WHY THE EU'S SINGLE MARKET IS FAILING BRITAIN

*NO DEAL
WILL BE BETTER
THAN A BAD DEAL.*

LEU002PEUTRADE

LEAVE MEANS LEAVE

Why the EU's Single Market is failing Britain

No deal will be better than a bad deal

Ewen Stewart & Brian Monteith

Contents

LEAVE MEANS LEAVE

A Global Britain campaign

Published by Global Britain
55 Tufton Street, Westminster, London SW1P 3QL

EXECUTIVE SUMMARY

- Trade is critical to the UK economy with UK exports of £669bn in 2015.
- The UK has the largest current account deficit in the G7 approaching 6% of GDP. Understanding the reasons for this are critical to designing the right trade strategy post BREXIT. It is clear from the UK's performance from within the single market that something is badly amiss.
- Asymmetry One – the UK runs a substantial global surplus in services and a substantial deficit in goods. The UK's goods trade deficit with the EU was £89bn in 2015. The UK recorded a £10bn goods surplus with the America's (largely USA). Odd that the UK should be in surplus with the US, where there is no preferential trade deal, and a massive deficit within the Single Market. Further, the UK service surplus with the US is approximately 50% higher than all 27 nations of the EU combined.
- Asymmetry Two – the UK runs a trade surplus with the rest of the world and a very large deficit with the EU. This is a paradox – the UK experiencing underperformance to the regulatory regime it is tied into, but out-performance where it is not.
- Asymmetry Three – the EU is a declining bloc. Its GDP growth has lagged every other region in the world for a generation. The rate of decline is accelerating. This has caused business to vote with its feet away from the declining EU to faster growth markets. In 1999 61% of UK trade was with the EU, now it is 43%. By 2025 we estimate the EU will account for under 35% trade.
- We believe structurally low EU economic growth and the nature of its Single Market, which favours trade in goods over the UK's strategic advantage in services, has caused the UK's exports with the EU to perform so poorly and so much better with the rest of the world. These are critical observations and greatly undermine the case for remaining in the Single Market or EEA.
- Global tariffs continue to fall. Average tariffs into the EU are now just above 1%. While they remain high in a few sectors, agricultural products being the prime example, the benefit from being inside the single market without facing the global tariff regime is minimal. Frankly, compared with currency swings, the tariffs into the EU in aggregate is a rounding error.
- Further, it is a fallacy that one needs to be inside the Single Market to trade with it. US, China, Japan and Australia all enjoy access so long as they meet the single market regulatory standards, just as the UK can trade with China so long as Chinese standards are met for its local market.
- On the other side of the coin the Single market remains the world's growth laggard, is highly regulated and inflexible. It advantages trade in goods over services. The outcome is a large deficit while the UK enjoys a surplus with the rest of the world.
- The US is the world's largest market, with a GDP of $17,947bn, compared with the EU ex UK GDP of $13,381bn. The UK does not have to be "inside" the US to trade there, why then should the UK have to be "inside" the EU's single market to trade with it?
- The key lesson is the UK does well with the world and very badly with the place the UK is currently tied to – the EU – and remaining in the Single Market will not improve this deficit. On the contrary it may make matters worse as the UK will be required to incorporate continuing EU single market related regulation into domestic law without any say in its framing.

- If the UK remains tied to the EU single market regulatory regime it will continue to pull our political and economic focus towards the world's least successful economic zone while tying us down with needless and expensive regulation for all businesses, even if they do not export. The UK has also been paying large membership fees for access into this failing market while other countries such as the US have not – continuing financial contributions will likely be demanded as the price for a bad deal.
- The EU's record on reaching Free Trade Agreements is very poor, with countries such as Switzerland and Chile having struck more deals and of higher value than the EU and the EU having no FTAs with the leading economies of US, Japan and China. This problem arises because the EU's 27 members have been slow to reach agreement, with each having their own peccadillos they want resolved. A single country, such as the UK will be able to achieve more FTAs and more quickly than the EU can.
- It is in the EU's interests to agree a zero tariff deal with the UK simply because they sell more to the UK than the UK sells to the EU. However if they refuse to do so within reasonable timeframe, the UK should leave the EU without a formal agreement, after Article 50 has been triggered, relying on WTO rules and striking free trade deals with our global partners. This stance would be far better than remaining in the failing Single Market, having left the EU, which would be worse than the current arrangements, unsatisfactory as they are. This is because the UK would swap a current marginal influence on Single Market regulation (12% vote in the council of ministers) for no say in regulatory framework at all – while having to accept free movement of people.
- To remain in the Single Market, having left the EU, is the 'no say, low growth, regulatory burden, sovereignty illusion' option locking in perpetual trade deficits. That is why no deal, is better than a bad deal.

