



Brexit snapshot

BREXIT AND TRADE LAW ISSUES

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Introduction¹

Following the UK's departure from the EU on 31 January 2020, attention now turns to the negotiation of a Free Trade Agreement (FTA) to come into force once the agreed transition period comes to an end. The Withdrawal Agreement signed by the UK and the EU on 17 October 2019 stated that the UK would continue to apply EU trade policy during the transition period, and that any trade agreements signed by the UK would not enter into force until the transition period had ended. The EU also confirmed that it would write to third countries with which it has trade agreements to request that the UK continue to benefit from such agreements during the transition period.

The (non-legally-binding) Political Declaration, which was agreed alongside the Withdrawal Agreement, set out the aspiration for the UK and the EU to agree a "*comprehensive and balanced*" FTA. However, because of the delay in obtaining UK parliamentary ratification of the draft Withdrawal Agreement, and in passing the associated legislation, the timescale for negotiating the proposed FTA has been seriously truncated, leaving only 11 months to negotiate and sign a deal before the transition period comes to an end on 31 December 2020.²

The new President of the European Commission, Ursula von der Leyen, has made clear her reservations surrounding Boris Johnson's plan to conclude negotiations on the future relationship between the UK and the EU by the end of the year. Speaking at the London School of Economics in January 2020, she said: "*Without an extension of the transition period beyond 2020, you cannot expect to agree on every single aspect of our new partnership*", adding that the UK could face difficult trade-offs between market access and regulations: "*Without a level playing field on environment, labour, taxation and state aid, you cannot have the highest quality access to the world's largest single market*". The EU's chief Brexit negotiator, Michel Barnier, in a speech delivered in Stockholm shortly afterwards, reiterated this message, referring to the "*hugely challenging timescale*" being proposed by the UK. According to the Guardian newspaper: "*A scrappy, relatively unambitious, low-alignment trade deal is arguably the most plausible landing zone, in contrast to a deal that keeps both sides economically close and the UK locked into the EU's regulatory orbit*".

International trade law – the basics

Tariff and trade law is complicated, so the text box below summarises the issues which need to be considered in terms of the UK's future trading arrangements with the EU27 states (both on the basis of an FTA having been

¹ For further information on the current position in relation to the negotiation of a Free Trade Agreement between the UK and the EU, refer to our client briefing "[Brexit: where do we go from here?](#)" (February 2020).

² Although the Withdrawal Agreement provides for a one-time extension to the transition period (for either one or two years) the UK government has said that it will not be seeking any extension to the 31 December 2020 date, and the European Union (Withdrawal Agreement) Act 2020 includes a provision prohibiting UK government ministers from doing so.

negotiated between the UK and the EU, and if the UK were to depart without an FTA) as well as with non-EU countries.

Free trade comes in many forms, ranging from single markets³ to customs unions⁴, to association agreements⁵, to FTAs⁶ as well as other permutations.

The UK and import tariffs in a post-Brexit world

Background

The World Trade Organisation (WTO) sets global rules for trade in goods and services and oversees those rules – although it is currently facing considerable challenges in the enforcement of these rules on account of the United States having recently decided not to approve appointments of new panel members to its appellate body for disputes.

The UK is a member of the WTO in its own right. As such, the UK does not need to apply to re-enter the WTO once it is no longer treated as a member of the EU at the end of the Brexit transition period.

Future trade with the EU

Since joining the European Communities on 1 January 1973, the UK has been able to conduct its global trade operations (outside the EU) under the terms of various bilateral or multilateral agreements which the EU, as a block of countries, has negotiated with a significant number of major trading partners. In addition, the EU has entered into various bilateral agreement with other countries on matters such as taxation, which are not regulated by the EU's international trade agreements. These EU international agreements cover many areas of economic activity and, importantly, set out the applicable tariffs (taxes on imports of goods) and quotas (limits on the volume of goods).

As a member of the EU, and until the end of the transition period, the UK (and all other countries in the EU) can export to all the other countries **within the EU** on a **tariff-free and quota-free basis**.

From the end of the transition period the UK will need to have in place its own tariffs and quotas for imported goods from the EU, as well as from third countries. In principle, the UK can expect to be subject to similar tariffs and quotas irrespective of whether it is exporting to the EU or to a third country. This is because a fundamental principle of GATT (the General Agreement on Tariffs and Trade 1994, which is one of the main WTO agreements and which relates to trade in goods) is the so-called "Most Favoured Nation" (MFN) principle, under which a

³ The creation of a "single market" (originally known as the "common market") lies at the heart of the EU. The rules for the EU single market require free movement from one EU member country to another of goods, people, services and capital (the so-called 'four freedoms'). The rules take two forms: (1) they remove barriers to trade; and (2) they harmonise, or unify, national rules at EU level.

⁴ A "customs union" is where a group of states agree to charge the same import duties as each other and is usually accompanied by a free trade agreement. A customs union reduces administrative and financial trade barriers such as customs checks and charges, and boosts economic co-operation. The advantages for the UK of leaving the EU customs union are that it would be able to negotiate free trade deals with non-EU countries. The disadvantages are that, although it could still trade with EU countries, the UK would face tariffs and other non-tariff barriers such as rules of origin checks, and vice-versa - pushing up the cost of goods.

