



TASK FORCE REPORT 2018

BREXIT:

**How to Shape Britain's
New Relationship with
the European Union**

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BREXIT:

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Executive Summary

On June 23, 2016 Britain voted to leave the EU, since then the public and government have struggled to understand the implications and formulate a plan for the future. With the formal exit date fast approaching, how the UK-EU relationship will be shaped is still unclear. It is important for the UK to formally establish its positions for its future relationship with the EU or risk damaging its relationship. Currently the UK is seeking to ensure its sovereignty while retaining its trade relationship with the EU. Given the intertwined nature between the two entities, this unprecedented move provides no simple or easy solution. It is suggested that the UK take the following actions to ensure a new, productive relationship with the EU

- Retain a close trade relationship with the EU Customs Union and Single Market to sustain market efficiency, as well as create a judiciary alignment based on a CETA model joint-committee to resolve future disputes.
- Create a trade agreement based on TISA principles that would allow for the uninterrupted flow of services between the UK & EU. This would see the prioritization of professional and digital services and seek to utilize a joint committee to maintain regulatory alignment.
- Negotiate a trade agreement that preserves passporting rights and equivalence standards and additionally create a joint committee from EU and UK regulations to resolve potential disputes.
- Create a new immigration system to regulate the flow of migrants. This can be done through a quota system combined with a contractual permit system.

Introduction

The United Kingdom is undeniably part of Europe but has historically separated itself from the continent. This sentiment became apparent on the 23rd of June 2016, when 51.9% of the participating UK electorate voted to leave the EU, an event that came to be known as Brexit. The UK voted to leave in hopes of regaining control of its borders, reestablishing full sovereignty, and ending its financial contributions to the EU. Having invoked Article 50 of the Treaty of Lisbon, which provides a mechanism for EU member states to withdraw from the Union, the UK is set to officially end its 45-year participation in the EU by the end of March 2019.

The process of leaving the EU has so far evolved through two phases. The first phase was completed with a bilateral UK-EU agreement on December 15, 2017. In this agreement, the UK promised to maintain the rights of EU citizens living in Britain and contribute to the EU budget during the Brexit transition period. Further, they guaranteed that the reestablishment of a 'hard border' between the Irelands would not occur.

As they enter phase two, both Britain and the EU are formulating their views on the shape of the future bilateral relationship.

Why is the UK leaving?

The UK wants to take greater control of its borders, eliminate financial contributions to EU budgets, and regain the freedom to make trade deals directly

with other countries. However, it wishes to maintain favorable access to EU markets that are vital to Britain's economic growth and prosperity. At present, however, the UK government is divided over the form its new relationship with the EU should take. Some are pushing for a complete break from all EU institutions, including the customs union and the Single Market, while others believe that retaining some EU participation, perhaps within a customs union, would preserve market access and avoid serious costs to the British economy.

It is estimated that if the UK were to make a clean break with the EU and reset the bilateral trade relationship on the basis of World Trade Organization (WTO) tariff levels, it could reduce Britain's GDP by as much as 4.9% over 10 years. Replacing current free access to EU markets with trade agreements that would impose new tariffs, regulatory barriers, and customs procedures would be costly, but less so; estimates under this scenario see a reduction in GDP of just 1.9% over 10 years.

Where does the UK Go from Here?

During Phase Two of the transition period, which could last as long as two years beyond Britain's exit date in March 2019, the UK will continue to abide by EU regulations, and continue its contributions to the EU budget. Thus, it will effectively remain within the EU Customs Union and Single Market, and temporarily preserve its free access to EU markets in goods and services while it negotiates a new relationship.

Membership in the Single Market enables the UK to vastly expand its trade and investment relationship with the EU. Single Market membership also requires the

acceptance of the right of all EU citizens to live and work in any member state, a requirement that is at odds with current UK policy.

Based on the “four freedoms” (freedom of movement in goods, services, capital, and people among EU member countries) enshrined in the 1987 Single Europe Act, the Single Market has eliminated a wide range of tariff and non-tariff trade barriers within the EU over time. The harmonization (common definition of standards between countries), mutual recognition (reciprocal acceptance of each countries standards), or outright elimination of national standards, rules, and regulations open the door to new markets across the EU, particularly in services and finance.

The EU Customs Union is a tariff-free internal market among EU members. The EU Customs Union allows for minimal customs procedures and costs, as well as a common external tariff to which all members adhere. This has benefitted UK goods exports, allowed the development of key markets within the EU involving supply chains and enabled the trade in intermediate goods processed in different member states. In fact, as a member of the customs union since joining the EU in 1973 and of the Single Market since its inception in the 1980s, Britain's export industries, in goods, services and finance have developed in unique ways. This allows the nation to take advantage of the trade incentives and benefits that these agreements offer.

Leaving the EU will entail costs for British businesses as they adjust to new tariff and non-tariff barriers, costlier customs procedures, reduced investment opportunities, and more difficulty in attracting skilled labor from EU countries.

UK Goals and Priorities

The UK government has not yet established its negotiating priorities for the new relationship with the EU. Instead, it has offered a number of policy statements widely interpreted as “red lines” (or minimum goals) for the negotiation process with the EU. These red lines include withdrawing entirely from the Single Market and the customs union. Though debate over negotiating a new customs union agreement with the EU continued in early 2018, UK policy remains unchanged on this point. Refusal to accept the free movement of people enshrined in the Single Europe Act constitutes another redline for the government. Legally, this would seem to foreclose any possibility of remaining a full member of the Single Market, which requires adherence to this fundamental principle.

The form that the new UK-EU relationship might take has been the subject of intense speculation. Experts within and outside government, as well as EU official and private commentators have suggested that the UK might seek a “bespoke” relationship with the EU based on one of the several existing models. These models are unique agreements between the EU and non-EU neighbors that grant access to all, or parts of the EU market without full membership in the Union. They have developed in distinct ways and as a result of unique circumstances, and thus may not be perfect options for the UK.

In addition, the EU has signaled its reluctance to grant the UK selective access to the Single Market enjoyed by some of countries utilizing these models. It seeks to prevent the UK (and perhaps others members contemplating leaving full EU

membership) from “cherry picking” only those Single Market elements that it most desires, and leaving behind the obligations that it wishes to avoid.

What Models Exist for a New UK EU Relationship?

Swiss model Switzerland is not a member of the EU, though it does enjoy access to certain sectors of the Single Market through 120 bilateral agreements. This allows the Swiss to make their own trade agreements with third countries, as well as have control over their social and employment laws. However, Switzerland does not have financial access to the EU through passporting, and must accept the free movement of people. The complexity involved in creating and upholding this model will mean that the EU would not agree to give such access to another country.

Norwegian Model This model allows Norway to have access to the Single Market as a member of the European Economic Area (EEA), without being a member of the EU. However, this requires Norway to accept all rules, regulations, principles (including the four freedoms), and financial contributions to the Single Market, without having any role in deciding EU rules and regulations. It is such a rule-taking position that the UK does not wish to take on. Additionally, Norway does not have customs union access, something the UK may wish to negotiate.

Canadian Model The Comprehensive Economic and Trade Agreement (CETA) between Canada and the EU has removed almost 98% of tariffs between the two entities. However, it is not a comprehensive agreement as it excludes certain food

items and all services, while retaining rules-of-origin requirements that demand customs enforcement. CETA (in a form popularly known as "Canada+++") was expanded to be more comprehensive, and is a potential model for a more standard trade agreement between the UK and the EU.

Barring any formal agreement between the two sides, the EU would presumably treat the UK as it does any other third country with which it does not have a bilateral trade agreement. Two-way trade in goods would be based on the tariff schedules negotiated in past WTO rounds, which means higher tariffs on trade in both directions. Outside of the customs union, the UK would be free to negotiate new agreements with third countries, though such agreements can be time-consuming and difficult to achieve. In the short run, at least, the cost of leaving the EU without a trade agreement would be extremely costly to the British economy.

The Trade in Goods

The Importance of EU Markets

Britain has relied on membership in the EU customs union and Single Market to expand its exported goods, and source imports at the lowest cost. Britain is fully integrated into EU supply chains and benefits from EU trade agreements with third countries around the world. In 2016, the EU accounted for 43% (€236 billion) of total UK exports of goods and services, and 54% (€318 billion) of total UK imports.¹

Operating within the customs union, member states maintain zero-tariff barriers, lowering the cost to trade goods. The common external tariff has deepened member state integration and protects all EU markets from international goods competition in the same manner. The EU acts as one trade entity through its customs union, and all members utilize the negotiated free trade agreements with third countries.

The EU Single Market has achieved further economic integration through regulatory alignment. Regulations are fully harmonized or mutually recognized between member states, reducing the non-tariff barriers to trade. The concept of a free trade area without any internal borders or regulatory obstacles increases the movement of goods within the territory.²

¹ Ward, Matthew, and Dominic Webb. 2018. "Statistics on UK-EU trade." Commons Library briefing - UK Parliament. February 23. <http://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7851#fullreport>

² Cadman, Emily, and Gemma Tetlow. "The EU single market How it works and the benefits it offers." *The Financial Times*, March 31, 2017

Post-Brexit Market Access

The UK government has issued multiple statements regarding its intention to leave the EU customs union and Single Market. While it continues to insist that it will exit the customs union, there have been proposals to negotiate a separate agreement that would effectively recreate the existing customs union.³ Recently, the UK political climate has become unclear regarding the creation of a new customs agreement. Remaining in the current customs union might present a more sustainable option, as the UK depends on the low cost of goods trade.

What are the Advantages of Leaving?

Permanently withdrawing from the EU customs union and Single Market would enable the UK to negotiate new trade agreements with third countries and determine its own regulatory regime for goods. Discontinuing its participation in the EU customs union would fulfill the UK government's stated desire to develop an independent economic policy and reduce its financial and legal obligations to the EU. The UK might take advantage of this independence to negotiate new agreements with existing EU trade partners to better serve its interests. Without the common external tariff, the UK would be able to target its own economic needs by negotiating lower tariff and non-tariff barriers. Rather than trading as part of a collective entity, these agreements could promote increased trade opportunities

³ Barker, Alex, Alan Beattie, and Peter Campbell. "May's vision of EU trade deal puzzles experts." *Financial Times* (London), January 24, 2017, World News sec

with global partners not previously available through the EU's agreements. The UK would also be able to develop its own regulations for the trade of goods without alignment with Single Market standards. By altering regulations in specific areas, the UK will reduce its budget contributions to the EU and allow these funds to be utilized elsewhere in its economy.

