

## Brexit: WTO Process and Negotiation of FTAs

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### 1. INTRODUCTION

- 1.1 WTO rules are not something you "fall back on" in the absence of a better bi-lateral agreement. They are the foundation for and structure around which all international trade is carried on. Bi-lateral and platform trade deals (such as FTAs and customs unions) build on this structure. WTO rules still apply, both to cover aspects of trade that are not dealt with in the trade deal and to regulate the parties' trade with countries that they do not have a trade deal with.
- 1.2 WTO rules comprise a suite of agreements between members. There is a body of cases arising out of dispute settlement and a continuous process of trade policy reviews. The most important agreements for current purposes come under the umbrella of the WTO Agreement, which was the conclusion of the Uruguay Round in 1994. It includes the General Agreement on Tariffs and Trade ("GATT"), the General Agreement on Trade in Services ("GATS") and the Agreement on Trade related Aspects of Intellectual Property Rights ("TRIPS"). Sector specific agreements and annexes sit under the GATT, including the Agriculture Agreement and each country has specific "schedules of commitments" under the GATT and the GATS. Other WTO agreements include subsidies and countervailing measures, trade facilitation, the government procurement and dispute settlement.
- 1.3 The GATT comprises general terms on non-discrimination in trade in goods as between WTO members. The so called most favoured nation or MFN principle means that a preference or advantage made available to one member, such as a lower tariff or higher quota, must be extended to all, unless it qualifies for an exception such as being part of a free trade agreement or customs union covering substantially all trade, or support for developing countries. Discrimination between imported and domestically produced goods is also prohibited, once the imported goods have entered a market. This is the principle of "national treatment".
- 1.4 WTO members are required to publish the tariffs and quotas that they apply to imports of goods from other WTO members in their schedules of commitments. These are legally binding commitments that set out the rates of duty that a country (or in the case of the EU, each member state) will apply to all goods and, in the case of agriculture, quantitative restrictions (quotas) on amounts of goods that can be imported from each country, tariff rate quotas (TRQs) whereby a higher tariff is applied after a certain quantity of imports has been reached, and limits on subsidies that can be paid to farmers. In WTO parlance, these commitment on tariffs, quotas and TRQs are known as "bindings", and the permitted agricultural subsidies<sup>1</sup> are the "aggregate measure of support" or "AMS".
- 1.5 The UK is a WTO member in its own right so will continue to benefit from the right and be subject to the obligations under the WTO agreements but at present its commitments and entitlements are

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<sup>1</sup> The AMS bindings refer only to s-called red and amber box subsidies, which are the most distortive, and not to exempt, blue and green box subsidies such as development support.

interwoven with those of the other EU member states. There will therefore need to be a process for the UK's rights and obligations to be rectified to operate independently. The purpose of this paper is to examine the implications of and requirements for the UK's withdrawal from the EU and subsequent rectification of its WTO schedules.

1.6 This paper focuses on the GATT, the Agriculture Agreement and the GATS. We will also consider the negotiation of bi-lateral and platform FTAs. It assumes an end state for the Brexit negotiations which has the core elements outlined in section 2 (*Core Elements*).

## 2. CORE ELEMENTS

This paper assumes an end state for the Brexit negotiations which has the following core elements:

### 2.1 Prosperity Zone

A goal of creating a "Prosperity Zone" consisting of like-minded countries who are agreed on the fundamental principles of open trade, competition on the merits as an organizing economic principle and property rights protection. The primary goal of the Prosperity Zone would be progress on the unaddressed, and more pernicious behind-the-border barriers to trade through a high-standards anti-distortions agreement, with binding dispute resolution among its members to lower anti-competitive market distortions ("ACMDs"). These behind-the-border barriers impede competition as a result of regulatory barriers, which artificially alter the cost structure of market participants. Candidate countries for such a platform would be, in the first instance, the UK, Australia, New Zealand and Singapore, and then the NAFTA countries, depending on the NAFTA renegotiation process that will be initiated by the USA. It should also be noted that if the TPP is completed with its remaining core members, after the exit of the USA, the UK could look to acceded to the TPP.

### 2.2 Bilateral agreements with India, Brazil, China and other emerging markets

At the same time, the UK can begin talks with emerging markets, which are important trading partners but which are not yet ready to be candidates for the Prosperity Zone because of their internal distortions. These agreements will be difficult to negotiate (especially the UK-China agreement), but it is necessary to initiate the process, as all of these relationships are not being conducted in isolation but have an impact on each other.

### 2.3 Economic Partnership Agreements with Developing Countries

The UK should enter into real economic partnership agreements with developing countries, particularly the ACP countries. These EPAs should incorporate the following elements:

#### 2.4 UK's agricultural openness to products produced in ACP countries

Many of the products produced by ACP countries are not produced by UK farmers. Here the UK can lower tariffs and quotas in the selected areas, and also end the practice of tariff escalation where processed products further up the value chain attract higher tariffs.

