

# **OPEN BRITAIN**

## **NEW PARTNERSHIP, NEW CHALLENGES**

**FOREWORD BY NICKY MORGAN MP**

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# Foreword

By the Nicky Morgan MP

**O**f all the challenges facing the Government now that the Prime Minister has triggered Article 50, the biggest risk the UK faces would be leaving the EU with no deal at all. Some members of the Cabinet have said we should prepare for such an eventuality. I am concerned, as are MPs from across the political divide, that this most extreme form of Brexit is being talked about with increasing fervour by those who favour a fundamental rupture with Europe.

The language has moved from talking about no deal being better than a bad deal to the most enthusiastic backers of Brexit talking it up as a good thing. And they are already rolling the pitch to use the impending 'Brexit bill' as an excuse to walk away from the negotiations. But the very real and very dangerous consequences of doing so need to be understood.

We should be under no illusion that this would be an extremely perilous path for our economy. Nissan recently warning that this could lead them to reconsider their UK investment, a stark reminder of what the 'WTO-only' outcome could mean in practice. Crashing out of the EU at the first sign of tension in our negotiations should not be something the Government entertains.

No deal means tariffs on goods. They are taxes on imports, which raise prices for consumers and users, and taxes on exports, which reduce the competitiveness of our firms. I have always believed in free trade and I do not understand how we can marry that traditional Conservative commitment with being in any way relaxed about the no deal option. This was a view expressed this week by the Chancellor who said he thought it would be 'ridiculous' to leave without a deal.

In the spirit of a 'global Britain', though, there are those in my party who argue that because we trade with the rest of the world in this way, it is fine for us

to do so with our largest trading partner. They say it works fine for the United States, so why not for Britain? The truth, however, is that walking away from the Brexit negotiations with no deal and defaulting onto World Trade Organisation (WTO) rules would leave the UK trading with the EU on less generous terms than any other country in the G20. It does not need my natural Conservative free-trade instincts to tell me this is not acceptable for our country and bad news for my constituents.

Proper scrutiny of the negotiations should not be confused with trying to frustrate the referendum result. The country voted to leave the EU and the two-year journey towards the exit door has begun. The result is being respected. If we are to move beyond the arguments and labels of last year, we need to have a national debate about the choices and consequences thrown up by the decision to leave. And we must involve those beyond Westminster, which is why Open Britain's initiative to gather academics and specialists to write about the UK's post-Brexit trade policy is so welcome.

It starts with public opinion. Because, especially given the lack of a Leave manifesto, it is vital to understand what voters expect the Government to deliver from the negotiations. Polling shows very few of them expect or would tolerate a hit to their living standards and Leave voters were almost unanimous in believing that Brexit was a cost-free option. This is going to be challenging but it must serve as the starting point for the Government's ambitions. As the Chancellor has also said, 'no-one voted to be poorer' on June 23rd.

It is even more challenging outside the EU's main economic architecture – the Single Market and Customs Union – membership of which have increased growth, living standards and investment in our country. Even if replicating existing arrangements on a sector-by-sector basis were politically feasible, given the EU's insistence that the UK will not be allowed to 'cherry-pick', it is still



unclear whether this would be desirable, given sectors are inter-connected and it will inevitably mean picking winners and losers.

What is clear is that no existing EU FTA allows a third-party country the same degree of market access as being a member of the Single Market, so minimising the cost of a lesser arrangement will be essential. As will negotiating a new customs co-operation agreement of the deepest kind. We will have to increase capacity to deal with increased declarations, minimise the cost of new Rules of Origin procedures, and negotiate bespoke arrangements to avoid a damaging re-emergence of a hard border in Northern Ireland.

The Government will now attempt to put their Brexit plan into action. We should all want them to succeed because we want what is best for our country. But that does not mean everybody must meekly support the concept of walking away without a deal. June 23rd was a starting gun, not a finishing line. Democratic debate must never end. Indeed, it is now more important than ever.

*Nicky Morgan MP is a leading supporter of the Open Britain campaign*



# Executive Summary

## ***The People have spoken, but what did they mean?***

**Peter Kellner**

- Referendums differ from General Elections in their lack of manifestos and accountability, which makes it even more important to try and understand what people thought they were voting for. The public's view of Britain's current relationship with Europe is significantly different from official statistics, particularly on core issues in the referendum such as immigration, welfare and the EU budget. Many people, including a large majority of Leave voters, have a view of immigration, EU "waste" and inward investment that is wide of the mark, which meant they overstated the problems to which they regarded Brexit as a solution.

- The Government has taken the referendum result to be a mandate for a 'global Britain', but there is little evidence to support this. Brexit support was a rejection not just of the EU but of our links with the world beyond Europe. Most Leave voters want less immigration of all kinds and believe that both globalisation and multiculturalism to be forces for ill rather than good.

- Leave voters do not expect things to get worse from Brexit in any feature of British life. They do not think, and would not tolerate, a reduction in their living standards resulting from Brexit. They were unanimous in their view that leaving the EU was a cost-free option. It is too early to say what the impact of Brexit will be and there may never be 'buyer's remorse', but the mandate from last June was conditional and it is possible there is an increasing public clamour in the future to think again.

## ***UK-EU trade arrangements post-Brexit***

**Vicky Pryce**

- Any comprehensive Free Trade Agreement (FTA), even including a positive transitional arrangement, would be worse for the UK economy

than continued UK membership of the Single Market or EEA. The worst option would be 'no deal' and opting for a WTO-only arrangement.

- The Single Market's common rules, legal system and four freedoms increase economies of scale; boost investment and innovation; and lead to higher productivity and lower costs for consumers. For the UK, membership has made our economy more attractive to foreign investment, increased UK-EU trade and eliminated non-tariff barriers.

- The Government's preference for specific sectoral arrangements would be a sub-optimal outcome. There is room for manoeuvre within FTAs and the pressure should be on the Government to obtain an agreement that is as close to the one we have with the EU now as Single Market members as possible. However, there simply is no FTA in existence that provides the same level of access as Single Market membership, particularly in services. And there is a political incentive in the EU to ensure any FTA delivers more restricted market access.

## ***A customs cooperation agreement***

**Timothy Lyon QC**

- To protect its own interests, the UK may wish to maintain the existing level of customs cooperation with EU member states, particularly if the aim is to reach a comprehensive agreement that will deliver the exact same benefits we have at present. To satisfy this objective, any agreement will need to address the breadth of functions carried out by modern customs authorities; the depth of their cooperation; the issues raised by rules of origin; and the avoidance of a hard border between Northern Ireland and the Republic of Ireland.

- Customs co-operation will need to consider how to preserve the framework for electronic



communications between the relevant agencies and between traders and customs authorities. There is likely to be a need to maintain if not increase the capacity of the UK's computer systems as the number of customs declarations is likely to increase substantially. It may be important to maintain the current common approach to issues such as risk management, procedures for the release of goods and classification and valuation matters. Mutual recognition of the status of authorised economic operators in both the EU and the UK may be thought highly desirable.

- In Ireland, creative solutions will need to be found to prevent a hard border from emerging. Doubts have been raised about whether the solution between Norway and Sweden could be replicated, as both are in the Single Market, and whether the technology even exists to make an open border possible. From the Irish border to traders to consumers and individuals, a suitable customs cooperation agreement will be one of the most important facets of the negotiations.

### ***Post-Brexit free trade agreements*** **Sam Lowe**

- Autonomy in trade policy was a key argument for Brexit but an FTA is not a good thing solely by virtue of its own existence. Substance, sequencing and strategy matter more than speed. The most important future agreement is with our biggest trading partner – the EU. Our degree of access to the Single Market and our integration with the EU's standards, customs procedures and regulatory bodies will impact on how appealing a trade deal is with Britain for other countries around the world.
- Through the EU, the UK enjoys over 60 FTAs with other countries, with others close to ratification. The Government wants to replicate these post-Brexit but that will be challenging. Countries may see this as an opportunity to negotiate better

deals in specific areas, such as South Korea on cars or South Africa on agriculture. And, as the Japanese Government have made clear, the UK would need to agree new rules of origin not just with the country involved, but also with the EU.

- Negotiating new FTAs will be even more challenging. Quick deals can be done but they are normally superficial or involve one party riding roughshod over the other – a test when negotiating with an economic heavyweight like the United States. In the modern world, the challenge is not primarily around tariffs but non-tariff barriers to trade, which are fraught with cultural preference, subjectivity and compromise. For example, differing agricultural and environmental standards in the United States and India's desire to use trade talks to demand visa liberalisation.
- Free trade deals will never compensate for lost EU membership. Large, wealthy nearby economies with whom we are already integrated will always be more important than smaller nations further away. Even the best trade deals possible with the US and India barely make a dent in the expected loss in growth from leaving the EU, a deep continuing relationship with whom should be our focus.

### ***Trade under the 'WTO model'*** **L Alan Winters**

- Leaving the EU with no deal in place will leave the UK trading with the EU under World Trade Organisation (WTO) rules, where both sides would charge the other the same tariffs on goods as they do other nations. Around half of all UK exports and imports would become subject to tariffs, which would be particularly problematic on cars and high on agricultural products. Those celebrating the UK raising more tariff revenue misses the point – tariffs are taxes on imports, which would increase prices for consumers and make markets less competitive. These problems would be compound-



ed by complications in customs arrangements and differences in standards.

- It is nearly universally accepted that dropping out of the albeit imperfect Single Market for services and instead trading under WTO rules will cut UK access to European markets considerably. It is difficult to quantify by how much. UK services exports to the EU will be hampered by a range of EU and member state-level non-tariff barriers, such as on qualifications (for example in professional services), differing regulations (for examples in financial services), and diverse regulatory bodies. Indeed, with many services regulated at country-level in the EU, the UK will have to negotiate with 27 other partners, not just with the Commission.

- Services must lie at the heart of the UK's Brexit strategy. A deep FTA would allow for some additional friction in the trade of some goods and services to be avoided on a sector-by-sector basis. However, the WTO model promises significantly higher trade costs for the UK when trading with the EU. Going beyond the WTO model might alleviate some, but many will remain.

