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THE FUTURE OF TRADE FOR THE UK
A GUIDE FOR BUSINESSES

THE FUTURE OF TRADE FOR THE UK

February 2017

CLIFFORD CHANCE LLP

Clifford Chance is one of the world's pre-eminent law firms with significant depth and range of resources across five continents. As a single, fully-integrated, global partnership, we strive to exceed the expectations of our clients, which include banks and other financial institutions, corporates from all the commercial and industrial sectors, governments, regulators, trade bodies and not-for-profit organisations. We provide them with the highest quality advice and legal insight, which combines the firm's global standards with in-depth local expertise.

CBI

With over 50 years of experience, the CBI is the UK's premier business organisation, providing a voice for firms at a regional, national and international level. We speak on behalf of 190,000 businesses of all sizes and sectors, which together employ nearly seven million people. With 13 offices around the UK, as well as representation in Brussels, Washington, Beijing and Delhi, the CBI provides members with the influence, insight and access they need to plan ahead with confidence and grow. We represent members' views as we work with policymakers to deliver a healthy environment for businesses to succeed, create jobs and ultimately, drive economic growth and prosperity.

ACKNOWLEDGEMENTS

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FOREWORD

The United Kingdom is, and always has been, a trading nation, and it will remain so once it has left the EU. As the Government considers how to recraft the UK's relationships with the EU and the rest of the world post-Brexit, trade with these 80 plus countries, where the current trading arrangements will be materially impacted, will be one of the key themes. There has been much debate over the legal basis of the UK's current global trade relationships, and how these might be affected by leaving the EU. Can the EU quickly lower tariffs against UK goods upon Brexit? Can the UK Government negotiate a better deal for the automotive industry? Does the UK have its own "schedules" under the WTO?

These discussions include a number of concepts unfamiliar to those who have traded solely with the EU: the complexities of rules of origin, legal analysis of our current trade deals, the relevance of the "MFN" principle and what that means for British trade.

Global free trade is increasingly controversial and was a key theme in the 2016 United States presidential election. Criticism of free trade agreements has been echoed in the EU, with vocal opposition from within various countries to both CETA and TTIP. Political pressures may therefore make it more difficult to achieve greater levels of global trade liberalisation.

At Clifford Chance we are speaking to our clients about these complex issues and advising them on how to prepare for the changes in the UK's trade relationships, including evaluating the benefits of existing EU free trade agreements for their specific business, advising on the impact of different regulatory standards across jurisdictions, and scenario-planning for some of the different possible outcomes for an EU-UK future agreement.

Clifford Chance and the CBI have worked together to produce a report which will act as a detailed primer for businesses faced with the prospect of a new global landscape of trade between the UK and the rest of the world. This report seeks to combine legal and practical analysis of the trade issues that are likely to have an impact on British business and UK trade.

Malcolm Sweeting
Global Senior Partner,
Clifford Chance LLP

FOREWORD

2016 was a year of unprecedented change for politics, society and for business. The decisions made in response in 2017 will shape the prospects for people and communities across the UK for generations to come.

To be a success, the UK's new relationship with the EU must meet the needs of our whole economy – covering business in every sector, size and location – as the consequences of leaving any part behind could have knock-on effects for others. The CBI has been clear that, as it prepares for negotiations with the EU to begin, business will help government to consider the complexity of the modern, interdependent economy.

We know that business has an incredible ability to adapt and be resilient. To help UK companies to position themselves for the post-Brexit business environment and identify future opportunities, the CBI is committed to sharing the information, data and facts needed for informed decisions.

This is why, as a first step on that journey, we have partnered with Clifford Chance on this practical guide which explains some of the complex concepts in the debate and the effect different potential outcomes could have on trade.

This publication gives a factual overview of the legal situation as it is currently understood, and is intended to inform, educate and support discussion and analysis of the potential scenarios which may lie ahead. Of course, much of what's to come in the Brexit negotiations will be determined by politics as this negotiation is unprecedented in many ways. Many more opportunities, challenges and changes will be evident in the months ahead and may change the assumptions we can make today. However, we hope that this report will be a useful aid as businesses begin planning for future scenarios.

Over the coming weeks, months and years, the CBI will continue to help our members access data on changes to the business environment, provide intelligence on political developments, and work closely with allies at home and abroad to secure the best possible outcome.

We are committed to making 2017 a year of progress and success and to working with Government and industry to shape a more prosperous, fairer economy.

Josh Hardie
Deputy Director-General, Policy & Campaigns
CBI

EXECUTIVE SUMMARY

International trade is of critical importance to the UK economy; approximately half of UK exports and imports are to and from the EU. Trade is an area of EU exclusive competence, meaning that the UK's current trading relationships both inside and outside of the EU are largely managed through its membership of the EU. The outlook for the UK's negotiation of new trading relationships upon exit from the EU will largely depend upon the future model of UK-EU trade arrangements, thus it is important for businesses to start preparing for these changes.

This report will address the key issues that UK and EU policy makers and businesses will have to consider when shaping the UK's future trading relationships with the EU and the rest of the world. The key concepts that underpin the discussions on trade are complex. Understanding the trade law environment should inform the planning that businesses will need to undertake, assist in making decisions, and feed into dialogue and partnership between businesses, the CBI and other trade associations and Government. It is essential that the new international legal arrangements between the UK and the EU, and the UK and the rest of the world, both properly reflect the commercial interests of those with a stake in the UK economy, and unlock prosperity in societies across the UK. To achieve this, business and government must communicate effectively, and work together to ensure the UK's future trading arrangements promote business, jobs and growth.

A disorderly exit from the EU where no withdrawal agreement was concluded under Article 50 during the two year negotiation period would result in UK-EU trade being regulated by WTO rules, with no implementation phase, with no temporary interim arrangement, without any agreement on a comprehensive framework for future UK-EU trade, or any agreement disentangling the UK from the EU.

Trading solely under WTO rules would give rise to a high risk that businesses in the EU and the UK and many international companies doing business with both would be subject to significant commercial and economic disruption, with immediate increased costs and administrative burdens, and would result in the erection of barriers to entry for those that trade in goods or services. It is therefore critical that the EU and the UK reach an agreement on the new relationship as soon as possible. If this is not achievable, the UK and EU must seek to agree temporary interim arrangements to cover the period from the expiry of the Article 50 negotiation period to the agreement of any new arrangement.

The process of establishing new trade relationships will consist of five basic elements, each of which should be viewed in relation to the other:

The Building Blocks of the UK's future trading relationships

The Withdrawal Agreement and Article 50

The legal basis for leaving the EU is set out in Article 50 of the Treaty of the European Union: the UK must notify the European Council that it intends to withdraw from the EU. This notification triggers a two year period in which the EU and the UK must negotiate and agree the steps governing the UK's exit from the EU. At the end of that two year period, if the UK and the EU have not reached agreement, the UK will leave the EU automatically, unless it can unanimously agree an extension of the negotiating period with the EU-27 (the rest of the EU Member States after the UK leaves). It may be possible to revoke Article 50; however, any definitive answer to this question is only likely to come if the issue is referred to the CJEU. The withdrawal agreement is highly unlikely on its own to enable businesses to continue trading on the same or similar terms as they do at present. If no implementation phase has been agreed, businesses will need to prepare for sudden and significant changes to trading, customs and a range of other areas.

The future relationship with the EU

As the Government has said that it will not seek an off-the-peg model for the future UK-EU relationship, it is likely that the UK will seek to negotiate a bespoke free trade agreement (FTA). An FTA could cover whatever the UK and the EU could agree. This model would give the UK the most flexibility, but is unlikely to replicate being part of the single market or the EU Customs Union.

Another option that is often discussed is whether to trade with the EU as part of a customs union. This would have a number of benefits, in that tariffs would not be charged on goods, non-tariff barriers to UK-EU imports and exports would be minimised and, in particular, British business would remain exempt from complex EU

rules of origin. However, customs unions are restricted to goods, so do not cover liberalisation of trade in services (which makes up around 80% of the UK economy). Membership of a customs union would also strongly limit the UK's ability to negotiate its own trade deals with other states, even though the EU's FTAs would not be negotiated for the benefit of the UK. In light of the government's stated intention not to be in a customs union with the EU post-Brexit, a future UK-EU deal on customs will likely consist of either a customs and trade facilitation chapter within the UK-EU FTA, or a standalone agreement, which will aim to speed up the process of getting goods over the border. It is therefore important that businesses know what the different models are and understand what they will mean for their specific industries and businesses.

Free trade agreements (FTAs)

Negotiating an FTA with the EU may not be a simple process, and a number of areas may be particularly contentious. Trading with the EU under an FTA would mean that UK businesses would most likely have to comply with complex trade requirements, such as rules of origin. These require manufacturers to certify where products they are exporting come from, in order to allow the authorities of the importing state to levy the correct tariffs. Rules of origin are of particular relevance to industries with international supply chains, such as the automotive industry, and can cost the equivalent of a significant additional "tariff" on goods.

The World Trade Organisation

The WTO forms the basis for international trade and UK-EU trade under WTO rules has been described in discussions about Brexit as the "fall-back option" for the UK. However, trading with the EU solely under WTO rules would have real disadvantages for UK businesses, not just in terms of the tariffs that would be applicable, but also in respect of other barriers to trade in goods and services that would likely be raised. The UK is an independent and full member of the WTO, so would remain a member post-Brexit. Current UK commitments to WTO members are found in joint EU schedules, which contain commitments from all 28 EU Member States. However, as part of the Brexit process, the UK would have to establish its own "schedules of commitments" on goods and services, which would be the foundation for future trade between the UK and the rest of the world.

A Temporary Interim Arrangement

Two years is not a long time in the world of trade negotiations – for example, negotiations for an EU-Canada trade deal, which currently is being ratified by the EU, were launched nearly eight years ago, in 2009. Therefore, it is possible that there could be no full agreement on a new UK-EU trade agreement before the end of the Article 50 timeframe. In order to avoid the risk of economic damage and uncertainty that could be caused by the 'cliff-edge' of a sudden end of the UK and EU's current trading arrangements, it would be necessary for the UK and the EU to provide for a smooth movement from the point of the UK's withdrawal from the EU, to the coming into force of any new arrangement.

Frequently asked questions

Can the UK "stay in" the EU customs union?
No – the EU Customs Union is governed by the EU treaties; leaving the EU means that the EU treaties would no longer apply to the UK. However, the UK could enter into a customs union with the EU, but this would not be the same as staying in the EU Customs Union. For example, Turkey is in a customs union with the EU; it is not in the EU Customs Union.

Can the UK be in a customs union with the EU without being subject to the CJEU?
No – the CJEU would still have an important role to play in relation to interpreting provisions regarding customs unions, such as the classification of goods for tariff purposes and the terms of regulations.

How long does the UK have to negotiate under the Article 50 procedure?
In reality, less than two years, although the negotiating period can be extended by unanimous agreement in the EU Council. Although Article 50 is a two-year procedure, within this time, the EU has to produce guidelines for the negotiation and a mandate for the European Commission to negotiate. Agreement must be reached several months before the end of the deadline to allow time for the agreement to be ratified by the European Council, after obtaining the consent of the European Parliament.

Can the UK formally negotiate a free trade agreement with the EU during Article 50?
There are practical and legal obstacles to this. First, timing. FTAs take a number of years to negotiate and longer to come into force; two years would be unlikely to be long enough. Secondly, the EU treaties state that the EU can only negotiate trade agreements with non-EU countries; legally, the UK can only formally negotiate with the EU once it is no longer a member. Additionally, whilst still a member of the EU, it would be contrary to treaty obligations for the UK to launch any formal trade negotiations with third countries. Although work is being done in the UK and the EU to see whether withdrawal negotiation and trade negotiation can proceed in parallel.

What happens to the UK's existing trade deals?
The UK will have to negotiate with the other states with which it currently has a trade deal (by virtue of being in the EU) in order to ensure continued access to these arrangements. Legally, the wording of the agreements means that they will not automatically continue to apply. However, British business has been clear that preferential access to third country markets will be of critical importance post-Brexit.

Why can't the EU and the UK just agree to reduce tariffs on cars to zero?
The WTO most-favoured-nation (MFN) principle requires WTO members to treat all others equally with some exceptions. This will prevent the EU from reducing tariffs on imports from the UK from discrete sectors, unless they also do so for all other WTO members and therefore prevents the EU from offering the UK more favourable treatment than it does for other members. There is an exception for FTAs and customs unions; however, these must be comprehensive agreements that cover substantially all trade in goods. Therefore, sectoral deals (whether they take the form of an FTA or customs union) are illegal under WTO law.

What happens if the UK can't have its schedules agreed by the WTO before it leaves the EU?
As the UK is a full and independent WTO member, it would still be able to trade. Although getting autonomous UK schedules approved by the rest of the WTO may be lengthy and complicated, the UK could just choose to apply the EU's schedules. This would come with some element of litigation risk, so would be unlikely as a long term option.

PRACTICAL CONSIDERATIONS FOR BUSINESSES

Trade partnerships

Map your global footprint →

- To what extent do you **trade with the EU**?
- Which countries do you trade with the most?
- With which third countries should the UK prioritise trade deals?

See Chapter 5 and Schedule 2 for further detail

Regulation & Supervision

Share economic and industry knowledge with the Government →

- What **regulatory standards** and **supervisory arrangements** do you currently have to adhere to?
- To what extent does your business depend on harmonised regulatory standards with, or supervision in, the EU?
- What should be included from an industry perspective, in a future EU-UK FTA?

See Chapter 5 for further detail

Rules of Origin

Obtain proof of origin certificates →

- Do you manufacture in the UK using products sourced internationally?
- Are your sales international? Have you considered how rules of origin may affect these?
- Have you calculated the extra costs involved in complying with **rules of origin**?

See Chapter 5 for further detail

Certification & customs procedures

Obtain certificates of compliance with standards →

- What regulatory standards do you currently have to adhere to?
- Will you need to obtain **certificates of compliance** (evidence that a product meets the requirements of the applicable EU directives)?
- If you export your goods, have you considered the impact of complying with different regulatory standards?

See Chapter 5 for further detail

Supply Chains

Conduct thorough analysis of supply chains →

- Have you assessed your **supply chains** to identify the most important markets?
- Do you supply components for products that are then sold internationally?
- Do you export products to countries with which the EU has an FTA?

See Chapter 5 for further detail

Tariffs

Assess the impact of tariffs →

- What impact would the **imposition of tariffs** have on your business?
- How would this affect future growth and investment?

See Chapter 6 for further detail

Non-tariff barriers

Assess the impact of non-tariff barriers →

- What impact would the imposition or presence of **non-tariff barriers** have on your business?
- How would this affect future growth and investment?

See Chapter 6 for further detail

Services

Assess potential restrictions to trade in services →

- To what extent does your business rely on the provision of services in the EU?
- If the **provision of services** in the EU were hampered, what would be the impact on your business?

See Chapter 6 for further detail

Other

Assess
- Procurement
- Treaties
- Finances

→

- Do you tender for **government procurement** contracts?
- Do you rely on the rules set out in international treaties to which the EU is a member?
- Have you considered how leaving the EU will affect your financing arrangements?