#### 2.5 Structural and Regulatory reform in ACP countries

Many of the least developed countries want to engage in serious structural and regulatory reform but are prevented from doing so by their own vested interest elites who benefit from the distortions in place. The EPA would give the government the external benefits necessary to convince its people to back regulatory reform.

#### 2.6 Reduction of tariffs on imports of advanced manufactured goods to ACP countries

Many developing countries maintain high tariffs on advanced manufacturing goods. These are only in place for revenue reasons. There is no domestic production for these goods. Removal of these tariffs would be essential to ensuring better access for UK advanced manufacturing in areas like medical devices and other life sciences products (for example).

#### 2.7 Domestic Regulatory System

After leaving the EU, provided it is no longer a member of the single market, the UK will be able to set its own regulatory system which is based on competition on the merits as an organizing economic principle. This can be achieved by ensuring that new laws and regulations are tested to ensure that they are the least market distortive possible consistent with the regulatory goal.

### 3. WTO RECTIFICATION PROCESS

- 3.1 As part of the Brexit process, the UK will have to rectify its WTO schedules. The starting point for this discussion is that the UK is already a WTO member, and has schedules that are currently comprised within the EU's schedules, so that the UK's share of import quotas, applicable TRQs and entitlements to export quotas need to be calculated or discovered. It is important that all the apportionments and separations of the bindings of the UK and the EU respectively are presented to WTO members as process-driven rectification rather than substantive changes to the commitments and concessions of both UK and EU. This is because substantive changes to schedules must go through a process of being negotiated with affected supplier countries, which may include making compensatory adjustments. However, under the Procedures for Modification and Rectification of Schedules of Tariff Concessions under the GATT a certification process was agreed in order to expedite "rectifications of a purely formal character". This means that "amendments or rearrangements which do not alter the scope of a concession ... in national customs tariffs in respect of bound items ... and other rectifications of a purely formal character" will be certified if the text is submitted to the director general and the other WTO members, and no member objects within three months that either the text either does not reflect the changes or the change is not a permitted purely formal rectification.
- 3.2 Similar Procedures for the Certification of Rectifications or Improvements to Schedules of Specific Commitments apply to rectification of GATS schedules, covering "new commitments, improvements to existing ones, or rectifications or changes of a purely technical character that do not alter the scope or the substance of the existing commitments".
- 3.3 This is why the calculations applied in discovering and rectifying the UK's schedules need to be transparent and communicated collaboratively so that WTO members can be assured that the scope

of their concessions from the EU and the UK is not being substantively altered. Even if there are objections to certification in this way, trading can and does continue under uncertified schedules while the matter is resolved.

3.4 The schedules to be attended to are outlined in the following sections.

#### 4. GOODS AND AGRICULTURE

The EU's Common External Tariff (CET) on industrial goods and agricultural products and its import quotas in agriculture will be the UK's goods and agriculture schedule. For goods other than agricultural products, simply replicating the CET will be a straightforward step to re-establish independent bindings and the government has already initiated this. For agriculture, quotas apply and are overlaid with TRQs so the separation of the UK's bindings is more complex. However, there is a lot of scope for liberalisation in the EU's tariffs and quotas in agriculture, and perhaps in other areas. The UK's position should be to seek to negotiate reductions in the CET rates in the context of a Free Trade Agreement on a country by country basis. Many of the countries we would seek to negotiate free trade agreements with (including prospective Prosperity Zone countries) value agricultural access highly. Furthermore, if the UK is unable to negotiate FTAs with these countries, they will increase pressure on the UK in the context of the WTO process and may raise objection to the proposed rectified schedules. For example, New Zealand will press for a higher lamb TRQ (so that it can import more at lower tariffs), unless the UK can credibly say that better access is on offer in the FTA. Not being able to conclude such FTAs spring-boarding off the WTO rectification process will complicate the WTO process.

##### 4.1 Agricultural Import Quotas

The UK will have to agree with the EU what its share of the EU's quota and associated TRQ is for each agricultural tariff line. This may be determined in a number of ways. We can look at the import levels of the particular product as a fraction of the total EU import levels, in order to determine a reasonable share of the quota. We have looked at this issue in a few key sectors, such as lamb, poultry and beef. There are a number of countries who will want to see increased access in these areas, and since the EU is also a significant exporter to the UK in these areas, it will also want to secure a quota from the UK. In the absence of agreement on retaining zero tariffs with the UK, the EU will want a quota for imports of agricultural products into the UK.

