



House of Commons
International Trade Committee

UK trade options beyond 2019

First Report of Session 2016–17

*Report, together with formal minutes relating
to the report*

*Ordered by the House of Commons
to be printed 1 March 2017*

International Trade Committee

The International Trade Committee is appointed by the House of Commons to examine the expenditure, administration and policy of the Department for International Trade and its associated public bodies.

Current membership

[Angus Brendan MacNeil MP](#) (*Scottish National Party, Na h-Eileanan an Iar*) Chair

[Liam Byrne MP](#) (*Labour, Birmingham, Hodge Hill*)

[James Cleverly MP](#) (*Conservative, Braintree*)

[Mr Nigel Evans MP](#) (*Conservative, Ribble Valley*)

[Marcus Fysh MP](#) (*Conservative, Yeovil*)

[Mr Ranil Jayawardena MP](#) (*Conservative, North East Hampshire*)

[Sir Edward Leigh MP](#) (*Conservative, Gainsborough*)

[Chris Leslie MP](#) (*Labour (Co-op), Nottingham East*)

[Shabana Mahmood MP](#) (*Labour, Birmingham, Ladywood*)

[Toby Perkins MP](#) (*Labour, Chesterfield*)

[Sir Desmond Swayne MP](#) (*Conservative, New Forest West*)

Powers

The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No. 152. These are available on the internet via www.parliament.uk.

Publication

Committee reports are published on the [Committee's website](#) and in print by Order of the House.

Evidence relating to this Report is published on the [inquiry publications page](#) of the Committee's website.

Committee staff

The current staff of the Committee are Lydia Menzies (Clerk), Rob Page (Second Clerk), Stephen Habberley and David Turner (Committee Specialists), Andrew Wallace (Senior Committee Assistant), Ian Blair (Committee Assistant), and George Perry (Media Officer).

Contacts

All correspondence should be addressed to the Clerk of the International Trade Committee, House of Commons, London SW1A 0AA. The telephone number for general enquiries is 020 7219 1812; the Committee's email address is tradecom@parliament.uk.

Contents

Summary	3
1 Introduction	5
2 Establishing the UK's position at the WTO	8
WTO membership	8
WTO schedules	9
Bound tariffs	9
Quantitative adjustments	10
Risk of political obstructionism	12
Certification	12
Other issues	13
Government Procurement Agreement	13
Trade defence instruments	13
Parliamentary scrutiny	14
Conclusions and recommendations	14
3 "Deal"—a UK Free Trade Agreement with the EU	16
Concluding a trade agreement by 2019	16
Introduction	16
Legal possibility	16
Practical feasibility	17
Potential features of a UK-EU FTA	23
Trade in goods	23
Trade in services in general	25
Trade in financial services	28
Inward investment	31
Dispute resolution	32
"Customs arrangements"	33
Purpose of rules of origin	33
Impact of rules of origin on UK-EU trade	34
Government policy	35
Sectoral customs union	37
Transitional arrangements	38
Conclusions and recommendations	39

4	“No deal”—Trading under WTO rules alone	41
	Introduction	41
	Unilateral options	41
	Consequences for British exports to EU	43
	Impact of MFN tariffs	43
	Impact of non-tariff barriers on trade in goods	44
	Impact of barriers to trade in services	45
	Overall impact	46
	Dispute resolution	47
	Contingency planning	47
	Conclusions and recommendations	48
5	UK Free Trade Agreements with non-EU countries	49
	Introduction	49
	Timing and sequencing of negotiations	49
	“Grandfathering” EU FTAs	51
	Re-joining the European Free Trade Association	53
	Capacity of DIT to undertake negotiations	54
	Prioritising FTAs	55
	Large and growing markets	55
	The Commonwealth	56
	Plurilateral agreements	59
	Conclusions and recommendations	59
	Conclusions and recommendations	61
	Annex 1: Terms of Reference	65
	Annex 2: The EU Single Market	67
	Formal Minutes	69
	Witnesses	70
	Published written evidence	72

Summary

The International Trade Committee's first inquiry has examined the different potential models for UK international trade after the UK leaves the EU. We have sought to understand the factual implications for the UK's future trading relationships of the UK's different options for trade after Brexit, and the issues that the Government will need to resolve in each case. In the report we consider the UK's relationship with the World Trade Organization (WTO); the Free Trade Agreement (FTA) the Government plans to strike with the EU; the implications of the UK falling back on trading with the EU under WTO rules alone; and the UK's future trading relationship with non-EU countries.

The UK's membership of the WTO will form the basis of its future trading relationships. The UK's status as a WTO member is beyond doubt but it needs to establish its own schedules of concessions and commitments separate from the EU's. This involves first setting maximum tariff levels, which should be straightforward. Second, it involves setting upper limits for Tariff Rate Quotas and Aggregate Measurement of Support. Opinion is divided as to whether or not this will prove to be a difficult and lengthy process. Nothing should be left to chance.

The Department has quite correctly made an early start on establishing its position at the WTO. It should report to the Committee about this regularly, and at least every quarter.

As part of a Free Trade Agreement with the EU, the UK must seek a reciprocal tariff-free basis for trade. Non-tariff barriers are arguably of much greater importance than tariffs. The Government should seek to retain the mutual recognition of rules and standards, and conformity assessment, that the UK currently has with the EU. The Government appears confident that non-tariff barriers to trade in goods would not be increased in a UK-EU FTA. However, regulatory divergence is likely to occur over time after Brexit. In respect of the services sector, the UK at present benefits from right of establishment and mutual recognition of professional qualifications. The UK should seek to preserve these as far as possible in a UK-EU FTA. At present, financial service firms based in the UK can rely on "passporting" to do business in the rest of the EU. The Government should seek the nearest achievable approximation to this. This is a matter to which the Committee will return, including the examination of regulatory change.

Were the UK to conclude an FTA with the EU without a customs union, rules of origin would apply and a customs border would consequently exist between the UK and the EU. This would create trade friction at the border and some UK products might not actually meet the criteria for sale in the EU under rules of origin.

The Government wants the UK to have "a customs agreement with the EU" but not a customs union. It must be much clearer about the defining characteristics of this. The Government should clarify if there will be a significant sectoral aspect to the arrangement they are seeking and whether that would impact on future international trade policy. Whatever option applies, the Government must clarify arrangements for customs and border operations, and specify the expected number and intensity of customs checks. Planning for this is a matter of urgency now.

The Government must set out as clearly as possible the likely consequences of trading under WTO rules alone. It must also show what contingency planning it is undertaking for that eventuality. Trading under WTO rules alone would mean that UK exports to the EU inevitably faced EU tariffs. Most of the EU's Most Favoured Nation (MFN) tariffs are low, with a few significant exceptions: the automotive industry, agriculture and textiles. WTO rules do not cover regulatory restrictions, geographic indicators or standards, so the UK cannot rely on them to prevent the occurrence of this type of trade barrier. The effect of trading under WTO rules on trade in services is complex to gauge, but trading in financial services under WTO rules alone would mean the loss of passporting rights, with no agreed substitute.

While there seems to be a broad consensus that the UK can, legally, undertake informal discussions with non-EU countries about future trade relationships, it is not clear how far the Government can go towards negotiating new agreements before leaving the EU. Given that striking new FTAs is a major strand of the Government's Brexit strategy, it is untenable that it should proceed in this work without clarity on this point.

The Government will need to prioritise countries or regions for new FTAs. The Department's priority is to "grandfather" those that the EU has with third countries, but uncertainty remains about whether the UK will have rights under these FTAs, and the Government must seek the earliest possible clarity on this matter. Clearly, there is a limit to how many FTAs can be negotiated at one time. Negotiating new FTAs is not something the UK has needed to do since joining the EU's predecessor in 1973. The Department was unable to say how many the UK would be able to manage simultaneously. There will have to be priorities, and the Government must be clear about what those priorities are, what negotiating resources it is able and willing to procure, and how those resources will be deployed.

We recommend that the Government now evaluate the implications of the UK's rejoining the European Free Trade Association (EFTA), which would offer an opportunity for a smoother transition as the UK exits the EU in 2019. We were impressed by the potential benefits of EFTA membership, given there is close alignment between the UK's economy and those of EFTA members, albeit the UK would be considerably the largest member were it to join. The prospect of UK membership of EFTA from 2019 onwards could clearly be to Britain's advantage and we, therefore, recommend that the Secretary of State publish a White Paper on EFTA membership before summer 2017, so that negotiations can commence before the end of the year.

1 Introduction

1. The International Trade Committee was appointed in October 2016 to scrutinise the work of the new Department for International Trade (DIT), which was created in the machinery of government changes that took place after the UK vote to leave the European Union (EU) at the referendum on 23 June 2016. On 17 November 2016 we announced our first inquiry, into “UK trade options beyond 2019”, seeking to understand the different potential models for UK international trade after the UK leaves the EU.

2. At the inception of DIT, in July 2016, the Government stated that the Department had:

overall responsibility for promoting British trade across the world. It will develop, coordinate and deliver a new trade policy for the UK, including preparing for and then negotiating Free Trade Agreements [FTAs]¹ and market access deals with non-EU countries.²

According to an accompanying Explanatory Note, the Department would “work side by side with the new Department for Exiting the EU [DExEU], which will negotiate the UK’s new relationship with the EU in tandem.”³ When DIT officials gave evidence to us in November 2016, they told us:

DExEU [...] is responsible for the exit negotiations with the EU and also the future relationship with the EU. We are responsible for the trade relationship with the rest of the world [...] We are working closely with DExEU to input and understand the analysis that they are doing, but we are not leading on arrangements for negotiations with the EU or how long that will take or whether or not there will be transition periods and things like that.⁴

Given that the nature of the UK’s post-Brexit trading relationship with non-EU countries will depend on its future relationship with the EU, we chose to consider the latter in our inquiry—notwithstanding the fact that it lies within the remit of DExEU rather than DIT. This report, therefore, considers the potential benefits and risks of different models for UK trade with the EU alongside some of the issues that DIT needs to resolve as it pursues its programme of work over the remainder of the Parliament and beyond. In any event, it would be a mistake to consider the UK’s trade policies with the EU and the rest of the world in isolation; it is vital that the Government has a coherent strategy.

3. When we began our inquiry, a broad range of options for the UK’s future trading relationship with the EU appeared to be on the table. Our terms of reference (see Annex 1) consequently sought views on this full spectrum of options, including those which

1 An FTA allows for the mutual lowering or removal of tariffs (taxes levied on goods crossing a border; also referred to as customs or duty) and non-tariff barriers (factors impeding trade that do not involve levying a tariff, such as regulatory measures). Such an agreement may be bilateral or it may involve more than two trading partners.

2 “[Machinery of Government Changes](#)”, Written Ministerial Statement, 18 July 2016, HCWS94

3 Cabinet Office, “[Machinery of Government: Creation of a new Department for International Trade](#)”, 18 July 2016

4 [Q7](#)

have been described as involving continued “membership” of the EU Single Market.⁵ Since then, however, the Government has clarified its position, with a number of options effectively being ruled out. Consequently, this report focuses on the options that remain likely given the Government’s position, and we have not commented on those options that the Government has now excluded from consideration.

4. The Government has said that it is aiming to establish a comprehensive FTA with the EU, without a customs union⁶ (but with a “customs arrangement”). It expects the essential features of this new trade relationship to be agreed as part of the two years of Brexit negotiations (up to 2019) under Article 50 of the Treaty on European Union (TEU),⁷ along with “a phased process of implementation” following Brexit.⁸ In the event that these “negotiating objectives” cannot be achieved, the UK will, at the point of Brexit, default to trading with the EU under World Trade Organization (WTO)⁹ rules alone.¹⁰ While the Government has chosen to pose the question simply in terms of “deal” or “no deal”,¹¹ there are many options available as regards the form that an FTA might take, as we set out in this report.

5. Among the public, civil society, Parliament—and indeed this Committee—there remains a range of views about which approach to the UK’s future trading relationships will cause it to prosper. We do not in this report aim to pick an option. We have attempted in our inquiry to understand the factual implications for the UK’s future trading relationships of the UK’s different options for trade after Brexit, and the issues that the Government will need to resolve in each case.

6. In the report we first consider the UK’s relationship with the WTO. Regardless of the path that the Government takes with respect to trade, the UK’s membership of the WTO will form the basis of its future trading relationships. We then go on to consider the FTA the Government plans to strike with the EU, its possible features and their implications for trade. Next we consider the implications of the UK falling back on trading with the

5 Strictly speaking, the only members of the Single Market are the member states of the EU. However, the non-EU members of the European Economic Area are also often regarded as members, since they have a level of access to the Single Market akin to that enjoyed by EU members. Switzerland also has a high degree of access to the Single Market without actually being an EU member. On the relationship of these countries to the Single Market, see Annex 2.

6 A customs union allows for the setting of a common external tariff between two or more trading partners, as well as a common trade policy (so that the parties to the customs union conclude FTAs with third countries as a bloc).

7 The TEU is one of two treaties that form the constitutional basis of the EU. Article 50, which sets out a formal process for the voluntary exit of an EU member state, was added in 2007 under the Treaty of Lisbon.

8 The Prime Minister stated in her speech to the Conservative Party conference on 2 October 2016 that Article 50 would be invoked “no later than the end of March next year”—“[Prime Minister: Britain after Brexit: A Vision of a Global Britain](#)”, Conservative Party website, 2 October 2016. Notwithstanding the subsequent complication of having to secure the passing of the European Union (Notification of Withdrawal) Bill, it remains the Government’s intention to stick to this timetable. Article 50 provides for a two-year negotiating period. This may be extended, subject to the unanimous consent of the European Council (on which the heads of state or government of all member states sit), but the UK Government does not intend to prolong the Article 50 process beyond two years.

9 The WTO is a global organisation of 164 members (states and autonomous customs territories) which deals with the rules of trade between nations.

10 “[The government’s negotiating objectives for exiting the EU: PM speech](#)”, Prime Minister’s Office, 17 January 2017; HM Government, *The United Kingdom’s exit from and new partnership with the European Union*, Cm 9417, February 2017

11 “[The government’s negotiating objectives for exiting the EU: PM speech](#)”, Prime Minister’s Office, 17 January 2017; HM Government, *The United Kingdom’s exit from and new partnership with the European Union*, Cm 9417, February 2017

EU under WTO rules alone. Finally, we consider the UK's future trading relationship with non-EU countries and some of the questions that it needs to resolve before embarking upon a programme of striking new trade agreements across the world.

7. During the course of our inquiry, we have taken oral evidence from 33 witnesses at nine evidence sessions and received 46 pieces of written evidence. We are grateful to everyone who has contributed to this inquiry. We also wish to record our gratitude to our Specialist Advisors: Dr Lorand Bartels, Reader in International Law and Fellow of Trinity Hall at the University of Cambridge; and Dr Angus Armstrong, Director of Macroeconomics at the National Institute of Economic and Social Research.

2 Establishing the UK's position at the WTO

WTO membership

8. The WTO is founded on agreed sets of multilateral rules which govern trade between members, the foremost being the General Agreement on Trade and Tariffs (GATT) and the General Agreement on Trade in Services (GATS). Under GATT and GATS, WTO members are bound to observe the “most favoured nation” (MFN) principle—meaning that they must give each other the same trading terms as those they have granted to their most-favoured trading partner. Under GATT, members may only deviate from this “non-discrimination principle” and apply lower-than-MFN tariffs in the case of:

- an FTA or customs union agreement;
- the granting by a developed country of unilateral or non-reciprocal trade preferences to developing countries in order to assist the latter's development;
- a specific waiver agreed by (in practice) all WTO members.

In addition to general rules that apply to all WTO members (for example on technical standards and subsidies), individual members lodge with the WTO “schedules” (one each in respect of goods and services), which reflect specific tariff concessions and other commitments that have been given.

9. Regarding the UK's status as a member of the WTO, the Director General of the WTO, Roberto Azevêdo, stated as follows in October 2016:

The UK is a member of the WTO today, it will continue to be a member tomorrow. There will be no discontinuity in membership. They have to renegotiate [their terms of membership] but that doesn't mean they are not members. Trade will not stop, it will continue and members negotiate the legal basis under which that trade is going to happen. But it doesn't mean that we'll have a vacuum or a disruption.¹²

He had previously stated, during the referendum campaign, that, while “Britain is a member of the WTO and will continue to be a member of the WTO” in the event of a vote for Brexit, its status in that circumstance as “a member with no country-specific commitments” would be unprecedented: “We have had no other situation like that”.¹³ He was also quoted to the effect that “the likely complexity of” negotiations to establish the terms of the UK's WTO membership “made them akin to the tortuous ‘accession’ negotiations countries go through to join the WTO”.¹⁴

12 [“Brexit will not cause UK trade ‘disruption’ – WTO boss”](#), Sky News website, 26 October 2016. The UK's Ambassador and Permanent Representative to the UN and other international organisations in Geneva, Julian Braithwaite, has stated: “The UK is a full and founding member of the WTO [...] Under the EU treaties, Member States have agreed that the European Commission will represent them on most things in the WTO. As a full member of the WTO, the UK has its own seat [...] But for most WTO business, the Commission speaks for all of us collectively”—[“Ensuring a smooth transition in the WTO as we leave the EU”](#), Foreign and Commonwealth Office, 23 January 2017.

13 [“WTO chief says post-Brexit trade talks must start from scratch”](#), *Guardian* website, 7 June 2016

14 [“WTO warns on tortuous Brexit trade talks”](#), *Financial Times* website, 25 May 2016

WTO schedules

10. While the UK's status as a member of the WTO is beyond doubt, there remains to be settled, as Mr Azevêdo indicated, the terms of the UK's membership. This relates to the establishment of the UK's own schedules of concessions and commitments. This is a necessary and inevitable technical aspect of Brexit, which is concomitant upon the UK ceasing to be a member of the EU, irrespective of the terms on which UK-EU trade ends up being conducted after Brexit.¹⁵ The accomplishment of this task falls within DIT's remit and in December 2016 the Secretary of State for International Trade, Rt Hon Dr Liam Fox MP, informed the House that it was initiating the process for doing so:

In order to minimise disruption to global trade as we leave the EU, over the coming period the Government will prepare the necessary draft schedules which replicate as far as possible our current obligations. The Government will undertake this process in dialogue with the WTO membership.¹⁶

Bound tariffs

11. There are two aspects to the process of establishing the UK's goods schedules at the WTO. The first concerns the setting of maximum tariff levels (often referred to as "bound tariffs" or "bindings"), which are annexed to the GATT.¹⁷ There seems to be general agreement that this is a straightforward matter. When the Secretary of State appeared before us, he said:

All members of the WTO trade under schedules, which are effectively the commitments we make in terms of maximum bound tariffs, and we have decided to go for a technical rectification, rather than a modification. That is for two reasons. First is it will be easier for us to achieve and will therefore have less chance of creating any turbulence whatsoever in global trading as we leave the EU; secondly, because going for EU bound tariffs means that if we change our trade policy, we can only move in the direction of liberalisation, so we do not have the option of increasing our tariffs once we are outside the EU.¹⁸

The Department explained to us in written evidence that "rectifications mean changes of a purely technical character that do not alter the scope or the substance of the existing commitments". Modifications, on the other hand, "mean new commitments or improvements to existing ones" and "WTO Members are allowed to modify or withdraw concessions from their Schedules through negotiation and agreement with other WTO Members".¹⁹

15 [Q208](#)

16 "[UK's Commitments at the World Trade Organization](#)", Written Ministerial Statement, 5 December 2016, HCWS316. See also HM Government, *The United Kingdom's exit from and new partnership with the European Union*, Cm 9417, February 2017, paras 9.16–18.

17 The actual tariffs levied by countries (within the bound tariff limits) are known as "applied tariffs". Tariffs are either *ad valorem* (levied as a percentage of the price of a product) or specific (levied per quantity of a product or per item).

18 [Q446](#). See also [Q486](#).

19 Department for International Trade ([UKT0049](#))

Quantitative adjustments

12. The second aspect of establishing UK schedules concerns upper limits for Tariff Rate Quotas (TRQs) and Aggregate Measurement of Support (AMS). Both of these are expressed as quantities and appropriate UK shares need to be extracted from the TRQ and AMS amounts shown in the EU schedules as they currently stand.²⁰

Tariff Rate Quotas

13. TRQs set quantities of a (usually agricultural or fish) product that are allowed to be imported tariff-free or at a reduced tariff. TRQs have arisen for a range of complex historical reasons.²¹ The EU has a number of TRQs of which the UK is a disproportionately large user, notably country-specific TRQs in relation to some New Zealand agricultural products.