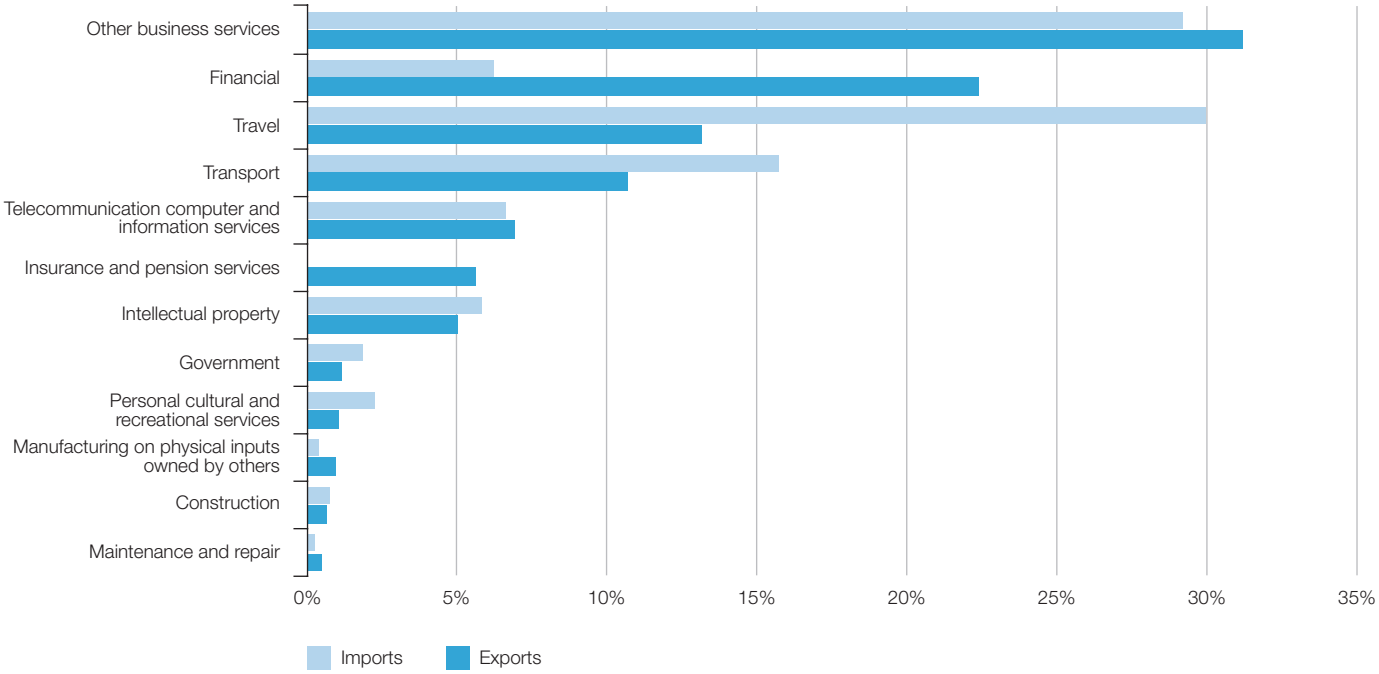
1

CHAPTER 1
INTRODUCTION – WHY TRADE MATTERS

International trade is central to the UK economy, accounting for nearly 60% of GDP.[1] Around half of UK exports and imports are to and from the EU. In 2015, the UK exported approximately £222 billion of goods and services to the EU, and the EU exported approximately £291 billion to the UK. Around 85% of the UK's trade is with EU members or countries which benefit from preferential trade arrangements with the EU.[2]

The services sector is fundamental to UK trade, especially as the UK's total trade in goods has been declining in recent years. The UK currently runs a deficit in trade in goods; which is partly offset by a surplus in trade in services. In 2015, the goods deficit widened to 6.9% of GDP from 6.7% in 2014, while the surplus in services remained broadly unchanged at 4.7% of GDP over the same period. This is consistent with the rising share of UK trade in services as a proportion of total trade, accounting for 44% of total trade in 2015. The UK's strength in services remains driven by financial services; which accounted for 22.5% of UK services exports in 2015.[3]

UK Trade in services, imports and exports



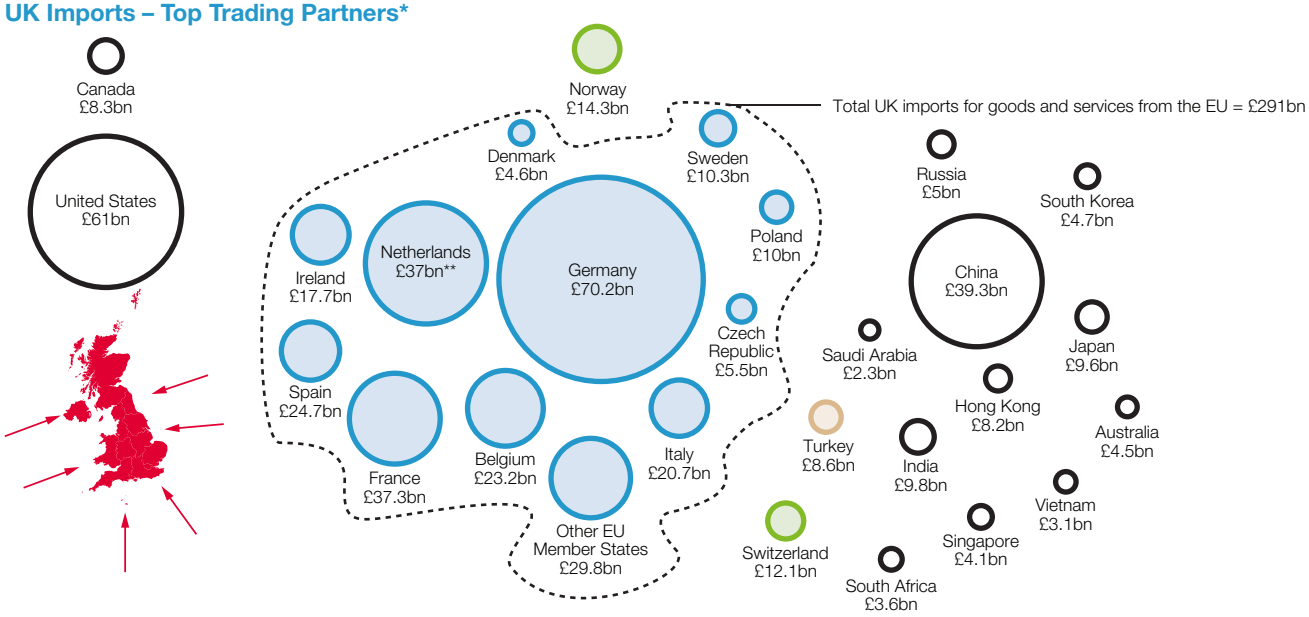
1 The World Bank (2016). *Data – Trade % of GDP data*. Available at: http://data.worldbank.org/indicator/NE.TRD.GNFS.ZS?locations=GB

2 Office for National Statistics (2016). *UK Perspectives 2016: Trade with the EU and beyond*. Available at: http://visual.ons.gov.uk/uk-perspectives-2016-trade-with-the-eu-and-beyond/

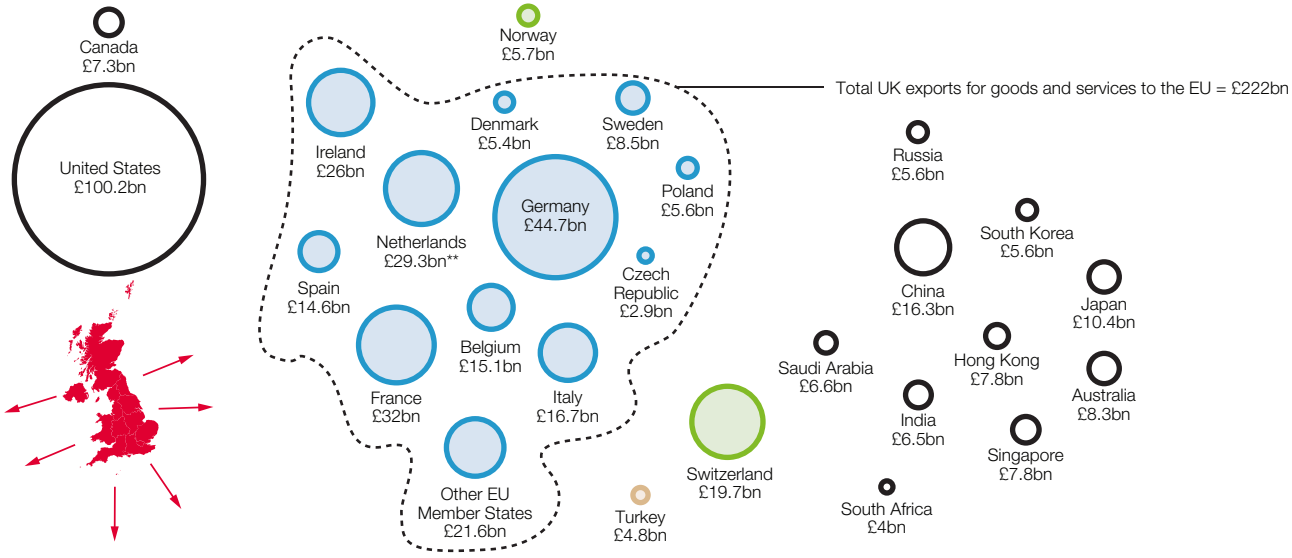
3 Office for National Statistics (2016). *UK Balance of Payments, The Pink Book: 2016*. Available at: https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/unitedkingdombalanceofpaymentsthepinkbook/2016#trade

There are several existing models governing trading relationships of varying depth between the EU and non-EU states. Post-Brexit, the EU and the UK are likely to develop a bespoke relationship, which may be based on a Free Trade Agreement (FTA). To recreate something akin to the UK's current global network of beneficial trade arrangements, the UK would need to negotiate free trade agreements with its other key trading partners as well as the EU.

UK Imports – Top Trading Partners*



UK Exports – Top Trading Partners*



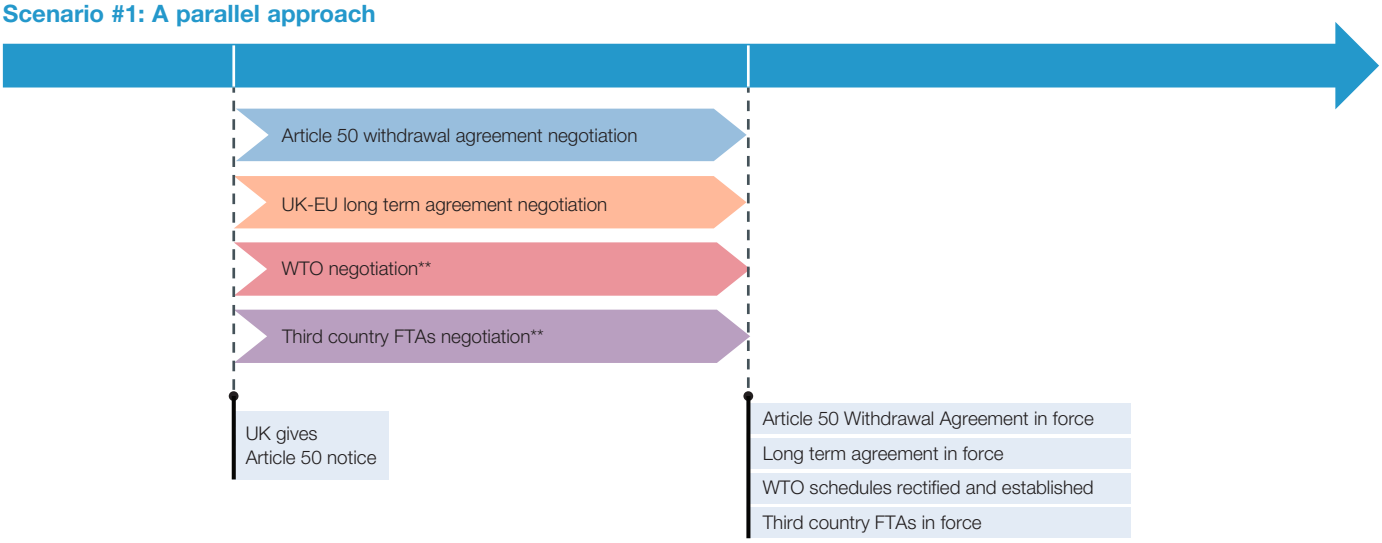
European Union
Customs Union
EFTA states

* Source: UK Balance of Payments, The Pink Book: 2016 – ONS December 2016
** The Rotterdam effect: An ONS article estimated that 50 per cent of all goods exports (value for imports not available) to the Netherlands was re-exported to non-EU countries. It also estimated that the Rotterdam effect would account for around four percentage points of the UK's exports of goods. – ONS: *UK Perspectives 2016: Trade with the EU and beyond*.

2 CHAPTER 2
TIMING AND PROCESS

Four possible scenarios for how the different building blocks of the UK's future trading relationships could fall into place are illustrated by the following diagrams:

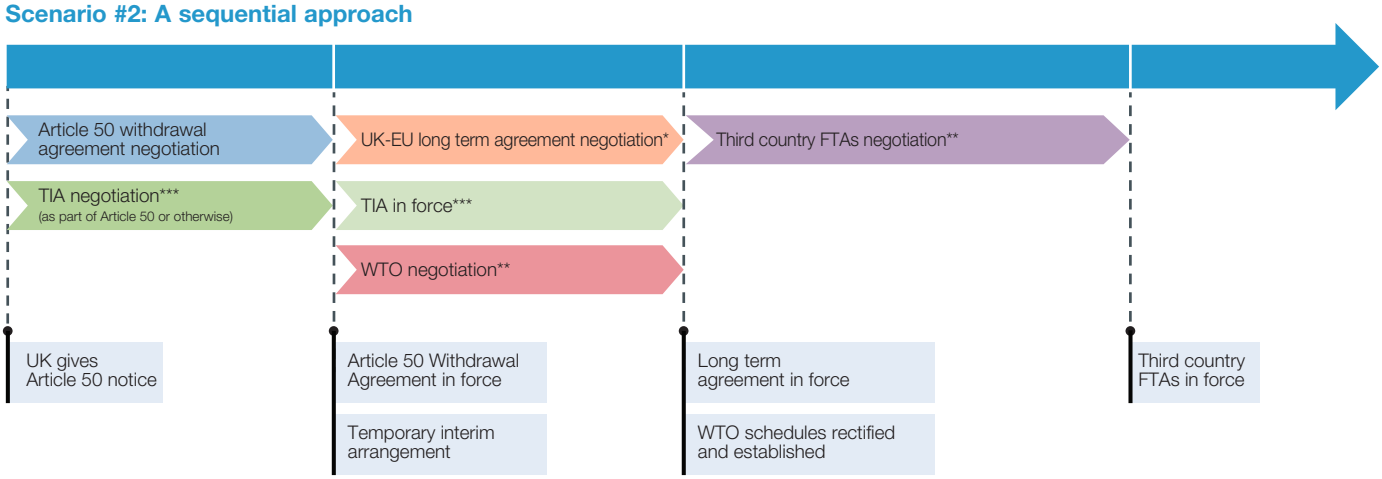
Scenario #1: A parallel approach



**Informal preparatory engagement may commence before the UK gives Article 50 notice.

This represents what the UK government has indicated is its preferred option in terms of timing, whereby the withdrawal agreement and the long term agreement are negotiated in parallel, and come into force at the same time. On the face of it, the EU treaties do not allow for this, as the EU can only negotiate trade agreements with third countries, which the UK would not yet be. It may be possible to achieve a roughly equivalent outcome if the UK and EU-27 are willing to engage in informal negotiations.

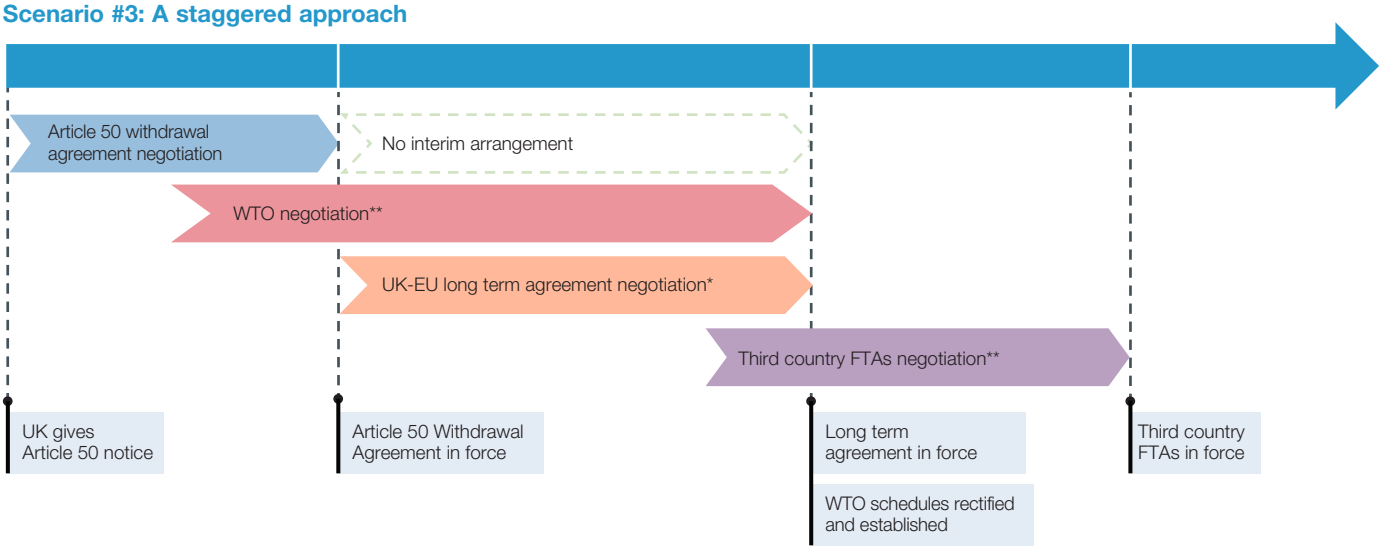
Scenario #2: A sequential approach



* Informal preparatory engagement may commence throughout the Article 50 negotiation process.
** Informal preparatory engagement may commence before the UK gives Article 50 notice.
*** Temporary Interim Arrangement negotiation/in force.

This scenario shows a sequential approach. However, it is important to note that even if temporary interim arrangements are agreed, there is still a risk that the UK would no longer have the benefit of third country FTAs since the temporary interim arrangement is unlikely to cover UK-third country relations.