⁵ An **association agreement** (AA) is a treaty between the states which creates a framework for co-operation between them. Areas frequently covered by such agreements include the development of political, trade, social, cultural and security links. The EU typically concludes AAs in exchange for commitments to political, economic, trade or human rights reform in a country and, as a quid pro quo, the country may be offered tariff-free access to some or all EU markets as well as financial or technical assistance. Most recently signed EU AAs also include a free trade agreement between the EU and the third country.

⁶ A **free trade agreement** (FTA) is defined by the World Trade Organisation as an agreement between countries that removes tariffs and other restrictions on "substantially all" goods traded between them, thereby forming a free-trade area between them. These agreements differ from customs unions in that countries remove tariffs on goods traded between them but do not adopt the same tariffs on goods imported from third countries. Because FTA partners charge different external tariffs, FTAs require complex rules which define whether a good produced in one FTA partner is eligible for tariff-free treatment in another. These "rules of origin" prevent valuable parts such as engines and high-tech components that are made outside an FTA from being slipped into a high external tariff FTA partner from a low external tariff FTA partner.

country which chooses to charge tariffs on imports must, subject to a number of permissible exceptions, charge the **same** tariffs to all other WTO countries.

Article XXIV of GATT sets out the permissible exceptions to the MFN principle. For example, two or more countries can decide to establish between themselves either a customs union or a free trade area, as is the case with the EU: the Treaty of Rome established a permissible customs union between EU member states as defined in Art. XXIV(8)(a) of GATT, under which all the tariff rates for intra-EU trade are set to zero.

The non-legally binding Political Declaration signed by the UK and the EU in October 2019 sets out their future trade aspirations, stating that: "*[t]he Parties agree to develop an ambitious, wide-ranging and balanced economic partnership. This partnership will be comprehensive, encompassing a Free Trade Agreement ...*" and "*[t]he economic partnership should through a Free Trade Agreement ensure no tariffs, fees, charges or quantitative restrictions across all sectors with appropriate and modern accompanying rules of origin ...*".

If the UK leaves the EU with a FTA which falls under Art. XXIV(8)(b) of GATT then the UK can negotiate with the EU the continuation of zero tariffs and quotas on goods originating in the UK when exported to the EU and vice versa. However, particularly given the short negotiating timeframe, there is no guarantee that this will be the outcome, despite the aspirations set out in the Political Declaration.

The UK Prime Minister, Boris Johnson, has stated that he is planning to negotiate a "**super-Canada-plus free trade agreement**"⁷ with the EU but if he is unable to do so and the UK departs the EU without any form of trade agreement being in place, then WTO rules would immediately apply to trade between the UK and the EU. The MFN principle would mean that the EU would be required to apply its standard external tariffs to goods imported from the UK, and the UK would be required to apply its own standard external tariffs (i.e. the tariffs it charges to other countries such as Russia, the United States and Brazil) to goods imported from the EU.

Future trade between the UK and non-EU countries

As an EU member, the UK is currently party to approximately 40 trade agreements (some bilateral, some multilateral) which the EU has negotiated with more than 60 countries. For example, the United States has [over 20 agreements](#) with the EU covering areas as diverse as civil aviation safety to duties payable on the import of rice.

The UK will lose the benefit that it currently enjoys under these trade agreements, no later than at the end of the transition period, possibly earlier, upon Brexit. The UK is therefore in the process of negotiating new trade deals with a number of non-EU countries. Bilateral agreements take time to negotiate, and the UK government has been issuing regularly updated guidance on the current status of the various EU trade agreements which it has been able to "roll over" so that equivalent trading terms would apply to the UK post-Brexit: see [UK trade agreements with non-EU countries in a no-deal Brexit](#) for further details.

These new trade agreements should ideally be in place for 1st January 2021. If this is not achievable, UK exports to these countries will be subject to the general rules of the WTO, as well as the import tariffs and other legal requirements of the importing third countries.

The UK had initially sought to address this issue by submitting to the WTO in 2018 a new, draft WTO Goods Schedule, effectively "copy and pasting" the existing EU Schedule other than where that schedule contained quotas, in which it split the quotas according to a complex formula.

⁷ In October 2016 the EU and Canada signed the Comprehensive Economic and Trade Agreement (CETA) under which all tariffs on goods traded between Canada and the EU are being removed within an agreed timeframe, and under which the EU and Canada are opening up public contracts at local, regional and federal levels to each other's contractors. In addition, the EU and Canada have agreed to co-operate on the alignment of regulatory standards, and CETA will also allow professional qualifications to be recognised both in Canada and the EU.

Under WTO procedures, the WTO Director-General is permitted to certify a draft schedule as 'official' 90 days after its submission provided no WTO member has signalled an objection. Unfortunately for the UK, a number of members indicated that they had objections to the quota split, and therefore the Director-General was unable to approve the draft schedule. Case law indicates, however, that the UK would nonetheless be free to give effect to its new schedule for goods, despite this certification process not having been completed – although this could only ever be a temporary solution.

