HOUSE OF LORDS

Library Note

Leaving the European Union: The Single Market, the Rights of EU Citizens in the UK and the UK's Future Economic Requirements

This House of Lords Library briefing has been prepared in advance of a debate that is scheduled to take place in the House on 26 January 2017 on the following motion:

> Baroness Hayter of Kentish Town to move that this House takes note of the impact of the United Kingdom's withdrawal from the European Union and potential withdrawal from the single market on the rights of European Union citizens living in this country and the United Kingdom's future economic requirements.

The European single market is an internal market which currently encompasses all 28 EU member states. A number of other European countries outside the EU also participate in the single market, such as Iceland, Liechtenstein and Norway, who are parties to the European Economic Area (EEA) agreement, and Switzerland, which has a number of bilateral agreements with the EU. The UK joined the then European Economic Community (EEC) in January 1973, with the single market as it exists today being established in 1992. The single market provides for the 'four freedoms' within the EU: the freedom of movement for goods, services, capital and people.

In a speech on 17 January 2017, the Prime Minister, Theresa May, confirmed that the Government, in negotiating the UK's withdrawal from the EU, would seek a bespoke model for future UK-EU relations. As part of this, Mrs May announced that the UK would not retain its membership of the single market. She said that the Government would seek to protect the rights of EU citizens living in the UK on the basis that the same rights were afforded to UK citizens living in EU countries.

This briefing explores the possible impact on the rights of EU citizens living in the UK following the Prime Minister's announcement that the UK will not retain its membership of the single market on its withdrawal from the EU. It focuses on the current and future legal status of non-UK EU citizens in the UK and considers the possible effects of withdrawing from the single market on the UK's labour force. In the context of the UK's future economic requirements, the briefing concludes with an examination of the possible implications of leaving the EU for UK economy, trade and financial services.

It does not examine the different models that the UK may adopt once it has formally withdrawn from the EU. Nor does it examine the future implications for immigration between EU countries and the UK. The House of Lords Library briefing on *Leaving the European Union: Future UK-EU Relationship* explores both issues in further detail.

Eren Waitzman
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1. Introduction

Single Market

The concept of the European single market was first introduced in the Treaty of Rome, which came into force in 1958.[1] The Treaty aimed to create a "common market", covering the whole territory of the then European Economic Community. The common market involved a customs union and committed members to the free movement of goods, which comprised of a single external customs tariff and the abolition of duties between member states. The common market also included provisions on the free movement of capital, services and workers. These mechanisms and provisions "continue to form the core of the single market (the more usual term nowadays for the common or internal market), today".[2]

The European single market is an internal market which currently encompasses all 28 EU member states. A number of other European countries outside the EU also participate in the single market, such as Iceland, Liechtenstein and Norway, who are parties to the European Economic Area (EEA) agreement, and Switzerland, which has a number of bilateral agreements with the European Union.[3] The UK joined the then European Economic Community (EEC) in January 1973, with the single market as it exists today being established in 1992.[4]

Customs Union

In terms of free trade, EU member states belong to a customs union.[5] Within the customs union, a common tariff is applied to goods entering member states from outside the EU. As part of the customs union, EU member states are unable to negotiate their own free trade deals with non-EU countries.[6] At present, trade deals are coordinated through the EU's Common Commercial Policy, which is the EU's policy for trading with non-member states. According to Article 207 of the Treaty on European Union:

> The common commercial policy shall be based on uniform principles, particularly with regard to changes in tariff rates, the conclusion of tariff and trade agreements relating to trade in goods and services, and the commercial aspects of intellectual property, foreign direct investment, the achievement of uniformity in measures of liberalisation, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies.[7]

The EU is also tasked with: handling negotiations in the World Trade Organisation (WTO) in regards to the levels of tariffs on goods being imported to EU member states from non-EU countries; concluding trade agreements with non-EU countries; and deciding "what to do about goods 'dumped' on the EU market".[8]

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[1] UK Government, *Review of the Balance of Competences between the United Kingdom and the European Union: The Single Market*, July 2013, p 6.
[2] ibid, p13.
[3] ibid.
[4] European Commission, *20 Years of the Single Market*, 2012, p 7.
[5] UK Government, *Review of the Balance of Competences between the United Kingdom and the European Union: The Single Market*, July 2013, p 14.
[6] UK in a Changing Europe Initiative, 'The Customs Union', accessed 14 January 2016.
[7] EUR-Lex, *Consolidated Versions of the Treaty on European Union and the Treaty on the Functioning of the European Union*, 9 May 2008, p 140.
[8] UK in a Changing Europe Initiative, 'The Customs Union', accessed 14 January 2016.