Potential Agricultural Benefits, but Not Without Negotiation

The agricultural sector has consistently been a point of contention between the EU and the UK. The EU's Common Agricultural Policy (CAP), of which the UK reluctantly participates, is not as significant to Britain's relatively small agricultural sector compared to that of other EU members. The CAP subsidizes farmers with market support and direct payments in order to maintain farmer employment and income. The high external tariffs and strict safety standards for agricultural products also protect EU goods from international competition. The subsidies British farmers receive from the CAP are outweighed, in the official view, by its annual budget contributions to the EU. As the highest net contributor to the EU budget, Britain is dissatisfied in supporting a policy that it regards as ineffective and wasteful. Brexit represents an opportunity to leave behind what the UK views as an intolerable financial burden imposed by the CAP.

Outside of the customs union, Britain can use tariffs to protect British farmers, rather than the EU subsidy system. Under WTO standards, the UK would be eligible for the Most Favored Nation (MFN) clause, allowing them to negotiate low tariffs like other third-party nations. Britain may be able to avoid excessive price increases

due to the new implementation of tariffs, but still face the possibility of decreased trade.⁴ The UK's agricultural sector is small, which has resulted in a trade deficit with the EU. EU trade partners that depend on their agricultural exports to the UK will push for low tariff trade so that their economies will go unaffected. Sustaining EU product availability within Britain is essential for less economic disruption. The UK could then negotiate lower barriers on their prominent agricultural exports, such as beef and lamb, which are dependent on EU consumers. The remainder of the agricultural sector would still be protected by heightened barriers to trade after exiting the CAP.⁵

Manufacturing is Heavily Dependent on EU Markets

Within the Single Market, the UK's manufacturing exports have benefited greatly from zero-tariff, frictionless trade with EU members. In 2016, 52% of the UK's total manufactured exports went to EU trade partners, suggesting the magnitude of trade that has developed within the internal market.⁶ UK manufacturing companies benefit from zero-tariffs, minimum non-tariff barriers, an interwoven supply chain with the EU, and ease of moving goods under a single regulatory environment.

⁴ Cardwell, Michael. "Brexit and Agriculture Implementing a New Legal Framework for Agricultural Support." *Cambridge Yearbook of European Legal Studies* 19 (2017) 311-35. doi 10.1017/cel.2017.10.

⁵ Feng, Siyi, Myles Patton, Julian Binfield, and John Davis. "'Deal' or 'No Deal'? Impacts of Alternative Post- Brexit Trade Agreements on UK Agriculture." *Agricultural Economics Society and European Association of Agricultural Economists (EAAE)*, 2017, 27-33. doi 10.1111/1746-692X.12171.

⁶ Fergus McReynolds, and Hywel Jarman. 2016. "BRITAIN AND THE EU MANUFACTURING AN ORDERLY EXIT." BRITAIN AND THE EU MANUFACTURING AN ORDERLY EXIT, September. <https://www.squirepattonboggs.com/~media/files/insights/publications/2016/09/britain-and-the-eu-manufacturing-an-orderly-exit/britainandtheumanufacturinganorderlyexit.pdf>

The automotive industry is more susceptible than other manufacturing sectors to Brexit, as four in every five UK produced vehicles are exported to the EU. The uncertainty of the UK's trade with the EU will hurt existing and potential foreign direct investments in the automotive industry. There are over 1,100 Japanese-owned businesses in Britain, accounting for 140,000 jobs with Nissan, Toyota, and Honda.⁷ The threat of foreign disinvestment will be a major cost to the UK as it could lead to jobs being lost. Automotive companies would also face additional non-tariff such as customs checks, rules of origin, and levying of tariffs. As a result, non-tariff barriers will impose monetary costs and disruption to the UK's cross-border automotive supply chain. According to Honda, a delay of 15 minutes to its delivery schedule could add €850,000 to the company's annual running costs. Under a no-deal scenario, the automobile industry will be subjected to trade under WTO rules, imposing tariffs of 10% on vehicles and 4.5% on engines and other parts. Operating in this new, higher-tariff environment would impose about €875 million in additional annual costs on the UK automotive industry.⁸

The Costs of Leaving EU Markets

It is clear that leaving the customs union and the Single Market would impose serious costs on Britain's trade of goods, at least in the short to medium term. As a third country trading partner with the EU, the UK would face higher tariff and non-tariff barriers to trade. The break-down or elimination of supply-chain cost

⁷ Blitz, James. 2018. "Japan's worries over Brexit." Financial Times. February 16. <https://www.ft.com/content/786c8efe-1304-11e8-8cb6-b9ccc4c4dbbb>.

⁸ Peter Campbell. 2017. "Car industry faces £4.5bn bill without Brexit deal." Financial Times. November 28. <https://www.ft.com/content/e00fbc9e-d438-11e7-a303-9060cb1e5f44>.

advantages, and a loss of competitiveness with EU member states would diminish British economic productivity. This is especially true for the British automotive industry, which is heavily integrated with the EU, in both trade and investment terms. The domestic price of goods would increase from a rise in the cost and delivery time, due to the regulatory barriers and customs checks.⁹ Without an agreement, decreased consumption and slowing markets could create a stagnant or declining economy.

In leaving the EU, the UK will lose the advantages it now has under trade agreements with third countries. If the UK pursues multiple new trade agreements with these countries, it will be necessary to renegotiate terms in every sector. The UK alone is unlikely to maintain the same leverage in trade negotiations that a customs union as large as the EU's can command. Negotiations with the EU would not only require setting tariff levels but also new bilateral agreements on the alignment of regulations and standards applying to goods. In this process, the UK could benefit from current regulatory alignment with the EU as a starting point. However, the development of new mechanisms to ensure ongoing regulatory alignment are necessary, as the UK will no longer automatically implement EU standards, and vice versa. New rules-of-origin would be required, to ensure that the UK does not undermine EU rules by passing off the products of other nations as its own. Such negotiations could take years to complete, leaving UK trade in a potentially uncertain state that might deteriorate confidence, trade, and investment.

⁹ Sandbu, Martin. "Stubborn facts about cross-border trade." *The Financial Times*, December 7, 2017.

Complications Regarding the Irish Border

The current border is frictionless, allowing goods to flow freely between Northern Ireland and Ireland as both nations participate in the Single Market and the Customs Union. Upon UK exit from the EU, the need for a hard border requiring border checks and customs controls could arise. Differences in regulatory standards will also have a detrimental impact on cross-border trade. Both the EU and the UK have prioritized avoiding the implementation of a hard border. In addition, the UK government has already promised to allow Northern Ireland to remain fully aligned with the EU if a negotiated solution cannot be found. This would presumably keep goods moving smoothly across the Irish border and ensure that products produced in Northern Ireland reflect EU standards and regulations. However, negotiations will become complicated as the UK would have a territory under the EU mandate while the rest of the country operates independently. Whether the UK can solve this issue without the need for a hard border or a special EU-aligned status for Northern Ireland, remains unclear.

Remaining in the EU customs union, or forging a new customs union agreement, could be one partial solution to this problem. Maintenance of tariff-free trade would minimize changes in customs practices, and dissolve the need for a hard border. However, the problem of maintaining regulatory alignment, for example health and safety standards, still remains. The disruption of cross-border trade could seriously impact intermediate goods that go into the final production of either EU or British exports.¹⁰

¹⁰ Hayward, Katy, and David Phinnemore. "The Northern Ireland/Ireland Border, Regulatory

What are the UK's Options?

Remaining in the EU customs union and Single Market would be the most economically beneficial option for Britain's future goods trade. The elimination of zero-tariff, regulatory-aligned, and frictionless trade will impose higher costs on the UK economy. Subsequent agreements will not be able to sufficiently minimize the impact of Brexit. The redline on leaving the Single Market, which emphasizes the free movement of people, remains firm in UK policy statements. The decision to leave the customs union appears considerably less firm, but still remains the official policy at this time.

The Norway model does not accurately appeal to Britain's trade in goods. Norway accesses the Single Market with full alignment to EU regulations, but it does not participate in the customs union.¹¹ This requires the need for customs controls and separate negotiations regarding tariffs. A similar agreement for the UK would significantly increase the cost of goods trade. Participation in the Single Market would allow British goods to avoid standards tests.¹² However, full alignment to present and future EU regulations, like the CAP, is required with budget contributions similar to what the UK currently gives.

Alignment and Brexit Principles and options in light of the UK-EU Joint Report of 8 December 2017." Queen's University, Belfast, no. 3 (February 2018) 1-8. Accessed February 26, 2018.

¹¹ Dixon, Hugo. 2018. "Norwegian Model Run by Europe." InFacts. Accessed February 28. <https://infacts.org/briefings/norwegian-model/>.

¹² Booth, Stephen. "As the UK searches for a post-Brexit plan, is the EEA a viable option?" Open Europe. October 26, 2016. Accessed February 19, 2018. <https://openeurope.org.uk/intelligence/britain-and-the-eu/as-the-uk-searches-for-a-post-brexit-plan-is-the-eea-a-viable-option/>.

The Swiss model is feasible for the UK but imposes challenges. British interests are fulfilled in maintaining regulatory alignment in high-export sectors and sustaining supply chain and market efficiency.¹³ Britain would have to accept the status of a rule-taking party and accept any new or altered EU regulations in the future. The EU is hesitant of this model as it allows the opportunity for Britain to be selective of its participation within EU institutions.

A Comprehensive Trade Agreement May be the Best Approach

Negotiating a separate trade agreement with the EU that encompasses the most critical sectors in goods trade would best serve UK interests in preserving economic sovereignty while maintaining access to the EU market. Such an agreement might include a new pact to maintain Britain's customs union access with zero-tariff goods trade. The low cost of trade would be sustained and other potential trade issues, including the Irish border, would be reduced. While this option presents a creative approach to the new trade relationship, it might not be a politically feasible option for the current UK government. Negotiating a customs agreement could prove to be a more viable option for the UK. However, various sectors could experience significant economic costs without an agreement on Single Market access.¹⁴

¹³ Owen, Joe, Alex Stojanovic, and Jill Rutter. "Trade after Brexit Options for the UK's relationship with the EU." Institute for Government, December 2017, 1-54.

¹⁴ Lilico, Andrew. "How Britain can make the most of leaving the single market." The Financial Times, January 10, 2017.

Without harmonized or mutually recognized regulations, British trade and output would decline. Not only an agreement on customs, but also one negotiating for areas of Single Market access will decrease barriers to trade.

Could the EU-Turkey Customs Agreement Provide a Model?

