

# Brexit Update – Trade Priorities for 2018

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The announcement on 23 March 2018 that the UK and the EU reached a Brexit transition agreement is a welcome development, but business still needs more clarity about the long-term basis for UK-EU trade and about UK policy towards its other trading partners if it is to plan effectively for Brexit.

The transition agreement comes just one year before the UK's scheduled withdrawal from the EU, on 29 March 2019, and means UK and UK-based business will continue to have full access to the EU Customs Union and the Single Market until December 2020. That is valuable because whatever happens in the continuing negotiations on a future trade deal between the EU and UK, the impact on trade of Brexit is postponed by 21 months. EU trade law will continue to apply in full during the transitional period, although the UK will no longer participate in the EU institutions.

The transition agreement does not eliminate the need for business to conduct contingency planning for the worst case of the UK crashing out of the EU without a new trade deal in a so-called "hard Brexit" – one where bilateral trade would revert to MFN terms under WTO rules, tariffs and non-tariff barriers would be imposed on trade in goods, and access for trade in services would be considerably degraded – but the threat of that happening in one year's time has diminished significantly.

The UK Government must do more before the end of this year in its response to Brexit to create the confidence needed for business to make long-term decisions on trade and investment in the UK. The UK must agree with the EU on the framework of a permanent new trade deal that will apply from 2021; the Withdrawal Agreement, which includes the agreement on a transition period, is dependent on that. The UK must retain preferential access to countries that have free trade agreements (FTAs) with the EU in the transitional period and start preparing new FTAs with its key trading partners, such as the United States, to enter into effect from 2021. The UK must confirm its legal obligations as an independent member of the WTO and accede to the WTO Government Procurement Agreement. At home, the UK Government must finalize the legislative basis for its trade policy beyond March 2019, including for its new Trade Remedy Authority, by creating an interface between UK and EU trade law underpinned by WTO law.

## The Transition Agreement

The UK and the EU have agreed on a transition period following the UK's withdrawal from the EU until 31 December 2020. This will allow UK and UK-based business to continue to have full access to the EU Customs Union and Single Market for an additional 21 months after the UK's exit from the EU. In principle, there could be agreement to extend the transition period (although there is no express provision to enable that), but political pressures in both the UK and the EU make it unlikely.

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## Key terms of the transition agreement include:

- **Entry into force.** The transition period's entry into force next year depends on the completion of the Agreement that is being negotiated on the Withdrawal of the UK from the EU.<sup>1</sup> The Withdrawal Agreement is itself dependent on agreeing on the framework of a permanent new trade deal that will apply from 2021. That includes resolving the difficult issue of avoiding a hard border between Ireland and Northern Ireland for trade in goods. The coming six months of negotiations are key. There remains a risk that those negotiations might fail, in which case a "hard Brexit" would ensue in March 2019 and there would be no transition period, but politically that risk is considered in London to be low.
- **Applicable law during the transition period.** During the transition period "Union law shall be applicable to and in the United Kingdom"<sup>2</sup>. This covers all EU trade law, including on trade remedies, state aid and public procurement. New EU trade regulations and directives that enter into force during the transition period will apply to the UK, although the UK will no longer have a voice in their development or adoption.
- **UK FTAs.** The EU has agreed that the UK will be able to negotiate and ratify trade agreements with other countries during the transition period, but those agreements cannot apply until the transition period ends unless authorized by the EU.<sup>3</sup> The UK will only benefit from existing EU trade agreements after Brexit if the third countries concerned agree to "roll over the benefits" during the transitional period and until new FTAs are agreed. The UK claims to have discussed this with all countries concerned and to be confident it can be achieved.

The transition agreement gives business confidence to assume that the status quo will continue until December 2020. This does not mean contingency planning should be postponed, but does mean that the effect of Brexit on trade will be deferred for almost two years. More clarity is needed on the terms of a new, long-term UK-EU trade agreement, but business will be able to make use of the transition period to plan and reorganize effectively.

## A New, Long-term UK-EU Trade Agreement

The framework of the UK-EU trade agreement that will apply from 2021 must be agreed on before the end of 2018 so that it can be included in the Withdrawal Treaty. It will provide the political mandate for detailed negotiations to take place on the trade agreement during the transition period. For the time being, there is little clarity on what the framework will contain.

The UK Government wants its future trade with the EU to be "as frictionless as possible".<sup>4</sup> It has ruled out remaining in the EU Customs Union beyond the end of the transition period, but it has not proposed yet what might replace that or what rules should govern trade in services. The political imperative of avoiding a hard border with Northern Ireland will probably require compromise from the UK in the type of trade arrangement that can be agreed.