2. UK Government's Negotiating Objectives for Leaving the EU

On 17 January 2017, the Prime Minister, Theresa May, made a speech at Lancaster House outlining the Government's position on the UK's future, once the country leaves the EU. In her speech, the Prime Minister contended that the Government's plan would be:

> One that gets us the right deal abroad but also ensures we get a better deal for ordinary working people at home. It's why that plan sets out how we will use this moment of change to build a stronger economy and a fairer society by embracing genuine economic and social reform.[9]

The Prime Minister also ruled out the option of the UK staying in the single market, arguing:

> European leaders have said many times that membership means accepting the 'four freedoms' of goods, capital, services and people. And being out of the EU but a member of the single market would mean complying with the EU's rules and regulations that implement those freedoms, without having a vote on what those rules and regulations are. It would mean accepting a role for the European court of justice that would see it still having direct legal authority in our country.
>
> It would to all intents and purposes mean not leaving the EU at all. And that is why both sides in the referendum campaign made it clear that a vote to leave the EU would be a vote to leave the single market. So we do not seek membership of the single market. Instead we seek the greatest possible access to it through a new, comprehensive, bold and ambitious free trade agreement (FTA).[10]

More broadly, in terms of trade and the UK's membership of the EU's custom union, Mrs May stated:

> I want Britain to be able to negotiate its own trade agreements. But I also want tariff-free trade with Europe and cross-border trade there to be as frictionless as possible.
>
> That means I do not want Britain to be part of the common commercial policy and I do not want us to be bound by the common external tariff. These are the elements of the customs union that prevent us from striking our own comprehensive trade agreements with other countries. But I do want us to have a customs agreement with the EU.
>
> Whether that means we must reach a completely new customs agreement, become an associate member of the customs union in some way, or remain a signatory to some elements of it, I hold no preconceived position. I have an open mind on how we do it. It is not the means that matter, but the ends.[11]

In response to the Prime Minister's speech, the Leader of the Opposition, Jeremy Corbyn, said he "welcome[d] that the Prime Minister has listened to the case we've been making about the need for full tariff free access to the single market" but said he was "deeply concerned about

[9] Prime Minister's Office, 'The Government's Negotiating Objectives for Exiting the EU: PM Speech', 17 January 2017.
[10] ibid.
[11] ibid.

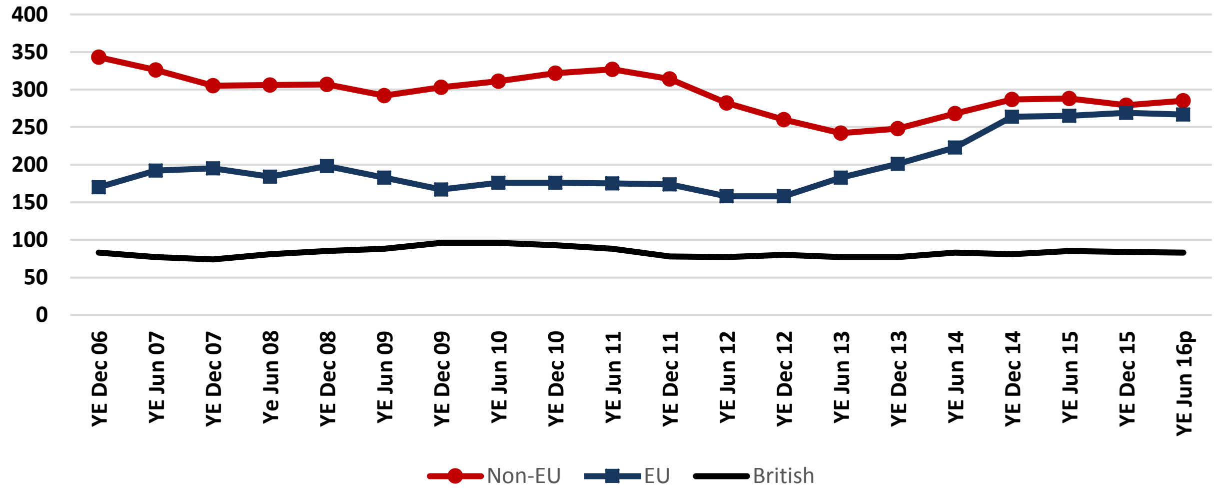
her reckless approach to achieving it.[12] The Government's decision to leave the single market was also criticised by the Leader of the Liberal Democrat Party, Tim Farron, who said that "ripping us [the UK] out of the single market was not something proposed to the British people. This is a theft of democracy".[13] Scotland's First Minister, Nicola Sturgeon, stated that it was "very likely the case" that Scotland would seek a second referendum on independence in light of the Government's plans to not retain membership of the single market.[14]

3. EU Citizens Living in the UK

3.1 Background

According to the latest Office for National Statistics (ONS) net migration statistics for the year ending June 2016, net migration to the UK was 335,000.[15] Of that figure, 284,000 EU citizens immigrated to the UK, whilst 95,000 emigrated from the UK. This resulted in an EU net migration total of 189,000. In contrast, 289,000 non-EU citizens immigrated to the UK, while 93,000 non-EU citizens emigrated, resulting in a non-EU net migration total of 196,000. The international passenger survey (IPS), from which the ONS data is based, projects that in the period 2005–14, approximately 469,000 British citizens have immigrated to EU countries.[16] However, it does not state how many British citizens have returned to the UK. The chart below sets out immigration to the UK by citizenship between 2006 and June 2016.

Figure One: Immigration to the UK by Citizenship (Thousands) between 2006–June 2016



Source: Office for National Statistics, 'Migration Statistics Quarterly Report: December 2016', 1 December 2016

[12] Tom Peck, 'Theresa May's Brexit Speech: Jeremy Corbyn Says PM Determined to 'Turn the UK into a Tax Haven'', *Independent*, 17 January 2017.
[13] BBC News, 'Brexit: UK to Leave Single Market, says Theresa May', 17 January 2017.
[14] BBC News, 'May's Brexit Speech: Sturgeon says Second Referendum 'Undoubtedly' Closer', 17 January 2017. For further information on the Scottish Government's positon, see: Scottish Government, *Scotland's Place in Europe*, 20 December 2016.
[15] Office for National Statistics, 'Migration Statistics Quarterly Report: Dec 2016', 1 December 2016.
[16] Office for National Statistics, 'Long-Term International Migration: Inflow of EU Citizens to the UK and Outflow of British Citizens to the EU—2005 to 2014', 26 May 2016. It should be noted that migration statistics are based on international passenger survey data, which collates information based on conducting 700,000 to 800,000 interviews a year, of which 250,000 are used to produce estimates. As a result, they are contested by some.