##### 4.2 Aggregate Measure of Support (AMS)

The UK has the right to a share of the European agreed AMS. As this is a WTO right, the UK should claim a reasonable share, and as long as its methodology is robust, it is likely that its suggested AMS level will be accepted by other WTO members. The European Union does not spend anywhere near its bound AMS of €60bn. It spends only around €7bn per year on so-called red and amber box support, which are the kinds of subsidy that count towards AMS. The UK does not rely on red and amber box subsidies, in any event, utilizing only some £38m for its two Voluntary Coupled Support programs in beef and sheep in Scotland. The rest of the UK's subsidies and supports fall into green and blue box types of support which do not count towards the AMS limits. This gives the UK tremendous flexibility when it comes to its AMS binding.

#### 4.3 UK Share of EU Share of Third Country Quotas

When the UK leaves the EU, if a zero for zero tariff deal with the EU is not agreed, then it will need quotas for access to the European market in agriculture. The UK currently exports most of its lamb to other EU countries. It would need to agree a quota with the EU for lamb. In the case of beef, the UK exports 85% (by value) of its beef to the EU, but 15% to other countries. The UK will need quotas for the EU and for these other export markets. In the case of poultry, the UK exports 30% of its poultry to other countries beyond the EU. It will therefore need a poultry quota for the EU and these other countries (particularly for China, US, Hong Kong and the Ivory Coast). The largest importers of dairy products are China, Russia, Mexico, Saudi Arabia, Malaysia, and the UAE. The UK will need to ensure it has access for its dairy exports into these markets. Roughly one quarter of UK exports of wheat are to countries outside the EU, so the UK will have to negotiate access with these countries, as well as the EU. In fruits and vegetables, the UK is primarily an importer.

#### 5. SERVICES

5.1 The EU's schedule of commitments under the GATS is already broken down on a member state basis so identifying the UK's bindings will be straightforward. However, it is self-evident from analysis of the EU services schedule of commitments that there is much scope for the UK to update and further open access commitments in services. Once again this can be communicated to other WTO members in the context of potential FTAs in the future.

5.2 The commitments on services are divided into four "modes of supply":

- 1 – cross border supply from one country to another;
- 2 – consumption abroad where the customer travels abroad to receive a service;
- 3 – commercial presence, which means the establishment of a branch or office in a country; and
- 4 – presence of natural persons.

5.3 Each sector where a country has accepted a binding commitment can have different conditions and limitations attached to each of the modes of supply. Generally, in the EU schedules mode 2 is unrestricted for most services and mode 4 is subject to "horizontal" restrictions so all sectors are subject to limits on the provision of services by sending people into a country, even for short periods of time, unless specifically provided otherwise.

5.4 GATS schedules of commitments work on a "positive list" basis so countries have bindings only in the sectors that are specifically identified. The sectors fall into 12 broad categories:

1. Business;
2. Communication;
3. Construction and Engineering;
4. Distribution;
5. Education;
6. Environment;

7. Financial;
8. Health;
9. Tourism and Travel;
10. Recreation, Cultural, and Sporting;
11. Transport;
12. "Other".

5.5 Beneath of these sector headings is a multiplicity of sub-sectors (which are drawn from the United Nation's Central Product Classification ("CPC")), and each of these sub-sectors must also be positively opted into for a country to accept a binding. In the case of the EU's schedule, each member state can also add its own conditions, or opt out of a binding, in a sector or mode of supply. All of these categories are covered in the EU services schedule (except for 12 "Other"). A detailed inventory will need to be taken of the UK's bindings against the sectors and sub-sectors listed in the CPC to establish where the UK would be able to give further commitments and relax the conditions and limitations that it currently reserves. An audit of the commitments of EU member states will also be required to establish what additional access the UK will require through its FTA with the EU. Many of the bindings are out of date (for example there are still references to deutschmarks and drachma) so the current state of play with respect to market access and national treatment in many sectors is not accurately reflected and the consolidated position following the most recent accessions to the EU has not yet been formalised.

## 6. USING THE WTO RECTIFICATION PROCESS AS A LAUNCHING PAD FOR FTA NEGOTIATIONS

While the UK's initial opening position should be to replicate the EU's schedules as much as possible, it should also make it clear to key trading partners that there is plenty of scope to liberalise the position under these schedules, which can be achieved through the negotiation of FTAs.

### 6.1 What does the UK need from its trade deals?

Eighty per cent of the UK's GDP is services, and forty four per cent of its exports are services also<sup>2</sup>. Therefore, any trade deal must include extensive provision for market access and national treatment in services, and mutual recognition of qualifications and licence where relevant. In order to achieve this, the UK will have to be prepared to make significant "concessions" in WTO language. Most of these concessions must come in areas where the CET is relatively high. This is primarily in agriculture. The UK will have to communicate to major supplier countries in certain sectors that it is willing to negotiate a trade agreement in order that the trading partner can take advantage of the increased liberalization available under the UK's WTO schedules.

