

External trade policy and a UK exit from the EU – the UK's WTO profile and beyond

BBA Brexit Quick Briefs are a series of short papers intended to inform readers about key commercial, regulatory and political considerations around Brexit. While they are focused on banking, many of the issues discussed have wider relevance. Each BQB may be read on its own or in conjunction with other papers in the series. It is intended to expand the series as further topics of significance are identified. Further information is available at www.bba.org.uk.

Key points

Today, as a member state of the European Union (EU), the UK's external trade policy is in most respects made collectively with the rest of the EU on the basis of the commitments the EU makes to other World Trade Organisation (WTO) members. These commitments determine the basic access for goods and services from other countries in the rest of the world (RoW) to the EU market, including the UK, and establish the access that UK-based financial services firms can rely on in the RoW.

Upon departure from the EU, the UK will need to focus on the following priorities as part of its future trade policy:

- **Establish the UK's WTO commitments.** These are the foundation and baseline for all other trading negotiations. This is not an automatic process. Establishing the UK's position under the WTO framework will be one of the most important building blocks for developing the UK's external trade policy both with the EU and the RoW. For financial services, the basic framework by which WTO members commit to provide access to their markets is set out in the WTO General Agreement on Trade in Services (GATS). This process is complex and could be contested.
- **Re-establish existing free trade agreements (FTAs) with third countries in the RoW currently derived under the UK's membership of the EU.** Existing FTAs entered into on the UK's behalf by the EU with markets such as South Korea, Singapore and Canada will also need to be translated to the UK when it leaves the EU. Both the UK and these trading partners have a shared interest in ensuring that these FTAs are translated as closely as possible at the point at which the UK leaves the EU to minimise disruption to trade. Many of these contain important elements for banking and financial services.

- **Re-establishing other framework arrangements with third countries in the RoW currently derived under the UK's membership of the EU.** There are also important arrangements for importers and exporters of financial services in the UK that are embedded not in FTAs but in other EU legal frameworks in areas such as market infrastructure (e.g. European Market Infrastructure Regulation) and data protection (e.g. Data Protection Directive). These will affect the UK's relationships with both the EU and with other third countries in the RoW and will require replication in the UK's new domestic frameworks to ensure continuity for existing trade. Examples include the frameworks for cooperation and mutual recognition between regulators of market infrastructure in the EU and the US.
- **Identifying priority third countries in the RoW with which to establish new and ambitious trade agreements.** Outside of the EU the UK will be in a position to pursue new FTAs with other partners. Market access arrangements for financial services in even the most advanced EU FTAs are limited and this will be an area in which the UK should aim to go further in developing new frameworks for cross border trade. It will also be important to focus on improving conditions for UK exporters of financial services outside of the framework of FTAs through regulatory cooperation and support for market reform in the UK's trading partners.

Traditionally, FTAs have concentrated primarily on liberalising trade in goods more than on services. Market access arrangements for financial services in even the most modern FTAs are limited. For a modern developed economy such as the UK, for which the services sector is a major contributor, it will be important to consider how a 21st century FTA and other frameworks can be developed so as to be more suited for this evolution.

How is external trade policy conducted as an EU Member State?

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Leaving the EU will require that the UK re-establish a trade policy of its own. As part of this the UK will need to:

- Confirm its place in the WTO and the establishment of its own external tariffs and schedule of commitments for goods and services.
- Negotiate what is to happen to the large number of FTAs to which it is currently party by virtue of being an EU Member State. This includes its relationship with the EU itself, if this is to be replaced with a bilateral agreement such as a Free Trade Agreement (FTA).
- Ensure operational rights for foreign firms in the UK currently established under EU law are translated into UK law and practice as part of the Great Repeal Bill, ensuring mutual recognition of these rights where relevant.
- Establish a forward agenda of new trade agreements that the UK will aim to seek with trading partners once it has left the EU.

