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After the UK has Withdrawn from the EU. What are the Options for Trade?

The British decision to withdraw from the European Union makes it necessary to renegotiate trade relations between the EU and the United Kingdom from scratch. At the same time the trade agreements that the EU has concluded with non-EU states will no longer apply to the UK.

There has been a great deal of speculation about how Brexit will work in practice. After the speech by Theresa May, the British prime minister, at the Tory party congress in Birmingham on 2 October 2016, it now seems clear that in March 2017 the UK will officially notify the European Union of its intention to withdraw and will set in motion the “breakup” procedure provided for in Article 50 of the Treaty of Lisbon. Thus the UK has just about two years in which to negotiate the terms of the divorce. However, these negotiations do not cover the way in which the UK and the EU will interact after deciding to go their separate ways, or the contractual basis on which they intend to build their relationship. It seems likely that the UK will come down in favour of a “hard” Brexit solution and will not be prepared to accept any EU restrictions on its sovereignty. Thus, unlike Norway and Liechtenstein, which are linked to

the EU via the European Economic Area (EEA), or Switzerland, which is tied to the EU by a mesh of bilateral agreements, the UK would proceed to sever all of its links with the EU internal market. The ways in which the UK and the EU intend to trade with each other in future, the tariffs, and various kinds of trade facilitation will have to be renegotiated from scratch. Furthermore, UK withdrawal from the EU means that trade agreements concluded by the EU within the framework of the World Trade Organization (WTO) and bilateral trade agreements with non-EU states will no longer apply to the UK. In order to be able to trade under the conditions that prevailed in the EU, the UK will have to renegotiate all of the EU trade agreements now in existence.

We asked Professor Stefan Oeter, a well-known expert in the field of international trade law, to tell us what, under these circumstances, the future trade and economic relations between the UK and the EU in particular, and with the world in general are going to look like.

What kind of status will the UK have after withdrawal from the EU when it comes to trade issues? Do the WTO rules automatically apply to the UK, and which goods and services that are of importance for the UK economy do they cover?

In principle the status of trade links between the UK and the EU will be determined by the provisions of the withdrawal agreement specified in Article 50 TEU. Paragraph 2 of the withdrawal article expressly states that the withdrawal agreement shall take into account “the framework for its future relationship with the Union.” In the event of a “hard” Brexit and in the absence of special agreements on trade relations, economic links between the UK and the EU would return to the level of the basic standards of WTO law. As a result of ratifying the WTO treaty as a mixed agreement the UK is already a member of the WTO in formal terms. Withdrawal means that trade links between the EU and the UK, and between the UK and non-EU states which are members of the WTO will automatically be subject to WTO disciplines. However, the UK does not as yet have its own schedule of tariff concessions since this area is covered by the schedule of tariff concessions jointly submitted by all of the EU member states. In this context the UK will have to adjust numerous technical provisions, since the common EU tariffs, which are stipulated in the EU schedule of tariff concessions, will have to be transferred to a new UK schedule of tariff concessions. In the course of this process it will be necessary to make numerous modifications, and in the final analysis these will require the approval of the other contracting parties. It might be possible to apply the usual EU tariffs to the UK’s trade with the EU and the UK’s trade with non-EU states, at least for a transitional period. In the context of transfer and adjustment the UK would not be allowed to raise tariffs to the detriment of other contracting partners. It would

simply create even more problems as a result of the WTO rules. Thus the external tariff as specified in the GATT (General Agreement on Tariffs and Trade) schedule of concessions would also apply to the relationship between the EU and the UK (as a non-member state).

In my opinion leaving the customs union and applying EU external tariffs to trade in goods would not constitute an insurmountable problem, for the tariffs that apply to most of the various types of goods are fairly low. However, there are exceptions as in the area of trade with agricultural products, and the automotive industry, where rather high tariffs are still in place. Under the WTO rules the UK would have a massive problem with the services sector. GATS, the WTO services sector agreement, has hitherto led to no more than a trickle of liberalization. It is of course true that the financial services sector, which is of particular importance for the UK, is one of the few areas in which agreement has been reached on a (limited) number of important market access issues. However, these still lag a very long way behind the completely open internal market for services in the EU. Thus the City of London with its high-powered and high-turnover financial services companies would find the question of market access in sensitive areas to a rather difficult issue. Furthermore, in the UK services are of especial importance for the balance of trade, whereas in the area of goods there is a massive imbalance in trade with the EU.

What does this mean for EU-UK relations? Would the UK in future be content to trade with the EU on the basis of WTO rules? Would it also be in the interests of the EU?