Basing the new customs agreement on the existing one between the EU and Turkey could provide the UK with the changes it seeks. Turkey and the EU have a mutual customs agreement, allowing Turkey to participate in the EU customs union, including the common external tariff and EU trade agreements with third countries. It excludes agriculture and services, leaving Turkey free to negotiate separately with third countries in those sectors. Turkey is constrained to maintain the common EU tariff on imports from third country trade partners, but retains the ability to negotiate its own export tariffs directly with these same partners.¹⁵ This flexibility would empower the UK to maintain zero-tariffs on its manufactured exports. While the UK would be unable to negotiate new trade agreements regarding these exports without the EU, it would be free to negotiate with other countries on agriculture and services trade. The structure and size of Turkey's economy differ substantially from the UK's, but this model offers a precedent for a compromise during negotiations. The UK's customs union access would be preserved in key sectors, while enhancing its flexibility in seeking new markets. This variation on

¹⁵ Aytuğ, Hüseyin, Merve Mavuş Kütük, Arif Oduncu, and Sübidey Togan. "Twenty Years of the EU-Turkey Customs Union A Synthetic Control Method Analysis." *JCMS Journal of Common Market Studies* 55, no. 3 (2016) 419-31. doi 10.1111/jcms.12490.

customs union participation would create a profitable relationship with the EU and fit British political goals of a new agreement. The arrangement would also simplify the Irish border conflict as customs expectations remain aligned.

CETA as a Model for Sectoral Single Market Access

An agreement that allows sector-by-sector Single Market access, as the Canada-EU agreement does, could ensure continued regulatory harmony with the EU in key areas of goods trade while reducing non-tariff trade barriers. The EU has stated its preference for the UK to pursue a deal similar to Canada's, which entails partial Single Market access in the areas of greatest trade interest, relying on mutual recognition to ensure regulatory alignment.¹⁶ For the UK, this approach has the benefit of preserving Single Market access in key trade sectors. The sectors that remain in the Single Market would require the UK to accept the free movement of people, sustaining current EU immigrant jobs in Britain's high-exporting sectors. The benefits of preserving access in certain sectors will outweigh the costs of continued EU budget contributions. Under sectors such as the automotive manufacturing industry, it is in the mutual interest of the UK and EU to maintain their value chains, as they are deeply integrated. As a result, major British trading partners in the EU would support the maintenance of Single Market access. The EU would also have the option to request unaltered access for its high-exporting sectors to the UK. The free movement of people would also be required in these sectors which could diminish Britain's power over EU immigration into its borders.

¹⁶ Brunsden, Jim. "Brexit Britain risks services squeeze with Canada-style deal that focuses on goods." *The Financial Times*, December 12, 2017.

Institutions for Regulatory Alignment

CETA also provides a model for resolving the regulatory divergences and trade disputes that will arise once the UK has left the Single Market. A “joint committee,” as coined by CETA, could be established as a permanent entity under a UK-EU agreement.¹⁷ It would monitor divergences between British and EU regulations and determine whether such changes block, complicate, or allow the trade of goods.¹⁸ Through harmonization or mutual recognition, the joint committee would allow economic sectors with aligning regulations to continue trade unabated. This process offers both parties a sustainable power in decision-making regarding regulation disparities, and the possibility to deny British market access if EU desires are not met.

The joint committee could also take on responsibility for dispute resolution, with final decisions relying on the European Court of Justice. Reliance on a mutually-agreed dispute resolution mechanism operating under specified guidelines and responsibilities could meet British insistence on no longer being subject to ECJ jurisdiction. Principles from both the ECJ and Britain's national courts should be taken into account to accurately represent the interests of both parties. The ultimate goal of the committee should be to maintain transparency and a willingness to resolve conflicts with impartiality.

¹⁷ "What precisely does 'Canada ' mean?" LSE BREXIT. January 14, 2018. Accessed February 19, 2018. http://blogs.lse.ac.uk/brexit/2018/01/15/what-precisely-does-canada-mean/?utm_content=bufferb5141&utm_medium=social&utm_source=twitter.com&utm_campaign=buffer.

¹⁸ Owen, “Trade after Brexit”

Recommendations for the Trade in Goods

- Remain in the EU customs union or negotiate a customs agreement, similar to that between Turkey and the EU, to maintain zero-tariff trade in key sectors.
- Seek continued Single Market access in British sectors of high exports to sustain current value chains and market efficiency.
- Create a joint committee, modelled after CETA's, to oversee regulation divergence and dispute resolution aligning with UK and EU judicial interests.

Trade in Services

Services Trade is Critical to the UK Economy

The UK is the second largest exporter of services on a global scale. The EU imports 39% of non-financial services from the UK and serves as the main services trading partner for Britain.¹⁹ Trade in services accounts for 80% of the UK's GDP.²⁰ In 2015, the UK generated a trade surplus of £33 billion in non-financial services.²¹ The services sector fuels economic growth, produces substantial opportunities for employment, and is predicted to be the driver of the professional and business services sector until 2025.²²

Key sectors in non-financial services trade include tourism, broadcasting, creative services, education, professional business services, information and communications technology (ICT), transport, and digital services.²³ These sectors are responsible for generating the UK's services trade surplus, and increasing integration among EU member states, emphasizing the need to maintain the liberalization of services trade.

¹⁹ House of Lords. "Brexit Trade in Non-Financial Services," March 22, 2017. 3. <https://publications.parliament.uk/pa/ld201617/ldselect/ldcom/135/135.pdf>.

²⁰ Higham, Will. "Leaving the EU An Assessment of Its Impact on Services and Trade." London First, June 2016. 6. <http://londonfirst.co.uk/wp-content/uploads/2016/06/Leaving-the-EU-impact-on-trade-June-2016.pdf>.

²¹ House of Lords. "Brexit," 12

²² Higham, "Leaving the EU", 7

²³ "Brexit The Impact on Sectors." KPMG Economic Insights, February 24, 2017. 5. <https://assets.kpmg.com/content/dam/kpmg/uk/pdf/2017/03/brexit-the-sector-impact.pdf>.

The Single Market Facilitates Trade in Services

Though Single Market regulations are still being developed, trade in this area is rapidly expanding compared to that of goods. Membership provides the UK with seamless trade access to partner markets within the EU, lowers costs, increases the competitiveness of services exports, and reduces non-tariff barriers. Single Market access reduces non-tariff barriers, by reducing specific restrictions and regulations on service activities provided and consumed by Member States.²⁴

Current Alignment Benefits the UK

UK's trade in services with the EU is made possible by a set of rules and regulations outlined in the Treaty on the Functioning of the European Union (TFEU). Article 56 and 57 of TFEU guarantee that businesses and people can engage in cross-border trade with other member states, and have the freedom of provision of services.²⁵

Moreover, the separate EU Services Directive specifies the rules and regulations that eliminate non-tariff barriers to trade in services.²⁶ This EU legislation was transposed into the national laws of EU countries, covers 90% of all services and sets common standards.²⁷

²⁴ Emmerson, Carl, Johnson, Paul, and Mitchell, Ian. "The EU Single Market The Value of Membership versus Access to the UK." The Institute for Fiscal Studies, August 2016. 10. <https://www.ifs.org.uk/uploads/publications/comms/R119%20-%20The%20EU%20Single%20market%20-%20Final.pdf>.

²⁵ "Europedia", 2018.

²⁶ Ibid.

²⁷ House of Lords, "Brexit", 45.

Services trade between the UK and the EU is made easier through the principle of mutual recognition, which is a key pillar of the Single Market. Through mutual acceptance of each other's rules and standards as being equivalent to their own, it eliminates an important non-tariff barrier and facilitates trade in the internal EU market. EU regulatory bodies monitor national regulations to ensure continued alignment across borders²⁸.

Services Trade Will Suffer Without Single Market Access

The UK government insists that leaving the Single Market is essential to achieving Brexit goals, including removing itself from EU regulations and the jurisdiction of the European Court of Justice (ECJ). The EU lacks a common policy regarding trade in services with third countries – which will include the UK upon exiting. A lack of access to the Single Market poses risks to UK services trade in terms of regulatory divergence, increasing non-tariff barriers, and uncertainty among firms about access to European markets. Moving forward, retaining alignment with EU regulations after Brexit would require the UK to comply with standards that they had no voice in deciding.

In the absence of a new trade deal, the UK services trade with the EU would be based on WTO rules regarding tariffs and regulations.²⁹ British services firms would face greater restrictions than restrictions that exist within the Single Market,

²⁸ Ibid. 18.

²⁹ "The Options for the UK's Trading Relationship with the EU." <https://www.instituteforgovernment.org.uk/explainers/options-uk-trading-relationship-eu>.

substantially inhibiting trade.³⁰

Options for Preserving Access to the Single Market

The Single Market enables a continuous flow of non-financial services between the UK and the EU. The UK government, however, has stated that Single Market membership is not an option for Britain's future relationship.³¹ Services trade with the EU would be carried out on the same basis as EU trade with other third countries that are members of the WTO but do not have trade agreements with the EU.

The UK government has publicly expressed a desire for a creative solution that allows the UK to maintain independence and sovereignty while retaining close alignment with the EU markets.³² Existing trade agreements attempt to gain access to the Single Market in specific sectors, however, the agreements lack the breadth and depth in the services sector necessary for the UK economy. The Norway and Switzerland models could apply to a new UK-EU relationship. While the Switzerland model offers the possibility of sector by sector trade participation in the Single Market, it fails to cover trade in services and lacks a joint institution to mediate relations between the two parties.³³ The Norway model directly addresses trade in

³⁰ European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72) para 30

³¹ Amur, Jennifer. "Full Transcript: Theresa May's Speech on Brexit." *Washington Post*, January 17, 2017, sec. WorldViews. <https://www.washingtonpost.com/news/worldviews/wp/2017/01/17/full-transcript-theresa-mays-speech-on-brexit/>.

³² "U.K. Prime Minister Theresa May's Speech in Florence: Full Text." *Bloomberg.Com*, September 22, 2017. <https://www.bloomberg.com/news/articles/2017-09-22/u-k-prime-minister-theresa-may-s-speech-in-florence-text>.

³³ "The Options for the UK's Trading Relationship with the EU."

services, and requires a contribution to the EU budget.³⁴ Nevertheless, these unique, bespoke trade agreements would not encompass the most important sectors of the UK's services industry - professional and digital services.

The Canada-EU trade agreement (CETA), covers trade in goods and services, providing Canada with sectoral market access to the EU. While CETA model provides an option for eliminating tariffs on goods, EU member states retain the right to apply restrictions on UK services exports.³⁵ Based on Canada's services exports, CETA scope is limited in comparison to the UK's services industry.

"Canada's service exports to Europe, adding up to merely €10 billion – half of which is tourism and transportation. Close to €110 billion, British exports of services to Europe are about eleven times the size of Canada's, and it's dominated by financial and business services."³⁶ CETA provides a viable model for Single Market access. However, it lacks the framework in the digital and professional business services sectors that the UK immediately requires.

Useful Model for a New UK-EU Relationship in Services Trade

There is no precedent for a trade in services agreement that extensively covers the scope of the UK services sector. However, there is a regional trade agreement that

³⁴ Ibid.

³⁵ "EU-Canada Trade Agreement." Trade - European Commission. September 20, 2017. <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1723>.

