



THE UK'S FUTURE TRADE RELATIONSHIPS

Post-Brexit, there is likely to be a bespoke relationship between the UK and the EU, which is likely to be based in form on a Free Trade Agreement (FTA). To recreate something akin to the UK's current global network of preferential trade agreements, the UK will also need to negotiate FTAs with its other key trading partners.

FREE TRADE AGREEMENTS

What is an FTA?

An FTA is a preferential trade agreement between different countries that allows them to trade with each other on terms more favourable than those set out under WTO rules. Modern FTAs are increasingly more complex than they have been in the past. Key areas in FTAs include: trade in goods; technical barriers to trade (e.g. regulations); sanitary and phytosanitary (health) measures; customs and trade facilitation; trade in services; government procurement; intellectual property; competition; sustainable development; investor protection; and dispute settlement.

FTAs deal with trade in goods and services separately. In relation to trade in goods, modern FTAs have also attempted to reduce non-tariff barriers ("NTBs") by reducing customs procedures and harmonizing regulations. On the other hand, historically, FTAs have not dealt comprehensively with trade in services. The most ambitious FTA in terms of services currently concluded by the EU is the EU-South Korea FTA which seeks to liberalize market access in more than 100 sectors.

However, 'liberalizing market access' does not give the same rights as being a member of the single market. Trade in services liberalization in EU FTAs follows the approach adopted in the WTO, meaning that the concept of market access is limited to an exhaustive list of restrictions.

Negotiating an FTA

Negotiating an FTA with the EU is a lengthy process. There are numerous stages, beginning with a public consultation and then a 'scoping exercise' between the EU Commission and the country concerned. The Commission then has to request formal authorisation from the Council to open negotiations. Negotiations themselves can take years. Once they reach 'technical finalisation', finalised texts are sent to the Member States and the European Parliament and lawyers begin to review the text.

This exercise alone can take from three to nine months. When this is finished, the chief negotiators of each country initial the English text of the proposed agreement, the text can be published, and it is translated into all official languages of the EU. It will then be signed on behalf of the EU and, if a mixed

agreement, by all Member States. Finally, the European Parliament has to give its consent to the document, individual Member States have to ratify it according to their national ratification procedures, and the Council will adopt the final decision to conclude the agreement.

Negotiating an FTA with third countries will, of course, depend on each country's individual constitutional structure. Countries (such as the US) have indicated that in any event they would want to see the outcome of UK-EU negotiations before agreeing their own FTA with the UK, as that future relationship may have a significant influence on the priorities of third countries for an FTA with the UK.

Timing

There are two key issues in relation to negotiating a free trade agreement with the EU. Firstly - when can we start? And secondly - how long will it take?

As a member of the EU and part of the EU Customs Union, the UK cannot negotiate free trade agreements, as this is part of the EU's competence. It is arguable that it would be a breach of EU law for both the UK and the EU to begin negotiating a free trade agreement until after the UK has left the EU.

The time period for negotiating FTAs varies according to their complexity and how controversial the provisions are. For example negotiations began between the EU and South Korea in May 2007, and the ratification process was not complete until 13 December 2015, despite the fact that the agreement was signed in October 2009.

An EU FTA takes a particularly long time to come into force where it is a "mixed agreement". Mixed agreements are increasingly common, because they are comprehensive arrangements which cover more than the reduction of tariffs on goods, but also cover trade in services and other elements. Where an FTA contains provisions on services, it will generally contain some different provisions for some different Member States as there is no single EU common policy on services.

A mixed agreement is therefore required to be entered into not just by the EU but also by each individual Member State, according to its domestic processes. In some states (e.g. the Netherlands), this can include a referendum. This process of Member State ratification can further delay - or frustrate - the entering into force of an FTA, even after the text has been agreed.

THE WTO

What happens if the FTA is not negotiated in time?

Unless transitional arrangements can be agreed, the UK may have to default to its membership of the WTO, and trade solely under WTO rules for at least a period of time.

What is the WTO?

The WTO is a global multilateral trading system with 164 members which has lowered import duties on goods through successive trade negotiation rounds.

The WTO's key functions include:

- to facilitate the implementation, administration and operation of the WTO agreements;
- as a forum for negotiations; and
- to administer trade disputes.