The organisation Full Fact reported that there were approximately 3 million EU-born residents in the UK in 2014. It also noted that there were approximately 1.2 million UK-born residents in the EU in 2015.[17] In a statement issued following the referendum, the Home Office confirmed that:

> EU nationals who have lived continuously and lawfully in the UK for at least five years automatically have a permanent right to reside. This means that they have a right to live in the UK permanently, in accordance with EU law. There is no requirement to register for documentation to confirm this status.[18]

Once an EU national has continuously and lawfully lived in the UK for at least six years, they are able to apply for British citizenship. For those who have lived in the UK for less than five years, they can "continue to have a right to reside in the UK in accordance with EU law".[19]

The ONS has reported that work is the "most commonly stated reason for immigration to the UK". It explained "IPS estimates show around 63 percent of immigrants arriving for work were EU citizens, 25 percent were non-EU citizens and 12 percent were British citizens".[20] It added: "in [the year ending] June 2016, 189,000 EU citizens arrived for work, compared with 162,000 in [year ending] June 2015".

According to the UK in a Changing Europe Initiative, EU migrants were "more likely to work in some sectors of the UK economy than others". It explained:

> The industry groups employing the largest number of people born in EU countries are manufacturing (15 percent of the EU-born in 2015), wholesale and retail trade (12 percent), health and social work (11 percent) and hotels and restaurants (10 percent). These are big sectors that also employ large numbers of UK-born workers.
>
> If we look at employment of people born in EU countries as a share of all workers in an industry, the pattern is slightly different. In 2015, 13 percent of workers in the accommodation and food services industry were born in EU countries—roughly double the average of 6.6 percent EU born people in employment overall. EU migrants were also overrepresented in admin and support services (10 percent) and manufacturing (10 percent). By contrast, education, health and social work (5 percent) and public administration (3 percent) relied relatively less on people from EU countries.[21]

Table 1 provides a breakdown of the percentage of each sector's workforce who were born in EU countries.

[17] Full Fact, 'Brits Abroad: How Many People from the UK Live in Other EU Countries', updated 29 March 2016.
[18] Home Office, 'Statement: The Status of EU Nationals in the UK', 11 July 2016.
[19] ibid.
[20] Office for National Statistics, 'Migration Statistics Quarterly Report: Dec 2016', 1 December 2016.
[21] UK in a Changing Europe Initiative, 'Where Do EU Migrants in the UK Work?', accessed 19 January 2017.

Table 1: Percent of sector's workforce who were born in EU countries, 2015[22]

Industry group	**Share of workers in industry who were born in EU %**	**Share of EU born who are working in this industry %**
Manufacturing	10	15
Wholesale/retail	6	12
Health/social work	5	11
Accommodation/food service	13	10
Construction	7	8
Education	5	7
Admin and support	10	7
Professional/scientific	6	7
Transport/storage	8	6
Information/communication	7	4
Financial/insurance	6	4
Public admin/defence	3	3
Total	**6.6**	**100**

Source: UK in a Changing Europe Initiative, 'Where Do EU Migrants in the UK Work?', accessed 19 January 2017

3.2 Possible Implications of Withdrawal from the EU

Status

On 17 January 2017, during her speech at Lancaster House, the Prime Minister addressed the issue of rights for EU nationals in Britain, Theresa May said:

> Fairness demands that we deal with another issue as soon as possible too. We want to guarantee the rights of EU citizens who are already living in Britain, and the rights of British nationals in other member states, as early as we can.
>
> I have told other EU leaders that we could give people the certainty they want straight away, and reach such a deal now.[23]

Later that day, the Secretary of State for Exiting the European Union, David Davis, made a statement to the House of Commons regarding the speech made by the Prime Minister.[24]

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[22] This is based on a Migration Observatory analysis of Labour Force Survey 2015, weighted average of four quarters. Excludes industries with fewer than 50,000 EU born workers. Further information about EU nationals working the NHS can be found in the House of Lords Library briefing *Leaving the European Union: NHS and Social Care Workforce*, 18 November 2016.
[23] Prime Minister's Office, 'The Government's Negotiating Objectives for Exiting the EU: PM Speech', 17 January 2017.
[24] *HC Hansard*, 17 January 2017, cols 792–822.

