ROOS AND RULES: WHY THE EEA IS NOT THE SAME AS MEMBERSHIP OF THE SINGLE MARKET

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INTRODUCTION

This briefing paper summarises two issues that a post-Brexit United Kingdom would face if it re-joined the European Economic Area (EEA).

It introduces the concept of the EEA+EU. as a `regulatory union' within which products, once approved in one country, can circulate freely. However, by definition, regulatory unions cannot overlap without prior agreement, making it impossible for a future UK-in-EEA to sign trade agreements with third countries that reduced regulatory and other technical barriers to trade.

Secondly, Rules of Origin (RoOs)— which in effect specify the domestic share of value-added — would need to be adhered to, raising concerns about the viability of supply chains with UK links.

THE EEA AND EU — CORE DIFFERENCES

It is often said that Norway, through its membership of the European Economic Area, has full access to the European Union's Single Market. Although this model is looking increasingly unlikely as a post-Brexit outcome, its features have relevance to any FTA we might sign.

For instance, Open Europe, a think tank, says: "The EEA is an agreement between the EU and three of the four members of European Free Trade Association (EFTA) – Norway, Iceland and Liechtenstein – that grants these countries virtually full access to the EU's single market (Switzerland, the fourth EFTA member, has a separate deal with the EU) [1]."

This briefing paper will argue that "virtually" means distinctly less than our current full access, while EEA membership would also restrict the ability of the UK to freely sign free trade agreements (FTAs) with third countries. "Access to the Single Market" is different from unrestricted access on current terms.

EEA membership would require the UK to re-join EFTA then sign up to the EEA. All EU and EFTA members would have to agree.

Here there is an important distinction between a free trade area — within which goods can move free of tariffs, but members can set their own external tariffs on third-country trade — and customs unions (CUs) — which have internal tariff-free trade and jointly set external tariffs.

A third, separate, concept is that of regulatory union — an agreement on common standards for goods to remove technical barriers to trade. This could be agreed in either an FTA or CU, and is conceivable, though unlikely, without either.

In principle, the members of the EEA pay no duty on their exports to the EU (it is an FTA) within the covered areas, which of course exclude agriculture and fisheries but include manufactured foodstuffs). They also avoid all technical barriers to trade as EEA states must incorporate all EU single market legislation into domestic law, delivering regulatory union.

However, the reality is more complex. The EU is a customs union while the EEA is a free trade area. There is duty free trade in third country imports crossing EU internal borders but not for such goods crossing the EU/EEA border. Japanese cars, for instance, unloaded in the UK now pay duty on entry and are then treated the same as goods wholly produced in the UK even if they are re-exported into another EU country. It would not be so after Brexit if the UK leaves the CU.

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Moreover, EEA states must comply with EU product regulations, and are assumed to do so at the border, but this not true of any other FTA that the EU has.

The EEA is a `regulatory union' and technical inspections at borders are minimal. This paper argues that if the UK remained in the regulatory union, it would be constrained in its ability to sign FTAs with third countries that included reductions in technical barriers to trade that the EU had not also agreed to.

RULES OF ORIGIN

The very fact that members of the EEA can conclude FTAs with third parties is because EFTA is itself an FTA, not a CU. It gives duty free access to goods produced in ("originating in") the EEA member states, but tariffs on third-country goods are set freely by each member.

This means that if Chinese goods come into an EEA member, for example Norway, and travel on into the EU they pay the EU Common External Tariff (CET) at the EU border.

The EU may not worry greatly about the enforcement of tariff collections at the Norwegian border, where manufactured exports to the EU are small, $16bn in 2015, but it would surely be less relaxed about enforcement at the UK border, where manufactured exports were $155bn in 2015[2].

An FTA has to have `Rules of Origin' to distinguish between goods originating within the FTA, from third country goods which pay a tariff. Firms from outside the customs area — such as the post-Brexit UK — need to supply proof that their products satisfy origin criteria. This is straight-forward for simple goods like iron-ore, but many manufactured goods are produced in international value chains using imported components, some of which may come from third countries.[3]

In these cases, the RoOs can be complex, but typically a product needs to `contain' 60% local value added to be eligible for duty free import into the EU from the EEA[4], a minimum that is common but not universal[5]. An example of the rules applying to different types of vehicles such as motorcycles is given in Table 1.