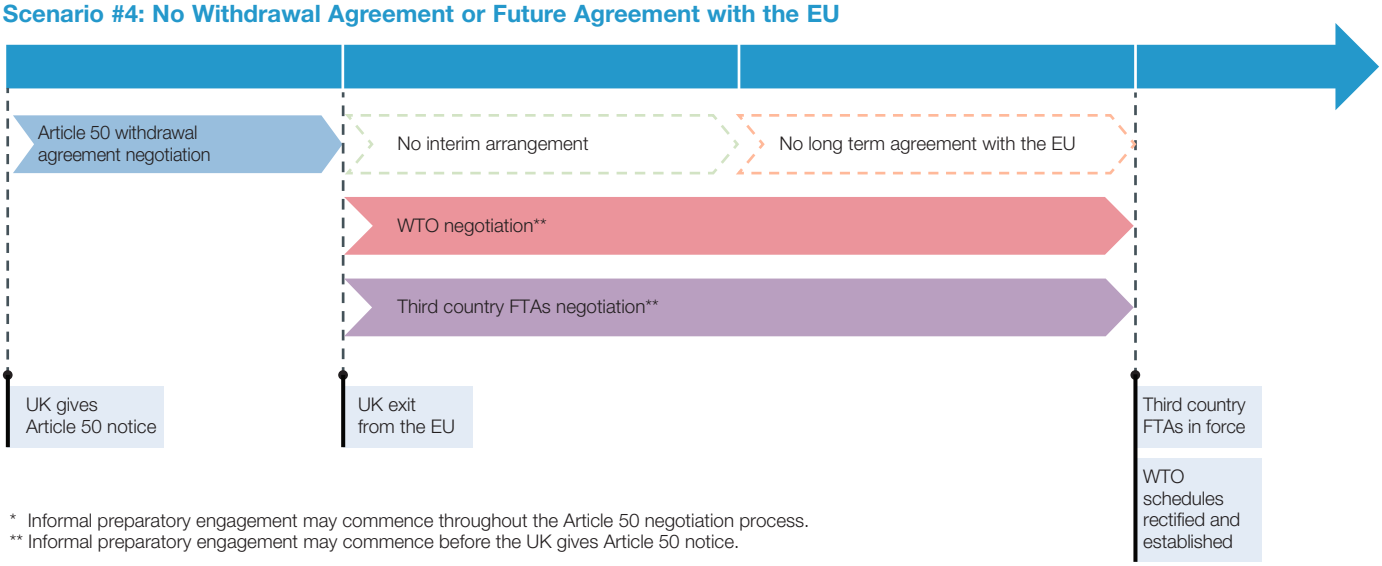
Scenario #3: A staggered approach



* Informal preparatory engagement may commence throughout the Article 50 negotiation process.
** Informal preparatory engagement may commence before the UK gives Article 50 notice.

The 'staggered approach' is one where there are no temporary interim arrangements agreed, and there is a 'cliff-edge' whereby the UK reverts to WTO rules whilst it negotiates the long term agreement with the EU.

Scenario #4: No Withdrawal Agreement or Future Agreement with the EU



* Informal preparatory engagement may commence throughout the Article 50 negotiation process.
** Informal preparatory engagement may commence before the UK gives Article 50 notice.

The fourth scenario would result from a breakdown of talks, where there is no withdrawal agreement, no temporary interim arrangement, and no long term agreement.

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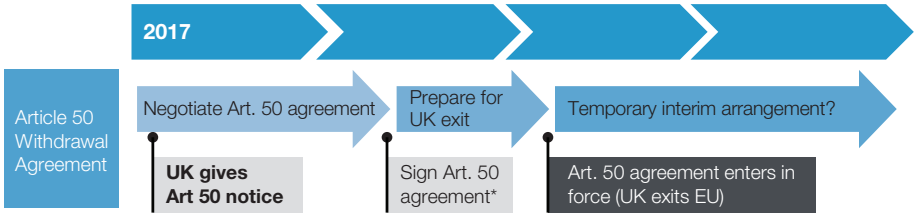
CHAPTER 3
THE UK'S WITHDRAWAL AGREEMENT WITH THE EU



What is Article 50?

- Legal basis for the process of the UK's withdrawal from the European Union – the UK must notify the European Council. The UK Government has said they will do so by no later than the end of March 2017.
- The withdrawal agreement will need to be approved by the European Council acting by a qualified majority (55% of Member States, representing at least 65% of the EU population) after obtaining the consent of the European Parliament.
- The UK has two years to agree a framework for withdrawal with the European Commission, unless the European Council (acting unanimously) and the UK agree to extend that period. Within that two years the European Council will produce guidelines for negotiations and the European Commission will receive a mandate to begin negotiations. This process might take up to six months. Negotiations will then begin and an agreement should be reached by autumn 2018 to allow time for it to be signed and ratified by the end of the two year process.

What is it likely to cover?

- On the face of the EU treaties, the withdrawal agreement must be separate to any agreement or agreements establishing the UK's long term relationship with the EU.
- The lack of clarity in the Article itself means that there is no definitive answer on what could properly be included in a withdrawal agreement.
- However, it is likely that the agreement will cover issues such as the disentangling of the UK from the EU budget and settling the status of citizens, including freedom of movement.
- The withdrawal agreement must take "into account the framework for the UK's future relationship with the Union".

What are the key risks?

- Two years is widely seen as a very limited time to complete negotiations, considering the complexity involved. Within this period of time, the EU must also agree its negotiating mandate, and make time to ratify the withdrawal agreement in the European Council and Parliament. The ratification process could take around four or five months, reducing the two year period to around 18 months.
- If no agreement is reached within the two year period, the EU treaties would cease to apply to the UK and the UK would revert to trading with the EU on the basis of the rules set out under the WTO.
- It may be possible to revoke Article 50; however, any definitive answer to this question is only likely to come if the issue is referred to the CJEU.

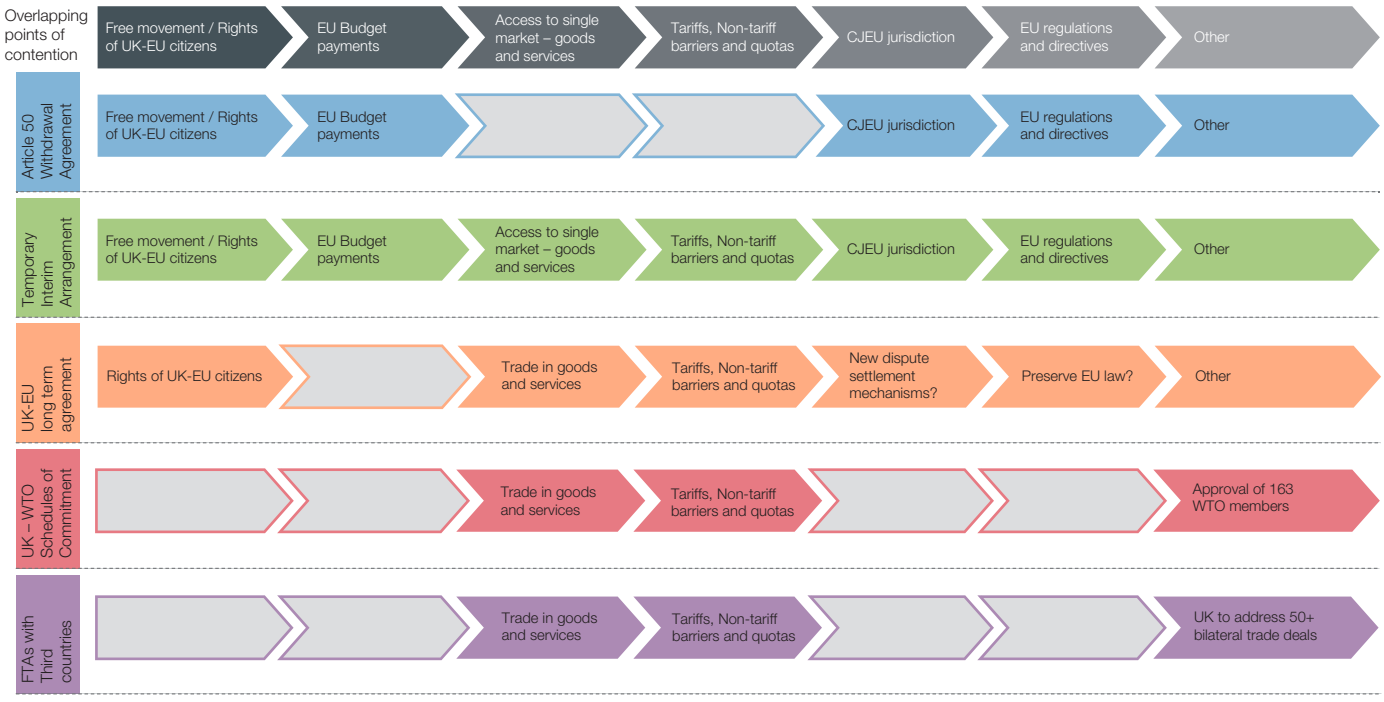
* Agreements subject to EU Parliament and Council approval and UK Parliamentary process under Constitutional Reform and Governance Act 2010.

UK exit will require at least five interlocking sets of negotiations/agreements

	Withdrawal Agreement	Temporary Interim Arrangement	EU-UK Long Term Agreement	UK's WTO Schedules of Commitments	New FTAs with third countries
Overview	Art. 50 TEU provides the legal mechanism for the UK's withdrawal from the EU.	A temporary interim arrangement may be included in the Withdrawal Agreement.	Negotiation may not formally start until the UK has left the EU.	UK to modify and negotiate its schedules of commitments.	EU rules prevent the UK from concluding trade deals with third countries until it has left the EU.
Content	Separate from the agreement setting out the framework for the UK's future relationship with the EU. The Art. 50 agreement will need to unravel the UK's rights and obligations with the EU, its institutions and processes, including budget contributions, single market access, and in all other joint areas of collaboration.	Must address the uncertainty businesses would face and provide temporary cover for the UK and EU-27 economies.	Options: - Norway (EEA/EFTA) - Switzerland (Bilateral sectoral agreements) - Turkey (Customs Union) - FTA+ (bespoke deal) - Canada (FTA) - WTO rules	The UK will remain a member of the WTO even before it has officially agreed its new schedules. The UK's proposed schedules will ultimately require the approval of other WTO members.	Upon exit, EU FTAs will no longer automatically apply to the UK. The UK will have to negotiate new trade deals with third countries.
Comments	2 year period to negotiate and agree. Extendable by unanimity. May include provisions of an implementation phase to allow businesses time to adjust to change	The EU and the UK will need to ensure arrangements do not breach WTO rules. A temporary interim arrangement is not referred to in the EU treaties and will need to be negotiated by agreement between the EU and the UK, which may take some time.	The timeframe for negotiation of a long term agreement may be lengthy and will vary according to the complexity and controversial nature of the provisions included. The EU-South Korea FTA took as long as 5 years from the preparatory talks to its provisional application. The UK government has said that the approach is to negotiate a bespoke deal (FTA+).	There are a number of methods the UK can take to modify its schedules. The UK is likely to try to agree elements of its schedules (e.g. quotas) with the EU during the Art. 50 process.	FTAs take years to negotiate. Before entering into negotiations, third countries are likely to want to see the EU-UK future agreement outcome.

* So far, the Commission has said: (i) Article 50 is the only exit provision for the UK, (ii) there will be no negotiation until the UK has served notice under Article 50, (iii) the negotiation of the withdrawal agreement and the long term agreement will be sequential, and (iv) the UK will not be able to "cherry pick."

Potential overlapping issues in the five sets of negotiations



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CHAPTER 4
THE UK'S LONG TERM AGREEMENT WITH THE EU

- The form of the future relationship will have a direct impact on the issues business will need to consider and be prepared for on the exit of the UK from the EU.
- There are a number of different precedents for this relationship, but the UK Government has been clear that it aims to secure a "bespoke" deal with the EU.
- This language suggests that the government may aim to negotiate a form of a free trade agreement with the EU. However, businesses need to be aware that this will almost certainly not replicate the current rights of access the UK has as part of the EU, and there are a number of additional issues (such as rules of origin) that will need to be considered.
- Whatever the form of the future EU-UK trading relationship, an implementation period may be required to phase in the changes agreed prior to the new arrangement coming fully into force.

There have been a number of discussions on what shape the future relationship between the UK and the EU will take. This chapter sets out briefly the various existing models for such a future relationship. The UK government has been clear that the future relationship will need to be bespoke, in order to fulfil the aims of both the UK and the EU. It is likely that the future arrangement may eventually take the form of a free trade agreement. See Chapter 5 for a detailed discussion on free trade agreements.

Article 207 of the TFEU grants the EU Commission and Council the power to negotiate and conclude trade agreements with "third countries or international organisations". On the face of it this article prevents the EU from putting in place a free trade agreement with the UK until after it has left the EU, as prior to this it is not a third country. However, this is a literal interpretation of the article, and whether or not informal negotiations take place before exit is likely to depend on whether there is a political will to do so.

Europe

European Union
28-nation single market of free trade and shared regulation; includes "free movement" of goods, services, capital and people

Euro Zone
19 countries using the euro currency

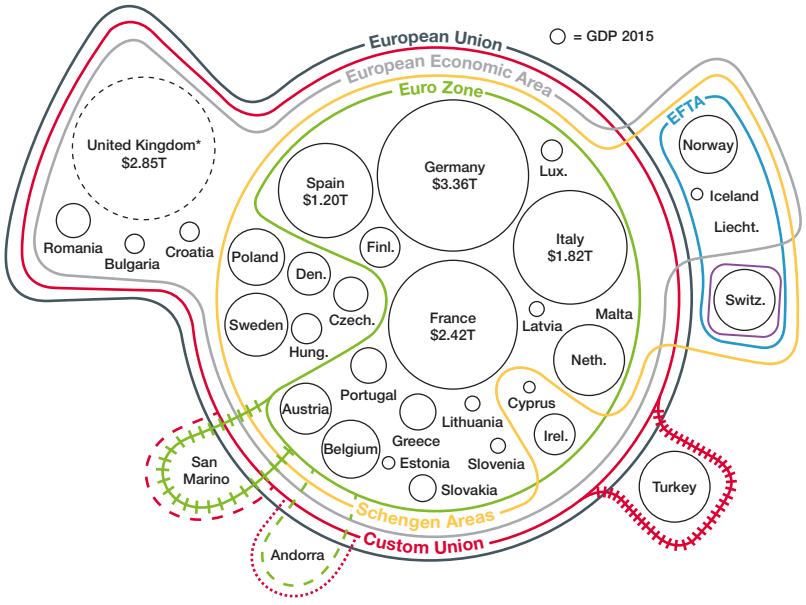
European Economic Area
Provides access to single market in exchange for payments. It encompasses other areas such as consumer protection, company law and social policy.

European Free Trade Association
Free-trade zone and network of agreements with other countries

EU Custom Union
Circulates goods without duties, has uniform system for handling imports

Schengen Areas
26-country passport-free travel zone

- Bilateral Agreements with Switzerland
- Customs Union agreement with Turkey
- Customs Union agreement with San Marino
- Customs Union agreement with Andorra
- Monetary Agreement with San Marino
- Monetary Agreements with Andorra



No GDP figures available for Liechtenstein, Malta, San Marino and Andorra. Channel Islands and the Isle of Man are part of the Custom Union (No GDP figures available). Sources: EU, ETRA, The World Bank.

* Based on a Bloomberg graphic – 4 October 2016.

Existing EU trade models	
Single Market (EEA + EFTA membership) (e.g. Norway)	• Almost complete access to the EU single market – in which goods, services, people and capital can move freely (it is possible to access the single market without being in the EU or in a customs union with the EU). • Aims to remove almost all non-tariff barriers (such as product standards); however, outside of the EU Customs Union certain non-tariff barriers will remain (such as rules of origin). • Can negotiate trade deals. • Required to implement the majority of EU legislation without any formal diplomatic or legal influence – EEA and EFTA members have recourse to the EFTA court (which must take into account CJEU case law). • Required to allow the free movement of persons. • Required to contribute financially to the EU.
The Swiss Model (bilateral agreements + EFTA)	• Bilateral agreements grant partial access to the EU single market; some areas (i.e. financial services) are excluded. • Agree FTAs with EFTA countries and other third countries. • Required to allow the free movement of persons and contribute financially to the EU.
Customs Union with the EU (e.g. Turkey)	• A form of trade agreement whereby countries agree not to impose tariffs on each other's goods and agree to impose common customs procedures, external tariffs and import quotas on goods from countries outside the customs union. • Access to the EU single market, but only for goods. • No need to comply with EU rules of origin. • Required to impose the EU common external tariff on imports, and so very limited autonomy to negotiate trade deals. • EU negotiates trade agreements without input from Turkey and, when deals are implemented, goods from the third country have free circulation into Turkey via the customs union (whilst Turkey has no reciprocal access to the third country's market). • Required to abide by EU state aid and competition rules, enforced by the CJEU.
Free Trade Agreement (e.g. EU-Canada)	• Allows the parties to trade freely with each other while still being able to set their own external tariffs on goods from the rest of the world. • Access to the EU single market will vary in extent depending on the specific terms negotiated. • More favourable terms than those set out under WTO rules but generally still limited liberalisation for trade in services. • May require the parties' standardisation bodies to cooperate closely. • Commitments on services can vary by Member State.
WTO	• Access to the EU Single Market limited to same treatment received by all third countries that do not have any preferential agreement with the EU. • UK exports to EU would be based on MFN tariffs as set out in the GATT schedules. • Barriers imposed on UK services subject to limitations set out in the EU's GATS schedule (these vary by Member State).

