

# Navigating Brexit: Priorities for business, options for government



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Allie's work focuses on devising recommendations and representing the voice of members on EU policy matters to Westminster, Whitehall and European institutions. She provides the link between business and government on increasing international trade through practical and policy-focused measures, as well as running a number of trade missions for IoD members around the world every year. She routinely provides advocacy for the IoD on a range of regulatory issues in Brussels.

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## Executive summary

The referendum campaign and its outcome are now over, and the substantive debate on what Brexit might mean is only really just beginning, despite the fact that it should have advanced long before 23 June. As a cross-sector body representing the interests of tens of thousands of company directors, the IoD adopted an institutionally neutral view for the duration of the campaign, opting instead to embark on an educational campaign for its members. Judging from our own research statistics, while there was tremendous enthusiasm for reform, Britain leaving the EU was not the preferred outcome for a majority of IoD members, with 63 per cent indicating they planned to vote to Remain and 29 per cent saying they would vote to Leave<sup>1</sup> shortly before the referendum.

However, business recognises the urgent need to move beyond the result to focus on how to tackle the challenges arising from Brexit while simultaneously identifying those opportunities that may arise from the UK leaving the EU. Navigating those challenges successfully makes the pursuit of Brexit dividends a much easier task. This report seeks to convey that while there are hurdles to clear, they are not insurmountable if all sides approach negotiations pragmatically and with a long-term perspective. While the campaign period unsurprisingly gave way to uncompromising black and white arguments, it is, belatedly, a time for identifying the nuance and varying shades of grey which charting a Brexit path necessarily entail.

While the prime minister is right to assert that negotiations will ideally yield a “bespoke” agreement that is not completely analogous to other existing “off the shelf” models, she should consider that this constrains the ability of businesses to comprehensively scenario plan for how Brexit might impact their operations. Therefore it is essential for the government to maintain open lines of communication with business about priorities and process in order to send confidence-boosting messages that will maintain some level of stability and certainty in the interim period. This need not be tantamount to revealing information about negotiating strategy, but rather signalling and signposting what it hopes to achieve in the negotiations.

The IoD, as with government, has undertaken extensive consultation with members across all sectors – those trading internationally, domestically-focused, and everywhere in between – in order to assess what business needs to minimise disruption for trading operations and maintain existing client and commercial relationships. This discussion is not static but rather an iterative process, meaning that IoD priorities will naturally assume more detail and evolve as the debate intensifies. However, it remains a fact that the UK will leave the EU, and that some disruption to trade is inevitable, whatever the post-EU model that it adopts. Business must balance principle with pragmatism in its approach to Brexit, although creative solutions and outside-the-box thinking is required.

This paper sets out what the IoD believes the government and other parties should prioritise at this preliminary point in terms of the Brexit process, outcomes and communication, and assesses what the trade-offs between various potential models would be for businesses across a range of key sectors.

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<sup>1</sup> IoD Policy Voice Survey – UK Relations with the European Union and Budget. April 2016.

Two comprehensive surveys of IoD members conducted in October and November across a range of issues and policy areas relating to the UK's EU withdrawal help to inform this report as an initial positioning paper. These priorities and principles should include:

- Avoiding the 'cliff-edge': ensuring there is no uncertain vacuum period between the withdrawal agreement and the enactment of a new framework covering relations between the EU and UK. In-principle agreement at the outset of negotiations to extend the two-year negotiating window should it be needed, particularly if no parallel negotiations
- Build confidence about the direction of negotiations through announcing, when possible, agreement on specific discrete areas of on-going cooperation, such as participation in the EU's Horizon 2020, Erasmus and other programmes
- Where gradual announcements are not possible, confidence can be built by guidance on objectives such as tariff-free access for all sectors, maintaining a preferential agreement with the EU on labour mobility and other areas
- A commitment across all major political parties for the next parliament to the political irrevocability of triggering Article 50 and not to undertake a second referendum on either EU membership or the Brexit deal to reduce uncertainty for business and boost public confidence about the way forward
- The government should immediately guarantee that the three million EU citizens living in the UK will be able to stay after Brexit, and that a similar deal will be sought to protect the status of the 1.2 million British citizens living in other EU countries. Employers are constrained in planning for the future and cannot give their employees the assurances they need until government makes this guarantee.
- A willingness from government to continue to contribute to the EU budget where broad UK interests can be advanced through doing so
- Ensuring regulatory stability and predictability for businesses with respect to continuity of EU law through the Great Repeal Bill, with any changes in the short term to be gradual and kept to a minimum, removing the pressure of short-term EU-imposed deadlines
- Seeking an arrangement with the EU which, on fundamental questions such as Single Market membership and a customs union, applies evenly across as many sectors and parts of the UK as possible, rather than cherry-picking access levels for different ones
- On the basis that the UK will not retain membership of the Single Market, the government must ensure that quality and content is the top priority for an agreement, not simply speed
- Working with the EU and national governments to maintain liberal economic principles which the UK fought to establish
  - Retain cross-border principles underpinning state aid control and competition policy
  - Ensuring robust rules on non-discrimination and national treatment which go well beyond the EU's commitments in the General Agreement on Trade and Services (GATS) are maintained between the UK and the EU
  - Provisions for cross-border enforcement of court judgements, dispute resolution and the wider principles listed here in the absence of the backstop of EU law
  - Tariff-free, quota-free trade in goods (including in agriculture)

- A liberal agreement on labour mobility which facilitates continuing movement of labour between the UK and the EU as much as possible even if controls are introduced. General visa-free travel must be maintained for UK/EU visitors
- Minimise customs checks by moving to set up a joint EU-UK customs committee as quickly as possible. The UK should join the Common Transit Convention, either through membership of the European Free Trade Association (Efta) or separate negotiations. The goal has to be to minimise the scope for cross-border consignment checks, particularly between Northern Ireland and the Irish Republic
- Extend EU trade agreements to the UK through discussions with governments from third countries which the UK has preferential access to through existing EU trade agreements to identify prospects for either grandfathering or renegotiating post-Brexit terms of application. Some discussion with the EU over these may be necessary and a sign of inclusive goodwill on the part of the EU

It is clear that government has a mammoth task on its hands with respect to negotiating an orderly exit from the EU. It is imperative for all parties to come together to explore various scenarios and priorities rather than using the situation at hand as an opportunity for short-term politically opportunistic gain. Making the best of Brexit, while tackling the manifold potential challenges that arise from it, requires a departure from campaign rhetoric and posturing. The role of business is to bring practical substance to debates that have been theoretical and ideologically-driven to date, informing policymakers about what is needed to mitigate risks for the widest share of companies across the UK while offering suggestions on what is required to create and pursue opportunities that could arise from the post-EU landscape.

Finally, it is not enough for business to simply voice its opinion on what government needs to do to avoid the cliff edge of Brexit. Companies rarely wait for states to negotiate trade agreements before venturing into cross-border trade. Accordingly, business people must not wait for the outcome of negotiations before undertaking their own planning and consultation in an attempt to minimise the potential for disruption to existing commercial relationships. While comprehensive scenario modelling remains difficult for many companies large and small, it is essential for firms to identify the extent of their business links both direct and indirect to the EU. This will facilitate pre-emptive discussions with customers, clients and other trading partners throughout supply/value chains to understand what is needed to maintain those relationships in the event of changes to formal trading arrangements between Britain and the EU. Businesses must play an active rather than a passive role in making a success of the UK's exit from the European Union, and the IoD is committed to supporting them to this end in navigating the challenges it presents for the duration of negotiations and beyond. Brexit is not just about a divorce. It is essential that all parties, all sides, view this period through the lens of creating a new long-term framework for close trading and political cooperation between the UK and the EU going forward.

## “It is still much too early to make a prediction about the impact on our business because we are still in the EU and nothing has changed”

*IoD member, human health and social work activities, 11–25 employees*

### Impact of the referendum – How are businesses coping?

For the most part, with respect to existing operations and activity, it is largely business as usual for IoD members. This is a separate but related question to issues stemming from confidence. In a survey conducted over a two-day period immediately following the referendum, a significant majority (64 per cent) reported that they believed the outcome would be negative overall for their business. This is broadly in line with how members likely voted, given they split 63-29 per cent on voting intentions in favour of remaining in the EU shortly before the referendum<sup>2</sup>.

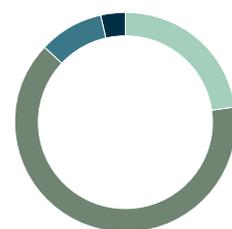
Since June, that degree of pessimism about the anticipated impact of leaving the EU has continued, albeit with a slight uptick in the share of respondents who believe that Brexit will be an opportunity for their business. Uncertainty over the UK's future trading status with the EU ranks second in terms of what members feel is having a negative impact on their organisation. However, any restrictions on employers' current access to the EU labour market – a stated priority for the government in Brexit negotiations and one of IoD members' foremost concerns<sup>3</sup> – is inherently linked to (and likely to exacerbate) the issue of skills shortages; another major barrier to growth.

Previous surveys indicate that IoD members tend to believe that economic headwinds and global political events will have more of an impact on the UK economy as a whole than on their businesses. This held true for overall business confidence in the months following the referendum. There was a sharp drop in optimism, though after a period of volatility, confidence is gradually returning albeit not to the levels pre-referendum. A majority of members expect no change in the outlook for employment or business investment at company level when comparing the next 12 months with the previous year. The picture is more mixed with respect to revenue and profitability, where the positive outlook is much more pronounced.

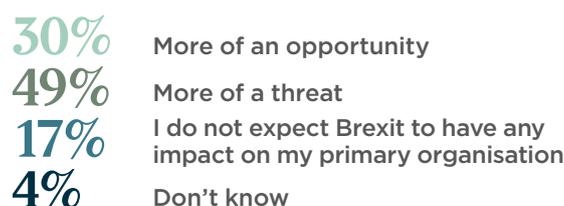
#### “Do you think the result of the referendum will be positive or negative for your primary organisation?”



Source – IoD Policy Voice Snap Referendum Survey, June 26th 2016



#### “On balance do you think Brexit will be a threat or opportunity for your business?”



Source – IoD Policy Voice Survey, October 2016



#### How optimistic or pessimistic are you about the prospects for your (primary) organisation over the next 12 months?

	Very optimistic	Optimistic	Neither optimistic nor pessimistic	Pessimistic	Very pessimistic
March 2016	14%	48%	24%	12%	1%
July 2016	8%	38%	33%	17%	4%
September 2016	15%	41%	25%	16%	2%
October 2016	10%	35%	33%	18%	3%
November 2016	11%	42%	32%	12%	2%
January 2017	14%	46%	29%	9%	1%

#### How optimistic or pessimistic are you about the wider UK economy over the next 12 months?

	Very optimistic	Optimistic	Neither optimistic nor pessimistic	Pessimistic	Very pessimistic
March 2016	1%	36%	39%	21%	2%
July 2016	5%	30%	22%	32%	10%
September 2016	10%	38%	18%	28%	5%
October 2016	6%	25%	20%	37%	12%
November 2016	6%	33%	26%	28%	7%
January 2017	5%	29%	28%	23%	5%

<sup>2</sup> “IoD publishes wide-ranging survey of business views on the EU”. 9 May 2016. [iod.com/news-campaigns/press-office/details/iod-publishes-wide-ranging-survey-of-business-views-on-eu](http://iod.com/news-campaigns/press-office/details/iod-publishes-wide-ranging-survey-of-business-views-on-eu)

<sup>3</sup> Question 18, IoD Policy Voice Survey, October 2016.

## “We bill in the currency of the country where a transaction takes place so the value of the pound is not necessarily a causal factor”

*IoD member, professional, scientific and technical activities, 26–49 employees*

Looking at planned changes is perhaps a more practical indication of the referendum’s effect on business activity, although it is still confined to a minority of IoD members across all areas. It is therefore more instructive as anecdotal evidence.

The picture emerging from business is that a minority of firms are actively making changes to hiring and investment plans as well as actively considering changes to their operations locations at the same time. This minority is not insignificant, hovering around the 20 per cent mark for members who say they have either decreased investment, delayed hiring plans or considered moving some business activity outside the UK since the referendum.