14. Roderick Abbott, a former senior official at the WTO and the European Commission, told us he thought major difficulties were unlikely. He said that, in extracting the UK element from EU TRQs:

[Y]ou have to look at the trade, and at what has actually happened. If you had 50,000 tonnes actually imported, how much of that went to the EU and how much of that went to the UK? This is not rocket science. This is really just high school mathematical people with calculators, calculating over three years the data you have and what the shares are. If you then follow that exactly, or even being slightly generous—you can add a little bit on both sides—you should not get into major trouble. I say “should not” because there is always something that goes wrong.²²

15. Professor Jim Rollo of the UK Trade Policy Observatory (UKTPO) took a more pessimistic view. He told us:

we currently have a more or less self-sufficient production of lamb in this country. We import lamb under these TRQs from third countries²³—New Zealand mainly but others—and we export just about as much as we import of high quality British lamb to the rest of the EU. You can see immediately there is a whole series of potential trade policy issues that could arise out of that. British farmers might not be terribly interested in extending the TRQ system, if they can't, after Brexit, export fully to the EU. Then we get surplus on the UK market that will drive prices down, so I can imagine quite a lot of what economists call political economy in that.²⁴

16. Professor Fiona Smith, of Warwick University Law School, also explained that where:

quotas are split and the UK gets the benefit of the quota, that product will only gain access to the UK and will not be allowed to freely circulate through the EU unless the UK has gone further and negotiated that preferential access with the EU.

20 [Q446](#)

21 [Q166](#)

22 [Q130](#)

23 A “third country” is one which is not party to an agreement between two other countries.

24 [Q70](#)

Consequently, “the conditions of competition for that product are different as far as the exporting state is concerned” and this could be an issue for the WTO member concerned.²⁵

17. An additional consideration is the UK’s interest in the determination of the EU’s revised TRQs after Brexit. This stems from the need to ensure that the EU’s TRQs contain enough capacity to take account of UK exports, in the event that a UK-EU FTA is not in place from 2019. Peter Ungphakorn, a former Senior Information Officer at the WTO, told us that in 2015 the UK had exported 75,000 tonnes of lamb to the EU. In the absence of a continued tariff-free arrangement for such exports after Brexit, the following question arose:

if you want to continue to export 75,000 tonnes of lamb to the EU duty-free, which you might, how can you get it in there when the tariff quota is allocated between all these countries and only 200 tonnes is left for others? Where does the UK fit into those others? That is why the negotiation over the tariff quota then becomes more complicated.²⁶

Marcus Dolman, Co-Chair of the British Exporters Association, explained that the same issue arose regarding the EU’s TRQ in respect of cheddar cheese, 40% of the UK’s exports of which go to the EU.²⁷ These points raise the interesting issue of whether it might actually be easier for the UK to establish its position at the WTO after concluding an FTA with the EU27.

18. In written evidence, the UKTPO argued that “a complex disentangling process will be unavoidable” in respect of agricultural TRQs and urged that “The UK and EU should act together to negotiate these with other [WTO] members”.²⁸ However, Dr Fox indicated to us that he did not foresee any major problems in this respect:

There are a number of countries who will have questions over quotas in relation to that and we wanted to deal with them and talk to them privately before we acted in a public way. We did that and I am happy to say that our discussions have been extremely useful and I think productive. As the Director General said, we are on course now for no turbulence and no vacuum.²⁹

Aggregate Measurement of Support

19. AMS relates to trade-distorting subsidies paid to domestic agriculture, in various forms.³⁰ Mr Ungphakorn told us that he did not expect the negotiation of these to cause difficulties:

25 [Q166](#)

26 [Qq170-1](#)

27 [Q529](#)

28 UK Trade Policy Observatory ([UKT0019](#))

29 [Q447](#)

30 These are known as “amber” subsidies in the “traffic-light” classification operated by the WTO. The intention is that the extent of such subsidies will reduce over time. In respect of a developed country, WTO rules do not allow such subsidies to be set at more than 5% of agricultural GDP (known as the *de minimis* level).

The EU uses only 8.2% of its entitlement on trade-distorting subsidies and there is huge room for manoeuvrability. I have used the word that it is eminently “fudgeable”. If people were going to haggle over the 90% of space that is not being used at the moment, that means there is a huge amount of ill will in the negotiations. I sincerely hope we never reach that point.³¹

Risk of political obstructionism

20. It has been suggested that political “ill will” might be shown towards the UK at the WTO by some countries wishing to use the establishment of UK schedules as a means of exercising leverage over other (geopolitical) matters.³² Sir Andrew Cahn, a former head of UK Trade and Investment, thought that the process did offer “some opportunities to [...] ill-wishers, who simply want to make difficulties for us” to cause delays.³³

21. However, when we questioned Lesley Batchelor, Director General of the Institute of Export and International Trade, who was quoted in a newspaper article on this, she indicated that the report had been somewhat overegged.³⁴ She told us: “I have no idea what is going to happen, but I can say that it is not unheard of for people to use things like this in terms of diplomacy or political gain.”³⁵

Certification

22. Although the Government has already begun the process of establishing UK schedules at the WTO, Mr Abbott told us:

You have to do it after you have left the EU, because you are no longer covered by the EU’s tariff and services commitment that covers all member states. What is involved is extracting from the EU collective commitments to what you want for the UK, but there is no timetable. You don’t have to do any of this before the end of Article 50.³⁶

23. The end point of the process of modification or rectification of a WTO schedule is its certification.³⁷ It has been suggested that if separate UK schedules have not been established by the point of Brexit in 2019, it would be unclear what tariffs, TRQs and AMS would apply to the UK at that point.³⁸ In this regard it should be noted that the EU’s own schedules have been consistently out-of-date. It took until 14 December 2016 for them to be updated to take account of the EU accessions of 2004 (expansion to EU25). It is unclear when they will be updated to take account of the accessions of 2007 (expansion to EU27) and 2013 (expansion to EU28)—they will then, of course, need to be further updated to take account of Brexit in 2019 (contraction to EU27).³⁹ In this case, the most recently certified schedules have been deemed to be still valid.

31 [Q179](#)

32 Ian Dunt, *Brexit: What the Hell Happens Now?* (London, 2016), p 94; “[Brexit: UK’s WTO status ‘could be blocked over territorial disputes’](#)”, *Independent* website, 12 December 2016

33 [Q317](#)

34 [Q527](#)

35 [Q528](#)

36 [Q128](#)

37 Department for International Trade ([UKT0049](#))

38 [Q533](#)

39 Peter Ungphakorn, “[12 years on, EU’s certified WTO goods commitments now up to date to 2004](#)”, 4 February 2017

Other issues

Government Procurement Agreement

24. Establishing the terms of the UK's membership of the WTO in its own right also raises other issues. One such is whether the UK will remain a party to the WTO Government Procurement Agreement (currently the UK is subject to the Agreement through the EU).⁴⁰ DIT could only tell us that it was “considering the UK's position” in this regard.⁴¹

Trade defence instruments

25. Trade defence instruments (also known as trade remedies) are policy tools which governments can use to take remedial action against imports that cause damage to domestic industry. Under WTO rules these are permitted as follows:

- anti-dumping measures (against imports that are sold at less than cost);
- anti-subsidy measures (against imports underpinned by government subsidies); and
- safeguard measures (against imports that have increased sharply and suddenly as a result of unforeseen developments).

26. In written evidence to us, Liverpool Law School explained that trade defence instruments are an area of exclusive EU competence and that, consequently, after Brexit the UK will have to make its own arrangements in this regard. There is a risk that trade defence instruments can slip into what would be regarded under WTO law as illegal protectionism. There is also the difficult and contested issue of whether China should be treated for the purposes of trade defence instruments as a “market economy” or a “non-market economy” (the WTO rules being different in respect of each of these classifications). Trade defence instruments may be complicating factors in any FTA that the UK enters into after Brexit. The Law School argued that:

The UK will require a UK Trade Act that will set out the procedure for industry to request government support. These requirements will need to reflect UK trade, industrial, and labour policy.

27. In addition, “a UK Trade Commission [i.e. investigating authority] to determine the validity of industry requests and the responses available to government”⁴² would need to be established.

28. The British Ceramic Confederation told us that trade defence instruments were of particular importance for the British ceramic industry in combatting dumping activity on the part of China.⁴³

40 Freight Transport Association ([UKT0033](#))

41 Department for International Trade ([UKT0049](#))

42 Liverpool Law School ([UKT0034](#)). See also UK Trade Policy Observatory ([UKT0019](#)); Freight Transport Association ([UKT0033](#)).

43 British Ceramic Confederation ([UKT003](#))

29. DIT stated in evidence only that it was “preparing a trade remedies framework that supports UK industry against injurious trade practices”.⁴⁴

Parliamentary scrutiny

30. When the Secretary of State gave evidence to us, he told us that, since UK bound tariffs at the WTO would simply replicate those of the EU (involving a technical rectification of schedules, rather than a modification), this was not a matter for Parliament to decide on. However:

Were Parliament to change tariffs it would need to be done under legislation in the House of Commons. One of the things that we will have to do as we go through the Great [Repeal] Bill is to look to see whether we still have powers and, if necessary, where we have to take new powers to set tariffs at a different level than we inherit from our EU arrangements. Were they to be altered, it is correct; they would have to be done by primary legislation [...]

[A]s part of the Great [Repeal] Bill we will need to see which powers, including trade defence and trade remedy powers for example, we needed to take because we would not in our own right have the legal abilities to do those as the United Kingdom.⁴⁵

31. In the Brexit White Paper, the Government states that it will be bringing forward a Customs Bill—but it is left unclear what exactly this will be concerned with.⁴⁶

Conclusions and recommendations

32. **The UK’s position in the WTO will be the foundation stone for all our future trading relationships after Brexit. DIT was, therefore, quite right to start work on this as soon as possible. There is no doubt that the UK is a member of the WTO in its own right, and establishing the bound-tariff element of separate UK schedules appears to be a straightforward matter. However, there is rather less certainty about how quickly and easily it will be possible to disaggregate the UK element from the quantitative aspect of the EU’s schedules, in respect of Tariff Rate Quotas and Aggregate Measures of Support. *Nothing should be left to chance and the devil will be very much in the detail of these arrangements. DIT ministers should report to this Committee regularly, and at least every quarter, regarding the progress of this work.***

33. ***In addition, the Government must seek early legal clarity on the consequences for the UK in the event that separate UK schedules at the WTO have not been agreed or certified by the time that Brexit occurs. The Government should make sure it has whatever contingency arrangements may be necessary.***

44 Department for International Trade ([UKT0049](#))

45 [Qq487, 489](#). The “Great Repeal Bill” will repeal the European Communities Act 1972 and incorporate (transpose) European Union law into domestic law, “wherever practical”. These legal changes will take effect on the day that the UK formally leaves the EU.

46 HM Government, The United Kingdom’s exit from and new partnership with the European Union, [Cm 9417](#), February 2017, para 1.8

34. *The Government should consider that negotiations concerning the establishment of the UK's position at the WTO are appropriately sequenced with those concerning a UK-EU Free Trade Agreement (FTA)—for instance in respect of the UK's interest in the determination of the EU's revised Tariff Rate Quotas after Brexit.*
35. *DIT must give a full account of the legislative and administrative preparations that the Government is making in respect of arrangements for UK trade defence instruments to take effect at the point of Brexit.*
36. *Material changes to the UK's position at the WTO should be subject to appropriate parliamentary scrutiny. If applicable, the Government will need to consider how this will be achieved in respect of bound tariffs, Tariff Rate Quotas and Aggregate Measurement of Support. The Government should also clarify, when appropriate, what the purpose is of the Customs Bill that it proposes to bring forward.*

3 “Deal”—a UK Free Trade Agreement with the EU

Concluding a trade agreement by 2019

Introduction

37. In this chapter we consider the advantages and disadvantages of the Government’s preferred option for the UK-EU trade relationship after Brexit, namely a bilateral FTA which meets the Government’s “red lines” (i.e. non-negotiable preconditions for an agreement).

38. We begin by considering whether it is legally possible and practically feasible that such an agreement can actually be achieved, as the Government maintains it can, within the framework of the two-year Article 50 negotiation process. This is particularly important given that the Government has effectively put all its eggs in this particular basket by insisting that “no deal for the UK is better than a bad deal for the UK”.⁴⁷

Legal possibility

39. In October 2016 the Secretary of State for Exiting the EU, Rt Hon David Davis MP, was challenged in the House regarding the fact that the other members of the EU (the EU27) had “so far refused to say that they will enter trade talks alongside our article 50 negotiations”. He replied that the EU27:

are now starting to read what article 50 actually says. Article 50 implies that there will be parallel negotiations. That is what we will have because [...] we need to conclude them within two years to avoid any cliff edge.⁴⁸

40. Evidence we received from the Law Society of England and Wales explained that there are broadly three areas which are likely to be covered in the Article 50 negotiations: arrangements for the UK to withdraw from the EU; arrangements to implement the new UK relationship to the EU; and the terms of that new relationship itself (including trade arrangements). Article 50, though, the Society further explained, requires the EU to negotiate only on the first of these, concerning “the logistics of withdrawal”—whilst merely “taking into account the framework for the future relationship between the EU and the withdrawing state”.⁴⁹ On this interpretation, there is no legal requirement for the Article 50 negotiations to cover the UK’s post-Brexit trade relationship with the EU. An even stronger interpretation of Article 50 on this point was given at a press conference in December 2016 by Michel Barnier, the EU Commission’s Chief Negotiator with the UK on Article 50: “Legally these things can’t be done together at same time”.⁵⁰

47 HM Government, *The United Kingdom’s exit from and new partnership with the European Union*, Cm 9417, February 2017, para 12.3

48 HC Deb, 20 October 2016, cols 937–938

49 Law Society of England and Wales (UKT0048)

50 “Brexit deal could be reached by October 2018, says lead EU negotiator Michel Barnier”, *Telegraph* website, 6 December 2016. Mr Barnier also stated that the Article 50 agreement was required to “take into account” the future relationship between the UK and the EU—“Introductory comments by Michel Barnier”, European Commission website, 6 December 2016.

41. Sir Andrew Cahn told us that he thought the Government had given up negotiating leverage on this point. He thought the Government should have told the EU:

“We will invoke Article 50 when you have agreed a negotiating process”, in particular saying very clearly that we would be able to negotiate trade agreements simultaneously with the exit arrangements. Whereas at the moment the EU side have simply said, “No, we will not. You sign your exit bill first, and then we will talk about trade”.⁵¹

42. Dr Fox acknowledged that “the legality of where we find ourselves” was an issue, but he did not appear to think it was an insurmountable obstacle.⁵²

Practical feasibility

Time constraints

43. Even if it is legally possible to settle the UK’s trading relationship with the EU during the Article 50 negotiations, there is still uncertainty as to the feasibility of doing so. The UKTPO told us:

It is important to recognise that while the Article 50 negotiation is effectively time-limited and approved in the EU27 by qualified majority vote, a trade agreement is not so constrained and requires unanimity among EU Member States. On the precedent of CETA [the EU-Canada Comprehensive Economic and Trade Agreement] for so-called “mixed agreements” which are necessary when the subject matter concerns member states’ competencies, the latter could entail approval by up to 38 different European [national and sub-national] parliaments. Thus it seems almost inevitable that a deep trade negotiation will take longer than two years; based on the EU’s prior experience of negotiating free trade agreements, it is more likely to take between five and ten years.⁵³

44. Furthermore, at Mr Barnier’s press conference in December he said:

It is clear that the period for actual negotiations will be shorter than two years. At the beginning, the two years include the time to the European Council to set guidelines, and for the Council to authorise negotiations, based on a recommendation of the Commission. And at the end, the agreement must, of course, be approved by the Council and the European Parliament. Finally, the UK will have to approve the agreement. All within the two year period. All in all, there will be less than 18 months to negotiate [...] Should the UK notify the Council by the end of March 2017 [...] it is safe to say that negotiations could start a few weeks later, and an Article 50 agreement be reached by October 2018.⁵⁴

51 [Q310](#)

52 [Q479](#)

53 UK Trade Policy Observatory ([UKT0019](#))

54 [“Introductory comments by Michel Barnier”](#), European Commission website, 6 December 2016

“Red lines, “cake and eat it”, “cherry picking” and “wriggle room”

45. The UKTPO told us that a particular stumbling block was likely to be the EU27’s stipulation that the UK cannot receive all the benefits of EU or Single Market membership whilst “cherry picking” which of the concomitant obligations it will take on.⁵⁵

46. The UK Government indicated following the referendum that it regarded the outcome as a mandate for certain “red lines” in negotiating Brexit—although no definitive, codified set of such principles was given.⁵⁶ The Prime Minister told the Conservative Party conference in October 2016: “Our laws will be made not in Brussels but in Westminster. The judges interpreting those laws will sit not in Luxembourg but in courts in this country. The authority of EU law in Britain will end.” While she wanted “free trade, in goods and services” between the UK and the EU and to give “British companies the maximum freedom to trade with and operate in the Single Market—and let European businesses do the same here”, she was not prepared to barter with British sovereignty. She said: “We are not leaving the European Union only to give up control of immigration again. And we are not leaving only to return to the jurisdiction of the European Court of Justice [ECJ].”⁵⁷

47. At the same time, there were signs that the Government believed it possible for the UK to obtain all the benefits of Single Market membership while adhering to its “red lines”. The phrase “have cake and eat it” occurred more than once.⁵⁸

48. In his December 2016 press conference, Mr Barnier emphasised that:

being a Member of the European Union comes with rights and benefits. Third countries can never have the same rights and benefits, since they are not subject to the same obligations [...] the Single Market and its four freedoms [free movement of goods, services, capital and people] are indivisible. Cherry picking is not an option.⁵⁹

49. In the Prime Minister’s Lancaster House speech on 17 January 2017 and the Brexit White Paper, published on 2 February 2017, the Government set out 12 “objectives” for the Brexit negotiations. Among these were: “Taking control of our own laws” (which would entail “an end to the jurisdiction of the Court of Justice of the European Union in the UK”); “Controlling immigration”; and “Ensuring free trade with European markets”.⁶⁰

55 UK Trade Policy Observatory (UKT0019). The UKTPO cites the following: “[Angela Merkel: no special favours for UK over single market](#)”, *Guardian*, 28 June 2016; “[Speech by President Donald Tusk at the European Policy Centre conference](#)”, 13 October 2016.

56 In November 2016, a paper published by the UKTPO identified the following “red lines”:

- No free movement of people / labour;
- Independent trade policy;
- No compulsory budgetary contribution;
- Legal oversight by UK courts only and not by the European Court of Justice

—Michael Gasiorek, Peter Holmes, Jim Rollo, [UK-EU Trade Relations Post Brexit: Too Many Red Lines?](#) (UKTPO Briefing Paper 5, November 2016), p 2.

57 “[Prime Minister: Britain after Brexit: A Vision of a Global Britain](#)”, Conservative Party website, 2 October 2016

58 “[‘We’ll have our cake and eat it’: Boris Johnson joins forces with Liam Fox and declares support for ‘hard’ Brexit which will ‘liberate’ Britain to champion free trade](#)”, *Sun* website, 30 September 2016; “[‘Have cake and eat it’—aide reveals Brexit tactic](#)”, *The Times* website, 29 November 2016

59 “[Introductory comments by Michel Barnier](#)”, European Commission website, 6 December 2016

60 “[The government’s negotiating objectives for exiting the EU: PM speech](#)”, Prime Minister’s Office, 17 January 2017; HM Government, *The United Kingdom’s exit from and new partnership with the European Union*, Cm 9417, February 2017

The Prime Minister stated that what the Government was proposing in respect of the last of these “cannot mean membership of the Single Market”, given that “European leaders have said many times that membership means accepting the ‘four freedoms’ of goods, capital, services and people”.⁶¹ Instead, the Government was aiming for “the greatest possible access to [the Single Market] through a new, comprehensive, bold and ambitious Free Trade Agreement” with the EU.⁶² Still there were signs that the Government had a “have cake and eat it” strategy. The Secretary of State for Exiting the EU told the House a week after the Prime Minister’s speech that the arrangements the Government had in mind “will deliver the exact same benefits as we have” presently as an EU member.⁶³

50. The UKTPO indicated in evidence to us that it might be possible to achieve a UK-EU FTA akin to those that the EU already has with third countries (which grant access to the Single Market that is limited and on less favourable terms than those enjoyed by members):

the EU has already granted non-member states some aspects of Single Market freedoms [...] Other than as a punishment strategy, it is hard to see why the EU would want to completely reject such options for the UK. Whilst WTO rules constrain the sort of preferential agreements that can be made, it should be quite possible, albeit complicated and time-consuming, to design an agreement that admits enough liberalisation relative to EU WTO schedules to satisfy WTO requirements while still excluding enough to meet a “no cherry picking” position.

