UK Trade with the European Union

UK trade in goods and services with fellow members of the European Union has deepened in the 36 years since we joined the European community. As of 2008 our geographical pattern of trade was as follows:

**Main export markets:**
- European Union: 57%
- United States: 15%
- Switzerland: 2%
- China: 2%
- Japan: 2%

**Main source of imports:**
- European Union: 55%
- USA: 9%
- China: 8%
- Norway: 5%
- Japan: 3%

Keep in mind that the EU is a **customs union** – a customs union comprises two or more countries which agree to:

1. Abolish tariffs and quotas to encourage free trade. For example, products that originate in the EU circulate duty-free. However they might be subject to charges such as VAT.

2. Adopt a **common external tariff** (CET) on imports from non-members countries. Thus, in the case of the EU, the tariff imposed on, say, imports of South Korean digital cameras will be the same in the UK as in France or Hungary. A CET prevents individual countries imposing their own unilateral tariffs that differ from other in the customs union.

A customs union has trade creation and trade diversion effects.

**Trade creation** involves a shift in people’s spending from a higher-cost domestic source to a lower-cost partner-source within the EU, as a result of the abolition of tariffs. UK consumers may switch spending on car insurance away from a higher-priced UK supplier towards a German insurance company that has decided to operate in the UK market.

In principle, trade creation stimulates an increase in intra-EU trade and ought to lead to a more efficient allocation of scarce resources thereby leading to gains in consumer and producer welfare.

**Trade diversion** happens when there is a shift in domestic consumer spending away from a lower-cost world source to a higher cost partner source country from within the EU - as a result of the elimination of tariffs on imports from the partner. The common external tariff on many products entering Europe makes imports more expensive leading to higher costs for producers and rising prices for consumers if previously they had access to a cheaper supply from a non-EU country. The effect is a reduction in consumer and producer welfare.

*Analysis diagrams showing trade creation and trade diversion should be used when discussing trade relationships between the UK and the EU.*
Trade balance with the EU

The UK has seen a growing trade deficit with the EU as a whole. Total exports grew from £113bn in 2001 to £139bn in 2007 but imports grew more quickly from £120bn to £185bn over the same period.

8 of our top export markets are inside the EU (China and USA are the other 2)

Export growth:
The table on the left shows the average annual growth rates for UK exports of goods and services to selected EU countries.

Consider the following questions:

1. Can you explain why the top eight countries for UK export growth are also nations that joined the EU in 2004 or 2007?
2. Since 2007-8 the value of sterling against the Euro has depreciated by more than 25%. Analyse how this might affect trade between the UK and the Euro Area
3. Explain three factors (other than the exchange rate) that can affect the competitiveness of UK exporters within the European single market
4. The Euro Area economy is in deep recession in 2009. Explain how this might affect the UK economy.