It is difficult to track supply chains in detail but a recent study for the Society of Motor Manufacturers and Traders, an industry lobby group, estimated that for the UK car industry an average of 37% of the "total spend in the supply chain" is sourced locally[6]. Furthermore, "depending on the manufacturer, between 20-50% is imported from the EU and the rest from outside the EU".

Cumulation rules for RoOs— allowing exporters to add within-FTA content to local content to meet the RoO limit — almost always apply. In the motor industry case, if post-Brexit UK were in the EEA, the RoO would generally be satisfied: adding the 37% local content to the 20%-50% of EU content would reach a cumulative 57%-87%, although of course these are averages so there may be specific cases which fail to meet the criterion. Many flows may be disrupted by the RoOs[7], whether because they do not satisfy rules or because the paperwork to prove they do is complex.

Enforcing Rules of Origin would entail customs checks of some kind between the EU and a possible future UK-in-EEA[8]. These could be minimal if electronic documentation could be used but they would give customs at Calais the right to inspect UK trucks to ensure RoOs are satisfied[9]. The rules and their enforcement also create concerns that value chains for EU final products could be disrupted. For example, final goods produced in the EU using parts and components from the UK risk losing preferential status in third countries with which the EU has an FTA because the UK content could no longer be counted towards EU 'local content'[10].

As the Japanese paper argues, this is seen as a major concern for Japanese investors. Nissan has already indicated that it will put decisions about new models on hold.[11] But whilst a major firm such as Nissan would ultimately be able to cope with origin problems if the UK were still an attractive location, the deterrence effect on small or occasional exporters could be quite severe.

REGULATORY UNION

Regulatory issues are even more complex than Rules of Origin, and also present concerns. The EEA+EU is a `regulation union' even if it is not a Customs Union. This means that all members must incorporate EU mandatory standards into their legislation, along with the rules for establishing conformity. In some cases, this requires third-party certification, in others, the manufacturer's declaration is sufficient and in the case of a third-country good, the importer must certify.

Therefore, products produced in or "placed on the market" within the entire EEA must conform to EU rules, are assumed to do so and can circulate without further inspection to other parts of the EEA/EU market[12]. The EFTA Surveillance Authority and the EFTA Court (based in Brussels) act to ensure compliance. In return there should be no technical barriers to trade within the whole EEA.

Within the EU, the direct effect of EU law means that there is no need to check at internal borders for compliance with safety rules. Each EU member state has an officially accredited agency for checking conformity with the rules.

EEA states are covered by this system. For Norway there are accredited agencies able to provide documents affirming that products satisfy EU mandatory rules. It is more complex for countries which are not in the EEA. as there needs to be

TABLE 1: EXAMPLE OF RULES OF ORIGIN

HS heading	Description of product	Working or processing, carried out on non-originating materials, which confers originating status	
		Either	Or
x Chapter 87	Vehicles other than railway or tramway rolling-stock, and parts and accessories thereof; except for:	Manufacture in which the value of all the materials used does not exceed 40 % of the ex-works price of the product	
8711	Motorcycles (including mopeds) and cycles fitted with an auxiliary motor, with or without side-cars; side-cars:		
	With reciprocating internal combustion piston engine of a cylinder capacity:		
	Not exceeding 50 cm^3	Manufacture in which: • the value of all the materials used does not exceed 40 % of the ex-works price of the product, and • the value of all the non-originating materials used does not exceed the value of all the originating materials used	Manufacture in which the value of all the materials used does not exceed 20 % of the ex-works price of the product
	Exceeding 50 cm^3	Manufacture in which: • the value of all the materials used does not exceed 40 % of the ex-works price of the product, and • the value of all the non-originating materials used does not exceed the value of all the originating materials used	Manufacture in which the value of all the materials used does not exceed 25 % of the ex-works price of the product

a specific Mutual Recognition Agreement (MRA) for testing and certification of conformity assessment. There are very few such MRAs in the EU's relations with third countries. Without an MRA, goods may, depending on the commodity, have to be checked on entry.