Discussing the status of EU citizens living in the UK after the UK's withdrawal from the EU, Mr Davis echoed the Prime Minister's views, stating that:

> We want to guarantee the rights of EU citizens who are already in this country and already make such a great contribution to our society, in tandem with similar protections for the rights of UK citizens in EU countries. We would like to resolve that issue at the earliest possible moment.[25]

The Government's approach has been criticised. Nicholas Hatton, the co-chair at the 3 Million—a group campaigning to preserve the rights of EU citizens in the UK and UK citizens in the EU, once the UK withdraws from the EU—argued that EU citizens "do not want to be bargaining chips in the renegotiations".[26] Giving evidence to the House of Commons Exiting the European Union Committee following Mrs May's speech, he noted that "there is a very strong feeling in the communities that we are negotiating capital, the main card in the negotiation. This is a political issue about not granting our rights".[27] In the report following its inquiry on acquired rights in the EU, the House of Lords European Union Committee concluded: "the Government is under a moral obligation to provide certainty and legal clarity to all EU nationals working, living and studying in the UK, who contribute so significantly to the economic and cultural life of the UK. It should do so urgently".[28]

British Future, a think tank on migration and identity, has called on the Government to end the "anxiety" for EU citizens living in the UK.[29] In December 2016, it published a report setting out the findings and recommendations of a cross-party, independent, inquiry into how to secure the status and rights of EU nationals currently living in the UK. The report recommended that EEA+ nationals who have resided in the UK for the past five years or longer "be offered permanent residence as it currently stands".[30] It also suggested that the Government pass regulations "to convert permanent residence into a bespoke indefinite leave to remain" on the date that the UK formally leaves the EU.[31] Further, the report recommended that the Home Office examine how it could process such a large volume of applications, contending that it could take 150 years to complete, given the current rate of processing permanent residency cards.[32]

This view was echoed by the Migration Observatory who contended that "the administrative task facing the Home Office is formidable, with a much larger volume of applications expected in a complex area of law that has received relatively little attention to date".[33] It also noted that whilst the Government had yet to reveal what the registration process for EU citizens would look like and who would qualify, "if the current rules for determining that a person has been

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[25] HC *Hansard*, 17 January 2017, col 793.
[26] House of Commons Exiting the European Union Committee, *Oral Evidence: The UK's Negotiating Objectives for Withdrawal from EU*, 18 January 2017, HC 815 of session 2016–17, Q 624.
[27] ibid.
[28] House of Lords European Union Committee, *Brexit: Acquired Rights*, 14 December 2016, HL Paper 82 of session 2016–17, p 20, para 47.
[29] British Future, *Report of the Inquiry into Securing the Status of EEA+ Nationals in the UK*, 14 December 2016, p 10.
[30] ibid, p 7. The report notes that "EC Directive 2004/38/EC, the 1992 EEA Agreement and the 1999 Bilateral I agreement between the EU and Switzerland permits freedom of movement for employees, the self-employed, job-seekers, students and self-sufficient people within EU member states, or Iceland, Lichtenstein, Norway and Switzerland. This group of people will be referred to as EEA+ nationals in this report".
[31] British Future, *Report of the Inquiry into Securing the Status of EEA+ Nationals in the UK*, 14 December 2016, p 7.
[32] ibid, p 9.
[33] Migration Observatory, *Here Today, Gone Tomorrow? The Status of EU Citizens Already Living in the UK*, 3 August 2016.

exercising their treaty rights in the UK were the model for any new post-Brexit application process, there would be groups of people who would not qualify despite having lived in the UK for several years".[34]

The House of Lords European Union Committee noted it had:

> Received evidence suggesting that many EU nationals who have been in the UK for over five years may not be able to prove that they meet the criteria for permanent residence as an EU citizen. For example, those who are not economically active, including students, will have to show that they have had comprehensive sickness insurance cover for five years in the UK, notwithstanding that the National Health Service is freely available.
>
> We call on the Government to explain whether this consideration will influence the decision it makes on the cut-off point for deciding which EU nationals in the UK are given a permanent right to reside after Brexit.[35]

In November 2016, the Shadow Secretary of State for Exiting the European Union, Keir Starmer, called on the Government to grant EU expatriates living in the UK long-term residency rights. He told the *Guardian*, that the Government could "pass a domestic law, dealing with the status of these individuals [EU citizens], and it would get cross-party support, and could be passed very swiftly".[36]

Impact on the Labour Market

A number of sectors of the UK economy have reported their concerns about current and prospective skills shortages. In this context, Marcus Mason, the Head of Business, Education and Skills at the British Chambers of Commerce, noted that even before the UK had left both the EU and the single market, "some businesses have witnessed reductions in the number of people from the EU applying for their jobs".[37] However, he was unsure if this was as a result of "sentiment that was discussed earlier [uncertainty of EU nationals' future prospects] or to the exchange rate, but it needs to be addressed".[38] In evidence to the House of Lords Home Affairs Sub-Committee on the UK-EU movement of people once the UK has left the EU, Mr Mason stated that his organisation's immediate concerns were "guarantees for current and existing EU workers" which he described as "crucial", in addition to receiving "clarity as to what will happen during the transition when it comes to recruiting EU workers".[39]

Similar concerns have been shared by the National Farmers Union. In its written evidence to the House of Lords Home Affairs Sub-Committee, it argued that the decision by the UK to withdraw from the EU had already impacted on recruitment in British agriculture

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[34] Migration Observatory, *Here Today, Gone Tomorrow? The Status of EU Citizens Already Living in the UK*, 3 August 2016.
[35] House of Lords European Union Committee, *Brexit: Acquired Rights*, 14 December 2016, HL Paper 82 of session 16–17, p 19.
[36] Heather Stewart, 'Keir Starmer: UK Should Guarantee EU Citizens' Rights Before Talks Begin', *Guardian*, 30 November 2016.
[37] House of Lords Home Affairs Sub-Committee, *Oral Evidence: Brexit: UK-EU Movement of People*, 14 December 2016, Q 30.
[38] ibid.
[39] ibid.