Box 1: The EU Common Commercial Policy

As a member state of the EU, the UK is part of the Common Commercial Policy of the EU. Because internal trade within the EU is heavily liberalised, especially for physical goods, it is necessary for EU Member States to harmonise their approach to imports of both goods and services from outside the EU as well. For this reason, the UK shares a single set of external tariffs with the other states of the EU and negotiates with external trading partners on access to their markets collectively with the EU. In both cases these negotiations are done on the UK's behalf by the EU.

This arrangement also determines the basic commitments that the UK makes on access to its market for financial services, which are defined by the EU's commitments in this area. It also shapes the access that financial services exporters from the UK can rely on abroad, where these are defined in FTAs agreed by the EU on the UK's behalf.

In all of these respects, exiting the EU will have practical consequences for the UK. It will have to establish its own external tariffs separate from those of the EU and will need to secure for itself a range of agreements with other countries that it currently benefits from by virtue of membership of the Common Commercial Policy. These implications are discussed below.

Establishing a WTO profile for the UK

The UK is a member of the WTO in its own right. However, a number of important elements of its WTO membership are currently defined by commitments made at the level of the EU. These include the 'most favoured nation' (MFN) terms that the UK offers as part of the EU. These are the guarantees of market access and non-discriminatory treatment that the UK commits to for all other WTO members with which the EU does not have preferential trading agreements.

Following the UK exit from the EU, the UK will need to establish its own schedule of WTO commitments. In banking and financial services the most important aspect of establishing this new framework is the confirming of the content of the UK's schedule of commitments under the General Agreement in Trade in Services or GATS. This is the WTO agreement that governs trade in services between WTO members.

The GATS requires that all WTO members draw up 'schedules' indicating the minimum rights that they will grant companies from all other WTO members with respect to the market access and operational rights in their own market. WTO members are free to go beyond the commitments made in their services schedule and provide more generous treatment through their national licensing regimes, but they cannot provide less than the access set out in their GATS schedule.

Some WTO members, including the EU, are also party to the WTO Understanding on Commitments in Financial Services (UCFS). This agreement adds additional guarantees for the treatment of foreign financial services firms. These include expanded rights to move staff into a market, non-discrimination in terms of access to payment and clearing systems and organised securities markets and open access to public procurement of financial services. However, the UCFS also confirms the rights of regulators to discriminate against foreign financial services firms for prudential reasons. The UK will also wish to accede to the UCFS in its own right.

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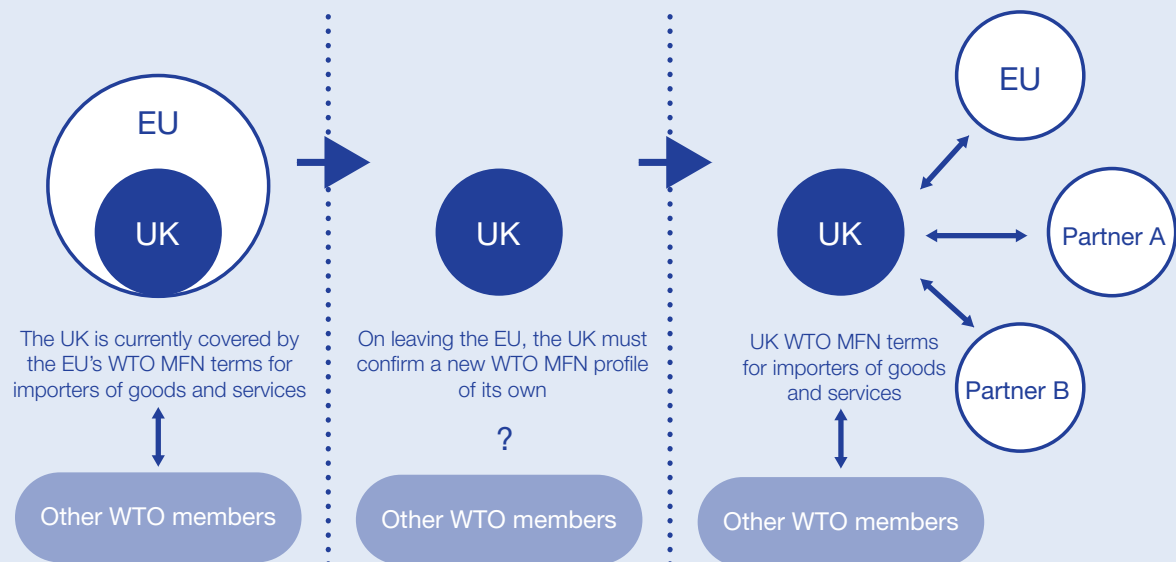
However, in practice, the UK's national licensing regime will define the key terms of market access, which may be more substantial in many cases than the UK's GATS commitments. It is worth noting in this respect that the UK's existing licensing regime is more open compared to that of other EU Member States and provides for a number of exemptions that banks from EU Member States and third countries from the RoW can rely on to secure access to the UK market.