The EU considers that the UK's "red lines" in the Brexit negotiations, particularly controlling immigration from the EU and ending jurisdiction in the UK of the European Court of Justice, limit the possible depth of the future partnership and rule out continued UK participation in the Single Market.<sup>5</sup> The EU's aim is a "... balanced, ambitious and wide-ranging free trade agreement ..." involving *inter alia* free trade in goods (no tariffs or quantitative restrictions) but with rules of origin, customs checks and regulatory controls, and market access for

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<sup>1</sup> [https://ec.europa.eu/commission/publications/draft-agreement-withdrawal-united-kingdom-great-britain-and-northern-ireland-european-union-and-european-atomic-energy-community-0\\_en](https://ec.europa.eu/commission/publications/draft-agreement-withdrawal-united-kingdom-great-britain-and-northern-ireland-european-union-and-european-atomic-energy-community-0_en). This must be accepted by the UK Parliament, and adopted by the EU in accordance with Article 50, before 29 March 2019.

<sup>2</sup> Article 122:1 of the draft Withdrawal Agreement.

<sup>3</sup> Article 124:4 of the draft Withdrawal Agreement.

<sup>4</sup> HM Government Future Customs Arrangements, A Future Partnership Paper, August 2017

<sup>5</sup> <http://www.consilium.europa.eu/media/33458/23-euco-art50-guidelines.pdf>

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trade in services based on host state rules. The EU has cited its Comprehensive Economic and Trade Agreement with Canada (CETA) as a potential model for a future UK-EU FTA.

To be meaningful for business, the framework of a new trade agreement will need to set out shared objectives of the UK and the EU on market access for goods and services and the basis for regulatory cooperation. UK business continues to lobby the UK Government to evolve its “red lines” in a way that allows for a closer partnership than the EU is currently willing to countenance. Keeping UK trade regulations aligned to the EU beyond the transition period is likely to increase the opportunity for an ambitious new trade agreement, but that could complicate the UK’s negotiation of other FTAs, particularly with the United States. There remain calls to keep the UK in the Customs Union (which would prevent the UK from negotiating its own FTAs) and the Single Market, but this is not UK Government policy.

## New UK Free Trade Agreements

The UK Government’s aim is for FTAs in goods and services to play a larger role in UK trade policy in future than they do at present.

About 40 FTAs<sup>6</sup> in which the UK participates by virtue of its EU membership will cease to apply to the UK as soon as it leaves the EU. These account for over 15% of UK exports and some of them are of considerable commercial value to UK and UK-based business, particularly the FTAs with Switzerland, Singapore, Canada, and South Korea. The UK and the EU have agreed that during the transition period the UK will continue to be bound by the obligations of these FTAs and that the EU “... will notify the other parties to these agreements that during the transition period the United Kingdom is to be treated as a Member State for the purposes of these agreements”.<sup>7</sup> However, legally the other FTA parties will no longer be obliged to provide preferential access to the UK once it ceases to be an EU member state. They may be willing to agree to do so, since in practice the FTAs would continue functioning exactly as they do today, but that cannot be taken for granted.

Long-term, the UK will need to negotiate new FTAs with these countries if it wishes to maintain preferential access to their markets. The terms of those FTAs are likely to depend on the terms of a new UK-EU FTA. The less integration there is between the UK and the EU, for example without allowance for diagonal cumulation of origin that supports established supply chains, the less value the partner countries are likely to find in standalone FTAs with the UK without additional market access concessions from the UK.

Other countries with which the UK hopes to negotiate FTAs are also likely to want to know the terms of the future UK-EU FTA before being willing to strike their own deals. Close alignment of UK and EU regulations is not likely to be viewed as a positive by the United States which is counselling the UK to use science-based and international standards instead, particularly for agricultural products. Negotiations on these FTAs can take place during the transition period but their completion is unlikely before 2021.

Preferential access for UK and UK-based business to markets covered by EU FTAs should continue during the transition period provided there is agreement with the third countries concerned, but new FTAs will be needed once that ends. FTAs with other countries are a longer-term prospect and are likely to depend on the terms of a new UK-EU FTA.

## UK Obligations in the World Trade Organisation (WTO)

The UK will become an independent WTO Member as soon as it withdraws from the EU in March 2019, even though it will continue to be bound by EU trade law during the transition period. Most of its WTO obligations will remain unchanged, but in at least two respects – its market access schedules and its government procurement obligations – they will have to be clarified and probably re-negotiated before they can be finalized.<sup>8</sup>

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<sup>6</sup> EU Free Trade Agreements, Association Agreements, Stabilisation Agreements and Economic Partnership Agreements.

<sup>7</sup> Article 124:1 of the draft Withdrawal Agreement

<sup>8</sup> The maximum level of farm subsidies that the UK can provide will also need to be agreed in the WTO.

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## Market Access Schedules

Each WTO Member must have legally-binding schedules of MFN commitments for access to its market, one for goods and one for services. Once the UK has withdrawn from the EU, it must have its own schedules approved (“certified”) by other WTO Members. The UK Government is aiming to replicate the EU schedules as far as possible. It has formally reserved its right under Article XXVIII:5 of the GATT 1994 to modify its goods schedule and to seek certification within three years. It has not yet submitted a proposal for the certification of its schedule of specific commitments on services.