1. INTRODUCTION

It is a cliché but Britain is a trading nation. Last year the UK exported £669bn of goods and services to the world equivalent to 36.5% of GDP. BREXIT provides a once in a lifetime opportunity to re-boot UK trade by the UK re-taking control of trade policy. What we do with those tools will be a major determinant of growth going forward.

This paper outlines the current trading and asset balance sheet and highlights the reasons for the continuing asymmetry in trading with the EU and the rest of the world. A second paper will outline the trading options for the UK when she leaves the EU.

Under the current arrangements we have a big problem. Locked into the failing EU 'Single Market' we have run up a huge and growing deficit with the EU. Despite this we are able to run a surplus with the rest of the world. This seems paradoxical – we are failing where we are tied in to the EU structure, currently legally, and succeeding where we are not, with the rest of the world.

The Single Market is the world's slowest growing bloc. That has been the case for a generation now. It is highly regulated and it has failed to play to UK strategic advantage, services. This has cemented a perpetual and growing UK trade deficit with the EU.

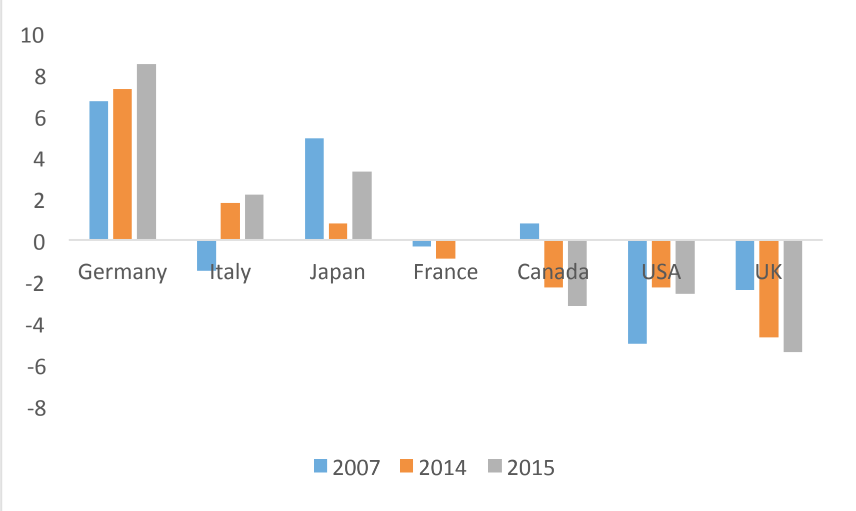
It is critical to understand that one does not need to be inside or part of the single market to trade with it. It is an enduring fallacy that Single Market membership enhances trade it does not. All countries, with a tiny number of exceptions of countries under sanction (like Syria or North Korea) have full access to the Single Market.

China is not a member but enjoys growing trade with the EU, as does the US, Japan and Australia. Indeed none of those examples have any special trade deals with the EU but trade flows freely under World Trade Organisation (WTO) guidance. All of them have can trade freely with EU nations. Yes, all counties need to comply with Single Market regulation, just as all countries, exporting to China have to accept its local standards, but it is absolutely the case that there is open access to trade for all nations outside the EU or EEA structures.

The UK has a problem

The UK runs a significant and growing trade deficit, currently the most serious in the G7. This is important as it has long term implications for the level of sterling relative to other currencies and long term growth prospects. While countries can and do run deficits for years ultimately a nation needs to 'pay its way in the world.'

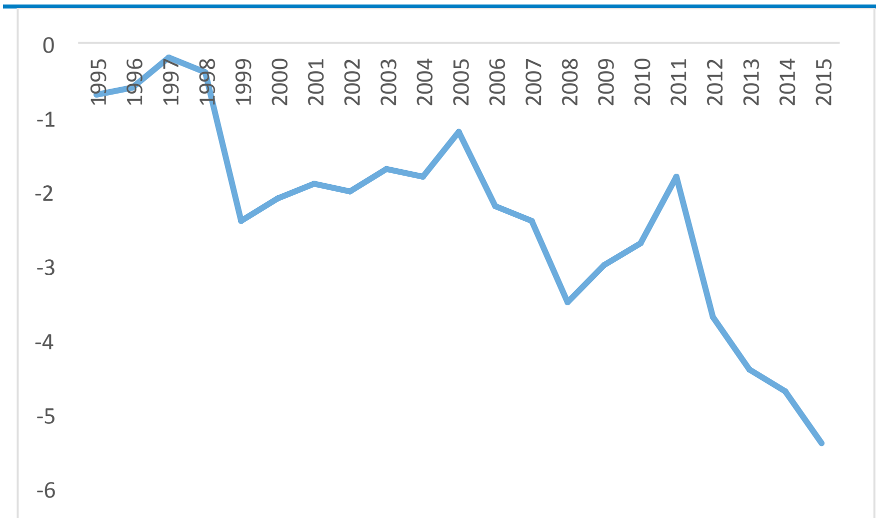
Figure 1: Current account balances of the G7 economies, 2007, 2014 and 2015, percentage of nominal GDP %



Source Pink book 2016

The UK's trade deficit is not a new phenomenon. Indeed over the last 20 years the UK has consistently been in deficit, however the magnitude of this deficit has escalated significantly over the last few years as can be seen from the chart below.