Box 2: Why does establishing a WTO profile matter for the UK and some of the key issues

All WTO members maintain a schedule of commitments that define the terms on which they trade with all other WTO members with which they do not have a preferential trading agreement. This sets the maximum tariffs it levies at the border on imports and defines the minimum conditions it guarantees for access to its markets for services. At present these terms are defined for the UK by the EU's WTO schedules.

On leaving the EU, the UK will need to establish such a profile for itself. Such a profile is important for the UK both as the basis for its trade with all other WTO states and also as the baselines from which the UK might seek to negotiate preferential agreements outside the WTO with individual WTO members, including the EU. To negotiate and strike such agreements with the UK, countries need a high degree of certainty about what the UK proposes to provide as its general WTO terms of market access. For this reason, basic stability in this WTO framework is a precondition for setting a wider UK trade policy and negotiating preferential agreements with the EU and others.

However, confirming new schedules is not an automatic process and the UK's approach to its own commitments could in principle be contested by other WTO members. They might do this for opportunistic reasons – using the UK's desire to establish a new schedule as leverage to press the UK to lower its external tariffs in products that matter to them, or improve access in others ways. They may feel the terms of their access to the UK market have been materially worsened, in which case they are entitled to request compensation if their claim to injury can be substantiated. To reduce the scope for these sorts of challenges the UK has indicated that it intends to adopt for itself the EU profile that it currently applies – meaning that in general tariffs at the UK border will remain the same.



However, even this could in principle be contested by a state that felt that the UK's tariffs as an EU member state were justified by the subsequent access to the EU single market, not the UK market alone. The EU also operates a range of quotas on agricultural imports that will have to be divided between the UK and the EU, and the quota levels adopted by the UK in this process may be contested. These discussions could in principle extend for many years both in informal consultations

between officials and in formal dispute settlement proceedings at the WTO.

If this process is highly contested and if other WTO member states actively seek to disrupt the adoption of schedules for the UK, what are the consequences for UK trade? While seeking confirmation of its schedules the UK can adopt a provisional profile, and trade can take place on this basis. The EU itself has operated for many years in the past on the basis of such unconfirmed schedules. The fact that the UK's schedules are being contested does not in itself stop trade or investment flowing – those that trade with the UK will have to be aware that some of its tariffs or other market access commitments may be subject to change in the future if the UK loses a WTO challenge, or concedes the demands of other WTO members.

The most important potential impact is on the willingness of other WTO states to reach preferential trade agreements with the UK while its basic schedules are subject to dispute. Whether this acts as a disincentive for states to negotiate new bilateral agreements with the UK will depend on the extent to which the UK's schedules are contested and realistically subject to potential change. If negotiations are focused on a small numbers of tariff lines out of the many thousands in the UK schedules, this may not dissuade potential partners. The EU itself negotiated FTAs with Korea, Canada and a number of others while simultaneously dealing with WTO negotiations on its revised MFN schedule following the entry of the ten new EU Member States after 2004, which was only finally confirmed recently. In this case, a relatively small set of contested technical revisions to the EU's schedules in areas such as rice, chocolate, pork and beef tariffs and quotas were not sufficient to dissuade these large trading partners from negotiating bilaterally with the EU, especially where they did not have priority interests in these areas. Whether the UK will be able to do the same will depend in part on how widely and substantively its proposed schedules are challenged.

