Global Counsel

UK trade policy and Brexit

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Summary

Among the many implications of a UK exit from the EU is a fundamental change to the way that the UK makes and implements trade policy. As part of the EU, the UK's trade policy is effectively set by the EU's common commercial policy. The UK shares a single external tariff regime with the EU – a corollary of the single market – and many of the key elements of its wider trade policy position (farm subsidies, investment and intellectual property rules) are defined in Brussels. Much of this is now set to change. For supporters of exit, this is indeed one of the potential attractions of greater UK autonomy. What policy choices need to underpin an independent UK trade policy? How quickly can the UK expect to be able to start signing deals – and who with? And what leverage will the UK bring to the table to attract a new level of ambition from others?

Among the many implications of a UK exit from the EU is a fundamental change to the way that the UK makes and implements trade policy. As part of the EU, the UK's trade policy is effectively set by the EU's common commercial policy. The UK shares a single external tariff regime with the EU – a corollary of the single market – and many of the key elements of its wider trade policy position (farm subsidies, investment and intellectual property rules) are defined in Brussels. Any model that returned control of UK trade policy to London, which includes most of the plausible ones, would change this. For supporters of exit, this is indeed one of the potential attractions of greater UK autonomy.

The transition to a fully autonomous UK trade policy involves a series of practical, procedural and political steps, most of which are necessary preliminaries to the UK launching a new wave of market access negotiations with willing partners. It is only after these process and political issues are resolved that the UK will be able to fully engage in the ambitious FTA negotiations agenda trailed by the new British government.

Preliminaries: capacity building and WTO profile

Capacity Building

The first priority for the new British government will be to build sufficient capacity to deliver an autonomous trade policy. This new trade policymaking institutional machinery will be overseen by the new Secretary of State for International Trade and a largely new department. This will require the recruitment of several hundred new specialists to cover both negotiations and policymaking. One of London's options will be attracting Brussels-based trade negotiators and trade policy specialists back to Whitehall, although this will also be challenging and potentially expensive. Borrowed trade consultants and lawyers can also potentially serve as a temporary solution, although these would lack experience in dealing with well-seasoned negotiation teams from the European Commission, China or the US.

London will also have to create from scratch a new institutional trade policymaking process. A number of important questions need to be answered here regarding issues such as the balance of responsibilities and competencies between and within different government departments – for instance, the role of the Department of International Trade or the Foreign and Commonwealth Office in setting the negotiating mandate and their level of involvement in negotiations – and the degree of accountability of negotiators to Parliament, Ministers and the executive. The UK will also need to build its own 'trade defence' bureaucracy to inherit the work done by the EU's anti-dumping service, which will probably require an independent agency similar to an economic regulator or agency similar to the US ITC. Some of these issues are bureaucratic in nature, others may need new legislation.

WTO profile

Aside from this practical question of capacity, the other key preliminary for the UK will be the establishment of its WTO policy profile – the collection of external tariffs, tariff rate quotas and services trade commitments it presents to all other WTO members on a 'MFN' basis. This will also have to include clarity on the farm subsidies and regulatory practices relevant to the wider framework of WTO rules. This is currently provided almost entirely by the EU equivalent of these things – the EU common fisheries and agriculture policies and the EU external tariff, for example.

This basic template matters, because without knowing what the UK plans to extend to all WTO members as its basic market profile, it is not possible for other states to negotiate 'preferential' trade agreements with the UK based on chipping away at this protection. Individual WTO members will be chiefly interested in the UK's tariff and services schedules, but developing countries collectively in the WTO will take a close interest in the UK's proposals for its farm subsidy regime. This matters because the new UK external profile will need to be agreed and confirmed by all 162 WTO members individually and then collectively. The WTO's consensus-based decision-making format means that, in both theory and practice, the opposition of only one of its members can force everyone back to the negotiating table.

The UK could facilitate this process by simply adopting the EU's external tariff and services schedule, which would provide continuity for most trading partners in most areas. But even in doing this there are complicated technical issues to resolve, such as 'reallocating' tariff rate quotas – nominal tonnages of imports subject to a lower tariff rate beyond which a higher import duty applies. For instance, how much of the EU's 20000 tons of beef imports benefiting from lower tariffs will be 'transferred' to London? These sorts of issues are the kind that could make confirming the UK's new WTO profile in Geneva a less-than-routine exercise as other states (including the EU) quibble and seek additional concessions in return for their support.