The Observatory suggested that “the UK government could agree to budgetary subscriptions, e.g. to [research and development] or regional funds, as a quid pro quo for certain restrictions on free movement.” It might further be possible to “finesse” the issue of immigration by means of a quota system for unskilled labour from the EU. And ECJ oversight might be replaced with a new mechanism acceptable to both sides (this is discussed further below).⁶⁴ The Observatory’s Professor Alan Winters suggested that the UK might propose that “for a small reduction in mobility, maybe we can negotiate a small reduction in single market rights”.⁶⁵

51. The Government has given a few signs which have been interpreted as meaning there might be “wriggle room” of this kind regarding its “red lines”. On 1 December 2016, the Secretary of State for Exiting the EU, Rt Hon David Davis MP, responded as follows to a question on the floor of the House regarding whether the Government would “consider making any contribution in any shape or form for access to the single market”:

The major criterion here is that we get the best possible access for goods and services to the European market and if that is included in what he’s talking about then of course we would consider it.⁶⁶

61 This effectively rules out membership of the European Economic Area and a Swiss-style bilateral relationship to the EU (on these two options, see Annex 2).

62 “[The government’s negotiating objectives for exiting the EU: PM speech](#)”, Prime Minister’s Office, 17 January 2017

63 HC Deb 24 January 2017, [col 169](#) [Commons Chamber]

64 UK Trade Policy Observatory ([UKT0019](#))

65 [Q233](#)

66 H C Deb, 1 December 2016, [col 1648](#) [Commons Chamber]

This statement was subsequently reported to have been endorsed by the Chancellor. Also on 1 December, Mr Davis reportedly said: “We won’t [end free movement] in a way that it is contrary to the national and economic interest. Britain must win the global battle for talent. No one wants to see labour shortages in key sectors”.⁶⁷

52. It may be possible to read into the wording of the Prime Minister’s Lancaster House speech and the White Paper an element of provision for “wriggle room”. Both refer to the possibility of continuing British financial contributions in respect of certain “European programmes”. The White Paper talks in cautious terms about the need to consider the impact of changes in immigration policy on different sectors of the economy and the labour market; and both it and the Prime Minister’s speech talk of the possible need for phased implementation of changes in this regard.⁶⁸

Strength of the UK’s negotiating position

53. Another view put to us was that, notwithstanding talk of “no cherry picking”, sheer commercial self-interest will ultimately oblige the EU27 to agree to an FTA that meets all of the UK’s “red lines” in time for Brexit in 2019. We heard from the former Trade Minister Digby, Lord Jones of Birmingham Kb, the view that the short time-limit on trade negotiations during the Article 50 process would be to the UK’s advantage, as it would concentrate minds and ensure an agreement was reached:

One of the best things for getting a deal done is Monsieur Barnier will know that, at midnight on a certain date, if he does not have a deal done, it is off to the WTO. It will not be in the remaining EU’s interests for that to happen.⁶⁹

Lord Jones thought that:

One of the great imperatives down at the wire in 2019 will be that there will be various vested interests in Europe [...] saying, “Please do not mess us about. Do not let our exports into Britain suffer a 10%, 15%, 20% or 130% tariff.” [...] Automotive is a good example. Audi, Volkswagen, Mercedes and BMW are not going to want their products in Britain, up against [Jaguar Land Rover], to be 15% more expensive that day.⁷⁰

54. We heard a similar view from Allister Heath, of the *Daily Telegraph*, with regard to trade in financial services. He told us that the “cliff-edge scenario” of the sudden removal at the point of Brexit of “passporting” rights for UK companies (which we discuss further below) would be “very, very damaging for both sides”. For that reason, he doubted that the EU27 would trigger “some sort of trade war or a complete breakdown in relations”, as it “would be a disaster for the EU just as much as it would be a disaster for the UK”.⁷¹ Similarly, we heard from other witnesses that the EU27 would have no interest in disrupting those UK-provided financial services (not least euro-denominated clearing) from which the EU27 derive considerable benefit.⁷²

67 [“Top ministers say UK open to paying for EU market access”, Financial Times website, 1 December 2016](#)

68 [“The government’s negotiating objectives for exiting the EU: PM speech”, Prime Minister’s Office, 17 January 2017; HM Government, *The United Kingdom’s exit from and new partnership with the European Union, Cm 9417*, February 2017, paras 8.51, 5.9–5.10](#)

69 [Q539](#)

70 [Q532](#)

71 [Q383](#)

72 [Q424–5](#)

55. However, Professor Winters of the UKTPO took a different view regarding the strength of the UK's negotiating position:

It is not that the EU is going to fall over and say, "Anything you want is fine with us because we are desperate for your market". It is going to be more likely the other way around.⁷³

He argued that the UK's negotiating position was weak, since the average UK exporter sent 45% of its exports to the EU, while the average EU exporter sent some 7% of its exports to the UK.⁷⁴ Professor Winters thought that the political pressure on the UK Government to accede to EU27 terms in order to avoid EU tariffs on UK goods would be greater than the equivalent pressure on the EU27 governments.⁷⁵ Regarding the interests of the German car industry, he thought the German Chancellor would listen to the industry "but it absolutely will not be the only thing she listens to".⁷⁶ Even where economic self-interest might seem to dictate that a particular country should look favourably on the UK's negotiating terms, wider concerns about the future of the EU may well also be in play. Sean McGuire, the Director of CBI Brussels, emphasised that EU27 governments:

have two challenges: getting a good deal for Brexit that helps their companies and their economies, but also trying to push forward in an EU of 27 that does not totally unravel and does not lead to even further market segmentation.⁷⁷

56. Mike Hawes, Chief Executive of the Society of Motor Manufacturers and Traders (SMMT), told us he thought that, self-interest notwithstanding, German car manufacturers "will align with what is best for Germany" regarding the terms of a trade agreement with the UK.⁷⁸ In this connection recent comments by Matthias Wissmann, the head of the German car manufacturers' association, are noteworthy. In October 2016, he said that: "The UK is an important market for us but the EU market is much more important [...] If the EU were to fall apart, that would be a lot worse for our industry". Germany's priority, he added, must be "to keep the EU 27 together".⁷⁹

57. Another issue here will be the relative price elasticity of demand for the goods that are traded between the UK and the EU27 countries. It is questionable whether UK tariffs are likely to have much effect on the demand for premium products such as German cars and French wine.

73 [Q229](#)

74 [Qq223-5](#)

75 [Q229](#)

76 [Q228](#)

77 [Q323](#)

78 [Q272](#)

79 ["Germany warns hard Brexit will damage UK car industry"](#), *Financial Times* website, 16 October 2016

58. Several statistics about UK trade with the EU27 are noteworthy in this connection:⁸⁰

- In 2015 some 44% of UK exports went to EU27 countries. In 2014 8% or 17% of EU27 exports (depending on how the figure is calculated)⁸¹ came to the UK.
- UK exports to EU27 countries are worth about 13% of the UK economy, while EU27 exports to the UK are worth around 3% to 4% of those countries' economies (taken as an aggregated whole).
- The UK has a deficit on trade in goods with the EU27 (£89 billion in 2015) but a surplus on trade in services (£28 billion in 2015).
- The UK's trade deficit in goods with the EU27 is very unevenly distributed among EU27 countries and is largely accounted for by just two countries (Germany and the Netherlands).

59. As we have noted, a UK-EU FTA requires (de facto) unanimity among the EU27 nations, and these are likely to perceive their interests differently regarding the terms of such an agreement.

60. The Secretary of State insisted to us that self-interest on the part of the EU27 meant that they would want to negotiate future trade arrangements during the Article 50 process. He did, though, acknowledge that there were countervailing political pressures, relating to: the propensity to see the EU project in political and even emotional terms, rather than purely economic ones; and the possible effects of the elections due this year in the Netherlands, France and Germany.⁸²

Availability of negotiators

61. A further question regarding the feasibility of arriving at a UK-EU FTA by 2019 is the extent to which the UK will have available sufficient numbers of expert staff to undertake negotiations. It seems as yet unclear how exactly DExEU will relate to DIT (which is being built up as the locus of trade-policy expertise in the civil service) in the conduct of the trade element of the Article 50 negotiations. However that relationship is handled, the limited pool of trained staff is likely to be under significant pressure during the two years of negotiating prior to Brexit. As we have noted, by 2019 the UK will also need to have established the terms of its separate WTO membership in a potentially complex and lengthy negotiating process. And, as we discuss in Chapter 5, the UK will probably also be involved in some form of trade talks (if not actual negotiations) with various countries in the run-up to Brexit, including those with which we already trade under EU FTAs and those with which we might be seeking a wholly new FTA.

80 *Statistics on UK-EU trade*, Briefing Paper [7851](#), House of Commons Library, January 2017; "[UK Perspectives 2016: Trade with the EU and beyond](#)", 25 May 2016, ONS Digital, Office for National Statistics; "[Everything you might want to know about the UK's trade with the EU](#)", *Full Fact* website, 20 June 2016. Regarding trade in goods, a margin of error must be allowed for in respect of the so-called "Rotterdam effect", whereby around half of all goods exported to the Netherlands are re-exported to non-EU countries. It is estimated that the Rotterdam effect could account for around four percentage points as regards UK goods exports.

81 About 8% of EU exports to both EU and non-EU countries went to the UK in 2014. If exports from EU countries to the UK are expressed as a proportion of EU exports to non-EU countries plus the UK, this gives a figure of 17%.

82 [Q479](#)

Potential features of a UK-EU FTA

Trade in goods

Tariff barriers

62. As a member of the EU, the UK is able to carry on trade in goods with the EU on a tariff-free basis. At the very least, a UK-EU FTA would be expected to preserve that arrangement. While this seems likely, it cannot, however, be taken for granted. (We discuss in Chapter 4 issues that would arise if UK exports were to face the EU's MFN tariffs—a situation that will necessarily arise if no UK-EU FTA is concluded before Brexit.) It is noteworthy that a UK-EU FTA would entail the introduction of trade defence instruments into trade between the UK and the EU27,⁸³ albeit possibly subject to some limitations.⁸⁴

Non-tariff barriers concerning goods

63. A much more difficult aspect of UK-EU FTA negotiations will be that of non-tariff barriers. In the contemporary context, these are arguably of much greater importance than tariffs. While a tariff affects the price of a product in a particular market, non-tariff barriers determine whether or not the product can be sold at all, or under what conditions, in that market.

The EU Single Market seeks to prevent regulatory systems inhibiting the free movement of goods by: harmonisation (of product rules, voluntary Technical Standards and certain regulatory regimes); and mutual recognition of rules and standards (meaning that goods lawfully manufactured or marketed in one Member State can be lawfully sold in all Member States). Manufactured goods must be marked “CE” (*Conformité Européenne*) for sale within the Single Market. In respect of most goods imported into the EU, conformity (also known as compliance) is not checked at the border⁸⁵ but is undertaken at the local level by trading-standards officials.

64. There are understandable concerns about the degree to which there will be continuity between these arrangements and those which will apply under a UK-EU FTA. The SMMT told us in written evidence of their concerns as a body representing a key manufacturing sector:

It is essential that there is certainty and continuity through harmonisation of EU and UK regulations affecting the automotive sector to support both UK manufacturing and the UK vehicle market. Government should establish appropriate, clear and non-burdensome structures that enable application and implementation of crucial EU legislation. Regulatory divergence or uncertainty in the legal framework for the automotive industry would amount to non-tariff trade barriers, increasing costs and reducing the competitiveness of both the manufacturing base and ability to sell vehicles.⁸⁶

83 UK Trade Policy Observatory ([UKT0019](#))

84 Liverpool Law School ([UKT0034](#))

85 Where such checks are made at the border, they are carried out by customs officials. It should be noted, though, that checking for compliance with product rules / standards is quite distinct from border checks that are concerned with the payment of duty.

86 The Society of Motor Manufacturers and Traders ([UKT0035](#))

65. We also heard the following from Which?, giving the perspective of consumers:

As members of the EU we have supported a harmonised and better-functioning single market for goods so as to allow improved access for consumers who wish to shop cross-border and encourage the growth of the EU's digital economy. Consumers have been accustomed to shopping cross border and will likely still wish to do so following the UK's exit from the EU regardless of whether the UK is a member of the Single Market or not. The negotiations should ensure that cross border trade is not hindered and is accompanied by suitable measures to deliver consistent enforcement, redress and safe products for UK consumers.⁸⁷

66. Were at-the-border checks to be introduced in order to enforce EU product standards, this would, of course, create trade friction at the border. It could also have political consequences in relation to the land border between Northern Ireland and the Republic of Ireland, which is currently not operated as a "hard" border (with physical barriers and traffic being stopped and checked).⁸⁸ Evidence given to the Treasury Committee by officials of HM Revenue and Customs (HMRC) indicates that electronic systems could help to limit the scope of trade friction at the border.⁸⁹ In respect of Ireland, scepticism has been expressed by the House of Lords EU Committee regarding how far such technology could obviate the need for physical checks at the border.⁹⁰

67. Even where standards barriers persist, conformity (or compliance) assessment barriers can be eased by means of equivalence of assessment (including mutual recognition of assessment⁹¹ and "Authorised Economic Operators").⁹² It is very common for the EU to have such an agreement, even in the case of countries with which it does not even have an FTA.

68. A particular issue is that of the UK losing access to EU certification agencies, which play an important role in facilitating the Single Market. The ADS Group, a trade organisation for companies in the UK Aerospace, Defence, Security and Space Sectors, told us:

Membership of the European Aviation Safety Agency (EASA) in particular, allows the UK to benefit from regulatory harmonisation, ensuring its products and components are certified and safe for use across Europe. EASA is the EU agency responsible for regulating and overseeing the safe operation of civil aviation across Europe. EASA is a unique agency, with

87 Which? ([UKT0031](#))

88 A customs border was operated between the UK and Ireland continuously between 1923 and the inception of the Single Market in 1993. During that period, security and immigration arrangements at the Irish border went through various phases of strictness and looseness.

89 Oral evidence taken before the Treasury Committee on [7 February 2017](#), HC(2016–17)387, Q599. Regarding the Irish border, see also Oral evidence taken before the Northern Ireland Affairs Committee on [1 February 2017](#), HC(2016–17)700.

90 House of Lords, Report of the Select Committee on the European Union, Session 2016–17, [HL Paper 76](#), paras 102–5

91 Mutual recognition of conformity assessment involves recognition by parties to an agreement that each other's conformity assessment bodies are capable of carrying out assessment procedures against each other's product rules.

92 Authorised Economic Operator status is an international quality mark which indicates that a company has a secure role in the international supply chain, with customs controls and procedures that are efficient and comply with recognised standards.

significant influence in technical aviation safety rulemaking in Europe and across the world. Its duties include certifying aviation products for use and overseeing approved organisations. The UK has been an influential member state at EASA over the past 10 years, participating actively in all of the technical working groups and rulemaking committees and helping to continually improve the safety of Aviation safety across Europe. For the Aerospace industry, EASA provides an efficient route to the global market for many UK companies, as agreed bilateral safety agreements ensure European certifications and approvals can be validated in markets such as the US and Canada.⁹³

69. The Brexit White Paper lays particular emphasis on the extent to which voluntary technical standards are increasingly developed globally. These standards are implemented at regional level (in Europe’s case through the European Standards Organisations, which are not EU bodies, although they have special status in the EU) and national level (in the UK’s case through the British Standards Institution).⁹⁴ It is noteworthy, however, that these voluntary technical standards are only one facet of the harmonisation of product standards within the EU.

70. In giving evidence to us, Dr Fox appeared confident that non-tariff barriers to trade in goods would not be increased in a UK-EU FTA: “We are already at the point of maximal regulatory equivalence. We have complete coincidence in fact of regulator equivalence so we are not trying to achieve something that doesn’t exist at the present time”.⁹⁵ A critical question, however, is the extent to which this will remain the case in the future, with the likelihood of regulatory divergence over time—which would have implications for the continued acceptance of UK standards as being equivalent to the EU’s.

Trade in services in general

71. The UKTPO told us:

Services are particularly important to the UK. In 2014 services generated 78.3% of UK GDP and UK exports of cross-border services to the world amounted to £220bn (almost 43% of total UK exports of goods and services), of which £81bn went to the EU. Around a quarter of the latter were financial services. Total imports of services were £131bn (24% of total goods and services imports) of which £64bn came from the EU.⁹⁶

It should be noted that official trade figures do not include sales by affiliates of UK companies that are based in the EU; and nor do they include trading behind the border, even though

93 ADS Group ([UKT0013](#))

94 HM Government, *The United Kingdom’s exit from and new partnership with the European Union*, [Cm 9417](#), February 2017, p 40

95 [Q483](#)

96 UK Trade Policy Observatory ([UKT0019](#))

this can involve the employment of UK citizens abroad and the resulting profits count as UK national income. Consequently, trade in services is even more significant than the narrow cross-border figures suggest.⁹⁷

72. The services sector is not subject to tariffs. Where barriers to trade in services exist, they are generally due to regulatory differences (concerning market access and minimum standards). At present, UK service-providers benefit from provision in the EU treaties for:

- right of establishment (meaning that individuals or companies from one member state must be legally free to deliver services in another member state either temporarily or permanently, while continuing to be regulated by the authorities of their home country); and
- mutual recognition of professional qualifications (the licensing of professionals by regulatory bodies is subject to the principle of mutual recognition throughout the Single Market).

In addition, the EU has developed sets of regulations for particular service sectors, including telecommunications, aviation, road-transport and media services. The Digital Single Market (covering digital marketing, e-commerce and telecommunications) aims to keep the EU's regulatory environment abreast of the fast-moving digital economy.

73. According to the UKTPO:

The EU Single Market for services is still incomplete but it greatly facilitates the exchange of services amongst members, so Brexit will almost surely be associated with a deterioration in market access conditions for UK providers.⁹⁸

This echoes the Government's view that "The Single Market for services is not complete".⁹⁹ The Law Society similarly told us: "It is commonly accepted that the EU single market in services is a work in progress. However in legal services a single market is already a reality."¹⁰⁰

74. Some, however, take a stronger view on the extent to which the single market in services is underdeveloped. Economists for Brexit said:

It is essential to understand that only a start has been made in regulating trade in services within the EU—known somewhat misleadingly as the "Single Market in Services". In reality, there essentially is no single market in services to leave.¹⁰¹

97 The WTO counts four modes of services exports in GATS:

- Mode 1: Cross border trade—from the territory of one Member into the territory of any other Member (e.g. call centres)
- Mode 2: Consumption abroad—in the territory of one Member to the service consumer of any other Member (e.g. tourism in the home country)
- Mode 3: Commercial presence—by a service supplier of one Member, through commercial presence, in the territory of any other Member (e.g. a bank setting up a branch overseas)
- Mode 4: Presence of natural persons—by a service supplier of one Member, through the presence of natural persons of a Member in the territory of any other Member (e.g. overseas postings, self-employment).

UK Balance of Payments statistics count only services under Modes 1 and 2.

98 UK Trade Policy Observatory ([UKT0019](#))

99 HM Government, *The United Kingdom's exit from and new partnership with the European Union*, [Cm 9417](#), February 2017, para 8.18

100 Law Society of England and Wales ([UKT0048](#))

101 Economists for Brexit ([UKT0024](#)). Economists for Brexit is now known as Economists for Free Trade.

And Lord Jones told us:

One of the great lies is that there is a single market in services in Europe. There isn't. There might be a document that says there is but it is not the same. There is a fabulous single market for manufactured goods. It does not mirror through into services.¹⁰²

75. Without the drive of the UK with its services-based economy, it seems there could be a risk that the EU's progress towards a single market in services could be slowed.