Figure 2:UK Trade Balance 1995-2015 % GDP



Source Pink book 2016

What's the problem?

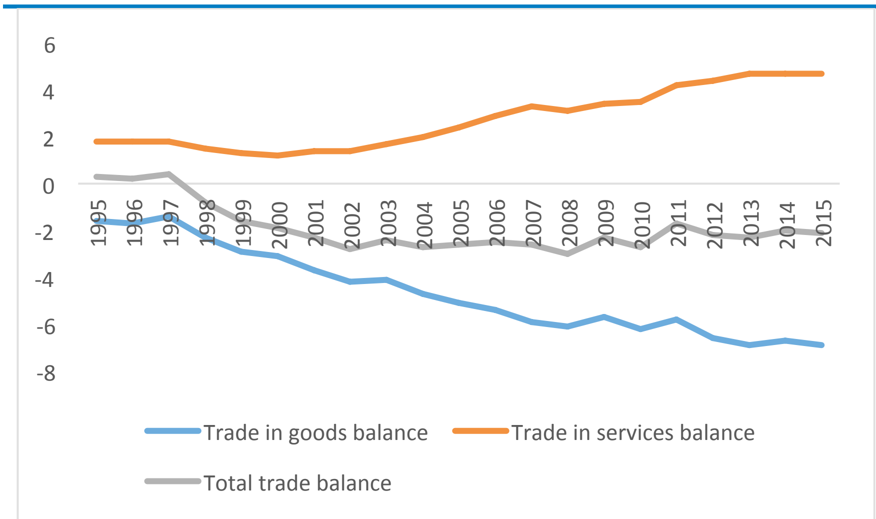
We believe that the primary reasons for this growing deficit are related firstly to economic failure in the EU in general and the Eurozone in particular leading to structural difficulty for business to expand sales in EU markets and secondly to the nature of the single market which favours goods over services – resulting in the strategic advantage the UK has in services counting for nothing.

2. ASYMMETRY ONE
– Good at services, not so good at goods

As can be seen from the chart below the UK runs a significant and growing trade surplus in services offset by an even more significant deficit in goods. Given the tendency for national excellence clusters to develop, the direction of UK investment and existing strategic advantage we expect the dependence on services to increase further over time.

This should not be considered a weakness, but a strength, as globally service exports tend to be 'higher added value' and less prone to low cost labour markets undercutting higher cost Western suppliers. Further as developing markets grow they tend to move up the import curve from basic manufactured product to a greater propensity to consume services. This plays to UK competitive advantage.

Figure 3: UK trade in goods and services balance, current prices, 1995 to 2015, percentage of nominal GDP



Source Pink book 2016

The table below clearly demonstrates the asymmetry. A goods deficit with Asia is understandable, given the relatively low labour costs in much of that continent. However the UK records a goods surplus with the America's (largely USA) and Australasia. Despite this the UK imports a staggering £89bn more goods from the EU than she sells. This does not make rational sense given the so-called advantage of access to the Single Market given our current EU membership. The irony is the UK records a surplus with the US, where it has no special deal and massive deficit with the EU were the UK does have a trade deal.

Thus with the EU the UK has an £89bn deficit in goods, a £69bn deficit in goods and services combined and £110bn current account overall deficit more than wiping out the surplus the UK has with the rest of the world.

Figure 4: UK trade balance by category £bn

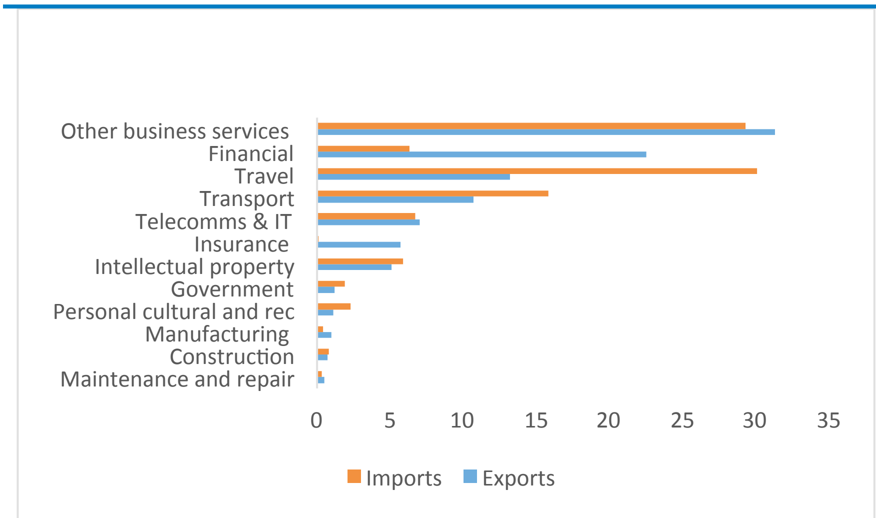
	Goods	Services	P'mary	Secondary	Current Accnt
EU	-89468	20932	-29549	-11926	-110011
EFTA	-10543	9323	-5232	-54	-6506
Americas	9783	32076	-10515	-673	30671
Asia	-32419	13735	5989	-4192	-16887
Australasia	1629	3085	3674	-302	8086
Africa	-1259	3736	2145	-4673	-51