Manging this process implies a large volume of policymaking choices that need to be made in London comparatively quickly if substantive discussions on future trade are to take place. These choices are on the whole industrial policy choices of the kind the UK has not made for a number of decades. As noted above, this is not simply a question of confirming the UK's external tariff, but also the detail of any subsidy and regulatory regimes and the UK equivalents of a range of technical and safety standards that make up the increasing bulk of irritants in modern trade policymaking.

Fig 1. UK independent trade policy: preliminaries, necessities, possibilities

	Counterparty	Rationale	Timing
Capacity building in London and across foreign representations and establishment of TDI agency	-	A necessary prerequsite for an effective UK autonomous trade policy	Can start immediately
Establishment of WTO MFN baseline for negotiations	All WTO members	Must take place before substantive negotiations on preferential agreements can begin; requires domestic policy decisions and consultation/agreement with all other WTO members	Informal discussions possible; may not be possible to codify new profile in WTO before exit
Replacement of deals providing current trade preferences with risk of disruption	EU27 Turkey Switzerland Current EU FTA partners	Will have to be prioritised for reasons of trade continuity as lapse in existing preferential terms could be disruptive	Negotiations may be possible before exit; trade deals can only be signed after UK exit from the CCP
New future trade deals	India/Japan/US/China and others	Politically and potentially economically important, but resourcing may have to reflect demands of replacing existing preferential access	Negotiations may be possible before exit; trade deals can only be signed after UK exit from the CCP

Time

Some liberal-minded supporters of exit have implied the UK's strategy on exit should be to unilaterally liberalise the small amount of remaining tariff protection that the UK would in principle inherit by adopting the EU external schedule as its own. Irrespective of the potential efficiency gains implied by this form of unilateral liberalisation, this is unlikely for the practical reason that it would remove the small amount of leverage that the UK has in incentivising other WTO members to reach preferential trade deals with it post-Brexit. The dirty secret of trade negotiations is that leverage comes from having market protection to trade with, not from an ambitious approach to free trade in itself.

Necessities: avoiding trade disruption

With this machinery and freshly-minted WTO profile in place, the UK will then need to decide where to focus resources. This choice will be partly imposed on it by the need to minimise disruption in two key areas – the two sets of markets to which it currently has preferential access by virtue of its membership of the EU. This means the 58 countries with which the EU currently has FTAs, and, even more importantly, the EU single market itself, which is at its core the most substantive free trade agreement in the global economy.

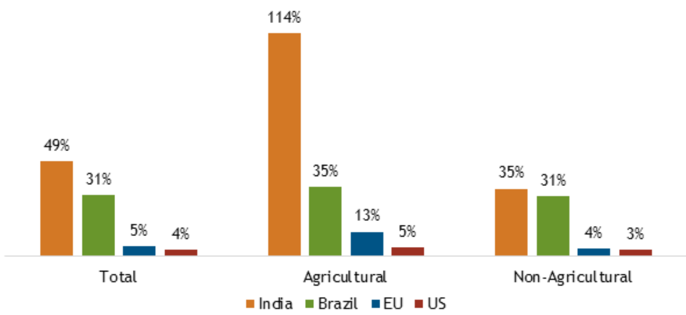
The EU-UK deal

The single market deal will dominate UK resources and time out of simple necessity. It is the UK's largest market by far and one in which the re-imposition of EU MFN tariffs, even at their current low levels, would be most disruptive for UK supply chains built on the current tariff-free arrangements. The market access terms that the UK grants and is granted by the EU will be watched closely by every other market with which the UK seeks a deal, because they will be rightly assumed to be the most generous, as the UK has much to lose from a failure to come as close as possible to the status quo by ensuring complete tariff liberalisation. Other states may want to set this benchmark of UK generosity for their own deals. Many will simply want to know what the prospects for onward trade to the single market are before they strike their own deals.

In terms of the substance, one interesting question will be how far the UK seeks to use an EU-UK bilateral agreement to reproduce some of the rights to trade financial services into the single market that it will lose if it becomes a third country outside the EU/EEA. This is currently provided by the EU passporting regime for financial services. However, access to this regime is likely to be problematic to the extent that the UK moves outside of the reach of EU financial regulation, but may be possible in some areas on the basis of some sort of mutual recognition of regulatory standards.

The close alignments of the two jurisdictions and the potentially high costs in both choice and liquidity of rolling back the services provided under the status quo means that the two sides might be inclined to seek creative solutions that go beyond anything that has been agreed in other FTAs. The UK will certainly want to explore similar ideas in its bilateral trade policy given its strength in financial services, its desire to deliver something genuinely new in its autonomous trade policy and the fact that it will be regarded by most trading partners as among the most robust regulatory jurisdictions in the world – although the UK's own regulators may have issues with granting others the same and the UK's very competitiveness may count against this in this area.