***Paper on post-Brexit options for State aid***  
**George Peretz**

- Some, such as Jeremy Corbyn, have supported leaving the Single Market on the basis that it will allow the UK to escape the EU's rules restricting State aid. However, the EU has generally insisted on compliance with State aid rules as a condition of a comprehensive trade agreement, which could be a red line on the European side for any deal with the UK in the range between CETA and an EEA agreement. Even if the UK ends up trading with the EU under WTO terms, restrictions on State aid will remain in relation to goods, in the form of the WTO's anti-subsidy rules, which the UK will want to respect.

- There are advantages to UK business of retaining State aid rules, including protecting British firms from subsidies in EU countries that affect them; giving the Government a legal recourse to take action to protect their interests; and possibly to give the UK a continued role in the development of EU State aid law (as EEA members and countries like the Ukraine currently do outside of the EU).

- Even with the Government's rejection of EEA membership, there are benefits to pursuing a "State-aid specific" EEA model, which in many ways is better than the EU model, with speedier decision making and a greater emphasis on economic, rather than political, decision-making.





# The people have spoken, but what did they mean?

*Peter Kellner*

**T**he people have spoken, but what did they mean? The question is asked so frequently after big electoral events that it has become something of a cliché. However, after last year's referendum, the answer matters more than ever – and certainly more than after any general election.

There are two reasons for this. The first is that parties publish manifestos ahead of elections. They form the basis of the contract between government and citizens, much as the "terms and conditions" supplied with our mobile phones and television sets form the basis of our contract with Apple or Panasonic. Voters generally don't read manifestos. They may not fully appreciate the plans of the winning party. The point is that they can discover them without much difficulty should they wish to do so.

No such discovery was possible last June. There was no Brexit manifesto spelling out the consequences of leaving the European Union, just a variety of suggestions and scares from the different participants. The only specific proposal from Vote Leave was impossible to deliver and, indeed, disowned by some Brexit campaigners such as Nigel Farage: that Brexit would make available an extra £350 million each week for the NHS. In the absence of an explicit Brexit manifesto, it is far more pertinent than after a general election to understand what people thought they were voting for.

This leads us to the second reason for asking what voters meant last June. A remedy is available to disappointed voters after an election. If a Government fails to deliver what it promises – or if it does keep its promises but is deemed more generally to have let people down – then in due course voters can chuck it out and install a different party. The Brexit referendum contained no such formal remedy. Only if Parliament insists on halting the process can the UK remain in the EU. It is plainly

significant that the Government seeks to deny this option by saying that when MPs vote on the final deal (if there is one) they will be able only to "take it or leave it" – that is, leave the EU on the agreed terms or crash out without a deal. The Government wants to rule out any possibility of Parliament, let alone the electorate, deciding that after all, Brexit will be bad for the UK and should not go ahead.

It is even more essential to understand voters' expectations of Brexit after the Government's announcement that they intend to seek to negotiate a Free Trade Agreement and leave the Single Market and Customs Union. This raises many uncertainties about the future shape of the UK-EU relationship, not least over the economy and migration.

By analysing what voters really thought at the time of last year's referendum, we can assess the true nature of the mandate delivered by the result, and compare it with the outcome of the coming negotiations. We can then go beyond the trivial statement that "Brexit means Brexit" and develop a framework with which to make sense of the unfolding drama of the next two years

So: what was going on in the minds of the 52% who voted for Brexit? Fortunately, there is ample research to provide an answer.

First, many Britons have a view of Britain's current relations with the EU that differs significantly from official statistics.

An Ipsos MORI survey conducted during last year's referendum campaign asked a number of knowledge questions. One concerned the issue at the heart of the referendum debate: immigration from the EU. On average, pro-Brexit voters said that 20% of people living in Britain were born in the EU. Given the UK's population of around 64 million, that 20% equates to more than 12 million.





“Remain” voters put the figure lower – 10% on average. The official figure for 2014 was just 3 million. Even allowing for further net immigration since then, the true figure is around 5%.

We can go further. One of the big controversies last year concerned welfare payments to immigrants. David Cameron put great store by his plan to delay the right of new immigrants to receive welfare benefits. YouGov research two years before the referendum showed why the public pressure on this point was both huge and misplaced.

YouGov asked:

Q. On the subject of immigrants and Britain’s welfare system; for anyone to claim such welfare benefits as Job Seekers Allowance, incapacity benefit or income support, they must first register for national insurance and get a national insurance number. What proportion of immigrants these days do you think claim one of these benefits within six months of obtaining a national insurance number?

The average answer was 23%. UKIP voters think the proportion is 46%. By comparison, data from the Department of Work and Pensions put the proportion at just 6%. This is not only far lower than the public thinks: it is also less than half the rate of British-born adults of working age.

Immigration is not the only issue on which perceptions vary from the statistics. Ipsos MORI also found that most people massively overstated the amount of EU spending that goes on staff and administration. The public’s average guess is that the figure is 27% of all EU spending. The true figure is 6%. At the same time, most people understate the importance of inward investment from other EU countries to Britain’s economy, a key indicator of how important people perceive the EU to be to the UK economy. On average, voters think that 30% of inward investment comes from the EU; the true figure is 48%.

As for our contribution to the EU’s Budget, YouGov found in late 2014 that people think, on average, that of every £100 they pay in taxes, £7 goes to Brussels. Among UKIP voters, the average is £10. The true figure is in fact £1.

It is, of course, ludicrous to suppose that more than tiny proportion of people would carry the correct figures in their heads. A wide variety of responses is only to be expected. But the size and direction of the average error is significant. It suggests that many people, including a large majority of Brexit voters, have a view of immigration, EU “waste”, and the impact of inward investment that is wide of the mark. This suggests that many voters overstated the problems to which they regarded Brexit as a solution – and understated the value of EU companies to the UK’s economy.

Secondly, there is little evidence that a vote for Brexit was a vote for “global Britain”.

The prospect of “global Britain” has been offered by Government ministers as the prize to be pursued outside the EU – where Britain engages with countries, people and businesses throughout the world, rather than looking inwards and becoming insular.

The evidence confounds this view. Support for Brexit was not just a rejection of the EU, but of many of our links with the world beyond Europe. Surveys have shown repeatedly that most “leave” voters want sharp reductions in immigration of all kinds: their opposition is not just to the EU’s freedom of movement rules.

This matters because around half of immigration to the UK is from outside the EU. The point here, of course, is that the Government could already have done this. It is not restricted in any way by EU rules. Why has it not done so? It could plead economic necessity, or humanitarian decency, or both. It

could speak of the value to the NHS of nurses and doctors from around the world. It could not plead public demand or impotence in the face of Brussels bureaucrats.

A broader picture of public attitudes was provided by a big survey of 12,000 people conducted for Lord Ashcroft during the week of the referendum. One of its sets of questions concerned issues linked to the notion of “global Britain”. Did people think each was a force for good, a force for ill, or a mixed blessing? This is what voters said:

	All voters %	"Remain" voters %	"Leave" voters %
Immigration			
Force for good	35	57	14
Force for ill	40	17	62
Mixed blessing	25	26	24
Globalisation			
Force for good	42	54	31
Force for ill	24	15	32
Mixed blessing	34	30	37
Multiculturalism			
Force for good	47	70	26
Force for ill	30	12	48
Mixed blessing	22	19	26

As these figures show, the appetite for “global Britain” is not negligible, but it is far stronger among “remain” voters than “leave” voters.

Taken together, these findings present a challenge to ministers. The prevailing mood of most Brexit voters is not just of hostility to the EU but one of wariness towards the rest of the world. Only by combining the minority of globally-minded Brexit voters with the much larger number of internationalist “remain” voters is it possible to argue that voters want a Britain outside the EU to be truly open to the rest of the world. But ministers show no sign that this is what they mean when they say that Brexit voters wanted “global Britain”.

Third, Brexit voters do not expect, and would not tolerate, a reduction in living standards as a result of the UK leaving the EU.

On the eve of the referendum, YouGov asked people what they expected the impact to be if the UK left the EU. It asked about different features of British life. In each case, these are the percentages of Brexit voters who expected things to get worse: British influence in the world: 5%; Britain’s economy: 4%; people’s own finances: 3%; pensions: 2%; NHS: 2%; British jobs: 2%; risk of terrorism: 1%.

Anyone familiar with polling data knows that figures this low are extremely rare, especially when senior voices in the worlds of politics, business and the media could be heard on both sides of the argument. Given the fact that the Government of the day, along with leading figures in Labour, the Liberal Democrats, the SNP and the Greens, were all warning of the dangers of Brexit, these figures are remarkable. They demolish any notion that there were voters who believed that Brexit might make things worse, that this was a price worth paying for Britain regaining its power to make its own laws. For all practical purposes, Brexit voters were unanimous in believing that leaving the EU was a cost-free option.

That is not all. In December 2016, six months after the referendum, a YouGov poll for Open Britain asked people how much they would be prepared to lose, taking into account income, taxes and prices, in order for the UK to leave the EU. Half of all Brexit voters said they were not willing to lose anything. A further 40% were willing to lose a small amount – £10 a month (11%), £20 (17%) or £50 (12%). Only one Brexit voter in ten was willing to tolerate a loss of more than £50 a month. As the average household income is around £2,000 a month, this means that few Brexit voters are willing to see their living standards fall by more than 2.5%.



So far, the only obvious impact of Brexit has been the reduction in the value of the pound. This has led to forecasts that inflation will rise this year from 1% to 3%. Whether living standards will be hurt in other ways – fewer jobs, stalled wages, higher taxes, less money for public services – remains to be seen. Maybe Britain's economy will defy predictions of a slowdown. But if daily life is hit in any, let alone all, of these ways, then the overall cost to living standards could well exceed 2.5%.

In itself, that may not be enough to provoke "buyer's remorse" among Brexit voters. They may blame circumstances other than the referendum vote. However, if a significant number of "leave" voters do blame Brexit, then it is possible that the 52-48% vote for leaving the EU may turn into a majority favouring second thoughts.