The plunge in the value of sterling has of course been the area where material fallout from the referendum has been most noticeable. Between Q2 (April to June) and Q3 (July to September) of 2016, import prices rose by a significant four per cent<sup>4</sup>. Some economists contend that this is a welcome change, noting that the current account pointed to the pound being overvalued and even going so far as to call for active monetary policymaking to keep sterling at a low rate to boost exports and redress the UK’s current account deficit<sup>5</sup>. However, historical data shows that devaluations in sterling over the past century have not yielded any material sustained improvement in the UK’s balance of payments<sup>6</sup>. In any event, the IoD does not support central bank or government policy intervention for the purposes of influencing the exchange rate.

The reality is that the impact of the fall in the pound is naturally a negative owing to the UK’s persistent trade deficit in goods. As a net importing nation, the effect has been marked among importers, who have yet to substantially pass higher prices on to retailers and customers. Indeed, among the 38 per cent of IoD members who import goods and/or services for use in their business activity, **75 per cent** have seen the cost of these imports rise since the referendum.

### Outlook for your business – 12-month forecast compared to previous 12 months

	Revenue	Profitability	Business investment	Employment
Much higher	9%	7%	4%	2%
Somewhat higher	44%	34%	25%	27%
No change	24%	31%	51%	54%
Somewhat lower	19%	23%	13%	14%
Much lower	3%	5%	5%	2%
Don’t know	1%	1%	1%	1%

Source – IoD Policy Voice Survey, November 2016

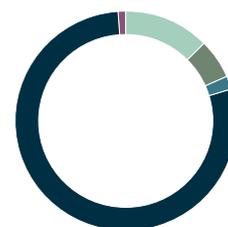
### How have the investment and hiring plans for your business organisation changed since the referendum?

	Investment	Hiring
Significantly increased	2%	1%
Slightly increased	6%	7%
Stayed the same	69%	68%
Slightly decreased	14%	14%
Significantly decreased	6%	7%
Don’t know	3%	3%

Source – IoD Policy Voice Survey, October 2016

### Since the referendum, has your business considered any of the following changes to the location of its operations?

- 13%** Move some or all operations from the UK to the EU
- 6%** Move some or all operations to outside the UK and the EU
- 2%** Move some or all operations (back) to the UK
- 81%** None of these
- 1%** Don’t know



Source – IoD Policy Voice Survey, October 2016

<sup>4</sup> ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/uktrade/sept2016#export-and-import-prices-for-trade-in-goods-not-seasonally-adjusted

## “We are looking at markets outside of the EU that will make up the shortfall we are anticipating as EU clients slash their UK supply chains”

*IoD member, Other services activities, 1–10 employees*

The elephant in the room is increased inflation, however it appears that the contribution of exchange rate volatility to that rise has been muted<sup>7</sup>, potentially because the sharp rise in imported inputs costs has not yet been significantly passed on through the supply chain to consumers. There is a chance that this may not come to pass should importers find other ways of mitigating sterling's fall than putting up prices. However, many firms who have engaged in currency hedging, for example, have only done so to the beginning of 2017, and as hedging falls away, prices may begin to rise.

Sixty-five per cent of IoD members who import for value-add purposes indicate they are considering putting up prices next year to compensate for the drop in the pound. For exporting members, only 22 per cent have seen this translate to a boost in exports and related turnover. However, they are rather more balanced in terms of expectations for this over the next 12 months, and 48 per cent say they intend to seek new foreign market opportunities outside the EU as a result of the referendum.

There are of course other potential drivers for increased inflation, including a recovering oil price pushing up transport costs, demand-pull factors such as the potential for (and prospect of) labour shortages – further fuelled by an ongoing skills gap crisis and possible restrictions on labour mobility from the EU – and a vast amount of quantitative easing undertaken to date by the Bank of England. The actions that businesses take in response to revenue challenges are also at play, and the IoD is closely monitoring member intentions to assess how firms might respond to any Brexit-related challenges.

### Which of the following factors are having a negative impact on your business?

Total	
UK economic conditions	58%
Uncertain trading status with the EU	48%
Global economic conditions	39%
Skills shortages/employee skills gaps	36%
Compliance with Government regulation	35%
Business taxes	33%
Broadband cost/speed/reliability	32%
Employment taxes	29%
Difficulty or delays obtaining payment from customers	28%
Cost of energy	23%
Access to, or cost of, finance	18%
Cost of transport	17%
Other (please specify)	4%
None of the above	4%
Don't know/Not applicable	1%

Source - IoD Policy Voice Survey, October 2016

**“We are currently restructuring so that our HQ and holding company will be in a proper EU country, with the UK offices as an ordinary subsidiary, serving only the UK. This will impact our growth in 2016 significantly but we expect it to pick up again in 2017. Seventy-five per cent of our revenue comes from the EU”**

*IoD member, professional, scientific and technical activities, 26–49 employees*

<sup>5</sup> Roger Bootle and John Mills. The Real Sterling Crisis: Why the UK needs a policy to keep the exchange rate down. Civitas. September 2016. [civitas.org.uk/content/files/The-Real-Sterling-Crisis.pdf](http://civitas.org.uk/content/files/The-Real-Sterling-Crisis.pdf)

<sup>6</sup> [thesaturdayeconomist.com/the-great-devaluation-myth--uk-and-sterling.html](http://thesaturdayeconomist.com/the-great-devaluation-myth--uk-and-sterling.html)

<sup>7</sup> [bbc.co.uk/news/business-37986365](http://bbc.co.uk/news/business-37986365)

**“2016 was fine but when reality hits in 2017/ 2018, we expect life to get tough. We are stockpiling cash now just in case, and this means short-term investment is very carefully managed”**

*IoD Member, ICT, 101–200 employees*

It is encouraging to see that IoD members would meet reduced revenue through pursuing new customers and reducing regular costs, rather than measures such as reducing wages, although a minority do say they would reduce headcount as a first measure. However, we also know from the last recession that many IoD members in fact froze wages or looked to reduce working hours in order to maintain their existing workforce<sup>8</sup>. While the hope is that firms carry on with planned investment rounds while UK-EU trading relations remain the same in the near term, it is clear that one of the first casualties of uncertainty in this area is likely to be delaying new investment decisions, particularly those which require long-term planning.

As the next section will explore, some of the present uncertainty could be mitigated through agreement at the outset of negotiations to avoid any cliff-edge scenario and reassure business that the current regulatory and trading landscape is unlikely to significantly or suddenly alter in the short- to medium-term. Quantifying and evaluating the impact of potential non-action is naturally more difficult at this early juncture but the consequences of reduced new investment will be manifested over time. The government must not be complacent in this regard and should endeavour to send out confidence-boosting measures in the interim both with respect to communication on Brexit priorities and committing to domestic policies which address crucial areas such as the skills gap, joined-up infrastructure investment and coordination through the opportunities that devolution presents and targeted trade promotion initiatives which collaborate with private sector intermediaries.

**Has your business seen, or does it expect to see, a boost in exports and/or export-generated turnover in overseas markets since the referendum as a result of the fall in sterling? (IoD Exporters)**

	Has seen	Expects to see
Yes	22%	39%
No	72%	47%
Don't know	7%	14%

Source – IoD Policy Voice Survey, November 2016

**Does your organisation plan to pursue new foreign market opportunities outside the EU over the next 12 months?**



Source – IoD Policy Voice Survey, November 2016

**If revenues were to come under pressure in the coming 12 months, what would your first actions be to address this challenge?**

Total	980
Seek out new customers	69%
Reduce regular running costs	59%
Reduce headcount	37%
Reduce planned new project investment	36%
Compliance with government regulation	35%
Run down accumulated reserves	33%
Reduce planned routine investment	29%
Reduce compensation levels	16%
Arrange to borrow revenue shortfall from banks	4%
Other (please specify)	3%
Don't know	1%

Source – IoD Policy Voice Survey, November 2016

<sup>8</sup> ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/uktrade/sept2016#export-and-import-prices-for-trade-in-goods-not-seasonally-adjusted

## “It’s too early to start any scenario planning. Brexit will not happen for at least 30 months and we need to be further down the road to see what the likely outcomes are”

*IoD member, human health and social work activities, 501–1000 employees*

### A smooth Brexit process

This section examines priority areas surrounding the process of Britain exiting the EU which the IoD believes are imperative to ending up with a smooth Brexit, something the prime minister has rightly recognised is of paramount importance to business<sup>9</sup>.

#### Parallel negotiations

Article 50 in the Treaty on European Union (TEU) lays out scant detail on the mechanics of a member state leaving the EU, which many observers conclude stems from a belief that it was never expected, or intended, to be used – including from one of its authors<sup>10</sup>. However, it does assert that:

***“In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union.”***

Clearly, having never been triggered, there is no further legal guidance or ruling by the European court of justice (ECJ) offering a decisive interpretation as to what this means for the staging of negotiations. While such guidance could lessen the scope for political wrangling between the two parties, any intervention or referral to the ECJ would dramatically fuel political tensions and complicate the negotiations in terms of substance, scope and timing, and is therefore broadly undesirable.

Therefore, it is essential that the EU and the UK set out some scoping parameters following the UK’s letter to the council notifying it of its intent to trigger Article 50. Reports and statements from the European Commission following the referendum indicate an institutional preference for completely separating out the withdrawal agreement from the negotiation of a new framework for EU-UK relations, potentially even

allowing for a vacuum period where the UK would ‘default’ to an uncertain WTO baseline before negotiating a new framework for relations with the EU<sup>11</sup>.

Such a move would lead to significant and sudden disruption for UK-EU trade and a potential shock for both sets of economies, although likely a deeper one for the UK and an effect felt more acutely in only a handful of EU member states, albeit large ones.

It is perhaps little surprise that the leader of one of those potentially most affected, German chancellor Angela Merkel, has to some extent quelled concerns relating to such a period of limbo<sup>12</sup>. However, the Commission reportedly continues to push for a complete separation between the withdrawal and trade-related negotiations, which raises questions about what the institutional balance and tensions between the Council and Commission will be throughout the Brexit process.

The IoD believes it is in the interest of both sides to ensure that this process is indeed as smooth as possible. Questions over the content of the final terms of the various agreements should be separated from those relating to scoping and structure. Pragmatism should play a central role in setting out the staging parameters, confining politics to the substance of the negotiations themselves as much as possible.

As part of such an initial scoping exercise, the EU and UK should aim to agree that the withdrawal agreement and new framework agreement should either be done in parallel or that, subsequent to the withdrawal agreement, transitional or extension provisions will be enacted subsequently in order to allow for a period of continuity between the two stages. However, this still does not remove the uncertainty business could face once negotiations on the trading framework are concluded, and would therefore (preferably) necessitate a secondary transitional period allowing all parties sufficient time to prepare

<sup>9</sup> news.sky.com/story/sky-views-may-needs-smooth-brexit-10625527

<sup>10</sup> independent.co.uk/news/uk/politics/brexit-eu-referendum-britain-theresa-may-article-50-not-supposed-meant-to-be-used-trigger-giuliano-a7156656.html

<sup>11</sup> bbc.co.uk/news/uk-politics-eu-referendum-36678222

<sup>12</sup> theguardian.com/politics/2016/jul/22/brexit-talks-uk-limbo-sequence-negotiations-eu

## “As we are halfway down the supply chain, we will have to follow the suppliers lead on planning for Brexit”

*IoD member, wholesale and retail trade, 101–200 employees*

before the new terms come into force. The IoD congratulates the prime minister on stating the government’s intention to seek a phased implementation approach of the new framework<sup>13</sup> once concluded.

The fact that it is in the clear stated interest of all sides not to let negotiations drag on interminably strengthens this case for parallel negotiations. Additionally, while the withdrawal agreement has yielded far less interest or discussion about what it covers in concrete terms than the new trading framework, it is difficult to see how both legally and politically the two could or should be entirely separated.

Liabilities relating to payment of pensions for UK nationals across the EU and vice versa, the future status and rights of EU/UK nationals, the termination of the EU *acquis*, and the issue of any continuing UK contributions to the EU budget all appear to inevitably cross-pollinate both sets of negotiations. A briefing on article 50 from the European Parliament Research Service notes that “experts agree [...] complete isolation of the withdrawing state from the effects of the EU *acquis* would be impossible if there is to be a future relationship between former Member State and the EU”<sup>14</sup>.