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Customs union

What is a customs union?

If the UK joined a customs union with the EU, goods traded between the UK and EU would be subject to minimal tariffs and fewer non-tariff barriers. However, the UK would have to negotiate a customs union deal with the EU (i.e. the UK could not "stay in" the EU Customs Union as its membership is provided for by the EU treaties, which would no longer apply to the UK; by leaving the EU, the UK would at the same moment leave the EU Customs Union).

Any new UK-EU customs union could take many different forms. The EU has a number of customs unions, including with Turkey, San Marino and Andorra. These trade agreements had to be negotiated like any other, meaning that entering into a customs union with the EU would not be a quick and easy process.

The Turkish model, for example, would give the UK tariff-free access to the EU single market for physical goods including for products (or parts) first imported into the UK from third countries. The UK would not be obliged to contribute to the EU budget, or participate in common policies such as the CAP[4], CFP[5] and regional funding. Additionally, the UK might not be obliged to implement EU social and employment law and would be able to regulate its own financial services sector.

British businesses would continue to be exempt from EU rules of origin on the import and export of goods between the EU and the UK. However, the UK would have to abide by EU regulations in relation to goods (i.e. product standards) whilst losing the right to participate in standards-setting in relation to the regulation of trade. To the extent that the UK does not align certain product legislation with the EU's legislation, customs checks would remain with respect to those particular products, so UK goods may still be subject to costly certification procedures. The UK would also remain bound by EU state aid and competition rules (without having a say in how those rules are developed).

The UK would have to continue to impose the EU's Common External Tariff on imports from outside the customs union and, as a result, would have minimal autonomy to negotiate FTAs with third countries.

In order for any trade deal (including a customs union) to be in compliance with the WTO agreement, it must satisfy certain conditions. As is analysed in more detail in the chapter below on the WTO, the WTO requires that all members treat each other equally in relation to trade, with a few exemptions. There is an exemption where there is a customs union (or free trade agreement) that covers "substantially all trade" in goods. Therefore, it is not possible for the UK to agree with the EU that some specific sectors or industries can remain within the customs union while the rest are outside; see the chapter below on the WTO for further analysis on the meaning of "substantially all trade". In summary, there is no definitive guidance as to what this means, but a WTO-compliant deal would have to cover "considerably more than merely some" trade in goods, and so a quick, isolated deal for the automotive sector, for example, would not be sufficient. Therefore, the decision on whether to join a customs union with the EU is seemingly binary.

4 The Common Agricultural Policy.

5 The Common Fisheries Policy.

As a customs union just covers goods, the UK would lose its current right to provide services, including financial services, in the EU, on equal terms with EU Member States (unless a separate agreement on services was negotiated). If the UK wished to gain preferential access to the EU in relation to services (including financial and professional services) and public procurement it would have to conclude additional agreements with the EU, either as part of the agreement establishing the customs union or in a separate agreement. These new agreements would take time to negotiate, and are unlikely to provide the same levels of access as currently enjoyed.

In the absence of an additional arrangement that covers services, the UK would have to rely on its rights under the WTO General Agreement on Trade in Services (GATS). It is important to note that this could also have a serious impact on manufactured goods as supply chains increasingly rely on both goods and services (for example, in relation to the financing and marketing of a product).

Trading with third countries outside the EU

Being in a customs union with the EU would mean continuing to abide by the EU's Common Commercial Policy, by imposing the Common External Tariff which consists of:

- common EU rules for imports;
- the EU procedure for administering quantitative quotas (apart from in relation to agricultural products);
- EU protective measures against dumped and subsidised imports;
- common rules for exports;
- common rules for export credits; and
- common rules on textile imports and exports.

For trade in goods, the UK would have to align to the EU's overall trade policy, resulting in loss of independence and influence in this area. For example, as a condition of its customs union with the EU, Turkey must aim to align its trade policy with the EU's. It is not included within the scope of EU FTAs and cannot negotiate any deals with third countries that do not already have a concluded deal with the EU. Therefore, when the EU negotiates FTAs with third countries, it invites its third country partners to negotiate a parallel FTA with Turkey – although it cannot force them to do so. In some cases, Turkey is able to secure a deal relatively quickly, but in others it does not. Turkish FTAs must follow the EU's trade policy with that third country as far as goods are concerned.

In summary, under a Turkey-style customs union, the UK could not negotiate trade deals entirely on its own terms, but would also not automatically benefit from the EU's trade deals. If a country had an FTA with the EU but not with the UK, that country would have access to the UK goods market on the terms the EU had negotiated to suit itself, not the UK. This would risk having an adverse impact on UK interests given that the EU's negotiating strategy for FTAs is generally to offer access to its market for goods in return for the third country offering access to its market for services. Thus; the UK manufacturing sector would be exposed to imports from the third country, but the UK services sector would have no export benefit without a separate and parallel UK-third country agreement. In this situation, the UK would have limited bargaining power as the EU's agreement would already allow the third country access (although indirect) to the UK's market.

Why is trade in services important to the UK?

A significant portion of the UK's exports are services. This includes not just financial services but transport, travel, scientific and technical services, and business services (such as law, accounting, architecture).

The UK's continued access to the EU's single market in services is particularly important in relation to financial services. For the UK to protect its economic interests, any long-term agreement with the EU will need to take this into account.

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It would therefore not be possible for the UK to have a fully independent trade policy if it entered into a customs union with the EU. The UK would also have to remain subject to the jurisdiction of the CJEU on the application and interpretation of the EU customs rules (such as the tariff classification of various products).

A bespoke customs agreement?

The UK Government has indicated that it will seek to enter into a "bold and ambitious" free trade agreement (see Chapter 5) with the EU (including some form of customs agreement) whilst retaining the ability to conclude trade deals with third countries independently and without being bound by the EU's Common External Tariff and Common Commercial Policy.

Free trade agreements and customs unions are WTO-compliant provided they eliminate duties and other restrictive regulations of commerce on "substantially all trade" in goods. Once an agreement meets that threshold, it is possible within the free trade agreement to liberalise some areas more extensively than others without breaching WTO MFN principles (see Chapter 6). This could allow for a free trade agreement to provide for substantially similar duties and other regulations of commerce to be applied to certain sectors by both the EU and the UK. However, there will be challenges, because the EU is likely to want mechanisms in place to ensure (i) that the UK is not being used as a back door for third countries to get their products into the EU at a lower level of duty than if they had been imported directly into the EU; and (ii) that the low duty/duty-free tariffs between the EU and UK under the FTA are only being claimed for UK origin goods. Equally, the UK will also need to consider the practicalities if there are no customs barriers in certain sectors between the UK and the EU, as goods in those sectors could have free circulation into the UK as a result of an FTA between the EU and a third country, without reciprocal access for the UK to that third country's markets.

Implementation Phase

Whatever form the UK and EU agree for the future trading relationship between them, a period of adjustment may be required to phase in the changes agreed prior to the new arrangement coming fully into force. An implementation phase would allow EU and UK regulators and EU and UK businesses to prepare for change, in the full knowledge of what that change is intended to be. The steps that businesses and government bodies may have to take within this period include: the production of guidance, staff training, renegotiation of long-term contracts and transaction agreements. There may also be a need to reconfigure supply chains and arrange mechanics for clearance/payment of duties, as well as ensuring the appropriate infrastructure (e.g. ports) and even government structures (e.g. Customs) are set in place.

The length that both businesses and government bodies may require for the implementation period will vary. It will also depend on the scale of the changes required: it is likely that substantial changes requiring changes to infrastructure will take years longer than less substantial changes. An implementation phase is a standard part of the process of most legislative change, and is a standard provision in every major international trading relationship.

The Irish Question: Border Complications

Leaving the EU Customs Union would raise complicated questions in relation to the border between the Republic of Ireland (which would remain in the Customs Union) and the UK (which would not). The UK and Republic of Ireland share a Common Travel Area. Both people and goods move freely between Northern Ireland and the Republic with few or no physical checks. Once the UK leaves the customs union, it is possible that physical customs checks would have to be established at the Irish border with Northern Ireland. There would also be a challenge presented by free movement of people. The UK Government has recognised that Northern Ireland's particular circumstances present a range of particular challenges to be taken into account post-Brexit.[6]

6 The United Kingdom's exit from and new partnership with the European Union, February 2017.

CHAPTER 5
FREE TRADE AGREEMENTS

- A UK-EU FTA would likely involve significant, complex and lengthy negotiations.
- Even a comprehensive UK-EU FTA would not replicate the current level of UK access to the EU single market and/or Customs Union.
- The UK will not be able to negotiate or conclude FTAs with other countries until after it has formally exited the EU.
- If the UK does not enter a customs union with the EU, businesses and government must be aware of the impact of complying with EU rules of origin, which will apply to all goods irrespective of the level of Single Market access, and need to ensure supply chains can withstand the cost and delay involved in complying with increased customs and regulatory administrative burdens.

The UK's future relationship with the EU could be based on a free trade agreement covering trade in both goods and services, as has been indicated by the UK Government and highlighted in the Green Paper, outlining the UK Government's Industry Strategy. This is also likely to be the framework for the UK's trade relationships with other countries, both those that the EU currently has trade agreements with, and additional countries that the UK may wish to negotiate with. As the majority of the principles and issues are the same, whether the UK is negotiating with the EU or with any other country, this chapter will discuss free trade agreements generally.

Although there have been some discussions of negotiating trade agreements with third parties in parallel with discussions with the EU, this is unlikely in practice to extend beyond informal discussions because (i) the UK may not negotiate formally while it is still a member of the EU, and (ii) other countries are likely to want to wait for the outcome of EU-UK negotiations before doing so (or at least until the nature of the long term agreement becomes clear).

What is an FTA?

An FTA is a preferential trade agreement between different countries that allows trade on terms more favourable than under WTO rules. The WTO only recognises FTAs which have substantial coverage across a broad range of goods, and which eliminate substantially all of the tariffs and other restrictive measures governing trade between the parties.

Modern FTAs are increasingly more complex than they have been in the past. Key areas in FTAs include market access (trade in goods, trade in services, government procurement), regulatory cooperation (to eliminate technical barriers to trade) and agreement on trade rules (including on customs and trade facilitation, investment, intellectual property, competition, sustainable development and dispute settlement).

FTAs deal with trade in goods and services separately. In relation to goods, FTAs aim to eliminate or substantially reduce tariffs.

Modern FTAs have also attempted to reduce non-tariff barriers in relation to trade in goods and services. The term "non-tariff barrier" covers an extremely wide range of restrictions on trade applying to any measure that increases the cost of trade, but that

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does not take the form of a tariff. For example, with regard to trade in goods, it would include import licensing, border costs of complying with customs procedures and the delays caused by such procedures and costs caused by regulatory or product standard differences across countries. With regard to trade in services, it would include market access restrictions, licensing and qualification requirements and technical standards.

FTAs aim to expedite customs procedures, facilitate mutual recognition of standards and testing and remove arbitrary ownership requirements for foreign investors. This is beneficial to businesses as it reduces red tape and the need for compliance with multiple identical tests on exports. While the exact approach in relation to regulations differs in different FTAs, they tend to involve agreements to cooperate on standards and regulatory issues, and may contain specific commitments in certain sectors such as consumer electronics and motor vehicles.

FTAs often provide that the parties should use the rules of an international standard-setting body as a basis for regulations and should ensure that their standard-setting bodies participate in the development of international standards, with a view to establishing common approaches. For example, the text of the EU-Canada FTA (CETA) requires the parties' standardisation bodies to cooperate closely, to consult each other when introducing new regulations and, to the extent possible, to ensure that their technical regulations are compatible. For industries such as aviation and financial services it is fundamental that an FTA contains appropriate provisions on regulation and certification.

Examples of non-tariff barriers		
Intellectual Property	Loss of membership of the EU Trade Mark Regime (TMR)	Under the TMR an "unregistered EU design right" arises automatically upon creation of a design within the EU and entitles the holder to protection across the EU. Post-Brexit, the UK may have to make filings and pay multiple registration fees across each Member State.
Pharmaceuticals	Market access restrictions	EU companies may not have access to UK trial data and vice versa.
	Separate approvals system	Obtaining separate national authorisations, potentially under divergent regulations, may result in an increase in administrative burdens and cost to pharmaceutical companies.
IT	Procedures and Administration	UK-EU regulatory divergence may result in a lack of implementation of international standards, where standards exists, which may create additional costs for service suppliers.

However, having better market access than would be guaranteed under basic WTO thresholds would not result in the same rights as being a member of the EU single market. Liberalisation of trade in services in EU FTAs follows the approach adopted in the WTO, meaning that market access is only granted by a list of restrictions on the parties' ability to discriminate in favour of their own services and service suppliers.

For example, CETA prevents parties imposing limitations on the number of service suppliers, the total value of service transactions or assets and the total number of service operations or the total quantity of service output. In addition, FTAs often contain provisions specifically exempting certain services from the scope of the agreement. These tend to include audio-visual services, freight shipping and air freight.

Negotiation points

There are likely to be some challenging issues. For example, recent FTAs, including the EU-South Korea FTA, have included "MFN" clauses ("most favoured nation" provisions) – these are different from the MFN principle under WTO rules – see the chapter below on the WTO. This means that if the EU grants more favourable treatment in an FTA with the UK, it would have to extend the same benefits to South Korea. However, there are a number of exceptions to this, including if the EU-UK FTA were to go significantly further than that with Korea (e.g. creating an "internal market" or establishing an "approximation of legislation").

Other contentious issues often involve agricultural products, particularly for products which are important to the UK; such as beef and dairy (as has been the case generally in negotiations involving Asian countries, such as the EU-South Korea FTA).

An additional theme for negotiation will be the dispute resolution mechanisms, referred to as Investor-State Dispute Settlement (ISDS). These provide investors with the right to arbitrate directly against the host state in the event of specific breaches affecting a "qualifying investment" such as, for example, an expropriation of assets without compensation, or unfair and inequitable treatment.

The EU has recently been moving towards an institutional system: an International Investment Court that would replace all existing ISDS mechanisms in the EU's future trade and investment agreements. This structure has been included in the EU's recent FTAs (with Vietnam and Canada), and has been proposed to be included in the EU-US FTA.

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Key differences between an FTA and being in the EU			
Overall framework		**EU**	**FTA**
		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 comprehensive legal and regulatory 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 over time.
	Certification	No need for certification – if a product can be lawfully sold in France, it can be lawfully 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**	In principle, freedom of movement (and freedom of establishment) across the EU.	Varies, but generally only contain provisions facilitating the temporary movement of people for specific business purposes.
	Regulation (for example, financial services)	Varies, depending on the service. In relation to 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" has not occurred in FTAs to any meaningful extent.
Subsidies/state aid		Subsidies are required to be notified to the European Commission and cleared as compatible with the EU internal market. Strict criteria are applied to determine if a measure is compatible.	Depends on the specific terms of the FTA. 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		Disputes between Member States are heard by the CJEU; disputes by a company against another company or against a Member state are heard through domestic courts, with the potential for a reference to the CJEU on a point of EU law only.	Depends on the specific terms of the FTA. Generally; there are no individual remedies for companies (only state-to-state remedies) unless the complaint falls under the "investor protection" chapter, in which case companies may be permitted to bring a complaint through the ISDS mechanisms.

Negotiating an FTA with the EU

The negotiation of FTAs is a lengthy process. Currently, there are numerous stages at EU level, beginning with a public consultation and a scoping exercise between the EU Commission and the country concerned.

- The Commission has to request formal authorisation from the Council to open negotiations. Negotiations themselves can take years and there tend to be a number of behind the scenes discussions with the Member States.
- Once they reach "technical finalisation", the chief negotiators of each country initial the text of the proposed agreement. Finalised texts will then be 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.

- Next, the text can be published, and it is translated into all official languages of the EU. The translation and legal verification of translated texts normally takes from 18 months to two years.
- The Council can then decide on the conclusion of the agreement and give authorisation to sign the agreement. Where the agreement covers topics that are the responsibility of the Member States (and not shared at EU level), all Member States need to sign as well.
- The Council then transmits the agreement to the European Parliament for consent and it can become provisionally effective. Where the agreement is a "mixed agreement", individual Member States also have to ratify certain parts of the agreement alongside the EU according to their national ratification procedures.
- After consent of the Parliament and ratification of any outstanding provisions by Member States, the Council adopts the final Decision to conclude the agreement and the agreement is published in the Official Journal and enters fully into force.