³⁶ "The Canada-EU Trade Deal Is No Model for Brexit." CapX, March 26, 2016. <https://capx.co/the-canada-eu-trade-deal-is-no-model-for-brexit/>.

bypasses the WTO's MFN principle³⁷ currently being negotiated among 23 countries and the EU.³⁸ The Trade in Services Agreement (TiSA) provides comprehensiveness by addressing a multitude of services sectors.³⁹ Considering that involved parties collectively contribute to 70% of world trade in services⁴⁰, TiSA has the potential to enhance UK global services trade and offers mutual recognition of qualifications agreements and regulatory coherence.⁴¹ The precedent set by TiSA provides the framework for a trade agreement that would position the UK for a leading global role in professional and digital services trade. Thus far, 21 rounds of negotiations have been conducted, the most recent in 2016 with no set deadline.⁴² Although negotiations are stalled, the principles of TiSA could serve as a basis for a UK-EU services trade agreement.

³⁷ Westberg, Johan. "An Overview of the WTO principle of MFN and Bilateral/Regional Agreements How does it work?" Trade and Environment. February 27, 2012. <http://www.tradeandenvironmentnexus.com/an-overview-of-the-wto-principle-of-mfn-and-bilateralregional-agreements-how-does-it-work>.

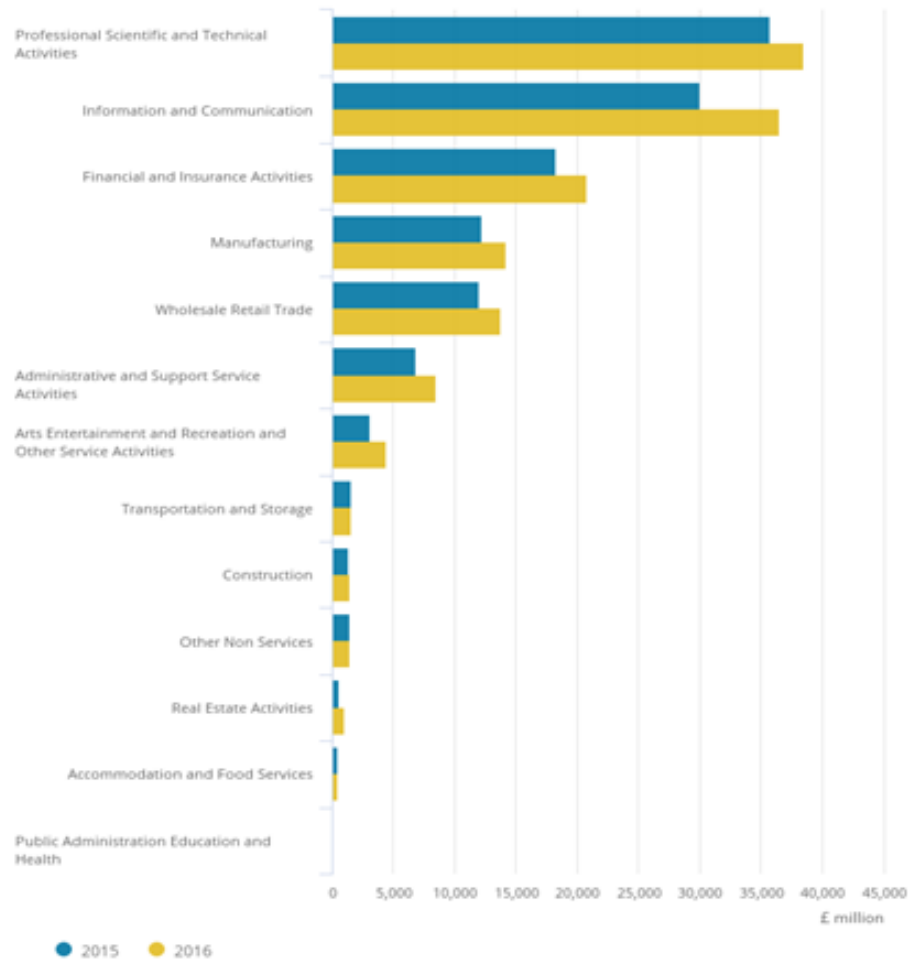
³⁸ European Commission. "European Commission Directorate-General for Trade." Trade in Services Agreement (TiSA) - Trade - European Commission. <http://ec.europa.eu/trade/policy/in-focus/tisa/questions-and-answers/>.

³⁹ European Commission. "Trade in Services Agreement (TiSA)." September 26, 2016. http://trade.ec.europa.eu/doclib/docs/2016/september/tradoc_154971.doc.pdf.

⁴⁰ Ibid. 2.

⁴¹ Ibid. 6.

⁴² European Commission. "European Commission Directorate-General for Trade." Trade in Services Agreement (TiSA) - Trade - European Commission. <http://ec.europa.eu/trade/policy/in-focus/tisa/questions-and-answers/>.



Source: Office for National Statistics

Figure A indicates the growth of the professional businesses sector and ICT sector in terms of exports to the EU from 2015 to 2016. This highlights the necessity for the UK to begin negotiations on these two sectors immediately⁴³.

⁴³ *International Trade in Services, UK - Office for National Statistics*. Accessed March 1, 2018. <https://www.ons.gov.uk/businessindustryandtrade/internationaltrade/bulletins/internationaltradeinservices/2016#around-half-of-uk-trade-in-services-in-2016-was-with-europe>.

Prioritizing Professional Business Services

The UK's Professional and Business Services (PBS) sector accounts for one fifth of the nation's GDP.⁴⁴ It is comprised of law, accountancy, insurance, audit, market research, advertising, management consultancy, and real estate sectors among others. Encompassing everything from "the big four" accounting firms, to six of the ten international accountancy networks, to leading law firms, and small and medium enterprises⁴⁵ – PBS accounts for 32% of UK's export business services to the EU, and generated a £6 billion surplus for the UK in 2015.⁴⁶ This sector is responsible for employing 3.8 million people.⁴⁷ It has grown by nearly 4% annually in between 2000-2010, making it one of the most important elements of trade in the British economy.⁴⁸ In 2016, PBS exported £66 billion worth of services, accounting for 27% of total services exports of the UK.⁴⁹ On an international scale, the services sector has experienced significant growth, with exports increasing from £40 billion in 2007 to £66 billion in 2016.⁵⁰ Some sectors grow at a faster rate than others, and this dynamism poses challenges as the UK attempts to maintain alignment with the EU. The difference in growth rate among the sectors requires detailed regulatory alignment to be negotiated to avoid divergence in these fields.

⁴⁴ Chaplin, Richard. "Professional Services and Brexit." Managing Partners' Forum, 2016. <http://www.pmint.co.uk/media/464261/MPF-Report-Professional-services-and-Brexit-October-2016.pdf>.

⁴⁵ "Professional and Business Services Sector Report." Government to the Committee, n.d. <http://www.parliament.uk/documents/commons-committees/Exiting-the-European-Union/17-19/Sectoral%20Analyses/28-Professional-and-Business-Services-Report%20.pdf>.

⁴⁶ House of Lords, "Brexit", 31.

⁴⁷ HM Government, Growth is our business a Strategy for Professional and Business Services. July 2013. 37 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/211842/bis-13-922-growth-is-our-business-professional-and-business-services-strategy.pdf

⁴⁸ Ibid

⁴⁹ "Professional and Business Services", 1

⁵⁰ Ibid. 6.

PBS: Recognition of Professional Qualifications

Maintaining the recognition of professional qualifications enables highly skilled professionals to offer their services to businesses in other EU countries. Common standards, regarding professionals, ensures that recognized qualifications are aligned in certain professional fields within the Single Market.⁵¹ Exiting the Single Market necessitates negotiations for a new agreement on the recognition of professional qualifications. Maintaining alignment via Single Market participation would ensure the least disruption among the services sectors, avoiding the need for negotiations of professional mutual recognition with the EU. A loss of mutual recognition for professional qualifications could result in UK professionals being confronted by new barriers in EU member states. In addition, EU professionals would face new barriers to entry into the UK.

Affected firms in this sector have called for action and maintain that the “government should retain, or, ideally, enhance mutual recognition of professional qualifications as part of the negotiation process under FTA or WTO models” in order to preserve their access to EU markets.⁵² The UK would have an advantage in negotiating recognition standards with the EU as they are currently aligned. Precedence for mutual recognition of professional qualifications between the EU and third countries is limited in their agreements with Switzerland and Canada.

⁵¹ “Review of the Balance of Competences between the United Kingdom and the European Union.” Her Majesty’s Government, 2014. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/332668/bis-14-987-free-movement-of-services-balance-of-competencies-report.pdf.

⁵² “Written Evidence - KPMG,” October 2016. <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-internal-market-subcommittee/brexit-future-trade-between-the-uk-and-the-eu-in-services/written/41479.html>.

However, the extent to which professionals are protected under these models is not as beneficial as full alignment with the Single Market.⁵³ The rapid growth and continuous evolution of services requires distinct mechanisms to counter any future divergences.

Preserving a Digital Single Market

The scope of the digital sector highlights the integration between the economies of the UK and EU. Referred to as “the fifth freedom” of the Single Market, the digital sector will face uncertainty with Britain’s exit from the Single Market. In terms of data flows and access to the EU’s Digital Single Market (DSM), digital technology contributes to the growth of the economy and employment of highly skilled workers. Digitally intensive sectors in the UK account for 10% of employment, 24% of total UK exports and 16% of domestic output⁵⁴ - of which 81% of UK digital exports are in services.⁵⁵ As a key exporter of digital services, the UK’s exit from the EU could affect business and growth regarding new regulations and an interrupted provision of digital services. Agreements are needed in each of the twelve sectors including, computer hardware, software, telecommunication, information, financial activities, media, advertising, and other business services to avoid disruption in services trade. Digital services providers prefer that regulations remain uniform across the board to avoid market shocks to consumers and producers alike⁵⁶.

⁵³ European Commission. "Trade in Services Agreement (TiSA)." 2016.

⁵⁴ Soni(techUK), Doniya. “TechUK Priorities for European Exit Negotiations.” Accessed February 28, 2018. <https://www.techuk.org/insights/news/item/10089-techuk-priorities-for-european-exit-negotiations>.

⁵⁵ Ibid.

⁵⁶ Ibid.

The prioritization of the digital sector during negotiations would facilitate an uninterrupted flow of digital business between the UK and EU; the break in this flow would be detrimental for both parties. Digital services CEO's have stated that "These businesses are highly dependent upon the single market – they need regulatory continuity and negotiated access in key areas. A bespoke free trade agreement is the best vehicle for that."⁵⁷ Focusing on the digital sector, would allow the UK to shape the future standards in the Digital Market. Negotiations and regulations for the future of the digital sectors continues to evolve, lacks precedence, and a basis for current EU engagement.