Source Pink book 2016

However despite having no special trade deal with the US the UK exports £53bn of services to the US and enjoys a trade surplus of over £26bn (Source ONS Pink Book 2016). This dwarfs the position with the EU, where despite being 'in the single market' the surplus is just £21bn. Moreover the UK's service trade surplus with Switzerland of £7.9bn is over a third of that of the entire EU despite Switzerland having just 2% of the EU's population. Something is amiss. The much vaunted single market doesn't even benefit the UK in its very area of advantage.

The components of service trade are outlined below but the lion's share of the surplus is accounted by financial services, partially offset by a large deficit in travel (largely net tourism).

Figure 5: UK trade in services export and import proportions by type 2015 %



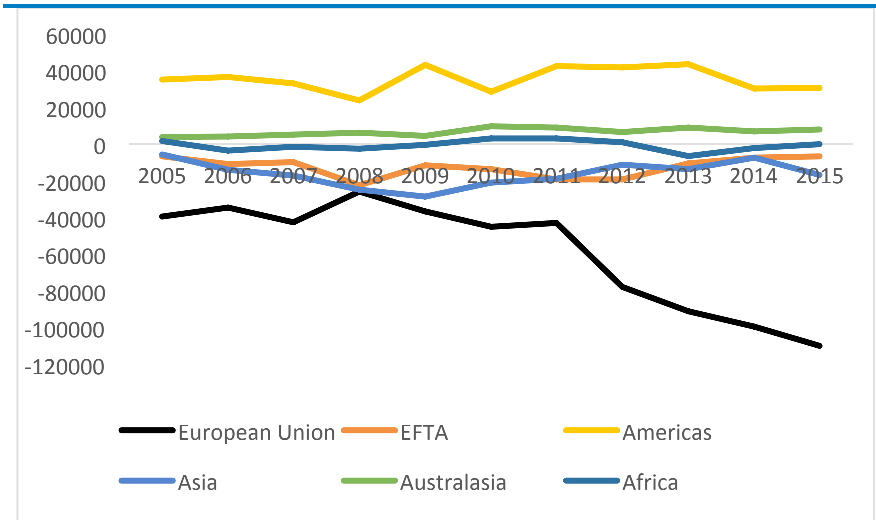
Source Pink book 2016

3. ASYMMETRY TWO
– we do well with the rest of the world and very badly with the EU

Britain competes well with the world. We are able to run consistent substantial surpluses with Americas (arguably the world's most competitive market – the US), surpluses with Australasia and a broad balance with Africa. The deficit with Asia is fairly small, at £16bn, when one considers the labour cost competitive advantage the region enjoys.

By comparison the UK's trading performance with the EU is extremely weak with a £110bn deficit in 2015. The UK's trade position has been constantly negative with the EU however since 2010 the position has sharply deteriorated. Understanding the reasons for this are critical to designing a coherent trade strategy post BREXIT and as we shall outline later we believe this weakness is partially down to the very poor GDP growth performance of the Eurozone, undermining UK export opportunities and the structure of the single market often locking out UK competitive advantage in services.

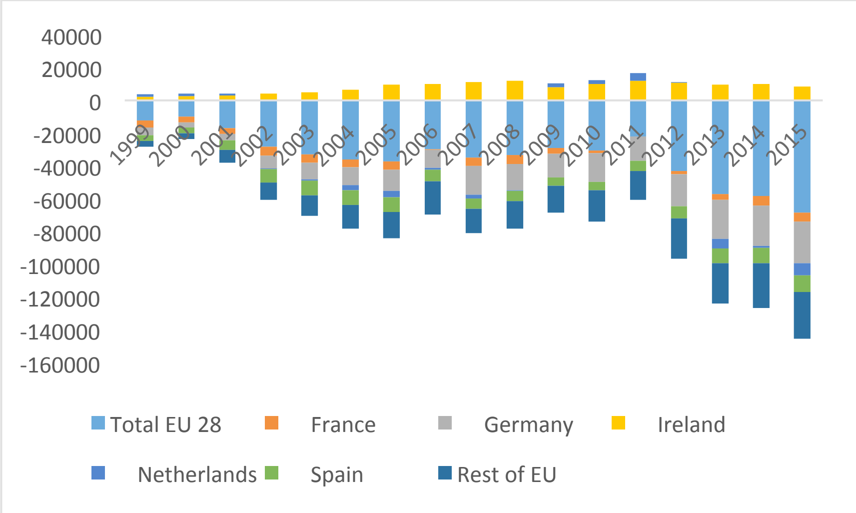
Figure 6:UK Current Account trade balance by region £bn



