International Trade Alert

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Brexit: Trade and Regulation Outlook

The UK vote to Brexit has material economic, financial, commercial, political, legal and social implications. Once the UK government has formally notified the European Council of its citizens' decision to leave the EU, the UK has a so-called two-year "divorce" period in which to negotiate a withdrawal agreement pursuant to Article 50 of the Treaty on European Union (TEU). Outgoing Prime Minister Cameron has said that he does not expect his successor to be elected for several months and that he currently does not expect the two-year withdrawal period to start before October. On this basis, EU law would cease to apply to UK citizens from October 2018. However, senior EU leadership has told Cameron that notice needs to be given earlier, because, otherwise, the UK would be involved for a longer period of time in EU lawmaking that would never apply to the country.

Uppermost in the UK government's mind is enabling continued access to the EU Single Market so that UK businesses will be able to trade freely throughout the EU/European Economic Area (EEA) block. The UK Government must continue to respect EU law during the two year withdrawal period. Any failure to respect EU law would harm the UK's negotiating position. As regards EU laws that are in the process of being implemented into UK (and other Member States') law, such as the EU General Data Protection Regulation (GDPR), the UK should, as a matter of EU law, continue to implement it. Parliament could subsequently decide to repeal all or part of the law from October 2018, as it can with any UK statutes. In practice, though, it is doubtful whether the European Commission would have the appetite and resources to take enforcement action against a country on its way out.

The UK–EU Treaty negotiations will be complex and fraught with issues. There will be a tension between, on the one hand, the need for the EU to take a strong stance against the UK in order to disincentivize the Dutch, the Danes and other Member States from exiting (the so-called "Domino Effect") and, on the other hand, ensuring that important industries in the remaining Member States can maintain competitive supplies to UK customers. German automotive manufacturers, for example, had already expressed concerns about Brexit and are now looking at production location shifts from the UK.

UK and EU leadership should now be focused on maintaining workable relations in order to broker a deal that works for both sides. Given the size of the UK economy and strong links with the U.S. and other leading economic powers, it is in the EU institutions' interests to agree to a mutually beneficial trade deal. Two years is, of course, a very short time for a long-standing and sophisticated EU Member State. It took Greenland more than six years to leave the EEC (an earlier incarnation of the EU). Only if the other 27 EU Member States unanimously vote to allow an extension to this two-year period would the UK and the EU have longer to broker the best deal that they can get.

In terms of the most likely outcome for the EU-UK relationship, the UK government has been considering various options, including (i) EEA/ European Free Trade Association (EFTA) membership (i.e., the Norway model); (ii) EEA/EFTA membership with additional cooperation on the basis of bilateral relations (i.e., the Switzerland model); (iii) customs union (i.e., the Turkey model); (iv) World Trade Organization (WTO) membership augmented by a free trade agreement; or (v) WTO membership only. Perhaps the more likely options are attempting to join EFTA and participate in the Single Market through the EEA market, and a more distant relationship, with certain rights emanating from WTO membership and the possibility of negotiating a free trade agreement to remove or reduce some of the barriers to trade that would re-emerge following withdrawal. The main drawback of EFTA/EEA membership is that the UK would need to follow the EU market rules and the four fundamental freedoms, including free movement of persons, in order to get access to the Single Market. Furthermore, the UK would not be able to participate in future EU rulemaking. Like Norway, the UK would have to follow rules that they had no involvement in drafting. Moreover, the UK would still need to make a contribution (albeit smaller) to the EU budget. It would be easier for the UK to fit into the WTO option. The UK is, after all, already a member. However, this would not give the UK access to the Single Market, so the UK would need to negotiate a separate free trade agreement with the EU, which could take years, with strong pressure from Brussels for the UK to follow most, if not all, EU rules.

In terms of other key areas, tax has always been a “national competence,” with the UK and other Member States remaining free to determine their own rates of corporation and income tax. The UK government has also managed to obtain a number of opt-outs over the years, including from Schengen, criminal justice and the Euro. Furthermore, from as early as summer 2018, UK businesses will be free from various EU laws that have arguably restricted commercial and financial freedom, including financial services rules, product liability, consumer protection limitations and other forms of red tape. Moreover, the UK government will be able to bail out and otherwise help struggling UK industries and small business without the need to obtain state aid approvals from the European Commission. Parliament will, at last, be able to take the “a la carte” approach to adopting the favorable EU rules, which it has been trying to do for some years. The UK will also be able to torpedo hostile acquisitions by Chinese, Russian and other nations of strategic UK assets, although the UK would need to think twice about alienating increasingly important future trading nations now that they have chosen to exit “Club Med.”

Brexit also poses difficult questions about the UK’s trade relationship with the rest of the world. As a member of the European Union, the UK profits from preferential trade relationships negotiated by the EU with 58 other countries. The UK will need to renegotiate these agreements bilaterally or risk losing its preferential market access.

Furthermore, while the UK is a member of the WTO in its own right, its market access commitments have been negotiated jointly with the EU. WTO Director-General Roberto Azevedo has commented that trade talks with the UK would have to start from the very beginning. This is because, after Brexit, the UK “will be a country with no country-specific commitments.” Thus, the UK may find itself having to negotiate bilaterally with each of the WTO’s 161 other members over the specific market access terms that will apply to the UK’s exports and imports of goods and services. In highlighting the potential complexity of the negotiations, Azevedo emphasized that “key aspects of the EU’s terms of trade could not simply be cut and pasted for the UK.”

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