Free Flow of Data

UK is a primary player in cross-border data flow in terms of international connectivity. From 2005 to 2015, data flows increased 28 fold, with an expected 5 fold increase projected for the year 2021.⁵⁸ Current data protection will be enforced on May 25th, 2018 under the EU General Data Protection Regulation (GDPR), which protects the exchange of data between private and public actors.⁵⁹ Since the implementation of the new regulation will certainly occur before any formal exit, the UK would be regarded as a third country. Third countries are required to

⁵⁷ Ibid.

⁵⁸ techUK. "The UK Digital Sectors After Brexit." Frontier Economics, January 24, 2017. 30. <https://www.frontier-economics.com/documents/2017/01/the-uk-digital-sectors-after-brexit.pdf>.

⁵⁹ Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) (Text with EEA relevance), Pub. L. No. 32016R0679, 119 OJ L (2016). <http://data.europa.eu/eli/reg/2016/679/oj/eng>.

demonstrate that their data protection are “adequate” in terms of EU standards. As a third country the UK would have to apply for “adequacy” by the EU Commission.⁶⁰

Nearly 75% of UK's cross-border data flows are conducted with EU member states⁶¹ Upon exiting, the risk of disruptions for the UK's cross-border data flows is high, considering that the EU has only fragmented services agreements like in CETA.⁶² Any free trade agreement concerning the digital sectors will require specific commitments regarding the adequacy of data protection to preserve the unique harmonization that the EU and UK share in digital services.

Pursuing a Trade Agreement with TiSA Principles

To ensure that UK services are largely uninterrupted, a new and focused trade agreement modeled on TiSA would address the immediacy and specificity that the UK requires after Brexit. Prioritizing the professional business and digital services sectors in negotiations would protect UK services exports.

A trade agreement modeled after TiSA standards would provide a platform for establishing regulation and divergence mechanisms in the professional and digital services sectors. New and specific services oriented elements of TiSA could provide the UK with a structure for negotiating an in depth trade agreement.⁶³ This specific

⁶⁰ Ibid.

⁶¹ techUK. “The UK Digital Sectors After Brexit.” 2017.

⁶² European Commission, “EU-Canada Trade Agreement,” 2017.

⁶³ European Union. “Trade in Services Agreement (TiSA) An end in negotiations in sight?” 2015. 16-19. [http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/570448/EXPO_IDA\(2015\)570448_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/570448/EXPO_IDA(2015)570448_EN.pdf).

trade agreement would grant the UK access to the Single Market in two specific sectors, without the obligation to contribute to the EU budget. The UK would be able to negotiate for the full access of specific sectors by leveraging the services sector as a whole. A trade agreement of this scale between the EU and UK mimics their current services oriented relationship.

Considering the breadth of UK's services sector, in the EU and globally, this TiSA based agreement will set the standards for the international market. The trade agreement should be consistent with the structure of the WTO's General Agreement in Trade in Services (GATS) to preserve the future of multilateral trade agreements.⁶⁴ The UK should aim to establish strong, transparent sectoral disciplines to facilitate trade in services.

In the event the European and UK parliaments do not internally ratify the trade agreement before the end of the transition period, it would be implemented through a provisional application. CETA provides a precedent for implementation of the provisional application to avoid an interrupted flow of services given an indefinite deliberation period.⁶⁵

⁶⁴ "World Trade Organization." WTO | Understanding the WTO - principles of the trading system. 2018. https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm.

⁶⁵ "What's CETA and what'll it do?" Trade - European Commission. 2018. http://ec.europa.eu/trade/policy/in-focus/ceta/ceta-explained/index_en.htm.

Key Elements and Regulations in an Agreement

The TiSA- based trade agreement would grant the EU and UK the right to regulate their own national services using domestic institutions. In international and cross-border services, the UK must determine a list of schedules in the digital and professional sectors since it differs from UK interests.⁶⁶ Schedules list specific market commitments and national treatment per party.⁶⁷ According to specific UK interests in these two sectors, national treatment and market access need to be negotiated via a schedule.⁶⁸ Market access allows the UK to decide which domestic sectors to open to foreign competition, and the extent to which it wants to do so.⁶⁹ National treatment requires nations to treat foreign- service suppliers no less favorably than one's own service suppliers.⁷¹ The trade agreement would recognize sector-specific mutual recognition, which would include the mutual recognition of professional qualifications.

In this agreement, negotiated regulatory annexes reinforce regulatory alignment.⁷³ These annexes would include domestic regulation⁷⁴, would follow the GATS

⁶⁶ "What is a WTO schedule?" World Trade Organization. https://www.wto.org/english/news_e/news17_e/mark_27jul17_e.pdf.

⁶⁷ Ibid.

⁶⁸ Fefer, Rachel F. "Trade in Services (TiSA) Negotiations Overview and Issues for Congress." January 3, 2017. <https://fas.org/sgp/crs/misc/R44354.pdf>.

⁶⁹ "World Trade Organization." WTO | Services - CBT - Basic Purpose and Concepts - Conditional Granting of Market Access and National Treatment - Page 1. 2018. https://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c1s7p1_e.htm.

⁷⁰ European Union. "Trade in Services Agreement (TiSA) An end in negotiations in sight?" 2015. 4-27. [http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/570448/EXPO_IDA\(2015\)570448_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/570448/EXPO_IDA(2015)570448_EN.pdf).

⁷¹ "World Trade Organization." 2018.

⁷² European Union. "Trade in Services Agreement (TiSA)" 2015. 4-27.

⁷³ European Commission. "Trade in Services Agreement (TiSA)." 2016.

⁷⁴ "TiSA Annex on Domestic Regulation." 138-144. <http://www.thefutureworldofwork.org/media/35370/tisa-foul-play-appendix-9-tisa-annex-on-domestic-regulation.pdf>.

articles,⁷⁵ and requirements necessary to facilitate cross-border trade without non-tariff barriers.⁷⁶ These annexes and clauses provide the necessary guidelines to ensure regulated, fair market competition and national treatment.

There are three regulatory clauses to negotiate in this trade agreement. These clauses address preventative restrictions against punitive actions from either party and provide further divergence mechanisms. The first, titled the Standstill clause, requires the parties to list the barriers to trade when they sign the trade agreement, leaving them unable to introduce new barriers.⁷⁷ Further, a Ratchet clause would allow parties to remove barriers in a sector where it had made a previous commitment.⁷⁸ However, the barrier cannot be reintroduced after its removal. In addition, a Revision clause would require the EU and UK to revisit mutually recognized regulations every two years. Regulations and annexes within the agreement would only provide guidelines and would lack the power to oversee the outcome of a fair market place.

Regulatory Body and Divergence Mechanism

Institutions within the UK and EU will have jurisdiction over their own regulations, and the clauses will ensure mutual recognition and harmonization when needed. The Revision clause necessitates a joint committee to ensure continued alignment

⁷⁵ Fefer, "Trade in Services (TiSA)," 2017.

⁷⁶ Ibid.

⁷⁷ European Commission. "Trade in Services Agreement (TiSA)." 2016.

⁷⁸ Ibid.

and prevent divergence between the two parties. This committee, meeting every two years, provides a platform for the EU and UK to agree upon evolving regulations that trade in services requires. Negotiating a joint committee also provides an avenue for resolution over disputes. The joint committee would be created with individual discretion and preference in regard to its representatives. Negotiations within the joint committee serve as the first avenue to resolve problems. If disputes are not negotiated in the joint committee, a sector specific appeal to the ECJ could be invoked. The ECJ would act as the higher authority and mediator in the two specified trade sectors. However, if disputes are not resolved in the ECJ, the agreement would foster a state-to-state discussion through the WTO Dispute Settlement System.⁷⁹ These mechanisms currently exist, eliminating the necessity to negotiate and create new institutions. However, the UK should only invoke this dispute settlement mechanisms when deemed necessary. State-to-state negotiations is the preferable route for resolution.

⁷⁹ "World Trade Organization." WTO | Disputes - Dispute Settlement CBT - Introduction to the WTO dispute settlement system - The Dispute Settlement Understanding - Page 1. 2018. https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c1s2p1_e.htm.

Recommendations for Trade in Services

- Create a new trade agreement based on TiSA principles to ensure uninterrupted flow of services between the UK and EU.
- Prioritize the professional business and digital services sectors in forthcoming negotiations.
- Utilize a joint committee to maintain regulatory alignment and resolve disputes between the UK and EU in services trade.

Financial Services

The Importance of Financial Services to Both the EU and the UK

London is the primary financial hub of Europe, and it facilitates corporate and investment banking services to the entire EU, as well as the rest of the world. In 2016, insurance and financial services contributed £124.2 billion in gross value added (GVA) to the UK economy, which was 7.2% of the UK's total GVA. London alone accounted for 51% of Britain's financial sector GVA in 2015⁸⁰. European demand for Britain's financial services is high, constituting approximately a quarter of the demand for all financial services from the EU-27. The UK accounts for 78% of total EU foreign exchange turnover, 85% of hedge fund assets, 49% of private equity funds raised, and 26% of bank lending⁸¹. Table 1 effectively showcases the symbiotic relationship that the UK has with the EU within the financial sphere. UK's financial success can be attributed to the large amount of business it conducts with the EU. For example, from the £23 billion generated in the asset management industry in 2015, 26% was generated by EU clients. In other words, £6 Billion of the total revenue from asset management in the UK was directly associated with the EU. Further, the UK accommodates over 250 foreign banks, which is more than any other financial center in the world. London is also home to 40% of the European banking headquarters⁸².

⁸⁰ Tyler, Gloria. 2017. "Financial services contribution to the UK economy." *House of Commons Library*, March, 1–11.

⁸¹ Casper De Vries et al., 2017. Policy Department economic and scientific policy, *European Parliament. European Parliament. European Parliament Committee for Economic and Monetary Affairs*. [http://www.europarl.europa.eu/RegData/etudes/STUD/2017/602058/IPOL_STU\(2017\)602058_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2017/602058/IPOL_STU(2017)602058_EN.pdf).

⁸² LSE Growth Commission and others. 2017. "UK Growth A New Chapter." *Centre for Economic Performance, London School of Economics and Political Science*. Accessed February 28. <http://www.lse.ac.uk/researchAndExpertise/units/growthCommission/documents/pdf/2017LSEGCRReport.pdf>

Table 1 Interconnections between UK and EU Financial Services

	Total	Banking	Asset management	Insurance & Reinsurance	Market Infrastructure
UK financial services revenues (in GBP)	190-205	108-117	20-23	39-42	22-26
Fraction of the UK financial services revenues related to the EU	23%	21%-23%	25%-26%	8%-12%	41%-46%
UK market share in the EU	24%	26%	41%	22%	-

Sources: Wyman 2016: 6 & EGOV 2016: 1.