As set out in the penultimate section, the IoD believes continuing UK contributions to the EU budget are likely to be necessary to continue participating in various EU programmes which are important for the UK to support its strong research and science base. Given the tendency of trade negotiations to entail trade-offs (whether explicit or implied) between different and seemingly unrelated chapters, it seems evident that those contributions are likely to be pertinent to areas covered by both the withdrawal and new framework agreements.

Lastly, the principle of parallelism is envisaged by Article 50 itself, where it stipulates the negotiation of an agreement with the departing member state “setting out arrangements for its withdrawal, *taking account of the framework for its future relationship with the Union*”. In fact, the

treaties envision one sole agreement comprised of multiple parts, arguably removing the scope for any supposed gap or cliff-edge and ensuring any new terms can only come into effect once the new framework is agreed. This should give comfort to those concerned that the experience of CETA – whereby a small regional assembly in Belgium was able to effectively veto the EU-Canada agreement owing to the need for unanimity in council on mixed-competence trade deals – would be repeated with Brexit. While its interpretation potentially hinges on what “takes account of” and “framework” is understood to mean in practice, Article 50 does set out that the withdrawal agreement – taking account of the new trading framework – shall be concluded by the council acting on the basis of qualified majority voting. This significantly reduces the likelihood of the agreement being blocked by a single country.

<sup>13</sup> “The government’s negotiating objectives for exiting the EU: PM speech”. 17 January 2017. gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech

<sup>14</sup> europarl.europa.eu/RegData/etudes/BRIE/2016/577971/EPRS\_BRI(2016)577971\_EN.pdf

## **“Maintaining the current situation until a new arrangement can be put in place would be the most reasonable course to pursue. Otherwise you will waste a great deal of time and effort trying to negotiate interim deals”**

*IoD member, professional, scientific and technical activities, 26–49 employees*

### **Transitional arrangements and the “cliff edge”**

The issue of transitional arrangements has rightly generated much discussion about the UK’s exit from the EU. They are crucial to ensuring the exit process is a smooth one for business, regardless of whether the final terms amount to a “hard” or “soft” Brexit. Judging from the media coverage to date, there is a mistaken view among some that this issue is primarily one for banking and financial services<sup>15</sup>. In fact, it is most likely that firms trading goods would feel the first, most immediate and sustained impact of moving rapidly to a situation where new tariffs and customs checks were put in place. Moreover, government itself will require its own period of adjustment to implement changes to existing infrastructure systems – especially HMRC – to cope with the increased administrative burden that regaining control over various policy areas likely entails.

Restrictions on cross-border provision of services are more likely to be felt on an ad hoc basis over time (if for example a British-based company finds itself subject to additional bureaucratic hurdles in setting up shop or moving temporary workers to an EU country, or is unable to rely on EU non-discrimination law as a backstop for cross-border disputes). The potential erection of more immediate and tangible barriers in the goods trade – such as additional paperwork to get products type-approved for the whole EU market, delays at the border, introduction of tariffs and tariff rate quotas etc – would be an immediate and quantifiable cost hike to cross-border trade. Immediate entry into force of these new terms and barriers would require an almost inhumanly rapid period of calculation and adjustment by goods traders and logistics firms as soon as the negotiations were concluded.

There are multiple ways in which measures could be undertaken to avoid the prospect of a sudden, disruptive and disorderly shift to new trading arrangements between the UK and the EU. One preliminary method would be, as part of pre-negotiation scoping discussions, for the two sides to come to an in-principle agreement to extend the two-year negotiating provided for in Article 50 *should it be needed*. This would take

the hostage element of article 50 off the table to a degree, removing concern and uncertainty for businesses that as the clock winds down, a sudden shift to WTO/Most Favoured Nation (MFN) rules might occur if no final deal is reached. In order to appease concern over negotiations dragging on without the constraint of any time pressure, this window could be extended to a set deadline of one to two years. However, the experience of CETA and David Cameron’s renegotiation should prove an instructive reminder to both sides about the drawbacks of creating artificial and pre-emptive deadlines for negotiations.

Securing EU agreement for this in-principle extension at the outset may be difficult, and requires unanimity per article 50, but the UK government could incentivise this by compromising to allow for the negotiation of the withdrawal agreement first. Should the need arise, a pre-emptive deal on extending the negotiating window to some extent reduces the urgency for both sets of negotiations to be done in parallel, although this is still highly desirable.

Another confidence-boosting measure at the outset of negotiations would be for the UK and the EU to agree as a further part of the scoping exercise to the principle of a transitional period to apply after the withdrawal and new framework agreement(s) were completed. This in-principle agreement need not go into any exhaustive detail at such a preliminary stage, leaving the “what” and “how” for the substantive negotiations.

Should it be needed, the most ideal extension period in between the withdrawal agreement and completion of the new framework would be a continuation of the status quo for a period of one to two years. This option would stand up to legal scrutiny from the perspective of WTO compliance as well as being free from any further political wrangling or negotiation. From the point of view of both government and business, an extension arrangement continuing with current arrangements would eliminate the need for multiple rounds of differentiated negotiating and

<sup>15</sup> [dailymail.co.uk/news/article-3955772/We-ll-cut-business-tax-lowest-rate-G20-says-PM-Theresa-vows-commitment-free-market-pledges-bring-corporation-rates-time-low.html](https://www.dailymail.co.uk/news/article-3955772/We-ll-cut-business-tax-lowest-rate-G20-says-PM-Theresa-vows-commitment-free-market-pledges-bring-corporation-rates-time-low.html)

## “I need time to make any changes to the supply chain”

*IoD member, manufacturing, 250–500 employees*

adjustment planning. It would mitigate the issue of prolonged uncertainty for longer-term investment planning for businesses, both in the UK and overseas, to know that a full level of predictability and stability would be maintained for a further 12-24 months (a normal investment cycle in the manufacturing sector<sup>16</sup>).

Remaining fully embedded in the EU over the next several years, potentially beyond the next general election, may be a difficult political message for the prime minister to deliver. However, in the context of asserting that “Brexit means Brexit”, it should be made clear that the imperative is to deliver the right exit, and that time may be needed to ensure that the UK is fully able to make the best – a success – of Brexit. However there are clearly major issues of trust about the commitment on all sides to delivering the outcome of the referendum.

UK politicians could mitigate the scope for suspicion that this might somehow lead to a revocation of the article 50 process by committing in their next manifestos to completing the ongoing negotiations for exit, should they look unlikely to be completed before 2020. A further measure to boost both political confidence and certainty for business would be for all parties to rule out a second referendum over the next parliament – either a repeat on EU membership or on the final terms of the deal. Additionally, the EU and UK could agree a legally binding commitment that, once concluded, the withdrawal agreement is irrevocable, thus obliging the next government to carry it out should the UK not be out of the EU going into the next general election.

Backdating the implementation of the withdrawal agreement to coincide with the signing of a new trade/cooperation agreement between the UK and EU would, as outlined above, be the smoothest and simplest route for all, and leave the UK with full voting rights in the Council until this point. However, this route may prove politically impossible for all sides if both the UK government and the EU wish for the withdrawal to be concluded – and in effect before – both

**From the point of view of your organisation, how important or unimportant is it for the government to secure transitional provisions for the period between Brexit negotiations and when new arrangements for UK-EU trade come into effect?**

**55%** Very or somewhat important

**24%** Neither important nor unimportant

**17%** Very or somewhat unimportant

From the November 2016 PV Survey – Q11 in the survey.

respective sets of elections. There is likely to be significant pressure within the EU not to allow the UK to elect MEPs in 2019. In this event, an extension period allowing for grandfathered rights and obligations to continue will be needed. The enforcement mechanisms for this however will be a thorny issue to tackle, if the European Commission and ECJ are no longer to have jurisdiction in the UK immediately following the withdrawal agreement’s conclusion. Under this scenario the immediate focus would then have to turn to negotiating interim extension provisions rather than the substance of the final new framework. Ultimately this could mean four possible agreements: withdrawal, extension, new framework and implementation. All this is not to suggest that negotiations necessarily will or should drag on beyond the two-year window, but highlights instead what may be needed in the hopefully unlikely event that they do.

Brexit planning for business is about building a roadmap. They cannot plan on the basis of speculation and conjecture. The IoD welcomes the pursuit of a bespoke agreement, but for planning purposes this means more ‘unknown unknowns’. Transitional arrangements therefore become more important.

In her speech, the prime minister removed one half of the cliff-edge in committing to this “implementation phase” once a new partnership deal is reached. But she still hasn’t acknowledged

<sup>16</sup> [data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-external-affairs-subcommittee/brexit-future-trade-between-the-uk-and-the-eu-in-goods/oral/41843.html](https://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-external-affairs-subcommittee/brexit-future-trade-between-the-uk-and-the-eu-in-goods/oral/41843.html)

## “My business has a major contract with a US organisation to serve European customers”

*IoD member, professional, scientific and technical activities, 1–10 employees*

that this might not be done within the timeframe currently provided under article 50. If the withdrawal and new framework agreements are not ultimately negotiated in parallel, this makes any extension period even more critical to get right.

### The “British option” – priorities and trade-offs

This section lays out firstly the degree of commercial links that IoD members have with the EU. It thereafter lays out some objectives we believe the government should prioritise, followed by an assessment of what some of the inherent trade-offs are between full Single Market membership, a comprehensive trade agreement, some form of a customs union with the EU and “defaulting” to the UK’s WTO membership. It is of course worth remembering that we are in an unprecedented situation, leaving the structures of a harmonised, economically and politically integrated trading area. This necessarily means considering options which are a mix of legal precedent and political possibilities which may require legal changes. The UK’s exit from the EU will set its own precedent, so a combination of pragmatism and creativity are needed in assessing the potential way forward.

### Business links to the EU

A fuller in-depth analysis of IoD members’ commercial integration into the EU and the implications thereof is provided in an earlier 2015 report, *The UK’s relationship with the EU: What does business really think about the EU – and why?*<sup>17</sup>. The table (above) sets out an updated reminder of what the variety of those links are.

The most important takeaway from this in the first instance is to recognise that only 18 per cent of IoD members have no business connections to the EU. That means that 81 per cent have

IoD members’ business links to the EU	
Total	
Export services to EU country/countries (includes having EU-based clients)	43%
Employ individuals from other EU country/countries	40%
Import goods from EU country/countries	28%
Export goods to EU country/countries	22%
Benefit from EU funding (directly or indirectly)	19%
My business has no links to the EU	18%
Subsidiary/Joint venture/Local branch/Franchise (or similar) in other EU country/countries	17%
Part of a supply chain with UK companies which trade with the EU	15%
Import services to EU country/countries	15%
Other (please specify)	5%
Don’t know	1%

From the October 2016 PV Survey – Q15 in the survey.

commercial interests relating to the European Union which could potentially be affected as a result of Brexit. The highest share export services to the EU and employ EU nationals as part of their business. This crucial connection between services trade and movement of labour is explored further below. Secondly, it highlights the vastly diverse complexity of firms’ trading and commercial links to the bloc which government needs to take into account when determining the scope of its priorities and negotiating strategy.

It should be noted that a surprisingly substantial (in comparative terms) minority of directors are linked in some way to EU funding. This is not simply restricted to companies bidding directly for Horizon2020<sup>18</sup> funds or EU regional and structural funds. Anecdotal evidence from IoD members across the UK shows an increasing tendency for businesses to have clients who are supported by EU funding, meaning any significant reduction in

<sup>17</sup> [iod.com/Portals/0/Badges/PDFs/News%20and%20Campaigns/Europe%20and%20trade/The%20UKs%20relationship%20with%20the%20EU.pdf?ver=2016-04-14-101213-223](http://iod.com/Portals/0/Badges/PDFs/News%20and%20Campaigns/Europe%20and%20trade/The%20UKs%20relationship%20with%20the%20EU.pdf?ver=2016-04-14-101213-223)

<sup>18</sup> Horizon2020 is the EU’s Framework Programme for Research and Innovation, which disburses funds for research, technological development and innovation through grants and competitive, calls for proposals and project funding. It aims to complete the European Research Area (ERA) by coordinating national research policies, pooling funding streams and organising a network for informational exchange and cooperation across higher academia, national and sub-national governmental organisations, civil society and the private sector.

