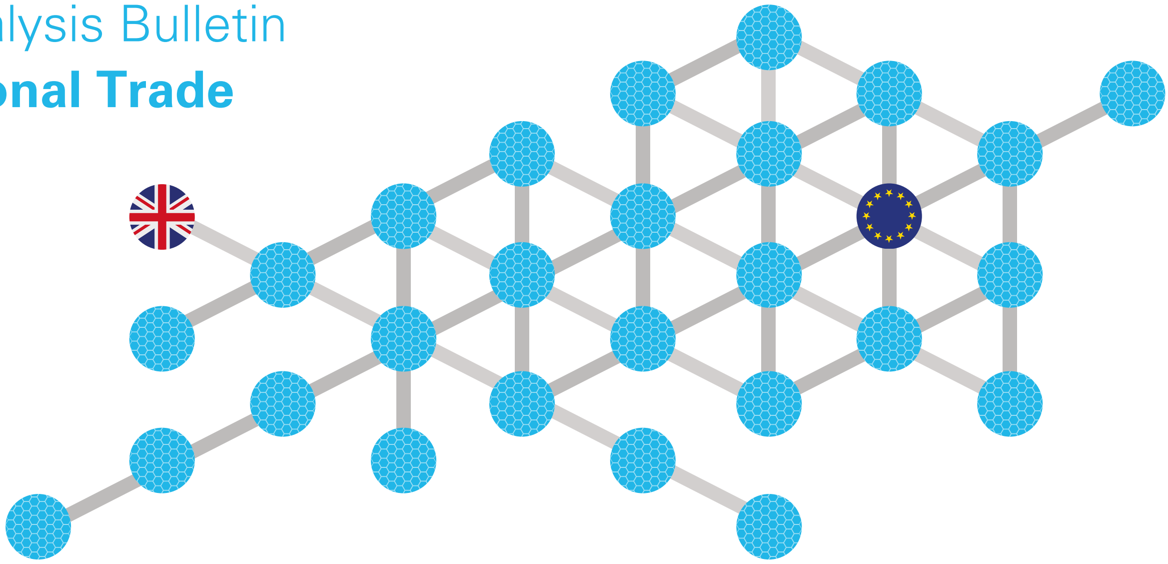
SHEPHERD+ WEDDERBURN

Brexit Analysis Bulletin
International Trade



The EU's single market is the world's largest trading block and as such, is the UK's most important trade partner. Two of the core tasks of the EU set out in the EU Treaty are the establishment of a single market, and establishing a customs union through which the "member states aim to contribute, in the common interest, to the harmonious development of world trade, the progressive abolition of restrictions on international trade and the lowering of customs barriers". In the event of a Brexit, the UK will no longer be a part of the single market or the customs union.

A large part of the debate concerning the UK's EU membership focuses on the single market and the UK's trade relationship with the rest of the EU. It is, however, equally important to consider the EU's trade relationships with the rest of the world and what the UK's position might look like vis-à-vis its non-EU trading partners. For example, the EU negotiates international trade agreements on behalf of its 28 member states which amongst other issues, determine customs duties and market access. In its negotiations, the EU benefits from the weight afforded by the single market, which the UK may not be able to replicate if it needs to renegotiate trade agreements on its own. The EU also has significant influence at the WTO level, as well as legislative powers in the areas of sanctions and trade defence measures.

In this short note we briefly review what the UK's trade position may look like with the rest of the EU and other important global trade partners such as the US, China and Turkey following a Brexit.

EEA (Norwegian) and EFTA (Swiss) options

Membership of the European Economic Area (EEA) (often referred to as the Norwegian example) would allow the UK to maintain access to the free movement of persons, goods, services and capital within the EU's internal market.

This is often touted as the simplest, or least disruptive solution, from an economic perspective. This may be true in the short term. As a member of the EEA the UK will be required to comply with the EU laws and regulations, as it currently does as a member of the EU. However, in respect of any future EU legislation which will become applicable to the UK by virtue of its membership of the EEA, the UK will not have any input on the content of such legislation and will simply have to comply with whatever legislation is put in place by the EU. This may ultimately place a greater burden on UK businesses seeking to trade within the EU.

In a similar vein, Switzerland is also often used as an example for the UK's relationship with the EU following a Brexit. Switzerland is a member of the European Free Trade Association (EFTA), which is a free trade area consisting of four European states: Iceland, Liechtenstein, Norway, and Switzerland. Switzerland is the only EFTA state that is not a member of the EEA. Its relationship with the EU, unlike the EEA states, is governed by bilateral agreements with the EU. In many respects, because the EU is Switzerland's largest trade partner, and because of its geographic location, it follows the EU legislation in order to access the EU's market, albeit it has no influence on the EU decision-making.