The larger point is that the "mandate" for Brexit from last June was conditional, framed by views of today's Britain that often vary wildly from official data, hard to square with notions of "global Britain", and considered by almost all "leave" voters to offer them cost-free route to a better life. As with new governments, after their honeymoon period wears off, disappointment may be in store. But whereas governments can be ejected at subsequent elections, referendum results can be overturned only by an explicit decision of parliament. We cannot yet tell whether there will be a public clamour to reverse last year's referendum result. But the evidence we have of the views and expectations of Brexit voters, the mandate they thought they were giving the Government, and the potential for disappointment, all suggest that the possibility cannot be ruled out.

***Peter Kellner, former President of YouGov  
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# UK-EU trade arrangements post-Brexit

*Vicky Pryce*

**W**hat does life outside the EU have in store for UK trade? If we follow the path the Government has set out, we will leave the Single Market and the Customs Union in pursuit of a Comprehensive Free Trade Agreement (FTA) with the EU.

It is unclear at this stage where this will lead: all is still up for grabs. The economic forecast accompanying the IFS 'Green budget' in early February assumed a three-year transition period during which a bespoke FTA would be negotiated. Such a transitional arrangement would be a positive and necessary outcome, but the IFS study, like many others, comes firmly to the conclusion that the economy will do worse than would be the case if the UK remained a member of the European Economic Area (EEA). The worst option in their and most trade analysts' views would be for the UK to opt for a WTO-only arrangement, which would be the fall-back position for the UK if Mrs May follows up on her threat that 'no deal for Britain is better than a bad deal for Britain'.

Such an outcome would see tariffs imposed on goods trade, so costs would rise, and exports and imports would fall. Some analysts have raised the option of cutting UK tariffs to zero to reduce costs and be 'open' to trade. That would of course then have to be applied to all our imports from what are labelled Most Favoured Nations (MFNs). This would have disastrous consequences for some of our sectors which would face being wiped out by competition from abroad.

This essay considers the implications of the UK leaving the EEA and Single Market in exchange for a bespoke FTA.

## **Advantages of the Single Market**

EU firms - and those coming from the outside and establishing a presence in any EU country -

currently operate in a large 'single' market of 500m people with a common set of operating rules and a robust legal system underpinned by the free movement of goods, services, capital and people. This offers the possibility of enjoying large economies of scale and, against a background of intense competition, provides incentives for higher investment and innovation. The benefits to the region as a whole come in terms of higher productivity and lower costs to consumers than would otherwise be the case.

Being part of that Single Market has helped the attractiveness of the UK itself. Professor Nick Crafts from Warwick University has calculated that the main benefit has come through the rise in productivity that was made possible by foreign direct investment<sup>1</sup>. Membership and access to the European market has been key. The estimates suggest that some 46% of FDI in 2014 came from the EU, some 27% from the US, and another 27% from the rest of the world. Movement of people has also meant that the growth in employment and output could continue for far longer without leading to inflationary pressures than was the case 10 or 20 years ago. And despite a perception that the EU has been left behind in the wake of fast growing emerging markets, according to the Bank of England two thirds of all global foreign investment involves the EU. Proximity matters in trade, and the 'gravity' models used by the Treasury and the NIESR all show that we tend to export to nations near us. As Professor Alan Winters from Sussex University has recently calculated, Europe has been growing in its importance as a trading partner for the UK since we joined the EU. Our exports to the region have risen from 21% of total goods exports in 1968-70 to some 32% in 2012-15.

It is often forgotten that the main advantages of membership of the Single Market emanate from the application of rules and regulations and

<sup>1</sup> <http://www.smf.co.uk/wp-content/uploads/2016/04/SMF-CAGE-The-Growth-Effects-of-EU-Membership-for-the-UK-a-Review-of-the-Evidence-.pdf>



standards that are applicable across the member countries. This reduces transaction costs and creates a level playing field for participants. The EU Single Market has moved a long way, often encouraged by the UK, towards preventing monopolistic or oligopolistic abuse; containing state aid and other support from national governments that favour domestic producers; and opening up access to public procurement opportunities across the region. The benefits to both market participants and customers has been significant. Obvious examples are the agreement on open skies, with a huge increase in the number of airlines in Europe and a huge increase in passenger numbers and passenger miles travelled. Similarly, there is the recent reduction in EU-wide mobile roaming charges. We have seen a real increase in consumer surplus in these two areas as low-cost aviation and phones have become a reality, generating significant extra economic activity in both home and host nations as a result. Closer cultural integration is a consequence too. Current moves to achieve a Single Market in digital services and energy as well as a capital markets union will see many more individual national cases of discrimination in favour of domestic players gradually disappear.

Clearly this requires regulatory harmonisation. EU-wide regulations coming from Brussels can add to costs, but many of them were introduced with the UK's agreement and at times active encouragement.

The EU Single Market is of course far from perfect. Standardisation of processes and regulations takes time and there are lots of opt-outs, mainly in agriculture and fishing, though not exclusively. Some countries persist in ignoring the rules while some, like the UK, gold-plate them more than others. There can still a lot of bureaucracy that baffles firms when dealing with the European Commission, especially for SMEs. Progress towards implementing the 2006 Services Directive

has been slow, though it is now being speeded up since it was transposed into the national legislation of all EU countries in late 2009. There is a lot still to do in achieving a true Single Market for digital, energy and retail banking, as well as in capital markets, which has in fact been put on the backburner since the resignation of Lord Hill, the UK's EU capital markets and financial sector Commissioner, after the EU referendum vote. And the economic and financial problems in some of the 19 countries in the Eurozone since the financial crisis hit in 2008 have also stalled progress in some areas.

### **UK-EU FTA: key issues**

Theresa May's government would love to see sectoral arrangements that would allow tariff-free movement of exports and imports for specific products. Mrs May herself said that may mean asking for 'associate' membership of the customs union to ensure zero tariffs for some products while also avoiding, if possible, restrictions on rules of origin, bureaucratic border checks, and any quotas imposed on exports to the EU. She has highlighted strategic 'preferred' sectors where she would like that to be the case.

The Prime Minister may of course not get any of that if we become a 'third country' as far as the EU is concerned. First, it is not clear whether highly selective sectoral preferential treatment tariff deals between the EU and the UK might be allowed under WTO rules. And, in any case, work done by the CEBR for Open Britain suggests that given the inter-linkages between sectors and the development of sophisticated supply chains, single-sector deals would not lead to anything other than a sub-optimal deal.

There is no FTA which exists that allows a third-party country the same degree of market access as a member of the Single Market. The EU-Canada Agreement (CETA), for example, states





that cross-border trade in services does not apply to “audio-visual services”; “financial services”; “air services, related services in support of air services and other services supplied by means of air transport”; or “procurement by a Party of a good or service purchased for governmental purposes”<sup>2</sup>. The agreement between the EU and South Korea does not harmonise product standards in key sectors such as food and drink or aerospace and machinery; does not provide full access to financial services; and keeps tariffs in place on important agricultural products<sup>3</sup>. The EU’s political incentive to ensure a UK-EU FTA must have some demonstrable cost to the UK, coupled with the economic incentive to gain competitive advantage over the UK in the EU’s own priority sectors, mean that derogations of this nature are likely to apply. The only issue is where and to what cost.

Furthermore, there is no EU FTA with a country outside the Customs Union which offers total tariff elimination. Again, using CETA as an example, quotas remain in place for key agricultural exports, which for the UK could mean, for example, a 12 per cent tariff on a large share of the UK’s beef exports to the EU<sup>4</sup>.

In 2016 the National Institute for Economic and Social Research (NIESR) attempted to calculate what the impact would be if the UK was outside the Single Market and the Customs Union but was able to negotiate free trade agreements with third countries or regions such as the EU itself. Looking at empirical evidence it estimated that EEA membership leads to substantial ‘statistically significant increases in bilateral trade flows’<sup>5</sup>. It concluded that an FTA arrangement with the EU and other third countries would not be able to replace trade flows lost in the future between the EU and the UK. What is more, they point out that the impact on services, on which the UK depends

and where we have a surplus with the EU, would be even greater. This is because while barriers to trade in goods have fallen consistently over the past decade, implied barriers to services remain some 2 to 3 times higher than those for goods.

The economic impact of having more restricted market access will reverberate beyond specific sectors. Foreign investment, for example, into key British industries could be affected if investors face uncertainty over the ability of their assets to generate income domestically and abroad.

FTAs take a long time to be negotiated precisely because of the different national norms that exist, although there is a move towards mutual recognition and regulatory equivalence to speed things up. This will not only be the central issue in agreeing new UK-EU trade arrangements, but also with third countries. Worryingly, while tariffs have fallen across the world, many nations (and trading blocs) have in fact responded by actually increasing non-tariff barriers as a protective measure. The WTO last year drew attention to the fact that 70% of recently imposed trade protectionist measures were by G20 countries.

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<sup>2</sup> CETA Text of the agreement, [link](#)

<sup>3</sup> European Commission DG Trade, *The EU-Korea Free Trade Agreement in practice*, 2011, [http://trade.ec.europa.eu/doclib/docs/2011/october/tradoc\\_148303.pdf](http://trade.ec.europa.eu/doclib/docs/2011/october/tradoc_148303.pdf)

<sup>4</sup> HM Government, *Alternatives to membership*, March 2016, [link](#)

<sup>5</sup> [http://www.niesr.ac.uk/publications/assessing-impact-trade-agreements-trade#.WK2fNm\\_yjX4](http://www.niesr.ac.uk/publications/assessing-impact-trade-agreements-trade#.WK2fNm_yjX4)



One of the main reasons many campaigned to leave the EU was greater regulatory freedom. However, this may be a costly ideal. The strong likelihood is that much EU regulation, once transcribed into main UK law, would continue to operate after we leave in order to make continuing free trade with the EU easier. Regulatory 'equivalence', would, however, have to be maintained, as divergence from EU standards as European regulation evolves would likely contravene the terms of any FTA. As an example, the UK could design its own food labels but would still need to abide by EU food labelling requirements when trading with the EU. In determining future trade arrangements, therefore, policy-makers need to consider the balance between the perceived benefits of regulatory freedom and the downsides of regulatory divergence, such as having multiple production lines if the sector is a major trader with the EU. Furthermore, as countries with an FTA have no representation on EU institutions, a democratic deficit arises.