Any negotiations towards a UK-EU FTA would be further complicated by the 2017 elections in the Netherlands, France and Germany. Not only will the election processes distract France and Germany from the discussions between the EU and the UK, it will also mean that certain issues may become politicised (given there is perceived growing opposition within many western countries to comprehensive free trade arrangements).

Mixed Agreements

EU FTAs tend to be "mixed agreements", which must be entered into not just by the EU but also by each individual Member State according to its domestic processes. This is because, firstly, EU FTAs tend to be comprehensive arrangements which cover more than EU competences, and secondly, there is increasing political demand for Member States to be involved in trade deals. For example, recent FTAs negotiated by the EU include investment chapters that apply to both foreign direct investment and portfolio investment. While Article 207 TFEU makes foreign direct investment part of the Common Commercial Policy and hence an exclusive EU competence, it does not mention other forms of investment such as portfolio investment.

The requirement for the trade agreement to be signed and ratified by all Member States, rather than just the EU, can be a significant stumbling block in the finalising of mixed agreements, especially as in some states (e.g. the Netherlands) domestic ratification can be complicated and involve multiple assemblies or similar. However, as the decision to sign and conclude trade agreements is taken by the Council, Member States are always required to vote, even where the agreement is not a mixed agreement. Unanimity is not usually required in the Council, although it should be noted that in the case of CETA, unanimity was sought for the Council vote and so the Belgian region of Wallonia was able to delay the signing of the agreement by voting against it.

It has not always been clear whether a specific issue actually is an EU competence or not, and the European Commission has requested that the CJEU issue an Opinion as to whether the EU-Singapore FTA covers areas outside of EU competence, meaning that it

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would have to be signed as a mixed agreement. The Advocate General of the CJEU recently issued an Opinion in which she found that it was in fact a mixed agreement and can only be concluded by the EU and the Member States acting jointly. She concluded that although the EU enjoys exclusive external competence as regards to most matters, it shares external competence with the Member States in relation to matters such as trade in air transport services, investment other than foreign direct investment, non-commercial IP rights, and labour and environmental standards. While the Advocate General noted that difficulties may arise from the requirement for all the Member States to ratify the treaty, she considered that this would not affect the question of who has competence to conclude the agreement. However, the Advocate General's Opinion is not binding on the CJEU and indeed, the CJEU does not always follow such Opinions. No definitive conclusions can therefore be drawn until the final judgement is given in 2017. This Opinion suggests any ambitious UK-EU FTA would require ratification at EU and Member State level, which could cause delays.

Timing

There are two key timing issues for the negotiation of an EU-UK FTA. Firstly, when can negotiations start? And secondly, how long will they take?

When can negotiations start?

As a member of the EU, the UK cannot conclude FTAs, as this is part of the EU's competence. The EU can also only enter into FTAs with third countries, i.e. not countries which are EU Member States.

As a result, it is arguable that it would be a breach of EU law for both the UK and the EU to begin formally negotiating a UK-EU FTA until *after* the UK has left the EU. Indeed, it is possible that the EU may take this position, and will not formally begin negotiating an agreement governing the future relationship until after the expiry of the Article 50 procedure (which could potentially be extended beyond two years).

How long will it take?

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. The agreement was signed in October 2009 and provisionally applied from July 2011, although the ratification process was not completed until 13 December 2015.

Currently, in the UK, treaties are ratified by being laid before Parliament for 21 "sitting days" (days on which both the House of Lords and the House of Commons sit). Both Houses have the opportunity to pass a resolution that the treaty should not be ratified. If either does so, the Government must give a statement setting out the

Key concerns

Will the EU-UK FTA have to be concluded as a mixed agreement? What does this mean? Can individual EU states block a trade deal with the UK?

reasons why it wishes to proceed with ratification, which will trigger a further 21-day sitting period. If there are two consecutive negative resolutions by the House of Commons, the treaty will not be ratified. This may also be complicated if the agreement is to be ratified by a different government than that which negotiated the FTA with the EU.

Negotiating a free trade agreement with third countries

Countries with which the EU currently has a free trade agreement

The UK is likely to have to negotiate with third parties to ensure that it can continue to benefit from the trade deals it currently has as a member of the EU. There are a number of ways to do this and indeed, Canada's Finance Minister has said that he expects to work with the UK to ensure that it will continue to be part of the CETA.[7] Legally, it is unlikely that existing EU FTAs will automatically continue to apply to the UK after it leaves the EU, even where the UK has also signed them as a mixed agreement. This is due to the contractual provisions in the agreements, particularly the provisions on "parties" and "territorial application".

(i) In the EU-South Korea FTA, the definition of the parties lists the individual Member States and describes them as "Contracting Parties to the Treaty on European Union and the Treaty on the Functioning of the European Union". Once the UK leaves the EU, it will no longer be a contracting party to the EU Treaties and so the definition of parties to the EU-Korea FTA would cease to apply to it.

(ii) In both the EU-South Korea FTA and the EU-Singapore FTA, the provision on territorial application (in Article 15.15 of the EU-Korea FTA) states that the FTA shall apply on the one hand, "to the territories in which the Treaty on European Union and the Treaty on the Functioning of the European Union are applied and under the conditions laid down in those Treaties", and on the other hand, to the territory of the other contracting party, i.e. South Korea or Singapore. The provision goes on to say that "as regards those provisions concerning the tariff treatment of goods, this Agreement shall also apply to ... the EU customs territory". Once the UK leaves the EU, the UK will no longer be a territory in which the EU treaties apply, nor part of the "EU customs territory", and therefore the FTA will legally cease to apply.

It may, however, be possible to agree an amendment to the FTAs, for example, to agree that the provision on territorial application should also include a sentence that the Agreement shall apply to the EU customs territory "and the United Kingdom". However, this would require agreement not only from the third country, but also from the EU-27. It may also require a certain relationship between the UK and EU to be able to continue.

Key concerns

Can the UK keep the trade relationships it currently has with third parties as part of the EU? How can it do so?

7 *Canada expects Britain to be part of the EU trade deal: finance minister,* Reuters Canada (16 November 2016).

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Alternatively, it may be possible for the UK and the third country to agree that the terms of the EU FTA will continue as between the UK and the third country. This means that the UK would not have to negotiate with the EU-27, and so it is likely that an agreement of this sort could be achieved more quickly. However, this would not be simple as there are a number of provisions that could not be easily transcribed, for example in relation to quotas, technical standards, and joint committees set up by the FTA. Negotiations on these points may lead to attempts to renegotiate the agreement more generally, particularly if the economics of separate agreements with the EU and the UK are less attractive for the third country.

Ultimately, whether the UK can continue trading with its current trade partners on the same terms will have to be negotiated, and the eventual outcome will depend upon what can be agreed.

Other countries the UK may wish to negotiate with

If the UK is not in a customs union with the EU, it will be free to negotiate its own trade deals with third countries. This could allow the UK to prioritise trade with countries where the EU has not been able to strike a deal, and could allow the UK to set its own priorities in these deals. This may mean that the UK is able to negotiate trade deals with third countries faster than the EU can, and perhaps with more focus on the specifics that are important to the UK economy, due to the requirement to take into consideration the sometimes competing demands of the EU bloc. However, self-evidently, the size of the relative market the UK can offer could be much smaller, depending on the specific industry.

Informal discussions are already underway with a number of third countries. Notwithstanding this, there are a number of issues which will hold up formal negotiations. First, numerous countries (such as Australia) have said they will prioritise negotiating their own free trade agreements with the EU before turning to the UK. Secondly, EU rules prevent the UK from formally concluding a trade agreement with third countries until after it has left; otherwise, it may be subject to infringement proceedings and eventually a heavy fine. Thirdly, some countries (such as Canada) 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 impact on the nature of the FTA with the UK. It is also important to note that there are only so many trade deals a country can negotiate at any one time, even assuming an unlimited staff of trade negotiators, because what is negotiated under one trade deal must be coherent with others; to a certain extent they are inter-linked.

What about Asia?

The UK, if it is not in a customs union with the EU is likely to consider negotiating FTAs with Asian countries as it expands its trade outside of the EU. Asia is making considerable headway in reducing trade barriers on goods. ASEAN is now the third largest free trade bloc in the world, behind the EU and North America (NAFTA) and has concluded FTAs with China and India, which gives it free trade advantages that will take the EU years to achieve. Three ASEAN states (Singapore, Malaysia and Vietnam) have also signed the TPP, which, if ratified, will lead the world in FTA practice. The 12 nations that have signed the TPP are responsible for nearly 40% of global GDP,* although its status is now uncertain after President Trump signed an executive order to withdraw from the TPP. Theoretically, the UK could join TPP, but this would mean signing up to an already negotiated agreement that was not designed with British interests in mind. A space also to watch is the negotiation of the mega-regional FTA, the Regional Comprehensive Economic Partnership (RCEP). The RCEP is currently being negotiated among all ASEAN countries, as well as China, Japan, South Korea, India, Australia and New Zealand. If concluded, it will create a free trade bloc that will include more than four billion people.

* Office of the United States Trade Representative, https://ustr.gov/tpp/overview-of-the-TPP

Practical implications of trading under a Free Trade Agreement

Rules of Origin

The EU Customs Union applies a common external tariff to all goods imported from outside the EU. This means that when a good (e.g. a toy) is exported to the EU from a non-EU country (e.g. Japan), a tariff is levied on that good once. Once the toy has borne the EU tariff, it can move around the EU and its customs unions tariff-free, in the same way as if it originated within the EU. However, unless the UK is in a customs union with the EU, the Japanese toy, if first exported to the UK, could not then enter the EU tariff-free.

Companies from countries that are not members of a customs union with the EU have to comply with EU rules of origin (the rules to determine the "economic nationality" of a product) when exporting to the EU. These rules ensure that the correct tariffs are levied against goods (taking into account any preferential tariff rate or trade defence measures, such as anti-dumping duties).

The EU has "non-preferential" rules of origin, which apply to every country unless they have negotiated "preferential" rules of origin, which are set out in a trade agreement. The rules will vary depending on the specific agreement. In the EU-South Korea FTA, unless a good has been "wholly obtained" (i.e. a vegetable grown) in South Korea, exporters to the EU have to prove that the good has been "sufficiently processed" in South Korea to benefit from the preferential rates. There are different thresholds for the "sufficiently processed" test according to the type of product being exported. For cars, for example, an exporter from South Korea to the EU would have to show that no more than 45% of value of all the materials used in manufacturing the car had been imported from outside of the EU or South Korea in manufacturing the good.[8] Other rules of origin may require a good to be "sufficiently processed" to the extent that its customs classification changes. In the textiles industry, for example, under the EU's non-preferential rules of origin, the manufacture of a hat involves a change in customs classification heading as the materials (i.e. the fabric) are used to create the hat. This change means that the hat will be classified as originating in the country in which its manufacture occurred.

In order to prove this, exporters have to obtain "proof of origin" certificates showing where the goods originated from, or the level of processing they have undergone in a specific country. If the UK left the customs union, goods manufactured in the UK to be exported to the EU using an international supply chain (as is especially the case in the automotive industry), would no longer be

8 See Annex II of the Protocol concerning the definition of "originating products" and methods of administrative cooperation in the EU-South Korea FTA.

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exempt from EU rules of origin. This would require detailed analysis of supply chains and the cost of obtaining a "proof of origin" certificate would be a substantial burden to exporters, acting as a significant non-tariff barrier even in a free trade area. Some studies have found that the cost of proving the origin of a product could be between 4 percent and 8 percent of the value of the goods.[9]

UK manufacturers and suppliers in cross-EU supply chains currently benefit from the EU's preferential rules of origin under the EU's trade agreements with third countries. This is because those trade agreements treat the EU as a whole when considering whether goods are "sufficiently processed in the EU" so as to qualify for the preferential tariff rates. UK manufacturers may lose these benefits after Brexit even if the UK negotiates its own trade agreements with those third countries on the same terms unless the UK, the EU-27 and the third country agree to adopt an arrangement under which rules of origin can be "cumulated" between the EU's FTA with the third country and the UK's FTA. This is particularly relevant where the exporter is currently relying on the value of the EU contribution to the final product to determine that goods are "sufficiently processed in the EU". Japan has already identified the issue of "cumulative rules of origin" as an issue in its letter to the UK and the EU.

For example, a company may conduct the final manufacture of products in the UK and export the products to a third country with which the EU has an FTA (such as South Korea). The exporter may currently be able to take advantage of the preferential tariff rate under the FTA even if only a relatively small proportion of the value is contributed by UK inputs, so long as the bulk of the value is contributed by inputs supplied by UK and EU-27 suppliers (taken together). Post-Brexit, the UK exporter will only be able to benefit from a preferential tariff rate in the third country if the UK has negotiated and concluded an FTA with the third country. However, even if the UK negotiates an FTA with the third country on similar terms to the EU FTA, the exporter may not be able to benefit from the preferential tariff for the goods it ships from the UK to the third country if only a small proportion of the value is contributed by UK inputs. This is because the components supplied by its suppliers in the EU-27 may not count as "UK content" for the purposes of the UK's FTA. If it is not possible for the exporter to replace the EU-27 suppliers with UK suppliers to increase the UK content of the products, it may have to shift the final manufacture into the EU-27 to preserve its current access to the third country market (see scenario A).

9 Centre for Economic Policy Research, London, Trade and Investment: Balance of Competence Review (November 2013).

Another example is where a company conducts the final manufacture of products in the EU-27 and then ships the products to a third country with which the EU has an FTA. The exporter may currently be able to take advantage of the preferential tariff rate under the FTA even if a large proportion of the value is contributed by components sourced from a UK supplier because those components count as "EU content" for these purposes. Post-Brexit, the EU exporter may only be able to benefit from the preferential tariff if the bulk of the value is contributed by EU-27 inputs, even if the UK also has a matching FTA with the third country. This may create incentives for the exporter to seek to replace its UK and rest of the world suppliers with EU-27 suppliers whose components can be counted as EU content under the EU's FTAs (see scenario B).

Non-EU suppliers participating in cross-border supply chains may also currently benefit from the EU's preferential rules of origins under the EU's FTAs with third countries where the non-EU supplier contributes components to a product that is exported from the EU to a third country under one of the EU's FTAs. For example, a company conducts the final manufacture of products in the EU-27 and exports them to a third country, such as South Korea, with which the EU has an FTA. The exporter may source components for that product from the EU-27, the UK and other third countries (such as Japan). However, at present, the UK components count as "EU content" and therefore the EU-27 exporter may still benefit from the preferential tariff under that FTA so long as the bulk of the value is contributed by UK and EU-27 inputs (taken together). Post-Brexit, the exporter may only be able to benefit from the preferential tariff if the combined UK and rest of the world content is below the relevant threshold for non-EU-27 inputs.

Similar issues arise where the final manufacture takes place in the UK where components are sourced from both the EU-27 and other third countries, again because both the UK and EU-27 content currently count as "EU content". Even if the UK negotiates an FTA with the third country on similar terms to the EU FTA, the UK exporter may not be able to benefit from the preferential tariff under that FTA if only a small proportion of the value is contributed in the UK – because the components supplied by suppliers in the EU-27 and the other third countries may not count as "UK content" for those purposes.

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In these cases, rules of origin may incentivise exporters to favour local suppliers over suppliers from third countries in order to preserve current access to third countries with which the EU or the UK has FTAs.

