

Brexit and Trade

30 August 2016

If trade policy has always been important to the UK, it is now more so than ever before. In this snapshot, FTI brings perspective to just what the UK will have to do to try to maintain its status as a global trade leader as it moves forward apart from the European Union.

FTI Consulting's Brexit response team will help you to keep track at each step of this evolving process to understand how this could impact your company and core business activities and help secure your trading, regulatory and operating environment.

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deals before about 2025 at the earliest.

Introduction

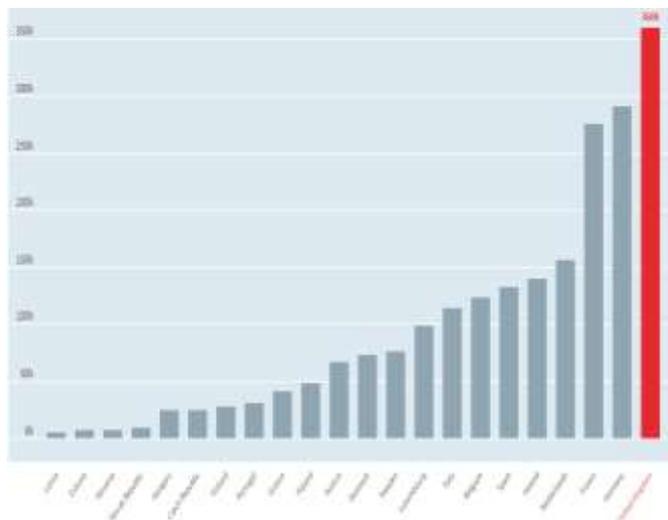
If you think divorce proceedings are tough – try negotiating a modern, deep and comprehensive free trade agreement (not an old-fashioned tariff-only deal). It can be a long, very long, drawn-out process to get it right. If you want to understand the true meaning of 'patience' then become a trade negotiator – and you would be in luck since the UK is apparently on the lookout for several hundred. The UK government has admitted it lacks skilled trade negotiators since the European Commission's trade department has undertaken trade negotiations on behalf of all the EU member states for the past several decades.

Make no mistake about it – trade negotiations are complicated. The EU-Canada trade deal (CETA) took some five years to negotiate and is more than 1500 pages long. If the deal is ever fully ratified and put into action remains to be seen – but the full process from a first scoping exercise to agree on the focus of future talks to launching actual negotiations to implementation will likely take just shy of a decade. On that basis – and given that Brexit is still some years away – it is hard to see the UK being able to strike any significant trade

Trade exposure

Global trade arrangements are complex – often as complex as the global supply chains that criss-cross our modern world to help build the smartphone you may be reading this from right now or the banking services on an app.

1. OECD: Exports of services (EU28), million US dollars (2014)



The UK is the biggest exporter of services (all private-sector economic activity other than agriculture, mining, construction, and manufacturing – e.g. telecommunication; banking, financial, and insurance services; transportation services) of the EU28. In any future trade talks, the UK will certainly seek to make services a key offensive interest.

Trade matters because it is a cross-cutting issue that touches on so many industry sectors – from agriculture and healthcare to energy and digital to name just a few. This also partly explains the controversy surrounding trade deals as so many stakeholders claim an interest in the outcome. For example, the EU-US deal (TTIP) has faced many protests across Europe – notably in Germany.

It should come as no surprise then that trade deals require a ‘trade-off’ as both sides try to negotiate a scenario that provides them with a win. As a general rule, size matters in trade as it strengthens your negotiating position. The larger and stronger your economy, the greater bargaining power you have including a greater ability to hold out from agreement. The EU – as a trading bloc – could even find advantages at times in having 28 individual members. In the long, hard slog of a trade negotiation “Team Europe” could share the benefits of a successful trade deal and could also share the negative impacts on sensitive industry sectors.

The UK will, of course, continue to pursue its trade interests, however from now on without “cover”. Westminster (and not the EU district of Brussels for a change) could once again become a location for angry protests from many different interest groups.