## “We need to steady the ship before embarking on new ventures”

*IoD member, manufacturing, 26–49 employees*

access to these programmes would potentially reduce some of these directors’ client base and, accordingly, revenue streams.

The particularly high exposure of IoD members to the EU underscores the importance of securing a comprehensive agreement. For reasons of historical and geographical proximity, trade ties will always exist between the two and the EU will be the UK’s largest trading partner for some time. However, this inevitable degree of integration between the two markets in turn means that any disruption in formal trading arrangements will have a reverberating effect across such tightly integrated supply and value chains. The comparative importance of Brexit negotiations to directors relative to other trading priorities is reflected in the chart (above).

While the IoD believes that full independent control over trade policy is one of the longer-term big gains for business and the wider UK economy out of Brexit, this clearly reflects a realism about where this sits with respect to the priorities for companies in the short to medium term. It is not “the EU vs the world”, but rather understanding how our future relationship with the EU sets the starting point for our relations with the rest of the world going forward.

### What do you consider to be the government’s most important trade negotiations to prioritise?

Total	
A new trade arrangement with the EU	62%
Renegotiating/maintaining agreements with third-country markets that we currently have preferential access to through EU trade deals	14%
New trade deals with markets that we currently have no preferential access to	13%
Clarifying our status in the World Trade Organisation	8%
Don’t know	3%

From the October 2016 PV Survey - Q20 in the survey.

### Priorities

We would like the government to prioritise the following areas and outcomes in order to minimise disruption for businesses and maximise the opportunity for cross-border trade to flourish:

- **Tariff-free trade in goods**

For IoD members, minimising the scope for any tariffs between the UK and the EU was of paramount importance (74 per cent). While tariffs are no longer the most central aspect of modern trade liberalisation agreements, the introduction of any duties would add an immediate quantifiable cost to businesses engaged in goods trade with the EU. Given the volume of this trade between the UK and EU relative to any other market, and the difficulty that any new tariffs or quotas would pose for speedy customs clearance, agreement remains critical. While the UK is a significant net importer of goods from the EU, and would be more directly hit overall by the government maintaining its own import tariffs against the EU, we think it politically very unlikely that the UK would not seek to counter any proposed EU tariffs and quotas with its own similar restrictions.

## “The ability for employees of UK firms to travel and work across the EU is vital so that we are not forced to incorporate in another European country”

**IoD member, other services activities, 1–10 employees**

- **Minimising customs-related disruptions**

While the IoD does not believe *remaining* in the EU’s customs union is viable in the longer term, members are clear that continued customs cooperation and streamlining processes between the UK and EU is extremely important. This is tied with maintaining UK-EU labour mobility as the third most important priority for IoD members. Trade facilitation, which deals with expediting the physical movement, release and clearance of goods, is one of the bread-and-butter issues for businesses large and small selling goods across borders and one of the few areas the WTO has made some progress on in recent years. This highlights the practical rather than political nature often associated with trade policy and as such provides an impetus for pragmatic, economically rational interests to take precedence in this section of the negotiations. The following section sets out various potential options, trade-offs and fallacies looking at the customs union and other alternative arrangements.

- **Maintaining a robust GATS+ commitment to enforceable non-discrimination and national treatment principles in services trade**

It is essential and indeed likely that the EU and UK will want to maintain some form of prohibitions on services protectionism. These need to go well beyond the EU’s original schedule of commitments in the WTO’s 1995 General Agreement on Trade in Services (GATS) in order to maintain much of the existing liberalisation enjoyed by UK and European firms<sup>19</sup>. Ensuring that businesses do not have to maintain a local presence as a condition of supplying cross-border services is vital. Limits on restrictions of data transfers between the UK and the EU is also important to minimise disruptions to e-commerce, particularly around data localisation requirements. The UK will likely need an adequacy assessment from the EU or a bilateral mechanism for data sharing akin to the EU-US Safe Harbour agreement<sup>20</sup>.

- **Maximum labour mobility with minimal administrative burden**

It goes without saying that continuing access to skills irrespective of nationality is of prime importance to British businesses (and vice versa). Forty per cent of IoD members employ non-UK EU nationals. Building up the domestic workforce’s skill base is a long-term initiative. In the short term, it is essential that employers are able to recruit from as wide a pool of talent as possible. Maintaining a preferential scheme for EU workers is essential with respect to Brexit negotiations and, at the very minimum, visa-free travel for EU nationals. The government will have more scope for negotiating on labour mobility in the context of – or an add-on to – a comprehensive trade agreement rather than seeking to fundamentally alter the EEA agreement. The UK should also seek to maintain access to EURES, the EU’s job mobility portal, which connects employers and jobseekers across the EU and EFTA countries.

- **Remaining an active participant in Erasmus, Horizon2020 and future EU framework programmes on research programmes**

While the treasury has pledged to underwrite H2020 projects beyond the UK’s EU membership, the government must prioritise remaining a part of the European Research Area (ERA) in order to support the UK’s strong research, science and technological development base as much as possible. Remaining a member, even if as an associate member, is not just important on the basis of funding streams to UK research. The ERA affords the UK access to a vital network of cross-border collaboration not only within higher education but also between universities and the private sector. H2020 has been crucial for the sustained development of the UK’s Catapult programme, which links industry with science to expedite innovation in high value-add manufacturing<sup>21</sup>. The UK should also participate in the Interreg programme, which allows non-EU countries some access to regional funding and cooperation programmes.

<sup>19</sup> See Annex 1 for an explanation of the various modes of supply as classified under the WTO’s 1995 General Agreement on Trade in Services.

<sup>20</sup> See Q17, “Corrected Oral Evidence: Brexit: Future Trade between the UK and the EU”. Select Committee on the European Union – External Affairs and Internal Market Sub-Committees. 8 September 2016. [data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-internal-market-subcommittee/brexit-future-trade-between-the-uk-and-the-eu/oral/37928.html](http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-internal-market-subcommittee/brexit-future-trade-between-the-uk-and-the-eu/oral/37928.html)

## “Our business depends on the UK following EU data protection laws. If it doesn’t we shall need to create another business in the EU”

*IoD member, ICT, 1–10 employees*

- **Maintaining cross-border rules on competition and state aid principles**

The IoD strongly believes in the need for effective competition and markets as free from distortion as possible. There is no point in maintaining tariff-free, barrier-free trade if governments are then free to subsidise their own producers with no restrictions, shielding them from import competition. Leaving the EU in any form will free the UK from the European commission’s sometimes heavy-handed and politicised approach to state aid policing, but it is desirable to have some form of state aid control continue (and indeed likely that the EU will want to include provisions in any trade agreement in any case). Implementing such a regime could either be done as members of the EEA operating under the oversight of the Efta Surveillance Authority, or through a domestic implementation model in the context of a comprehensive trade agreement with the EU<sup>22</sup>. The latter would afford the UK greater flexibility in application of state aid principles, but less recourse to day-to-day enforcement than under the EEA model.

- **Provisions for cross-border enforcement of court judgements and dispute resolution in the absence of the backstop of EU law and the ECJ**

While the EU’s Single Market in services is still highly fragmented with a number of exceptions and restrictions, the rules, rights and freedoms underpinning it provide an important legal backstop for ensuring non-discriminatory treatment. The use of English law provisions in commercial contracts is a helpful mitigating factor but not a panacea when it comes to intra-EU litigation, particularly when it can be argued that a contract was predicated on the assumption of free movement of goods/services/labour etc<sup>23</sup>.

- **Do not destabilise the regulatory environment in the Great Repeal Bill**

The IoD welcomes the government’s stated intention to bring forward a bill that is intended to provide comfort both to business and to our EU partners that the existing stock of EU-derived law currently on the UK’s statute books will be transposed and given direct effect by new and/or amended legislation. However, it should be made clear that this bill is not intended to fundamentally alter or unpick EU rules which underpin it at this immediate juncture, but something for subsequent domestic wrangling after the UK has left the EU. That would either require an iterative bill lasting for several sessions of parliament or a separate series of bills thereafter. The secretary of state for exiting the EU has made comments to this end which we welcome<sup>24</sup>. There may be some scope for small retrospective changes to strip back particularly onerous gold-plating provisions that have been added to EU directives which have been implemented. After negotiations have concluded, the government should use that opportunity to work in consultation with industry to undertake an audit of that stock of laws to assess where changes can best benefit business. This is not to say that the government shouldn’t be consulting now as part of its industrial strategy to develop broad directions of travel for areas such as our future trade policy, public procurement, agricultural policy, strengthening the UK’s research and science base, tax policies etc beyond Brexit.

<sup>21</sup> See the Catapult programme’s evidence to the House of Commons Science and Technology Committee on the implications of Brexit: [data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/science-and-technology-committee/leaving-the-eu-implications-and-opportunities-for-science-and-research/written/35659.html](https://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/science-and-technology-committee/leaving-the-eu-implications-and-opportunities-for-science-and-research/written/35659.html)

<sup>22</sup> For more information on the particular features of each option, see the Commercial Bar Association’s Brexit working paper on competition law, pp 55-71

<sup>23</sup> The invoking of “force majeure” and/or “material adverse change” arguments to renegotiate contracts may increase as a result of Brexit.

<sup>24</sup> [theyworkforyou.com/debates/?id=2016-10-10b.39.6](https://theyworkforyou.com/debates/?id=2016-10-10b.39.6)

## Potential models

While recognising the likelihood and desirability of a unique bespoke “British” model that takes into account the shared history of cooperation, integration and uniform starting point between the UK and the EU, it is worth briefly considering each of the potential models which inform the wider discussion about the UK’s post-Brexit options. In doing so, we will endeavour to provide an honest, objective assessment about the benefits, drawbacks, likelihood and risks that would need to be mitigated under each scenario. As evidenced from the chart below, there is no overall majority preference among IoD members for one particular option, although they favour either the EEA or a free trade agreement by two to one over defaulting to WTO terms and being in a customs union with the EU. Given the ongoing debate about the implications of the prime minister’s decision that the UK will not continue as a member of the Single Market, we have retained a section on the EEA.

**It is important to note that there are no easy options or obvious answers about the way forward for business. Given the variation in exposure both by sector and within sectors to different risk/opportunity elements of Brexit, it is inevitable that many firms will face a more challenging and costly operating climate whatever the final model that emerges. Others will clearly benefit from areas where some of the trading status quo is maintained or from more legislative and policy-setting control being returned to the UK. What is more difficult to predict is to what extent those changes will impact and/or reduce trade between the UK and the EU – and at what pace.**

**The analogy often drawn between countries that have different preferential trading arrangements with the EU and the UK seeking to mimic those arrangements overlooks a fundamental difference in starting points. Norway, Switzerland, Turkey and Canada have moved to deepen their formal trading ties with the EU, while the UK is moving away from some of them. Reducing existing trade liberalisation**

**in any form – particularly with two deeply intertwined economies – means the UK is not simply negotiating a trading arrangement with the EU in the traditional sense. Accordingly, Brexit cannot be considered analogous to other models that have gone before in comparing anticipated outcomes.**

IoD Member Preferences	
Total	
UK negotiates a free trade agreement with the EU (no/minimal tariffs on goods, but more limited access for services across the Single Market – comprehensive but likely to take several years)	29%
UK leaves the EU, but like Norway remains a member of the Single Market (less disruption for trading businesses, but UK likely has to accept free movement, continuing budget contributions and EU regulation, without being able to vote on it)	28%
UK relies on World Trade Organisation (WTO) rules and tariffs to trade with the EU (no agreement negotiated at all with the EU on trade or migration)	14%
UK stays in a customs union with the EU like Turkey (no creation of a customs border with the EU, but no privileged access in services or migration)	12%
Other (please specify)	10%
Don't know	7%

From the November 2016 PV survey

### European Economic Area

Currently the only route to date for retaining membership of the Single Market<sup>25</sup> rather than just access to it, the EEA is open to EU and Efta members, and would likely require the UK to rejoin Efta first and apply to join the EEA thereafter<sup>26</sup>. For businesses currently trading with and operating in the EU market, this would cause the least potential for disruption owing to the harmonised regulatory framework governing the internal market which the UK would then continue to be a part of. However, separate negotiations would be needed if the UK wanted to minimise customs-related disruptions unless the UK chose to remain or enter into a customs union arrangement with the EU (being part of both

<sup>25</sup> In academic literature there is a live debate over whether the “Single Market” (a more general and politicised interpretation which still finds its origins in various EU legislative acts) or “internal market” (derived from the EU treaties, specifically article 26 TFEU) constitutes more accurate terminology. For the purposes of this paper and the benefit of a wider audience, the former is employed as much as possible.