## Conclusions

From studying the content of EU FTAs with third parties, as the UK will be, and from looking at existing economic analysis of the impact of a future UK-EU FTA, it is hard to draw any conclusion other than that FTAs are a worse outcome than what we have now. There is still room for manoeuvre of course within them, so the pressure must be to obtain as close an agreement with the EU as we now have as members of the Single Market. That may be hard to negotiate. It will be even harder to do so with the agreements that we are at present signatories to with other countries, which will now have to be renegotiated. Furthermore, in this increasingly protectionist environment, we must also not underestimate the inherent difficulties in concluding any quick win-win agreements with any new countries that we would like to forge closer trade links with in

the future.

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# A customs cooperation agreement

*Timothy Lyons QC*

**T**here are at least two areas of customs practice and law that should be considered in agreements between the UK and the EU in relation to Brexit.

First, there may be agreements relating to the level of customs duty chargeable in respect of goods and rules relating to its calculation, such as rules of origin. There are a number of broader legal issues to be considered in this context. They include the compatibility of merely sectoral agreements with WTO rules. GATT 94 permits free trade areas and customs unions in which duties and other restrictive regulations of commerce are eliminated on "substantially all" the trade in products originating in them (see Article XXIV.8). It remains to be seen whether or not any agreements entered into by the UK would comply with this requirement.

Secondly, whatever the agreement between the EU and the UK about the imposition of duty, there will need to be an agreement about cooperation between the customs authorities of the EU and the UK. This topic could be dealt with in a separate agreement but may well form part of the general EU/UK trade agreement. If a transitional agreement is established, then customs cooperation ought to be dealt with by it to avoid disrupting cooperation between the respective authorities.

This essay concentrates on the second area referred to above, namely customs cooperation. It contains some brief comments on rules of origin because their application requires cooperation between customs authorities. This is the case in CETA where the protocol on origin and origin procedures runs to approximately 200 pages.

## **Customs cooperation**

The maintenance of a customs union in a single market requires cooperation between the relevant customs authorities of the deepest possible kind. The national authorities of Member States aim to exercise their functions "as efficiently as though they were one"<sup>1</sup>. The necessary cooperation is not just between Member States but also between Member States and the European Commission. General references below to "the EU customs authorities" should be understood to refer to all relevant authorities.

It seems possible that the UK may wish, in order to protect its own interests, to maintain its existing level of cooperation with both Member States' authorities and the European Commission after it has left the EU. Certainly, the Secretary of State for Exiting the European Union has spoken of aiming to establish a comprehensive free trade agreement and a comprehensive customs agreement that will deliver the exact same benefits as we have at present<sup>2</sup>.

Negotiators of a customs cooperation agreement between the UK and the EU may need to satisfy two conflicting objectives. First, they may seek to retain the existing level of customs cooperation to ensure legitimate trade is facilitated and illegitimate trade is countered. Secondly, they may well wish to enable the UK to exercise control of its national borders and the EU to protect the borders of its customs territory.

In satisfying these objectives a UK-EU agreement needs to take account of at least four general matters: the breadth of the functions carried out by modern customs authorities; the depth of their cooperation and the need for an appropriate institutional framework for it; the need for

<sup>1</sup> Decision 624/2007/EC of the European Parliament and the Council of 23 May 2007 establishing an action programme for customs in the Community (Customs 2013) [2007] OJL154/25, Article 4.1(b).

<sup>2</sup> <https://www.theyworkforyou.com/debates/?id=2017-01-24b.161.0&s=same+benefits+speaker%3A10162#g169.2>



an appropriate institutional framework for it; the need for cooperation in applying rules of origin; and the general desire to avoid the creation of a so-called “hard border” between Northern Ireland and the Republic of Ireland.

### **The breadth of cooperation**

Modern national customs authorities have responsibilities which extend far beyond the collection of customs duty and the verification of the nature, origin and value of goods. They supervise and facilitate legitimate international trade, manage trade quotas, contribute to the security and efficiency of supply chains, and assist in the protection of intellectual property rights. They have responsibilities related to environmental and product safety standards and checks on animal and plant health. An agreement needs to take all these into account.

Customs authorities also play vital roles in countering illegal trade (e.g. the trafficking of drugs, weapons and other goods) which frequently uses similar supply chains to legitimate trade. Customs authorities, therefore, have crucial functions in relation to the enforcement of international conventions governing matters such as trade in endangered species, international sanctions and trade in goods capable, for example, of being used in torture. An agreement needs to take account of these functions as well.

In order to maintain the breadth of existing levels of cooperation to combat illegitimate trade, it will be necessary to ensure the continuation of UK-EU cooperation between the police and other law enforcement agencies and judicial authorities. Cooperation in customs matters will involve much more than cooperation between customs authorities.

### **The depth of cooperation**

Customs cooperation agreements with countries such as Japan<sup>3</sup> and Canada<sup>4</sup> not only set out the framework for cooperation, they also establish a Joint Customs Cooperation Committee (“JCCC”). It has an important role in relation to the implementation of customs cooperation agreements. A general EU/UK trade agreement will be likely to establish a number of specialised committees, of which a JCCC would be one, each reporting to a central committee.

Any customs cooperation agreement between the EU and the UK should ensure that the remit of the JCCC reflects the already close customs cooperation between their respective customs authorities. It should also have a clear relationship to other committees which are established. It will probably have a role in relation to dispute resolution in customs matters which may be both important and sensitive.

Particular areas requiring careful attention may be:

- The need to preserve the framework for electronic communications between the relevant agencies and between traders and customs authorities. Some may wish to ensure that the UK remains part of the EU’s Customs Information System. Electronic communications are the subject of an EU work programme, operating up to 2020, established to ensure the development and deployment of the necessary electronic systems in the EU<sup>5</sup>. The UK’s continued participation in this may be thought desirable.
- There is likely to be a need to maintain if not increase the capacity of the UK’s computer systems. The number of customs declarations to be handled seems likely to increase substantially,

<sup>3</sup> Agreement between the European Community and the Government of Japan on cooperation and mutual assistance in customs matters, Official Journal L62/24, 6.3.2008.

<sup>4</sup> Agreement between the European Community and Canada on customs cooperation and mutual assistance in customs matters, Official Journal L7/38, 13.1.98. Under CETA, the JCCC is granted authority to act under the auspices of the CETA Joint Committee: see CETA, Article 26.2.

<sup>5</sup> Commission Implementing Decision (EU) 2016/578 of 11 April 2016 establishing the work programme relating to the development and deployment of the electronic systems provided for in the Union Customs Code OJ L99/6, 15.4.2016.



and probably beyond the capacity of existing systems when the UK ceases to be an EU member state. According to one source, customs declarations may rise from 90 million to 390 million per year by 2019. Any resulting increase in customs communications between authorities must also be accommodated<sup>6</sup>.

- It may be important to maintain the current common approach to issues such as risk management, procedures for the release of goods, the provision of advance rulings by authorities, classification and valuation matters, and the imposition of fees and charges in respect of consignments of goods.

- The validity of authorisations and decisions given to traders by customs authorities, particularly those which span the time of the UK's exit from the EU, must be addressed. The validity of binding information in relation to the origin and value of goods is likely to be of special importance both where the period of validity goes beyond the date of Brexit and more generally.

- Mutual recognition of the status of authorised economic operators in both the EU and the UK may be thought highly desirable. Such status offers simplicity and certainty to traders and facilitates authorities in taking a risk-based approach to customs controls.

### **The origin of goods**

EU trade agreements frequently have a protocol entitled: "Concerning the definition of 'originating products' and methods of administrative cooperation". As its name indicates, such a protocol contains the rules of origin in respect of goods. It also contains rules governing the certification of origin by customs authorities and

the verification of that certified origin. Rules of origin are an essential feature of any free trade agreement, and ensure that only goods which originate in the contracting parties benefit from it. They are bound to be part of an EU-UK free trade agreement and their application and management will be a matter of considerable importance.

Provisions governing cooperation between customs authorities will not deal with all the issues relating to the origin of goods which may need attention. For example, some traders appear to be requesting rules of origin which ensure that certain processes carried out in the UK do not prevent products being classified as having EU origin under agreements between the EU and third countries. This seems likely to be not a matter of cooperation so much as one of the application of the relevant rules. Appropriate provisions can be determined only after consultation with the industries affected.

The provisions for administrative cooperation in respect of origin are likely to provide, for example, for verification of certificates of origin, communication between customs authorities on matters relating to origin, and the resolution of certain disputes related to origin by a specified committee.

### **Northern Ireland and the Republic of Ireland**

When the UK leaves the EU, the EU's customs territory will obviously shrink. Its border will follow the border between Northern Ireland and the Republic of Ireland.

This change gives rise to potentially conflicting interests. On the one hand, there appears to be a general desire to ensure that the border is not a hard one. On the other hand, if the border is not in

<sup>6</sup> <https://publictechnology.net/articles/news/brexit-could-sink-hmrc-customs-system>



some way maintained, the EU's customs authorities will not be able to carry out their functions. They may well consider that there could be a possible loss of duty and damage to the interests of traders and others. The UK's authorities may also have some concerns about border control.

In these circumstances, it has been suggested, quite reasonably, that lessons be learned from the treatment of the EU's borders elsewhere, for example between Sweden and Norway. Unlike the future position of the UK and the Republic of Ireland, however, both Norway and Sweden are within the Single Market. This requires the removal of customs controls and maintains levels of conformity between its participants to which the UK will not adhere once it leaves the EU.

If a similar approach to that implemented in relation to Sweden and Norway is adopted, customs officers will require cross-border powers and some capacity for video and electronic surveillance. Furthermore, certain types of commercial vehicles may be required to use only specified roads, subject to surveillance. Some questions have been raised about whether such measures would be generally acceptable or even, perhaps, technically possible. Mr Bertie Ahern has been reported as saying in relation to the suggestion that there be an open border like that between Norway and Sweden: "I haven't found anyone who can tell me what technology can actually manage this."<sup>7</sup>

It may be that other options should be considered, particularly so as to benefit communities living on both sides of the border whose members often need to cross it many times a day. All current EU Member States are used to applying reduced controls to authorised persons in pursuance of risk

management. Some may wish to consider, therefore, whether it would be practicable to classify confirmed reputable businesses or individuals, resident or established in border areas, as "frontier travellers" so that they could cross the border frequently, free of customs checks.