It reported that:

> The results of the first three quarters of the *2016 NFU Labour Provider Survey* found that there was a dramatic change in labour availability within the space of nine months, clearly showing the deterioration in the ability to maintain EU labour in the horticulture sector.[40]

During its inquiry into leaving the EU and the financial services sector, the House of Lords European Union Committee heard from witnesses that "expressed concern" over the ability of the sector "to recruit and retain staff".[41] The Committee's report noted that:

> Sir Charles Bean said that access to a deep pool of skilled labour was one of the attractions of London. Financial services firms would want "to get the specialised labour that they need in a relatively efficient and smooth way." His worry was that "some heavy bureaucratic process is put in place that takes a very long time to operate and becomes very cumbersome".[42]

The Committee concluded that the "ability to continue to access to highly qualified staff and the ability to transfer them between the UK and the EU is a key issue for the financial services industry".[43] It added "that maintaining appropriate labour market flexibility will be critical to the UK's long-term economic prosperity". The previous day, in its report on acquired rights in the EU, the Committee had called on the Government to "act quickly" on the issue for the benefit of the UK economy. It argued:

> There is also a forceful economic case for the Government to act quickly. EU workers play an important role in filling gaps in the labour market that cannot otherwise be filled by UK workers. This is as true for highly skilled job markets, such as medical or financial services, as it is for lower skilled or seasonal job markets. The longer their future is uncertain, the less attractive a place to live and work the UK will be, and the greater labour market gaps will be.[44]

On 11 January 2017, the House of Commons Exiting the European Union Committee published its report on the process for leaving the EU and the Government's negotiating objectives. It noted that in relation to EU workers coming into the UK:

> The Secretary of State told us that decisions around the levels of EU migration that would be permitted after the UK left the EU would not be a matter for discussion during the course of negotiations. The decisions would be made independently by the UK Government:
>
>> I think that the operation of that decision after we have left the European Union will be in the national interest, and that will affect all levels of skills. The

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[40] House of Lords Home Affairs Sub-Committee, *Written Evidence: Evidence submitted to the EU Home Affairs Sub-Committee by the National Farmers Union*, 19 January 2017.
[41] House of Lords European Union Committee, *Brexit: Financial Services*, 15 December 2016, HL Paper 81 of session 2016–17, p 28, para 77.
[42] ibid.
[43] ibid, p 29, para 81.
[44] House of Lords European Union Committee, *Brexit: Acquired Rights*, 14 December 2016, HL Paper 82 of session 2016–17, p 20, para 48.

> Government will come to a judgment as to what is necessary for universities, for business and for fruit picking.[45]

As a result, the Committee concluded that in deciding on a new system for controlling EU migration, the Government would need:

> […] to take full account of the importance of workers from the EU, including the highly skilled, and the ability to undertake intra-company transfers to a large number of sectors of the UK economy.[46]

The Government has continued to resist the Scottish National Party's (SNP) proposals that would keep Scotland in the EU's single market. At Scottish questions in the House of Commons on 18 January 2017, Kirsten Oswald (SNP MP for East Renfrewshire) argued that "a hard Brexit outside the single market threatens to cost Scotland 80,000 jobs over a decade and to cost people an average of £2,000 in wages".[47] She asked what actions the Secretary of State, would take "to keep Scotland in the single market, even if the rest of the UK leaves". David Mundell, the Secretary of State for Scotland, responded:

> It is absolutely clear that Scotland cannot be a member of the single market if it is not a member of the EU, and the United Kingdom will not be a member of the EU. The Scottish Government accept that proposition. What is important is access to the single market and, as the Prime Minister set out yesterday, we aim to achieve the best possible access to that market.

4. UK Economy

The section below examines the contributions of trade and financial services to the UK economy. It also presents statistics on the UK's trade in goods and services with EU and non-EU countries.

4.1 Background

Trade

In 2015, the UK exported goods and services valued at £508 billion, and imported a total of £547 billion.[48] As a result, the UK had an overall trade deficit of £38.7 billion. In terms of goods, the UK exported a total of £283.3 billion and imported a total of £409.7 billion, resulting in a deficit of £126.4 billion. In regards to services, the UK exported a total of £225.5 billion, with imports totalled at £137.7 billion, resulting in a surplus of £87.8 billion in 2015.[49] Table 2 outlines these figures.

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[45] House of Commons Exiting the European Union Committee, *The Process for Exiting the European Union and the Government's Negotiating Objectives*, 11 January 2017, HC 815 of session 2016–17, pp 41–2.
[46] House of Commons Exiting the European Union Committee, *The Process for Exiting the European Union and the Government's Negotiating Objectives*, 11 January 2017, HC 815 of session 2016–17, p 42.
[47] HC *Hansard*, 18 January 2017, cols 926–7.
[48] Office for National Statistics, *Statistical Bulletin: Balance of Payments—April to June 2016*, 30 September 2016, Table B.
[49] ibid.

Table 2: UK Trade in Goods and Services, 2015

	Exports (£ Billions)	Imports (£ Billions)	Balance (£ Billion)
Goods	283.3	409.7	-126.4
Services	225.5	137.7	+87.8
Total	**508.8**	**547.4**	**-38.7**

Source: Office for National Statistics, *Statistical Bulletin: Balance of Payments—April to June 2016*, 30 September 2016, Table B. Please note that figures have been rounded and may not sum.