### 6.2 Specific Areas of Potential Liberalization

Within agriculture, there are many areas of potential liberalization. First, in all areas where the UK has no production, and there is no directly competitive or substitutable product (as revealed by a cross-elasticity study), the UK does not need to maintain a tariff or a quota. While the CET is the declared schedule, the UK

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<sup>2</sup> ONS Pink Book 2016

should communicate this flexibility to countries that seek to export such agricultural products that the UK does not produce.

### 6.3 Protection for UK Farmers against Distortions in Other Markets

While agricultural tariffs and quotas can be lowered in an FTA negotiation or dispensed with altogether, we will need to recognize the reality that, if the UK is devoid of all border barriers, then its farmers will be exposed to products flooding the UK market whose costs have been artificially reduced as a result of subsidy or other less direct methods of economic distortion (what we have separately described as Anti-Competitive Market Distortions or ACMDs). This will be particularly important because the UK will be next to one of the world's biggest agricultural subsidizers. Mechanisms are available to protect UK producers from such distortions and provide financial support to farmers in more efficient ways than are currently possible under the common agricultural policy.

### 6.4 GSP and Other Preference Beneficiaries

- 6.4.1 Many developing countries benefit from trade preferences into the EU. If the UK drops tariffs and quotas in products that it does not produce but that these countries do, they will be concerned about so-called "preference erosion" as they become exposed to competition with larger developing country producers. The UK will have to provide these smaller ACP countries some measure of comfort that their industries will not be damaged, as happened when the smaller textile producer countries were decimated when the global textile quotas (the Multi-Fibre Agreement) were removed in 2004, and China's production supplanted many of these countries' exports. In that case, an attempt was made to minimize disruption by giving some of the affected countries a special safeguard which was linked to the proof of market disruption. The mechanism capped exports of textiles to six per cent above the imports from the year previously, but could not be in place for more than 6 months.
- 6.4.2 GSP beneficiaries should be protected from loss of access to markets or preference erosion if that preference erosion comes as a result of distortions in other markets. In order to accommodate this, ACP countries must be given some form of safeguard mechanism that would enable them to return to their preference (tariff or quota or some combination) if distortion in the country of export, causation and damage to their industry can be proved.
- 6.4.3 If, as a result of greater openness of the UK agricultural market, it is flooded with products from major producers who benefit from subsidies or whose costs are artificially reduced by distortion, then it will be important to provide a mechanism that not only protects UK farmers who are adversely affected, but also protects ACP country farmers who will lose market share into the UK market through no fault of their own. If preferences are to be eroded, some mechanism must be developed which ACP countries can use to ensure that they do not lose critical market share because of another country's distortions. However, at the same time, moving away from the preference system is a necessary part of a forward-looking, market-based agricultural system in the

UK. We note that some market share will inevitably be lost to countries that are major agricultural producers of products that do not benefit from distortions and subsidies. While this could adversely affect the ACP producers, the reduction of food prices that could result from this market opening would be very important to UK consumers and would be particularly important for poorer consumers. As we develop policy we must be careful not to transfer wealth from poor UK consumers to rich developing country agri-producers who have benefited from a protected position.

- 6.4.4 One of the major problems of the preference system is that it locks in selling patterns which are not based on commercial and innovative reasons, but rather result from the protection of the preference. In many ways this is the soft bigotry of low expectations. Instead, we must develop incentives for producers in these markets to rise up the value chain, producing better products more efficiently and cheaply and fully utilizing their work force.
- 6.4.5 There are other ways that the UK can and should provide support to the ACP countries. We suggest that DFID and the FCO create a fund which can provide bridging loans for producers who have specific one-time needs to improve the efficiency of their production methods. These funds should be carefully administered so that they do not become like subsidy payments, but actually enable producers in these markets to become more efficient and competitive. Funds could also be provided for technical assistance to ensure that key inputs of these producers are made as cheap as possible. In developing countries, energy costs tend to be very high, due to various inefficiencies in how the power generation and transmission markets operate. It may be that in other markets buying and selling practices put farmers in a price squeeze (such as the C-4 cotton farmers who have to buy cotton seed from monopoly French parastatal sellers, and have to sell cotton to the same parastatals who then use their monopsony power to lower the price of the end product). These measures will be necessary to assist developing countries in much needed structural reform so represents a win-win for all sides. The UK's active engagement in these areas will enhance its soft power.
- 6.4.6 Many of the countries that benefit from GSP programs are concerned about preference erosion and have been lobbying HMG to ensure that the MFN rate is maintained to protect the preference. The reality is that it may be impossible for the UK to resist a unilateral reduction in tariffs in agriculture and other products if the Europeans do not cooperate on interim arrangements on tariffs as the UK leaves the EU (the zero for zero offer). Lack of cooperation in this area could lead to considerable food price inflation which will require the UK to unilaterally lower tariffs in precisely the products which ACP countries and GSP beneficiaries typically produce (food and textiles/clothing). This will lead to preference erosion. The only solution for ACP countries is to lobby Brussels to cooperate with the UK on interim measures so that Brussels and London agree a zero for zero tariff deal on exit. ACP countries should not make the mistake of lobbying only London, and not Brussels.