<sup>26</sup> Q23. [data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-internal-market-subcommittee/brexit-future-trade-between-the-uk-and-the-eu/oral/38491.html](https://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-internal-market-subcommittee/brexit-future-trade-between-the-uk-and-the-eu/oral/38491.html)

## “Even the EEA leaves a major difficulty in that Norway is outside the EU VAT scheme, so many of the cross-border problems will remain for our business”

*IoD member, wholesale and retail trade, 1–10 employees*

would effectively amount to retaining EU membership in trading terms). Being part of the EEA as an EFTA country would also not remove the thorny issue of rules of origin for future goods trade between the EU and UK, which deal with how a product is labelled with respect to where its components are sourced from and which will almost undoubtedly be introduced in some form with Brexit.

For a number of sectors, the UK’s continued formal participation in the Single Market would provide the guarantee which expedites both testing and deployment of products, not only across the whole of the EEA but also in some areas to non-EU markets as well. This is a somewhat separate but related issue to the setting of “standards”. The European Committee for Standardisation (CEN) brings together a vast number of standards bodies across various sectors, drawn from all corners of Europe to establish voluntary technical standards that reduce the scope for conflicting product standards across borders. Membership extends well beyond EU countries, and it is unlikely that the UK or British Standards Institution would lose its membership – voting or otherwise – regardless of what model future relations between the UK and EU take<sup>27</sup>. CEN, alongside other bodies in the European Standardisation System (ESS) is seen as “a key instrument for the Single Market”<sup>28</sup>. While it has legal recognition by the EU, it is not an EU body itself, and the UK’s continued participation in it therefore does not depend on EU agreement.

However, free circulation of goods into and across the EU does not begin and end simply with basic uniform product standards. Conformity assessment and type approval govern a much wider set of regulatory, technical and safety requirements across a wide array of manufacturing industries. Should the UK not continue as a member of the Single Market, the ability of its Vehicle Certification Agency (VCA) to issue type approval – in particular whole-vehicle

type approval – for automotives to be sold to EU markets (without the need for further testing once there) would be significantly constrained<sup>29</sup>.

In many life sciences industries, membership of the Single Market means companies in those sectors can rely on one application for licensing and/or authorisation across the EEA. For a heavily regulated and heavily traded sector like pharmaceuticals, which has generated the largest trade surplus of any industrial sector in the UK over the past decade<sup>30</sup>, the European Medicines Agency (EMA) plays a vital role in fast-tracking approvals for products to be traded across the Single Market through its single centralised marketing authorisation application procedure. At present, the EMA is only comprised of EU and EFTA-EEA national regulatory agencies as members (therefore Switzerland is excluded). While the UK might be relegated to observer status in the EMA’s Committee for Medicinal Products for Human Use (CHMP) were it to go down the EEA route, this would not affect companies’ ability to make use of the agency’s centralised procedure application, nor any of the EU’s other approvals mechanisms<sup>31</sup>.

Out of the EEA, the UK’s Medicines and Healthcare products Regulatory Agency (MHRA), while having its workload likely increased, could use the opportunity to speed up a number of testing and approvals procedures. The trade-off, as with many other heavily regulated and heavily traded industries, is that greater divergence in legislation increases potential delays in getting UK rules and UK products and technologies to EU markets. The pharma industry is actively pushing back against the creation of any new stand-alone UK drugs regulator for fear of additional administrative complexity and increase in industry costs<sup>32</sup>. For the pharmaceutical and chemicals sectors, economies of scale mean delays matter even more. Fifty-one per cent of British medicinal and pharmaceutical exports go to the EU<sup>33</sup>, while 60 per cent of UK chemical product exports are

<sup>27</sup> [cibsejournal.com/opinion/what-brexit-would-mean-for-european-standards-2/](http://cibsejournal.com/opinion/what-brexit-would-mean-for-european-standards-2/)

<sup>28</sup> [cen.eu/you/EuropeanStandardization/Pages/default.aspx](http://cen.eu/you/EuropeanStandardization/Pages/default.aspx)

<sup>29</sup> [data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-external-affairs-subcommittee/brexit-future-trade-between-the-uk-and-the-eu-in-goods/oral/42811.html](http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-external-affairs-subcommittee/brexit-future-trade-between-the-uk-and-the-eu-in-goods/oral/42811.html)

<sup>30</sup> [abpi.org.uk/industry-info/archive/knowledge-hub/uk-economy/Pages/uk-pharmaceutical-trade.aspx](http://abpi.org.uk/industry-info/archive/knowledge-hub/uk-economy/Pages/uk-pharmaceutical-trade.aspx)

<sup>31</sup> It should be noted that the centralised procedure is but one of several current application options for medicines to be placed on the Single Market.

<sup>32</sup> [pharmaceutical-technology.com/features/featurewhat-would-brexit-mean-for-uk-clinical-research-4824855/](http://pharmaceutical-technology.com/features/featurewhat-would-brexit-mean-for-uk-clinical-research-4824855/)

## “I do not see the benefit of reducing access to the Single Market. Tariffs are only part of the story – other barriers include reporting and non-tariff bureaucracy”

*IoD member, professional, scientific and technical activities, 1–10 employees*

also EU-bound. Geography will always matter in trade, and so it is unlikely that other markets such as the US, Asia or Middle East would be able to sufficiently compensate for any loss or increase in operating costs in UK-EU trade in the short to medium term, even with the advent of bilateral trade agreements.

However, for other industries, some of which create a substantially higher contribution to the UK economy, the dichotomy of regulatory control-vs-market access yields a much more balanced outcome of interests. Financial services, making up nearly 12 per cent of UK GDP and generating a significant share of the country’s trade surplus, has been the subject of a torrent of EU regulation since 2008. The debate about the necessity and efficacy of this entire volume is endless, but it is clear that the UK’s formal voice and vote at the EU table has played an important role in mitigating some of the more potentially punitive measures. The government’s challenge at the EU’s court of justice (ECJ) against proposed ECB guidelines relating to the location of euro-clearing resulted in a significant win for the UK. As a member of the EEA but not the EU, Britain would not have the grounds or legal backstop of EU law to challenge the European commission at the ECJ, and it would be obliged to adopt new EU rules in an area still subject to significant regulatory wrangling in Brussels without a formal vote.

Since the referendum, both of the UK’s major financial services regulators, the Prudential Regulation Authority and the Financial Conduct Authority, have attested to the undesirability of ending up in a situation where the country “were just a taker of standards as opposed to being involved in the making of them”<sup>36</sup>. Without spelling out a preference for any particular model, it is clear that adopting a Norwegian-style relationship with the EU is a major concern for financial sector regulators (and it is worth noting that some of Norway’s biggest industries – fishing and agriculture – are not subject to EU control).

Contrary to popular perception, the issue of UK flexibility and input into EU regulation in financial services is not simply a question of countering rules “that go too far”. Bank of England governor Mark Carney made this clear in a speech and report on the impact of EU membership on the Bank’s primary functions prior to the referendum.

Assessing the challenges posed by EU rules and regulations to the UK’s financial stability, it set out examples ranging from national discretion in insurance supervision to trigger thresholds for contingent convertible capital instruments where UK regulators’ ability to go further than EU provisions have been hamstrung<sup>37</sup>. Stripping the government’s ability to intervene and engage directly in the formation of these rules would thereby dramatically exacerbate these risks going forward. The UK makes up a dominant majority share of the EU’s financial services market. A scenario where representatives from the remaining minority regulate that massive market with no formal input from Britain would be anathema with respect to the idea that it was leaving the EU to take control.

While the IoD strongly supports the principle of free movement to support labour mobility between the UK and the EU, it recognises the futility of insisting on maintaining it in its current form in the wake of the prime minister’s statements since the referendum. There is a live debate over the extent to which controls on free movement would be legally vs politically possible from the EU’s end (though it would not simply be the EU and UK involved as negotiating parties) in the context of the EEA agreement<sup>38</sup>. The other apparent red line to date – leaving the jurisdiction of the ECJ – is an even greyer line to navigate. The Efta court is duty-bound to “correspond” to the EU court in implementing the EEA agreement in EEA Efta states (for example, not Switzerland), but it arguably offers more flexibility than is currently afforded by the ECJ<sup>39</sup>.

<sup>33</sup> [raps.org/Regulatory-Focus/News/2015/01/14/21075/Among-Global-Drug-Regulators-FDA-Still-the-Best-But-Others-Are-Catching-up%E2%80%94Fast/](https://raps.org/Regulatory-Focus/News/2015/01/14/21075/Among-Global-Drug-Regulators-FDA-Still-the-Best-But-Others-Are-Catching-up%E2%80%94Fast/)

<sup>34</sup> [ft.com/content/713b61be-b6f8-11e6-ba85-95d1533d9a62](https://ft.com/content/713b61be-b6f8-11e6-ba85-95d1533d9a62)

<sup>35</sup> [gov.uk/government/uploads/system/uploads/attachment\\_data/file/32475/12-579-uk-trade-performance-markets-and-sectors.pdf](https://gov.uk/government/uploads/system/uploads/attachment_data/file/32475/12-579-uk-trade-performance-markets-and-sectors.pdf)

<sup>36</sup> Q’s 36–31. [data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/financial-conduct-authority-november-2016/oral/42882.html](https://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/financial-conduct-authority-november-2016/oral/42882.html)

<sup>37</sup> 4.2. [bankofengland.co.uk/publications/Pages/speeches/2015/852.aspx](https://bankofengland.co.uk/publications/Pages/speeches/2015/852.aspx)

However, there is evidence to show that there is a precedent of the Efta court following ECJ jurisprudence in an area where the ECJ has posed a persistent headache for businesses of late. On employment law, in particular the working time directive, a number of successful legal challenges have significantly and rapidly changed the landscape for holiday pay in the UK. With fundamental aspects of EU rules being altered through questionable judicial (re)interpretation rather than through consultative and transparent legislative means, the continued reach of the ECJ in employment law is a significant concern for business. And cases brought before the Efta court, such as *Langeland v Norske Fabricom*, have indeed confirmed that seminal ECJ rulings on labour law still apply to Norway and countries that are contracting parties to the EEA agreement<sup>40</sup>.

The government clearly had to think long and hard about whether it wished, in a potentially time-limited scenario, to expend initial energy and efforts on negotiating its way back into the EEA only to find that the red-line controls it seeks to append to this off-the-shelf model were impossible to agree, and only then opting for a plan B. By its very definition as off-the-shelf, the scope for negotiating flexibility is inherently constrained when compared to more bespoke options. Therefore, given the red lines put forward by the prime minister, the article 50 time constraints and the challenges being a permanent 'standards taker' would pose for key sectors, it is somewhat understandable why the government felt compelled to move towards an FTA approach.

## Customs union

**It is misguided to suggest that being in a customs union with the EU is an inherently mutually exclusive choice between control over trade policy and frictionless free trade with the EU.**

It is important to clarify there are two different types of EU customs union models currently in effect. One is the EU's customs union, which is a full customs union covering all sectors with the

EU-28, and the other in effect a customs union agreement with the EU. The latter, which is partial in scope (most industrial products are covered but agriculture excluded), is most notable with respect to the EU's trading relationship with Turkey. Andorra and San Marino have also entered into customs union agreements with the EU, although its relations with these microstates is unique and recognised as distinctly separate from the Turkish model. British crown dependencies such as the Channel Islands and the Isle of Man are also part of the EU's customs territory, though their relationship with the EU has been negotiated on their behalf by the UK.