Source Pink book 2016

Further the UK's trading performance with the EU is constantly poor across the board. While Britain enjoys a surplus with Ireland deficits are pronounced with most EU nations, but particularly with Germany and the Netherlands (although in the latter case the Rotterdam effect almost certainly comes into play.)

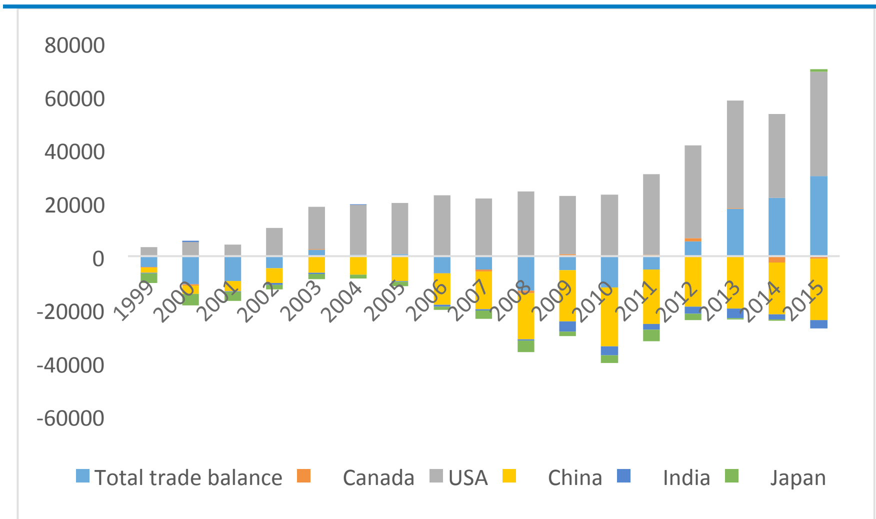
Figure 7: UK trade in goods and services balance with the EU and selected EU countries, 1999 to 2015 £bn



Source Pink book 2016

Contrast this with how the UK performs with other no EU major global trading partners. With the exception of low cost China the UK more than holds its own against the US, Canada, India and Japan.

Figure 8:UK trade in goods and services balance with selected non-EU countries, 1999 to 2015 £bn



Source Pink book 2016

It is often said that the EU's Single Market is the largest in the world and that the UK should remain inside it for that reason, but this does not compare 'single markets' equally. Only by comparing single markets without the UK's trade being included can the true size be seen and it is the single market of the US which is the larger – having a trade value of $17947bn to the EU's $13381bn in 2015. The UK does not have to be "inside" the US to trade with it, why then should the UK have to be "inside" the EU's single market to trade with it? When the UK leaves the EU and its single market the largest single market in the World will be the US, not the EU.

4. ASYMMETRY THREE
– Global growth

The world is a changin'. Since the credit crunch, growth has eluded the EU with five major EU countries having a smaller GDP currently than in 2009. Indeed over that period the Eurozone economies, in aggregate, have grown by just 2%, which given unprecedented negative interest rates is pretty extraordinary and in sharp contrast to growth in the UK (8%), non-Eurozone EU, US (13%) and major emerging markets.

The only conclusion that can be drawn is the inherent contradiction within the Eurozone locking the more uncompetitive nations into perpetual low growth as the safety valve of devaluation is removed. This remains unresolved and in our view will continue to result in socially unacceptable levels of unemployment at the EU periphery in the medium term.

The table below shows GDP growth, for selected major nations, since 2009. Eurozone countries are in red.

