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BREXIT TRADE AND TREATIES



— THOUGHT LEADERSHIP



BREXIT – TRADE AND TREATIES

After the historic vote to leave the EU, the UK must now reconsider its trading relationships with countries around the world. Here, Clifford Chance experts together with Professor Jim Rollo of the University of Sussex, consider how companies should prepare themselves for the changes that are to come, specifically analysing what free trade agreements encompass; what the WTO is and how it works; and what third-state agreements might involve.

A few months on from the UK's vote to leave the EU, and the dust has started to settle. The British government has been regrouping, consulting, discussing and strategizing, and yet while some initial uncertainties have been resolved, there are still a lot of big decisions to be made. These will have very real consequences for businesses operating in the UK.

When it comes to trade and treaties, the UK must reconsider the basis of its trading relationships with the EU and other countries around the world post Brexit. Three of the biggest discussions to be had concern the potential for a new UK/EU free trade agreement, the possibility of reverting to trading under World Trade Organisation (WTO) rules, and entering into other third state agreements. "These are not all the options," says Jessica Gladstone, a partner in public international law at Clifford Chance. The possibility of the customs union, the UK joining the European Economic Area, or following the Swiss model have not yet been formally ruled out, even though they each bring with them some political and economic difficulties. For the time being, both the UK and the EU are playing their cards very close to their chest."

the advantage of being incredibly bespoke, so that it could cover whatever the UK and EU are able to agree. With increasing technology and globalisation, FTAs are becoming more complex in order to try to limit both tariff and non-tariff barriers. Some provisions might reduce tariffs to zero, while others may reduce them gradually over time, and there are always exceptions; it is unlikely that a free trade agreement will eliminate all tariffs.

Alice Darling, a lawyer in Clifford Chance's London office, says: "FTAs also contain agreements aimed at reducing the differences in regulatory standards, and so might, for example, contain provisions to use an international standard-setting body as the basis for regulations, or to consult each other before making regulatory changes."

Historically, trade in services has not been dealt with as comprehensively as trade in goods under FTAs, though this is changing. The new FTA between the EU and South Korea aims to liberalise trade in services, although there is still no provision creating anything like the liberalisation of services within the single market.

One thing that often gets overlooked in discussions about a new FTA between the UK and the EU is the fact that different member states can give different commitments on services. The EU's FTAs typically contain schedules setting out specific commitments and limitations of each member state, adding another layer of complexity to the UK's negotiations.

Jim Rollo, Emeritus Professor at the University of Sussex and Deputy Director of the UK Trade Policy Observatory, says: "When it comes to an FTA between the



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— **ALICE DARLING,**
Lawyer, London,
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Free trade agreements

Free trade agreements (FTAs) are a type of treaty between states that governs the basis on which they will trade with each other. They have the aim of reducing barriers to trade, such as tariffs and disparities between regulatory standards, and allow nations to trade with each other on terms more favourable than those set out under WTO rules.

An FTA could form the basis for the UK's future relationship with the EU, and has

UK and the EU, it is important to remember that we are starting from a position where the UK is probably the most services-intensive large economy in the world. We are heavily reliant on our trade in services, and have a consistent trade surplus, while the rest of the EU is less competitive than we are and so we would want to keep our advantage.”

Any proposal from the UK would therefore be skewed towards a more services-centric FTA, rather than just goods. The EU would be looking to take away the UK’s market share, and would therefore likely seek to achieve less market access for UK services than is available today.

The application of FTAs requires that each country be able to recognise the goods and services of the other party to the agreement, to make sure they deserve the preferences they are seeking. That means that Rules of Origin are required, to identify the origin of a particular good, perhaps setting out what percentage of that good’s value be sourced from local content. The UK is not currently subject to EU Rules of Origin, because it is a member of the customs union that provides a single external border.

“If we have an FTA with the EU,” says Rollo, “we will have to have barriers put in place. They may just be documentation borders, that add on to the cost of doing business, but there may also be delays at the frontier, rejections of particular loads, and so on. That’s why a large number of economists are clear that there’s going to be a cost to any new arrangements.”

He says complying with the EU’s current Rules of Origin, applied to the rest of the world, add around 10% to the cost of imports, the equivalent of a 10% tariff, though that will vary by country and by product.

The Rules of Origin are a key downside of an FTA compared with the customs union. But if the UK enters into a customs union with the EU, the EU will take responsibility for determining its relations with other countries. That means if the EU were to sign a preferential deal with a third country, that country would be entitled to whatever preferences the EU

granted in the UK market as well, without any input from the UK government, thereby failing to meet the UK’s political objective of taking back control.

WTO rules

The WTO was formally established in 1995 to regulate international trade, and currently boasts 164 member states. Its rules are the basis on which all trade agreements rest, and there are two separate agreements – the General Agreement on Tariffs and Trade (GATT), and the General Agreement on Trade in Services (GATS).