A debate has belatedly emerged since the referendum over whether the UK will be in any form of customs union with the EU, with the debate in the run-up to 23 June predominantly focusing on the Single Market dimension. While it is almost impossible that the UK could stay as a full member of the EU's customs union as a permanent option, the possibility of doing so as a transitional measure and/or "going the Turkish route" on a longer-term basis has increasingly been mooted. The argument against any formal customs union arrangement primarily centres around the maintenance of the EU's common external tariff (CET), and the implications of that for future independent control of trade policy as well as the ability to manage and change import duties and quotas<sup>41</sup> according to the specific needs of the UK's various sectoral sensitivities.

There is a mistaken conflation purported in some quarters that Turkey's customs union agreement with the EU prevents it from negotiating its own trade agreements with third countries<sup>42</sup>. Turkey has negotiated a number of preferential trade agreements (PTAs) both on the back of EU trade deals with countries and independently of the EU's priorities. Any time the EU changes its CET – either unilaterally or through PTAs with countries – Turkey is required to adjust customs tariff to take account of those alterations. It has left the country in a supplicant position of needing to

<sup>38</sup> Liechtenstein's accession to the EEA agreement – and a subsequent amendment to it – contains a provision for 'safeguard measures' on free movement of persons. However, the scope for the UK to replicate this as a more permanent opt-out/restriction is hotly contested and extremely difficult to predict. See [civitas.org.uk/2016/10/11/the-liechtenstein-solution-is-not-a-model-that-the-uk-could-use-to-permanently-control-migration/](http://civitas.org.uk/2016/10/11/the-liechtenstein-solution-is-not-a-model-that-the-uk-could-use-to-permanently-control-migration/)

<sup>39</sup> [mlexmarketinsight.com/editors-picks/Efta-court-could-offer-post-brex-it-uk-more-flexibility-than-ecj/](http://mlexmarketinsight.com/editors-picks/Efta-court-could-offer-post-brex-it-uk-more-flexibility-than-ecj/)

<sup>40</sup> [keepcalmtalklaw.co.uk/escaping-daddys-dance-hall-the-impact-of-brex-it-on-employment-law/](http://keepcalmtalklaw.co.uk/escaping-daddys-dance-hall-the-impact-of-brex-it-on-employment-law/)

## “Efficient and effective trade depends on international standards for goods and services. The UK, through the British Standards Institution is part of this, and it must be continued”

*IoD member, other service activities, 1–10 employees*

convince third countries with whom the EU is negotiating to run negotiations in parallel or thereafter with Turkey to grant it reciprocal tariff preferences to their market. Moreover, while the EU has exclusive competence to negotiate formal trade agreements, member states have a considerable amount of input in drafting the guidelines and oversight through its trade policy committee (TPC). At best the UK might hope to have observer status in the TPC were it to enter a customs union with the EU, something which has been recommended for Turkey as a way of upgrading its current agreement<sup>43</sup>.

What is less clear is to what extent this is an inherent and absolute prerequisite of any customs union agreement, or a particular feature which the EU has extracted from other countries as a conditional adjunct of it. As some analysts have pointed out, the Mercosur countries in South America are in a customs union, but do not necessarily have to adopt a united common trade policy<sup>44</sup>. This has been held up by some as being an imperfect customs union, but it is a functioning one nonetheless.

The EU has signalled its interest in tandem with the US in respect of the TTIP trade negotiations to provide for a mechanism which would allow third countries to accede to the agreement once completed. This could act as an important precedent to mitigate the asymmetry outlined above<sup>45</sup>. Both the EU and Turkey have recognised that the 1995 customs union agreement is outdated and in need of an upgrade – potentially as a medium-term alternative to Turkish accession to the EU, an increasingly remote possibility<sup>46/47</sup>. This not only counters the notion that the Turkish model is a static one and could never be amended (to suit the UK, for example), but also the idea that a partial customs union agreement is unfeasible because it is intended as a stepping stone towards

full EU membership.

Even if the UK were to be in a full customs union with the EU, it would almost certainly not be in the EU’s customs union, but rather have to enter into a customs union agreement with the EU, with the scope of what is covered to be determined. By leaving the EU, regardless of what (new) trading relationship is negotiated with it, the UK is for all intents and purposes leaving its actual customs union. The EU’s customs union long predates the Single Market – by several decades – and in effect serves as a way of marking out the EU’s formal borders. It is extremely difficult to imagine the UK being a formal part of its Union Customs Code as governed under EU law and treaties while not a member state. This would clearly continue to subject the UK to a significant and active area of ECJ jurisdiction.

One incentive for being in a customs union of some kind with the EU is the perceived reduction in compliance for traders with more complicated rules of origin governing whether a product qualifies for tariff-free or other preferential duty treatment. Goods covered by EU customs union agreements also have some qualification caveats in order to benefit, but the onus on proving this is somewhat less onerous than for most trade agreements containing preferential rules of origin. Those which are covered and qualify to benefit from the EU-Turkey customs union must either originate in the EU or Turkey, or are in “free circulation<sup>48</sup>”. As the next section sets out, there are alternative ways for goods to be afforded free circulation without being in a customs union.

However, it must be noted that the EU’s customs union arrangements with non-EU member states does not eliminate the need for customs declarations, which are likely inevitable regardless of the future EU-UK relationship (going on the

<sup>41</sup> It should be noted in respect of the EU-Turkey customs union (CU) agreement, while there are no trade quotas there are “road transit quotas” which enable EU countries to apply restrictions (via transit permits) to the number of Turkish vehicles allowed to provide services between the two markets because Turkey is not in the EU. The Turkish government contends particular “quota effect” has kept its vital industries from being able to fully capitalise on the potential of the CU agreement. [unece.org/fileadmin/DAM/trans/doc/2014/sc1/Presentation-SC1-2014-1e.pdf](http://unece.org/fileadmin/DAM/trans/doc/2014/sc1/Presentation-SC1-2014-1e.pdf)

<sup>42</sup> [lawyersforbritain.org/eu-deal-customs-union.shtml](http://lawyersforbritain.org/eu-deal-customs-union.shtml)

<sup>43</sup> p.11, file:///C:/Users/laptop/Downloads/A\_New\_Era\_For\_The\_Customs\_Union.pdf

<sup>44</sup> p.4, [eureferendum.com/documents/BrexitMonograph016.pdf](http://eureferendum.com/documents/BrexitMonograph016.pdf)

<sup>45</sup> [atlantic-community.org/-/ttip-how-to-minimize-risks-for-third-countries](http://atlantic-community.org/-/ttip-how-to-minimize-risks-for-third-countries)

<sup>46</sup> [atimes.com/turkey-upgrade-customs-deal-european-union/](http://atimes.com/turkey-upgrade-customs-deal-european-union/)

<sup>47</sup> [ec.europa.eu/smart-regulation/roadmaps/docs/2015\\_trade\\_035\\_turkey\\_en.pdf](http://ec.europa.eu/smart-regulation/roadmaps/docs/2015_trade_035_turkey_en.pdf)

precedent of existing EU customs unions agreements at least). On its website, HMRC states: “Customs documents are required for exports to Turkey including a preferential statement on the movement certificates called an ATR form (see below) if the goods are in free circulation.”<sup>49</sup> If claiming preferential treatment under the EU-Turkey customs union on the basis of goods originating in the EU or Turkey rather than being in free circulation, an invoice declaration or EUR1 certificate is needed to act as proof of origin. Proof of direct transport between the EU and Turkey is also needed to meet the preferential duty requirements. Rules of origin are not completely absent from the EU-Turkey customs union agreement either. The table below from the port of Rotterdam illustrates that new customs formalities and paperwork are inevitable no matter how the UK leaves the EU, even if it pursues a new customs union arrangement.

While not legally governed by the EU’s union customs code (UCC), Turkey has changed a great deal of its customs legislation to be in line with it. The UK is starting from a far better point than Turkey in the sense that it will already be fully compliant with the UCC, an updated, modernised version of the old Community Code. This should in theory help with convincing the EU that, at least in the short to medium term, an established system of trust and identical customs procedures mean the need for complicated customs measures is unnecessary. Trade facilitation is not as contentious as tariffs, although the rules governing who qualifies for them can be.

It is impossible to predict to what extent a UK-EU customs union agreement would be analogous to the Turkish example in terms of scope or documentation requirements needed for firms to prove they qualify to benefit. But Theresa May is right that issues of customs control and co-operation are not dependent on being in a customs union with the EU.

Free movement of: <sup>50</sup>								
	No duties	Custom formalities	Goods / VAT system	People	Services and capital	EU legislation	Contribution Payments	Agricultural politics
EU	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
Norway	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes
Switzerland	Yes	Yes	No	Yes Schengen	Yes Via UK licence	Yes (in part)	Yes (lower)	No
Turkey	Yes	Yes	No	No	No	No	No	No
WTO	No	Yes	No	No	No	No	No	No

The following two model scenarios include some of the additional options around customs cooperation procedures, making clear that a customs union arrangement (like Turkey’s) is not the sole vehicle for close administrative cooperation in that area.

### Sample ATR movement certificate for EU-Turkey goods trade

1. Exporter (Name, full address, country)		A.T.R. No.A 1234567	
		2. Transport Document (optional) No ..... Date .....	
3. Consignee		4. Association between the EUROPEAN ECONOMIC COMMUNITY and TURKEY	
		5. Country of Exportation	6. Country of Destination (1)
7. Transport Details (optional)		8. Remarks	
9. Item Number	10. Marks and Number: number and kind of packages (for goods in bulk, indicate the name of the ship or the number of the railway wagon or road vehicle: description of goods)		
12. CUSTOMS ENDORSEMENT		13. DECLARATION BY THE EXPORTER	

<sup>48</sup> Goods which are in “free circulation” are those which have **either** been imported into the EU or Turkey **or** manufactured in the EU or Turkey wholly or partly from materials/parts originating outside the EU/Turkey. In both cases, they must fulfilled all initial import formalities and have had any customs duties paid - that is, they cannot be sitting in a customs warehouse. Non-EU goods can be treated as EU goods for the purposes of moving around the EU customs territory if they qualify as being in “free circulation”.

<sup>49</sup> gov.uk/guidance/dispatching-your-goods-within-the-eu

<sup>50</sup> Warburg, Marjolein. “Brexit Consequences”. Port of Rotterdam in Dublin Presentation, 8 September 2016.

## Comprehensive free trade/partnership agreement

In the wake of the PM's speech, we now know that this is the route which the UK government intends to take in pursuing a framework for future EU-UK relations. It is essential that both sides view negotiations with this longer-term perspective in mind, rather than just through the narrow prism of a divorce. This reflects the view that an EEA-type deal would not have been a permanent solution, and that a preferential trade agreement (PTA)<sup>51</sup> is more desirable to fit some of the more bespoke needs of both parties.

One of the biggest trade-offs with a PTA and any bespoke model is of course time needed to conclude the agreement, not least because of the unprecedented situation that Brexit entails. However, the fact that the starting point for the UK and the EU – in terms of tariff and non-tariff areas to cover – is uniformly the same and even harmonised in many areas should cut down on some of this. There is no real need for stocktaking exercises to identify where shared interests can be bridged, although the lack of clarity around article 50's interpretation means a preliminary scoping exercise to set out parameters for negotiations is essential.

While the degree of harmonisation and mutual recognition differs by sector, negotiators do not need to spend months examining each other's regulatory systems to see how –for example– respective conformity assessments can be recognised. Assuming that HMRC continues with the roll-out of the EU's new UCC, the UK has a customs framework in place which not only replicates but is identical to the rest of the EU's. At this point in time, both parties can have absolute trust and confidence in each other's regulatory systems, and so the debate turns to how to put mechanisms in place to continue to be able to do so given the inevitable potential for regulatory divergence over time.