Whatever solution is adopted, while cross-border customs cooperation generally between the EU and the UK should be deep and broad, it may well be at its most comprehensive in relation to the border between Northern Ireland and the Republic of Ireland.

## Conclusion

Customs cooperation may seem, at first sight, like an arcane subject of interest only to specialist traders and officials. Nothing could be further from the truth.

The broad scope of the activities of customs authorities means that the cooperation between customs authorities affects not just traders but consumers and individuals generally. It will be especially important for those near the border between Northern Ireland and the Republic of Ireland. A customs cooperation agreement between the EU and the UK will be of very great significance for all concerned, and will be as important, if not more important, than other customs cooperation agreements entered into by the EU with its trading partners.

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<sup>7</sup> <http://www.bbc.co.uk/news/uk-northern-ireland-38949539>.



# Post-Brexit Free Trade Agreements

Sam Lowe

**"J**une the 23rd was not the moment Britain chose to step back from the world. It was the moment we chose to build a truly Global Britain."  
*Theresa May, January 2017*

Brexit's meaning is no longer confined to the realm of tautology. Theresa May, the Prime Minister, has told us the UK is to give up its membership of the EU's Customs Union and Single Market. We will be leaving the confines of the EU's Common External Tariff and Common Commercial Policy, freeing us to pursue new trading relations further afield. Australia, Brazil, China, India, New Zealand and the USA. The list of countries interested in quick, post-Brexit trade agreements with the UK is impressive, and seemingly ever-growing.

With hindsight, this should not have come as a surprise. Autonomy in trade policy has always been a central political and economic objective of Theresa May's Government, as evidenced by the creation of Liam Fox's Department for International Trade. But beyond the headline rhetoric, little analysis has been conducted on the pros and cons of such an approach. A free trade agreement (FTA) is not a good thing solely by virtue of its own existence. And the UK will soon find that substance, sequencing and strategy matter far more than speed.

## The European Union

One relationship remains more important than all others: that with the EU.

While much noise has been made about the fact we cannot sign trade agreements with new partners until we officially leave, to make that your focus is to miss the bigger point. Not only is the EU our biggest trading partner – accounting for 48% of

our total exports and 54% of our total imports<sup>1</sup> – but the continued integration, or not, of our standards, customs procedures and relationships with EU regulatory bodies sets the floor on what can, or cannot, be included in our negotiations with future potential partners.

Additionally, the extent of our continued access to the Single Market has implications for how appealing a trade agreement with the UK is, and thus what concessions a country is willing to make to get one. Until all this is resolved, it will be very difficult to agree anything of substance with anyone new.

In all likelihood resolving the EU question will take years, well beyond the two afforded by Article 50. But when it comes to trade negotiations time is not a bug, it is very much a feature, and there is much to keep the UK busy in the meantime.

## The WTO

In parallel to resolving its relationship with the EU, the UK must also prioritise reasserting its position at the WTO – our default trading position with the rest of the world.

Although a founding WTO member, the UK's status is now intertwined with the EU's, and upon Brexit we will need to present, and have certified by all 163 other members, our own unique schedules on goods and services. Certifying our schedules doesn't need to be the minefield suggested by some – although the divvying up of existing agriculture quotas and tariff-rate quotas will likely cause many a headache – but it does require delicacy. The evidence to-date suggests the UK is working to make this process run as smoothly as possible<sup>3</sup>.

<sup>1</sup> [https://www.uktradeinfo.com/Statistics/OverseasTradeStatistics/Pages/EU\\_and\\_Non-EU\\_Data.aspx](https://www.uktradeinfo.com/Statistics/OverseasTradeStatistics/Pages/EU_and_Non-EU_Data.aspx)

<sup>2</sup> <https://tradebetablog.wordpress.com/2016/06/07/uk-wto-brexite/>

<sup>3</sup> <https://blogs.fco.gov.uk/julianbraithwaite/2017/01/23/ensuring-a-smooth-transition-in-the-wto-as-we-leave-the-eu/>





## Existing Free Trade Agreements

There is then the question of existing EU free trade agreements, to which the UK is currently party. Not only are there over 60 preferential trading agreements, of one form or another, already in place – including critical ones with the EEA/EFTA countries (Norway, Iceland and Liechtenstein), Switzerland and Turkey – deals with Canada, Japan and Singapore could feasibly all be ratified prior to the conclusion of the Article 50 period. The expressed desire of the UK is to carry over or replicate existing agreements, as outlined by Liam Fox, the Secretary of State for International Trade:

"We have made it very clear to countries that we would like to see a transition of their agreements to a UK agreement when we leave the EU. So far we have not yet had a country that didn't want to do that. That is a lot easier as a process than negotiating a new FTA"<sup>5</sup>

While certainly easier than negotiating a new FTA from scratch, potential pitfalls abound.

When originally negotiating these FTAs, and in order to get access to the EU's single market, many countries were forced to make significant, one-sided concessions. South Korea's economy, for example, is less than one tenth that of the EU and it was forced into making concessions on vehicle emissions and agreeing to a "safeguard" clause to protect European industry<sup>6</sup>. They will likely treat this as an opportunity to eke greater access out of a capacity-strapped UK and seek a more equal partnership. South Africa has already indicated that while it is happy to use the existing EU-South Africa agreement as a template, it

expects there to be a renegotiation of agriculture quotas and sanitary standards<sup>7</sup>.

Furthermore, as flagged by Japan<sup>8</sup>, to avoid supply chain disruption, the UK will need to agree permissive cumulative rules of origin requirements<sup>9</sup> in its 'carried over' FTA with the third party and its future FTA with the EU. For this to work, the EU will also need to amend its existing agreement with the third party. Doing so would allow EU inputs to be treated as being of UK origin, and vice-versa, for the purpose of continued qualification for the preferential trading arrangement with the third party. Failure to resolve this issue would, for example, see UK car exporters struggle to qualify for the preferential tariff rate granted by a 'carried over' UK-Korea free trade agreement.

While certainly achievable, at least in theory, resolving rules of origin issues will require time, capacity and goodwill. As to whether the EU and third party will agree to take on the extra hassle, it remains to be seen. If this isn't resolved there will be considerable incentive for UK-based exporters to shift their operations and supply chains to the EU27, as noted by Clifford Chance and the CBI<sup>10</sup>.

## Sequencing and speed

Much has been made of us penning a quick deal with Donald Trump's America. While this has political appeal for some, I would urge caution; after spending decades outside of the ring, only the most arrogant of competitors calls out the heavyweight champion of the world for their comeback fight. A more sensible approach would see the UK testing its fledgling negotiation

<sup>4</sup> <http://researchbriefings.files.parliament.uk/documents/CBP-7792/CBP-7792.pdf>

<sup>5</sup> <http://uk.reuters.com/article/us-britain-eu-trade-idUKKBN15G46E>

<sup>6</sup> <http://blogs.lse.ac.uk/brexit/2017/02/07/can-global-britain-forge-a-better-trade-deal-with-south-korea-this-is-why-its-unlikely/>

<sup>7</sup> <http://www.thetimes.co.uk/article/fox-suffers-south-africa-trade-setback-wwv0jzpf>

<sup>8</sup> <http://www.mofa.go.jp/files/000185466.pdf> (page 7)

<sup>9</sup> In order for a UK exporter to take advantage of a preferential trading arrangement with another country, depending on the agreed rules of origin requirements, they will likely be required to prove that the product they are selling has either been wholly obtained in the UK; been produced exclusively from UK originating materials; or has undergone sufficient production in the UK. What counts as sufficient production varies, product by product. When agreed, cumulative rules of origin allow an exporter to classify inputs originating from outside the UK, as being from the UK, for the purpose of qualifying for a preferential trade agreement.

Read more: <https://medium.com/@SamuelMarcLowe/explaining-cumulative-rules-of-origin-2c13fb4dfca1#umbcrta6d>

<sup>10</sup> <https://www.cliffordchance.com/microsites/brexit-hub/thought-leadership/the-future-of-trade-for-the-uk.html> (pages 31-35)



muscles against smaller, less aggressive economies, with reduced scope for political and economic fallout.

Quick deals can be done, of course – even with the US – but as a general rule they are largely superficial, or the result of one party riding roughshod over the other. Australia's 2005 free trade agreement with the US was hurried through by Australia's then prime minister, John Howard, and negotiated and signed in under a year. However, a 2015 review of the agreement found that the gains predicted by some – one long-term estimate as high as A\$5.6 billion – had not materialised. Instead it has led to trade diversion away from the rest of the world and could be "associated with a reduction in trade between Australia and the United States". At best, you can make the case that trade between Australia and the US would have fallen even further in its absence<sup>11</sup>. Shiro Armstrong, the author of the review, concluded:

"Deals that are struck in haste for primarily political reasons carry risk of substantial economic damage. The question then is whether the economic costs of such policies are worth whatever the political gain, and indeed, how the balance of properly calculated political gains and costs might look."<sup>12</sup>

These things take time. And so they should.

### **It's not about tariffs**

In the modern trading world, tariffs – taxes on imports – are largely yesterdays' news (and in the few areas they do still reign king you can be sure there is a powerful domestic lobby that won't be easily shifted). Negotiations now focus on so called non-tariff barriers, more easily understood as

differences in approach to regulation, standards, customs procedures and the like. Attempting to whittle down non-tariff barriers requires negotiators tread through territory that is fraught with cultural preference, subjectivity and compromise. This is one of the reasons recent negotiations, such as the Transatlantic Trade and Investment Partnership (TTIP), have taken so long and hit many a stumbling block.

Take agriculture. The reason we rarely see US beef on our supermarket shelves is not because of tariffs, but because the EU bans the use of growth hormones in meat production. The US Trade Representative has identified this ban as one of the biggest non-tariff barriers facing its exporters, alongside other issues such as EU requirements for whisky to have been aged for a minimum for three years for it to be labelled whisky; our approach to regulating chemicals; and prohibitions on the use of certain antimicrobial washes to clean poultry after slaughter. Any comprehensive post-Brexit trade agreement with the US will require domestic decisions regarding whether we continue to uphold these rules or not, taking into account that if, for example, we were to concede on the first point raised above, it could create difficulties for UK processed food exports to the EU.

