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The trade consequences of Brexit: how I see the situation

Roderick Abbott is a Senior Advisor at ECIPE.

The trade consequences of Brexit are just one element of the overall withdrawal exercise to be triggered by a notification under Article 50 TEU. Withdrawal covers policy areas such as EU jurisdiction through the ECJ; broad areas of regulation, mainly for Single Market purposes; citizen's rights (EU and UK) and immigration questions - among others.

This note discusses the situation on the basis of one basic assumption: that the UK government intends to leave the EU and to secure "the best deal for the country". This must include the best trade deal¹.

1. When the UK exits the EU it will have to negotiate new trade arrangements in three areas:
 - between the UK and the EU/27
 - between the UK and non-EU third countries
 - submission of a new UK Schedule of tariff commitments at the WTO, as well as new UK services commitments
 - this implies the creation of a UK Customs Tariff to replace the EU common external tariff².
2. The situation at the time of exit will be: the UK becomes a non-EU country and on the following day, the EU external tariff will be applied to UK exports of goods to the EU.
3. The UK will leave the EU customs union, and it will also leave the EU single market (and the EEA). This is because membership of these (bodies) is open only to EU member states³.
4. Unless some preferential trade deal has already been made, the UK will be trading with the EU on the basis of MFN duty rates, in accordance with WTO practice. The UK should also have prepared legislation for a new UK customs tariff, to ensure protection of domestic producers and to yield revenue from import duties.
5. So: in terms of urgent action required after exit, a new basis for free trade in goods and services with the EU is a first priority. The difficulty is that there is a formal EU position that it cannot discuss/negotiate 'new' trade arrangements with an EU member until it has left the EU. This would mean that the discussion could only begin after the end of the Article 50 process, with the result that there would be a 'cliff face' situation at the time of exit, with nothing alternative to govern trade in place.
6. This is however a formal, legal position and it could in my view be overruled by a political decision if both parties wished to engage in trade discussions at an earlier moment. This might be the case if both parties wish to avoid the serious trade disruption to UK—EU exports which would otherwise occur.
7. If this scenario is possible, trade discussions would take place within the Art.50 process and subject to the same timetable (two years unless extended). This timetable is already difficult to meet for the overall

¹ Another general assumption is that the UK government will wish to abide by the rules of the multilateral trading system, as set out in GATT 1994 and GATS, and in the agreements at the end of the Uruguay Round (1994).

² The customs tariff will enable the UK to apply MFN duty rates to imports from all countries. A further twist is that there will be EU antidumping duties in force at the time of exit; trade defence, or trade remedy matters will need to be addressed.

³ No decision by the UK or EU is required. The EU will simply apply its tariff to imports from a non-EU country, as is usual practice.

withdrawal exercise, given the wide ramifications of leaving after 40 years of membership for many different areas of policy: it would also be difficult in relation to trade.

8. In the alternative, where this ‘early scenario for trade’ is not agreed, it would be necessary to consider some form of transitional arrangements, perhaps in the form of an interim agreement. However, it is far from clear that negotiation of transition would be any easier than agreement on the definitive trade agreement.

A similar timetable should be envisaged for the beginning of the WTO process – for the same reasons of continuity: to avoid any break in the UK’s rights as a WTO member or any interruption in its obligations to other WTO members.

At the time of writing, it appears that the government has decided to replicate the EU tariff rates and tariff classification headings, and to replicate also the tariff and other commitments that the UK had accepted when a member of the EU.

At the point of exit, the UK will lose the preferential benefits of the free trade agreements that the EU has signed with other countries. The negotiation of trade deals with third countries cannot begin until the end of the Art. 50 process – although that moment can be prepared and analysed in the interest of a smooth transition from trade under the EU’s free trade agreements to trade with the UK. A similar move towards agreements with other countries such as China and India should also be prepared.

The major difficulty in these negotiations will arise from the fact that the UK offers a much smaller population target for exports and investment than it did when a member of the EU⁴. The dynamics of bilateral trade between country X and the UK will therefore look rather different.

Part II WTO schedules: commitments on tariffs levels (bindings) and on services markets

What has to be done in connection with the UK’s membership of the WTO, and why?

1. The UK is a member of WTO, indeed was a founding member of the GATT in 1948 and a founding member of WTO when it was established in 1995. All members are required to make commitments to other members on the maximum level of tariffs they will apply to individual products; and since 1995 they have also submitted commitments in relation to the level of access provided to services markets⁵.

2. The difficulty for the UK arises because since 1995 the EU has made collective commitments for its members in accordance with the EU common commercial policy rules. When the UK leaves the EU it will need to disentangle its own commitments from those submitted by the EU up to now.

3. In principle the UK can simply ‘copy paste’ the EU tariff levels and tariff classification data in order to establish its own schedule, and this clearly will facilitate an easier passage through the procedure since it can be argued that a change in UK status (leaving the EU) results in no meaningful change in the obligations of the UK. At the same time it may create domestic political problems, although there are some indications that the government has in fact decided to replicate these tariffs. This remains to be confirmed⁶.

4. A similar process of disentangling the UK services commitments would also need to be initiated.

5. What the UK will have to do is to submit its schedules and to seek approval through a process of consultation and negotiation with other members. This is a bilateral procedure between the UK and others and

⁴ 65 million UK against 500 million in EU

⁵ The formal position is that there are two separate Schedules: one for goods is attached to the GATT 1994 (the basic treaty on goods) and relates to tariffs, non-tariff barriers and the level of subsidy support payments on agricultural products; and the other for services is attached to the GATS (the treaty on services).

⁶ To be noted: there are some products subject to tariff rate quotas which permit a given quantity of imports at a lower or zero duty rate, with additional imports charged at a higher duty rate. In such cases the EU and the UK will have to determine the respective shares of actual imports into each of the markets, and thus determine what obligation the UK should propose in WTO.

it follows a long established pattern for the “Modification and Rectification of Schedules” which is managed in accordance with general principles set out in Article XXVIII of GATT⁷.

6. This process is not adversarial but more pragmatic in nature, and gives certain rights to both sides. The party proposing changes (or in the UK case proposing its own commitments) is entitled to proceed, after a certain time, if it cannot find agreement with the other side; and the other party in turn can apply higher duties to the trade of the proposer. In effect an automatic balancing mechanism is created.

7. Other members can claim compensation if changes in the commitments lead to damage to their trade interests; but only those countries with “negotiating rights“ on a specific product can in fact make such claims. These rights are linked to the past pattern of trade in the products concerned, and have to be calculated on a product-by-product basis. This could in theory result in a massively wide exercise, covering all 97 chapters of the HS classification system; but in practice, if replication of the EU data is the selected approach, the scope of the negotiation will be largely reduced to manageable proportions.

⁷ Under Art. XXVIII there is no deadline for concluding negotiations which often extend for many months and even years. The process does not lead to a big conference and a concluding vote, and there is no veto power for other members. Equally, there is no impact on the UK's rights as a member during the process.