A comprehensive free trade agreement between the UK and the EU can therefore dispense with looking at areas of difference to bridge gaps and instead focus on establishing these mechanisms for future cooperation. It is clear then that these

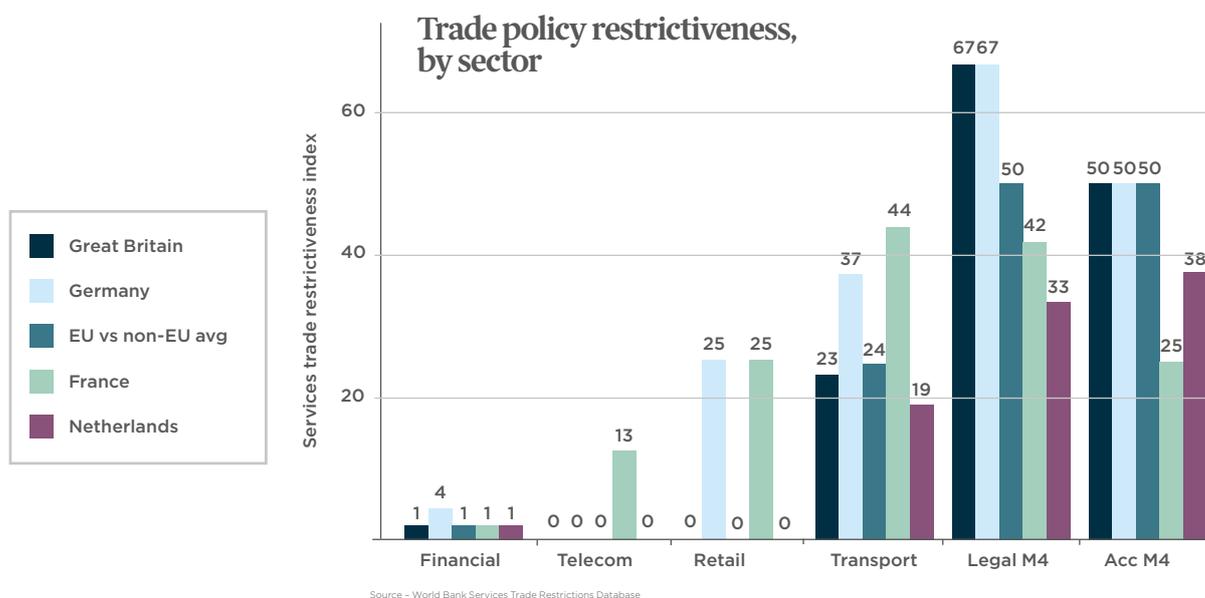
negotiations should produce a “living agreement”, allowing it to be updated on a rolling basis to address trade issues that may arise going forward. This would afford it the flexibility to comprehensively deal with UK-EU economic needs – given the substantial and complex trade ties between the two – that may not be completely covered in a time-delimited period such as the one provided for under article 50. Such an approach is also crucial to providing a framework for continued ad hoc sectoral liberalisation – for example, in mutual recognition of professional qualifications.

The incorporation of this “living” element into any agreement is particularly essential given the UK will likely need to establish a number of new regulatory agencies to replicate the functions of EU bodies, or substantially increase the functions and scope of existing ones. Continued mutual regulatory cooperation and accreditation between UK and EU agencies will be vital for ensuring British firms' products and services can continue to operate seamlessly in each other's markets without incurring substantial new authorisation delays. While there is every reason to assume this can and will happen, it will of course be subject to negotiation. It is heartening to see that the European commission's chief negotiator Michel Barnier has said regulatory equivalence between EU and UK financial services frameworks could work, as long as vigilance on financial stability risk is maintained. That lends itself to the presumption that he anticipates those mechanisms for constant regulatory cooperation going forward.

But assessing equivalence, particularly if domestic standards and rules diverge in the future, can be a time-consuming and unpredictable task. It essentially means that regulators and legislators on both sides will have to design any new standards with their counterparts closely in mind if reciprocal market access is to be maintained. This will be a particular consideration when the UK is negotiating on non-tariff barriers and regulatory cooperation with third countries in future trade agreements. However, ensuring the

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<sup>51</sup> A “preferential trade agreement” (PTA) is the generic category name given to cover a wide variety of trade deals – including a free trade agreement (FTA), economic partnership agreement (EPA), association agreement etc.



UK-EU agreement is a living one will help mitigate the potential for conflict in this area after implementation. It should also be noted that the concept of a chapter laying down the foundations for horizontal regulatory cooperation within a trade agreement is a novel feature proposed by the European commission for TTIP<sup>52</sup>. It would therefore follow that including this in a comprehensive free trade deal with the UK is of even greater importance to the EU this time around.

A free trade agreement between the EU and UK should follow a “negative list” approach to continued sectoral liberalisation commitments in services with respect to both market access and national treatment. This would be in keeping with a growing trend in EU trade agreements like TTIP and CETA<sup>53</sup>, and reflect the uniquely uniform and comparatively open starting point of both parties. It is essential that “standstill clauses” are incorporated through which both sides commit to keep their markets at least as open as they are at the time of the agreement, which would limit the scope for future reservations and restrictions. Additionally, taking into account the desired “living” nature of the agreement and the likelihood that the EU continues to deepen the Single Market in services, an automatic binding clause (“ratchet

effect”) should be included to help both sides take advantage of these developments and lock in future liberalisation reforms.

Assessing the likely impact of moving to a free trade agreement with the EU on market access for services is difficult given the varying degrees of applied liberalisation by country. As Sussex University’s Trade Policy Observatory notes in *Services Trade in the UK: What is at Stake?*:

**“unlike goods there is no uniform EU services trade regime for suppliers outside the EU [...] hence upon leaving [...] access to EU markets for UK service providers is likely to deteriorate in a way that differs across EU member states, sectors and modes of supply”**

The EU’s lack of a fully integrated services market mitigates some of the concerns over what leaving the internal market may mean in practice for firms with cross-border operations. However, firms’ loss of access to legal redress and the enforcement mechanisms of the ECJ and/or Efta court, as well as the European commission, to contest individual countries’ discriminatory restrictions could make this departure more pronounced over time. For this reason, measures and mechanisms to replicate some level of existing enforcement provisions in an

<sup>52</sup> [trade.ec.europa.eu/doclib/docs/2016/march/tradoc\\_154377.pdf](https://trade.ec.europa.eu/doclib/docs/2016/march/tradoc_154377.pdf)

<sup>53</sup> [trade.ec.europa.eu/doclib/docs/2016/april/tradoc\\_154427.pdf](https://trade.ec.europa.eu/doclib/docs/2016/april/tradoc_154427.pdf)

**“Create a bespoke deal to permit free trade in goods and services, defined limits and criteria for immigration, protection for existing immigrants both ways. Given the magnitude of trade and historical links, it would be foolish to impose some existing agreement between minor states as our arrangement”**

*IoD member, professional, scientific and technical activities, 26–49 employees*

FTA between the UK and EU are critical.

One of the potential benefits of pursuing a free trade agreement with the EU is the comparative flexibility around negotiating a new settlement on labour mobility. While the loss of free movement is a worry for businesses used to minimal red tape and the predictability associated with hiring EU nationals, moving to a bespoke system within or annexed to an FTA could set a new standard for trade agreements. There has been scant progress to date in mode 4 services commitments in PTAs, which cover the movement of natural persons as cross-border service suppliers. It predominantly covers temporary movement issues (for example, for the fulfilment of services contracts, extending visa waivers to business visitors etc) and is therefore no silver bullet substitute. However, the UK and EU could go deeper in their commitments in this area to set a new gold standard for skilled labour mobility in the context of PTAs.

If the UK government opts for a unilateral scheme for EU nationals, any work permit system must have exemptions for intra-corporate and temporary transfers. Additionally, the Home Office must be prepared to create a simplified electronic system to help expedite any such scheme.

Beyond mode 4, there is a particular concern over how to ensure the UK can continue to take advantage of EU nationals' skills and talent even in the absence of a job offer as a quid pro quo for entry – and vice versa. The advent of a young entrepreneurial class within Europe necessitates a rethink of how governments approach skilled migration policy. Ensuring visa-free travel is maintained between the UK and EU would be a bare minimum means of maintaining the ability of that mobile generation to physically bring their ideas and talents as a precursory first step. Expanding the Tier 1 visa category for graduate entrepreneurs who are EU nationals and allowing for a mutual recognition system between UK and EU universities in this context (so that it is not only those in receipt of UK degrees who qualify)

would be another way of facilitating the movement of talent. As with EU association agreements (Ukraine, for example) and CETA, there is a precedent for linking visa-free travel and changes in visa systems to EU trade deals.

Finally, there is a great deal of interest in what form customs cooperation might take in the context of a free trade agreement with the EU. It seems inevitable that rules of origin will form part of the negotiations, which could spell increased customs paperwork and checks not just for UK companies trading goods with the EU and vice versa, but also third-country firms with a presence in either market who are engaged in UK-EU trade. In the case of the former, bilateral cumulation provisions would likely cover the concerns of those UK manufacturers reliant on component parts/raw materials coming from the EU about qualifying for duty-free preferences.

However, this would still amount to a significant burden for Japanese companies operating in the UK who are importing large volumes of parts from outside the UK and EU and then selling on to EU markets<sup>54</sup>. If the finished product does not then meet requirements for being “sufficiently worked on” in the UK to obtain UK or EU originating status under an FTA, it will lose any entitlement to those trade preferences. Therefore, the UK government should push for either full cumulation provisions as exist between the EU and the EEA/OCT/ACP countries etc, or at least accede to the pan-Euro-Mediterranean Convention which allows for diagonal cumulation of rules of origin between the EU and a wider set of countries<sup>55</sup>. The looming conclusion of the EU-Japan EPA may complicate agreement in this area, but it could also provide a basis or forum for trilateral discussion and agreement of further cumulative provisions.

There are other ways of mitigating the scope for increased paperwork trails and customs checks within, or attached to, a free trade agreement between the UK and the EU. It is important to stress that this is about mitigation, rather than expecting the current relatively burden-free

<sup>54</sup> A good summary of the practical implications of this can be found here: [medium.com/@SamuelMarcLowe/explaining-cumulative-rules-of-origin-2c13fb4dfca1#x9p9g5nhaw](https://medium.com/@SamuelMarcLowe/explaining-cumulative-rules-of-origin-2c13fb4dfca1#x9p9g5nhaw)

<sup>55</sup> [ec.europa.eu/taxation\\_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin/arrangements-list/paneuromediterranean-cumulation-pem-convention\\_en](https://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin/arrangements-list/paneuromediterranean-cumulation-pem-convention_en)

framework for moving goods between the UK and the EU to continue. This was unlikely whichever way the UK left the EU. However, joint customs cooperation committees already exist between the EU and third countries, even where no FTA exists yet. Therefore, work on this between the UK and EU could begin independently of an FTA.

Given that the UK is expected to fully implement the EU's new UCC legislation, which HMRC are currently in the midst of implementing, it could still potentially agree a deal with the EU to continue allowing UK firms to apply for authorised economic operator (AEO) status in the EU. Since the UK will need to design its own AEO region, a mutual recognition agreement between the UK and EU AEO systems might be a more feasible option.

Additionally, to facilitate the movement of UK goods within the EU's customs territory, the UK could accede to the common transit procedure convention, which would essentially confer EU status on non-EU goods once they are inside that territory<sup>56</sup>. It allows third-country products to be treated as being in "free circulation", thus eliminating the need for multiple customs checks and suspending duty payments once inside the area covered by the convention. Contracting parties to this agreement include the Efta states, as well as Serbia, Macedonia and Turkey.

A customs frontier of some kind is inevitable between the EU and the UK – even Turkey's customs union arrangement with the EU does not remove this reality<sup>57</sup>. The question is about how to minimise the scope for checks, which in turn depends on how much trust the two sides can place in each other's customs management systems. HMRC's roll-out of the new UCC and the likely replication of existing EU customs legislation in domestic statute as part of the Great Repeal Bill should go a long way towards ensuring this. It is imperative that the UK government consults extensively with freight forwarders as well as customs and shipping agents on an ongoing basis in order to reach a

tailor-made solution with the EU which keeps administrative costs for firms to an absolute minimum.

## World Trade Organisation

Even before the prime minister's speech asserting that "no deal [with the EU] is better than a bad deal", the UK and EU falling back on most-favoured nations (MFN) terms provided for under various WTO agreements was always a possibility. The time constraints imposed by article 50, compounded now by the UK's option to seek a bespoke free trade agreement rather than an off-the-shelf model, upgraded that risk from remote to distinctly possible. In any event, it is a worst-case scenario that businesses trading with or operating in the EU should be planning for now.