## 6.5 Services Liberalization

- 6.5.1 The UK also has a relatively open market in terms of services. As noted above there is significant water in the EU services schedule for the UK. This means that the UK can agree a more liberal set of services obligations in the context of a FTA negotiation, while retaining its parts of the EU services schedule as a binding. Any further liberalization beyond these WTO bindings may be accomplished in the context of FTAs with other countries or in the context of wider platform agreement.
- 6.5.2 The UK's initial WTO rectification process will include accepting that part of the EU services schedule which is relevant to the UK as the UK's services schedule. The UK, as noted above can then offer countries a more liberalized services schedule in the context of FTAs with them. The starting point is the EU services schedule and so it is useful to know how much water is in the schedule, in other words, where could the UK provide a more liberalizing offer to its trading partners.
- 6.5.3 There are key sub-sectors, for example audio visual services, that are not in the schedule at all, therefore no EU member state has any binding in them. There are others, where the sector is included but is subject to significant limitations and qualifications, most notably financial services, or like legal services (sub-sector of category 1 "Business"), which is included but only for advising on the service provider's home law and public international law. Both of these examples, due to their highly regulated nature, also depend on mutual recognition of qualifications and licences. This can be included in FTAs. For Prosperity Zone candidate countries that have common law based legal systems and are compliant with global financial standards such as Basel III this would be a viable offer from the UK.
- 6.5.4 For sectors that benefit from wide access and national treatment (such as IT implementation and consultancy services) in modes 1 to 3, mode 4 is still strictly controlled. Mode 4 services access for services will be a key offensive interest for all potential FTA partners, and will also be necessary for the UK economy to thrive in sectors where the presence of specialists is required, and to cover service provision where there are not enough UK-based workers to fulfil a need. Mode 4 services access is closely linked to immigration policy and it will be critical for the government to have such a strategy in place to be able to make commitments to interested countries that could unlock huge reciprocal benefits for UK businesses.
- 6.5.5 There are many areas where the EU services schedule is not liberalizing of trade and can be improved upon by the UK. In addition, a group of 23 parties (one of which is the EU so in total 50 countries are represented) has been negotiating an agreement that would further liberalise trade and investment in services the Trade in Services Agreement ("*TiSA*"). *TiSA* builds on the GATS but would advance the position under GATS significantly. It aims to open up markets and improve rules in areas such as licensing, financial services, telecoms, e-commerce, maritime transport, and professionals moving

abroad temporarily to provide services. Negotiations have been under way for several years. As an independent party to the TISA negotiations the UK would be in a position to contribute to and influence their progress in a positive direction.

## 7. NEGOTIATIONS WITH COUNTRIES WHERE THE UK HAS AGREEMENTS THROUGH THE EU

7.1 The EU has agreements with a number of countries with whom the UK will have to agree an exchange of notes such that both parties will agree to be bound by the terms of the agreements until such time as new agreements are developed, subject to the agreement on the new regulatory bodies which would enforce the subject matter of any agreement in the UK, and carry out necessary activities on standards and regulations.

7.2 The full list of countries with whom the EU has FTAs is set out in Appendix A (EU FTAs).

7.3 In addition there are a number of deals which have been finalized but not yet applied. These include:

- East African Countries (EAC) – Interim Economic Partnership Agreement , end of negotiations, 16 October 2014
- Ecuador - Trade agreement, legal revision ended, 17 February 2015
- Singapore – Free Trade Agreement, initialled on 17 October 2014
- Vietnam – Free Trade Agreement, negotiations concluded on 1 February 2016
- West Africa – Economic Partnership Agreement, initialling, 10 July 2014

7.4 Of all these agreements, the key ones that are priorities for the UK to continue to benefit from would include the agreements with the following 29 countries:

- Bosnia
- Georgia
- Iceland
- Moldova
- Norway
- Russia
- Serbia
- Switzerland
- Turkey
- Ukraine
- Algeria
- Egypt
- Israel
- Jordan
- Lebanon
- Morocco
- Tunisia
- Canada
- Central America
- Chile
- Colombia
- Peru
- Ghana
- Kazakhstan
- Mexico
- South Africa
- South Korea
- Singapore
- Ecuador.

7.5 Of these we believe that the UK would need, and could agree, much higher standards agreements with the following countries:

- Switzerland

- Norway
- Iceland
- Turkey
- Canada
- Chile
- Mexico
- South Korea
- Singapore

7.6 For the other countries, an exchange of notes, identifying the UK regulatory bodies which replace the European bodies, and setting out an agreement between the UK and the third country to abide by agreements on standards, and technical barriers to trade will suffice for the time being. These issues will need to be resolved in the context of the Great Repeal Bill in any event. The EU will have agreed rules on technical standards and technical barriers with these third countries which the UK will have to honour, at least initially until other arrangements are agreed.

