEA membership. The result is freedom in the trade of goods and the free movement of persons within the EU, although it includes no agreement on the trade in services. In some agreements, Switzerland has agreed to participate in EU programs. Since these programs are largely influenced by the EU, there is little room for Switzerland to influence those programs and requires the implementation of EU policies and legislation in these specific Treaties. However, Switzerland is free to decide whether or not to participate in any given program. Trade agreements with third countries can be agreed upon independently from the EU. Switzerland now contributes 40 percent of what the UK is currently paying.[7] A similar agreement would be beneficial for the UK.

In the field of free movement of persons, the situation is unique. Switzerland is member of the Schengen agreement (which focuses on in- and external borders) and has also concluded an agreement with the EU on the free movement of persons. The latter is more extensive than the Schengen agreement in that it

establishes rights to entry, of residence and of access to work. It is noteworthy that article 25(4) of the agreement implies that if it is either not renewed or is terminated the agreements on trade would cease to apply. This keeps the pressure on Switzerland to comply with the agreement on the free movement of persons. Given Juncker's statement about the free movement of persons, it is likely the UK would share the fate of Switzerland in this respect. An advantage for the UK would be that it could negotiate each agreement separately, allowing it to try to find the best way to serve its own interests. However, the same would apply to the EU. Given the competing interests, the Swiss option might turn out well for either the EU or the UK, but each negotiation will have a winner and a loser. Generally speaking, however, this model would be most attractive for the UK given the possibility to negotiate agreements per topic with the EU on an individual level.

Customs Union-model

Another option would be to conclude a customs union agreement. Turkey has made such a deal with the EU, and the result is that no taxes or duties are imposed on the import or export of industrial goods. However, this does not apply to agricultural goods and services (and this limitation would prove burdensome to the UK's trading position). When Turkey negotiates agreements on free trade with third countries, these agreements need to be equal to those which the EU has concluded with these respective third countries. Also, Turkey needs to apply autonomous trade (generalized trade instruments) that allow for some particular third countries to pay less or no duties on EU exports in the same way as the EU does it. Under this model, the UK would, as shown, have no free say on the tariffs and duties that it wants to impose on imports from outside the EU. Given the primary industries in the UK, a Customs Union would not be in its best interest unless it included all goods and services. For the EU, it would also not be the most attractive option since it does not cover any agreement on the free movement of persons.

Comprehensive Economic and Trade Agreement (CETA)-model

Yet another option would be to set up a trade agreement like the CETA, which Canada has concluded with the EU. Tariffs are in that case only abolished for specific areas of trade, and access is granted to the Single Market. The problem for the UK would be that services are usually not included in agreements of this type. Given its dependence on services, there is little chance that such an agreement would be in the best interest of the UK. From an EU perspective, this option would

also not be the most attractive, since it would most likely not include the free movement of persons.

World Trade Organization (WTO)-model

A final option would be to not conclude any agreement, and to rely on the WTO as a fallback. This would mean that export to EU Member States and other countries would be subject to most favored nation tariffs, nonetheless resulting in higher export costs for the UK. Also, the WTO has made no progress on trade service liberalizations. One benefit would be that no contributions need to be made to the EU budget. Although the UK would not be required to adopt EU economic policies and Regulations, divergences between UK and EU Regulations would still result in non-tariff barriers to trade, and would increase the costs of doing business with the EU.[8] As already stated, the UK economy is highly dependent on services, so there is little chance that the UK would like to rely on the WTO framework to govern its relations with the EU. Also, the EU would not be best served by this option since the free movement of persons is not part of the WTO framework.

Which is the best option?

Comparing all models, the Swiss model would be the best option for the UK, provided it prevails in not agreeing to the free movement of persons. The reason for this is that, as opposed to becoming a member of the EEA, the Swiss model can be tailored to include services as well as allowing for the freedom to negotiate trade agreements with third countries. However, Juncker's words seem to indicate that the free movement of persons will be non-negotiable. This will make it difficult for the UK to reach an agreement that allows for the freedom to provide services, but excludes the free movement of persons. At the same time, the UK's contribution would be lower when compared to EU and EEA membership.

From the EU's point of view, EFTA and additional EEA membership for the UK would be the most interesting. It would grant the UK access to the Single Market, but at the same time the UK would have to implement EU Single Market policies and would have no say in the creation of Single Market rules. The UK would also have to accept the free movement of persons, also given Juncker's statements. EEA membership would most likely imply EFTA membership. As already said, a transitional membership of the UK in the EEA might be beneficial as it allows for the UK to fully reconsider its future in trade relations with the EU. In any event, it will be interesting to see how the UK manages the negotiations in pursuing its interests. Will the Second Agreement provide something of a *New Deal*[9] for the

UK?

Next week's post will deal with the consequences of Brexit in the field of taxation.

[1] It is important to distinguish the free movement of persons (which also involves non-economic active persons) from the free movement of workers.

[2] The European Free Trade Association (website) <<http://www.efta.int/about-efta/european-free-trade-association>> accessed 15 August, 2016.

[3] Patrick Wintour 'Norway may block UK return to European Free Trade Association' *The Guardian* (London, 9 August 2016) <<https://www.theguardian.com/world/2016/aug/09/norway-may-block-uk-return-to-european-free-trade-association>> accessed 9 August, 2016.

[4] Swati Dhingra and Thomas Sampson, 'Life after BREXIT: What are the UK's options outside the European Union?' [2016] Centre of Economic Performance (The London School of Economics and Political Science) PaperBrexit01, p. 1 <<http://cep.lse.ac.uk/pubs/download/brexit01.pdf>> accessed 6 July 2016.

[5] Suzanne Lynch, 'Brexit: Juncker rules out free movement in future negotiations' *The Irish Times* (Dublin, 1 July 2016) <<http://www.irishtimes.com/news/world/europe/brexit-juncker-rules-out-free-movement-in-future-negotiations-1.2706760>> accessed 5 July 2016.

[6] James Blitz, 'Brexit latest: The interim European Economic Area option' *The Financial Times* (London, 25 July, 2016) <<http://www.ft.com/cms/s/0/931bffc8-5253-11e6-befd-2fc0c26b3c60.html#axzz4HPcYZyUU>> accessed 15 August, 2016.

[7] Swati Dhingra and Thomas Sampson, 'Life after BREXIT: What are the UK's options outside the European Union?' [2016] Centre of Economic Performance (The London School of Economics and Political Science) PaperBrexit01, p. 1 <<http://cep.lse.ac.uk/pubs/download/brexit01.pdf>> accessed 6 July 2016.

[8] Swati Dhingra and Thomas Sampson, 'Life after BREXIT: What are the UK's options outside the European Union?' [2016] Centre of Economic Performance (The

London School of Economics and Political Science) PaperBrexit01, p. 8
<<http://cep.lse.ac.uk/pubs/download/brexit01.pdf>> accessed 6 July 2016.

[9] This was the name of a series of social liberal programs of US President Franklin D. Roosevelt implemented in the 1930's for recovery of the US economy after the Great Depression.