Services liberalisation throws up its own conundrums. The prospective EU-India trade agreement juddered to a halt in part due to the UK objecting to provisions that would make it easier for Indian service providers – think consultancy and IT – to bring their staff over to the UK for a fixed period of time to deliver a project in person. Additionally, while technically outside of the scope of a standard trade negotiation, countries regularly use them as a vehicle to push for increased visa liberalisation. Most recently, Alexander Downer, Australia's high commissioner to the UK, indicated

<sup>11</sup> <https://crawford.anu.edu.au/pdf/ajrc/wpapers/2015/201501.pdf>

<sup>12</sup> <http://www.eastasiaforum.org/2015/02/08/the-costs-of-australias-free-trade-agreement-with-america/>

<sup>13</sup> <https://ustr.gov/sites/default/files/2016-NTE-Report-FINAL.pdf>





they would be looking for better access for Australian business people before signing a post-Brexit trade agreement<sup>14</sup>.

If the EU referendum has taught us anything, it's that people moving around the world remains controversial, alas.

And then there is investment, specifically an arbitration mechanism known as Investor-State Dispute Settlement (ISDS). ISDS – which affords enhanced protections to foreign investors – has proven controversial, and contributed to the demise of the Trans-Pacific Partnership, and delays to the Canada-EU free trade agreement, CETA. Proponents claim it provides a much-needed extra level of legal certainty for foreign investors, opponents that it creates an extra-judicial legal system that is frequently used to undermine regulatory protections. The UK has supported ISDS's inclusion in recent EU trade agreements, but it remains unclear as to its position post-Brexit.

The examples above are just a selection of issues that arise and require resolution. There are many others, including the enforceability of labour and environmental provisions, the impact of intellectual property rules on drug pricing, and bust-ups over the inclusion, or not, of public services. All have the potential to become highly politicised and partisan, and can hold up the ratification of a trade agreement for months, years ... forever.

### **A dose of realism**

In our haste to prove 'Global Britain', we must acknowledge that platitudes and plastic 'Free-Trader of the Year' trophies will never compensate for lost EU membership.

Economics has taken a kicking over the last few years. But many of its lessons hold firm. Simply speaking, for trading purposes, the large, populous, wealthy economy on our doorstep, with which we are already integrated both economically and culturally, will always be more important than, for example, a relatively small island on the other side of the world. Whatever Liam Fox says, geography continues to matter more than ever<sup>15</sup>. When it comes to services, being awake at the same time as the person you are working for is helpful. For trade in goods, despite huge innovation, time, cost and distance still need to be factored in.

This economic rule of thumb is born out in the numbers. I would encourage you not to focus on the exact figures, more the difference in scale:

The long-run Treasury estimation of the softest of Brexits finds we would be 3.8% poorer than we would have been had we remained. (You can use a lower figure, say 2%, if you like, the point holds.)

Measure this against the upper, and in my opinion very ambitious, estimate of what a comprehensive trade agreement between the UK and US can achieve: a long-run increase in GDP of 0.35%<sup>16</sup>. An agreement with the single richest country on earth and it would hardly make a dent. And that is, as I said, assuming a degree of liberalisation – including the inclusion of financial services in the agreement, zero tariffs across the board and a quarter of non-tariff barriers removed – far beyond that which is likely. The more conservative estimate sees a relative increase in GDP of 0.14%.

I can't find any UK-specific forecast for a deal with Japan, but I'm going to appropriate the most optimistic forecast for the EU-Japan free trade agreement which is currently under negotiation<sup>17</sup>.

<sup>14</sup> <http://www.bbc.co.uk/news/uk-politics-38704325>

<sup>15</sup> <https://www.ft.com/content/e456c008-8642-11e6-8897-2359a58ac7a5>

<sup>16</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/198115/bis-13-869-economic-impact-on-uk-of-transatlantic-trade-and-investment-partnership-between-eu-and-us.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/198115/bis-13-869-economic-impact-on-uk-of-transatlantic-trade-and-investment-partnership-between-eu-and-us.pdf)

<sup>17</sup> [http://trade.ec.europa.eu/doclib/docs/2016/may/tradoc\\_154522.pdf](http://trade.ec.europa.eu/doclib/docs/2016/may/tradoc_154522.pdf)



As such, let's assume that a new deal with Japan leads to a 0.76% rise in long-run GDP. Progress, I'll allow, but we're still making up lost ground. And we are starting to run out of big economies to strike trade agreements with.

Let's try India.

Unfortunately, when the EU modelled the impact of a future EU-India trade agreement, it found that "The EU's large economic base means that the changes are too small to lead to significant changes in percentage GDP growth"<sup>18</sup>. The UK is slightly smaller than the EU as a whole, so let's assume that this agreement adds a couple of basis points to our long-run GDP.

After all that, by my estimates, UK GDP will still be, at best, 2.67% lower than it would have been had we simply stayed in the EU. Of course, Brexit supporters such as Andrew Lilico<sup>19</sup>, the chairman of Vote Leave-affiliated Economists for Britain, argue that there are additional gains to be had. This may or may not be the case. Regardless, free trade agreements can't do it alone.

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The past months have seen a flurry of trade-related announcements. Deals with Trump; missions to India; and weapon sales to Turkey. These can be relied on to produce front-page headlines, but front-page headlines do not a trade strategy make.

Ensuring the fundamentals – a deep, continued relationship with the EU, our membership of the WTO, and the continuation of existing trading relationships – are secure is essential if the Government is to achieve a positive vision of Global Britain. This must happen alongside an honest, level-headed, national discussion about

our values as a nation. About whether we see free trade as a prize in and of itself, or a tool to achieve something greater. About what it is we actually even export and import. About whether we continue to cooperate with our neighbours on issues such as product safety, carbon emissions, and environmental safeguards. About whether negotiating a trade agreement with India is worth all the hassle. And so on.

In the heated fallout of the Brexit vote such measured discussions are yet to take place. In its absence, hubris has filled the vacuum. Absent a significant course change, any benefits that do materialise from future trade deals will be more likely the result of luck than judgement.

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<sup>18</sup> [http://trade.ec.europa.eu/doclib/docs/2010/june/tradoc\\_146221.pdf](http://trade.ec.europa.eu/doclib/docs/2010/june/tradoc_146221.pdf)

<sup>19</sup> <http://www.andrewlilico.com/2017/01/09/my-presentation-to-the-aea-annual-conference-on-brex-it-six-months-on/>



# Trade under the 'WTO model

*L Alan Winters<sup>1</sup>*

**T**rading under the 'WTO model' can mean at least two different things. First, the World Trade Organisation has many rules about international trade among its members governing, for example, non-discrimination in trade, the characteristics of acceptable regional trading agreements, and the use of anti-dumping duties.

The second sense in which the term is used is loosely to define the trade regime between the UK and the EU, that will apply if there is 'no deal'.<sup>2</sup> This is the sense that I discuss here, first for goods and then for services.

## **WTO rules on trade in goods**

The WTO obliges members not to discriminate in international trade, to ensure that for any good the tariff they impose on an import is the same regardless of the good's origin. This is known as the 'Most Favoured Nation' (MFN) clause, because everyone receives the same treatment as country treated most favourably. The main exception to this is when a small set of members sign a Free Trade Agreement (FTA), which, subject to certain conditions, allows them to charge each other zero tariffs. Thus, if the UK and EU fail to sign such an agreement they will have to charge each other the same tariffs as they charge other 'non-Agreement' partners.

In the course of a multilateral trade negotiation, each member negotiates with the others the highest tariff that it will levy on any good; these amounts are recorded in the member's WTO tariff schedule and the WTO is then charged with ensuring that that no more than these maxima is levied. The EU's schedules are well defined, but there has been some debate about the UK's status

in the WTO once it leaves the EU. Most commentators now agree that the UK is a full member of the WTO and that its obligations are those notified to the WTO on its behalf by the EU. On exit, the UK needs to relabel these as UK obligations in a WTO Procedure termed a 'rectification', and, provided that it does not try to change anything, this should not, on the whole, generate great difficulties<sup>2</sup>.

There are a few nasty details to settle – most notably the division of the EU's right to subsidise agriculture and its obligation to import specific minimum amounts of certain agricultural goods tariff-free (so-called tariff rate quotas). Both are defined at the EU level and we have no law or precedent to guide their division. Agriculture is always sensitive in trade talks, but the division can be achieved with rather little cost to other WTO members, and so with some active diplomacy, the challenges should not be insurmountable. Once the UK has 'regularised' its position in this way, it could then, if it wished, start to negotiate tariff and trade policy changes over the next few years.

If the UK and the EU were to treat each other on an MFN basis, around 45% of UK exports of goods and around 54% of UK imports of goods would become subject to tariffs. Based on the EU schedule, around a third of these are zero and another third between 0 and 5%; the simple average tariff is 5.1%<sup>3</sup>. To be more specific, if UK-EU trade in 2015 had been subject to MFN tariffs, the UK would have collected £12.9 billion on imports from the EU (with an average rate of 5.8%) and the EU would have collected £5.2 billion (at an average of 4.5%)<sup>4</sup>. Thus, tariffs are not, on average, very high.

However, at a more detailed level, around 16% of UK exports to the EU would have faced tariffs of

<sup>1</sup> I am grateful to Ingo Borchert for some inputs into this paper.

<sup>2</sup> In fact rectification is government policy, as announced on 5th December, 2016 -

<https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2016-12-05/HCWS316/>

<sup>3</sup> These figure refer to 2015, see the WTO's Tariff Profile of the EU - [http://stat.wto.org/TariffProfiles/E28\\_e.htm](http://stat.wto.org/TariffProfiles/E28_e.htm)

<sup>4</sup> Prots (2016). The averages differ because the pattern of trade differs between UK imports and exports.



more than 7%, and of that 16%, half would refer to motor cars, which would face a tariff of 10%<sup>5</sup>. The highest EU tariffs by broad category of good are 44% on tobacco, 40% on preparations of meat and fish, and 39%<sup>6</sup> on dairy .

Some commentators celebrate that the UK would collect twice the tariff revenue on mutual trade that the EU would, but that is to miss the point. Tariffs – which are merely taxes on imports – raise prices to consumers and users, who either suffer a loss of spending power or just don't bother to consume the good at all. And because imports are set at a competitive disadvantage, markets become less competitive and local producers are likely to raise their prices as well, compounding the costs.