Figure 9: Cumulative GDP 2009-2016 (2009= 100) Eurozone countries in red

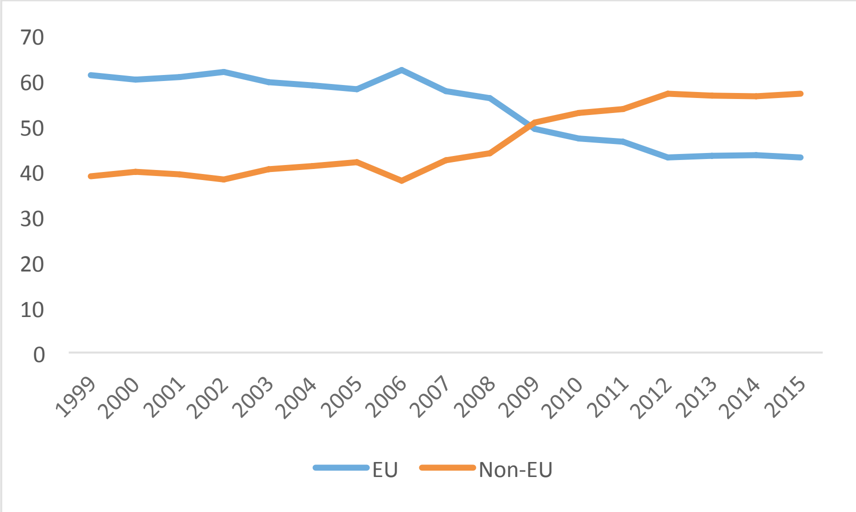
China	187
India	**164**
US	113
Sweden	112
Ireland	110
Switzerland	110
Norway	110
UK	109
G10	108
Germany	108
Belgium	106
France	105
Austria	105
Japan	104
Netherlands	102
Euro Area	102
Denmark	101
Spain	99
Portugal	96
Finland	96
Italy	94
Greece	74

Source ONS

This has had a profound impact on the UK's trading patterns and has resulted in the long drift away from trading with the EU, as our primary partner, as can be seen from the chart below. In 1999 over 61% was with the EU. Today that figure has fallen to 43%.

Astonishingly, UK trade with the EU is actually lower today than it was in 2010 with £281bn of sales against £289bn in 2010. Business is voting with its feet and following growth.

Figure 10: UK goods exports to the EU and non-EU areas, percentage of total UK goods exports 1999 to 2015

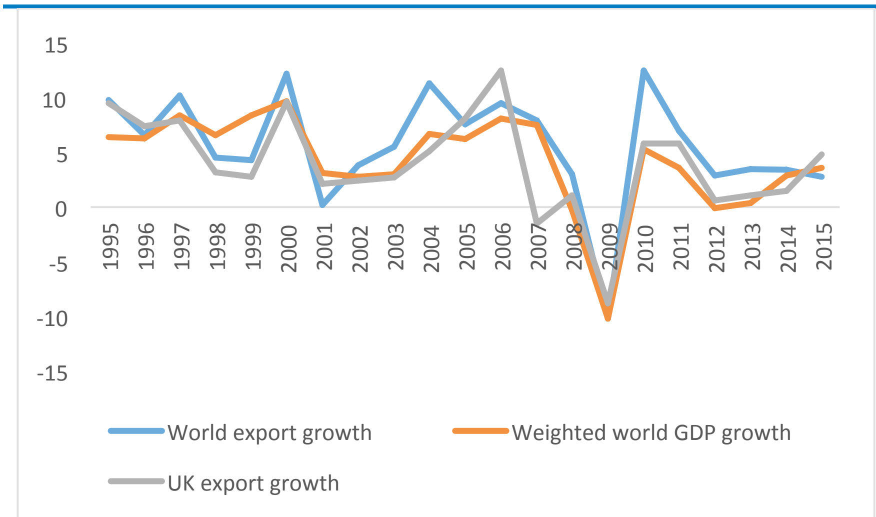


Source Pink book 2016

Towards free trade

The poor trading performance of the EU needs to be put in global context. Since the credit crunch global trade growth has been below trend but, at a current 4%, is reasonably robust, as can be seen below. Opportunity is moving East and across the Atlantic.

Figure 11: Annual change in world export growth, weighted world GDP growth and UK export growth, chained volume measure as percentage, 1995 to 2015



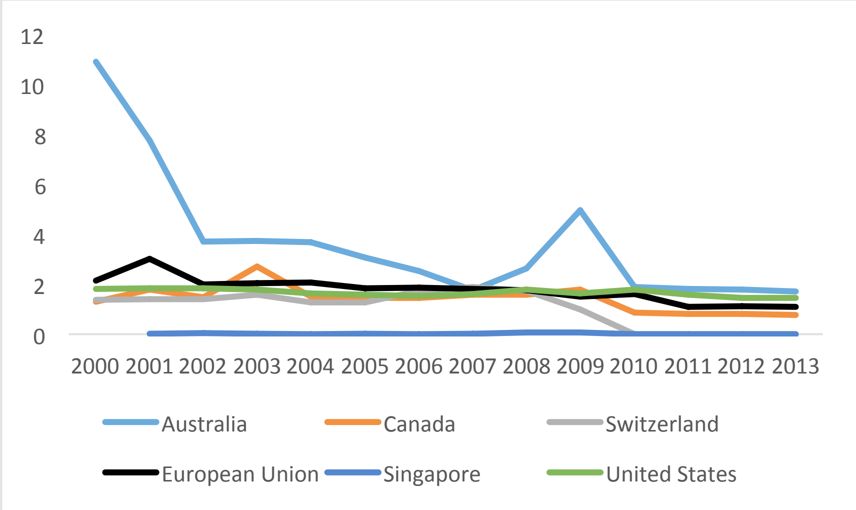
Source Pink book 2016

The outlook for global trade growth remains moderately optimistic in our view in the medium term based on global demographics, continuing global productivity improvements, low commodity prices and the artificial stimulus of exceptionally low interest rates.