The EU requires that goods to be sold in the EU from outside the EEA must be certified by an EU body as conforming to EU rules, yet there is dispute about how this would work in the absence of an MRA.

In evidence to the House of Commons Treasury Committee on July 13, 2016, political analyst Richard North argued that certification would be problematic[14]. Other views are that tests can still be carried out by EU based bodies in factories outside the EU or EEA and the importers could use this documentation[15].

The position is sufficiently unclear to be of concern to the Japanese government. "Maintaining the harmonisation of the regulations and standards between the UK and the EU *(including the maintenance of established frameworks of mutual recognition and equivalence)*," was one its position-paper requests (my italics).

There is concern about the integrity of value chains and fears that there could be burdensome customs procedures both for checks on origin and for compliance with technical rules. In the initial period after Brexit all EU rules would still be in place. Directives are incorporated into UK law and if the European Communities Act Repeal Bill goes as planned all directly effective regulations will be as well. But as time goes by the UK would be obliged to adopt more and more new EU regulations as an EEA, but also simply to be able to sell its products in the EU if we were outside the EEA. The burden of proving compliance would undoubtedly increase if the two jurisdictions diverged in other respects.

RELATIONS WITH THIRD COUNTRIES

The EEA agreement makes a distinction between the FTA provisions that give freedom from tariffs to originating goods (under Article 8(2)), and to circulation free from non-tariff barriers to goods placed "on the market[16]".

'Placed on the market' is not the same as originating in the EEA. Goods can only be `placed on the market' if they have papers showing they obey EU rules.

What will happen if factories in the UK use third country goods as components? The issues about free circulation within the EU can be illustrated by asking what would happen if the UK wanted to negotiate an FTA with a third country, such as China, which included provisions to reduce technical barriers to imports into the UK.

Press reports indicate that the UK has proposed that it could use the China-New Zealand FTA as a template for such an agreement[17]. This contains the special provision that Chinese electronic products certified by Chinese labs to have been produced to New Zealand standards can be sold in New Zealand.

However, New Zealand is also part of the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA), a free trade agreement that is also a regulatory union. Because of the harmonisation of rules within ANZCERTA, Australia also had to agree to allow the Chinese-certified products to enter New Zealand because they could from there flow freely to Australia.

Nevertheless, the terms of the China-New Zealand deal would probably be impossible for a UK-China FTA, since they would require a change in the EEA rules. As noted above, the EEA requires all goods placed on the market in the EEA/EU to have been inspected by an EU based entity. In other words, if it were in the EEA, the UK could do what it liked with tariffs on Chinese goods, but not technical rules.

This has implications for UK external trade policy. The UK would be required to ensure that it did not sign any FTAs with third countries that modified technical barriers to trade in such a way as to allow goods to enter the UK that would not automatically be allowed free access to the EU. Any other form of FTA would require less harmonisation of rules but would create more technical barriers.

CONCLUSION

- For the UK, EEA membership would result in distinctly less access to the European Union's Single Market than as a full member of the EU.
- EEA membership would restrict the ability of the UK to freely sign trade agreements with third countries in important respects.
- EEA membership would require the UK to re-join the European Free Trade Association (EFTA) then sign up to the EEA. All EU and EFTA members would have to agree.
- Rules of Origin (RoOs) would need to be applied to third country goods and components incorporated into UK products , which could disrupt value chains and would entail customs checks
- Regulatory issues are highly complex and could create burdensome customs procedures as well as destabilise value chains

EEA membership for the UK would require the UK to ensure that it did not sign any Free Trade Area (FTAs) with third countries that modified technical barriers to trade in such a way as to allow goods to enter the UK that would not automatically be allowed free access to the EU. The EEA deal would require the UK to accept all existing and future EU technical regulations but would still not give the same unrestricted access to the Single Market for industrial goods we have now. In particular it could create documentation requirements that might disrupt value chains. And it would constrain the UK's ability to sign non-tariff provisions in third country FTAs