76. Regarding the extent to which the UK should seek to harmonise regulation of services with the EU as part of an FTA, we received mixed evidence. Mickael Laurans of the Law Society told us that:

a key ask for my organisation was the continuation of the participation of the UK legal services sector in the two EU lawyers directives and the mutual recognition of qualifications directive. If you leave the Single Market, you have to look at 27 different national regimes of regulation, each having different restrictions in terms of market access and national treatment. There would be member states in which you cannot fly in/fly out. In others you cannot establish or in others you cannot partner with local lawyers.¹⁰³

77. Some saw a move to UK-based regulation as an opportunity. Gerard Grech, Chief Executive of TechCityUK, told us that, because the UK was a leader in the digital sector:

A key focus for Government is to continue to make sure that they are creating the right policy and regulatory conditions for the digital tech sector to thrive, which I think a lot of European countries will look to.¹⁰⁴

78. A further issue is the way in which UK businesses will be able to provide services after Brexit (which we consider further below in the specific context of financial services). Dr Federico Ortino, of King's College London, told us that:

you could have the most liberal service industry—unregulated, efficient, whatever you want—but if the receiving states say, “No, you can't enter”, there is nothing you can do. What you need to be able to export your services is that the host state opens up to your services. At the moment in the single market, it is not an absolute single market but it is as good as it gets. If you step away from that, even the most advanced FTA with Korea or with Canada just gives you a little bit more than what the WTO provides.¹⁰⁵

79. It is notable that general trade in services receives scant attention in the Brexit White Paper. Regarding the Government's aspirations for the shape of future UK-EU trade in services other than financial services, it says only: “In our new strategic partnership we will be aiming for the freest possible trade in services between the UK and EU Member States.”¹⁰⁶

102 [Q545](#)

103 [Q355](#)

104 [Q370](#)

105 [Q126](#)

106 HM Government, *The United Kingdom's exit from and new partnership with the European Union*, [Cm 9417](#), February 2017, para 8.21

Trade in financial services

80. Financial services are a particularly important industry for the UK. Mr Heath of the *Daily Telegraph* argued that the stakes around the trade negotiations for financial services were significantly higher than in other sectors:

[W]hen it comes to financial services, the EU, if it wants to be protectionist, can impose, effectively, infinite tariffs. It can simply ban activity from taking place, trading from happening, from the UK to the EU. That does not happen in other areas, for example in automotive or manufacturing, or so on.¹⁰⁷

81. At present, financial service firms based in the UK can rely on “passporting” to do business in the rest of the European Union. The Bank of England provides the following explanation of passporting:

Subject to its fulfilment of conditions under the relevant single market directive, a firm authorised in a European Economic Area (EEA) state is entitled to carry on permitted activities in any other EEA state by either exercising the right of establishment (of a branch and/or agents) or providing cross-border services. This is referred to in Financial Services and Markets Act 2000 (as amended) (FSMA) as an EEA right and the exercise of this right is known as “passporting”.¹⁰⁸

82. Niamh Moloney, Professor of Financial Markets Law at the London School of Economics (LSE), told us that it would be “very, very difficult” for the EU to allow the UK passporting rights indefinitely after Brexit.¹⁰⁹ She argued that this was for two reasons:

The first thing is that passporting is an access mechanism, but the reason why it is possible, the reason we have this at all, is that we have what is called the Single Rulebook in the EU. This is this enormously densely harmonised set of standards that go from high-level principles right down into the administrative wheels, in terms of how financial actors operate. Sitting beside that, if you like, there are legally binding pan-European supervisory co-ordination arrangements: exchange of information, financial stability arrangements, data exchange. Because these two are in place, this is what allows—economically and politically, as it were—member states to accept financial actors from other jurisdictions. It is the pay-off, if you like. It is the price of access.¹¹⁰

83. Should passporting for UK firms into the remaining EU countries not be the negotiated outcome, then firms could seek other ways of doing business with the remaining members of the EU. As the Bank of England notes above, passporting allows a firm to set up a branch (as opposed to a subsidiary) in another EEA country. Having to set up subsidiaries instead, as a result of the removal of passporting, would not be without

107 [Q378](#)

108 Bank of England Prudential Regulation Authority, “[Passporting](#)”

109 [Q384](#)

110 [Q384](#)

cost. The General Council of the Bar of England and Wales noted that: “The passport is undeniably beneficial: it avoids the costs and requirements of setting up a subsidiary authorised and regulated in each Member State into which it is desired to do business”.¹¹¹

84. One suggestion to minimise the costs for UK firms on withdrawal from the Single Market would be to rely on “equivalence”. The EU Commission states that “In certain cases the EU may recognise that the regulatory or supervisory regime of a non-EU country is equivalent to the corresponding EU regime”. The Commission states that such equivalence brings the following benefits to both parties:

- it allows authorities in the EU to rely on supervised entities’ compliance with equivalent rules in a non-EU country
- it reduces or even eliminates overlaps in compliance requirements for both EU and foreign market players
- it makes certain services, products or activities of non-EU companies acceptable for regulatory purposes in the EU
- it allows less burdensome prudential regime to apply to EU banks and other financial institutions with exposures in equivalent non-EU countries.¹¹²

85. Several witnesses noted, though, that there might be drawbacks to relying on equivalence. Anthony Browne, CEO of the British Bankers’ Association, characterised equivalence as “very one-sided” and a “gift given by the Commission”.¹¹³ He argued that:

If you are basing your operations and making multi-billion pound investment decisions, you need to know that the tap cannot suddenly be turned off by politicians in another country. You need a stable legal framework underpinning your operations and your trade.¹¹⁴

86. Hugh Savill, Director of Regulation at the Association of British Insurers (ABI), noted that “If we have to fall back on equivalence, that is really not so good in the insurance sector. It is a very restricted set of permissions by comparison with passporting.”¹¹⁵ He also noted that “There are many things that are wrong with equivalence. One of them is that the Commission decides it and the Commission can rescind it with a month’s notice.”¹¹⁶

87. If passporting is unavailable, and if equivalence were deemed too restrictive and potentially short-term, then some type of alternative agreement might be reached. Mr Savill argued that:

As the Prime Minister has now decided that we are not to be members of the Single Market, we are hoping that the Prime Minister strikes an ambitious deal that replicates in some way the kind of passporting arrangements we have now.¹¹⁷

111 General Council of the Bar of England and Wales ([UKT0040](#))

112 European Commission, “[Recognition of non-EU financial frameworks \(equivalence decisions\)](#)”

113 [Q420](#)

114 [Q420](#)

115 [Q372](#)

116 [Q353](#)

117 [Q352](#)

88. Mr Browne provided us with more detail as to what such an agreement (something “in between” passporting and equivalence) should look like:

What we want is mutual market access and passporting rights. Passporting as currently defined only exists within the single market. We are leaving the single market. What we mean by “passporting rights” is the ability to sell directly to customers across border in another country and to set up branches in those countries without burdensome regulatory approvals. That matters more in some sectors than others. It matters more in wholesale banking than retail. There is not much possible in retail banking. We would like to retain those rights in some form.¹¹⁸

Mr Heath noted that “On the other hand, there is a distinction to be made between equivalence of outcomes and equivalence of process”.¹¹⁹ Gary Campkin, of TheCityUK, argued that:

The bespoke deal needs to allow current arrangements to continue to the extent possible. We would argue that the bespoke deal also offers an opportunity to take things even further. The bottom line of the point is to look at what happens here in London and the UK as the world’s leading financial centre and as Europe’s financial centre. Part and parcel of that is not just straight [financial services], it is also legal, accountancy and business advisory.¹²⁰

89. There would, however, be potential costs to such an arrangement. Professor Moloney of the LSE also told us that as she had looked:

at systems of passporting and how these sorts of arrangements work internationally, and you do indeed get access, you do get subsidiaries and branches and so on, but there is no example of complete unfettered access to a visiting system without concessions to that regulatory system.¹²¹

90. Whatever form of agreement is struck, there are bound to be forces on both sides tending towards regulatory divergence after Brexit. Mr Savill of the ABI told us that such divergence is “inevitable”. He argued that the UK version of Solvency II (the EU directive which allows for passporting in the insurance industry):

is going to focus on what is good for the UK. Meanwhile, on the European side there are lots of bits of Solvency II that were put in there for the British market. When they review that, they will think, ‘Why on earth is that there?’¹²²

From a position outside the EU, the UK will, of course, have limited influence over evolving EU standards and, consequently, little leverage to ensure the continuation of equivalence (or whatever other arrangement has been arrived at).

118 [Q415](#)

119 [Q390](#)

120 [Q426](#)

121 [Q385](#)

122 [Q370](#). See also [Q405](#) [Allister Heath] and Association of British Insurers ([UKT0050](#)).

91. On the future framework for UK-EU trade in financial services, the Brexit White Paper says only: “In our new strategic partnership agreement we will be aiming for the freest possible trade in financial services between the UK and EU Member States.”¹²³ It adds that:

As the UK leaves the EU, we will seek to establish strong cooperative oversight arrangements with the EU and will continue to support and implement international standards to continue to safely serve the UK, European and global economy.¹²⁴

92. It would further need to be resolved how the current role of the ECJ would be performed in a future agreement on financial services. Professor Moloney told us that the ECJ currently had a significant role, both in cross-border resolution of financial institutions when they fail and in dispute resolution more generally. She said that “the Court of Justice has been critical. We will need to ensure in the negotiations that this gets mapped to a certain extent, not so much on the detailed rules, technicalities and passporting but on the big principle of non-discrimination”.¹²⁵ She further said that the EU’s rules for third countries:

do not specifically arrange for dispute resolution and what would happen if the European structures refused to comply with a resolution decision made in the UK that required action to be taken in the EU. It is at that level of granularity that the free trade agreement will be very, very important. There will be means of dealing with this, whether it is a tribunal or other. It will not be the Court of Justice because I do not think that sort of single market location of the Court of Justice will translate to a free trade agreement. However, that is exactly the level of granularity that will have to be addressed.¹²⁶

Inward investment

93. Regarding inward investment into the UK economy, the Brexit White Paper states:

The UK is an attractive destination for inward investment. After the US and China (including Hong Kong), the UK ranks third globally for the amount of inward Foreign Direct Investment stock, having passed the £1 trillion level in 2014. Investors remain confident in the UK and according to major independent reports, the UK is the number one destination for Foreign Direct Investment in Europe.¹²⁷

123 HM Government, *The United Kingdom’s exit from and new partnership with the European Union*, [Cm 9417](#), February 2017, para 8.25

124 HM Government, *The United Kingdom’s exit from and new partnership with the European Union*, [Cm 9417](#), February 2017, para 8.26

125 [Q410](#)

126 [Q411](#)

127 HM Government, *The United Kingdom’s exit from and new partnership with the European Union*, [Cm 9417](#), February 2017, para 9.4

94. It is important to note that the UK benefits from inward investment by third-country businesses which use this country as a “bridgehead” into the Single Market. In addition, half of direct investment in the UK actually comes from EU nations and such investment will be substantially predicated on the UK’s current status as a member of the Single Market.¹²⁸ The UKTPO noted in evidence to us that:

For business services in particular, EU membership also has an indirect effect [on investment] by foreign firms seeking to serve UK manufacturing activity, which itself benefits from the Single Market. Thus Brexit could alter the rationale for at least some of the investment that has previously flowed into UK services sectors.¹²⁹

Dispute resolution

95. A key consideration regarding the terms of a UK-EU FTA is the form of dispute-resolution procedure that will apply. In respect of financial services, Mr Browne told us:

It is completely normal in trade agreements to have dispute resolution mechanisms [...] [Y]ou can start off with the current regime, but in order to be dynamic and future-proofed against changes on either side you need some sort of dispute resolution mechanism that both sides accept.¹³⁰

96. The UKTPO told us in written evidence that:

an EU-UK agreement might have its own dispute settlement or mutual recognition body that eased the continuation of existing standard setting procedures for food and other products.¹³¹

97. As we have noted, a key “red line” of the Government in negotiating Brexit is for the UK no longer to be within the jurisdiction of the ECJ. The Prime Minister’s Lancaster House speech clearly ruled out the form of dispute resolution that applies to non-EU EEA members (involving another supranational court which has a collateral relationship with the ECJ).¹³² This, she said: “would mean accepting a role for the European Court of Justice that would see it still having direct legal authority in our country”.¹³³

98. As we have also noted, the Prime Minister said in her Conservative Party conference speech that Brexit will mean Britain no longer has laws made in Brussels and interpreted by judges in Luxembourg.¹³⁴ However, as we heard in evidence, entering into any form of international dispute-resolution mechanism inevitably entails relinquishing an element of sovereignty. Dr Ortino of King’s College London told us “in theory, there is no difference” between the ECJ and any other dispute-resolution body: “Whether it is a panel decision or

128 Swati Dhingra, Gianmarco Ottaviano, Thomas Sampson, John Van Reenen, *The impact of Brexit on foreign investment in the UK* (Centre for Economic Performance, London School of Economics, April 2016)

129 UK Trade Policy Observatory ([UKT0019](#))

130 [Q421](#)

131 UK Trade Policy Observatory ([UKT0019](#))

132 Law Society of England and Wales ([UKT0048](#))

133 “[The government’s negotiating objectives for exiting the EU: PM speech](#)”, Prime Minister’s Office, 17 January 2017

134 “[Prime Minister: Britain after Brexit: A Vision of a Global Britain](#)”, Conservative Party website, 2 October 2016

an appellate body decision or any other decision of an international tribunal, it may have the effect of telling a country that that certain behaviour is not complying with a specific international obligation”.¹³⁵

99. The Brexit White Paper states that:

The UK already has a number of dispute resolution mechanisms in its international arrangements. The same is true for the EU. Unlike decisions made by the [ECJ], dispute resolution in these agreements does not have direct effect in UK law.

As with any wide-ranging agreement between states, the UK will seek to agree a new approach to interpretation and dispute resolution with the EU.

[...]

The actual form of dispute resolution in a future relationship with the EU will be a matter for negotiations between the UK and the EU, and we should not be constrained by precedent. Different dispute resolution mechanisms could apply to different agreements, depending on how the new relationship with the EU is structured.¹³⁶

100. Dr Fox told us in evidence that:

All the EU FTAs have dispute resolution mechanisms that lie outside the ECJ. All the current EU FTAs tend to have bespoke agreements, depending on the agreement they [...] and I think that that would be a good model going forward for a potential EU FTA [...]¹³⁷

101. This leaves open a wide range of possibilities. Notably, it remains unclear whether any possible dispute-resolution mechanism could involve provision for foreign investment protection, such that companies could sue states in an international tribunal for alleged discriminatory practices. As we heard in evidence, the inclusion of such investment protection arrangements (in the form of the Investor-State Dispute Settlement system and the Investment Court System) in FTAs has proved highly controversial.¹³⁸

“Customs arrangements”

Purpose of rules of origin

102. An FTA requires certain safeguards to be in place to prevent third countries using it to circumvent higher tariffs in one FTA party by routing goods through another FTA party with a lower tariff (effectively using the second FTA party as a “back door” into the first—known as “trade deflection”).¹³⁹ These safeguards take the form of: customs

135 [Q146](#)

136 HM Government, *The United Kingdom’s exit from and new partnership with the European Union*, [Cm 9417](#), February 2017, paras 2.8–2.10

137 [Q463](#)

138 Trade Justice Movement ([UKT0011](#)); StopTTIP uk ([UKT0025](#)); Friends of the Earth (England, Wales and Northern Ireland) ([UKT0028](#)); Royal College of Nursing ([UKT0038](#)); Cheryl Coyne ([UKT0043](#)); Timothy Flitcroft ([UKT0044](#))

139 [Q212](#)

checks at borders to determine whether duty is payable on a product by virtue of its having originated outside the area of the FTA; and rules of origin, i.e. criteria to determine the source of a product on which such customs checks are based.

103. In the case of a customs union (such as the EU Single Market), the need for rules of origin and associated customs checks is obviated by means of a common external tariff (CET). By this means, the principle of “free circulation” of imported goods can be allowed, such that imports are treated as though originating within the customs union. The existence of a CET means that the members of a customs union pursue a common trade policy and conclude FTAs with third countries as a bloc rather than individually.

Impact of rules of origin on UK-EU trade

104. Were the UK to conclude an FTA with the EU but without a complementary customs union, rules of origin would apply and a customs border would consequently exist between the UK and the EU. This would again raise the issues of trade friction and a “hard border” between Northern Ireland and the Republic of Ireland.¹⁴⁰ As we have already discussed, there would apparently be some scope for electronic systems to ease any trade friction caused by at-the-border customs controls. Also, the Secretary of State for Exiting the EU has suggested that a potential model for the future UK-EU border might be that between Sweden (an EU member) and Norway. The latter state, as a non-EU member of the European Economic Area (EEA), trades on a tariff-free basis with the EU but is outside the EU customs union.¹⁴¹ However, evidence taken on this subject by the House of Lords EU Committee¹⁴² and the Northern Ireland Affairs Committee¹⁴³ casts some doubt on the applicability of this model to the Irish land border.

105. Even with minimal trade-friction at the border, though, there would still be significant compliance costs associated with rules of origin for some industries with a complex supply chain. The SMMT told us that “Irrespective of how generous the tariff set under the terms of such a trade agreement, the necessary introduction of rules of origin will result in new administrative costs”.¹⁴⁴ Where a sector already has a high level of traceability built into its supply chains (for instance, aerospace), compliance with rules of origin will not impose significant additional costs. However, in other sectors (such as the automotive industry), the additional costs may be such that it could actually prove cheaper just to export subject to the tariff.¹⁴⁵

106. A more serious problem still would be that some products which are made in the UK and currently traded freely across the EU might not actually meet the criteria for sale in the EU under rules of origin. Mr Hawes of the SMMT told us:

140 [Q338](#)

141 Oral evidence taken before the Exiting the EU Committee on [14 December 2016](#), HC(2016–17)815, Qq418, 420. The Sweden–Norway border has a small number of one-stop customs posts on “red lane” routes (for those carrying goods to declare), operated by both countries with streamlined procedures. Most routes across the border are operated as open “green lanes”, monitored by number-plate recognition cameras – [“Scandinavia’s borders set an example for Ireland”](#), *The Times* website, 27 October 2016,

142 House of Lords, Report of the Select Committee on the European Union, Session 2016–17, [HL Paper 76](#), paras 100–1

143 Oral evidence taken before the Northern Ireland Affairs Committee on [1 February 2017](#), HC(2016–17)700, Qq392, 403, 409

144 The Society of Motor Manufacturers and Traders ([UKT0035](#))

145 Oral evidence taken before the Treasury Committee on [7 February 2017](#), HC(2016–17)387, Q618

generally rules of origin require around 50%, 55% local content. Currently in the UK the average car has about 41% local content. Being part of the customs union, basically European content counts, so that is not an issue. If you then have a free trade agreement, and again you can look at the EU and South Korea as an example here, they require 55% local content. As a consequence, potentially a lot of the vehicles made in the UK may not qualify, depending on the nature of that agreement, because we would not reach the threshold for rules of origin.

107. Although the local content of UK-produced cars had increased, Mr Hawes warned that increasing to 55% “cannot happen overnight”: “The danger is that UK-built cars may not qualify under most normal free trade agreements”.¹⁴⁶

108. In written evidence, the SMMT argued for the application of the “diagonal accumulation of origin principle”.¹⁴⁷ This would involve the EU and the UK accepting (for the purposes of rules of origin) products manufactured in each other’s territory which contain a high proportion of components originating outside the UK-EU free trade area. The basis for doing so would be that the components concerned originated in third countries with which both the UK and EU had FTAs that were aligned in terms of tariffs and rules of origin.¹⁴⁸

Government policy

109. Towards the end of 2016, several Government pronouncements were made which left it unclear whether or not it was intended to try and remain in a customs union with the EU. On 16 November, the Prime Minister told the House that “the customs union is not just a binary decision”.¹⁴⁹ This was subsequently reiterated to Members by the Secretary of State for Exiting the EU.¹⁵⁰ On 1 December, an interview with Greg Hands MP, a Minister of State at DIT, was published in which he explained the Prime Minister’s remark as follows:

You can choose which markets, which products the customs unions affect and which they don’t—so there isn’t a binary thing of being inside the customs union or outside of the customs union [...] The history of international trade has got all kinds of examples of customs unions.