First things first

UK, European and international business seek predictability and legal certainty and they are rightly concerned at the questions that Brexit poses on UK, EU and the broader international trade environment. The only certainty for the moment is the fact that there is likely status quo for the next two years or so during the Article 50 process.

Figuring out the type of trade relationship the UK government should aim for with the EU is the first task. The [Financial Times](#) has illustrated the possible interplay between a customs union, a free trade agreement and the single market.

2. Eurostat: List of exported services by the UK, million USD (2014)

Service label	Exported Value in 2014
Other business services (various)	95,016
Financial services	81,858
Travel	47,131
Transport	44,412
Insurance and pension services	33,443
Telecommunications, computer, and information services	27,160
Charges for the use of intellectual property	18,195
Government goods and services	4,109
Personal, cultural, and recreational services	3,536
Construction	3,268
Manufacturing services on physical inputs owned by others	4,780
Maintenance and repair services	2,553
All services (SUM)	365,460

Financial services in the UK accounts for the biggest unique sector of overall exported services.

In just a single month since the UK referendum Brexit decision, the media and commentators have provided us with page after page of analysis regarding the options before the UK. Will the UK seek a “hard Brexit” – meaning it decouples completely or will the UK seek the “soft” option or and join the European Economic Area (like Norway) thereby participating in the EU’s single market? For the moment, Theresa May has refused to be drawn into supporting one option over another; rather she has preferred to stress she is keeping an open mind – including possible new formulas and arrangements.

Then there is the question of the future UK relationship with the WTO. The UK is a member of the Geneva-based international trade body but is represented there by the EU. The organisation’s chief Roberto Azevêdo has made it clear in media [interviews](#) that the UK

will have to start from scratch and cannot 'cut and paste' its old EU trade agreements. He also observed that - apart from the lack of trade negotiators - the UK also lacked the technical expertise and teams to police trading arrangements once in place. Trade challenges seem in plentiful supply from Brexit.

Show me the money

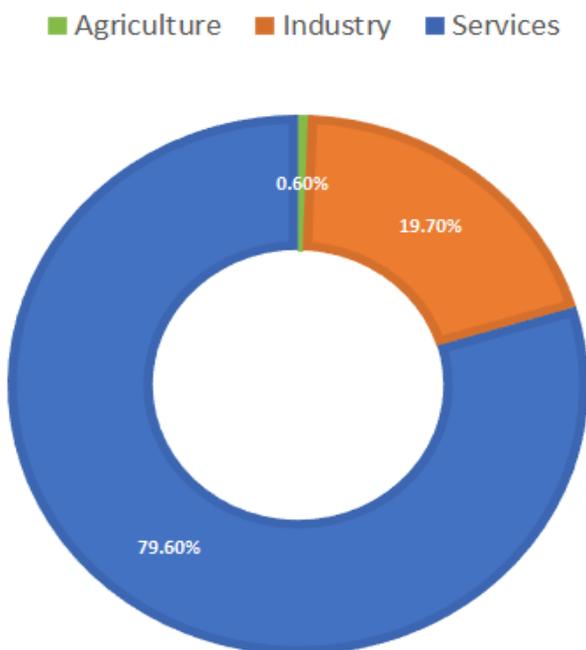
Neither side of the Brexit debate has ever suggested that the UK will not be able to achieve trade deals on its own. Some scholars have suggested that the UK will have to re-negotiate or start afresh 124 trade deals (not including the negotiation of the UK's new relationship with the EU) to match its current trade position as an EU member.

The challenge now for those choosing change – i.e. Brexit – is to establish a system whereby trade with the EU and other international countries and/or trade blocs becomes more profitable for the UK economy and its people after Brexit.

The EU has set the benchmark very high. Five years ago, the first of the EU's new, modern, deep and comprehensive free trade deals went into force with South Korea. In July, the EU announced that the deal had turned around its traditional trade deficit with South Korea into a €6 billion surplus in 2015.

The UK government will need to show UK citizens that modern trade deals - which tackle regulatory issues and not just tariffs - are do-able and that these deals are comparable and preferably better than those that the EU currently negotiates. These are also the legitimate 'asks' of UK business going forward. In particular, the expectations will be high in the services sector, where success will be critical for the UK economy.