One of the key principles of WTO membership is the most-favoured nation (MFN) provision, which requires that all

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**– PROFESSOR JIM ROLLO,
University of Sussex**

members treat each other equally, so that if a country were to lower a tariff applied to one member state, it would have to do the same for all.

GATT sets out the schedules of tariffs that members have agreed to charge each other on the import of goods into their country, and the classifications are incredibly granular. GATS, on the other hand, is not as comprehensive for services, but applies the principle of MFN, and of transparency. Under GATS, countries can apply exemptions to MFN, so do not in fact have to treat all WTO members equally.

MFN gives the UK protection against other countries taking discriminatory action against it via their trade provisions, as a kind of punishment for Brexit, as some had feared. In addition, although it may be in the EU’s interest quickly to reduce tariffs in some of the most important areas, such as automotive, it cannot do that without either breaching WTO rules, or reducing the tariff for all other WTO members.

When it comes to WTO schedules, the UK currently shares its schedules with the EU, though it is an independent





**TPP is a treaty that
Asia really wants.**



— **ROMESH WEERAMANTRY,**
Foreign Legal Consultant, Hong Kong,
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member as well as being represented by the EU in negotiations. In theory there will be no need for the UK to negotiate its own schedules post-Brexit, because it should not make much difference to simply say the UK's schedules are the same as the EU's. There will, however, be some areas that require negotiation between the UK and the EU, such as the quantity of tariff-rate quotas of agricultural products the UK is entitled to.

But there is a question of timing and sequencing. Rollo argues that the best thing would be for the WTO schedule discussions between the UK and the EU to take place as part of the Article 50 negotiations: "If we have to wait until the end of Article 50 before we begin those negotiations, then we are in a difficult position," he says. "We can't actually tell countries the value of the preferences we are offering in FTAs until we have the agreed WTO MFN tariff. So until we have done that, we will find it hard to do an FTA with the EU, and it's very likely the rest of the world will say they want to know what preferential treatment we are giving our biggest customer, the EU, so that they can work out how competitive they will be. You get in to some quite complicated sequencing."

Third state agreements

As well as negotiating new arrangements with the EU, the UK also needs to turn its attention to its trading relationships with the rest of the world. President Elect Donald Trump has said of a possible trade deal: "The UK will certainly not be at the back of the queue, that I can tell

you. With me they will always be treated fantastically."

The UK can learn lessons from Asia, where there has been a flurry of dynamic activity in the signing of FTAs. In that region, governments have given significant priority to promoting free trade. For example, the Association of Southeast Asian Nations (ASEAN), comprising 10 states including Indonesia, Singapore, Malaysia, Vietnam and Thailand, has recently negotiated its own FTA, as well as ASEAN FTAs with China, India, South Korea, Japan, Australia and New Zealand. The next step is to group all those 16 nations together as a single bloc with one FTA, to be known as the Regional Comprehensive Economic Partnership, or RCEP. Those negotiations have been going on since 2012. An RCEP trade bloc will comprise almost half of the population of the world and will account for approximately 40 per cent of world trade.

Earlier this year, the Trans-Pacific Partnership (TPP) was signed. The TPP is a regional FTA among 12 Asia-Pacific countries: Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam. "That's a treaty that Asia really wants," says Clifford Chance Hong Kong counsel Romesh Weeramantry. However, President Elect Donald Trump's opposition to the TPP makes the future of the treaty uncertain. There is a possibility that the other parties may go ahead anyway.

Should it come into force, the TPP will be open for other nations to sign up to, and

so may represent a fast-track option for the UK, which is keen to be part of an FTA with countries like Japan, US, Canada, Australia and New Zealand. The same can be said of the Transatlantic Trade and Investment Partnership (TTIP), which the EU is currently negotiating with the US. That, too, is meant to be open, and so may allow the UK to sign up to an arrangement with the EU and the US in one stroke.

Rollo says, “The issue would be services, as financial services are not currently covered by TTIP, and also the fact that the UK would have no room for negotiation – we would have to take TPP and TTIP as we found them. Given that the 12 countries in TPP have spent nearly seven years negotiating it, the British are unlikely to be able to negotiate any changes.”

The treatment of services is going to play an important role in any negotiations of trade and treaties, because services have been one of the major beneficiaries of the UK’s membership of the EU. Trying to emulate that success will be a focus for negotiators.

Gladstone says there is a lot of scope for negotiations of FTAs, and points out that politics will have a massive part to play in how the UK’s trading relationships pan out. She adds: “All of this is going to require a level of analysis of the British economy, and British business, that has never been done before. The level of dialogue between the government and business is going to have to increase significantly.”



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—JESSICA GLADSTONE,
Partner, London,
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Jim Rollo is Professor Emeritus at the University of Sussex and Associate Research Fellow at Chatham House. He is also Deputy Director of the UK Trade Policy Observatory, which offers independent advice to assist the UK Government, industry and public in addressing the critical international trade challenges posed by the UK’s exit from the European Union.

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