This network of financial interconnectedness has been possible due to one of the key provisions of the EU financial legislation, known as the European passport. Financial institutions can operate freely by establishing a branch in one of the current 28 members of the EU. Once an institution has received authorization or a “passport” in one EU country, it can also provide certain services throughout the EU without any additional legal approvals⁸³. London has benefited from EU passporting, as EU financial firms are able to locate themselves in the UK to gain a share of the financial market, and vice versa. Passporting allows institutions in one EU country to trade across the Single Market without additional arrangements or administrative costs.

UK's exit from the Single Market would prevent it from operating within the EU 27 without individual passporting licenses. Banks could be forced to relocate away from the UK to continue business. The European continent also faces greater risks to its financial stability as EU nations rely heavily on UK's finance industry. If

⁸³ “Brexit Quick Brief #3.” 2018. *BBA organization*. The voice of banking. Accessed February 28. <https://www.bba.org.uk/wp-content/uploads/2016/12/webversion-BQB-3-1.pdf>.

international banks in London were to lose access to the European countries and corporations, European nations would find it costlier to raise capital.

Due to these deep seeded financial interdependencies between the UK and the EU, Brexit would disrupt several EU economies. The lack of passporting rights would require financial services institutions from the UK to relocate within the EU. This fragmentation would disrupt business lines, making access to financial services costlier for the UK and EU. It would also create a contagion effect of economic destabilization throughout the EU.

Financial services entail a conflicting field of negotiations between the European Union and the UK due to the list of costs and benefits on both sides. At a minimum, the UK is likely to seek a separate deal outside the Single Market that would grant them Single Market access and passporting rights. A trade agreement in the financial sector would be instrumental in granting the UK and the EU equal market access. In such an agreement, the UK, negotiating as a third country, is likely to seek agreements on the harmonization or mutual recognition of existing regulations. These regulations in the UK are fully aligned with those of the EU. This agreement would also grant the UK with reciprocal equivalence in some financial sectors such as banking and asset management. Therefore, mutual recognition in regulations is required in the trade agreement would allow financial institutions in the UK to continue representing EU clients. It would also allow them to retain passports in some financial sectors.

Problems in Current Market Access for Financial Services

Without a trade deal following Brexit, major banks are planning on shifting operations away from the UK to gain Single Market access. Lack of administrative planning regarding the future of financial services will cause institutions to establish contingency plans. For example, Frankfurt is the target city for Morgan Stanley, Standard Chartered Plc, etc.⁸⁴. In addition, highly-skilled European financial workers are planning on leaving the UK. The situation results from a lack of transparency between regulators and the British government. Financial companies need to be prepared in the event that they need to relocate before the conclusion of negotiations.

Financial Regulation Dilemma - Passporting Issue

Pre-Brexit Passporting Rights

Resolving the issue of passporting is an urgent problem for the British government. Before Brexit, EU countries possessed passporting rights that allowed financial firms to conduct cross-border services within the EU. Establishing a new passporting system demands harmonization under EU law, and a mutual recognition of licenses to avoid losses. For instance, the revenue of the investment and capital markets, approximating £9bn, could be disrupted if the UK loses the EU passport⁸⁵.

⁸⁴Arnold, Martin. 2016. "Financial Times Standard Chartered back atop takeover target list." *Financial Times*. January 21. <https://www.ft.com/content/0bd13682-8208-11e3-87d5-00144feab7de>.

⁸⁵ Ibid.

Market Access Issues Caused by the Loss of Passporting

Because of its complexity, an agreement based on the Swiss model involves a long-term negotiation and doesn't include financial services in the agreements. At the same time, the Swiss seek full market access in specific sectors, making negotiations time-consuming. The EU is unwilling to adopt such a model to avoid cherry picking. Further, the UK has no interest in staying the single market, making this model inapplicable to its situation. On the other hand, the Norwegian model is too expensive to pursue because it subjects Britain to all EU regulations without giving it a say in the rulemaking process. Moreover, this approach is contrary to the original goal of Brexit, which is to give the UK more freedom to deal with their domestic policies.

Compared to the Swiss and the Norwegian models, the negotiation of a trade deal focused on prioritizing passporting in banking could be a feasible solution for both parties. If a trade deal for passporting within banking systems is successful, additional financial sectors such as asset management could be covered in the agreement to enlarge financial benefits for both the EU and the UK.

A trade deal that includes policies regarding passporting rights would be preferable for the banking system. This system is considered an important component of the financial sector. Losing passporting rights means that banks established in EU will change their status from branches to subsidiaries. Creating a new subsidiary could be costly because of potential legal barriers imposed in the process. In addition to the loss of banking services, it also threatens tax revenues generated by banks operating in the EU.

A bilateral trade deal between the EU and the UK would also create harmonization between the two with regard to financial services. Regulatory alignment based on harmonization or mutual recognition would apply to financial institutions located in the EU that are subject to ECJ laws, as well as to companies located in the UK that are subject to British laws. Financial companies functioning under the laws of the ECJ would be able to continue operations. By adopting a trade deal, UK would be able to determine its own financial policies with non-EU members. Additionally, EU-UK banking integration allows for future mutual recognition of existing licenses rather than requiring the application of individual licenses from EU countries⁸⁶. Following that interval, it would be advisable for passporting rights to function within the regulatory procedures of the EU, with specific conditions developed for the Brexit situation. This solution would eliminate financial barriers and the banking system could function like it did prior to Brexit.

A dispute resolution mechanism needs to be established within the trade deal, as the new regulatory relationship between the EU and the UK does not follow Single Market rules. The UK should incorporate a joint-committee in the trade deal for financial services to overlook possible disputes in the banking system. Regulations for the committee should be drawn from EU as well as UK laws to reflect interests of both sides. In the future, such a joint-committee could expand and cover additional financial services such as asset management.

⁸⁶ *BBA organization*

Asset Management

The Importance of Asset management in the UK and the EU

The UK has the second largest asset management industry in the world.

Approximately £7 trillion worth of assets are managed within the borders of the UK.

Asset managers in Britain oversee up to £1 trillion worth of funds designated strictly for individual use. In addition to this national prominence, international investors constitute about 40% of the assets managed. In 2015, this sub industry of the financial sector provided 92,000 jobs and produced 1% of the UK's GDP⁸⁷. In addition to its global position, the industry provides several advantages to the UK. Local investors benefit from economies of scale, and the overall economy benefits from skilled jobs that constitute higher taxes paid. Further, a strong share of UK's assets, approximating £1.2 trillion, are connected directly to European clients. This close-knit relationship of manager (UK) and client (EU) is important when trying to maintain the current structure and functionality of the asset management sector.

Post-Brexit Asset Management Services

Asset management in Europe and the UK is regulated by the Undertakings for Collective Investment in Transferable Securities (UCITS) and the Alternative Investment Fund Managers Directive (AIFMD) for alternative funds (funds not covered in UCITS). UCITS provides a harmonization of regulations and protections, and the funds that comply with its mandates are free to sell their assets in the EEA.

⁸⁷“The implications of Brexit on UK asset managers.” 2017. *Ernst & Young*. Oxford Economics. [http://www.ey.com/Publication/vwLUAssets/ey-the-implications-of-Brexit-on-UK-asset-managers-April-2017/\\$FILE/EY-The-implications-of-Brexit-on-UK-asset-managers.pdf](http://www.ey.com/Publication/vwLUAssets/ey-the-implications-of-Brexit-on-UK-asset-managers-April-2017/$FILE/EY-The-implications-of-Brexit-on-UK-asset-managers.pdf).

AIFMD targets those funds that are not included in the UCITS, such as private equity and hedge funds⁸⁸.

Approximately £6 billion, or 25% of UK's asset management revenue comes from the EU. Brexit will categorize the UK as a third country, having a direct impact on this business. The asset management industry will be impacted by three major factors. These include the disappearance of passporting rights, the lack of development for third country equivalence, and negative trends in established value chains.

Cross-border trading between EU and non-EU markets can be aided by the legal concept of equivalence. This requires nations and their respective markets to recognize each other's regulations as equivalent. Further, financial institutions from different nations that are considered equivalent can have mutual access to each other's markets. UK institutions can maintain access to EU markets with mutual recognition of each other's regulations.

Currently, the free selling of assets is under the jurisdiction of the UCITS. This ensures that funds meeting its criteria are sold freely on the market. However, there is no provision for third countries under the UCITS regime, which believes that a fund must be domiciled in the EU and managed by an EU company⁸⁹.

⁸⁸ Ibid.

⁸⁹ Casper De Vries et al., Policy Department economic and scientific policy.

What the UK wants out of their relationship with the EU: Analysis of Future Access

Without a trade agreement, cross-border marketing and the selling of UK's mutual funds (assets) and associated products under the UCITS regime would come to a halt. This is because the regime fails to provide third countries with access to the financial market. The absence of a trade agreement will cause UK managers and the wealth that they oversee to suffer in the UK as well the EU. Due to the increased liabilities to both sides after Brexit, these institutions will be forced to relocate. Following the regulations of the UCITS would be politically and financially infeasible due to lack of prospects for future equivalence.

The absence of equivalence clauses within regulatory institutions such as the UCITS will negatively affect passporting rights. UK asset management institutions would adhere to the national regulations of each EU country. All asset managers in the UK would require the establishment of subsidiaries across the EU to maintain their services. This would cause investment and asset management services to become more expensive for clients, while also requiring increased levels of legal authorization for UK institutions to set up shops in the EU. This fiscal shift would result in more than a third of EU financial business, approximating between £2 to 3 billion, to leave the UK⁹⁰.

Due to the absence of third country regimes in the UCITS, EU investors can utilize AIFMD funds. While these funds have a developed third country provision, a non-

⁹⁰ Djankov, Simeon. The City of London after Brexit. No. PB17-9. 2017.
<https://piie.com/system/files/documents/pb17-9.pdf>

EEA manager would require authorization from an EEA regulator, resulting in increased regulations for these funds. Besides this, most of the AIFMD regulated funds are sold to retail investors and not individual investors. This causes a decrease in confidence and increases uncertainties for UK asset managers. AIFMD regulations would not meet UK's asset management needs due to the restricted market access, the extensive control given to the EEA and the lack of provisions for equivalence that it entails.

Mutual recognition would be the only way for UK investors to maintain access to EU funds, and for EU investors to invest with UK asset managers. This approach towards attaining mutual recognition with the EU for third country access underlines the globalized nature of the financial sector. Therefore, existing equivalence clauses in regulatory structures must be emphasized, and similar efforts should be made to establish such clauses in related regulatory institutions. If the rules governing a UK financial firm are considered equivalent (to EU rules), the firm is not subject to complete EU regulations and supervision⁹¹.