The Minister cited the *Zollverein*, formed by a group of German states in the 1830s, as an example of how “These things can be multifaceted and dynamic”.¹⁵¹ In an interview on 18 December, Dr Fox responded as follows when asked about customs union membership:

146 [Q273](#)

147 The Society of Motor Manufacturers and Traders ([UKT0035](#))

148 A more developed form of this approach to rules of origin is “full cumulation”, whereby products are accepted by parties to an FTA as originating in the free-trade area despite their constituents having originated outside, on the basis that they have been subject to working or processing within the area.

149 H C Deb, 16 November 2016, [col 232](#) [Commons Chamber]. The Prime Minister was responding to criticism of the Foreign Secretary regarding an interview in which he apparently stated that the UK would “probably have to leave the customs union [...] while maintaining free trade [with the EU]”—“[Free trade outside the EU customs union](#)”, *Full Fact* website, 16 November 2016.

150 H C Deb, 7 December 2016, [cols 236–7](#) [Commons Chamber]

151 “[U.K. Could Stay in Customs Union After Brexit, Trade Aide Says](#)”, *Bloomberg* website, 1 December 2016

It's not binary, I hear people talking about "hard" Brexit and "soft" Brexit as though it's a boiled egg we're talking about. It's a little more complex. So Turkey, for example, is in part of the customs union but not other parts.¹⁵²

Since then, the Government has stated that one of its key Brexit "negotiating objectives" is for the UK to be able to operate its own independent trade policy, unhindered by the EU's Common Commercial Policy and CET.¹⁵³ Consequently, a customs union with the EU (as exists in the case of a small number of countries—see Annex 2) is also categorically ruled out.

110. In her Lancaster House speech, the Prime Minister said that she wanted cross-border trade with the EU to be "as frictionless as possible". Consequently, while she did not want the UK to be in a customs union with the EU:

I do want us to have a customs agreement with the EU. Whether that means we must reach a completely new customs agreement, become an associate member of the Customs Union in some way, or remain a signatory to some elements of it, I hold no preconceived position. I have an open mind on how we do it. It is not the means that matter, but the ends.¹⁵⁴

111. When the Secretary of State appeared before us on 1 February, we asked him to clarify for us what exactly the Prime Minister had meant by a "customs agreement", but he was apparently unable to do so.¹⁵⁵ He did appear to rule out the sort of customs union that Turkey has with the EU. And he told us:

What we will look like in terms of our customs arrangements is yet to be discussed fully and determined because of the complication that the UK has with the Irish border. We will want to ensure that there is no return to a hard border in Ireland.¹⁵⁶

112. Also on 1 February, Lord Price, a Minister of State at DIT, was reported in the German press as giving the following answer to a question regarding the Prime Minister's reference to a "customs agreement":

During the last weeks, I have met with many of my EU counterparts [...] Most of them were very clear. There will be no cherry-picking. We have understood this message [...] The aim must be now to agree on all questions through a free trade agreement with the EU 27. We hope to find a solution on that within the next two years.¹⁵⁷

152 [The Andrew Marr Show](#), BBC One, 18 December 2016. Turkey has a form of customs union with the EU, but it is not part of the EU's customs union.

153 ["The government's negotiating objectives for exiting the EU: PM speech"](#), Prime Minister's Office, 17 January 2017; HM Government, *The United Kingdom's exit from and new partnership with the European Union*, Cm 9417, February 2017, para 8.43

154 ["The government's negotiating objectives for exiting the EU: PM speech"](#), Prime Minister's Office, 17 January 2017

155 [Qq474–8](#)

156 [Q478](#)

157 ["Government accepts UK must leave EU Customs Union"](#), *Die Welt* website, 1 February 2017

113. However, in the Brexit White Paper, which was published on the following day, the Government stated:

the UK will seek a new customs arrangement with the EU, which enables us to make the most of the opportunities from trade with others and for trade between the UK and the EU to continue to be as frictionless as possible. There are a number of options for any new customs arrangement, including a completely new agreement, or for the UK to remain a signatory to some of the elements of the existing arrangements. The precise form of this new agreement will be the subject of negotiation.

[...]

Whatever form that customs arrangement takes, and whatever the mechanism to deliver it, we will seek to maintain many of the facilitations that businesses currently enjoy, whilst aiming that, if there are requirements for customs procedures, these are as frictionless as possible.¹⁵⁸

Sectoral customs union

114. In October 2016, the car manufacturer Nissan UK indicated its intention to continue manufacturing cars in the UK after Brexit;¹⁵⁹ and subsequently announced that it would be building two new models at its Sunderland plant, following “support and assurances” from the Government about mitigating the consequences of Brexit.¹⁶⁰ The Secretary of State for Business, Energy and Industrial Strategy, Rt Hon Greg Clark MP, denied that any financial inducements had been given to the company.¹⁶¹ However, the Government has thus far not made public the letter that Mr Clark sent to the company detailing the Government’s assurances. It was speculated that what the Government actually gave Nissan was an assurance that the UK would be in a customs union with the EU after Brexit (which we now know will not be the case)—or that there would be some sort of sectoral arrangement specifically for the automotive industry.

115. The idea of a sectoral customs for the automotive industry (along with a sectoral mutual recognition agreement for conformity assessment) was floated in November 2016 in a paper published by the UKTPO.¹⁶² The Observatory’s Professor Winters explained to us how it might work:

Maybe you would just follow the EU, but you would confirm that you would have the same tariff on motor vehicles themselves, on all the various component parts or significant component parts and therefore that there was no worry, no concern about trade deflection. Therefore, even if you had a rule of origin written down, you would not seek to enforce it in a very bureaucratic way because the problem it was designed to solve would not arise. It is a very pragmatic sort of thing. It is not a separate trade agreement.¹⁶³

158 HM Government, *The United Kingdom’s exit from and new partnership with the European Union*, Cm 9417, February 2017, paras 8.45 and 8.47

159 “Brexit: Nissan boss meets PM over Sunderland plant fears”, BBC News website, 14 October 2016

160 “Nissan and Government deny ‘sweetheart deal’ over UK investment”, Sky News website, 27 October 2016

161 “‘No cheque book’ involved in Nissan pledge, says minister”, *Guardian* website, 28 October 2016

162 Michael Gasiorek, Peter Holmes, Jim Rollo, *UK-EU Trade Relations Post Brexit: Too Many Red Lines?* (UKTPO Briefing Paper 5, November 2016), p 5

163 [Q212](#)

Regarding the objection that it would be difficult to distinguish between components for use in an industry within a sectoral customs union and identical components for use in other industries, Professor Winters thought it would be “absolutely silly” to attempt to do so: “You would have to have the same tariff on the intermediate goods for all their uses.”¹⁶⁴

116. He told us that a sectoral customs union would not be in violation of the WTO’s MFN principle, since it would be a form of preferential trade agreement (as allowed under GATT Article XXIV).¹⁶⁵ There remains, however, the question of whether a sectoral customs union would be in violation of GATT Article XXIV:8, which states that preferential trade agreements must cover “substantially all the trade” in goods. This would seem, by its very nature, to rule out sectoral arrangements.

117. The UKTPO paper suggests that “an FTA with the EU, but with a specific deal for cars which maintains existing access to the EU market” (with a CET on cars and their components) would not be WTO incompatible.¹⁶⁶ It is unclear, though, whether this would be legal under WTO rules. In addition, it is hard to see how it could be reconciled with the Government’s policy of pursuing an independent UK trade policy. The adoption of a CET, albeit only a sectoral one, of necessity limits the UK’s negotiating position as regards third-country FTAs, since these would have to be aligned with the EU’s FTAs in respect of automotive trade.

118. We also heard that there would be business and trade-union objections to any approach that privileged certain sectors of the economy at the expense of others.¹⁶⁷

Transitional arrangements

119. The Government expects to be able to achieve agreement on a “phased process of implementation” from the point of Brexit in 2019, so that there is no “cliff-edge for business” or “threat to stability”. The Prime Minister has emphasised that this will not be “some form of unlimited transitional status, in which we find ourselves stuck forever in some kind of permanent political purgatory”, but a bridge to a definitively agreed new relationship between the UK and the EU.¹⁶⁸

This position clearly rules out the possibility of merely extending the status quo from 2019 and then, over a protracted period, negotiating an FTA on that basis.

120. The Government envisages that the transition process:

might be about our immigration controls, customs systems or the way in which we cooperate on criminal and civil justice matters. Or it might be about the future legal and regulatory framework for business. For each issue, the time we need to phase in the new arrangements may differ; some might be introduced very quickly, some might take longer.¹⁶⁹

164 [Q213](#). See also [Qq282](#), [284](#), [338](#).

165 [Q221](#)

166 Michael Gasiorek, Peter Holmes, Jim Rollo, [UK-EU Trade Relations Post Brexit: Too Many Red Lines?](#) (UKTPO Briefing Paper 5, November 2016), p 5

167 [Qq279](#), [335](#), [338](#)

168 [“The government’s negotiating objectives for exiting the EU: PM speech”](#), Prime Minister’s Office, 17 January 2017

169 HM Government, [The United Kingdom’s exit from and new partnership with the European Union](#), [Cm 9417](#), February 2017, para 12.2

121. We heard that there are particularly important transition issues around financial services. Professor Moloney of the LSE told us that:

The transitional arrangement is absolutely critical. The cliff-edge effects are bad for everybody. There is absolutely no doubt about that. There is an interdependency there. It is how long it goes on for and what the conditions of the transitional arrangements are. A critical one will be, if you transition and we keep passporting for two, three years, how do we mediate disputes at that stage? Do we have the [European] Court of Justice? One can see that would become a tricky issue. Yes, it is in everybody's interests to avoid the cliff-edge effect, but there will come a point where passporting will lift and it will be replaced by something else.¹⁷⁰

Conclusions and recommendations

122. *The government must initiate negotiations for an EU-UK FTA, including customs arrangements and a phased process of implementation, in parallel to the Article 50 negotiations. The Government should identify and address the legal implications of doing so and should make clear how it will address the resourcing implications of doing so.*

123. *The Government must seek a reciprocal tariff-free basis for trade with the EU after Brexit. In addition, a UK-EU FTA should seek to retain the mutual recognition of rules and standards, and conformity assessment, that the UK currently has as an EU member—bearing in mind the potential need to align rules and standards with those of other trading partners. Even if this is not possible, a UK-EU FTA should allow for equivalence of assessment (including mutual recognition of assessment), in order to minimise as far as possible the friction to trade caused by any regulatory barriers to trade in goods.*

124. *In respect of trade in services in general, a UK-EU FTA should seek as far as possible to reproduce the right of establishment and mutual recognition of professional qualifications from which the UK currently benefits as a member of the EU. Regarding trade in financial services, the Government should seek the nearest achievable approximation to the EU system of “passporting”. This is a matter to which the Committee will return, including the examination of regulatory change.*

125. *It would be helpful if the Government could be clearer about the design principles for the dispute-resolution mechanism it will seek as part of a UK-EU FTA. In particular, it should say whether it envisages the possibility of such a mechanism involving provision for foreign investment protection along the lines of the Investor-State Dispute Settlement system. Clarity on how complex disputes in the financial services sector will be resolved without the involvement of the European Court of Justice (ECJ) would also be welcome.*

126. *A UK-EU FTA should also take full account of the importance of inward investment for the UK economy, and the importance of UK outward investment into the remaining 27 member states.*

127. The Government says that it does not wish the UK to continue in a customs union with the EU and that it aspires instead to some form of post-Brexit “customs arrangement”—but the latter has thus far been described only in very vague terms. The current uncertainty is delaying investment decisions, particularly in the manufacturing sector. *The Government must be much clearer about the defining characteristics of the proposed “customs arrangement” and explain how it would differ from a customs union. The Government should clarify if there will be a significant sectoral aspect to the arrangement they are seeking and whether that would impact on future international trade policy.*

128. *Regarding the “phased process of implementation” which the Government envisages, it must take particular account of the need to avoid the sudden ending of passporting in financial services. Any such transitional arrangements will need to include fully worked-out arrangements for dispute resolution.*

129. *As a general principle, we strongly urge that, in the interests of allowing businesses to adapt and plan for new trading arrangements with the EU, the Government provide as much certainty as possible, as early as negotiations allow.*

130. *Whatever option applies, the Government must clarify arrangements for customs and border operations, and specify the expected number and intensity of customs checks. Planning for this is a matter of urgency now.*

4 “No deal”—Trading under WTO rules alone

Introduction

131. As we have noted, the Government is confident that it will get the agreement it wants with the EU27 by 2019 because such an outcome will be in the interests of both parties. However, as we have also noted, the Government has stated categorically that “no deal for the UK is better than a bad deal for the UK”.¹⁷¹ Consequently if no UK-EU FTA, or set of transitional arrangements, is in place by 2019, the UK will have to trade with the EU under WTO rules alone.¹⁷² (Furthermore, the UK will also have to trade with all of the rest of the world on the same terms if there is no “grandfathering” of EU FTAs, as we discuss in Chapter 5.)

Unilateral options

132. Trading under WTO rules alone is an option only in the sense that it is the “default option”, a fallback position in the absence of any other trading arrangement. Nonetheless, it would provide the UK with a degree of choice in respect of unilateral actions that could be taken.

133. As we have noted, MFN “bound” tariffs constitute a maximum or “ceiling” to which WTO members must adhere. Actual (or “applied”) tariffs can be set at lower rates, right down to zero, on a unilateral basis (i.e. irrespective of whether or not other WTO members are willing to reciprocate). It has been argued that the UK, once it is no longer an EU member, should adopt a unilateral free-trade model, removing all tariffs on imports, as some WTO members (for instance Singapore) have done. This approach has been promoted by one of our witnesses, Professor Patrick Minford of Cardiff University. Under this arrangement, the UK would not prioritise the seeking of a trade agreement, with the EU or anyone else. UK exporters would simply have to pay the tariffs imposed by the countries in which they sell their products. Professor Minford argues that this will result in a 10% fall in the cost of imported (manufactured and agricultural) goods. This is because, he argues, although the EU’s CET (which the UK must currently adhere to as a member of the EU) is on average 3%, once non-tariff barriers are taken account of, it actually amounts to 10%.¹⁷³

134. This approach was criticised by others. In evidence to us, Dr Swati Dingra, of the Centre for Economic Performance at the London School of Economics (LSE), said that:

Professor Minford’s numbers rely essentially on comparing goods prices across different OECD countries, and it turns out that the UK, Netherlands, Belgium and Germany [...] tend to have much higher prices for comparable goods compared to the rest of the OECD countries. What Professor

171 HM Government, *The United Kingdom’s exit from and new partnership with the European Union*, Cm 9417, February 2017, para 12.3

172 The same also applies in respect of the non-EU EEA countries and Switzerland if the UK does not have FTAs in place with them at the point of Brexit.

173 Professor Minford’s views are summarised in “Brexit and Trade: What are the options?”, in [The Economy after Brexit](#) (2016).

Minford's work does is attribute that to protectionism. What I am going to argue is that, in fact, that is not correct. [...] That difference in prices cannot be attributed just to protectionism. It has to be attributed, at least partially, to differences in quality, which are good for the consumers, potentially, if they are willing to pay for it.¹⁷⁴

135. Professor Minford, however, defended his hypothesis, saying that: "The price indices we use, which are aggregated across broad sectors, are based on very authoritative consumer price indices from the UN, national statistical agencies and so on. They have all been screened for quality."¹⁷⁵

136. Both proponents and opponents of the model agreed that by increasing imports of goods to the UK, unilateral free trade could have a negative effect on at least some parts of the manufacturing sector, although opinions differed on the effect on the economy as a whole. Professor Minford told us that:

manufacturing would be subjected to competition. The metal-bashing element, the pure making element, would reduce substantially and those industries doing that would go up the value-added chain and become more and more high tech.¹⁷⁶

The British Ceramic Confederation took a negative view of the effect on manufacturing, saying that:

The basis of the "unilateral free trade" model is a hypothesis that by importing most of the goods it consumes the UK could focus on services, thereby becoming a more productive economy. This approach, even by many of its advocates' own admission, would devastate UK manufacturing including in the ceramics industry. Unsurprisingly the BCC and our members would find this approach completely intolerable.¹⁷⁷

137. Dr Anamaria Nicolae and Michael Nower, of Durham University, noted that the value of the unilateral free trade model depended on what one valued in the economy:

[I]t would be desirable for the UK to adopt a unilateral free-trade, low-tariff or uniform-tariff approach if [...] [the Government] are prioritizing maximising UK productivity growth, consumption, or wages, and minimising UK price growth. However, if the UK government is prioritizing maximizing the number of firms (and hence employment), then adopting such an approach would not be desirable.¹⁷⁸

138. A less radical form of unilateral action would be for the UK to reduce or abolish tariffs inherited from the EU that relate to protecting industries which are non-existent or less important in the UK. Peter Ungphakorn noted that "oranges have a very high tariff because the EU tariff on oranges is designed to protect Mediterranean producers". Consequently, the UK could decide to change this tariff to give UK consumers access to

174 [Q78](#)

175 [Q78](#)

176 [Q89](#)

177 British Ceramic Confederation ([UKT003](#))

178 Dr Anamaria Nicolae and Mr Michael Nower ([UKT0017](#))

cheaper oranges.¹⁷⁹ Tate and Lyle Sugars Ltd suggested that the UK could drop the EU's high sugar-cane tariffs, which are designed to protect producers that refine sugar from beet (which tend to dominate the sugar industry in a number of EU27 countries).¹⁸⁰

139. Another form of unilateral action would be to form Free Trade Zones (FTZs). These are clearly demarcated areas in which goods may be imported, stored, handled, manufactured (or reconfigured) and exported under specific customs regulations (generally without any tariffs being levied). FTZs are typically located at major ports, international airports and national frontiers. The British Chambers of Commerce told us they favoured exploring this idea in depth.¹⁸¹ However, we also heard that FTZs are mainly of benefit for a particular type of industry, in which parts are imported and assembled, and finished products are all exported. For other business models, FTZs would entail costly and cumbersome bureaucracy that would have to be offset against any advantages. There is also the objection that FTZs are unfair in that they arbitrarily grant advantages to some producers but not others.¹⁸²

Consequences for British exports to EU

Impact of MFN tariffs

140. Trading under WTO rules alone would mean that UK exports to the EU inevitably faced EU tariffs. UK exporters would, other things remaining equal, need to raise their prices, cut their costs or reduce their profit margins in order to maintain their position. It is true that most of the EU's MFN tariffs are low; the EU's average applied tariff in 2014 was just 2.7%.¹⁸³ There are, however, a few significant exceptions ("peak" tariffs): the automotive industry; agriculture; and textiles.

141. Mr McGuire of the CBI told us:

If we fall under WTO rules we will then have to apply tariffs, and in some areas these tariffs can be significant. In the dairy/agri-food sector, it can be up to about 40%. In the automotive and automotive parts sector, it can be 10%. If you are operating in the automotive sector at the moment and have to put your prices up by 10% in a highly competitive, global economy automotive industry that puts UK manufacturers at a significant disadvantage, because we would have to apply the tariffs under the arrangements of the WTO. For us, the no deal and going into the WTO, operating in a tariff world would significantly dent the competitiveness of the UK industry at the moment [...]¹⁸⁴

179 [Q195](#)

180 Tate & Lyle Sugars Ltd ([UKT0015](#))

181 British Chambers of Commerce ([UKT0022](#)); [Qq306–8](#)

182 [Qq215–22](#)

183 This is the trade-weighted average tariff (i.e. total tariff revenue as a proportion of the total value of imports). The EU's simple average tariff rate in 2015 was 5.1% – World Trade Organization, International Trade Centre, Conference on Trade and Development, [World Tariff Profiles 2016](#) (Geneva, 2016), p 81.