7.7 The UK must prioritize the countries that it needs to have agreements with, and that list is set out above. These countries must be approached to ascertain whether they will agree to be bound by the terms of these agreements. All of the EU FTAs set up technical committees between the Parties which the UK would have to stand up (such as the technical committees on TBT/SPS measures, intellectual property and other areas which are required under the terms of the EU-Mexico agreement).

## 8. TRANS PACIFIC PARTNERSHIP (“TPP”)

8.1 The TPP is probably the most advanced agreement that has been agreed by any group of countries. It is a high standards, platform agreement that attempts to make progress on the most difficult aspects of international trade – especially behind the border barriers, regulatory protection, the impact of state-owned business on trade, and distortions more generally.

8.2 Although the new US administration has rejected the TPP and it will not now proceed in its current form with the negotiating parties, it does provide a useful starting point for a discussion about a high standards agreement that could underpin the Prosperity Zone. In addition, if enough members of the TPP opt to keep the agreement, without the US’ participation, then the UK could simply accede to the TPP. This would be a quick win for the UK.

8.3 The process for such accession would be to agree schedules with the TPP countries of the UK’s tariffs and quotas, and for the UK to accept the disciplines of the TPP. The major disciplines of the TPP include the following:

8.4 Key elements of TPP we recommend should be carried into future UK FTAs:

- 8.4.1 Liberal rules of origin with cumulation - cumulation rules should be deployed within the Prosperity Zone so that as the provisions make the overall zone better for supply chains, so efficiencies can be developed.

- 8.4.2 Strong Customs Administration and Trade Facilitation chapter - to provide for, amongst other things:
- a. prohibition on excessive penalties
  - b. cooperation between customs authorities
  - c. special provisions for express shipments and business facilitation measures
  - d. provisions for risk management and release of goods.
  - e. transitional safeguard mechanism (eventually to be replaced by ACMD mechanism).
- 8.4.3 Sanitary and phytosanitary measures - to be based on sound science and not to be unjustified barriers to trade. Historically within the EU this has not been the case, and a strong framework will be required. Headings will include:
- a. transparency provisions;
  - b. equivalence recognition of SPS measures; and
  - c. risk management object not to be more trade restrictive than is necessary to achieve the regulatory goal.
- 8.4.4 Technical Barriers to Trade:
- a. transparency provisions – consider sector specific measures;
  - b. standards setting bodies to be with full stakeholder participation; bottom-up consultations;
  - c. move fully away from government-mandated systems towards self-regulating and private standard setting; and
  - d. liberal conformity assessment programs.
- 8.4.5 Investment - very strong rules protecting investment on a negative list basis with annexes for any non-conforming measures. Provisions should include:
- a. investor/state dispute resolution;
  - b. measures to deal with state owned enterprises;
  - c. prohibition of measures which are not technologically neutral;
  - d. provisions to deal with forced localization, local content rules etc.; and
  - e. application to sub-federal entities.
- 8.4.6 Competitiveness and Business Facilitation - to achieve supply chain development, enhancing efficiencies.
- 8.4.7 Financial Services – useful sector specific commitments in areas back office functions, portfolio management for collective investment schemes and electronic payment card services.
- 8.4.8 Regulatory Coherence - a very important provision in any UK-X FTA. It should be based on impact assessment where impact on competition is considered (by the UK's CMA and the partner country's competition agency) – again aimed at regulation that it least distortive to markets as possible consistent with the regulatory goal.

The following elements of TPP will in particular need to be modified to reflect the UK's negotiating objectives:

8.4.9 Measures dealing with labour:

- a. The measures agreed under TPP may not be universally applicable. TPP requires compliance with fundamental labour rights recognised by ILO and effective enforcement of labour laws. Many of the specific plans for particular countries in TPP would not be necessary with a like-minded group. UK FTAs need not necessarily cover labour issues to the same extent as TPP. More helpfully, mutual recognition of qualifications was considered by the advocate general to fall within the common commercial policy.
- b. The recent opinion delivered by the Advocate General in respect of the EU/Singapore FTA suggests that the labour provisions in that FTA are a matter of shared competence as they are not immediately and directly linked to trade such that they would fall within the common commercial policy. A UK FTA with the EU could exclude provisions on labour standards (given that both parties clearly meet whatever minimum commitments and international standards that are generally included in FTAs) in order to avoid a "mixity" problem that would require ratification at member state level.

8.4.10 Environment:

- a. Environmental provisions that relate to enforcement of one's law are adequate
- b. Environmental provisions that call for ending fisheries subsidies would also be appropriate.
- c. The Environmental chapter of UK FTAs should ensure that environmental rules should not be used as disguised barriers to trade and should be the least trade and market distortive consistent with the regulatory goal (which goes much further than TPP or other trade agreements).
- d. Note that environmental measures would make a UK-EU agreement a mixed agreement and therefore an environmental side letter might be a better approach.