Trade agreement negotiations should focus on maintaining equivalence with the EU as a whole. The asset management industry should be recognized under this trade agreement, and both sides should agree on reciprocal third country mandates. The third country regime in the Markets in Financial Institutions Directive (MiFID II), will improve the way in which third country firms like those in the UK would access the Single Market in investment/asset management services. Several firms that provide

⁹¹Casper De Vries et al., Policy Department economic and scientific policy.

investment services in the EU will no longer have to seek separate authorizations in every member state that they do business. Instead, they will be able to register with the European Securities and Markets Authority (ESMA) to provide investment services in any member state directly, from its home jurisdiction, or from one of its EU-based branches. This registration will require the firm to be from an equivalent third country jurisdiction. As the UK is a prominent financial center providing valuable services to the EU, the equivalence process doesn't seem to pose any obstacles for mutual recognition.

Recommendation for Financial Services

- The best means of preserving EU passporting rights for the UK would be a detailed trade deal prioritizing the banking system.
- Creation of a joint-committee drawing from EU and UK regulations would be a dispute resolution mechanism as a part of the trade deal.
- Negotiations of equivalence standards within the trade agreement would be the best way to preserve passporting in the asset management sector.

Immigration

The Importance of Immigration

Brexit has raised serious problems for the UK in terms of immigration. The UK is dependent on migrant labor from the EU, and if migrant flows are cut off or strictly regulated, it would adversely affect employment in virtually every sector of the British economy.

Despite the fact that UK immigration rules have not yet changed, seeing an uncertain future, many foreign citizens are choosing to leave the UK. Continuation of this trend could have a negative impact on UK growth and prosperity. Similar to other developed nations, the UK's economy and welfare depends on immigrants. It would thus be ideal to keep the flow of migrants open. This is true in both high-skilled jobs such as banking, and low-skilled jobs that many British citizens will not take. The UK's failure to make a decision on the future of immigration is causing the number of migrants entering the UK to decrease. The UK needs an immigration system to continue both skilled and unskilled labor flow into the country, while also overcoming political barriers.

The Free Movement of People is Vital to the UK

Brexit has put the future of free movement of migrants between the UK and EU into question. Understanding the options available to the UK will expedite the process of declaring and implementing a plan that will prioritize maintenance of

current movement policies, minimize costs, and reassure employers and employees. Maintaining free movement would minimize economic costs for both parties and ensure a productive UK-EU relationship. Obstacles to the freedom of movement threaten the integral role of migrants in the general population, major industries, and in the UK's economy.

Immigrant Contribution in the UK population

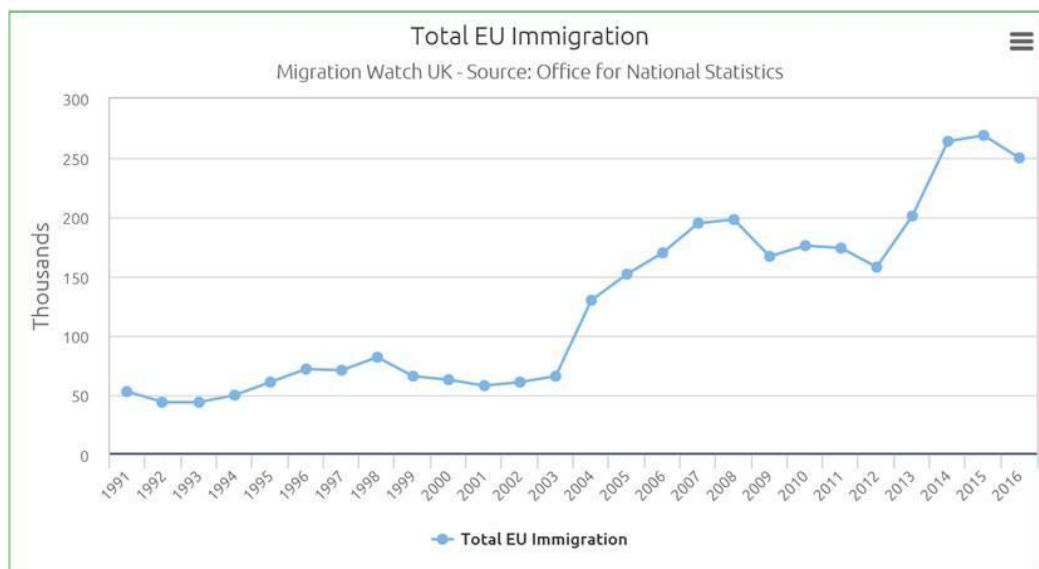
As of May 2017, 9 million individuals (7.4 million adults of working age) in the UK were born abroad, twice that of 20 years ago. In that timeframe, the number of immigrants from EU countries has tripled from 0.9 million to 3.3 million.⁹² From 2004 to 2012 alone, UK residents of Eastern European birth rose from 125,000 to 1,074,000.⁹³ (See **Figure B** for Net Immigration to the UK from EU, 1991-March, 2017)⁹⁴

⁹² Wadsworth, Jonathan, Swati Dhingra, Gianmarco Ottaviano, and John Van Reenen. "Brexit and the Impact of Immigration on the UK." *CEP Brexit Analysis 5* (2016) 34-53.

⁹³ Horan, Blair. *Brexit and Free Movement of People*. The Institute of International and European Affairs. liea.com.

⁹⁴ "Net Migration Statistics." Migrationwatchuk.org. <https://www.migrationwatchuk.org/statistics-net-migration-statistics>.

Figure B



Reducing the mobility of migrants will lessen contributions to the economy and UK welfare state, since immigrants provide savings to taxpayers by financing public services.⁹⁵ Additionally, a large portion of immigrants bring their professional background and education into the country. From 1995 to 2011, the absence of these immigrants would have otherwise cost the UK £14 billion in native education systems.⁹⁶

⁹⁵ Ottaviano, G. I. P., João Paulo Pessoa, Thomas Sampson, and John Van Reenen. "Brexit or Fixit? The trade and welfare effects of leaving the European Union." (2014).

⁹⁶ Dustmann, Christian, and Tommaso Frattini. "The fiscal effects of immigration to the UK."

EU Migrant Roles in the UK Economy: Employment

An important post-Brexit issue is the UK's access to migrant skills and labor. Due to concerns about a declining UK population, the nation is not in a position to refuse migrant workers. The UK is dependent on economic migrants (migrants looking for work) from the EU to fill job vacancies and stimulate the economy.⁹⁷ European immigrants have consistently made positive net fiscal contributions. From 2001 to 2011, immigrants from the European Economic Area (EU+ Iceland, Liechtenstein and Norway) contributed approximately £20 billion net to the UK economy through taxes and the consumption of goods and services.⁹⁸ These contributions far outweigh the perceived burden on the social safety net.

High-Skilled Labor: The Medical and Financial Industry

The Financial Industry

There is ambiguity as to whether or not London will remain the financial capital of Europe after Brexit negotiations. The UK depends on the capital produced by London for infrastructure, welfare, and jobs. Business services is the largest industry in the UK with regards to employment⁹⁹, and the 500 largest companies in Britain have expressed serious concerns over Brexit negotiations. These companies believe that the freedom of movement and access to skilled labor are critical to

⁹⁷ *Brexit 2016*. Report. Centre for Economic Performance, London School of Economics and Political Science. June 2016. <http://www.kenwitsconsultancy.co.uk/wp-content/uploads/2016/09/BREXIT-2016-Policy-Analysis-from-the-Centre-for-Economic-Performance.pdf#page=50>.

⁹⁸ Dustmann, Christian, and Tommaso Frattini. "The fiscal effects of immigration to the UK." *The economic journal* 124, no. 580 (2014).

⁹⁹ *Beyond Brexit 2016*

produce a positive outcome from UK-EU negotiations.¹⁰⁰ Following Brexit, upwards of 500,000 UK and 1.2 million EU jobs could be lost.¹⁰¹ In the financial sector alone, the Bank of England is anticipating a loss of up to 75,000 jobs, which would cost the country upwards of £18 billion in revenue.¹⁰² Inhibiting the flow of labor to the financial sector will cause a loss in foreign direct investment (FDI), leading to a drop in productivity, GDP, and overall incomes.¹⁰³

The Medical Industry

The National Health Service (NHS) has previously experienced issues with being overstretched¹⁰⁴, and has struggled to fill vacant job openings. EU migrants have long played an essential role in filling such vacancies. However, recent uncertainty with regards to citizenship and employment has resulted in a mass exodus of nurses and doctors. Brexit supporters maintain that immigrants limit access to medical care for native citizens. As a result, the rate of nurses registering to practice in Britain has dropped as much as 90%.¹⁰⁵ Further, around 60% of doctors working in the UK are unsure of whether to stay due to the ambiguous future that lies ahead for them and their families.¹⁰⁶ The UK has one of the lowest doctor to patient

¹⁰⁰ Gordon, Sarah. 2018. "Financial Times UK industry leaders express fears over Brexit deal, poll finds." *Financial Times*. Accessed February 26. <https://www.ft.com/content/017fb636-0288-11e8-9650-9c0ad2d7c5b5>.

¹⁰¹ Neilan, Catherine. 2017. "Hard Brexit will cost EU twice as many jobs as UK." *City A.M.* September 26. <http://www.cityam.com/272707/hard-brexit-cost-eu-twice-many-jobs-uk>.

¹⁰² Milliken, David. 2017. "Bank of England sees up to 75,000 finance job losses after Brexit BBC." *Reuters*. Thomson Reuters. October 31. <https://uk.reuters.com/article/us-britain-eu-boe/bank-of-england-sees-up-to-75000-finance-job-losses-after-brexit-bbc-idUKKBN1D00MX>.

¹⁰³ *Brexit 2016*

¹⁰⁴ Bennhold, Katrin. 2017. "Where Brexit Hurts The Nurses and Doctors Leaving London." *The New York Times*. The New York Times. November 21. <https://www.nytimes.com/2017/11/21/world/europe/nhs-brexit-eu-migrants.html?rref=collection%2Fseriescollection%2Flosing-london>.

¹⁰⁵ *Ibid.*

¹⁰⁶ *Ibid.*

ratios amongst EU member states¹⁰⁷, and the inflow of diverse migrant doctors and nurses alleviates this issue, while also improving patient care and medical research. Therefore, the UK cannot afford losses of staff in the medical sector.

Low/Unskilled Labor: Agriculture and Hospitality

The Agricultural Industry

A shortage of unskilled labor would impact the food supply, since most laborers in the fields are migrants. Such losses may result in closures of smaller farms.¹⁰⁸

Paired with a decrease in wages and immigrant labor, UK citizens face losing buying power of domestic produce due to increasing prices. These migrants perform the jobs that British citizens do not want to, contribute taxes, and serve as consumers that reinvest their wages into the British economy.