Alongside its new tariff schedule for goods the UK will have to confirm its GATS schedule for services, including banking. Because the UK is already much more open in practice than the minimum commitments in the EU services schedule or a likely future UK schedule, WTO members in principal ought not to have substantive grounds to object to the UK's new GATS schedule and the impact on day to day trade in financial services into the UK is likely to be minimal, provided the UK maintains its national regime as it currently operates.

How will existing EU third country FTAs be translated to the UK?

The UK will also need to consider the implications of losing the preferential access granted to UK-based exporters via the FTAs negotiated and signed on its behalf by the EU. Whether these agreements can be simply translated to the UK remains to be determined. EU trading partners may argue that the terms of access to their own market granted to the UK as part of the EU are too generous when set against the much smaller opportunities provided by the UK market compared to the EU. They may make the same argument with respect to the now smaller EU market.

However, they will also want to ensure a smooth transition to new preferential terms for their own exporters to the UK. All sides will have a shared interest in minimal disruption, even if a renegotiation of terms may be requested. As noted above, basic clarity on the UK's approach to its WTO commitments will be a prerequisite for this process.

Facilitating this will require careful planning and diplomatic handling. Avoiding a sudden stop to the preferential terms provided by these FTAs will require new or transitional arrangements to be in place at the point at which the UK formally leaves the EU. While the UK is legally not empowered to agree trade deals with other countries while a member of the EU, the EU and the UK should agree a mechanism whereby these FTAs could be formally discussed and agreed with trading partners while the UK remains inside the EU.

For banking and financial services, the implications of this transition of

Confirmation of the UK's WTO commitments may therefore be subject to negotiation and may not be finalised before the UK exits the EU.

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existing FTAs are less acute than for many UK traders in goods, as these EU deals have limited content on financial services. However, all of these agreements include important commitments on the fair treatment for foreign investment and services businesses that also apply to banking and financial services.

Moreover, some of the more advanced and recent EU FTAs include commitments on financial services that will be important to confirm for UK-based exporters. The EU-Korea (2014), EU Canada and EU-Singapore FTAs (both pending full ratification) all contain new concessions on the guaranteed rights of EU banks and general limitations on the scope for using prudential rules to limit the scope for cross border trade between the EU and the trading partner in question (see Box 3: Advantages created by EU FTAs for UK financial services exporters).

Box 3: Advantages created by EU FTAs for UK financial service exporters

Recent EU FTAs have secured important market access improvements and the removal of discriminatory measures for EU financial services providers operating in EU FTA partners which go beyond their MFN commitments at the WTO. For instance:

- Commitments in the EU-Canada FTA that ensure that EU financial services businesses are permitted to transfer certain forms of data out of the country for processing;
- Commitments in the EU-Singapore and EU-Canada FTA to allow the provision of certain portfolio management services cross border between related entities providing collective investment schemes in the EU and Singapore and Canada;
- Commitments by Canada in the EU-Canada FTA to remove some restrictions on non-Canadian nationals serving on boards of Canadian financial institutions and to create a special committee to oversee commitments on the use of prudential rules and to regulate in a transparent and consultative way;
- Commitments in the EU-Singapore FTA to raise the cap on the number of branches and ATMs for EU banks in Singapore from 25 to 50. This agreement also includes provisions ensuring non-discriminatory treatment of branches from EU banks with regard to the provision of remote and online banking services.

UK financial services providers and banks would no longer be able to benefit from these preferential market access rights and non-discriminatory treatment commitments until they are re-confirmed in bilateral agreements between the UK and these third countries.

The need to translate EU operational rights into UK law and practice

From the perspective of banking and financial services it is also important to recognise that confirming the stability of the UK's GATS commitments and the replacement of EU FTAs with UK agreements are only part of ensuring continuity for exporters from the UK and importers to the UK and avoiding any damaging cliff edge effects.