The Office for National Statistics (ONS) noted that the EU is "a large market for the UK, particularly for our exports of services and goods". It reported that in 2015, 44 percent of the UK's goods and services were exported to the EU, while 53 percent of the UK's imports came from EU member states.[50] In the same period, UK exports to the EU were valued at £222.9 billion, while UK imports from the EU stood at £290.9 billion. In contrast, for countries outside the EU in 2015, UK exports were valued at £285.9 billion, with imports worth £256.6 billion.[51]

Table 3 below sets out the most recent annual statistics on trade in both goods and services between the UK, the EU and countries outside the EU.

Table 3: UK Trade in Goods and Services with EU and non-EU Countries, 2015

	Exports (£ billions)	Imports (£ billions)	Balance (£ billion)
EU	222.9	290.9	-68.0
Non-EU	285.9	256.6	+29.3
Total	**508.8**	**547.4**	**-38.7**

Source: Office for National Statistics, *Statistical Bulletin: Balance of Payments—April to June 2016*, 30 September 2016, Tables B and C. Please note that figures have been rounded and may not sum.

Financial Services

According to the UK Trade and Investment (UKTI), which has since been replaced by the Department for International Trade, "the financial services industry plays a pivotal role across the UK economy", with over 2 million people employed in the industry.[52] It also noted that:

> As well as providing support functions that underpin all sectors, financial services (which include banking, insurance, securities dealing, derivatives and fund management) and related professional services (ie legal services, accounting and management consulting) are a major contributor to growth and employment in their own right.[53]

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[50] Office for National Statistics, 'UK Perspectives 2016: Trade with the EU and Beyond', 25 May 2016.
[51] Office for National Statistics, *Statistical Bulletin: Balance of Payments—April to June 2016*, 30 September 2016, Table C.
[52] UK Trade and Industry, *UK Financial Centres of Excellence*, August 2016, p 3.
[53] ibid.

UKTI reported that financial and related professional services account for 11.8 percent of the UK's gross domestic product. The industry also contributed £66 billion in tax revenue for 2014/15, accounting for 11 percent of total UK receipts. The UKTI noted that this was the largest contribution of any sector in the UK.[54]

In terms of global influence, it stated that the UK's trade surplus in financial services "is more than double that of the next largest trade surpluses recorded by the US, Luxembourg and Switzerland".[55] In 2014, the trade surplus stood at £57.3 billion, which was larger than the combined surplus of all other net exporting countries in the UK. Financial services also accounted for over half of total foreign direct investment flows into the UK, with £14.0 billion out of £27.8 billion.

In November 2016, CityUK, a representative body of the industry, reported that:

> The UK has the leading share of trading in many international financial markets such as cross border bank lending (16 percent), international insurance premium income (29 percent) and foreign exchange trading (37 percent). It is also a global leader in providing professional services.[56]

4.2 Possible Implications of Withdrawal from the EU

Economic Prospects

Prior to the referendum, in April 2016, the Treasury published a report analysing the long-term economic impact of EU membership and alternatives models. Examining some of the proposed alternative models, for example, membership of the EEA, a negotiated bilateral agreement and WTO membership,[57] the Treasury argued that "the UK would be permanently poorer if it left the EU and adopted any of these models".[58] The report contended that should the UK leave the EU and adopt any of these alternative models, both productivity and GDP per person would be lower in all of them, "as the costs substantially outweigh any potential benefit of leaving the EU".[59] The Treasury's central estimates for the annual loss of GDP per household under the three models after 15 years were as follows:

- £2,600 under the EEA.
- £4,300 in a negotiated bilateral agreement.
- £5,200 under membership of the WTO.[60]

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[54] UK Trade and Industry, *UK Financial Centres of Excellence*, August 2016, p 4.
[55] ibid, p 5.
[56] CityUK, 'Key Facts About the UK as an International Financial Centre 2016', 1 November 2016.
[57] The EEA includes EU countries and also Iceland, Liechtenstein and Norway. It allows them to be part of the EU's single market; negotiated bilateral agreements, for example, between the EU and Norway, includes access to the single market as Norway does for most of its industries; WTO membership does not include access to the single market. For further information on the possible models for UK-EU trade, see: House of Lords Library, *Leaving the European Union: Future UK-EU Relationship*, 25 November 2016.
[58] HM Treasury, *HM Treasury Analysis: The Long-term Economic Impact of EU Membership and the Alternatives*, April 2016, Cm 9250, p 8.
[59] ibid.
[60] ibid.

The Institute for Fiscal Studies (IFS) argued in May 2016 that were the UK to withdraw from the EU, in the short-term, the overall effect would be "to damage the public finances".[61] The IFS estimated that the effect could be somewhere between £20 billion and £40 billion in 2019/20, which it contended would be "more than enough to wipe out the planned [budget] surplus" by the Government.[62] It also suggested that in the long run, lower GDP would possibly lead to "lower cash levels of public spending". As a result, should this "remain the Government's priority", the IFS contended that dealing with the public finance effect would require "at least one or two years of 'austerity'—spending cuts or tax rises—at the same rate as we have experienced recently to get the public finances back to balance".[63]

With regard to the single market, the IFS argued that membership of the single market "goes beyond 'access' to a market through a trade deal or customs union by substantially addressing 'non-tariff barriers', which are particularly important to trading services".[64] As a result, it contended that:

> […] full membership of the single market is the deepest form of trade integration and reduces trade costs in a way that an FTA or a customs union is unable to do, especially for services.[65]