As the House of Lords noted on 13 December 2016 in its most [recent report on Brexit](#), a trade regime based solely on WTO rules would not be very satisfactory as far as the UK is concerned. The flow of imports from the EU would be unimpeded, whereas the high-powered British services sector would find it rather difficult to gain the market access that it needs. The UK will have to try to secure a more broadly-based (contractual) free trade regime which also takes in the services sector. These negotiations will

demonstrate that the interests of the two sides are very dissimilar. The UK must do everything it can to obtain special access rights for its services sector, whereas the EU will probably be far less interested in this topic. As a kind of quid pro quo it will be tempting to make concessions in the services sector dependent on British concessions in the area of the free movement of people. From a purely economic point of view this is not absolutely necessary. Most economists are of the opinion that there is no compelling economic reason why there should be a link between the services sector and freedom of movement. However, in political terms it will be well-nigh impossible to jettison the links between the two freedoms, which after all are an essential feature of the EU project. It is to be hoped that political good sense will gain the upper hand, and that the link between the services sector and freedom of movement is not overdone. In political terms unreasonable concessions in the area of freedom of movement will be virtually impossible to sell to Brexit supporters in the UK. If it acquiesced to such demands, the British government would feel compelled to make massive sacrifices in the services sector, and this would have a very negative impact on the economy.

What in point of fact are the various options available to the UK as it tries to reshape its trade relations? It is true that the UK is still the fifth most important economic power in the world, but is that enough to enable it to negotiate advantageous trade agreements with the U.S., the EU, China and India? What in your opinion is the most likely scenario, and are you in a position to predict how the British economy will now develop?

The withdrawal agreement is supposed to outline the UK's relationship with the EU, and here there are a number of quite different options. As we have seen, reverting to a trade regime based solely on WTO rules would not be particularly advantageous to the UK. Conversely, a de facto incorporation in the internal market via EEA membership would be difficult to sell to the UK electorate in political terms, since it would mean subservience to the legislative powers of EU

institutions, and the far-reaching acceptance of the free of movement of people. When all is said and done there is still, as in the case of Switzerland, the option of negotiating (limited) access to the internal market and the common legal space via bilateral agreements. In terms of the negotiating process such agreements are very time-consuming and cannot really solve the problem of the political links between access to the internal market and freedom of movement which are so difficult to sever. Switzerland is currently experiencing this with regard to the implementation of the so-called "mass immigration initiative" of 2014. The Swiss Federal Council and the Swiss Parliament have decided to back a very much watered-down version of the implementation procedure in order to prevent disagreements with the EU on the subject of freedom of movement from getting out of hand. A customs union—as in the case of Turkey—is still a possibility in the absence of complete freedom of movement. However, the kind of participation in the internal market that goes beyond this will entail paying a high political price.

The situation is even more difficult when it comes to trade relations with non-EU states. As long as the United Kingdom is a member of the EU in formal terms — and this will be the case until such time as the withdrawal agreement, which has not as yet been negotiated, enters into force — the UK, as stipulated in the EU treaty, is not permitted to negotiate its own trade agreements. It could of course — in so far as potential contract partners are prepared to do so — embark on informal negotiations of a preliminary nature. However, these can be upgraded to the level of formal negotiations only after withdrawal — and it should be remembered that such negotiations are very time-consuming. After withdrawal from the EU the UK would not in fact have free trade relations with any non-EU states, and its trade relations would be determined solely by WTO rules. For the British economy this would be a significant problem with regard to certain trading partners, though at present — in the absence of specific free trade agreements — trade relations with the EU's largest partners (the U.S., China, India, and Japan) are based solely on WTO

rules. Nothing of any great importance would change with regard to these trade flows.

Negotiating free trade and cooperation accords such as the CETA (Comprehensive Economic and Trade Agreement) agreement between the EU and Canada and the TTIP (Transatlantic Trade and Investment Partnership) agreement between the EU and the U.S. is difficult and very time-consuming. How long, do you think, will it take the EU and the UK to conclude a new trade agreement? How long, in your opinion, will it take the UK to renegotiate its trade relations so that they are to its advantage?