Some of this can be anticipated by working out what the additional costs of MFN tariffs applied by the EU would be to specific products, operating on the assumption that the UK would, at least initially, replicate and reciprocate its tariff schedules and tariff rate quotas (TRQs) for imports coming into the UK. What WTO rules do not provide any substitute for, however, is the current regulatory cooperation and mutual accreditation between various EU/UK agencies and bodies that expedite market access for a range of high-value products and services that the UK is renowned for producing. Ranging from chemicals and car parts to financial services and pharmaceuticals, market access in these highly regulated and heavily traded sectors is largely governed by agreements at the bilateral and regional levels.

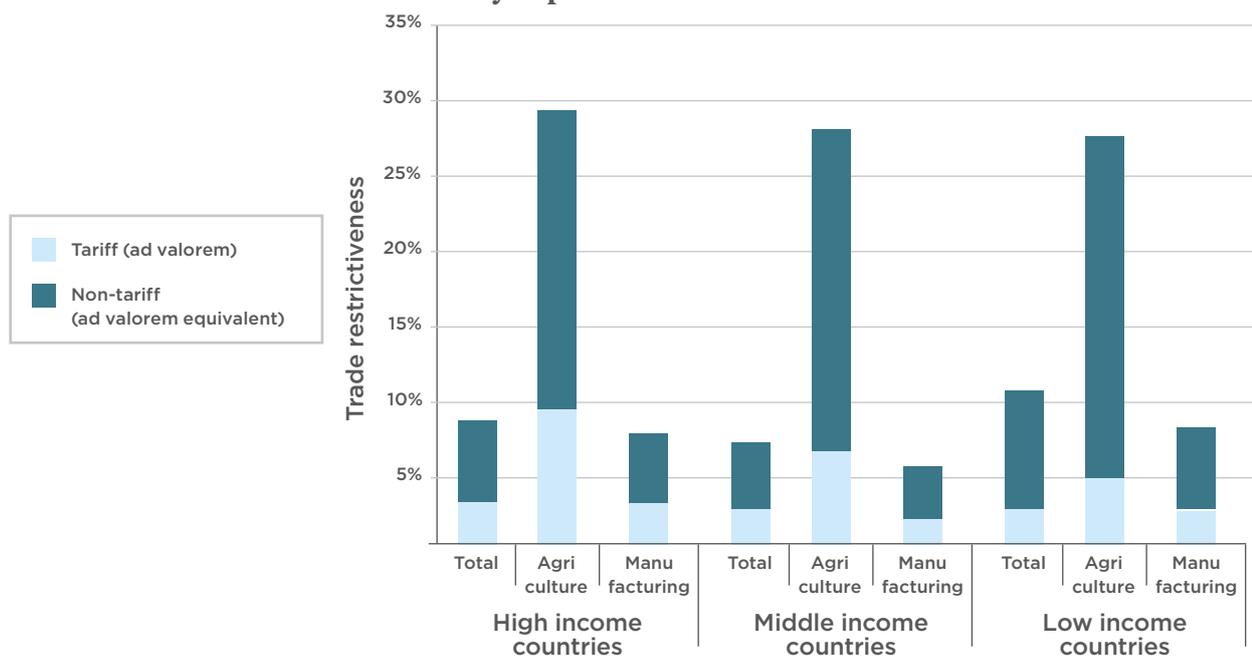
There can be no assumption made that the largely uniform starting point on UK-EU technical regulations serves as a way of mitigating the absence of any agreement at that level. The constantly evolving nature of many of these goods and services means that continual engagement between regulators and oversight bodies is needed to ensure they can carry on being authorised and traded across each other's borders.

<sup>56</sup> [gov.uk/guidance/transit-and-other-suspensive-regimes](https://www.gov.uk/guidance/transit-and-other-suspensive-regimes)

<sup>57</sup> [factcheckni.org/facts/would-brexitead-to-a-customs-frontier/](https://factcheckni.org/facts/would-brexitead-to-a-customs-frontier/)

<sup>58</sup> [cnbc.com/2016/11/25/reuters-america-interview-uk-financial-firms-seen-applying-for-licenses-in-dublin-by-early-2017.html](https://www.cnbc.com/2016/11/25/reuters-america-interview-uk-financial-firms-seen-applying-for-licenses-in-dublin-by-early-2017.html)

## Tariffs and ad valorem equivalents of NTMs faced by exporters



Source - UNCTAD, 2012

As the above chart illustrates, the impact of non-tariff measures (NTMs) can often be more significant than tariffs themselves.

It is understandable as a negotiating tactic to set out the UK's willingness to walk away from a "bad deal", though what difference with WTO/MFN terms this would have to be to count as such (and at what point in negotiations this would become clear) is highly questionable. It will undoubtedly make it more likely that firms – for whom such terms would present an insurmountable cost addition – begin making contingency preparations to open up supplementary operations bases elsewhere in the EU. Given that applications for national operating licenses in other member states can take between 12-24 months in sectors such as financial services, many companies with cross-border operations have either begun or will begin to do so rapidly on the premise that no deal is reached within two years<sup>58</sup>.

We would urge the prime minister and the UK government, as well as the EU institutions and governments, to stress at every possible opportunity the importance of reaching an agreement and their commitment to doing so. Every country among the world's top 10 economies has some form of regional trade agreement with their most important neighbours. The absence of one between the UK and the EU would send a destabilising message about the predictability and stability of the UK as an open trading nation. There is a significant difference between acknowledging the existence of WTO/MFN rules as a basis for trade between some of the world's biggest economies and suggesting, as some have, that the UK would be "happy" and "fine" with moving back to these terms<sup>59</sup> with its biggest trading partner. The difference in starting points here is a crucial differentiating factor with respect to the potential for disruption to trade.

<sup>59</sup> pp.3-4, Halligan, Liam and Lyons, Gerard. Clean Brexit. [policyexchange.org.uk/wp-content/uploads/2017/01/Policy-Exchange-Clean-Brexit-16th-January-2017.pdf](http://policyexchange.org.uk/wp-content/uploads/2017/01/Policy-Exchange-Clean-Brexit-16th-January-2017.pdf)

<sup>60</sup> [openeurope.org.uk/today/blog/norway-has-little-to-lose-from-having-the-uk-in-Efta/](http://openeurope.org.uk/today/blog/norway-has-little-to-lose-from-having-the-uk-in-Efta/)

## European Free Trade Association

We urge the government to consider the merits of rejoining Efta, although this is not to suggest that this should be a basis for negotiating trade relations with the EU in the first instance. There are some significant benefits to being part of Efta with respect to governing trade ties with Norway, Iceland and Switzerland, who make up six per cent of the UK's trade<sup>60</sup>. The UK will need to negotiate new trade arrangements with them in any event to maintain our existing preferential access afforded to us through the EU's various Efta agreements.

Membership of Efta allows for third-country trade negotiations either as a bloc (for example, with India) or individually (such as the Iceland-China FTA), and agreements contain an accession clause to allow new Efta members to become a contracting party to their existing trade deals. Efta also has a number of technical cooperation agreements with the EU in the area of customs and trade facilitation, although the UK could theoretically gain access to these through bilateral negotiations with the EU.

There are several question marks on how and when the UK might wish to open negotiations on an application to join Efta. It could do this in parallel to its article 50 negotiations, although it would have to be clear that its prime focus in the first instance was negotiating a bilateral agreement with the EU. Were time constraints removed then the UK might wish to seek to rejoin Efta first, but given the current conditions it may be more suitable for any entry into Efta to take place after the Brexit agreement has been concluded and potentially come into force. However, the UK should make clear to the EU during the course of negotiations that it intends to pursue membership of Efta. This may help set the framework for future cooperation in specific areas where Efta has already concluded technical agreements with the EU. It may be however, that negotiating a trade agreement with Efta is a more practical and less time-consuming alternative.

## Communication and preparation

### Government

While Theresa May's speech offered welcome clarity, we do not think that this should be the sum total of the government's communication strategy. Below are several recommendations to help give further confidence to business about the way forward:

- Setting out clearer objectives about outcomes – this need not be communication about negotiating strategy (the “how”), but rather focusing on what outcomes the government is seeking (the “what”), including participation in specific EU programmes such as Horizon 2020 or Erasmus, tariff-free trade etc.
- Committing to a level of transparency that goes some way towards matching the EU's in-trade agreements to date – publishing a negotiating mandate and fact sheets by area and chapter, if textual proposals prove impossible to put forward (as the European Commission has done with TTIP).
- Beginning consultations now with business on priorities for the great repeal bill.
- Establishing stakeholder working groups/parties within each department to allow for engagement with business on an iterative and comprehensive basis during negotiations.
- Ensuring that the development of the government's industrial strategy and other domestic measures are in sync with Brexit negotiations so that no dramatic alterations need to be implemented upon the conclusion of a UK-EU trade agreement.

### What can business and the IoD do to prepare?

- Engagement with European corporates and trade bodies across both the EU and third countries with a substantial interest in the outcome of Brexit (such as Japan) is essential to ensure commercial and trade priorities are given equal footing to political considerations in the EU's approach to negotiations. The IoD has already started some of this preparatory collaboration work to ensure proper representations are made to EU governments and institutions.

- For those businesses engaged in the EU goods trade, it is essential to begin exploring what extra paperwork dealing with the EU as a third country would entail. Planning for a worst case scenario is necessary, therefore exploratory discussions with freight forwarders, customs brokers etc and other firms who already sell and buy products on WTO/MFN terms to assess the full range of potential cost implications should be part of forward planning. VAT considerations in this regard are extremely important.
- Inward and outward processing relief, duty drawback and temporary warehousing are procedures which will become important for those firms selling or importing from the EU. Businesses already trading with non-EU markets will have an advantage in knowing how to use these kinds of procedures to mitigate any increase in costs or delays.
- Unless the UK and EU agree to continue using Intrastat declarations and EU sales list forms for goods trade, these will be replaced with import/export documents.
- There is a strong incentive for UK-based goods traders who have not yet done so to apply now for AEO authorisation under HMRC's ongoing roll-out of the EU's new UCC.
- Start having talks – informally as a precursor – with existing clients, suppliers, customers etc to assess what is needed from both ends to ensure your trading relationships can carry on as before. This means reviewing all EU-related components of your existing operations, and ensuring you know where your company fits into any supply chain(s).
- Examine the rules and requirements in each EU and/or EEA country to see which framework provides for the most efficient, cost-effective route to setting up operations if you are in a sector that is likely to need regulatory/licensing approval.
- Brexit-proof your existing and/or future contracts – pricing mechanisms or anything which might be predicated on unimpeded access of goods/services/capital/people between the UK and EU may need to be revised.

- Ensure you are fully compliant with EU legislation (particularly regulations which are directly applicable as opposed to directives) such as the General Data Protection Regulation due to come into effect in May 2018 – it is an unsafe bet to pre-emptively assume the UK government will renege on its existing or upcoming EU legislative commitments.
- Engage with the IoD and sector-specific trade associations even on the most detailed and business-specific concerns. The more case studies we and the government have, the better informed our approach to negotiations will be. Linking up trade policy with practical, real-world considerations is essential in formulating negotiating objectives.

<b>4 Modes of supply</b>		
<b>MODES</b>	<b>CRITERIA</b>	<b>SUPPLIER PRESENCE</b>
<b>Mode 1: Cross-border trade</b>	Service delivered within the territory of the Member, from the territory of another Member. The advancement of technology has made this possible, eg internet (e-trading)	<b>Service supplier not physically present within the territory of another Member</b>
<b>Mode 2: Consumption abroad</b>	Service delivered outside the territory of the Member to a service consumer of another Member. It involves the consumer traveling to the country in which the service is produced, eg tourism and education services.	
<b>Mode 3: Commercial presence</b>	Service delivered by a service provider of one country through commercial presence in another country, eg.FDIs	<b>Service supplier physically present within the territory of another Member</b>
<b>Mode 4: Movement of natural persons</b>	Service delivered by a service personnel of one country who travels to another country to provide the service, eg, services provided by expatriates, business and professionals and foreign workers.	

## Institute of Directors

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### The Institute of Directors

The IoD has been supporting businesses and the people who run them since 1903. As the UK's longest running and leading business organisation, the IoD is dedicated to supporting its members, encouraging entrepreneurial activity, and promoting responsible business practice for the benefit of the business community and society as a whole.

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