9. CETA

The Comprehensive Economic and Trade Agreement ("*CETA*") between Canada and the EU. The Commission considers that it "sets a new global standard for future trade agreements". It includes a number of useful provisions that could usefully be built on in the UK's FTA with the EU, and some that should be avoided. In any event it is a useful indication as to the EU's positions and what is achievable. Points to note include:

- 9.1 CETA includes a restriction on the application of duty drawback, deferral and suspension programmes conditional on export, where the relevant export benefits from preferential tariff treatment between the EU and Canada. The UK should not look to include this rule in its FTAs as it

is distortive and could be particularly adverse for the UK in the period where it does not have FTAs with many countries and manufacturers would be particularly reliant on duty reliefs.

- 9.2 CETA has a different approach to SPS than that taken under TPP. An equivalence mechanism is used rather than the TPP requirement that measures be based on sound science and not to be unjustified barriers to trade. The equivalence mechanism allows parties to accept the other parties' SPS measure if it gives equivalent levels of protection. The UK will face pressure from the EU to adopt this approach which should be resisted. The TPP approach is to be preferred, but this in turn is likely to be strongly resisted by the EU.
- 9.3 Both CETA and TPP include provisions against export subsidies for agricultural products. In practice this does not go very far as most export subsidies are "red box" illegal anyway, the real issue is domestic supports and other subsidies for those products. Neither TPP nor CETA go far enough in restraining those.
- 9.4 The parties to CETA are to respond to consultations by endeavouring to remove the adverse effects of subsidies for non-agricultural goods, and are to use best endeavours to do so for fisheries and agriculture. UK may wish to strengthen this, particularly in the context of agriculture and fisheries, although it should be noted that the resistance to stronger disciplines in agriculture and fisheries will likely have come from both the EU and Canada.
- 9.5 With respect to customs and trade facilitation, TPP customs measures are more robust and include, for example, provisions on express delivery, which the UK should look to replicate in its FTAs.
- 9.6 CETA has an audio-visual/cultural industries exemptions that can be eliminated in the UK's FTAs, although they will remain a priority for partners like Canada.
- 9.7 CETA requires parties to work for the setting up of a multilateral investment tribunal, whereas TPP has a more general process for arbitration of investment disputes. Investor protection and investor/state dispute resolution have been controversial matters in both CETA and TPP and UK policy makers will need to develop and engage publicly on the UK's position in this area as it will be of particular interest to Parliament and interest groups.
- 9.8 CETA provides for a process towards mutual recognition of professional qualifications. This kind of provision will be very helpful in fully addressing services in the UK's FTAs. The FTA with the EU should look to go further and retain the mutual recognition of qualifications that already exists.
- 9.9 The financial services section under CETA is significant progress against the parties' respective commitments under the GATS. It includes provision for the cross border supply of financial services on an unsolicited basis but retains the broad prudential carve out and does not provide for recognition of prudential supervision or licensing between the parties. CETA does not include the useful specific commitments in respect of certain services that were agreed in TPP.
- 9.10 In respect of intellectual property rights, CETA (like TPP) affirms the parties' commitments to the Doha declarations in respect of compulsory licensing of pharmaceutical patents in certain circumstances. While fully understanding the health issues in developing countries, the UK should

be looking for agreements that require strict compliance with Article 31 of TRIPS which regulates such compulsory licensing, notwithstanding the Doha declaration, in order to protect the interests of the UK life sciences sector.

9.11 The Regulatory Cooperation chapter in CETA is prescriptively looking towards harmonisation driven by the regulatory goals of protection of human, animal, plant health themselves and is less concerned with building markets based on competition, which is the goal of the Regulatory Coherence chapter in TPP. The position in the UK/EU FTA will be different as the two sides are already highly integrated and harmonised so the agreement will need to be focused on managing co-operation in the progress of future regulation and any eventual divergence, rather than harmonisation.

9.12 CETA goes further than most trade agreements by allowing temporary access of workers, movement of key personnel and so forth on easy terms and for a short period.