SHEPHERD+ WEDDERBURN

These two options are largely focused on trade and would allow UK businesses, from a practical perspective, to carry on trading with its EU partners in a largely similar way to the current position as both EEA and EFTA members follow the EU regulatory and legislative measures quite closely. However, as a country has never withdrawn from the EU and then sought to join the EEA and/or EFTA, it is not clear how long such a process may take and whether there may be a risk that the UK exits the EU before its membership of EEA/EFTA is complete. This would clearly lead to a period of uncertainty for UK businesses.

World Trade Organisation (WTO)

The WTO operates a rules-based trade system comprising 162 members covering over 90% of the world's trade. The EU Commission and all EU member states are members of the WTO in their own right. However, under the EU Treaty the EU Commission has significant powers to act on behalf of the EU at the WTO level, including negotiating various agreements. The EU is currently grappling with the significant decision of whether to grant China Market Economy Status, as envisaged in the Chinese WTO Accession Protocol. Granting such a status will have a significant impact on the EU anti-dumping (exports priced lower than the normal value of the product) protection measures, as it will be more difficult to impose such measures against Chinese exports. The EU is addressing this issue via a bilateral dialogue with China.

Following a Brexit, the UK's WTO membership would remain intact and the UK would instead negotiate such agreements and hold any dialogues with other countries as an independent party.

In addition, any trade deal that may be negotiated in the future between the UK and the EU would have to comply with the WTO rules. This may prove difficult because under the WTO 'most favoured nation' clause, members are not allowed to grant preferential terms to certain members, without extending them to all WTO states. This rule has two exceptions – free trade agreements and customs unions.

Free Trade Agreements

Free trade agreements are designed to create opportunities by, amongst other things:

- making trade cheaper - by eliminating substantially all customs duties within the free trade area;
- making trade faster - by facilitating transit of goods through customs and setting common rules on technical and sanitary standards; and
- making the policy environment more predictable - by taking joint commitments on areas that affect trade such as intellectual property rights and competition rules.

The EU has most recently concluded comprehensive trade agreements with, amongst others, South Korea (the first of a new generation of free trade agreements that goes further than ever before in terms of lifting trade barriers and making it easier for EU and South Korean companies to do business together) and Canada (Comprehensive Economic and Trade Agreement (CETA)), and is currently negotiating the Transatlantic Trade Investment Partnership (TTIP) with the US – a trade deal, which, if adopted, will cover the largest two trading blocks. Following a Brexit, the UK may have to renegotiate the free trade agreements it currently benefits from in their entirety.

Although following Brexit the UK would be free to renegotiate its own free trade agreements, any negotiation will depend on the will of the other parties and may be a fairly lengthy process. By way of an example of the timeframes involved, the EU/US TTIP negotiations were launched in June 2013, and are currently undergoing their 13th round, with an optimistic deadline to reach a final agreement by the end of 2016 before it goes through the US and EU ratification processes.

As many of these free trade agreements are entered in to by the EU and each member state on its own behalf (usually where the agreement covers additional matters which are outside of the scope of the EU's remit), it may be possible for the UK to seek agreement with the relevant third party (e.g. South Korea) that they will each continue to comply with their substantive obligations under the existing free trade agreement. Whilst this would allow trade to continue as it currently does, there are likely to be procedural matters covered in the free trade agreement which the UK and the relevant trading partner would need to negotiate and amend separately. For example, it would no longer be appropriate for disputes to be dealt with in the EU forum, which would be provided for in the free trade agreement.

Even without free trade agreements in place, UK businesses will still be able to trade with other countries and if significant barriers to trade exist, the UK will be able to hold discussions with other countries to seek to remove or reduce the effect of such barriers.

Customs Union

A Customs Union goes one step further than a free trade agreement in that it abolishes all tariffs amongst member countries, while members also agree to a common foreign trade policy, with one set of policies for trading with countries outside the union and a single, external tariff on goods imported from outside the customs union.

The EU, as well as being a customs union itself, also has three customs unions with non-EU trading partners: Andorra, San Marino, and Turkey. According to the UK Trade & Investment department, there are over 2,500 UK companies currently operating in Turkey including global companies such as BP, Shell, Vodafone, Unilever, BAE, HSBC, Aviva, Diageo, and high street names such as Tesco, Harvey Nichols, Marks and Spencer and Laura Ashley also have extensive operations in Turkey.