The Centre for Economics and Business Research forecasted in November 2016 that if the UK withdrew from the single market, every key sector in the UK economy would be impacted. In its report, it concluded that:

> There appears to be no single sector whose economic characteristics—whether gross value added (GVA), growth potential of trade density—do not link closely to and benefit from trading within the EU's single market today. A sector-by-sector approach, which seeks to prioritise or choose 'winners' in isolation of others, therefore, cannot be achieved without the risk of creating 'losers' through reduced access and reduced future mutual benefits.[66]

However, Economists for Brexit, a group of eight economists who campaigned for the UK to leave the EU, argue that withdrawing from the EU would "enhance the growth potential of the UK economy further".[67] Describing leaving the EU as "a major supply-side reform to the UK economy",[68] they projected that it would raise output, employment and productivity in the country. This, they stated, was because:

> [The UK's] industrial structure would be guided again by comparative advantage; we would be able to shape or repeal both product and process regulations (such as

[61] Institute for Fiscal Studies, *Brexit and the UK's Public Finances*, May 2016, p 11. The IFS has published a table outlining various quantitative estimates of the future of the UK economy, once the country leaves the EU. These estimates are sourced from academics, organisations and think tanks own studies, and have been published in the last two years. The table also examines the potential trade scenarios once the UK withdraws from the EU; GDP in 2030; and each study's assessment of the main impacts. The table can be found at Institute for Fiscal Studies, *Brexit and the UK's Public Finances*, May 2016, p 18.
[62] ibid.
[63] Institute for Fiscal Studies, *Brexit and the UK's Public Finances*, May 2016, p 11.
[64] Institute for Fiscal Studies, *EU Single Market: Membership Versus Access*, August 2016, p 21.
[65] ibid.
[66] Centre for Economics and Business Research, 'How the UK Economy's Key Sectors Link to the EU's Single Market', 28 November 2016.
[67] Economists for Brexit, *The Economy After Brexit*, April 2016, p 16.
[68] ibid.

> employment law) to suit our domestic circumstances; trade with fast-growing non-EU countries will be encouraged; immigration policy will be redirected towards non-discriminatory admission of those most needed by the economy; and the 1 percent of GDP paid to the EU budget would be better used.[69]

Further, Open Europe, an independent think tank, contended that although it estimated that leaving the EU "means a degree of economic dislocation with the UK's largest trade partner and therefore an economic cost"—likely to be in the range of 0.5 percent to 1.5 percent of GDP over the long-term—it believed that "it is possible for the UK to get back into positive economic territory over the long-term if it takes a liberal approach to trade, immigration and deregulation".[70]

Following the publication of recent data, suggesting that the UK economy had fared better than economists had thought since the vote to leave the EU[71], Jonathan Portes, Professor of Economics and Public Policy at King's College London, has written about the difficulties in "short-term economic forecasting", which he argued was "very unreliable". He said that many short-term forecasts that a leave vote would lead to a sharp slowing of the economy had been "proved wrong" by economic forecasts in November.[72] In his blog, he argued that:

> […] what forecasters fundamentally got wrong was their judgement about the short-term behaviour of millions of individuals interacting in a very complex system, where (as we know from the analysis of such systems) relatively small changes in a few variables can lead to quite different outcomes.[73]

However, he argued that "predictions about the long-term impact of Brexit—like climate science are based on quite different reasoning, about how changing one key factor—our openness to trade, or the degree to which the earth's atmosphere retains heat—changes the long-run properties of the system". The methodologies used, he said, were "well-established and robust". Nevertheless, "economists' forecasts of the long-term impacts of Brexit could still be wrong" because of the uncertainties that remain. However, the insights of such "gravity modelling" were "common sense, and their empirical and practical validity is not seriously in question. More CO_2 will make us hotter: less trade and migration will make us poorer".[74]

The Office for Budget Responsibility (OBR), in its economic and fiscal outlook published in November 2016, struck a note of caution, observing that:

> Given the uncertainty surrounding the choices and trade-offs that the Government may have to make, and the consequences of different outcomes, we have not attempted to predict the precise end result of the negotiations. Instead we have made a judgement—consistent with most external studies—that over the time horizon of our forecast any likely Brexit outcome would lead to lower trade flows, lower investment and lower net inward migration than we would otherwise have seen, and hence lower potential output. In time the performance of the economy will also be affected by future choices that the Government makes about regulatory and other policies that are currently

[69] Economists for Brexit, *The Economy After Brexit*, April 2016, p 16.
[70] Open Europe, *Where Next? A Liberal, Free-Market Guide to Brexit*, April 2016, p 53.
[71] See for example: BBC News, 'How Has Economy Fared since Brexit Vote?', 17 January 2017.
[72] Jonathan Portes, 'The Weather is not the Climate: Predicting the Economic Impacts of Brexit', Not the Treasury View Blog, 16 January 2017.
[73] ibid.
[74] ibid.