This issue demonstrates the challenges which lie ahead for the UK post-Brexit, with or without an FTA with the EU: it will represent a much smaller market than when it formed part of the EU and will therefore wield less power in trade agreement negotiations, while at the same time its exported goods will become more expensive by virtue of being subject to higher tariffs than those of its competitors.

A particular problem for both the UK and the EU relates to the splitting of the quotas which were negotiated as a single trade area, such as in the case of certain agricultural products (e.g. beef, lamb and sugar) from non-EU countries. And time is running out to complete what are always complex negotiations, in which every country will be standing up for its own interests.

Customs delays

As well as the direct cost implications from the application of import tariffs, the imposition of tariffs also introduces the need for physical infrastructure in order to police these arrangements. At present, the EU's "single market" means that goods move freely around the EU, whereas in the event of no FTA being agreed, the UK/EU frontier would have two "sides", each of which would require its own customs checks.

There is therefore a significant risk that delays could occur when clearing customs. For businesses importing goods from outside the UK, it will be important to agree at contract negotiation stage which party will be responsible for bearing this risk. Manufacturers will want to avoid being in default under their supply agreements simply because otherwise compliant goods have been delayed by having to undergo customs checks, or from tailbacks at customs checkpoints. Equally, customers may object to being on the hook for matters which are outside their control.

No-deal Brexit

As described above, in the event of no FTA having been signed by the end of the transition period, from 1 January 2021 trade between the UK and the EU would be on non-preferential terms and WTO tariffs would immediately apply. These are the tariffs which the UK currently charges to any "third countries", of which the EU would become one. WTO rules contain detailed and complex tables setting out (often at component level) which tariffs apply to different goods traded between parties.

Probably the easiest way to explain how WTO tariffs apply is to use an example, based on the type of international contractual matrix one comes across in major infrastructure projects.

One particular category of infrastructure which demonstrates the scale of the complexity involved are contracts for the construction and operation of trains - termed "rolling stock" within the rail industry. The operating model in the rail sector is that the Department for Transport enters into rail franchise agreements with train operating companies ("TOCs") setting out the terms on which train services need to be provided for the duration of the franchise (e.g. 7-15 years). TOCs typically enter into leasing agreements with rolling stock leasing companies ("ROSCOs") to hire the rolling stock required to provide the train service. The ROSCOs then typically enter into a Manufacturing and Supply Agreement ("MSA") with train manufacturers, many of whom are based outside the UK, for the provision of the required rolling stock.

Applicable tariff rates when importing such rolling stock into the UK will depend on whether the UK has negotiated a bilateral agreement with the country in which the rolling stock is manufactured. It will also depend on whether the ROSCO decides to import completed trains, or to import composite parts/materials, as the applicable tariffs can vary greatly. Set out below are some examples of average WTO tariffs which apply when importing into the EU. Note that these are average tariffs only: there are a myriad of WTO codes and within the codes there may be some variation.

Examples of materials/goods and average tariffs⁸

- Railway or tramway locomotives rolling stock (*this includes parts, fixtures and fittings and traffic signalling*): 2% average. But note the following rates for composite parts:
 - rail locomotives powered from an external source of electricity: 1.7%
 - diesel/electric locomotives: 1.7%
 - other locomotives: 1.7%
 - self-propelled railway or tramway: 1.7%
 - coaches: 1.7%
 - other parts of tramway locomotives or rolling stock (including bogies, brakes, couplers, etc.): 1.7%
- Iron and steel: 0.1%
- Aluminium: 6.8%
- Electrical Machinery: 2.4%
- Miscellaneous manufactured articles: 2.8%
- Carpets and other textiles, floor coverings: 7.9%
- Special woven fabrics: 7.7%
- Glass and Glassware: 4.9%

⁸ These figures have been extracted from the government website: www.trade-tariff.service.gov.uk which sets out commodity codes, duty and VAT rates.

Conclusion

To conclude, at this stage there are many questions surrounding the UK's future international trading arrangements post-Brexit, but precious few answers. What type of trade agreement – if any – will Boris Johnson manage to negotiate with the EU? What is the likelihood that he will request an extension to the implementation period? And how many bilateral trade agreements with non-EU countries will the UK succeed in signing before the end of 2020? We will need to keep a close eye on developments.

The fact that Ireland's Phil Hogan, a vocal opponent to Brexit on account of its potential impact on the Irish economy, has recently been appointed as the EU's new Trade Commissioner, is an important factor to take into account. He recently gave an upbeat prediction of how quickly trade negotiations could begin, saying that the EU would be ready to go "before St Patrick's Day" [17 March] this year. In remarks which will be seen as encouraging for Boris Johnson, Mr Hogan said that because the UK had been part of the EU's trading regime for 45 years neither side would be starting from scratch in the negotiations: "*We're not starting from zero so therefore I believe we can do - with a bit of goodwill on both sides - an agreement more quickly than we would do with any other negotiations around the world which would take three or four years.*"

Time will tell whether this optimism is misplaced or not.

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