NOTES

1. Strictly speaking the European Economic Area comprises the EU plus the three EFTA partners, Norway, Iceland and Liechtenstein (not Switzerland) but "EEA" is often used to refer to only the three non EU states. http://openeurope.org.uk/intelligence/britain-and-the-eu/as-the-uk-searches-for-a-post-brexit-plan-is-the-eea-a-viable-option/. For definitive definitions see Baudenbacher (2016)

2. From the World Integrated Trade Solution (WITS) database maintained by the World Bank. wits.worldbank.org

3 This point is of considerable concern to foreign-owned firms in th.e UK since they often form part of supply chains based in their home country. See for example "Japan's Message to the United Kingdom and the European Union", the position paper of a Japanese government task-force published by the Ministry of Foreign Affairs, http://www.mofa.go.jp/files/000185466.pdf

4 See: http://www.efta.int/sites/default/files/documents/legal-texts/eea/the-eea-agreement/Protocols%20to%20the%20Agreement/protocol4.pdf; http://www.efta.int/media/documents/legal-texts/free-trade-relations/ukraine/annexes-and-protocols/Protocol%20RoO%20-%20Appendix%202%20-%20List%20Rules.pdf, and http://ec.europa.eu/taxation_customs/resources/documents/handbook_en.pdf

5. Official Journal of the European Union L321 8.12.2005 DECISION OF THE EEA JOINT COMMITTEE No 136/2005 of 21 October 2005 amending Protocol 4 to the Agreement on rules of origin. See also: http://tprc.org.uk/pages/posts/rules-of-origin-in-free-trade-agreements-10.php

6. http://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-KPMG-EU-Report.pdf 2012

7. Also, of course, if, improbably, cumulation rules were not agreed as part of an EU-UK FTA, tariffs might be placed on components imported into the UK from the EU and then again on UK-assembled final goods sold to the EU.

8. The burden of proof is on the exporter: An HMRC notice, given to UK exporters as current members of the EU advising firms who wish to avoid duties on a group of countries that include Norway, states that: "All materials are considered to be non-originating unless you hold evidence to prove that they originate." https://www.gov.uk/government/publications/notice-828-tariff-preferences-rules-of-origin-for-various-countries/notice-828-tariff-preferences-rules-of-origin-for-various-countries para 2.6.1

9. The recent Japanese government paper (see footnote 3, above) has specifically expressed concerns about RoOs and the way they are monitored as they may affect Japanese investors. For example: http://www.mofa.go.jp/files/000185466.pdf, page 7.

10 "For products such as automobiles, the division of production of materials and parts is in place between the UK and the EU," the Japanese taskforce notes. "Brexit would make such products unable to meet the rules of origin as EU products, which means that Japanese companies operating in the EU would not be able to enjoy the benefit of the FTAs concluded by the EU http://www.mofa.go.jp/files/000185466.pdf, page 7. And these issues also apply to relations with developing countries. The Japanese paper notes: "Some Japanese companies import goods into the UK by utilising the FTAs or [generalised scheme of preferences (GSPs)] between the EU and third countries, and there are concerns over whether these frameworks could be maintained.

11. See "Nissan sets 'hard Brexit' compensation condition for new UK investmenthttp://uk.reuters.com/article/uk-autoshow-paris-nissan-britain-idUKKCN11Z1YQ

12. Non-EU EEA states have a right to be consulted before EU regulations are passed but they do not have a vote on them.

13. http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/the-uks-future-economic-relationship-with-the-european-union/oral/35137.html

14 A. Chapman argues testing and certification would be easy matters to resolve. See http://doortofreedom.uk/technical-barriers-to-trade-in-the-absence-of-a-mutual-recognition-agreement and also https://www.export.gov/article?id=European-Union-Automotive-Legislation

15. The EFTA website says that under the EEA: "a product placed on the market (approximately 500 million consumers) in accordance with harmonised technical requirements, circulates freely throughout the EEA."

16. http://www.bbc.co.uk/news/business-36877573

BACKGROUND REFERENCES

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FURTHER INFORMATION

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