Fig 2. Average bound tariff levels at the WTO
Source: WTO



The sequencing of this core EU-UK deal also remains subject to debate and matters for minimising disruption. If the UK must wait to agree an FTA with the EU until it has left the EU this implies a possibility of tariffs being re-imposed on cross-channel trade only to be removed at a subsequent point. It is both legally and politically unclear whether market access negotiations will be included in exit negotiations under Article 50 or be permitted to run in parallel. While the European Commission and a number of member states such as France and Germany have said market access talks will only take place after the end of Exit negotiations once the UK is a 'third country', in reality, this will only be made clear once the new UK government has clarified its negotiating aims and preference for relationship with the EU.

Officials in Brussels are informally considering the possibility of a transitional market access agreement provisionally grandfathering the status quo or elements of it for a determined period of time - 4 years has been mentioned - starting at the end of the exit negotiations to ensure minimum disruptions to bilateral trade before the conclusion of negotiations on a EU-UK FTA. However, this option will only be seriously considered and discussed after London invokes Article 50.

Importantly the UK will probably need to negotiate a UK-Turkey FTA in parallel to cover the reciprocal concessions it may want to grant to Turkey secured via the EU-Turkey customs union. Because of the structure of the customs union, while a UK-EU FTA would cover existing UK exports to Turkey, imports from Turkey would need to be covered in a bilateral deal. Switzerland's close integration with the EU single market (and thus the UK market) will also need to be rendered into a bilateral agreement in a way that is synchronised with exit from the EU itself.

Existing EU FTAs

A similar problem on a smaller and more disaggregated scale exists with the potential disruption caused by falling out of the EU's current network of FTAs and having trade with these markets revert to MFN terms. Some current EU FTA partners may agree to have their FTAs with the EU simply devolve onto the UK on the same terms, including those 'mixed' deals in which the UK may reasonably claim that it is a full party to the agreement alongside the EU because of the issues covered – for example, the current EU-Canada FTA awaiting ratification. Some former FTA partners may want agreements renegotiated, at least in sensitive areas where concessions to the UK are perceived as being no longer balanced by the benefits of access to a wider EU market. They may also want to go further than the EU chose to. For instance, the understanding in Hanoi is that the Vietnamese government will seek to renegotiate some parts of the agreements to trade its current concessions in the EU-Vietnam FTA for greater access to UK market.

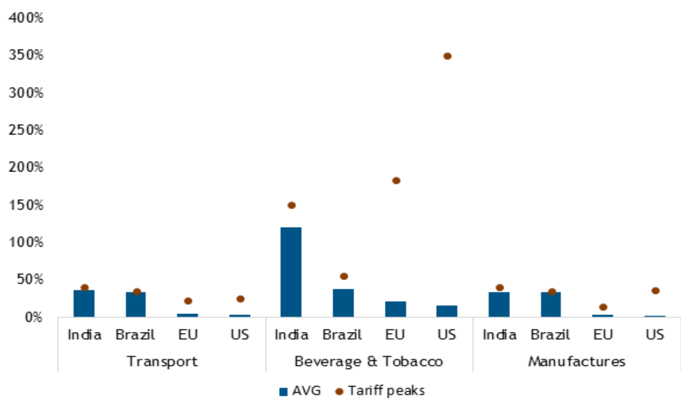
There is no simple way to handle this issue. FTAs are not subject to WTO mediation or adjudication, and the dispute settlement mechanisms built into them apply only the parties. The simple reality is that the easiest way to negotiate the transition of these FTAs to the UK will be to…negotiate an FTA. While the UK can in theory continue to apply preferential terms to former EU FTA partners, and third countries have their own incentive to ensure this, if these are not codified in a new FTA for any reason, and not affirmed by the WTO membership as such via GATT requirements, they could in theory be challenged by other WTO states.

Not all of these EU deals matter for the UK in the same way. Most of them focus largely on goods and are comparatively shallow in the key UK area of services – the EU-Korea FTA would be an obvious priority given its relative depth and the risks attached to reverting to high Korean MFN tariffs from the current liberalised levels. Many of the EU/UK's current agreements with developing countries are highly asymmetrical in that they grant much greater freedom to imports than UK exports, but for this reason confirming their terms will be a priority for the signatories and this will need to be managed.

Possibilities: new future deals

Beyond these practical steps to smooth the transition to a new trade regime, a genuinely autonomous UK trade policy opens up. The UK will seek to negotiate with key markets with which the EU is currently or has not yet started negotiating FTAs, such as the US, Japan, China or India. The key issue for the UK here will be its degree of leverage to secure substantive deals in these negotiations. Assuming that the UK adopts something similar to the EU's external tariff profile and services schedule, the UK's market access regime will be relatively open compared to that of its prospective large emerging markets negotiating partners, such as India (Fig.1). This is an important factor in negotiations.