3. The World Factbook (CIA): GDP composition by sector of origin in the UK (2015)



Services play by far the most important role in the British economy with agriculture barely registering

Until the UK has decided upon the structure of its relationship with the EU, there can be no meaningful bilateral trade discussions with partners as the UK's new international trade minister Liam Fox discovered in Washington in July when the United States Trade Representative noted "it is not possible to meaningfully advance separate trade and investment negotiations with the United Kingdom until some of the basic issues around the future UK-EU relationship have been worked out." And why would a key ally and partner take such a firm position?

Pro-Brexit Conservative MEP Daniel Hannan summed up why countries negotiate trade deals together during a BBC interview when he observed that there was a strange notion often raised toward the end of the referendum campaign that "countries trade with each other out of kindness. No they don't. They do so out of self-interest", Hannan explained.

Many would argue the US is waiting to see how successful the UK is at renegotiating its trade relationship with the EU to better judge how it can forge the best trade deal with the UK to the benefit of US exporters and US companies.

Of course, maintaining ties and an open dialogue is always important. However, promises from Australia, India and many other countries that they would like trade deals with the UK are not unexpected but remain just promises at this stage.

Even if a trade deal is possible to achieve in several years, the UK's trade negotiation team will have to choose their priority countries as only a few trade negotiations will be able to be handled at any one time.

The geopolitics of global trade

To think that trade is only about doing business is to miss the point. Trade is a vital extension of any country or bloc's foreign policy.

US President Obama's Trans Pacific Partnership is part of his strategy to pivot toward Asia. The EU-US trade talks are an ambitious plan to ensure future global trade rules are set by the world's largest democracies – the EU and US – after the failure of the Doha global trade talks.

A number of commentators have suggested that the UK will be able to reap many more bilateral deals alone than when it was part of the EU. These commentators often point to China's rapid conclusion of trade deals with Switzerland and Iceland (and its ongoing negotiation with Norway) as proof that it is possible. Ever wonder why China would be so keen to do a trade deal with Iceland? Along with the other European Free Trade Association countries, this is China's geopolitical foot in the door of Europe. This is the geopolitics of trade.

China has long wanted to have trade negotiations with the EU – the world's number one marketplace – but the EU has been cautious to do so, instead preferring to launch investment negotiations as a first step: a point rarely – if ever – mentioned during the Brexit debate.

Investment is where the untapped economic potential lies for both the EU and the UK. According to the European Commission, China accounts for just 2-3% of overall European investments abroad, whereas Chinese investments in Europe are on the rise. "The

(eventual) Agreement will provide for progressive liberalization of investment and the elimination of restrictions for investors to each other's market. It will provide a simpler and more secure legal framework to investors of both sides by securing predictable long-term access to EU and Chinese markets respectively and providing for strong protection to investors and their investments.”

One of the EU's principal concerns regarding China's business environment includes its restrictive government-sponsored economy, which lacks transparency and therefore legal certainty for European companies. The EU has simply been using its position of strength as the world's number-one economic bloc to show China that it is willing to be a cooperative partner, but that a successful investment deal would serve as a litmus test towards a full and comprehensive trade deal.

Although predicting trade outcomes is fraught with difficulty, it is not unimaginable that a UK-China trade deal could turn out to be the first target and the first success. It would be in the UK's

interest to secure a first win and in China's interest to win such a prize as a trade deal with the UK to be able to maintain its pressure for similar talks with the EU. This scenario is even more likely if the UK maintains its pro-China strategy and relationship. However, Theresa May's decision to re-examine the Hinkley Point nuclear power deal has now thrown the UK-China relationship into serious doubt.

Conclusion

There is no trade crystal ball for a post-referendum UK. Business is in for a long period of uncertainty as it waits to see how the UK's future trade relationship with the EU will look. But, as always, uncertainty offers opportunity for companies that stay abreast of current developments, find allies and mobilise to engage with the UK government to ensure their sectoral interests are recognised and advocated since in any trade deal there are always winners and losers.

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