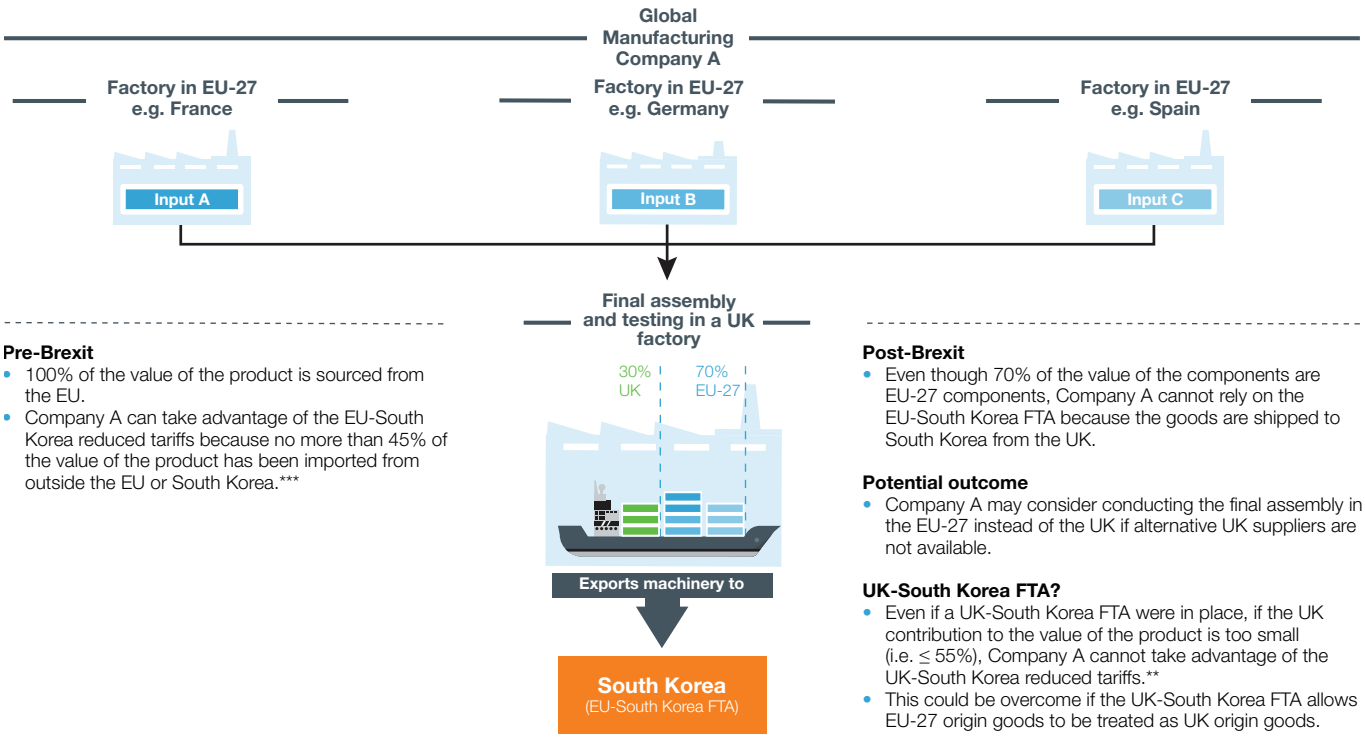
The UK and the EU may be able to address these issues by arrangements which allow the "cumulation" of rules of origin between the UK and the EU in their respective trade agreements with third countries, so that, for example, both EU and UK exporters to South Korea can count both UK and EU content as "EU content" under the EU-South Korea FTA or "UK content" under a future UK-South Korea FTA (with corresponding benefits for South Korean exporters being able to treat UK and EU content as "South Korean content" in their exports to both the EU and the UK). However, this would require both the EU to amend its trade agreements with third countries and the UK to include appropriate provisions in its future trade agreements (for example, CETA envisages the possibility of "cumulation" of rules of origin with the US for some purposes if both Canada and the EU have free trade agreements with the US). Alternatively, it would mean the UK and the EU adopting a strategy of seeking to create common free trade areas by establishing plurilateral free trade agreements with third countries to which both the UK and the EU (and possibly other countries) are parties.

Customs classification

The classification of certain goods will become increasingly important for trade between the EU and the UK. In particular, as mentioned above, the reasons behind the classification of a good can be a relevant factor in determining which country that good has originated from and whether it can then benefit from preferential tariffs negotiated between one country and another. For example, if a non-EU good is "sufficiently processed" in the EU to the extent that the resulting product has a different customs classification from that of the non-EU good, the resulting product may be considered an EU product and therefore benefit from preferential tariffs under the EU-South Korea FTA.

Rules of Origin

Scenario A



Pre-Brexit
- 100% of the value of the product is sourced from the EU.
- Company A can take advantage of the EU-South Korea reduced tariffs because no more than 45% of the value of the product has been imported from outside the EU or South Korea.***

Post-Brexit
- Even though 70% of the value of the components are EU-27 components, Company A cannot rely on the EU-South Korea FTA because the goods are shipped to South Korea from the UK.

Potential outcome
- Company A may consider conducting the final assembly in the EU-27 instead of the UK if alternative UK suppliers are not available.

UK-South Korea FTA?
- Even if a UK-South Korea FTA were in place, if the UK contribution to the value of the product is too small (i.e. ≤ 55%), Company A cannot take advantage of the UK-South Korea reduced tariffs.**
- This could be overcome if the UK-South Korea FTA allows EU-27 origin goods to be treated as UK origin goods.

Scenario B

Pre-Brexit
- 70% of the value of the inputs to build the machinery are from the EU.
- Company B can take advantage of the EU-South Korea reduced tariffs because no more than 45% of the value of the products has been imported from outside the EU or South Korea.***

Post-Brexit
- 50% of the value of the product is made up of non-EU-27 components.
- Company B cannot take advantage of the EU-South Korea reduced tariffs because more than 45% of the value of the product has been imported from outside the EU-27 and South Korea.**

Potential outcome
- Company B may re-assess the use of UK and RoW suppliers and seek to source all or some of its components from within the EU-27 or South Korea.

UK-South Korea FTA?
- This could be overcome if the EU-South Korea FTA is amended to allow UK origin goods to be treated as EU-27 origin goods.

* Rest of the World – excluding South Korea

** Assuming other criteria for sufficient processing is not met, such as, change of tariff heading

*** Assuming the EU-South Korea FTA establishes that no more than 45% of value of the products used to manufacture this machinery have been imported from outside the EU or South Korea.

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Certification and customs procedures

Businesses exporting goods to the EU would also need to obtain certification of compliance with relevant standards and regulations (it is important to note that even within a customs union, as mentioned above, the UK would still be subject to EU customs procedures). These would constitute an additional burden in terms of time, cost and bureaucracy. Over time, the regulatory standards of the UK and the EU could diverge, making it more difficult for businesses to comply. For example, under the Machinery Directive 2006/42/EC, manufacturers must declare that their products comply with all applicable Directives. A declaration of conformity allows the product to be marked with the CE ("Conformité Européenne") mark; machinery may not be sold in the EU without CE marking unless it falls within an exclusion category.

Equally, the UK would need to conclude arrangements with the EU with regard to certification, whether that be accreditation of UK certification bodies, or provisions which allow the UK to continue to participate in EU certification regimes. In certain industries, such as the pharmaceutical industry (in which certification is carried out by the European Medicines Agency) and the aviation industry (in which it is carried out by the European Aviation Safety Agency), this will be of fundamental importance as it is likely to take significant time to re-build the UK's certification capabilities.[10]

The increased requirements for certification would place additional burdens on the UK's custom system. It is currently designed to process 100 million customs declarations a year, but it has been estimated that it may need to process as many as 350 million annually.[11] The risk of disruption is exacerbated because the current system is an old system, due to be replaced in 2018.

There would also undoubtedly be initial problems and delays as UK and EU-27 Member States customs adapted to the increased workload. Companies need to have considered and budgeted (both in terms of time and cost) for the impact of such delays on their supply chains, and the need for trained staff to handle the increased administration. Many manufacturers (particularly in the automotive sector) are keen to limit the stock they hold to reduce storage costs and so even small delays could have a significant impact on production. The ease of moving goods across borders within the EU has led to deeply integrated supply chains which may no longer be as commercially practical or appealing.

10 The Aerospace Defence Securty Space has estimated that it may take up to ten years to re-build the certification capabilities of the UK's Civil Aviation Authority. See *Leaving the European Union* available at https://www.adsgroup.org.uk/policy-and-media/leavingtheeu/

11 Financial Times, *UK trade sector warns of Brexit customs disruption at borders* (24 October 2016).

Analysing supply chains

In order properly to assess how leaving the EU will impact businesses, companies will need to undertake a detailed analysis of their trade-flows and supply chains. In the automotive industry in particular, goods often move throughout Europe several times in the process of manufacturing a car. If the UK traded with the EU under WTO rules, tariffs could be chargeable not only on the final product, but also on the components, each time they crossed the border between the UK and the EU. Even if a free trade agreement reduced tariffs to zero, non-tariff barriers (such as the rules of origin and customs procedures described above) would still be applicable and would increase the cost of goods. If a car component originated in the UK, with further manufacture undertaken in the EU before being exported back to the UK then tariffs would be payable twice with no ability to set-off or discount any tariff.

In addition, supply chains become increasingly complicated where, as is often the case, trade in services and trade in goods are interlinked. Take for example, a UK-based bank that provides trade finance to a German automotive manufacturer, which imports components from countries around the world via a processing plant in the UK, and then sells its cars outside the EU. Every element of this supply chain would be affected by leaving the EU.

In order to adapt to the changing political and legal landscape, companies will need to look at what products make up their supply chain, where they come from, through where they travel and where they end up – for example, if a product is imported from China to a hub in Germany, and then distributed onwards to the UK. Companies will need to consider what markets are most important, where most of their sales take place, where their products are produced and where the machinery and components to produce those products come from.

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PRACTICAL CONSIDERATIONS FOR BUSINESSES FREE TRADE AGREEMENTS

Trade partnerships

Map your global footprint →

- To what extent do you **trade with the EU**?
- Which countries do you trade with the most?
- With which third countries should the UK prioritise trade deals?

Regulation & Supervision

Share economic and industry knowledge with the Government →

- What **regulatory standards** and **supervisory arrangements** do you currently have to adhere to?
- To what extent does your business depend on harmonised regulatory standards with, or supervision in, the EU?
- What should be included from an industry perspective, in a future EU-UK FTA?

Rules of Origin

Obtain proof of origin certificates →

- Do you manufacture in the UK using products sourced internationally?
- Are your sales international? Have you considered how rules of origin may affect these?
- Have you calculated the extra costs involved in complying with **rules of origin**?

Certification & customs procedures

Obtain certificates of compliance with standards →

- What regulatory standards do you currently have to adhere to?
- Will you need to obtain **certificates of compliance** (evidence that a product meets the requirements of the applicable EU directives)?
- If you export your goods, have you considered the impact of complying with different regulatory standards?

Supply Chains

Conduct thorough analysis of supply chains →

- Have you assessed your **supply chains** to identify the most important markets?
- Do you supply components for products that are then sold internationally?
- Do you export products to countries with which the EU has an FTA?

See Chapter 8 for further detail

CHAPTER 6
THE WTO

- The World Trade Organisation is a multilateral trading system with 164 members, formally established in 1995.
- The key principles of the WTO, particularly the "most favoured nation" principle, underpin all other trade agreements. The MFN principle prevents the EU offering the UK more favourable treatment than it presently offers the other WTO Members, unless there is an agreement that liberalises "substantially all trade". This therefore prevents the UK and EU entering into a quick agreement to reduce tariffs on only a few key sectors.
- The UK will remain a full and independent member of the WTO in its own right, even after it has left the EU.

What happens if an FTA with the EU is not negotiated in time?

Unless temporary interim arrangements can be agreed, following the UK's withdrawal from the EU, it is likely that trade relations between the UK and the EU in all likelihood will be regulated by WTO rules for at least a period of time. Notwithstanding that the commitments of the UK and the other EU-27 are currently included in joint EU "schedules", the UK is a member of the WTO and will continue to be so once it leaves the EU. It is also a signatory in its own right to the majority of WTO Agreements.

Trading only under WTO rules would have significant disadvantages for trading relationships and economies. This is not just due to the imposition of tariffs on goods (for example 16% of goods exported to the EU from the UK would face tariffs of over 7% which would reduce profits and increase production costs[12]) 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).

Civitas has estimated that exporters of goods to the UK from 22 of the EU-27, including Germany and France, would face a larger financial cost due to tariffs than UK exports to those countries would face, due to the specific goods and quantities being exported[13]. The EU-27 exporters would have to face an absolute additional tariff cost of £12.9bn annually, whereas UK exporters would face an additional cost of £5.2bn.

WTO rules are primarily set out in two agreements: the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS).

The key principle of the WTO – the Most Favoured Nation principle

Although trade in goods and trade in services are dealt with separately under the WTO, both the GATT and the GATS contain the same underlying principle – the "most-favoured-nation" (MFN) principle. This requires WTO Members to treat all other

Key concerns

Can the EU and the UK agree to trade with each other on a more favourable basis than under WTO rules?

12 *The World Trade Organization: A Safety Net for post-Brexit UK Trade Policy?* UK Trade Policy Observatory (July 2016).

13 *Potential post-Brexit tariff costs for EU-UK trade,* Civitas (October 2016).

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members equally, for example, imposing the same tariffs across all other members, and not applying different discriminatory measures (non-tariff barriers).

There are, however, exceptions to this principle. The most important of these is the exception that allows for the existence of free trade agreements, and for customs unions, such as the EU, to provide more favourable treatment to its own members.

This exception is set out in GATT at Article XXIV and in GATS at Article V. In order to benefit under GATT (for agreements addressing trade in goods) an FTA must eliminate tariffs and other restrictions on "substantially all the trade" in goods, and the duties and other restrictive regulations of commerce should not be higher or more restrictive than those existing between the parties before the agreement of the FTA.

The WTO does not define "substantially all". The provisions have been analysed by the WTO Appellate Body in the *Turkey-Textiles case*, which established that "substantially all" was not the same as "all" of the trade, but was considerably more than "merely some" of the trade. It has been suggested that 80% of total trade could be considered "substantially all", but also that percentages alone are not sufficient, and, for example, if a major sector of economic activity was excluded altogether, the agreement could not be considered to cover substantially all trade in goods. Similarly, for trade in services, a free trade agreement must have substantial sectoral coverage (both in terms of the number of sectors, overall volume of trade and the modes of supply covered).

There is, therefore, no definitive ruling that a particular percentage of trade would lead to an agreement being classified as extensive enough to comprise an FTA or the creation of a customs union. However, it has been said to be unlikely that an agreement will be deemed to be a valid customs union or free trade agreement under WTO rules if it excludes a major economic sector from consideration entirely (although it should be noted that the EU-Turkey customs union excludes agriculture except processed agricultural products).

It is important to note that a free trade agreement does not have to cover both trade in goods and in services in order to benefit from the exception; given that the WTO has two different regimes for goods and services, an agreement may focus on one of the two, but it must not cover just a few products or a few service sectors. On the other hand, it is possible for a free trade agreement to go well beyond the minimum requirements set out above and provide for deeper integration, including in certain product or service sectors only.

What are the modes of supply of services?

1. **Cross-border supply:** the possibility for non-resident service suppliers to supply services cross-border into another country's territory
2. **Consumption abroad:** the ability for a resident of one country to purchase services in the territory of another
3. **Foreign commercial presence:** the ability for foreign companies to establish, operate or expand a commercial presence in another country
4. **Presence of natural persons:** the ability for individuals to move temporarily to another country in order to supply a service

Trade in goods

The overarching framework for trade in goods is provided in the GATT.

Schedules in the GATT set out the tariffs that WTO Members will impose on imports from other States. These tariffs are applied on various goods according to their classification under the WTO, and can be very specific (for example, as set out in the table below, in relation to aeroplanes, WTO tariffs are split into sub-categories dependent on the weight of the aeroplane).

Several more specific agreements address non-tariff barriers, including: (i) technical barriers to trade; (ii) sanitary and phytosanitary measures; (iii) dumping; (iv) subsidies and countervailing measures; (v) trade-related investment measures; (vi) safeguards and (vii) product valuation.

Latest available MFN applied tariffs – European Union Tariff Data – WTO – Aerospace industry

European Union

Year 2016 HS 2012

Last Update Date 08JUL2016

Source: Based on notifications to the Integrated Database (IDB).

HS subhdg	MFN Applied Tariff								HS subheading 6-digit description
	Number of TL	Number of AV duties	Average of AV Duties	Minimum AV Duty	Maximum AV Duty	Duty Free TL (%)	Number of Non-AV Duty	List of Distinct Non-AV Duties	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
880211	1	1	7.5	7.5	7.5	0	0		Helicopters of an unladen weight <= 2.000 kg
880212	1	1	2.7	2.7	2.7	0	0		Helicopters of an unladen weight > 2.000 kg
880220	1	1	7.7	7.7	7.7	0	0		Aeroplanes and other powered aircraft of an unladen weight <= 2.000 kg (excl. helicopters and dirigibles)
880230	1	1	2.7	2.7	2.7	0	0		Aeroplanes and other powered aircraft of an unladen weight > 2.000 kg but <= 15.000 kg (excl. helicopters and dirigibles)
880240	1	1	2.7	2.7	2.7	0	0		Aeroplanes and other powered aircraft of an of an unladen weight > 15.000 kg (excl. helicopters and dirigibles)
880260	2	2	4.2	4.2	4.2	0	0		Spacecraft, incl. satellites, and suborbital and spacecraft launch vehicles
880310	1	1	2.7	2.7	2.7	0	0		Propellers and rotors and parts thereof, for aircraft, n.e.s.
880320	1	1	2.7	2.7	2.7	0	0		Under-carriages and parts thereof, for aircraft, n.e.s.
880330	1	1	2.7	2.7	2.7	0	0		Parts of aeroplanes or helicopters, n.e.s. (excl. those for gliders)
880390	4	4	2	1.7	2.7	0	0		Parts of aircraft and spacecraft, n.e.s.