There are two further dangers. First, once the UK leaves the customs union, border formalities become more important. Whereas at present there is virtually no border inspection or paperwork for trade between the UK and the EU, unless the parties can strike an unprecedentedly special deal on customs formalities, Brexit will increase the paperwork, inspections, delays and uncertainty on UK-EU trade. Second, the European Single Market has more or less abolished the differences in standards between Member States: what is good in one State is good in another. The significance of this varies by sector but in some – e.g. the food trade – it is very important. Overcoming them requires the UK and the EU to negotiate (sector by sector) Mutual Recognition Agreements (MRA) which recognise each-others' standards and testing regimes. Unlike tariffs, which merely transfer resources from one party to another, both customs formalities and standards differences absorb real resources as well as further reduce competition and variety.

## WTO rules on trade in services

The WTO also applies to trade in services. Services transactions are typically managed via regulations rather than tariffs, but the same basic ideas of non-discrimination and of negotiating trade restrictions and then scheduling them apply here too. Services have been covered by the multilateral trade rules only since 1995, and trade liberalisation has been much less far-reaching than in goods. This is partly just a matter of time, but also because it is much more difficult to measure the degree of trade restriction in a regulation, and to trade it off against legitimate regulatory concerns. Also, bureaucratically speaking, regulations are 'owned' by national regulating authorities whose briefs are typically less concerned with opening markets than are Trade Ministries'. Thus, it is more or less universally accepted that dropping out of the, albeit imperfect, Single Market for services and trading under the EU's provisions for third countries will cut UK access to European markets considerably. For three reasons, however, it is very difficult to quantify exactly by how much.

First, there are four different ways of delivering services – referred to as Modes in the relevant WTO Agreement, the General Agreement on Trade in Services (GATS). These modes are: (1) cross-border trade (e.g. streaming a video from abroad); (2) consumption abroad (e.g. moving for medical treatment); (3) commercial presence (Foreign Direct Investment), and (4) presence of natural persons. In any sector, each mode is regulated in a different fashion and the effects of the regulations are not simply additive. For example, you may be able to establish a firm to provide services in a country, but if you cannot get your skilled workers in on occasion to, say, repair equipment or solve complaints, you may not be able to provide a decent service experience and so not bother to trade at all.

<sup>5</sup> UKTPO (2016)

<sup>6</sup> Weighted averages on UK exports to the EU; 'broad categories' refers to 2-digit chapters of the Harmonised System of Trade Classification.



Second, there is a great deal of so-called 'binding overhang' in the GATS schedules. That is, the EU's (and other countries') actual policies are actually much more liberal than is recorded in the schedules. But actual practice is not all recorded in one place and so it is a major task identifying actual service trade restrictions.

Finally, the EU Single Market in services is not complete. Thus, trade within Europe is sometimes still restricted by national regulations. And even where trade within the EU is more or less unrestricted, different Member States have different restrictions on third country suppliers. For example, while the conditions for establishing commercial presence (mode 3) in life insurance are similar across most EU members, those pertaining to the legal sector (advice on foreign law) differ widely. As a result, the EU's WTO services schedule has many country-specific entries, so working out the consequences of replacing membership of the Single Market by MFN treatment from EU Member States becomes a detailed country-by-country job.

In the end, it will have to be individual sectoral, or sub-sectoral, bodies or associations that assess how the changes consequent to Brexit will affect services trade. Only they have the detailed information to describe the web of interlocking constraints and incentives that emerge from the regulation of services. Government's job is to encourage such analysis to take place by defining the policy options that are worth analysing and then setting up robust procedures for testing the views put forward by industry bodies.

There are several clear dimensions to the regulation of services and hence trade in services, any or all of which may be important in a particular sector and which would be affected by the UK leaving the Single Market without a preferential

arrangement in place. For example, two European Professional Qualification Directives have helped the mutual recognition of professional qualifications between member states. Even if the qualifications were not changed by Brexit, formal recognition would have to be enacted (as, for example, was done for Swiss qualifications); and in time differences would be likely to emerge (if not, what does 'retaking control' mean?), and so recognition would require constant work and uncertainty. The result will be less mobility between the UK and the EU with consequential complications for individuals and for firms seeking to serve both markets.

Second, regulations cover the right to trade in markets. The most obvious examples are those in the financial services sectors, in which firms in one EU member state can be granted 'financial passports' that permit them to trade elsewhere in the EU on the grounds that their home country regulations offer sufficient assurance for all other EU markets. It is widely accepted that passports will not be available to UK firms post-Brexit. Some hope had been placed in the EU's so-called equivalence processes, whereby third-country regulations can be deemed equivalent to the EU's and market access granted on these grounds. However, equivalence is in the gift of the EU authorities and can be withdrawn at 30 days' notice, and so provides a slender reed on which to hang long-term investment. Moreover, according to Brunsden and Fortado (2017), the EU is independently considering tightening up conditions for equivalence to include continuous monitoring and special attention paid to 'high-impact' countries (which presumably includes Britain).

Third, there are regulatory bodies and procedures. Many EU activities are currently regulated by a single EU body whose approval is required to trade





within the EU. The UK will need to establish its own bodies – which is a massive job in itself – and then seek to negotiate that their approval is sufficient (equivalent) for trading in the EU. A related issue is that while the UK is within the EU, regulatory enforcement ultimately falls to the European Court of Justice, which pretty much guarantees strong conformity and uniformity across Europe. Once the UK is outside the EU, European partners will have to rely either on the UK courts or on the dispute settlement procedures of a UK-EU FTA or the WTO to ensure a level playing field. These are less powerful and direct than the ECJ and, even if ultimately they produce the same outcomes, their greater uncertainty will reduce partners' confidence and hence tend to discourage investments in services trade.

It is also worth noting that since many services are regulated at a country level within the EU, the UK will have to negotiate arrangements for services access with 27 partners, not just the Commission as is the case with goods. This has further implications for the cost of regulation and the capacity to negotiate satisfactory trade deals.

The World Bank's Services Trade Restrictiveness Index offers rough indicators of the restrictiveness of countries' applied policy regimes<sup>7</sup>. It covers five major sectors and is based on scoring available policy information from 0 (wholly open) to 100 (wholly closed). The average score for internal services trade within the EU is 18, while that for EU imports from outside it is 26. The UK is among the more liberal members, with an average score over intra- and extra-EU trade of 14. But this is far from uniform across sectors. All EU economies are fairly open in financial services, telecoms and retailing, both vis-à-vis each other and towards non-EU providers, but in professional services sectors, (and to a lesser extent transportation), access for foreign providers is restricted. Lawyers and

accountants looking to provide services in the EU face major restrictions on Mode 4 mobility (67 and 50, respectively). Moreover, whilst the UK individually is as restrictive as the EU's external regime, other markets such as France and the Netherlands tend to be more open for service professionals from within the EU. These advantages to UK service suppliers would evaporate if "EU-EXT" policies were applied to UK firms.

The increasing importance of value chains highlights the importance of services trade in two separate ways. First, the important thing about exports is not their gross value, but how much income they generate after you allow for the imported inputs used to make the exports. We know, albeit from relatively old data, that a pound's worth of exports generates more UK income for services exports than for goods – 88.5p vs. 64.3p for manufactures (WTO Profile of UK Trade). Second, inputs of services provide 21.3 percent of the UK value-added in UK manufactured exports: thus if foreign services become less available and UK services markets become correspondingly less competitive, there will be some erosion of the competitiveness of manufactured exports. Services must, indeed, lie at the heart of the UK's Brexit strategy.

### **What is the Alternative?**

The natural question is whether the UK can avoid these extra frictions in its trade with the EU. If the UK were to remain in the Single Market, the standards issues in both goods and services would be avoidable, and if it remained in the Customs Union, the border frictions on goods would also largely be avoided. But both of these are ruled out by the White Paper. A very deep FTA would potentially allow some of them to be avoided, but only on a sector-by-sector basis because the EU is

<sup>7</sup> This paragraph draws heavily, with permission, on Borchert (2016).



determined that UK access will be less than membership of the Single Market permits. Sectoral deals will be hard to negotiate, especially if they are to be secure enough to encourage long-term investment, and will inevitably entail more border formalities than we have at present because the authorities will need to ensure that only the goods covered by an agreement take advantage of it. Likewise, even if there are zero tariffs between the UK and the EU for the goods they produce and sell to each other, there will still need to be border measures to ensure that goods are actually produced in the UK or the EU - so-called rules of origin. All told, the 'WTO model' promises significantly higher trade costs, and while agreements – i.e. going beyond the model - might alleviate some of them, many will remain<sup>8</sup>.

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<sup>8</sup> This paper drew on:

Borchert, Ingo (2016) *Services trade in the UK: what is at stake?* UKTPO Briefing Paper No. 6, November 2016  
Brunsden J and L Fortado (2017) 'Brussels sets out tough new line on equivalence', *The Financial Times*, 27th February 2017, <https://www.ft.com/content/f9f3ffc2-fc1a-11e6-96f8-3700c5664d30>  
UK Government (2016) *The United Kingdom's exit from and new partnership with the European Union*, Cm 9417, <http://www.gov.uk/government/publications>  
Protts, Justin (2016) *Potential post-Brexit tariff costs for EU-UK trade*, Civitas, October 2016, [http://www.civitas.org.uk/reports\\_articles/potential-post-brexit-tariff-costs-for-eu-uk-trade/](http://www.civitas.org.uk/reports_articles/potential-post-brexit-tariff-costs-for-eu-uk-trade/)  
UK Trade Policy Observatory (2016) *The World Trade Organisation: a safety net for a post-Brexit UK trade policy?* UKTPO Briefing Paper No. 1, July 2016





# Post-Brexit options for State aid

*George Peretz QC*

The issue of EU State aid rules has been raised during the course of the debate over the UK's post-Brexit relationship with the EU. Primarily, the Leader of the Opposition has said that escaping the EU's State aid regime is a reason for the UK to leave the Single Market.