The basic features of the EU-UK trade regulations that will be in force after the UK has withdrawn from the EU should in fact be defined in the withdrawal agreement as stipulated in Article 50 Paragraph 2, Sentence 2 TEU. Article 50 Paragraph 3 TEU states that it shall be negotiated within two years after formal notification of the UK's intention to withdraw from the EU. If the United Kingdom is a member of the EEA or if the customs union continues unchanged, this would certainly be technically possible in the context of the negotiations. However, in political terms the two options are extremely unlikely. The question is of no importance in the event of a "hard" Brexit solution, but it seems likely that the UK will attempt to secure a bilateral free trade agreement that will enable it as far as possible to obtain access to the internal market, and at the same time give the UK the ability to take political action in central areas. The time frame needed to negotiate such an agreement clearly exceeds the period of time specified in the provisions of Article 50 TEU. Such negotiations designed to determine the future relations between the EU and the UK would be so complex in technical and political terms that withdrawal on the basis of Article 50 TEU and negotiations about future trade relations will probably have to be dealt with separately. This will demonstrate the need for transitional regulations in the context of the withdrawal agreement. It is true that the provisions of Article 50 Paragraph 3 TEU

empower the European Council to extend the negotiating period as long as it acts unanimously. However, the need for unanimity means that it is at the mercy of individual member states which may well threaten to exercise their veto rights. It is rather unlikely that the negotiations will continue for more than a few years. If we bear this in mind, a plausible scenario might be that the UK will withdraw after two or three years have elapsed even though it has proved impossible to reach agreement on the new regime. One would then conclude a withdrawal agreement consisting of purely technical regulations designed to facilitate the withdrawal (though this may be augmented by a number of transitional regulations relating to EU-UK trade), and defer the negotiations on the new regime to a later date. This would be unwelcome news for the British and European economies, since in 2019 they would still have no clear idea about future economic relations and the issue of market access. Such uncertainty certainly complicates matters when it comes to long-term investment decisions by large multinational companies which are based in the UK and sell their products (or intend to sell their products) on the European market. They will probably put important investment decisions on ice until there is clarity about the future "terms of trade." If the negotiations drag on, this could be detrimental to the British economy, at least in the medium term.

There can be no doubt about the fact that the issue of the time frame of forthcoming negotiations on trade relations with non-EU states is even more dramatic. As we have seen, in formal terms these negotiations can begin only after the UK has withdrawn from the EU, that is, from 2019 onwards at the earliest. Going by previous negotiations of this kind, which have been very difficult and time-consuming, one is talking about time frames of five or ten years (or even longer). Moreover, the negotiations can only be conducted one after the other, for even now the UK has a massive human resources problem. After decades of EU membership during which trade agreements were to all intents and purposes negotiated by the EU Commission, the British government has only a handful of civil servants with the right kind of experience. Most of them will initially be needed for the

negotiations with the EU, which means that sufficient human resources for trade agreements with non-EU states will become available only after 2020. Apart from this there is a need for clarity with regard to market access (and tariffs) as defined by the WTO. This will make it possible to negotiate in a meaningful manner about greater liberalization within the framework of free trade agreements. And this clarity will probably emerge only in a few years' time. Thus a mesh of trade agreements comparable to the current legal status will materialize after 2030 at the earliest.

Is there a danger that the process of renegotiating relations between the UK and the EU will force the EU to defer other free trade agreements (e.g. with India, the U.S., or, in the long run, with China) because it simply does not have the resources to conclude such complex trade agreements at one and the same time?

The EU clearly has at its disposal more of the right kind of staff than the member states. I believe it is rather unlikely that this issue will pose a threat to the negotiating processes of free trade agreements with the U.S., India and China. In any case it is a good idea to assess the time frame of such negotiations in a realistic manner. After the election of Donald Trump the agreement with the U.S. has been put on ice for years to come (the most optimistic scenario), and it is also a very controversial issue within the EU. As long as the EU is unable to ratify a rather trivial agreement (which deals with economic policy convergence and complementary economic structures) such as CETA within a reasonable length of time, negotiating partners of the calibre of India and China will continue to maintain a low profile. Ambitious projects such as "comprehensive trade agreements" are proving to be increasingly problematical within the EU, partly on account of the fact that they are "mixed agreements" which require the assent of the national parliaments. Until CETA has been ratified it will be difficult to conclude similar agreements with India or China. For this reason people will look carefully at the fate of the comprehensive trade agreement with Japan, which is on the verge of being finalized. An

alternative would be to pare down the negotiating agenda to classical trade subjects, which would mean excluding investment protection and regulatory cooperation. Since these would be EU agreements pure and simple, they would be easier to implement in political terms, even though one would have to put the negotiations with Japan, India and China on a new footing. The time frame of these negotiations reaches far into the 2020s, which means that focusing on the negotiations with the UK in the next two, three or four years does not seem to be very problematical.

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