Link: https://www.wto.org/english/tratop_e/schedules_e/goods_schedules_table_e.htm

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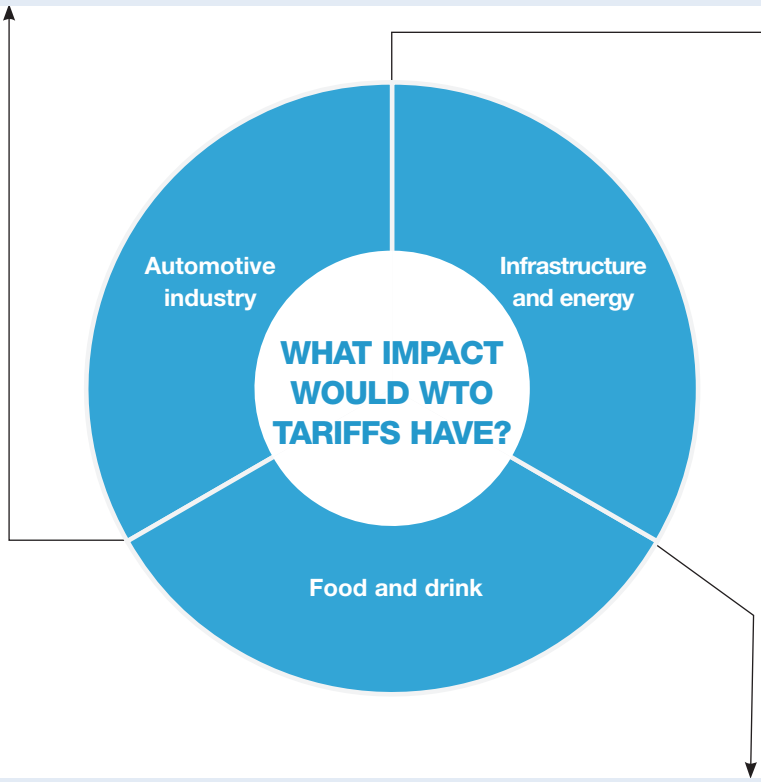
Automotive industry

Although cars may be manufactured in the UK, their components come from all over the world, and these components attract tariffs. So, if the UK was trading with the EU under WTO rules, components imported into the UK from the EU would attract tariffs (subject to any available Inward Processing Relief), as would the car itself. Civitas has estimated that UK exporters of cars to the EU would face an additional cost of £1.348bn annually in tariffs.

Although the UK automotive industry has increased the number of parts sourced from within the UK, approximately 59% of the value of a car is still sourced externally (Automotive Council UK Report, *Growing the Automotive Supply Chain*). The EU charges tariffs of 10% on the import of cars. Tariffs on parts vary hugely as the number of components is extensive and these fall under many different WTO classifications.

Product	Tariff
Metal fittings (i.e. door handles)	2.7%
Seat belts	3.8%
Brakes	4%
Lead acid batteries	3.7%



Infrastructure and energy

Infrastructure projects in the UK often involve components imported from all around the world. As a result, it is another industry particularly susceptible to increases in tariffs. A recent Civitas report has suggested that, for example, EU exporters to the UK of nuclear reactors, boilers and other mechanical appliances would have to pay tariffs amounting to £366m (and UK exporters to the EU, £210m). This would increase the costs of energy projects in the UK, in some cases making them practically untenable.

Food and drink

The UK food and drink sector contributes £26.9bn to the UK economy, and the EU takes more than two-thirds of the UK's exports. For non-agricultural goods, the average tariff imposed will be relatively small at 2.3%. However, for agricultural goods, the tariffs are far higher, averaging at 22.3%.

Calculating tariffs can be hugely complex – the EU charges different tariffs on baked goods and confectionery depending on the proportions of milk fat, milk proteins, starch or glucose and various forms of sugar. For example, 13,608 categories of bread, biscuits and confectionery are each potentially charged at a different tariff rate.

Product	Tariff
Whisky	0%
Chocolate	38%
Salmon	13%
Coffee	11.5%

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 GATS. There are no "tariffs" as such in relation to trade in services – instead, trade can be limited by non-tariff barriers and the WTO has provisions limiting the non-tariff barriers a member can impose on other members. There are two elements to these provisions: the general obligations (the MFN principle outlined above, and an obligation of transparency); and specific commitments, in which WTO members undertake to provide market access and national treatment for services. This means that they have to provide access to their domestic market, and treat foreign services and service suppliers in the same way as they treat domestic services and service suppliers.

The obligations, while relatively limited, are, in principle, automatically binding. However, WTO Members can list MFN exemptions, and, for example, the EU has done so in the audiovisual sector. This means that the EU does *not* have to provide equal treatment to other WTO Members in the audiovisual sector.[14]

EU GATS SCHEDULE – ARCHITECTURAL SERVICES

EUROPEAN COMMUNITIES AND THEIR MEMBER STATES (continued) GATS/SC/31 Page 20

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
d) Architectural Services (CPC 8671)	1) B, GR, I, P: Unbound	1) B, GR, I, P: Unbound	
		D: Application of the national rules on fees and emoluments for all services which are performed from abroad	
	2) None	2) None	
	3) E: Access is restricted to natural persons F: Provision through SEL (anonyme, a responsabilité limitée ou en commandite par actions) or SCP only. I, P: Access is restricted to natural persons. Professional associations. (no incorporation) among natural persons permitted.	3) None	
	4) Unbound except as indicated in the horizontal section and subject to the following specific limitations: GR, P: Condition of nationality F: Condition of nationality unless waived by ministerial authorization	4) Unbound except as indicated in the horizontal section and subject to the following specific limitations: B, D, F: Use by third country qualified professionals of the professional title is only possible on the basis of mutual recognition agreements or for B, with special authorization by Royal Decree. I: Residence requirement	

Excerpt from the EU's GATS schedules

14 The audiovisual sector is also often excluded from trade deals as it is seen as a "culturally sensitive" area. France, in particular, has very stringent rules on the provision of audiovisual services.

6

The specific commitments are binding only with regard to sectors expressly identified by each WTO Member in its schedule of commitments, and are subject to the limitations expressly included in its schedule. For example, the EU schedules contain limitations in relation to Road Transport Services, one of which states that suppliers of road transport services may be refused authorisation to establish a commercial presence in Spain if their country of origin does not accord effective market access to Spanish transport service suppliers. The table above is an excerpt from the EU's GATS schedules, setting out the commitments and limitations with regards to architectural services.

Accordingly, the level of liberalisation achieved by the WTO with regard to trade in services is dependent on the level of commitments found in members' schedules. The limited level of liberalisation of trade in services under WTO rules is the primary reason why trading solely under WTO rules would have a significant impact on UK businesses.

Implications for UK trade

The effect of the above on the UK and its future relationship with the EU could therefore be two-fold:

- The EU cannot generally discriminate against the UK in its trade provisions; to do so would be against the rules of the WTO (the MFN principle).
- Equally, since the UK will not remain a member of the EU Customs Union, unless the UK enters into an FTA with the EU (see Chapter 5), the EU cannot offer the UK more favourable treatment, without also offering that treatment to every other WTO Member. For example, take the much-talked about issue of tariffs on cars. While Germany might not want to charge 10% tariffs on the import of British cars, unless a comprehensive free trade agreement was agreed between the EU and the UK, the EU could not drop this tariff without doing so for all other WTO members.

How will the WTO apply to the UK after Brexit?

The UK has been a WTO Member since 1995 and a member of GATT since 1948. However, its commitments (both for trade in goods and trade in services) are represented in the joint EU schedules. Opinions differ on the impact of this fact on the UK's trading relationships once it leaves the EU. However, it is important initially to note that the UK can continue to trade legally even if no agreement is reached on the status of the UK's schedules of commitments.

On this analysis, some elements would be relatively straightforward. For example, there could be a simple transposition of tariff commitments from a common (EU) schedule to an individual (UK) schedule in the case of ad valorem tariff rates on goods (those that are expressed as a percentage of the overall value).

Other elements would require more thought. For example, the WTO schedules also include tariff quotas and subsidies commitments, which are currently specified in quantitative terms for the entire EU. These would need to be apportioned between the UK and the EU-27. Although it may be relatively easy to find a principled basis on

Key concerns

Does the UK have its own schedules under the WTO? If not, what does that mean for imports to the UK post-Brexit?

which to carry out such an apportionment (for example, on the basis of destination of imports over the last three years), there could be a number of different principled bases from which to choose and this would need to be agreed. It would also be fairly straightforward to transpose the EU commitments with regard to trade in services, as current EU GATS schedules of commitments are divided by each individual EU Member State, meaning that each EU Member State can identify its own GATS commitments.

WTO schedules

There are a number of different methods by which the UK could seek to amend its schedules, some less complicated and time-consuming than others.

The UK government has indicated that the UK will need to establish its own schedules covering trade in goods and services at the WTO, and has made clear that the UK's new schedule will offer third countries the same level of market access they currently enjoy.[15] Where there are changes to WTO schedules of a "purely formal character", these can be made by way of Certifications, which give other WTO members limited grounds on which to object. The amendments could take effect within three months unless an objection is actively raised.

It is likely that the UK could continue to apply EU schedules, and could reach an agreement with the EU on apportionment of quotas during the Article 50 process. No matter the specific procedure used to approve the new UK schedules, it would be open to other WTO Members to bring a complaint or objection against the UK (for example, if they have suffered loss as a result of the way the UK and the EU decided to apportion the quotas).

What actions could other WTO member States bring against the UK if they disagreed?

If another member state did bring a complaint, the UK would be drawn into the WTO dispute settlement procedure, and ultimately the Dispute Panel or an Appellate Body would make a decision on the complaint. Compliance with a WTO decision may be achieved by withdrawing the WTO-inconsistent measure or, alternatively, by modifying or replacing it. If the UK did not comply, the complaining state may negotiate a compensation agreement, or it may request permission to retaliate, by way of withdrawing concessions or obligations granted to the UK (such retaliation could be against the UK's access to their services market for an infringement in relation to trade in goods). The WTO does not have the ability to impose fines.

WTO law also allows any Member to bring a complaint even if there is no violation by another Member of its WTO obligations, where the complainant can demonstrate that the respondent's non-violation conduct frustrated its reasonable expectation of improved market access opportunities. However, successful non-violation claims are very rare, and in the *Japan-Film* case, the Appellate Body stated that the non-violation remedy "should be approached with caution and should remain an exceptional remedy".

15 *Liam Fox opens talks with WTO over terms of membership*, Financial Times, 5 December 2016, The United Kingdom's exit from and now partnership with the European Union, February 2017.

6

The UK's position in relation to other treaties to which the EU is a member

International agreements can take a number of different forms (in addtion to FTAs) depending on, for example, the number and identity of the parties. The table below sets out some examples:

Types of trade agreements and treaties	
Bilateral agreement	An agreement between two states – these come in many forms: *Association Agreements/Stabilisation Agreements/Free Trade Agreements* – all remove or reduce customs tariffs in bilateral trade. *Partnership and Cooperation Agreements* – provide a general framework for economic relations without eliminating or reducing custom tariffs.
Customs Union	An agreement to eliminate customs duties and establish a joint customs tariff for foreign importers.
Economic Partnership Agreements	Trade and development agreements negotiated between the EU and developing countries. The aim of EPAs is to promote trade in goods and services between the EU and developing countries and ultimately to contribute to sustainable development and poverty reduction.
Mixed agreement	An agreement of a third state with the EU covering more than just trade, and entered into by both the EU and its Member States. For example, CETA and the EU-South Korea FTA are mixed agreements.
Multilateral agreement	This term has a specific meaning under the WTO – an agreement that all WTO Members are party to (for example, GATS or GATT). Outside of the WTO, it means an agreement to which three or more entities are party.
Mutual Recognition Agreements	Bilateral or plurilateral agreements aimed to facilitate market access for goods and services by stating conditions under which countries will accept conformity assessment results showing compliance with their product requirements. MRAs include lists of designated laboratories, inspection bodies and conformity assessment bodies.
Open agreement	An agreement which other states can join at a later date. For example, TPP was anticipated to be an open agreement.
Plurilateral agreement	This term has a specific meaning under the WTO – an agreement involving only some members of the WTO, allowing WTO Members to agree to new rules on a voluntary basis (for example, the Government Procurement Agreement is a plurilateral agreement).
Regional agreement	An agreement between a group of states within a specific region (for example, NAFTA, the TPP).

The UK is only party to some of these other treaties by virtue of its membership of the EU; it has not ratified these agreements itself. These agreements will therefore cease to apply to the UK after Brexit takes place. It is important to note that the number of these is limited; the UK has signed up to many international treaties in its own right. For example, the vast majority of WTO agreements are multilateral agreements, meaning that every WTO Member is a signatory to treaties such as the Agreement on Trade-Related Aspects of International Property Rights and the Agreement on Trade in Civil Aircraft. However, the UK has not ratified in its own right the Government Procurement Agreement.

The UK would have to consider whether or not to accede to other international treaties, the procedure for which is set out in the terms of the specific treaties. For example, in the Government Procurement Agreement, Article 22 Final Provisions (2) sets out the procedure for accession; the UK would merely have to deposit an "instrument of accession" with the Director-General of the WTO, stating that the terms of the

Government Procurement Agreement are agreed. The Government Procurement Agreement would then come into force in the UK 30 days after the deposit of the instrument of accession.

Continuing state?

Some have argued that the international law on state succession could be relevant in the wake of Brexit, particularly with respect to the UK's continuing participation in the EU's FTAs with third countries. As the UK is an independent state that will be "continuing" after leaving the EU, should it therefore be allowed to maintain its rights and obligations under the treaties to which it is currently a party as a member of the EU?

However, the international law on state succession is not directly applicable in these circumstances. The UK was an independent state prior to Brexit and will remain so after Brexit. It may be that the principles of the law of state succession are useful by analogy as a starting point for considering the complex issues arising from Brexit, but they will not be directly applicable.

It is arguable that Brexit might be considered to be a fundamental change of circumstances under international law, which would permit states to withdraw from or terminate existing FTAs with the EU. The EU could consider making statements that it intends to be bound by the existing agreements, but it would only be able to do so if the other state also agreed to be bound. It is therefore possible that Brexit could lead to attempts to renegotiate existing agreements not only between the UK and third states, but also between the EU and third states.

PRACTICAL CONSIDERATIONS FOR BUSINESSES – WTO RULES

Tariffs

Assess the impact of tariffs →

- What impact would the imposition of **tariffs** have on your business?
- How would this affect future growth and investment?

Non-tariff barriers

Assess the impact of non-tariff barriers →

- What impact would the imposition or presence of **non-tariff** barriers have on your business?
- How would this affect future growth and investment?

Services

Assess potential restrictions to trade in services →

- To what extent does your business rely on the provision of services in the EU?
- If the **provision of services** in the EU were hampered, what would be the impact on your business?

7 CHAPTER 7
A TEMPORARY INTERIM ARRANGEMENT

- The UK and the EU would risk facing significant commercial and economic disruption if the UK exits the EU immediately to trade solely under WTO rules without any arrangement to cover these two periods of time. The UK and EU could indicate at the outset of the Article 50 negotiations that they intend to have a temporary interim arrangement between the point of UK withdrawal and the coming into force of a long-term agreement.
- Such an agreement must not breach WTO rules (particularly in relation to the MFN provisions) and could be negotiated as part of the withdrawal agreement under Article 50 TEU.
- This would provide the UK and the EU with sufficient time to negotiate a long-term agreement and allow businesses and relevant stakeholders to adapt to the new legal, trade and economic architecture.
- Even a temporary interim arrangement may take time to negotiate and may require both the UK and the EU to agree on politically difficult arrangements.

In a scenario where the negotiation of a long-term agreement between the UK and the EU takes place after the UK formally withdraws from the EU, there would be a gap between the UK leaving the EU and the signing of a new agreement. This has often been referred to as a "cliff-edge", whereby the UK and EU would default to WTO tariffs for a period until the new arrangement was in place. Such a scenario risks major substantial extra costs on UK and EU businesses and consumers.

The UK and EU could avoid the risk of such a "cliff-edge" effect by agreeing to put in place a temporary interim arrangement between the UK's withdrawal from the EU and the agreement of the new arrangement. In order for any such temporary interim arrangement to be effective, and to allow businesses to properly plan for the UK's departure from the EU, the UK and EU-27 could make it clear at the outset of the Article 50 negotiation that agreeing a temporary interim arrangement is an objective of the negotiation process.

It is important to consider how long a temporary interim arrangement might be, how it could be structured, and what it might have to cover. If the UK should seek to include the temporary interim arrangement in the Article 50 withdrawal agreement, it would allow the European Council to bind the EU as a whole, and the UK Parliament would do so for the UK.

An additional issue arises in relation to the EU and the UK's obligations as members of the WTO. Given the MFN obligations outlined above, any temporary interim arrangement would have to be fully comprehensive in order to not breach the WTO rules. It would not be desirable for a temporary interim arrangement to take as long to negotiate as a full FTA, for example. A way forward would be for the temporary interim arrangement: (i) to fall within the scope of the Article 50 agreement; (ii) to only run until the long term

agreement comes into force; (iii) to anticipate the likely scope and content of the final bilateral agreement between the UK and the EU; and (iv) to replicate to the fullest extent possible current levels of market access. Such arrangement may be consistent with WTO-related constraints.