The prospects for completing the UK’s schedules depend on the products at issue:

- Securing approval of the UK’s tariff schedule for **manufactured goods** should be straightforward, but cannot be taken for granted. Although the UK is proposing to leave its tariffs unchanged, other WTO Members may view the concessions they gave when negotiating the Common External Tariff with the EU to be excessive when valued in terms of access to the UK market alone and request the UK to make additional tariff cuts before agreeing to certify this part of its schedule.
- Reaching agreement on the UK’s MFN schedule for **agricultural products** will be more complicated. The UK cannot duplicate the EU schedule *in toto* because it includes over 100 Tariff-Rate Quotas<sup>9</sup> (TRQs) that affect imports of certain meat and dairy products, cereals, fruits and vegetables. These have been set on an EU-wide basis; they will have to be divided between the UK and the EU27. The UK and the EU have proposed using historical market shares to split the TRQs. That is a recognized WTO methodology, but several countries<sup>10</sup> have objected to using it in this case. Their view is that splitting the TRQs would prevent them from shifting exports between the UK and EU27 to take account of market conditions and fill the TRQs once the UK and EU markets are separate. To satisfy their concerns, the UK may have to increase the volume of in-quota imports in its TRQs.
- Negotiations to agree on the allocation of TRQs are likely to be drawn out because a solution must satisfy the UK and the EU as well as the third countries involved. That could push back for years the certification of the UK’s tariff schedule in the WTO. Experience suggests that other WTO Members will be tolerant as long as the UK engages constructively in requests to renegotiate its tariffs and TRQs. In the meantime, the UK will trade on its proposed (“uncertified”) market access schedules.<sup>11</sup>

Business can expect day-to-day trade with the UK to continue uninterrupted while negotiations to certify its market access schedules take place in the WTO. There is no time limit for that process. The UK may need to cut some tariffs and expand some TRQs in order to secure the agreement of other WTO Members to certify its schedule. It may also face demands to improve its market access in services once it submits its services schedule for certification.

## Government Procurement

Public procurement is excluded from standard WTO rules, but 47 WTO Members, including the EU, the United States, Canada and Japan, have opened their procurement markets to each other on a preferential (non-MFN) basis through the WTO Agreement on Government Procurement (GPA). Ten other countries, including China and Russia, are negotiating their GPA accession. Losing access to these markets would be costly for UK and UK-based business.

The UK is a GPA Party only by virtue of its membership in the EU, so it must accede to the GPA in its own right. The timeline for doing this is tight because of the GPA accession conditions and procedures. The UK must agree with other GPA Parties on its access commitments to its public procurement market (covered entities, listed goods and services, and threshold values for procurement contracts), pass legislation confirming what is in its GPA

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<sup>9</sup> TRQs apply a low tariff to a specified volume of (“in quota”) imports and a higher tariff to imports above that threshold.

<sup>10</sup> Including the United States, Canada, Thailand, New Zealand, Brazil, Argentina and Uruguay.

<sup>11</sup> WTO jurisprudence has confirmed that a Member country’s tariff schedule does have legal effect before it has been formally certified, see EU – Poultry Meat (China) DS492, June 2017

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schedule, and notify the WTO that it has ratified the GPA at least 30 days before its withdrawal from the EU in March 2019.

The core of the negotiation with other GPA Parties will be their access to the UK's procurement market. The UK may need to improve the commitments it has as an EU member to secure its accession.

The UK's status as a GPA party must be formalized before March 2019. Slippage could cause lost business opportunities in the public procurement markets of the UK's key trading partners.

## Legislative Preparations for Brexit

The UK Government is preparing new legislation to implement UK trade policy after the European Communities Act 1972 is repealed in March 2019. UK trade law will remain fully aligned with EU law and the Union Customs Code during the transition period. Thereafter, it will depend upon the terms of the new UK-EU trade agreement in areas such as the introduction of customs controls and trade facilitation practices, the treatment of product regulations and standards, and rules of origin.

The *European Union (Withdrawal) Act* will convert EU Regulations into UK law and will preserve existing UK trade laws that derive from EU Directives in a new category of "retained EU law". In some areas, additional legislation is needed since the *European Union (Withdrawal) Act* cannot be used to impose or increase taxation, including customs and excise duties and VAT. The Trade Bill (*Trade Act 2018*) and the Customs Bill (*Taxation (Cross-Border Trade) Act 2018*) are currently progressing through the UK Parliament. They will create the authority for the UK Government (i) to set and collect customs duties; (ii) to implement trade and customs regulations, including ensuring that the Customs and Excise Management Act 1979 continues to have effect; (iii) to implement UK trade agreements with countries that already have FTAs with the EU; (iv) to implement UK legal obligations in the WTO; and (v) to establish the UK Trade Remedies Authority and impose trade remedy measures consistently with WTO rules. Additional legislation will be needed at a later stage to implement the results of negotiations with the EU and with other FTA partners.

The existing, unified framework of EU trade law will be replaced after March 2019 by an interface between UK and EU trade law underpinned by WTO law. For business, managing this change will be complex, and considerable additional uncertainty could result from the fact that the exact terms of a new UK-EU trade arrangement are not likely to be known much before the transition period expires in 2021.

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