However one of the critical factors behind a strong global trading environment is the trend to much lower global tariffs. According to the WTO average tariffs into the EU now average just over 1% and while they remain stubbornly high in certain product lines, agriculture being the primary example, the world is increasingly embracing very low tariffs with a number of countries, Singapore in particular, leading the way with a near zero tariff regime. Low tariffs are good for global growth and low tariffs undermine the *raison d'etre* of being in a customs union like the EU's 'Single Market.'

The EU's record on reaching Free Trade Agreements is very poor, with countries such as Switzerland and Chile having struck more deals and of higher value than the EU and the EU having no FTAs with the leading economies of US, Japan and China. This problem arises because the EU's 27 members have been slow to reach agreement, with each having their own peccadillos they want resolved. A single country, such as the UK will be able to achieve more FTAs and more quickly than the EU can.

Figure 12: Average global tariffs



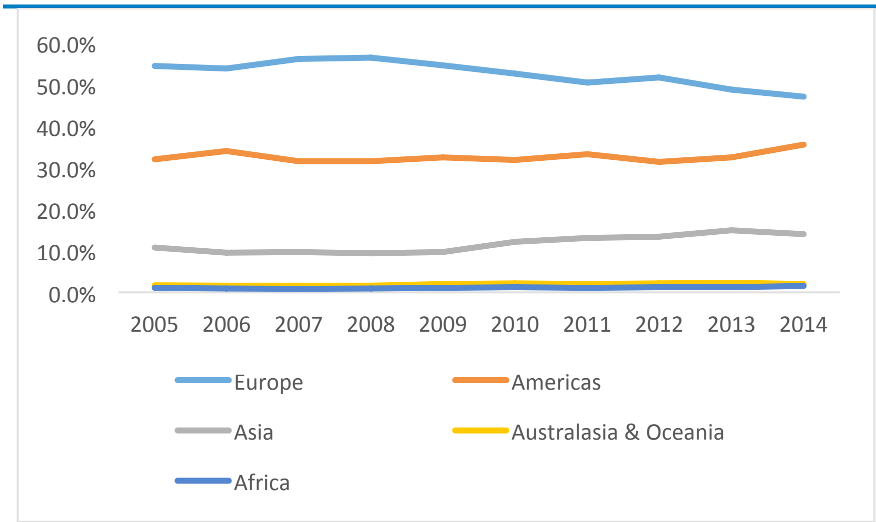
Source WTO

Where are the assets held?

Trade is a critical part of the mix but if we also examine UK asset holdings we find a similar pattern to trade with the importance of the EU diminishing. While the continent of Europe remains the primary home for UK investment as a proportion of total assets held, Europe's importance is declining from 54% of UK foreign assets held in 2005 to 47% today. Most of the growth in overseas investment has been to North America and Asia which together now account for a slightly bigger portfolio investment than our near neighbour Europe.

Further, absolute investment in Europe peaked in 2012 at £3802bn. The latest data indicates a decline of net investment in excess of £250bn. The data is for the European continent including significant non EU members like Switzerland so it is probable the underlying decline to the EU has been even greater.

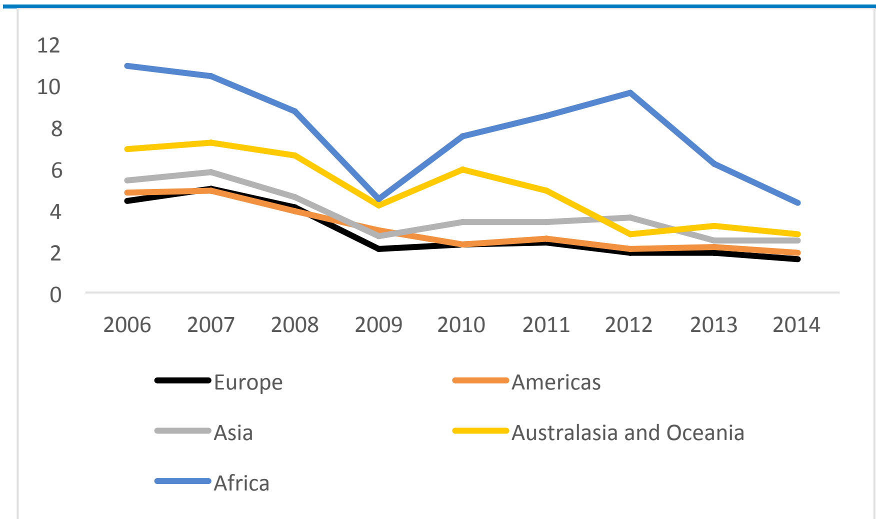
Figure 13: UK foreign assets by continent, £ billion, 2005 to 2014



Source Pink book 2016

It is little surprise that the UK has been gradually moving assets away from the EU to other regions. The average rate of return on foreign held European assets remains very poor and over the last decade has lagged every other region. If anything returns are still trending downwards.