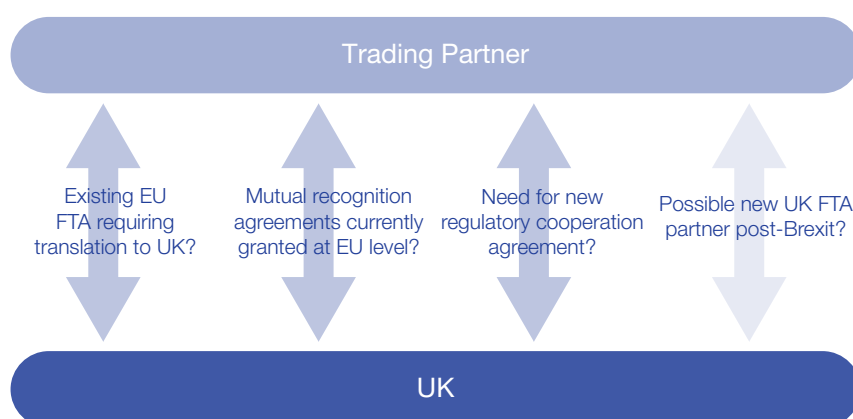
EU legislation contains a number of third country regimes by which the EU has recognised the equivalence or adequacy of another country's rules in a way that creates operational rights or advantages for UK firms operating in those markets, or for firms from those markets operating in the UK (See also BQB#4: What is 'equivalence' and how does it work?). Where non-EU regimes have secured EU recognition of this sort, the UK will generally want to carry that recognition into its own autonomous framework, and will want to secure reciprocal recognition in return.

This may require both UK entities, third country authorities and firms to submit new applications for recognition. Such requirements need to be clearly foreseen in UK planning and may require transitional arrangements of their own. In many cases, mutual recognition agreements of this kind will

need to be underpinned by new memoranda of understanding, regulatory colleges or cooperation agreements between UK and third country regulators, just as EU equivalence assessments require that regulatory cooperation frameworks are in place before a judgement of equivalence can be made. Such frameworks will be the basic channels for much of the regulatory cooperation that will shape the day to day treatment of UK firms operating in markets abroad.

It is important to note that while some of these frameworks may be strengthened by Free Trade Agreements, they will generally stand alone and do not require them. In many cases the vehicle for establishing them will be the effective transposition of current EU practice into UK law and practice, generally via the Great Repeal Bill or flanking legislation, linked with the negotiation of new cooperation agreements by UK regulators.

Key considerations for continuity in existing frameworks for financial services trade and investment in the UK



Further ahead – Forging new trade relationships

Aside from the relationship with the EU itself, the priority for the UK over the period of the negotiation of a withdrawal agreement from the EU should be to ensure as much continuity as possible for UK exporters to non-EU markets and importers trading or investing in the UK. Agreeing new terms with the EU itself clearly dominates this challenge, but securing the preferential trading relations created both by existing EU FTAs and by other EU bilateral agreements is also important.

Once outside the EU, the UK will be in a position to enter into new FTAs with non-EU markets. Its leverage in these deals will depend both on the interest of its trading partners in greater access to the UK market and the nature of its relationship with the EU. In any context, trading conditions for financial services will need to be an important part of the UK's future trade policy given the importance of services to the UK's export markets.

This will become another important potential area for innovation and reform. This is because FTAs have traditionally concentrated primarily on liberalising trade in goods more than on services. Market access arrangements for financial services in even the most modern current FTAs are limited. For a modern developed economy such as the UK, for which the services sector is a major contributor, it will be important to consider how a 21st century FTA and other frameworks can go further than the existing practices in relation to trade in services has chosen, or been able to. The possible approach to and structure for such a future framework will be the subject of further work by the BBA.

See also:

BQB # 1 Staying in or leaving the EU Single Market.

BQB # 2 An orderly exit from the EU.

BQB # 3 What is 'passporting' and why does it matter?

BQB # 4 What is equivalence and how does it work?

BQB # 5 Data protection and transfer.

BQB # 6 Time to adapt – the need for transitional arrangements.

BQB # 7 The Great Repeal Bill explained.