184 [Q330](#)

142. The SMMT, warned of the consequences for the automotive industry:

[Trading under WTO rules alone] would see the application of a 10% tariff on vehicles and an average 4.5% tariff on components which will increase the cost of production, undermine competitiveness and potentially increase the cost of cars for consumers. SMMT analysis suggests that the UK motor industry faces a £4.5 billion tariff cost for cars alone which could add at least an annual £2.7 billion to imports and £1.8 billion to exports. Import tariffs could push up the list price of cars imported to the UK from the EU by an average of £1,500 if brands and their retail networks were unable to absorb these additional costs¹⁸⁵

143. The automotive industry would particularly suffer as a result of its complex supply chains. The fact that some automotive parts cross the UK-EU border multiple times in the course of manufacturing raises the prospect of significant costs due to the compounding of tariffs.¹⁸⁶

144. We also heard that the consequences would be significant for British agriculture. The National Farmers Union told us: “The impact assessment produced by the University of Wageningen shows that under this scenario [WTO rules alone] with the full abolition of direct support, farm incomes would fall on average by €17,000 [per year]”.¹⁸⁷

145. It should also be noted that the imposition of tariffs would entail interposing a customs border between the UK and the EU, again raising the prospect of a “hard” border between Northern Ireland and Republic of Ireland. The Chancellor of the Exchequer told the Treasury Committee in December 2016 that, in the event of the UK having to trade with the EU under WTO rules alone: “We are talking about something like perhaps five times as many submissions and inspections being required on EU trade”.¹⁸⁸ However, in subsequent evidence to the Committee (to which we have already referred), HMRC officials stated that preparations were in hand for the use of electronic systems which would minimise friction at the border resulting from such a substantial increase in customs checks.¹⁸⁹ (As previously mentioned, this would apparently also limit the implementation of a “hard border” in Ireland.)

Impact of non-tariff barriers on trade in goods

146. WTO rules do not cover regulatory restrictions, geographic indicators and standards. Consequently, the UK cannot rely on WTO rules alone to prevent the occurrence of this type of non-tariff barrier in respect of accessing the Single Market. The SMMT told us: “WTO rules alone could mean “the prospect of having to certify exports as being compliant with EU rules which will create significant administrative burdens and additional costs”.¹⁹⁰

147. The impact of trade friction at the border (and the implementation of a “hard border” in Ireland) in respect of conformity assessment can be mitigated by electronic systems and equivalence of assessment.

185 The Society of Motor Manufacturers and Traders ([UKT0035](#))

186 The Society of Motor Manufacturers and Traders ([UKT0035](#))

187 National Farmers Union ([UKT0032](#))

188 Oral evidence taken before the Treasury Committee on [12 December 2016](#), HC(2016–17)387, Q303

189 Oral evidence taken before the Treasury Committee on [7 February 2017](#), HC(2016–17)387, Qq546–7, 567–77

190 The Society of Motor Manufacturers and Traders ([UKT0035](#))

Impact of barriers to trade in services

Services in general

148. As we have noted, tariff barriers do not arise in respect of trade in services; in this sector, barriers to trade take the form of regulation. The UKTPO told us that gauging the extent of UK service-providers' access to the Single Market under WTO rules alone was not straightforward, for a number of reasons:

First, applied services trade policies in the areas of cross-border trade, investment, and movement of people are typically more liberal than the EU's commitments under WTO's General Agreement on Trade in Services (GATS) prescribe. Second, unlike for goods trade, there is no uniform EU services trade regime for suppliers from outside the EU. Hence, upon leaving the EU, access for UK service providers will deteriorate in ways that differ across EU member states, sectors, and modes of supply.¹⁹¹

Professor Winters of the UKTPO told us in oral evidence that a third complicating factor was the complex interaction of the four different modes of supplying services on which the WTO's rules are predicated.¹⁹² However, bearing in mind these provisos, he was able to tell us that:

If we dropped back to so-called World Trade Organization rules [...] [UK service-providers' access to the Single Market] would not be what is written down in the [EU's WTO] schedules. It would be something more liberal, but it would be considerably less liberal than what we get at the moment in the single market. The financial services sector is one where we hear a lot about passporting, but there is a similar sort of regulation, I understand, about broadcasting. As you go through the various sectors there are things that we are able to deliver single market but are clearly not possible if we relied on the MFN position. So, no, I do not think it would just be the same. Most people think it would be very different.¹⁹³

The Law Society told us that the EU's schedule of commitments under GATS includes a whole slew of restrictions on legal practice which vary among member states. Some EU jurisdictions operate nationality requirements. In some cases right of audience before EU courts could be lost by UK lawyers. There might also be problems regarding clients' ability to benefit from legal professional privilege.¹⁹⁴

149. We heard from the law firm Hook Tangaza that:

Less than a quarter of the WTO's 164 Member States have made commitments in legal services and none of those that have, match the quality of the UK's access to the EU, which is based on full national treatment. Some large countries, such as India, are closed markets; and many other

191 UK Trade Policy Observatory ([UKT0019](#)). On the modes of supply under GATS, see footnote 97 above.

192 [Q242](#)

193 [Q243](#)

194 Law Society of England and Wales ([UKT0048](#))

emerging markets severely limit access to foreign lawyers. The US market is fragmented and access ranges from good in some states through to impossible in others.¹⁹⁵

Financial services

150. Trading in financial services under WTO rules alone would mean the loss of passporting rights, with no agreed substitute arrangement to fall back on. Thus, as Professor Moloney of the LSE told us, “there probably would not be any difficulty in setting up subsidiaries or branches, but the financial actor in question would be subject to the relevant law of whatever member state they were operating in.” Professor Moloney explained that there would also be another significant effect of trading under WTO rules alone:

[I]f I am a broker in the EU, there are EU rules governing how I interact with the rest of the world. For example, if I want to trade derivatives, let’s say, on a London exchange—and London is our third country—unless the UK has equivalent status, I cannot trade on that market. That is bad for the EU but also troublesome for the UK [...]¹⁹⁶

151. Mr Heath of the *Daily Telegraph* told us that the “worst-case scenario” for the City of London as a result of trading under WTO rules alone would be the loss of around 10,000 jobs.¹⁹⁷

Overall impact

152. Some attempts have been made to quantify the likely impact on the UK economy of trading under WTO rules alone. The UKTPO told us that: “The Institute for Fiscal Studies’ synthesis of various models suggested that—under a ‘WTO rules’ scenario—trade between the UK and EU will fall between 17 and 29 per cent and GDP by between 2.6–3.1 per cent”.¹⁹⁸ At 2016 prices, this would amount to a loss of between £48.6 billion and £58 billion, equivalent to between £741 and £884 per head of population.¹⁹⁹ Such figures were contested by other witnesses.

153. An important constituent part of the effect on the economy will be that on direct investment. Here again, however, there seems to be little or no absolute certainty.

195 Hook Tangaza ([UKT0046](#))

196 [Q380](#)

197 [Q379](#)

198 UK Trade Policy Observatory ([UKT0019](#))

199 The IFS’s statistics derive from work by two other bodies. The Centre for Economic Performance at the LSE estimates that the direct trade effects of trading under WTO rules alone would reduce GDP by 2.6% in 2030. The National Institute of Economic and Social Research, incorporating some effects on foreign direct investment as well as direct trade effects, estimated that a static fall in GDP of 3.2% would result from trading under WTO rules alone—*Brexit and the UK’s Public Finances*, Institute for Fiscal Studies (May 2016), p 36; Office for National Statistics, *Gross domestic product, preliminary estimate: Oct to Dec 2016*, January 2017

Dispute resolution

154. Where one WTO member is alleged by another to have broken the WTO's rules, disputes procedures can be invoked to settle the matter. This is a judicial system, ultimately administered by the Dispute Settlement Body—which is the same body as the WTO's General Council, on which all members are represented. Mr Abbott explained that in respect of disputes procedures:

[T]he WTO isn't the same thing at all as the ECJ. The ECJ is a whole jurisdiction and it is clear there that they make legal rulings and so on. The WTO system has judicial elements and it has political and practical elements. You don't have judges. You have an appellate body that has some judicial experience, and they produce rulings on interpretation of the WTO law.²⁰⁰

155. Mr Abbott told us that, under the WTO procedure, “We have had 400 or 450 disputes in the last 20 years and most of those have been resolved one way or another.” Nevertheless, “There are still one or two cases that are well known where you could argue it hasn't really worked”.²⁰¹

Contingency planning

156. Sir Andrew Cahn told us he doubted that the Government seriously intended to fall back on trading under WTO rules if its negotiating objectives were not met, given what the consequences of doing so would be:

It isn't believable that the UK could, with equanimity, fall back on WTO rules, falling off a cliff edge without any transition or implementation-phase arrangements. It would be so chaotic, and so bad for British business and the British people, that it is not really conceivable that the British Government could allow that to happen.²⁰²

157. An indication of what might be the Government's contingency plan in this event was given by the Chancellor of the Exchequer in an interview with the German press:

If we have no access to the European market, if we are closed off, if Britain were to leave the European Union without an agreement on market access, then we could suffer from economic damage at least in the short-term. In this case, we could be forced to change our economic model and we will have to change our model to regain competitiveness. And you can be sure we will do whatever we have to do. The British people are not going to lie down and say, too bad, we've been wounded. We will change our model, and we will come back, and we will be competitively engaged.²⁰³

200 [Q146](#)

201 [Q146](#)

202 [Q315](#)

203 [“Philip Hammond issues threat to EU partners”](#), *Welt am Sonntag* website, 15 January 2017

158. The Government states in the Brexit White Paper that, while it is confident of reaching an agreement:

In any eventuality we will ensure that our economic and other functions can continue, including by passing legislation as necessary to mitigate the effects of failing to reach a deal.²⁰⁴

159. The Secretary of State was likewise thoroughly confident of reaching an agreement. He did say that modelling of various possible outcomes was “ongoing”²⁰⁵—but could say nothing about any contingency plans.

Conclusions and recommendations

160. *The Government must set out as clearly as possible the likely consequences of trading under WTO rules alone. It must also show what contingency planning it is undertaking for that eventuality—including in respect of the legislation which it says it is prepared to bring forward “as necessary to mitigate the effects of failing to reach a deal”.*

161. *When considering policies such as adopting a unilateral zero tariff policy, the DIT should produce evidence showing the likely winners and losers, and the amounts involved. This should also be carried out with the involvement of the devolved assemblies and governments of the UK.*

162. *It is quite clear that “no deal” is in effect a deal to trade with the EU under WTO rules. The Prime Minister has said that it is her ambition to seek tariff-free trade with the EU and frictionless customs arrangements. It is clear that WTO rules would not permit this. Therefore, the “no deal” option should be discounted entirely.*

204 HM Government, *The United Kingdom’s exit from and new partnership with the European Union*, [Cm 9417](#), February 2017, para 12.3

205 [Q480](#)

5 UK Free Trade Agreements with non-EU countries

Introduction

163. The Government has made clear that part of its overall Brexit strategy is to build closer trade relations with non-EU countries. In her Lancaster House speech, the Prime Minister said that:

A Global Britain must be free to strike trade agreements with countries from outside the European Union too. Because important though our trade with the EU is and will remain, it is clear that the UK needs to increase significantly its trade with the fastest growing export markets in the world [...] it is time for Britain to get out into the world and rediscover its role as a great, global, trading nation.²⁰⁶

Forming new trading relationships with non-EU countries is the primary task of DIT and much of this Committee's work over the remainder of the Parliament will involve scrutinising the Department's performance in this task. We will not, therefore, discuss in detail in this report the Government's strategy for forging new FTAs with non-EU countries, but we set out below some of the issues that have emerged during this inquiry that the Government will need to resolve early in its work. The terms of individual trade agreements, including but not limited to, the level of tariffs, rules of origin, and dispute resolution, will need to be considered in detail as trade agreements develop. We will undertake further work in this area over the course of the Parliament, and in this chapter will consider only the most immediate questions the Government will face. These are: to what extent the Government can negotiate new FTAs while it is negotiating its exit from the EU; the capacity of the Department for International Trade to negotiate new Free Trade Agreements; the extent to which the UK can continue in the FTAs the EU currently has with third countries; and the Department for International Trade's strategy for selecting future partners for FTAs. In this section we finally consider as a case study the UK's potential future trading relationship with other Commonwealth countries.

Timing and sequencing of negotiations

164. While the UK remains a member of the EU, it cannot legally negotiate new FTAs because it is bound by the EU's Common Commercial Policy. However, the Secretary of State indicated to us that the Government was already undertaking some work preparing for new agreements:

The legal position is that any country that is in the European Union and is bound by common commercial policy has to abide by certain duties [...] we will be discussing and scoping out future agreements with [other]

206 ["The government's negotiating objectives for exiting the EU: PM speech"](#), Prime Minister's Office, 17 January 2017

countries. We will not be signing any negotiation, but we will want to be taking legal advice as we go on about what we think the parameters are for our freedom of movement.²⁰⁷

165. While there seems to be broad consensus that the UK can, legally, undertake informal discussions with non-EU countries about future trade relationships, it is not clear how far the Government can go towards negotiating new agreements on the spectrum from having informal discussions to having a deal ready to sign the day after the UK leaves the EU.

166. Regardless of its ability to conclude formal trade agreements, we heard some evidence that the UK could undertake activity to support trade with non-EU countries. The British Chambers of Commerce told us that:

the importance of Free Trade Agreements should not be overemphasised. There is a range of non-tariff barriers (NTBs) that are often unaddressed by FTAs, such as: licensing requirements, capital controls, ownership rules, discrimination in public procurement, among others. In our survey, for future terms of trade between the UK and non-EU “third countries”, NTBs came out as the most important area of concern for businesses.²⁰⁸

167. Lord Marland told us that:

The fact is businesses do trade. They trade very actively with a lot of these countries without any trade agreements. As I have quite frequently commented, we do not have a trade agreement with America, who is our biggest trading partner, obviously, in terms of a country, yet we do an enormous amount of business there.²⁰⁹

168. The Secretary of State told us that work was underway to establish what could be done without an FTA to improve trade relations with India. He said that:

We said, “[...] we would like you to set out on paper your perceived impediments to doing trade and investment in the UK and we will do a parallel exercise. We will come together [...] and see where we think those main impediments lie and where we might be able to start to remove them”, whether, for example, we need to go to a full free trade agreement, whether we can use mutual co-operation agreements and so on; those are the tools that are available to us to do that.²¹⁰

169. In the services sector, as stated above, barriers to trade occur due to regulatory issues rather than tariffs. The impact of FTAs on the services sector would therefore depend on the extent to which these deals addressed these regulatory issues. Mr Savill of the ABI was sceptical about the potential in this area:

[I]nsurance is a regulated industry and it is the regulators that say whether or not you can have permission to do business in a particular country. They normally fall outside FTAs. I don’t think there is a single FTA that offers

207 [Q450](#)

208 British Chambers of Commerce ([UKT0022](#))

209 [Q595](#)

210 [Q456](#)

market access. There is also a tradition: FTAs normally deal with goods. If we are going to follow some of our major competitive advantages in financial services, we are going to have to change that.²¹¹

Mr Browne of the BBA argued that regulatory issues could be better addressed outside FTAs:

The opportunities are not just necessarily on free trade deals, they are actually in market access arrangements that could be done before or outside free trade deals [...] The sorts of obstacles we are talking about are restrictions on ownership of subsidiaries. There are often countries with quite strict ownership rules. It would be good to make it easier for UK-based banks to own subsidiaries in other countries. Restrictions on appointment of staff such as board directors: quite a lot of countries have strict quotas for the number of local citizens who must be members of boards [...] There are quite often restrictions on employment of local staff and intercompany transfers from the UK outside. It is all of those sorts of agreements; we would like to remove all those issues. You can do that outside a free trade deal.²¹²

“Grandfathering” EU FTAs

170. The EU is party to some 50 FTAs;²¹³ and, consequently, the UK’s access to the markets of the countries concerned is currently mediated through those agreements. The Secretary of State told us that DIT’s second priority (after establishing the UK’s position at the WTO) was “the ability to adopt the EU FTAs that currently exist”.²¹⁴ He clarified his position on both the UK’s priorities and the process for doing this:

“EU-Korea and EU-Switzerland [...] account for about 80% or so of the trade by value—others are much smaller countries in terms of trade value—and they are clearly the ones that we would prioritise. But we would like to get them [all] done.”²¹⁵

171. The idea that the UK should seek to inherit (or “grandfather”) the rights the EU had acquired under its FTAs was supported by a number of people who gave evidence to us. For example, the British Chambers of Commerce told us that:

an important next step is to grandfather existing deals that we benefit from thanks to our current membership with the EU (with a proviso to re-examine their terms at a later stage). This is important to ensure that British businesses do not face less advantageous terms than those on which they currently trade with the many third countries where the EU presently has a trade deal.²¹⁶

211 [Q365](#)

212 [Q433](#)

213 [Q241](#) [Dan Lewis]

214 [Q452](#)

215 [Q453](#)

216 British Chambers of Commerce ([UKT0022](#))

The ABI said that the Government should: “Grandfather existing EU Free Trade Agreements (FTAs) to preserve the value they present to the UK economy and ensure a smooth transition on EU exit.”²¹⁷

172. Some uncertainty remains about whether the UK will have rights under the EU’s existing FTAs. The Secretary of State appeared confident that the securing of these deals would be relatively straightforward. He said that:

[I]t is relatively easy to do so [...] rather in line with our process of technical rectification at WTO, we see them as simply being transitions from the current agreement [...] [W]e have made it very clear to countries that we would like to see a transition of their agreements to a UK agreement at the point that we leave the EU. So far, we have not yet had a country that did not want to do that.²¹⁸

173. Other witnesses told us that there was unlikely to be continuity under these agreements. Roderick Abbott told us that:

these agreements are between the EU and member states and a third country. The acquired rights belong to the EU and member states and the third country. As soon as the UK is not an EU member state, it has no acquired rights.²¹⁹

We likewise heard from Dr Ortino that:

The legal question specifically has not been answered. This is somewhat a novel issue because the UK and each EU member is a signatory of most of those FTAs so technically they are party to the agreement, but on the other hand the agreements are constructed as bilateral between the third party, and the EU and the member states.²²⁰

And the Law Society regarded the issue of establishing identical agreements with the EU’s existing FTA partners as “political rather than legal”.²²¹

174. If the UK and the countries with which the EU has an FTA were simply to start applying the terms of the FTA, this is likely to be against the rules of the WTO. The Agriculture and Horticulture Development Board told us that “If the UK and other countries were to simply continue allowing each other tariff-free market access without a formal new trade agreement, other WTO members might claim they should have the same rights. WTO rules countries are not supposed to discriminate among trade partners.”²²²

175. The practicality and desirability of grandfathering EU trade agreements with some developing countries was also called into question. The Fairtrade Foundation argued that Economic Partnership Agreements (EPAs), EU trade agreements with developing countries, should not be replicated. They told us that:

217 Association of British Insurers ([UKT0006](#))

218 [Q454](#)

219 [Q163](#)

220 [Q163](#)

221 Law Society of England and Wales ([UKT0048](#))

222 Agriculture and Horticulture Development Board ([UKT005](#))

If the government were to replicate or seek to grandfather the EPAs it is likely to face criticism and public mobilisation against these deeply unpopular agreements. The government would be wise to apply the learning from the challenges facing the EU and avoid staking political capital on unpopular, discredited deals.

Further there is no guarantee that the relevant contracting parties to existing EPAs would agree to the grandfathering of these agreements without further negotiation. Free-trade agreements need to be supported by both partners and the UK cannot expect partners to simply continue to apply existing treaties when the political and economic dynamics have changed.²²³

Re-joining the European Free Trade Association

176. As well as fundamentally altering the UK's trading relationship to the EU, Brexit will likewise affect the UK's relationship to the non-EU EEA countries and Switzerland (which is currently mediated through the EU). Any UK-EU FTA would not automatically be replicated by those countries and the UK would need to negotiate new trade relationships with them.

177. All of these countries belong to the European Free Trade Association (EFTA), of which the UK was also a member from the Association's foundation in 1960 until 1973, when the UK joined the predecessor of the EU (the European Economic Community). It would be possible after Brexit for the UK to re-join EFTA; and doing so need not entail joining the EEA or constructing a Swiss-style bilateral relationship with the EU (both of which options have effectively been ruled out by the Government). The Freight Transport Association told us in evidence:

Considering trade with non-EU countries, joining EFTA would presumably allow the UK to accede to the Free Trade Agreements (FTAs) and other types of trade preferences and relationship established by EFTA with non-EU countries, although legal advice would be needed on whether the UK accession to EFTA would require renegotiation of these agreements and arrangements.