Figure 14: Rate of return on UK foreign assets by continent, percentage, 2006 to 2014



Source Pink book 2016

The scale of divestment from the EU is staggering. The chart below looks at global flows which indicate global investor unease with EU assets.

Figure 15: Net international investment position by continent, £ billion, 2005 to 2014

Source Pink book 2016

5. CONCLUSIONS

It is a myth is that the Single Market is central to UK prosperity. It is not. We have demonstrated that the UK trades well with the world but poorly with the EU. This is odd as the UK has no special trade arrangements with the US, China, Japan or Australia but runs a small trade surplus with the rest of the world, but a very large deficit with the very region we have a customs union with the EU.

The EU customs union is in structural decline. It has underperformed every other region in the world for a generation now. This is not a coincidence as other advanced economies including the US, Canada and Australia have powered ahead. It is the institutional arrangements of the EU and the single currency in particular that has resulted in rapid economic decline and socially unacceptable levels of unemployment in much of the EU. The trend towards centralisation undermines competition and increases regulatory burden. Within the single market framework the UK will continue to be beholden to needless regulation and legal creep as EU lawyers interpret a definition of EU competence well beyond merely trading standards to many other areas of national life.

The EU has also failed to sign global free trade deals with the world's most important partners including the US, China, japan or Australia. Inside the EU the UK cannot strike its own deals with much faster growing nations. Because the EU is a diverse group of 28 nations agreement is highly problematic and cumbersome, hence the failure to reach agreement. Outside the EU the UK can much more readily strike free trade deals.

It is now apparent from comments from the US, China and Australia and others far from being 'at the back of the queue' other countries are very keen to strike mutually beneficial free trade deals with the UK. This will allow the UK to rebuild its historic mission of encouraging global free trade which has gone off track over the last 40 years as the UK has surrendered its trade policy, so unsuccessfully to the EU.

It is also a myth that the UK needs to be part of the Single Market to trade with it. This is clearly not the case. All nations have access, outside a tiny number under sanction (North Korea and Syria for example) so long as they comply with local regulations. This is the case the wold over. One does not need to join China to trade with it any more than one needs to join the EU.

It is clearly in the EU's interests to agree a zero tariff deal with the UK. There are many reasons for this but the primary one is simply because they sell more to the UK than the UK sells to the EU. It would be nonsensical to undermine its own trade particularly at a time when EU growth is so weak.

If, however, the EU refuses to do so within reasonable timeframe, the UK should leave the EU without a formal agreement, after Article 50 has been triggered, relying on WTO rules and striking free trade deals with our global partners. Remaining in the failing Single Market after having left the EU would be worse than the current arrangements, unsatisfactory as they are, because the UK would swap a current marginal influence on Single Market regulation (12% vote in the council of ministers) for no say in regulatory framework at all – while having to accept free movement of people. Financial contributions might also be demanded.

To remain in the Single Market, having left the EU, is the 'no say, low growth, regulatory burden, sovereignty illusion' option locking in perpetual trade deficits. That is why no deal, is better than a bad deal.

About the authors…

Ewen Stewart

Ewen is an economic consultant having previously been worked for major investment banks as a Strategist. Ewen joined Global Britain as director in 2012 when Brexit was still a concept and has since helped make it a reality.

Brian Monteith

Brian worked in financial PR in the City in the early 80s before establishing his own businesses in Scotland, where he later served eight years as an elected member of the Scottish Parliament. He returned to political and strategic communications in 2007 and works internationally in Europe, Africa and the Caribbean.

Leading Leave

The Leading Leave campaign has been established by Global Britain to provide support, evidence and arguments for a genuine exit from the European Union by the United Kingdom. It is based upon the primacy of the UK making its own laws, trading openly across the world outside of the single market with no tariffs and having full control of its own borders.

Global Britain

Founded in 1997, Global Britain has been providing authoritative research and analysis building a positive case for the United Kingdom leaving the European Union for nearly twenty years. With that argument won and endorsed by the British people in the highest popular vote in the country's history Global Britain is now seeking to ensure the politicians entrusted with the task of Brexit do not betray the peoples' decision by ensuring leaving the EU means just that.

COMPANY DETAILS: Global Britain Limited, Registered office: 7-12 Tavistock Square , London WC1H 9BQ
Registered in England