#### 10. AGREEMENTS WITH COUNTRIES WHERE THERE ARE NO EU AGREEMENTS

For countries that the EU does not have agreements with, the UK has the chance to agree new agreements. The process for negotiating these agreements must be initiated as soon as possible. As a legal matter, the UK can negotiate agreements, but cannot conclude them until it has officially left the EU. Whether the trading partner will negotiate an agreement will largely depend on several factors including:

- whether it is likely that the UK will leave the customs union when it leaves the EU, and is in fact able negotiate free trade agreements, and whether it will not be a member of the single market (by way of the European Economic Area or otherwise), as this would prevent it negotiating its own regulatory arrangements. In this context it is very important how UK policymakers talk about the Customs Union. From the perspective of trading partners, it is crucial that the UK will not be bound by the CET as of the EU exit date, which we assume will be no later than April 2019. Trading partners need to know that they can conclude trade deals with the UK as of April 2019. Any suggestion that the UK will remain in the Customs Union for an additional two years would change the balance of their calculations and priorities and may result in time being spent on other agreements, although a lesser period to allow adjustment to new customs arrangements may not be fatal. For example, both Australia and New Zealand have scoping agreements with the EU. If it appears that no deal with the UK is possible for four or more years from now, then these countries will re-focus their energies on their EU relations; and
- given that more significant negotiations will have an impact on the relationship between the trading partner and the EU, the trading partner may consider the likelihood of it negotiating a trade agreement with the EU and may fear EU reprisals. However, the threat of reprisals can be managed by working together with DG Trade to ensure that both EU and UK objectives are met with respect to moving those third countries to more liberalized trade and more open markets.

## 11. PROSPERITY ZONE AND BI-LATERAL AGREEMENTS

In addition to the eight countries listed above where the UK can build on the EU's existing FTAs, we recommend that the following are prioritised on a fast track with a view to forming the Prosperity Zone:

- Australia
- New Zealand
- Singapore
- USA

These countries were the original drivers of the TPP and so will be interested in an alternative, high standards agreement. The Prosperity Zone will create growth in member countries by eliminating behind-the-border-barriers and domestic ACMDs and improving the climate for investment and protection of property rights.

Bilateral agreements with the following countries should be pursued on a slower track in recognition of the inevitable complexity of the barriers involved:

- India
- Brazil
- China.



## Appendix A – EU FTAs

- Albania - Stabilisation and Association Agreement, 22 May 2006
- Herzegovina - Stabilisation and Association Agreement, 1 June 2015
- Faroe Islands - Agreement, 1 January 1997
- Georgia – Association Agreement, 1 July 2016
- Iceland - Agreement, 1 April 1973
- Kosovo - Stabilisation and Association Agreement, 1 April 2016
- The former Yugoslav Republic of Macedonia - Stabilisation and Association Agreement, 1 April 2004
- Moldova - Association Agreement, 1 July 2016
- Montenegro - Stabilisation and Association Agreement, 29 April 2010
- Norway - Agreement, 1 July 1973
- Russia - Partnership and Cooperation Agreement, 1 December 1997
- San Marino - Customs Union, 1 December 1992
- Serbia - Stabilisation and Association Agreement, 1 September 2013
- Switzerland - Agreement, 1 January 1973
- Turkey – Customs Union, 30 December 1995
- Ukraine- Deep and Comprehensive Free Trade Agreement, 1 January 2016 / Association Agreement, 29 May 2014
- Algeria - Association Agreement, 1 September 2005
- Egypt - Association Agreement, 1 June 2004
- Israel - Association Agreement, 1 June 2000
- Jordan - Association Agreement, 1 May 2002
- Lebanon - Interim Agreement, 1 March 2003
- Morocco - Association Agreement, 1 March 2000
- Palestinian Authority - Association Agreement, 1 July 1997
- Syria - Co-operation Agreement, 1 July 1977
- Tunisia - Association Agreement, 1 March 1998
- Azerbaijan - Partnership and Cooperation Agreement, entered into force on 17 September 1999
- Central America - Association Agreement with a strong trade component, signed on 29 June 2012
- Chile - Association Agreement and Additional Protocol, 1 March 2005
- Colombia and Peru - Trade Agreement, signed on 26 July 2012
- Ghana - Stepping stone Economic Partnership Agreement provisionally applied, 15 December 2016
- Iraq - Partnership and Cooperation Agreement, signed on 11 May 2012
- Ivory Coast – Economic Partnership Agreement provisionally applied, 3 September 2016
- Kazakhstan – Enhanced Partnership and Cooperation Agreement, 30 April 2016
- Madagascar, Mauritius, the Seychelles, and Zimbabwe Economic Partnership Agreement signed in August 2009
- Mexico - Economic Partnership, Political Coordination and Cooperation Agreement, 1 July 2000
- Papua New Guinea and Fiji - Interim Partnership Agreement ratified by Papua New Guinea in May 2011
- Southern African Development Community (SADC) - Economic Partnership Agreement provisionally applied, signed on 10 October 2016
- South Africa - Interim Trade, Development and Co-operation Agreement, 1 January 2000
- South Korea - Free Trade Agreement, signed on 6 October 2010, entered into force on 13 December 2015
- Cameroon– Interim Economic Partnership Agreement, signed on 28 February 2009
- Canada – Comprehensive Economic and Trade Agreement (CETA), signed on 30 October 2016
- CARIFORUM States - Economic Partnership Agreement, Provisionally applied

- Armenia - Partnership and Cooperation Agreement, entered into force on 9 September 1999