Under this scenario the UK would avoid having to start from scratch in negotiating FTAs with other countries. The EFTA States have 27 free trade agreements (covering 38 countries). From the perspective of avoiding a "cliff edge" and continuing trade relationships with the world following Brexit, this option appears attractive.²²⁴

178. We also heard from the Law Society that:

An advantage of being within the European Free Trade Association is that the UK would be able to undertake its own free trade agreements with third countries. The EFTA provides for a trading platform, participating in which the UK would be able to trade with the four EFTA States (in addition to

223 Fairtrade Foundation ([UKT0042](#))

224 Freight Transport Association ([UKT0033](#))

the EEA States, this includes Switzerland). The EFTA agreement is fully intergovernmental and its application is based on international law. Like the EEA agreement, only national governments can start a claim whereas under EU law a private party can do so.²²⁵

179. Re-joining EFTA would put the UK in reach of FTAs covering 19% of UK exports. Indeed, just five further FTAs (with the EU, the US, Japan, China and Australia) would be needed to cover 89% of UK exports.²²⁶

Capacity of DIT to undertake negotiations

180. Negotiating new FTAs is not something the UK has needed to do since joining the EU's predecessor in 1973. The British Exporters Association wrote that:

BExA is concerned that, having outsourced our trade negotiations to the EU, we do not have a body of trained negotiators for establishing trade arrangements both with the EU and to other countries and trading blocs. It has been reported that a bilateral trade agreement requires a trade team of between 50 and 100 experienced individuals. Although some of this number could conceivably work on simultaneous trade deals, it is fair to say that in order to negotiate the number of trade deals required, that the DIT and DExEU will require in excess of this number of trade specialists.²²⁷

181. DIT officials told us in November 2016 that the Department was building up a cadre of skilled staff who could undertake trade negotiations:

[W]e started from a core that was strong on trade policy, so we had about 45 people in June who were focused on trade policy, albeit within the context of that being a support position for the European Commission in the EU. That is the core that we are building from. We are about 100 up from that.²²⁸

182. They indicated that a negotiation team for an FTA might consist of between 50 and 100 people, but there could be “double-hatting”, with one person covering the same specialist area across more several sets of negotiations in parallel; and “sector specialists” might be drawn in from other Government departments. Other countries could typically undertake four or five sets of negotiations at once—but the DIT officials were unable to say how many the UK would be able to manage simultaneously, given that some negotiations would not be starting “from scratch”.²²⁹

183. In oral evidence to us in February 2017, the Permanent Secretary at DIT, Sir Martin Donnelly, said the Department was “confident that we are building the expertise we need to run really effective trade negotiations” and working with other departments that had staff with relevant skills. Sir Martin told us about the Trade Policy and Negotiations Faculty, which the Department had established in collaboration with the Foreign and

225 Law Society of England and Wales ([UKT0048](#))

226 Office for National Statistics, [Balance of Payments annual geographical data tables](#), February 2017; “[Free Trade Agreements](#)”, European Free Trade Association website; House of Commons Library

227 British Exporters Association ([UKT0036](#))

228 [Q31](#)

229 [Qq 31, 32, 37, 38](#)

Commonwealth Office.²³⁰ DIT informed us that: “To date, over 400 officials across several Government Departments, including the Cabinet Office, DExEu, DEFRA and BEIS have undertaken training provided by the Faculty”.²³¹

184. The Secretary of State was unable to say how many FTAs the Department could negotiate at once. DIT further told us in written evidence that: “Establishing and balancing [the interests involved in trade negotiations] is a complex task. The amount that we can do at any one time will depend upon budgets and resources.”²³²

Prioritising FTAs

185. Given that the resources of DIT are finite, the Government will need to prioritise countries or regions for new FTAs. Below we consider some of the options that have been suggested as possible places to start. The Government has already indicated that its first priority will be the countries with which the EU has existing FTAs.

186. The Secretary of State told us that the Government did not consider itself to be in a position of choosing between the EU and the rest of the world. If it does find itself in that position, there has been some debate over whether it will be possible to make up for lost trade with the EU with increased trade with other countries. The economic orthodoxy is that trade patterns follow the “gravity model”, which Dr Dingra explained as follows:

What we know from 50 years of trade data, and what has often [...] been called social physics, is that the law of gravity holds on trade data, which is to say most countries, whether we look at any time period, any set of countries, tend to trade much more with their closer trade partners, bigger, rich, close-by countries. By close by, this is both geographically as well as culturally.²³³

187. However, Professor Minford challenged the gravity model, saying that “If you look at trade data and relate it to GDP and a bunch of factors, you get the gravity equation, which is a very good predictor but it is not telling you what is driving that stuff”.²³⁴ He said that the model was “completely wrong in the case of the UK because we have always had a very far-flung set of relationships.”²³⁵

Large and growing markets

188. Dan Lewis, Chief Executive of the Economic Policy Centre, told us that the UK should focus its attentions on trade with the fastest growing parts of the world. He said that:

The basic issue is that in some ways Brexit is about rebalancing the British economy, in terms of trade, to the faster-growing parts of the world. That is what you should be aiming to do over the longer term. Europe has been very slow growing and seems set to be slow growing for some time. It is a declining part of the world economy.²³⁶

230 [Q466](#)

231 [Department for International Trade \(UKT0049\)](#)

232 [Department for International Trade \(UKT0049\)](#)

233 [Q86](#)

234 [Q95](#)

235 [Q94](#)

236 [Q241](#)

189. Perhaps unsurprisingly, a number of witnesses and evidence submissions suggested that the UK should focus its attention on large and growing markets, although there was by no means consensus on where the Government should start. The USA is the UK's largest single country trading partner and was mentioned by a number of witnesses as a priority.²³⁷ Despite a protectionist stance by President Trump, he has indicated that he wishes to conclude a trade agreement “very quickly” with the UK.²³⁸ We have already launched an inquiry to examine the pros and cons of a potential FTA with the US and will publish a further report on this in due course.

190. Other witnesses emphasised other large or growing markets. Mr Grech of TechCityUK said that:

In terms of size, Japan, China and the US are very big markets [...] Then there are markets where they are English speaking, including Australia—29% of our companies operate in Australia—and Singapore, but obviously they use Singapore as a hub for operating in other parts of Asia.²³⁹

The ABI suggested that the UK should focus on high growth markets: India, China, Hong Kong, Indonesia, Japan, Malaysia, Singapore and South Korea.²⁴⁰ The London Chamber of Commerce and Industry told us that: “At least two in five London business leaders consider potential trade deals with the USA (54%), China (48%) or India (41%) a high or essential priority for the UK.”²⁴¹

191. The Secretary of State told us that, beyond the countries with which the EU has FTAs, work was going on to investigate trade agreements with India, Australia, China, South Korea, New Zealand and “a collection of Gulf states”.²⁴² Additionally some confidential discussions were taking place.²⁴³

The Commonwealth

192. The Commonwealth, comprising 52 developed, emerging and developing nations, presents a range of potential trade options—and challenges—for the UK. Trade between the UK and the bloc declined markedly between 1948 and 1973, with UK goods exports to the group and Commonwealth goods imports to the UK both falling from 38% to 18%. From 1991 to 2011, however, UK exports changed from 9.2% and 8.8% (bottoming out at 7.4% in 2006); while Commonwealth imports rose steadily from 7.7% and 10.6%.²⁴⁴ Some observers have pointed out that the UK has much larger export partners outside the Commonwealth, noting also that other countries in the group such as Canada and Australia appear more intent on cultivating trade relations with the EU and China.²⁴⁵ While acknowledging the size and potential of UK markets in, for example, the US, the Department nevertheless sought to point out the growth potential represented by the UK's 51 Commonwealth partner nations:

237 [Qq241, 291, 343](#)

238 “Donald Trump: ‘Brexit will be a great thing . . . you were so smart’”, *The Times* website, 16 January 2017

239 [Q367](#)

240 Association of British Insurers ([UKT0006](#))

241 London Chamber of Commerce and Industry ([UKT0016](#))

242 [Q456](#)

243 [Q456](#)

244 *UK-Commonwealth Trade Statistics*, Standard Note [SNEP6497](#), House of Commons Library, December 2012

245 British Influence, [Brexit: the Commonwealth Dimension](#)

Around 80% of commonwealth countries benefit from preferential access to the UK market. This is a strong base from which to cultivate future trading arrangements with our commonwealth partners.²⁴⁶

The Royal Commonwealth Society also explained there was a trade advantage between nations in the bloc, noting that a recent study calculated that trade between two Commonwealth partners costs 19% less than between those that are non-Commonwealth.²⁴⁷

193. There are a number of ways in which the UK might seek to trade with Commonwealth countries, including via FTAs, through unilateral arrangements with developing countries and by increasing exports. We were told that a pan-Commonwealth FTA was unfeasible, at least in the short term, given the number and range of economies in the group.²⁴⁸ One suggested alternative is that the UK initially pursue agreements with open economies such as Australia, Canada and Singapore.²⁴⁹ Australia's High Commissioner to the UK reportedly said recently that "The fewer industries Britain wants to protect, the faster a trade deal can be done"²⁵⁰—although it has also been noted that Australia's priorities may lie with its own region and negotiating an EU deal.²⁵¹ The UK is Canada's largest EU export market and has a template deal in place through the CETA agreement with the EU,²⁵² although opinions differ on how straightforward it will be to replicate this bilaterally.²⁵³ Ahead of Canada, Singapore was the UK's leading Commonwealth export destination in the first three months of 2016.²⁵⁴ Its attractiveness as a potential gateway to business with other south Asian countries has been noted,²⁵⁵ as has its status as a hub for tech companies operating in the region.²⁵⁶ Singapore is also finalising an FTA with the EU.

194. India is also considered a key target, with recent forecasts suggesting that a deal could boost UK exports to the country by 50%.²⁵⁷ But India's Government has taken a more tentative approach to deals recently, following domestic unease about increased foreign competition,²⁵⁸ and, like other prospective deals, a UK-India agreement may require negotiations on migration.²⁵⁹

195. While those submitting evidence agreed that the Government should pursue FTAs with developed and emerging Commonwealth economies, they also stressed that this should not take place to the detriment of developing countries. The UK has preferential trading schemes and agreements with such nations, and these would lapse if alternative

246 Department for International Trade ([UKT0049](#))

247 Royal Commonwealth Society ([UKT0023](#))

248 Royal Commonwealth Society ([UKT0023](#)); British Influence, *Brexit: the Commonwealth Dimension*

249 The Free Enterprise Group, *Reconnecting with the Commonwealth: the UK's free trade opportunities*, January 2017

250 "Free trade means free trade, to borrow a phrase", *Telegraph* website, 6 October 2016

251 British Influence, *Brexit: the Commonwealth Dimension*

252 The Free Enterprise Group, *Reconnecting with the Commonwealth: the UK's free trade opportunities*, January 2017

253 Oral evidence taken before the International Trade Committee on [17 January 2017](#), HC(2016–17)934-i, Qq7, 8, 22

254 British Influence, *Brexit: the Commonwealth Dimension*

255 The Free Enterprise Group, *Reconnecting with the Commonwealth: the UK's free trade opportunities*; Royal Commonwealth Society ([UKT0023](#))

256 [Q367](#)

257 Commonwealth Secretariat press release, "[UK-India bilateral trade deal to boost UK's exports by 26 billion](#)", 9 November 2016

258 British Influence, *Brexit: the Commonwealth Dimension*

259 "[India warns UK immigration policy could wreck post-Brexit trade deal](#)", *Guardian* website, 6 November 2016

arrangements were not made in time for the UK's departure from the EU. Trading with the UK on WTO terms alone would add large sums to the import costs of some of the poorest countries in the world.²⁶⁰

196. Through its EU membership the UK participates in two main schemes with developing countries. First, there is the Generalised System of Preferences (GSP), a trade arrangement through which the EU offers certain foreign goods non-reciprocal preferential access to the EU market in the form of reduced or zero tariffs.²⁶¹ Secondly, the EU has a number of Economic Partnership Agreements (EPAs)—at different stages of implementation—with the African, Caribbean and Pacific (ACP) regions.²⁶² These are traditional FTAs which are intended to open up EU markets fully and immediately, but allow ACP countries long transition periods to open up partially to EU imports while providing protection for sensitive sectors.²⁶³

197. According to the Commonwealth Secretariat, a replacement UK GSP scheme should be achievable:

One straightforward option would be for the UK to devise its own GSP for LDCs [least-developed countries], providing duty-free and quota-free market access for all goods originating in LDCs, similar to that of the EU.²⁶⁴

But the Secretariat noted that future arrangements for grandfathering or replicating EPAs were more complex.²⁶⁵ A number of stakeholders agreed. Dr Peg Murray-Evans, Research Associate in the Department of Politics at York University, has explained that African opposition to the initial EPAs was a key obstacle to realising ambitious trade liberalisation, and questioned whether the UK's negotiating capacity should be focused on such countries, "most of which are ultimately of marginal significance as UK export destinations."²⁶⁶ The Fairtrade Foundation also pointed out that many developing countries resisted EPAs, signing them only under threat of tariff imposition:

developing countries were required to offer reciprocal access prematurely, undermining policy space and their ability to nurture emerging sectors. The inclusion of investor protection measures which allow investors to sue governments through unaccountable tribunals has been particularly problematic.

260 Commonwealth Secretariat, "[Concern over Brexit in vulnerable Commonwealth states](#)", August 2016. The Secretariat notes, for example, that goods from Bangladesh could incur an extra £220 million in tariffs if the country were to trade with the UK on WTO terms alone.

261 Two further elements of the GSP scheme are GSP+, an incentive arrangement offering tariff reductions to vulnerable countries that have ratified and implemented international conventions relating to human and labour rights, the environment and good governance; and the Everything But Arms (EBA) initiative which guarantees duty-free and quota-free access to the EU for all products except arms and ammunition for 49 least-developed countries.

262 The Royal Commonwealth Society ([UKT0023](#)) notes that the EU currently has EPAs with the Caribbean Forum, Southern African Development Community, South Africa, Cameroon, Papua New Guinea and Fiji; and that the EU has finalised but not yet applied EPAs with the East African Community, Singapore, and West African Community.

263 European Parliament, "[Trade regimes applicable to developing countries](#)"

264 Commonwealth Secretariat, "[Staging Brexit at the WTO](#)", December 2016

265 Commonwealth Secretariat, "[Staging Brexit at the WTO](#)", December 2016

266 Dr Peg Murray-Evans, "[Myths of Commonwealth Betrayal: UK–Africa trade before and after Brexit](#)", *Commonwealth Journal of International Affairs*, 13 October 2016

The foundation concluded: “Attempting to copy EPAs would be a missed opportunity to improve on EU policies.”²⁶⁷ Others have been more optimistic about securing deals, however, noting that in market size and sector focus the UK represents a more equal trading partner than the EU.²⁶⁸

198. FTAs are not, however, the only route to market. Lord Marland, Chairman of the Commonwealth Enterprise and Investment Council, has said that the focus on FTAs hides the real issue, which is that not enough small businesses are exporting.²⁶⁹ Lord Marland added that the abuse of the rule of law and a lack of trust in trading partners were barriers to trade for UK companies, and the Government should focus on increasing its capacity to support businesses confronted by such obstacles.²⁷⁰

Plurilateral agreements

199. It should be noted that the UK need not be restricted to bilateral FTAs. The Government told us that “As it has been challenging to reach agreements at the global level, the UK is also a strong champion for plurilateral agreements”, citing as an example its support for the expansion of the WTO Information Technology Agreement.²⁷¹

200. The Trade in Services Agreement (TiSA) is currently being negotiated on a plurilateral basis (including by the EU). The Brexit White Paper states that “The UK continues to be committed to an ambitious TiSA and will play a positive role throughout the negotiations”.²⁷² We heard evidence from several quarters in favour of the UK pressing ahead with these negotiations after Brexit²⁷³—although it was also suggested in one submission that TiSA could pose a threat to public services.²⁷⁴

Conclusions and recommendations

201. **Given that striking new FTAs is a major strand of the UK’s Brexit strategy, it is untenable that it should proceed in this work without clear knowledge of how far it can go towards negotiating new FTAs before it leaves the EU. Negotiators will need clear guidelines. While we accept that there is no precedent for this situation—and that the EU’s view could differ from that of the UK—the Government’s position must be clear. We request that the Secretary of State write to us setting out clearly the Government’s position on how far it can go towards negotiating new FTAs before the UK leaves the EU.**

202. **There is a further major element of uncertainty as the UK goes into the Article 50 process: how far is it possible for the UK to negotiate post-Brexit “grandfathering” arrangements in respect of FTAs to which we are currently a party in consequence of our EU membership? Here too, the Government must seek the earliest possible clarity. If such “grandfathering” is legally possible, particular effort should be put into this,**

267 Fairtrade Foundation ([UKT0042](#))

268 The Free Enterprise Group, *Reconnecting with the Commonwealth: the UK’s free trade opportunities*, January 2017

269 “Lord Marland: people are obsessed with free trade agreements”, *Guardian* website, 13 January 2017

270 [Q595](#)

271 Department for International Trade ([UKT0049](#))

272 HM Government, *The United Kingdom’s exit from and new partnership with the European Union*, [Cm 9417](#), February 2017, para 8.20

273 See for example: [Q368](#); Association of British Insurers ([UKT006](#)), Hook Tangaza ([UKT0046](#))

274 [StopTTIP uk](#) ([UKT0025](#))

with the setting out of a roadmap for this purpose, including early discussions with the WTO about the degree of proactive support they can provide to promote such a smooth transition.

203. We recommend that the Government now evaluate the implications of the UK re-joining the European Free Trade Association (EFTA), which would offer an opportunity for a smoother transition as the UK exits the EU in 2019. We were impressed by the potential benefits of EFTA membership, given there is close alignment between the UK's economy and those of EFTA members, albeit the UK would be considerably the largest member were it to join. The lighter-touch dispute and arbitration system of EFTA offers a more flexible process than that in operation across EU member states under the ECJ. In addition, membership would give significant advantages in the pursuit of new FTAs across the global economy, in a framework more suitable to UK policy following the referendum decision to exit the EU. And amending EFTA's 27 FTAs with 38 countries to include the UK could be a more straightforward way of substituting for the EU's FTAs should a "grandfathering" process in respect of the latter be legally impossible, or prove complex and time-consuming. The prospect of UK membership of EFTA from 2019 onwards could clearly be to Britain's advantage and we, therefore, recommend that the Secretary of State publish a White Paper on EFTA membership before summer 2017, so that negotiations can commence before the end of the year.