Key differences between an FTA and being in the EU

		The EU	An FTA
Overall framework		The European Commission proposes new laws and regulations that are adopted by the European Parliament and Council. These then have to be incorporated into the national law of the EU Member States.	No overall framework. Therefore maintaining ongoing equivalence and mutual recognition is complicated and costly.
Goods:	Tariffs:	No tariffs – goods pass freely throughout the EU.	Usually contain provisions reducing tariffs to zero in stages.
	Certification:	No need for certification – if a product meets (for example) health and safety standards in France it is able to be sold in Italy.	Depends on the specific terms of the FTA but can contain certain provisions where the parties recognise each others' certification in specific areas.
Services:	Freedom of movement:	Freedom of movement across the EU.	Varies but generally contains provisions facilitating the temporary movement of people for specific business purposes.
	Regulation (e.g. financial services):	If a company is authorised to provide financial services in France, it can do so in Italy – no further authorisation is required.	This "passporting" does not occur in FTAs.
Subsidies / state aid		Subsidies are required to be notified to the European Commission and cleared as compatible with the EU internal matter. Strict criteria are applied to determine if a measure is compatible.	Depends on the specific terms of the FTA. Although subsidies are allowed, there tend to be a number of specified exclusions for public policy objectives, and subsidies are only allowed for services on a limited basis.
Dispute Settlement		Through domestic courts of member states, and ultimately to the ECJ.	Depends on the specific terms of the FTA. There may be no individual remedy for companies but only state-state remedies, unless the complaint falls under the "investor protection" chapter – in which case companies may be permitted to bring a complaint through arbitration on a limited basis.

It is fair to say that trading only under WTO rules is not an attractive prospect for UK business and would have significant disadvantages for trading relationships and economies. This is not just due to the imposition of tariffs on goods (although 16% of goods exported to the EU would face tariffs of over 7% and potentially vice versa for goods imported from the EU into the UK) but, more importantly given the UK's reliance on services, the ability of service providers to provide services within the EU would be significantly hampered (and vice versa for EU companies providing services into the UK).

Trade in goods

The overarching framework for trade in goods is provided in the General Agreement on Tariff and Trade ("GATT"). The key principle of the GATT is the "most-favoured-nation" ("MFN") principle - this requires WTO Members to treat all other members equally.

Trade in Services

WTO rules for trade in services are not as comprehensive as those for trade in goods. There exists only an overarching framework, which is found in the General Agreement on Trade in Services ("GATS"). There are no "tariffs" as such in relation to trade in services - instead trade in services is limited by "non-tariff barriers" ("NTBs") and the WTO has provisions attempting to limit the NTBs a member can impose on other members.

Implications for UK trade

The effect is two-fold:

- The EU cannot generally discriminate against the UK in its trade provisions as to do so would be against the rules of the WTO.
- However, unless the UK remains in the customs union, or enters into a free trade agreement with the EU, the EU cannot offer it more favourable treatment than it does under the WTO, without also offering that treatment to every other country.

Moreover, WTO schedules include tariff quotas and subsidies commitments, which are currently specified in quantitative terms for the entire EU. Key figures within the WTO have suggested that the UK would have to negotiate its own schedules. This would be a very lengthy procedure as the UK's schedules would have to be agreed with the 163 other members of the WTO.

A TRANSITIONAL AGREEMENT

Given the timing for negotiating a future agreement with the EU, it is likely that the Article 50 timeframe may expire before there is a full agreement on the relationship going forward. The UK therefore needs to give serious consideration to the possibility of securing a transitional period - though this in itself may not be straightforward to negotiate and will involve overcoming a number of political and legal challenges in practice.

Legally, there would be advantages for the UK to characterise the transitional agreement as part of the Article 50 exit agreement. It is important to note, however, that a transitional agreement between the UK and the EU will not bind other states once the UK is outside the EU.

CONCLUSION

Apart from the complexity of the legal and commercial challenges that Brexit presents, a key practical difficulty facing Government and businesses is timing. There is not scope in the Article 50 timetable to negotiate fully an

agreement comprehensive enough to address all of the issues important to the UK and to British businesses. However, leaving the EU and trading under WTO rules is likely to be a deeply unsatisfactory option. As a result, the optimal scenario in the circumstances would involve some form of a transitional arrangement with the EU.

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