Fig 3. Prospective UK FTA negotiations
Source: WTO



Like the EU, the UK will have to focus on bargaining its few remaining tariff peaks and services import barriers in those sectors where its target markets will have offensive interest – such as agriculture, transport equipment (automotive) and the movement of services professionals (the so-called 'Mode 4' category of services trade that covers the movement of professional staff across borders) – for greater market access for UK exports, especially in services (Fig.2). Given their already good access in most areas, the 'price' Indian or Chinese negotiators will be willing pay for improved access for their exports also depends on how they value the UK market as an export destination. London, with barely 10% of the EU's 510mn strong single market (590mn including Turkey's customs union with the EU), has less to offer its prospective trade deal partners than Brussels.

As suggested by advocates of leaving the common commercial policy during the referendum campaign, London is likely to have an easier job in balancing its offensive and defensive interests in these negotiations than the European Commission, which has to take into account those of the 28 (soon to be 27) EU member states. For instance, the UK is likely to have far fewer demands than then EU in areas such as Geographical Indications (champagne, cheeses, etc), tariff protections on wines, or protections for culture-related services. All of these have been important offensive interests of the US in the TTIP negotiations and the UK would be more accommodating on all of them. UK public opinion is also relatively more favourable to trade liberalisation than in many other EU member states, although this should definitely not be overstated, and both farm and manufactured goods tariff will definitely have their own political defenders in the UK. Getting good deals will involve tough political choices.

This means the real question for the UK government is not really whether it can ultimately conclude trade agreements with large emerging markets, but how substantive these agreements will be. Leaving the EU is likely to give London more leeway in negotiating FTAs once it has completed its transition to a new trade regime, but it also raises important questions about what protections and export market potential it will have to bargain with for greater access to UK exports abroad.

Fig 4. Prospective UK FTA negotiations

US	Although there is currently some political support in the US for a UK-US FTA, the next US president is very likely to be generally less supportive of trade agreements than the Obama administration. However, the UK, as a developed market with high standards may in fact be an attractive political prospect. A decision must also be made on whether the UK might join a future TTIP, and the US-led Trans Pacific Partnership. It would also have to be determined whether Washington would be ready to negotiate with London in parallel to its ongoing negotiations with the EU. Perhaps more than in other prospective UK trade negotiations, the real question for a UK-US FTA is how substantive it would be in addressing key UK offensive interests. It is reasonable to expect similar resistance from Washington in accommodating key UK offensive interests in areas such as financial services, although the UK as a standalone proposition in this area may look like a more reasonable prospect for cross border cooperation than an EU covering states like Bulgaria and Cyprus.
Japan	Tokyo's interests in a Japan-UK FTA would be largely similar to those in the EU-Japan FTA talks – above all the elimination of UK automotive tariffs. The UK has considerable interest in improved market access in areas such as luxury goods and processed agricultural goods, both of which are protected by Japan. Japan will also be particularly interested in the post-Brexit terms of access to the EU single market for UK-based corporates as well in the evolution of the UK's competition regime in relation to the EU's given the high stakes of Japanese firms such as Hitachi in infrastructure and energy-related projects such as Hinkley point. This looks like a relatively easy deal for a post-Brexit UK, but only at the price of some painful political choices on vehicle tariffs – which will go to the heart of the UK's apparent new commitment to industrial strategy.
China	The deepening of economic ties with China will figure highly among the UK government's post-Brexit foreign economic policy priorities. UK enthusiasm for developing London as a leading international centre for renminbi financing will only grow, as will the UK's openness to inward investment from China. However, London will face a number of difficult questions when considering the launch of negotiations with Beijing, not least in terms of how interested will China be in deepening ties with the UK without first getting clarity about the prospects for onward trade from the UK into the single market. The UK government would also need to decide whether it is willing to accommodate Chinese offensive interests in sectors currently protected by the EU's few remaining tariff peaks, including cars and low-tech ICT goods such as television sets.
India	While in principle both London and New Delhi are interested in negotiating an FTA, the prospects of concluding a substantive deal are uncertain. The UK is likely to face the same set of demands faced by the EU in terms of tariff elimination in automotive, low tech ITC goods and free movement of services professionals in the ITC sector. India is also likely to resist UK demands for greater market access in services sectors such as banking, insurance, regulation of the gas and oil sector and taxes.

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