204. If it is legally possible to conduct negotiations regarding the "grandfathering" of EU FTAs and/or membership of EFTA and the adoption of EFTA FTAs during the Article 50 process, appropriate resources will need to be devoted to them. Yet these negotiations will be taking place at a time when the UK's trade negotiators are likely also to be negotiating a comprehensive FTA with the EU, as well as FTAs with other countries which are neither EU members nor parties to FTAs with the EU. *Clearly, there is a limit to how many FTAs can be negotiated at one time. There will have to be priorities (while taking account of issues related to the sequencing of negotiations). The Government must be clear about what those priorities are, what negotiating resources it is able and willing to procure, and how those resources will be deployed.*

205. We accept that there is a balance to be struck between not revealing the Government's hand on FTAs around the world and keeping Parliament informed. *Nonetheless, DIT should publish a broad strategy document on negotiating FTAs, describing and justifying the outlines of its approach.*

Conclusions and recommendations

Establishing the UK's position at the WTO

1. The UK's position in the WTO will be the foundation stone for all our future trading relationships after Brexit. DIT was, therefore, quite right to start work on this as soon as possible. There is no doubt that the UK is a member of the WTO in its own right, and establishing the bound-tariff element of separate UK schedules appears to be a straightforward matter. However, there is rather less certainty about how quickly and easily it will be possible to disaggregate the UK element from the quantitative aspect of the EU's schedules, in respect of Tariff Rate Quotas and Aggregate Measures of Support. (Paragraph 32)
2. *Nothing should be left to chance and the devil will be very much in the detail of these arrangements. DIT ministers should report to this Committee regularly, and at least every quarter, regarding the progress of this work.* (Paragraph 32)
3. *In addition, the Government must seek early legal clarity on the consequences for the UK in the event that separate UK schedules at the WTO have not been agreed or certified by the time that Brexit occurs. The Government should make sure it has whatever contingency arrangements may be necessary.* (Paragraph 33)
4. *The Government should consider that negotiations concerning the establishment of the UK's position at the WTO are appropriately sequenced with those concerning a UK-EU Free Trade Agreement (FTA)—for instance in respect of the UK's interest in the determination of the EU's revised Tariff Rate Quotas after Brexit.* (Paragraph 34)
5. *DIT must give a full account of the legislative and administrative preparations that the Government is making in respect of arrangements for UK trade defence instruments to take effect at the point of Brexit.* (Paragraph 35)
6. *Material changes to the UK's position at the WTO should be subject to appropriate parliamentary scrutiny. If applicable, the Government will need to consider how this will be achieved in respect of bound tariffs, Tariff Rate Quotas and Aggregate Measurement of Support. The Government should also clarify, when appropriate, what the purpose is of the Customs Bill that it proposes to bring forward.* (Paragraph 36)

"Deal"—a UK Free Trade Agreement with the EU

7. *The government must initiate negotiations for an EU-UK FTA, including customs arrangements and a phased process of implementation, in parallel to the Article 50 negotiations. The Government should identify and address the legal implications of doing so and should make clear how it will address the resourcing implications of doing so.* (Paragraph 122)
8. *The Government must seek a reciprocal tariff-free basis for trade with the EU after Brexit. In addition, a UK-EU FTA should seek to retain the mutual recognition of rules and standards, and conformity assessment, that the UK currently has as an EU member—bearing in mind the potential need to align rules and standards with those of other trading partners. Even if this is not possible, a UK-EU FTA should allow for*

equivalence of assessment (including mutual recognition of assessment), in order to minimise as far as possible the friction to trade caused by any regulatory barriers to trade in goods. (Paragraph 123)

9. *In respect of trade in services in general, a UK-EU FTA should seek as far as possible to reproduce the right of establishment and mutual recognition of professional qualifications from which the UK currently benefits as a member of the EU. Regarding trade in financial services, the Government should seek the nearest achievable approximation to the EU system of “passporting”. This is a matter to which the Committee will return, including the examination of regulatory change. (Paragraph 124)*
10. *It would be helpful if the Government could be clearer about the design principles for the dispute-resolution mechanism it will seek as part of a UK-EU FTA. In particular, it should say whether it envisages the possibility of such a mechanism involving provision for foreign investment protection along the lines of the Investor-State Dispute Settlement system. Clarity on how complex disputes in the financial services sector will be resolved without the involvement of the European Court of Justice (ECJ) would also be welcome. (Paragraph 125)*
11. *A UK-EU FTA should also take full account of the importance of inward investment for the UK economy, and the importance of UK outward investment into the remaining 27 member states. (Paragraph 126)*
12. *The Government says that it does not wish the UK to continue in a customs union with the EU and that it aspires instead to some form of post-Brexit “customs arrangement”—but the latter has thus far been described only in very vague terms. The current uncertainty is delaying investment decisions, particularly in the manufacturing sector. (Paragraph 127)*
13. *The Government must be much clearer about the defining characteristics of the proposed “customs arrangement” and explain how it would differ from a customs union. The Government should clarify if there will be a significant sectoral aspect to the arrangement they are seeking and whether that would impact on future international trade policy. (Paragraph 127)*
14. *Regarding the “phased process of implementation” which the Government envisages, it must take particular account of the need to avoid the sudden ending of passporting in financial services. Any such transitional arrangements will need to include fully worked-out arrangements for dispute resolution. (Paragraph 128)*
15. *As a general principle, we strongly urge that, in the interests of allowing businesses to adapt and plan for new trading arrangements with the EU, the Government provide as much certainty as possible, as early as negotiations allow. (Paragraph 129)*
16. *Whatever option applies, the Government must clarify arrangements for customs and border operations, and specify the expected number and intensity of customs checks. Planning for this is a matter of urgency now. (Paragraph 130)*

“No deal”—Trading under WTO rules alone

17. *The Government must set out as clearly as possible the likely consequences of trading under WTO rules alone. It must also show what contingency planning it is undertaking for that eventuality—including in respect of the legislation which it says it is prepared to bring forward “as necessary to mitigate the effects of failing to reach a deal”. (Paragraph 160)*
18. *When considering policies such as adopting a unilateral zero tariff policy, the DIT should produce evidence showing the likely winners and losers, and the amounts involved. This should also be carried out with the involvement of the devolved assemblies and governments of the UK. (Paragraph 161)*
19. It is quite clear that “no deal” is in effect a deal to trade with the EU under WTO rules. The Prime Minister has said that it is her ambition to seek tariff-free trade with the EU and frictionless customs arrangements. It is clear that WTO rules would not permit this. (Paragraph 162)
20. *Therefore, the “no deal” option should be discounted entirely. (Paragraph 162)*

UK Free Trade Agreements with non-EU countries

21. Given that striking new FTAs is a major strand of the UK’s Brexit strategy, it is untenable that it should proceed in this work without clear knowledge of how far it can go towards negotiating new FTAs before it leaves the EU. Negotiators will need clear guidelines. While we accept that there is no precedent for this situation—and that the EU’s view could differ from that of the UK—the Government’s position must be clear. (Paragraph 201)
22. *We request that the Secretary of State write to us setting out clearly the Government’s position on how far it can go towards negotiating new FTAs before the UK leaves the EU. (Paragraph 201)*
23. There is a further major element of uncertainty as the UK goes into the Article 50 process: how far is it possible for the UK to negotiate post-Brexit “grandfathering” arrangements in respect of FTAs to which we are currently a party in consequence of our EU membership? (Paragraph 202)
24. *Here too, the Government must seek the earliest possible clarity. If such “grandfathering” is legally possible, particular effort should be put into this, with the setting out of a roadmap for this purpose, including early discussions with the WTO about the degree of proactive support they can provide to promote such a smooth transition. (Paragraph 202)*
25. We recommend that the Government now evaluate the implications of the UK re-joining the European Free Trade Association (EFTA), which would offer an opportunity for a smoother transition as the UK exits the EU in 2019. We were impressed by the potential benefits of EFTA membership, given there is close alignment between the UK’s economy and those of EFTA members, albeit the UK would be considerably the largest member were it to join. The lighter-touch dispute and arbitration system of EFTA offers a more flexible process than that in

operation across EU member states under the ECJ. In addition, membership would give significant advantages in the pursuit of new FTAs across the global economy, in a framework more suitable to UK policy following the referendum decision to exit the EU. And amending EFTA's 27 FTAs with 38 countries to include the UK could be a more straightforward way of substituting for the EU's FTAs should a "grandfathering" process in respect of the latter be legally impossible, or prove complex and time-consuming. The prospect of UK membership of EFTA from 2019 onwards could clearly be to Britain's advantage and we, therefore, recommend that the Secretary of State publish a White Paper on EFTA membership before summer 2017, so that negotiations can commence before the end of the year. (Paragraph 203)

26. If it is legally possible to conduct negotiations regarding the "grandfathering" of EU FTAs and / or membership of EFTA and the adoption of EFTA FTAs during the Article 50 process, appropriate resources will need to be devoted to them. Yet these negotiations will be taking place at a time when the UK's trade negotiators are likely also to be negotiating a comprehensive FTA with the EU, as well as FTAs with other countries which are neither EU members nor parties to FTAs with the EU. (Paragraph 204)
27. *Clearly, there is a limit to how many FTAs can be negotiated at one time. There will have to be priorities (while taking account of issues related to the sequencing of negotiations). The Government must be clear about what those priorities are, what negotiating resources it is able and willing to procure, and how those resources will be deployed.* (Paragraph 204)
28. We accept that there is a balance to be struck between not revealing the Government's hand on FTAs around the world and keeping Parliament informed. (Paragraph 205)
29. *Nonetheless, DIT should publish a broad strategy document on negotiating FTAs, describing and justifying the outlines of its approach.* (Paragraph 205)

Annex 1: Terms of Reference

As matters currently stand, “Brexit” means that the UK’s trade relations with both the European Union and the wider world will need to be on a new footing from 2019.

In the absence of a settled way forward, the International Trade Committee wishes to examine the available options for the basis on which the UK’s international trading can take place after its withdrawal from the EU. The aim would be to identify as clearly as possible for each option:

- the respective advantages and disadvantages;
- the legal and political potential for realisation; and
- the implications for the agenda and resources of the Department for International Trade.

Written submissions are invited, from an economic, legal and/or political perspective, regarding the following issues:

Transition

- the implications of the “sequencing” of the steps towards Brexit (triggering Article 50, the two-year negotiating period, formally leaving the EU) for negotiating new UK trade arrangements;
- the necessity and potential for the UK to make medium-term transitional trading arrangements pending the conclusion of long-term agreements;

Parameters

- whether the distinction between so-called “Soft Brexit” and “Hard Brexit” is a useful one;
- the difference between “membership” and “access” in relation to the EU Single Market;
- what trade-offs might be involved in securing privileged access to the Single Market;
- the implications of Single Market access for UK trade in services (particularly “passporting rights” in respect of financial services);

Models for UK-EU trading relations

- membership of the European Free Trade Association, with or without membership of the European Economic Area / additional bilateral arrangements with the EU;
- a bespoke UK arrangement, such as the “Continental Partnership” model proposed by the think-tank Bruegel;

- maintaining a Customs Union with the EU, on the same or similar terms as certain other non-EU states;
- a bilateral free-trade agreement, such as the Comprehensive Economic and Trade Agreement with Canada;
- trading under World Trade Organization rules only (including the “most favoured nation” rule and the relevant schedule of tariff concessions);

Other issues

- the nature and extent of the EU’s external tariffs, customs checks and non-tariff barriers;
- whether the UK will be able after Brexit to continue trading under the terms of existing EU bilateral free-trade agreements with certain countries (on the basis of so called “grandfathering”);
- the terms on which major economies outside the EU (such as the USA, China and India) are able to trade with the rest of the world;
- the possibility and desirability of the UK adopting a unilateral free-trade, low-tariff or uniform-tariff approach;
- whether trading models operated by countries that belong to the Commonwealth might be applicable to the UK and the lessons of the UK’s historic trading relations with the Commonwealth before 1973.

Annex 2: The EU Single Market

The EU Single Market (or “internal market”):

- eliminates tariffs between member states;
- provides for a customs union between member states (with a Common Commercial Policy and Common External Tariff);
- reduces non-tariff barriers in respect of goods between member states (through harmonisation and mutual recognition of rules and standards);
- reduces barriers to trade in services between member states (through right of establishment and mutual recognition of professional qualifications).

The Single Market is underpinned by the “four freedoms”, by which EU members must abide—i.e. freedom of movement for:

- goods;
- services;
- capital;
- people.

EU members must also:

- pay financial contributions;
- abide by EU laws and regulations (the *Acquis Communautaire*, the accumulated body of EU law, takes precedence over national law and may have a direct effect on member states);
- adhere to rulings of the European Court of Justice (which is a superior court to all national courts);
- abide by EU sectoral policies (such as the Common Agricultural Policy and the Common Fisheries Policy).

At the same time, they participate fully in EU institutions (including the European Parliament).

Any non-EU country can gain access to the Single Market (i.e. trade with EU countries), but the terms of that access vary greatly:

- The three non-EU members of the European Economic Area (Norway, Liechtenstein and Iceland) have access to the Single Market in respect of most goods and services on terms similar to those enjoyed by EU members (and they are sometimes referred to as being “members” of the Single Market). There are corresponding obligations to: abide by the four freedoms; contribute financially to the EU; accept a large proportion of EU laws and regulations; and be subject

to the rulings of the European Free Trade Association Court, which must take account of the rulings of the ECJ. Non-EU EEA countries are not: part of the EU customs union; bound by EU sectoral policies; or represented in EU institutions.

- By means of a series of bilateral Free Trade Agreements with the EU, Switzerland has a high degree of access to the Single Market in all non-agricultural goods and some services. There are corresponding obligations to: abide by the four freedoms; make a relatively small financial contribution to the EU; and adapt domestic legislation to reflect some EU regulations. Switzerland is not: part of the EU customs union; bound by EU sectoral policies; represented in EU institutions; or subject to the ECJ.
- Turkey's customs union with the EU allows it to trade tariff-free with the Single Market in manufactured goods and processed agricultural goods only. There is a corresponding obligation to impose a common external tariff on all manufactured goods and processed agricultural goods entering Turkey from outside the EU. (Turkey is, however, not an automatic beneficiary of the trade advantages that EU members enjoy in respect of countries with which the EU has FTAs.) In addition, EU product regulations must be applied. There are no corresponding obligations on Turkey in respect of: the four freedoms; financial contributions to the EU; EU laws; and EU sectoral policies. Turkey is not represented in EU institutions. A small number of European microstates are also in customs unions with the EU.
- The EU has FTAs with some 50 countries. These agreements give varying types and degrees of access to the Single Market—substantially (but not entirely) in relation to goods.
- The rest of the world trades with the EU on the basis of WTO rules alone, meaning that their exports to the EU are subject to the EU's tariffs under WTO rules, as well as other trade barriers. Likewise, EU exports to those countries are subject to the tariffs that they operate under WTO rules and other barriers to trade.

Formal Minutes

Wednesday 1 March 2017

Members present

Angus Brendan MacNeil, in the Chair

Liam Byrne	Chris Leslie
James Cleverly	Shabana Mahmood
Marcus Fysh	Toby Perkins
Mr Ranil Jayawardena	Sir Desmond Swayne
Sir Edward Leigh	

Draft Report (*UK trade options beyond 2019*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 205 read and agreed to.

Annexes 1 and 2 and Summary agreed to.

Resolved, That the Report be the First Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Wednesday 15 March at 10.00 a.m.]

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the [inquiry publications page](#) of the Committee's website.

Tuesday 29 November 2016

Question number

John Alty, Director General, Trade Policy Group, **Oliver Griffiths**, Director, Capability, Trade Policy Group, **Paul McComb**, Programme Director—Transition, and **James Norton**, HR and Organisational Development Director, Department for International Trade [Q1–57](#)

Professor Patrick Minford, Professor of Applied Economics, Cardiff University and Co-chair of Economists for Brexit, **Martin Howe QC**, Economists for Brexit and Lawyers for Britain, **Dr Swati Dhingra**, Centre for Economic Performance, The London School of Economics and Political Science, and **Professor Jim Rollo**, UK Trade Policy Observatory, University of Sussex [Q58–105](#)

Tuesday 13 December 2016

Roderick Abbott, former Deputy Director-General, World Trade Organization and European Commission Directorate-General for Trade, and **Dr Federico Ortino**, The Dickson Poon School of Law, King's College London [Q106–163](#)

Peter Ungphakorn, former Senior Information Officer, World Trade Organization Secretariat, and **Professor Fiona Smith**, School of Law, University of Warwick [Q164–204](#)

Tuesday 10 January 2017

Professor L. Alan Winters, UK Trade Policy Observatory, University of Sussex, **Dan Lewis**, Chief Executive, Economic Policy Centre, **Gary N. Horlick**, Attorney-at-Law, International Trade Lawyer [Q205–263](#)

Tuesday 17 January 2017

Mike Hawes, Chief Executive, Society of Motor Manufacturers and Traders, **Mike Spicer**, Director of Research and Economics, British Chambers of Commerce, and **Peter Hardwick**, Head of Exports, Agriculture and Horticulture Development Board [Q264–308](#)

Tuesday 24 January 2017

Sir Andrew Cahn, former head of UK Trade and Investment, **Owen Tudor**, Head of European Union and International Relations, TUC, and **Sean McGuire**, Director, CBI Brussels [Q309–343](#)

Mickael Laurans, Interim Head of International Policy and Engagement, Head of Brussels (European Union and World Trade Organization) Affairs, The Law Society, **Hugh Savill**, Director of Regulation, Association of British Insurers, and **Gerard Grech**, CEO, Tech City UK [Q344–375](#)

Tuesday 31 January 2017

Professor Niamh Moloney, Professor of Financial Markets Law, The London School of Economics and Political Science, and **Allister Heath**, Deputy Editor, The Telegraph

[Q376–413](#)

Anthony Browne, Chief Executive, British Bankers' Association, **Chris Cummings**, Chief Executive, The Investment Association, and **Gary Campkin**, Director of Policy and Strategy, The City UK

[Q414–444](#)**Wednesday 1 February 2017**

Rt Hon Dr Liam Fox MP, Secretary of State for International Trade and President of the Board of Trade, and **Sir Martin Donnelly KCB CMG**, Permanent Secretary, Department for International Trade

[Q445–525](#)**Tuesday 7 February 2017**

Lord Jones of Birmingham Kb, former Minister of State for Trade and Investment, **Lesley Batchelor OBE**, Director General, Institute of Export, and **Marcus Dolman**, Co-Chair, British Exporters Association

[Q526–585](#)

Dr Mohammad Razzaque, Economic Adviser, Commonwealth Secretariat, **Dr Peg Murray-Evans**, University of York, **Lord Marland**, Chair, Commonwealth Enterprise and Investment Council, **Professor Nauro Campos**, Brunel University London

[Q586–621](#)**Tuesday 28 February 2017**

Colin Lawther, Senior Vice President, Manufacturing, Supply Chain Management and Purchasing, Nissan

[Q622–739](#)

Published written evidence

The following written evidence was received and can be viewed on the [inquiry publications page](#) of the Committee's website.

UKT numbers are generated by the evidence processing system and so may not be complete.

- 1 ADS Group ([UKT0013](#))
- 2 Agriculture & Horticulture Development Board ([UKT0005](#))
- 3 Association of British Insurers ([UKT0006](#))
- 4 Association of British Insurers ([UKT0050](#))
- 5 British Ceramic Confederation ([UKT0003](#))
- 6 British Chambers of Commerce ([UKT0022](#))
- 7 British Exporters Association ([UKT0036](#))
- 8 Center for Global Development in Europe ([UKT0037](#))
- 9 Country Land & Business Association ([UKT0012](#))
- 10 Dairy UK ([UKT0029](#))
- 11 Department for International Trade ([UKT0002](#))
- 12 Department for International Trade ([UKT0049](#))
- 13 Dr Anamaria Nicolae ([UKT0017](#))
- 14 Economic Policy Centre ([UKT0030](#))
- 15 Economists for Brexit ([UKT0024](#))
- 16 Fairtrade Foundation ([UKT0042](#))
- 17 Falkland Islands Government ([UKT0039](#))
- 18 Freight Transport Association ([UKT0033](#))
- 19 Friends of the Earth (England, Wales and Northern Ireland) ([UKT0028](#))
- 20 General Council of the Bar of England and Wales ([UKT0040](#))
- 21 Hook Tangaza ([UKT0046](#))
- 22 Institute of Export and International Trade ([UKT0054](#))
- 23 Institute of Export and International Trade ([UKT0055](#))
- 24 Keep Our NHS Public ([UKT0027](#))
- 25 Liverpool Law School ([UKT0034](#))
- 26 London Chamber of Commerce and Industry ([UKT0016](#))
- 27 Mr Martin Allen ([UKT0026](#))
- 28 Mr Peter Ungphakom ([UKT0051](#))
- 29 Mr Peter Ungphakom ([UKT0052](#))
- 30 Mr Peter Ungphakom ([UKT0053](#))
- 31 Mr Timothy Flitcroft ([UKT0044](#))
- 32 Ms Cheryl Coyne ([UKT0043](#))
- 33 National Farmers' Union ([UKT0032](#))

- 34 Overseas Development Institute ([UKT0041](#))
- 35 Polar Research and Policy Initiative ([UKT0045](#))
- 36 Royal College of Nursing ([UKT0038](#))
- 37 Royal Commonwealth Society ([UKT0023](#))
- 38 Society of Motor Manufacturers and Traders ([UKT0035](#))
- 39 StopTTIP UK ([UKT0025](#))
- 40 Tate & Lyle Sugars Ltd ([UKT0015](#))
- 41 The Investment Association ([UKT0014](#))
- 42 The Law Society ([UKT0048](#))
- 43 Trade Justice Movement ([UKT0011](#))
- 44 Traidcraft ([UKT0020](#))
- 45 UK Trade Policy Observatory ([UKT0019](#))
- 46 Which? (UKT0031)