> determined at the European level. These could move in either a growth-enhancing or a growth-impeding direction.[75]

Looking further ahead, it forecast "growth to slow further":

> […] reaching a trough of 0.2 percent a quarter in the second quarter of 2017. Growth then picks up gradually in the second half of 2017 and through 2018. We expect the economy to be running 0.7 percent below full capacity by the end of 2017 (compared to 0.2 percent in the third quarter this year), with above-trend growth then closing this output gap by mid-2021.[76]

The OBR also noted that it had "not assumed any further uncertainty-related hit to growth in 2019 when the UK's exit from the EU is assumed to be completed".[77]

Financial Services

Some commentators have argued that after leaving the EU, financial services firms based in the UK may leave if they lose their rights to passporting. The term 'passporting' means the exercising of the right of a firm in the EEA to do business in any other EEA member state without needing further authorisation in each country.[78]

In its *Review of the Balance of Competences between the UK and the EU* into the single market and financial services, published July 2014, the Coalition Government noted that in addition to the UK financial service sector making a "significant contribution" to the UK economy, access to the single market was "key" for many financial services firms, which a number of stakeholders who contributed to the review cited as important in their decision to locate in the UK.[79] According to the IFS, the EU is an "important market" for financial services. As a result, it warned that "without passporting rights that come with single market membership, a substantial portion of that EU-related activity—either from UK firms or from non-EU firms with subsidiaries in the UK—will consider moving activity elsewhere".[80] PWC estimated that the final services sector could be 7.3 percent smaller than its present level by 2030, after the UK has withdrawn from the EU.[81]

The House of Lords European Union Committee, in its report *Brexit: Financial Services*, found that:

> The existing business models of UK-based financial services rely to a degree on 'passporting' rights granted in several pieces of EU legislation, and it has been estimated that around £40 to £50 billion of annual revenues are related to the EU. Were the negotiations to result in the UK being treated in the same manner as any other non-EEA 'third country', the UK could find itself seeking equivalence under legislative provisions that are patchy, unreliable and vulnerable to political influence. It has recently been

75 Office for Budget Responsibility, *Economic and Fiscal Outlook*, November 2016, p 6.
76 ibid, p 10.
77 ibid.
78 Bank of England, 'Passporting', accessed 18 January 2017.
79 UK Government, *Review of the Balance of Competences Between the UK and the EU: The Single Market—Financial Services and the Free Movement of Capital*, July 2014, p 41.
80 Institute for Fiscal Studies, *The EU Single Market: The Value of Membership Versus Access to the UK*, August 2016, p 18.
81 ibid.

> reported that the European Commission is proposing to tighten the equivalence provisions in EU legislation: this highlights the unpredictability of such a regime.[82]

The Committee concluded: "if the current passporting regime is not maintained, the Government should seek a deal to bolster the current equivalence arrangements for third country access, to cover gaps in the regime and to ensure the continuation of equivalence decisions as financial services regulation develops".

In contrast, others argue that even if firms lost passporting rights, many firms in the UK already had representation in EU member states. Dr Gerard Lyons, a British economist and member of Economists for Brexit, argued that although the concern for financial services upon the UK leaving the EU was the loss of passporting rights, the single market had "not worked particularly well" for financial services, particularly, in retail markets where many firms already had representation in many EU countries.[83] He contended that after the UK withdrew from the EU, "the city of London will retain its role as the world's leading financial centre".[84] He noted that as part of the EU, the sector had faced a "difficult time" in recent years, and had "seen a declining ability to influence the regulatory environment for the financial sector".[85]

The House of Commons Treasury Committee found that "the passporting regime provides benefits to financial firms that undertake cross-border activity, including large banks and some asset managers".[86] It found that "whether or not the UK negotiated a comprehensive trade agreement with the EU, maintaining the passporting would probably require the UK to show equivalence with EU regulation", which it said:

> […] would limit the UK's flexibility, from outside the EU, to set its own regulatory framework, and it would lead to a loss of influence over financial regulation with which it might nonetheless have to comply or adhere. In this sector, the trade-off between domestic regulatory control and market access is particularly acute.

The Committee concluded that: "a loss of passporting would not be fatal for the UK's financial services industry; its competitiveness is founded on a wider constellation of factors, including time zone, language and the legal system". It added "but it would be plausible to suppose that some relocation of activity, particularly by foreign banks that currently base their European operations in London, might take place […]".

In October 2016, the chief executive of the British Bankers' Association, Anthony Browne, wrote in the *Guardian* that:

> Banking is probably more affected by Brexit than any other sector of the economy, both in the degree of impact and the scale of the implications […] It is the UK's biggest export industry by far and is more internationally mobile than most. But it also gets its rules and legal rights to serve its customers cross-border from the EU.[87]

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[82] House of Lords European Union Committee, *Brexit: Financial Services*, 15 December 2016, HL Paper 81of session 2016–17, p 3.
[83] Economists for Brexit, *The Economy After Brexit*, April 2016, p 22.
[84] ibid, p 4.
[85] ibid.
[86] House of Commons Treasury Committee, *The Economic and Financial Costs and Benefits of the UK's EU Membership*, 27 May 2016, HC 122 of session 2016–17, p 50, para 193.
[87] Anthony Browne, 'Brexit Politicians Are Putting Us on a Fast Track to Financial Jeopardy', *Guardian*, 22 October 2016.

He stated that many smaller banks planned to start relocations before the end of 2016, whilst bigger banks were expected to start in the first quarter of 2017.[88] It has since been reported that HSBC and UBS could both relocate about 1,000 jobs from the UK.[89] However, Barclays chief executive, Jes Staley, told the BBC he believed that "the UK will continue to be the financial lungs for Europe".[90]

[88] Anthony Browne, 'Brexit Politicians Are Putting Us on a Fast Track to Financial Jeopardy', *Guardian*, 22 October 2016.
[89] BBC News, 'London Will Remain 'Financial Lungs' of Europe, says Jes Staley', 19 January 2017.
[90] ibid.