The Hospitality Industry

The hospitality industry has expressed concerns about the access to skills come 2019.¹⁰⁹ This industry is one of the largest employers of EU migrants, and through permanent or seasonal contracts, these migrants have played a major role in establishing stability in an unstable industry. Employment in the hospitality industry has seen growth and has in fact exceeded 2008 levels of employment.¹¹⁰ Some

¹⁰⁷ "Somebody call a doctor; brexit and public services." Jul 30, 2016. *The Economist*, 420, 22. Retrieved from <https://search.proquest.com/docview/1807651029?accountid=14784>

¹⁰⁸ Morphet, Janice. "What Immediate Actions Does the UK Need to Take?" In *Beyond Brexit? How to Assess the UK's Future*, 75-96. Bristol, UK; Chicago, IL, USA Policy Press at the University of Bristol, 2017. <http://www.jstor.org.offcampus.lib.washington.edu/stable/j.ctt1t894jx.8>.

¹⁰⁹ PricewaterhouseCoopers. 2018. "Hospitality, leisure, and Brexit's uncertainty." PwC. PwC. Accessed February 28. <https://www.pwc.com/us/en/library/brexit-us/hospitality-and-leisure.html>.

¹¹⁰ "The Economic Contribution of the UK Hospitality Industry." September 2015. <http://www.bha.org.uk/wordpress/wp-content/uploads/2015/09/Economic-contribution-of-the-UK-hospitality-industry.pdf>.

voters argue that employers are hiring EU workers in order to avoid training in the hospitality industry.¹¹¹ However, there is no evidence to suggest that EU migrants are hired more or less than UK citizens. Due to the large number of seasonal workers, and the minimal skills required to work in the hospitality industry, employers are hesitant to provide costly training.¹¹² As a result, growth in the hospitality industry ultimately requires skilled migrants to fill the unemployment gaps.

Challenges Facing EU Economic Migrants in the UK

Free movement of EU migrants to the UK has cemented their role in the economy. While this unhindered movement is ideal post-Brexit, it is not politically feasible. However, by restricting free movement, Britain may face difficulties in offsetting natural population decrease, labor shortages, wage inflation, reduced tax revenues, and increased prices for goods and services within British borders. Challenges from a smaller labor force will also increase the fiscal burden of Britain's ageing population.¹¹³ There is near-consensus among experts that a decline in the number of economic migrants would expose how vital they have been to British economic growth.¹¹⁴

¹¹¹ Rolfe, Heather, and Nathan Hudson-Sharp. n.d. "The impact of free movement on the labour market case studies of hospitality, food processing and construction." *NIESR*. National Institute of Economic and Social Research. <https://www.niesr.ac.uk/sites/default/files/publications/Free%20movement%20-%20Final%20report.pdf>.

¹¹² Ibid.

¹¹³ Visco, I. (2001) 'Ageing populations economics issues and policy challenges', Economic Policy for Ageing Societies Conference, 18–19 June, www.oecd.org/economy/growth/2431724.pdf

¹¹⁴ Morphet, Janice. "What Immediate Actions Does the UK Need to Take?"

In the absence of a concrete plan from the government, several institutions are preparing contingencies. For example, the prominent UK berry producer Haygrove Farms has stated it's intent to relocate part of their business to China due to fears that there will be insufficient seasonal migrant labor.¹¹⁵ Prompt government issuance of post-Brexit immigration plans would reduce the uncertainty for British businesses and workers.

The idea that immigrants from the EU are taking jobs and undercutting the benefits available to native citizens is a popular, but inaccurate notion amongst many British citizens (See **Figure C**).

¹¹⁵ O'Carroll, Lisa. "British farmer moves fruit-growing to China over Brexit uncertainty." *The Guardian*, February 11, 2018. <https://www.theguardian.com/politics/2018/feb/11/british-farmer-moves-fruit-growing-to-china-over-brexit-uncertainty>

Figure C ¹¹⁶ This shows the relationship between UK-born employment rates and EU percentage in the population. Due to the onset of the recession between 2005-2010 UK employment falls, but then rises in tandem with higher EU percentages in the population. These statistics negate claims that EU immigrants reduce the chance of employment for those born in the UK.



Source: CEP analysis of Labour Force Survey.

Notes: % EU is the proportion of EU nationals in the working age population (16-64 for men, 16-59 for women).

Declining UK wages can more accurately be attributed to the 2008 global financial crisis and weak economic recovery, rather than immigrants.¹¹⁷ The lump of labor fallacy is a belief that immigration results in an increase in competition for the same jobs between immigrants and UK citizens.¹¹⁸ This notion presents a challenge to the continued flow of migrant labor into the UK by influencing political attitudes.

¹¹⁶ Wadsworth, Jonathan, Swati Dhingra, Gianmarco Ottaviano, and John Van Reenen. "Brexit and the Impact of Immigration on the UK."

¹¹⁷ Wadsworth, Jonathan, Swati Dhingra, Gianmarco Ottaviano, and John Van Reenen. "Brexit and the Impact of Immigration on the UK."

¹¹⁸ Morphet, Janice. "What Immediate Actions Does the UK Need to Take?"

However, the number of jobs in the British market are not finite, as immigrants may not seek the same jobs as UK citizens, or may have skills that complement those of UK citizens.¹¹⁹ The inflow of migrants in recent years has helped produce steady growth in the consumption of goods and services, increased economic competition, and has provided more job prospects in areas of high demand.¹²⁰

Looking Forward: Migrant Workers in the UK

Contractual Permit System

If the government were to impose a highly restrictive immigration strategy, restructuring migratory controls or implementing new immigration frameworks would be a challenge. Existing immigration systems in the Home Office are incapable of processing residency applications and issuing documentation for both UK citizens living in the EU, and vice versa. As a result, implementing new systems in both the UK and EU is not feasible at the time of a formal exit, "not just for government who will need to design and deliver the regime, but also the employers, landlords and providers of public services who rely on the system and support its functioning".¹²¹ Therefore, immigration control systems should remain the same until new structures are fully staffed and prepared to function. The UK

¹¹⁹ Ibid.

¹²⁰ Ibid.

¹²¹ Owen, Joe. "Implementing Brexit Immigration."

government is currently working towards a short-term registration system for EU migrants entering after March 2019¹²², and in the meantime should design new immigration institutions or develop the capability of the Home Office.

Current movement policies should be sustained for economic migrants in the short term. In the final relationship with the EU, the UK government could establish a points-based visa, where migrants who have agreed to job contracts prior to immigrating will be able to enter the country.¹²³ This will limit the number of migrants coming into the country but constrain availability of labor. On the other hand, a continued free flow of talent under current policy would reflect the interests of various industries but may not be politically feasible.

Instead, the UK should collaborate with sectors to establish contractual agreements. This enables the establishment of an industry-based, pre-agreed contractual system. Such a system would grant entry to those already hired or actively recruited into the UK and would minimize high costs associated with recruiting and retaining employees.¹²⁴ The British government would then possess required migrant employment data, so there are no unknown entities entering and exiting the country.

¹²² Rudd, Amber. 2017. "Commissioning letter to the Migration Advisory Committee." *Commissioning letter to the Migration Advisory Committee - GOV.UK*. July 27. <https://www.gov.uk/government/publications/commissioning-letter-to-the-migration-advisory-committee>.

¹²³ "Points-Based system Tier 5 (Temporary Worker)." 2013. *Points-Based system Tier 5 (Temporary Worker) - GOV.UK*. Gov.UK. October 17. <https://www.gov.uk/government/publications/points-based-system-tier-5-temporary-worker>; "Points-Based system Tier 1 (Exceptional Talent)." 2013. *Points-Based system Tier 1 (Exceptional Talent) - GOV.UK*. Gov.UK. October 7. <https://www.gov.uk/government/publications/points-based-system-tier-1-exceptional-talent>.

¹²⁴ PricewaterhouseCoopers. 2018. "Hospitality, leisure, and Brexit's uncertainty."

The proposed contractual permitting system will allow for a controlled flow of migrants that will benefit all UK citizens. In the short-term, the UK government should establish a 6-month grace period in these contracts, enabling migrants to find jobs before they must leave the UK. This can be used as a long-term solution or until institutions are in place.

Quota System

The British government could move towards a hybrid system that minimizes disruptions to major industries dependent on unskilled EU migrants. The UK could negotiate an immigration agreement with the EU that establishes a legal, work-based quota on the inflow of migrants. The introduction of such a quota would apply to immigrants in search of employment arriving from the EU, while those already in possession of valid permits would be exempt. A yearly quota agreed upon by the UK and EU promotes controlled flow of migrants and ensures that employers have sufficient migrant labor. Properly applied restrictions would benefit the economy and alleviate popular political concerns about migration.

Policy Recommendations for Immigration

- Model after current immigration systems to guarantee a continued, but regulated, flow of migrants.
- Establishing a quota for low/unskilled labor to protect dependent industries while avoiding political hurdles
- Create a contractual permit system with employers for high-skilled labor, minimizing deficiencies to the UK and EU economies in the final relationship.

Conclusion

Trade in Goods

To stabilize the trade relationship between the UK and the EU, the UK should remain in the current customs union or negotiate a new customs agreement with the EU. Additionally, the UK should seek sectoral Single Market access for its key industries. This will allow the nation to maintain low trade costs through the zero-tariff movement of goods with the EU. To ensure regulatory alignment and resolve potential disputes between the UK and the EU, a joint committee should be created in line with the judiciary interests of both parties.

Trade in Services

Although remaining in the Single Market ensures complete access in services trade, the future relationship with the EU requires UK services to maintain sovereignty while negotiating close alignment with the EU. The British government should prioritize the professional business and digital services sectors, as they provide continued access to an integrated services industry and generate economic growth. To maintain an uninterrupted flow of services, pursuing a trade agreement based on TiSA principles would establish strong and transparent sectoral disciplines. Such a trade deal would include a joint-committee to maintain regulatory alignment and resolve potential disputes in the services sector.

Financial Services

UK's exit from the EU could lead to London losing its position as a leading financial center. The nation could face a modification of various financial directives, and reduced mobility for its financial firms within the EU. A trade agreement between the UK and the EU would be necessary to shape their future relationship. It would preserve the passporting rights that UK financial firms require to maintain EU market access. Further, this agreement should include equivalence provisions for financial sectors such as asset management industries to function seamlessly. A trade agreement would allow the UK to cease budget contributions to the EU and save on regulatory costs, while having greater control over their policies.

Immigration

With the loss of free movement of people, UK industries risk being negatively impacted by a reduced inflow of immigrants, who contribute to the general welfare and the economy. As a result of restrictive immigration policies, the UK will face issues such as rising food prices and an increasingly overstretched NHS. To preserve the economy while avoiding political obstacles, the UK must seek a solution that allows for the continued flow of migrants. This can be achieved by pursuing a permit system combined with a capped immigration agreement with the EU. Through this step, the UK can control the flow of migration while maintaining a productive relationship between UK-EU economies.

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