This paper provides a brief summary of the EU's rules, and concerns that have been expressed about them, and then considers various options that might be considered for maintaining or replacing the State aid rules, or aspects of them, after Brexit.

## **State aid rules**

The essential thinking behind the EU State aid rules is that the grant of subsidies to firms of one State, in a single market or free trade area, will often distort competition to the detriment of competing firms from other participating States. Put shortly, it is one thing to open up your domestic markets to foreign competition, but quite another thing to open your domestic markets up to subsidised competition. And the freedom to export to another country without restriction is of little value if the government of that country can freely subsidise its domestic producers so as to defeat competition from imports.

On the other hand, there may well be powerful arguments for subsidies in order to achieve important domestic (or indeed pan-European) policy aims, such as regional development, promoting R&D, encouraging training, dealing with natural disasters, and supporting important fundamentally viable businesses over short-term market turbulence. These are recognised in the range of justifications that permit the Commission to authorise State aid.

## **Brief summary of the State aid rules**

First, EU State aid rules have a wide scope. They apply to all sectors of the economy. They also apply to a wide variety of State measures: not just straight subsidies, but also measures that are economically equivalent (such as access to government assets on favourable terms, favourable tax treatment, guarantees and so on). That extensive scope means that the rules will usually catch any attempt to dress up in some other legal form what is in economic terms a subsidy.

Second, and very importantly in practice, the State aid rules do not apply to measures taken by the State that are equivalent to those that a rational private operator in the market would take (the "market economy operator principle" or "MEOP").

Third, they do not apply to measures that do not (even potentially) affect competition or trade between States.

## **Criticisms of state aid rules**

Policy concerns about the State aid rules have generally focused on three areas.

First, there is concern that the Commission and the European Court of Justice (ECJ) have tended to widen the scope of the State aid rules to catch measures that should not be the concern of a regime whose principal purpose was to protect competition in the internal market against distortions caused by unjustified subsidies.

The second set of concerns focuses on the policy of the Commission in deciding whether to approve aid notified to it. Concerns have centred on lack of transparency, lack of economic rigour and, partly as a result of those failings, a concern that the



Commission's approach is sometimes too "political".

The third set of concerns relates to procedural issues: for present purposes, the most important of these is the delay caused by the time taken by the Commission to deal with individually notified measures, given the unlawfulness of proceeding with those measures before the Commission's approval has been obtained.

### Options available post-Brexit

The UK Government's policy is to seek to negotiate a comprehensive trade agreement with the EU. With the exception of Switzerland, every other European country with which the EU has entered into comprehensive trade agreements has accepted that it will comply with State aid rules.

The UK has rejected pursuing membership of the EEA. The EEA Agreement effectively replicates the EU State aid rules, with the EFTA Court playing the same role as the ECJ and the EFTA Surveillance Authority ("ESA") playing a role equivalent to that of the Commission.

However, even if the United Kingdom generally rejects membership of the EEA, it would be open to the UK and EU (as well as the EEA States) to agree that the ESA and EFTA Court would have a role in supervising any State aid commitments entered into by the UK. That would presumably satisfy the EU (since it already accepts those bodies as enforcers of the State aid rules for the EEA States) as well as complying with the UK's "red line" of freedom from the jurisdiction of the ECJ.

An alternative is the "domestic implementation" model, and is found in agreements with European

countries outside the single market. Perhaps the most pertinent example (since it is with a large State that will not be applying for EU membership for the foreseeable future) is the Association Agreement between the EU and Ukraine ("the Ukraine Agreement"). Article 262 of the Ukraine Agreement sets out the State aid rules; Article 264 provides that they are to be applied "using as sources of interpretation the criteria arising from the application of [the EU State aid rules] including the relevant jurisprudence of the [CJEU], as well as [Commission frameworks and guidance]." Article 263 requires each of the EU and Ukraine annually to report to each other on the State aid granted on each side. Most interestingly for present purposes, Article 267 requires Ukraine to implement a domestic system of State aid control, with "an operationally independent authority ... entrusted with the powers necessary for the full application of [the State aid rules]"<sup>2</sup>.

The EU has been prepared to negotiate agreements with countries outside Europe – notably CETA (Canada) and the stalled negotiations on TTIP (United States) – that do not contain prohibitions on the grant of subsidies. However, Article 7 of CETA reflects and reinforces WTO anti-subsidy obligations (see below) by providing for notification to each other of subsidies granted and for a consultation procedure between Canada and the EU if either considers that the other is harming it by granting subsidies. The EU-Singapore FTA contains a prohibition on subsidies based on the WTO anti-subsidisation rules as a basis but extending, in part, to services: it also provides for an arbitration mechanism covering disputes about prohibited subsidies.

What can be concluded from that brief survey is that the EU, as far as Europe is concerned, has

<sup>1</sup> See Art. 61 and 62 of the EEA Agreement. Art. 61 essentially repeats Art. 107 TFEU. Art. 62 requires "constant review" of existing and planned measures in the EEA to ensure compatibility with Art. 61, a task which in the EEA/EFTA States is allocated to the ESA. The ESA then has, under Art. 5 of the Surveillance and Court Agreement ("SCA"), the general duty to ensure the compliance of the EEA/EFTA States with their duties under the EEA Agreement, and Article 24 SCA then enumerates compliance with the State aid rules as an aspect of that duty and points to Protocol 3 SCA. That Protocol effectively incorporates the equivalent provisions to Art. 108 TFEU: it provides for the duty to notify new aid (Art. 2), and an obligation not to put that aid into effect before approval by the ESA (Art. 3).

<sup>2</sup> There are similar provisions in Accession Agreements with Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Serbia, and Turkey.



generally insisted on compliance with State aid rules as a condition of a comprehensive trade arrangement, and that even with countries outside Europe the EU has sought to strengthen and give teeth to WTO anti-subsidy rules. It is ultimately a political question whether and to what extent the EU would so insist in the case of the United Kingdom. But it is at least possible that State aid compliance will be a “red line” condition on the EU side for any comprehensive trade deal anywhere in the range between CETA and the EEA Agreement, not least because it will be hard to explain to EU voters why their employers should potentially face competition from subsidised UK businesses when their employers are unable to receive equivalent subsidies. Moreover, the EU will bear in mind that (unlike the US, Canada, or Singapore) compliance with State aid rules is not a novelty as far as the United Kingdom is concerned, and that the United Kingdom has considerable experience and expertise in applying the State aid rules over the last four decades.

### **WTO Rules**

It is also important to be aware that, even outside any trade agreement with the EU containing State aid rules, the United Kingdom will, in relation to goods, still be bound by WTO anti-subsidy rules. There are considerable differences between EU and WTO state aid regimes. For example, the WTO regime does not apply to services, but only to goods. Moreover, the enforcement mechanisms for the WTO rules are (i) either state-to-state dispute resolution (there being no mechanism for private enforcement, injunctions or damages, or for actions to be brought in ordinary courts) or (ii) the imposition by the adversely-affected state of countervailing duties on products from the infringing state. There is therefore no scope for WTO enforcement of the rules by private operators: they have no right of action in national

courts and no independent body to which they can complain, and their only option is to persuade their own government to invoke the WTO procedure.

### **Should a state aid regime be retained post-Brexit?**

What policy considerations should the UK Government bear in mind in deciding, in the context of negotiations with the EU, what, if any, State aid regime should be retained post-Brexit?

There are two principal domestic considerations.

The first is that the United Kingdom will want to ensure that it respects its obligations under the WTO SCM Agreement (and any other anti-subsidy commitments that the UK enters into with the EU or third countries). The UK Government can of course ensure through administrative means that its own conduct complies with those obligations. But there are a large number of public bodies which have wide powers to make their own spending decisions without reference to Whitehall, and it may well be necessary to ensure that support measures adopted by public bodies do not put the United Kingdom in breach of its WTO obligations.

The second, linked to the first, is that increasing devolution (both to Scotland, Wales and Northern Ireland and increasingly within England) means that there are now a large number of public bodies with their own substantial tax and spending powers independent from the financial control of the UK Government. That strengthens the case for a form of legal control on the ability of those bodies to subsidise favoured firms. There is a powerful policy case for such control, given that it is in no-one's interests for there to be “subsidy races” between different parts of the United Kingdom to attract investment.



There are also advantages of retaining State aid rules in terms of protecting the interests of UK business.

EU State aid rules only catch measures that (at least potentially) distort competition in the EU/EEA. As the United Kingdom is planning to leave not only the EU but also the EEA, a measure that affected competition only in the United Kingdom (for example an Irish subsidy aimed at assisting exports to the United Kingdom) would not as such be caught by the EU State aid rules. Those issues would not arise if the UK were to negotiate an agreement similar to the Ukraine agreement, since the effect of both the EEA and Ukraine agreements is to give the EU institutions the power (and the duty) to regulate State aid measures by EU Member States that harm competition in (respectively) EEA States and Ukraine.

Second, when an EU Member State takes State aid measures that harm businesses trading in (respectively) an EEA State or one of the States with agreements similar to the Ukraine agreement, the relevant Agreement gives a right of action in the courts of the Member State concerned to obtain damages.

Third, in cases where the United Kingdom has granted subsidies to UK companies operating in the EU, the fact that such subsidies have been approved under provisions analogous to the EU State aid provisions will make it in practical terms difficult for the EU to take retaliatory measures against the United Kingdom under the WTO SCM Agreement.

Fourth, under both a Ukraine-type arrangement and an arrangement based on the EEA, the United Kingdom would retain a role in the development of EU State aid law (which, given the importance of

the EU market to the United Kingdom, will remain a matter of important policy concern for the United Kingdom).

Against that background, and even given the UK Government's rejection of EEA membership as such, there are considerable benefits in pursuing a "State-aid specific" EEA model as discussed above. It should be noted that the EEA model addresses many of the concerns about State aid in the EU: the ESA and EFTA Court are both much speedier decision-takers than the Commission/ECJ, and have a better record for economic reasoning and for refraining from expanding the State aid rules. There are also real difficulties with a "domestic implementation" model, since any national enforcement body (such as the Competition and Markets Authority) would have to be in a position to overrule decisions of central and devolved governments.

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<sup>3</sup> see e.g. Case T-34/02 EURL Le Levant 001 ECLI:EU:T:2006:59 at §§115-117.



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