Finally, it is important to note that a temporary interim arrangement between the UK and the EU will not bind other states once the UK is outside the EU. In a situation where the UK has left the EU, but has agreed a temporary interim arrangement, it would be a matter for the other countries with which the EU has free trade agreements as to whether they continue applying the provisions of these agreements vis-a-vis the UK, or to trade with the UK under WTO rules only.

CONCLUSION

Apart from the complexity of the legal and commercial challenges that Brexit presents, a key practical difficulty facing government and businesses is timing. Negotiating an agreement comprehensive enough to address all of the issues important to UK and EU businesses within the two year period in Article 50 presents very considerable legal, practical and political challenges.

Leaving the EU and trading under WTO rules would be a deeply unsatisfactory option – not just for British business, but for companies across Europe and internationally.

A smooth movement could be ensured by an implementation phase before any new relationship enters into force, and/or a temporary interim arrangement; should there be a period between the point at which the UK left the EU and when a new arrangement was agreed and came into force. This would avoid a cliff edge, and give the UK and the EU time to agree a comprehensive, beneficial and sustainable long term agreement. It would also allow businesses the time to ensure that their concerns and priorities were fully understood by the UK Government and incorporated into its approach in reaching agreement with the EU.

PRACTICAL CONSIDERATIONS FOR BUSINESSES

Phase 1

Self-assessment →

- Undertake a detailed analysis of supply chains, including where products and their components originate from (both within the EU and externally) and the impact of delays. Focus on (i) what do you rely on the EU system for; and (ii) what do you rely on the EU's FTAs for?
- Consider the market and where sales take place to understand which FTAs with third countries you will want to be prioritised.
- Assess different business areas, including in relation to trade, services, financing, regulations, data protection, intellectual property, tax, pensions and dispute resolution.

Phase 2

Collaboration with trade associations (such as the CBI) →

- Share the key findings of the self-assessment with the CBI and other relevant trade associations in order to establish common interests.
- Businesses will have more influence if they are able to portray their demands as part of a unified voice from a specific industry, rather than as individual companies.

Phase 3

Dialogue with government →

- It is important that businesses communicate with the Government, to make sure their key concerns are heard and that the Government is aware of the issues and priorities for different industries.
- Clifford Chance can assist businesses develop strategies for communications with the Government and other institutions, so as to maximise the impact of the dialogue.

Phase 4

Monitor the situation →

- As the exact impact of Brexit is still uncertain, and will remain so even as the UK and the EU enter into negotiations, businesses should be prepared to monitor the progress of the negotiations and stay alert to their likely direction.

Phase 5

Adapt →

- Businesses should be ready to make necessary adaptations as the future becomes clearer.

SCHEDULE 1
GLOSSARY

ACP: African, Caribbean and Pacific Group of States

ASEAN: Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam

CAP: Common Agricultural Policy

CETA: The Canada-EU Trade Agreement

CET: Common External Tariff

CFP: Common Fisheries Policy

CJEU: Courts of Justice of the European Union

Customs union: an agreement to eliminate customs duties and establish a joint customs tariff for foreign importers

DSB: the WTO Dispute Settlement Body

ECA: European Communities Act

EEA: European Economic Area

EFTA: European Free Trade Area

EPA: Economic Partnership Agreement

EU-27: the remaining EU Member States after the UK leaves

FDI: Foreign Direct Investment

FTA: Free Trade Agreement

GATS: The General Agreement on Trade in Services

GATT: The General Agreement on Tariffs and Trade

GPA: Government Procurement Agreement

HS: Harmonised System (the code used by the WTO to classify products)

ISDS: Investor-State dispute settlement

MFN: Most favoured nation

MRA: Mutual Recognition Agreement

NAFTA: North American Free Trade Agreement

Non-tariff barrier: any measure that increases the cost of trade but does not take the form of a tariff

SPS: Sanitary and Phytosanitary

TEU: Treaty on European Union

TFEU: Treaty on the Functioning of the European Union

TPP: Trans-Pacific Partnership

TRIPS: Agreement on Trade-Related aspects of Intellectual Property Rights

TRQ: Tariff-rate quotas

TTIP: Transatlantic Trade and Investment Partnership

WTO: World Trade Organisation

SCHEDULE 2
WHAT ARE THE TRADE TREATIES THAT THE EU CURRENTLY HAS AND WITH WHOM?

AFRICA			
Algeria – Association Agreement	**Cameroon –** Interim Economic Partnership Agreement	**Egypt –** Association Agreement	**Ivory Coast –** Economic Partnership Agreement provisionally applied
Madagascar, Mauritius, the Seychelles and Zimbabwe – Economic Partnership Agreement	**Morocco –** Association Agreement	**South Africa –** Interim Trade, Development and Cooperation Agreement	**Tunisia –** Association Agreement
AMERICAS			
CARIFORUM States (Caribbean Nations) – Economic Partnership Agreement, provisionally applied	**Central America –** Association Agreement with a strong trade component	**Chile –** Association Agreement and Additional Protocol	**Colombia and Peru –** Trade Agreement
Mexico – Economic Partnership, Political Coordination and Cooperation Agreement			
ASIA AND THE MIDDLE EAST			
Armenia – Partnership and Cooperation Agreement	**Azerbaijan –** Partnership and Cooperation Agreement	**Georgia –** Association Agreement	**Israel –** Association Agreement
Iraq – Partnership and Cooperation Agreement	**Jordan –** Association Agreement	**Kazakhstan –** Enhanced Partnership Agreement, provisionally applied	**Lebanon –** Interim Agreement
Palestinian Authority – Association Agreement	**South Korea –** Free Trade Agreement	**Syria –** Association Agreement	
EUROPEAN COUNTRIES			
Albania – Stabilisation and Association Agreement	**Andorra –** Customs Union	**Bosnia and Herzegovina –** Stabilisation and Association Agreement	**Faroe Islands –** Agreement on Free Trade
Iceland – Agreement	**Kosovo –** Stabilisation and Association Agreement	**Moldova –** Association Agreement	**Montenegro –** Stabilisation and Association Agreement
Norway – Agreement	**Russia –** Partnership and Cooperation Agreement	**San Marino –** Customs Union	**Serbia –** Stabilisation and Association Agreement
Switzerland – Free Trade Agreement	**The former Yugoslav Republic of Macedonia –** Stabilisation and Association Agreement	**Turkey –** Customs Union	**Ukraine –** Free Trade Agreement and Association Agreement

SCHEDULE 3

WHO IS THE EU CURRENTLY NEGOTIATING FREE TRADE AGREEMENTS WITH?

AMERICAS			
Andean Community (Colombia, Peru, Ecuador, Bolivia) Columbian, Peruvian and Ecuadorian trade agreements provisionally apply. Ecuador acceded in December 2016 and the agreement was provisionally applied from 1 January 2017.	**Canada (CETA)** Signed in October 2016.	**Mercusor (Argentina, Brazil, Paraguay, Uruguay and Venezuela)** Ten rounds of negotiation have taken place (most recently in October 2016). The next round will take place in March 2017.	**Mexico** The EU and Mexico have met to start the negotiation process for the modernisation of the EU-Mexico Global Agreement.
USA (TTIP) Fifteen negotiation rounds have taken place; the latest round took place during the first week of October 2016.			
ASIA			
ASEAN A regional agreement remains the ultimate objective. Negotiations halted in 2009. The possible resumption of negotiations could take place over coming months.	**China** Negotiations for a comprehensive EU-China investment agreement have been launched. This is not an FTA but an attempt to remove market access barriers to investment. It will replace 26 existing bilateral investment treaties between the individual EU Member States. 12 negotiation rounds have taken place.	**India** There have been 16 rounds. Negotiations were brought to a standstill in 2013. Discussions resumed in 2016 to assess whether formal negotiations can be resumed.	**Indonesia** Introductory round of negotiations took place on 20 and 21 September 2016.
Japan The EU and Japan are aiming to conclude a deal in early 2017, so negotiators are in regular contact.	**Malaysia** Negotiations are on hold. A stocktaking exercise is taking place to assess the prospect of resuming negotiations.	**Myanmar/Burma** Three rounds of negotiation have taken place. No date has been set yet for the next round.	**Philippines** The first round of negotiations took place in May 2016.
Singapore Negotiations were completed in October 2014. The draft agreement needs to be formally approved.	**Thailand** Four rounds of negotiations have taken place, the last one in April 2014.	**Vietnam** Negotiations have formally concluded. The FTA will be presented to the Council for approval and the European Parliament for consent in 2017. It is expected that the agreement can enter into force at the beginning of 2018.	

SOUTH MEDITERRANEAN & MIDDLE EAST (The EU has established a network of "association agreements", which include reciprocal FTAs essentially limited to trade in goods, in order to promote broader regional integration. Under the framework of these agreements, a series of bilateral negotiations have been launched to complement and expand these agreements.)			
Algeria An association agreement was signed in 2002. Negotiations for Algeria's accession to the WTO are ongoing.	**Egypt** An association agreement was entered into in 2004. A dialogue on a DCFTA was launched in June 2013. Bilateral negotiations are on hold.	**Gulf Cooperation Council** Negotiations for a FTA have been suspended. Informal discussions are on-going.	**Israel** An association agreement has been in force since June 2000. Other agreements concerning agriculture and conformity in pharmaceuticals have been in force since 2013. Bilateral negotiations are on hold.
Jordan An association agreement was signed in 2007 and agreements to further liberalise trade have since been entered into. A preparatory process of launching a DCFTA is quite advanced.	**Lebanon** An association agreement was signed in 2002 and a dispute settlement agreement has been reached. Negotiations for Lebanon's accession to the WTO are ongoing.	**Libya** Negotiations for a FTA were suspended in 2011. A lack of political settlement in Libya is preventing any trade discussion.	**Morocco** Negotiations for a Deep and Comprehensive Free Trade Area (DCFTA) have been entered into to extend the scope of an existing association agreement. It will include the gradual integration of the Moroccan economy into the EU single market. Four rounds have taken place.
Palestine An association agreement was signed in February 1997 and a duty free agreement relating to agriculture was entered into in 2012.	**Syria** In view of the political situation, the EU has adopted restrictive measures towards Syria. Signature of an association agreement remains on hold.	**Tunisia** An association agreement was signed in 1995 and a dispute settlement agreement has been reached. Negotiations for a DCFTA were launched in 2015. Second round negotiations are due to take place over the coming months.	
EASTERN NEIGHBOURHOOD COUNTRIES			
Georgia An association agreement is in the process of being implemented, including a DCFTA.	**Moldova** An association agreement is in the process of being implemented, including a DCFTA.	**Ukraine** An association agreement is in the process of being implemented, including a DCFTA.	
SERVICES (TiSA) Talks have begun on a new international agreement on trade in services. Negotiations cover all service sectors including ICT, logistics and financial services. 14 negotiation rounds have taken place. Currently 23 WTO members (including the EU representing its 28 Member States) are taking part in negotiations.			

SCHEDULE 4
BACKGROUND INFORMATION ON THE WTO

The WTO initially focussed on lowering import duties on goods through successive trade negotiation rounds. It now also seeks to liberalise trade in services; for example, there are currently negotiations ongoing for a multilateral agreement on trade in services and specific working groups on smaller issues, such as a working group on e-commerce.

The WTO's key functions include:

(a) to facilitate the implementation, administration and operation of the WTO agreements (for example, covering trade in goods, trade in services and trade-related intellectual property rights);

(b) as a forum for negotiations; and

(c) to administer trade disputes (through ad hoc panels and a permanent Appellate Body). It differentiates between how it deals with trade in goods and trade in services, through two separate agreements and separate structures.

The meaning of "substantially all" the trade in the exception to the most-favoured-nation provision

Article XXIV of GATT

As referred to above, there are different views as to the meaning of "substantially all" in relation to free trade agreements and customs unions. As there are many relevant factors other than the percentage of total trade, many have suggested that account should also be taken of these qualitative factors such as the size of the free trade area and its percentage of global trade.[16]

Article V of GATS

In order to benefit under GATS, a free trade agreement must have substantial sector coverage, and such agreement must provide for the absence or elimination of substantially all discrimination in relation to "national treatment" (meaning that WTO members must not adopt discriminatory measures to benefit their national services or service suppliers). The agreement must not raise the overall level of barriers to trade in services compared to the level applicable prior to such agreement.

Article V of GATS specifies in a footnote that the requirement for an agreement or customs union to have substantial sector coverage has both qualitative and quantitative elements; it will be reviewed by reference to the number of sectors and the overall volume of trade covered, as well as the modes of supply. There should be no a priori exclusion of any mode of supply. Just as is the case under the GATT, there is no definitive interpretation of "substantial sectoral coverage", and there are disagreements as to whether all sectors are required to be covered. Each case will turn on its own specific factors.

16 See particularly the Report of the Sub-group of the Committee on the "European Economic Community", the Report of the Working Party on "European Communities – Agreements with Portugal" and the Report of the Working Party on the "European Free Trade Area – Examination of the Stockholm Convention".

Negotiation and modification of WTO schedules

Article XXVIII of the GATT allows a member to renegotiate its schedules by negotiation and agreement with (i) members with which the concession was initially negotiated, (ii) members which have a "principal supplying interest" and (iii) members which have a substantial interest in the concession. Under such a procedure, the UK would not, therefore, have to negotiate with all other WTO members. Agreeing a renegotiation of schedules may include some element of compensatory adjustment. If an agreement cannot be reached, a State can still modify or withdraw the concession, but other members that are "primarily concerned" or have a substantial interest in the concession will be free to withdraw substantially equivalent concessions initially negotiated with that state.

There are a number of different types of renegotiation provided for under the GATT. The first is an "open season" renegotiation, which occurs on a rolling three year basis. The state has a maximum of six months to negotiate before the start of each three year period. The modifications take effect on the first day of the next three year period. At the time of writing, the next three year period begins 1 January 2018 (i.e. before the UK will have left the EU). Alternatively, a state can reserve the right at the beginning of the three year period to modify its schedules at any point within that period; however, for this type of renegotiation, there are no time limits set out in the GATT.

Finally, Article XXVIII:4 contains a provision for renegotiating schedules in special circumstances, as authorised by the Ministerial Conference. There has been little examination of what would constitute "special circumstances", and, indeed, the Council has said specifically that it would not be a good policy to define this too rigorously. Arguably, the UK leaving the EU would be a special circumstance. In this case, WTO members have only 60 days from the Ministerial Conference's authorisation to reach agreement.

WTO dispute resolution procedure

The WTO dispute resolution mechanism involves a review and final report by a Dispute Panel and potentially an Appellate Body. Dispute Panels are supposed to provide their final reports to disputants within six months of the Panel being composed, but extensions are common and in practice it often takes longer than a year for reports to be publicly circulated. Panel Reports are to be adopted within 60 days after circulation of the Report, unless appealed.

Compliance with a WTO decision may be achieved by withdrawing the WTO-inconsistent measure or, alternatively, by modifying or replacing it. The offending state must do so within a "reasonable period", being the period proposed by the member and approved by the Dispute Settlement Body (DSB), a period mutually agreed by the disputants, or, absent approval and/or agreement, the period determined through binding arbitration.

The WTO does not have the ability to impose fines on members. If the member state fails to comply, there are two possible solutions: negotiation of a compensation agreement; or, if negotiations have not been requested or agreement not reached, the prevailing member may request authorisation from the DSB to retaliate. Such retaliation involves the suspension of concessions or obligations with regard to the offending member. First, a member should suspend concessions or obligations in the same trade sectors as the one at issue in the dispute. If this is not practicable or effective (for example, if there is an imbalance in the types of goods traded between the parties) and the circumstances are serious enough, the member may seek to suspend concessions or obligations in another sector, or under another WTO agreement.

WTO law also allows any member to bring a complaint even if there is no violation by another member of its WTO obligations. In the case of so-called "non-violation complaints", a member is acting on the basis of the "nullification or impairment of a benefit" accruing to it directly or indirectly under WTO law as the result of the application by another member of any measure, whether or not such measure conflicts with the provisions of the applicable agreement.

The rationale of the "non-violation" provision is to prevent members from using non-tariff barriers or other policy measures to negate the benefits of negotiated tariff concessions. Accordingly, a non-violation complaint will turn on the complainant's ability to demonstrate that the respondent's non-violation conduct has frustrated the complainant's reasonable expectation of improved market access opportunities.

However, successful non-violation claims are very rare, and in the *Japan-Film* case, the Appellate Body stated that the non-violation remedy "should be approached with caution and should remain an exceptional remedy". The Dispute Panel in that case had noted that, although the non-violation remedy was an important and accepted tool in WTO dispute settlement, parties had been cautious in using this remedy and there had only been eight cases at that time (1998) in which panels or working parties had substantively considered non-violation claims. The Dispute Panel stated that "members negotiate the rules that they agree to follow and only exceptionally would expect to be challenged for actions not in contravention of those rules".

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