If the UK is no longer a member of these customs unions following a Brexit, it may seek to form similar customs unions itself with third parties (including individual EU countries unless it forms a customs union with the EU itself). As with free trade agreements, the absence of a customs union does not prohibit trade with other countries. It will be open to the UK to discuss and negotiate with other countries how to remove or reduce the effect of any significant trade barriers, including customs tariffs.

Sanctions

The EU has various powers to impose restrictions or conditions on trade, for example regimes operated by the EU's External Action Services (EAS) which imposes sanctions – restrictive measures – on trade with third countries on various foreign and security policy grounds. In most cases it follows the resolutions adopted by the UN Security Council, but it may also adopt such measures on its own accord. Individual EU member states have to follow the EU sanctions, but may also impose more restrictive measures if they so choose. As such, following a Brexit, the UK sanctions regime is unlikely to change significantly as it will continue to be bound by the UN resolutions and will continue to be able to impose stricter and independent measures.

Where the EU acts independently from the UN, the UK would no longer have any influence over the imposition of EU sanctions, but the UK will be able to independently adopt any sanctions considered appropriate (as it currently does if it wishes to impose stricter measures than flow from the EU). In addition, the EU courts, which oversee the legality of the EU sanctions, will have no jurisdiction over the UK and any sanctions it chooses to impose.

EU sanctions generally apply to EU nationals, whether or not they are in the EU, to any business done in whole or in part within the EU and to companies organised under the law of a member state. As such, UK businesses that employ EU nationals or have operations or subsidiaries located in the EU may find that they are still required to comply with the EU sanctions, even where these diverge from the regime adopted by the UK. However, as noted above, in reality a Brexit may not have any significant impact on the UK's sanctions regime.

Trade defence mechanisms

With respect to defending the EU single market from unfair trade practices, the EU Commission's Directorate General for Trade has powers to impose anti-dumping (essentially protect against damaging below cost exports) and anti-subsidy duties (subsidised exports) against exports from third countries to the EU that harm European producers. The UK can currently influence the EU's trade policy during the legislative process of the EU trade defence legislation, and also, by voting at the stage when individual trade defence measures are imposed. The EU also defends EU exporters that face discriminatory measures and market entry difficulties in third country markets before the WTO.

Again, the UK will want to try to replicate such measures itself in order to defend its own market from unfair trade practice. It will be able to decide on, and negotiate, these measures independently.

Conclusion

Following a Brexit, at least during the period of negotiating exit terms (up to two years), there will be no immediate changes to the current UK trade regime with the EU, and also with third countries to the extent they have trade agreements with the EU. Following this period the situation will become rather complex, as terms of the UK's trade relationships with the EU and with the rest of the world will depend on entirely new and uncertain terms, yet to be negotiated.

The UK will be entirely free to set its own customs duties and laws, will be able to negotiate free trade agreements on its own accord, and will have more room for independent decision making in the area of sanctions and trade defence mechanisms. However, it may also be subject to customs duties and other trade barriers which it is not currently subject to and this could clearly have an impact on UK businesses.

In practice this is likely to result in a period of uncertainty for UK businesses in relation to their individual trading partners.

SHEPHERD+ WEDDERBURN

SHEPHERD AND WEDDERBURN'S BREXIT ADVISERS
JOINING THE DOTS OF THE EU REFERENDUM

What If?
Shepherd and Wedderburn has been for many years offering balanced and impartial advice on how the different scenarios might play out in the event of constitutional change.

With the EU referendum now only months away, members of our dedicated Brexit Advisers will continue to interrogate the 'what if' questions, relating to specific sectors, that will emerge when the UK decides whether to remain in or leave the EU.

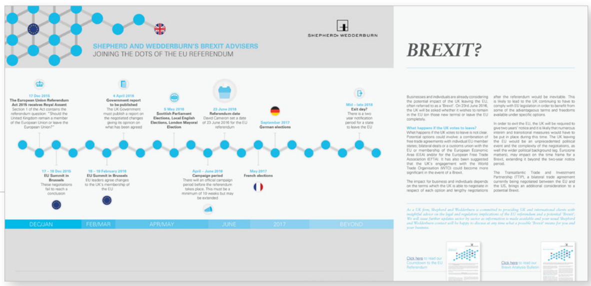
For further information in the first instance, please contact:

James Saunders
Partner
T +44 (0)131 473 5288
M +44 (0)771 863 7297
E james.saunders@shepwedd.co.uk

Alison Rochester
Associate
T +44 (0)131 473 5350
M +44 (0)773 869 7405
E alison.rochester@shepwedd.co.uk

Bookmark our Brexit Advisers page for a comprehensive collection of EU referendum updates and guidance

Click here to view our EU referendum timeline



Click here to read our Countdown to the EU Referendum