The long and winding road

Indirect Tax **International Tax** **Large Corporate**

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Michael Steed reviews the long stony journey from Referendum to the Withdrawal Agreement and considers some of the various trading models that have been proposed for a post-Brexit world

Key Points

What is the issue?

A 21-month transition period has been agreed between the UK and EU to ‘smooth the way’ to post-Brexit relations.

What does it mean to me?

Although a draft withdrawal agreement has been agreed between the UK and EU, we still have no real idea as to what the final outcome might be.

What can I take away?

Other countries have different trading and customs arrangements with the EU. It's worth familiarising ourselves with the rights and responsibilities of each.

Post-Brexit trading models – the long and winding road!

'A cold coming we had of it /Just the worst time of the year / For a journey, and such a long journey / The ways deep and the weather sharp, / The very dead of winter' (TS Eliot, The Journey of the Magi)

This article looks at how some of the various trading models that have been proposed for a post-Brexit world have fared when examined in detail and whether they could still provide working models in a post-Brexit world. The article does not look at the no deal scenario as this has been covered in TA recently ('Avoiding the post-Brexit freeze' by Tarlochan Lall, *Tax Adviser,* August 2018).

At the time of going to press the news is that on 25 November, the UK and EU came up with an agreed draft withdrawal agreement. This covers (inter alia): the divorce bill (an estimated £39bn), what happens to the Northern Ireland border, and what happens to EU citizens living in the UK and UK citizens living in the EU. To buy more time, the two sides have agreed on a 21-month 'transition' period to smooth the way to post-Brexit relations.

So what has been proposed since the referendum and how have the various models fared?

1. The Norwegian model

When the Referendum took place, there were a significant number of calls for the UK to adopt what is widely called the Norwegian model. It sounded tempting!

Norway is a rich country and is a member of the European Free Trade Association (EFTA). EFTA was formed in 1960 and it now comprises four countries: Norway, Iceland, Liechtenstein and Switzerland. It's interesting to note that the seven original members were Austria, Denmark, Norway, Portugal, Sweden, Switzerland, Norway. The UK and some of these migrated to the EU.

EFTA has a population of around 14m people (the EU has currently over 500 million). EFTA is the ninth largest trader in the world in goods and the fifth largest in trade in services.
It is the third most important trading partner in goods for the EU and the second most important when it comes to services.

EFTA has a number of trading agreements with the EU, of which the European Economic Area Agreement (EEA) is the most important. The EEA agreement, which was signed in 1994, extends the EU 'Internal Market' to trade between the two trading blocks – the EU and EFTA (but not Switzerland as its electorate refused to sign up). It allows free trade between the two blocks with little or no tariff barriers or friction (such as border checks) and free movement of services.

What the EEA does not do, is to create a Customs Union (CU) between EFTA and the EU. Just to be clear, a customs union means common external rules with other countries. So, jumping back into EFTA and the EEA Agreement sounds like a good idea for some people. Norway is not part of the Common Agricultural Policy or the Common Fisheries Policy either.

The practical problem is that in order to trade with the EU, Norway has to pay into the EU pot, ostensibly to support some EU projects, but the more cynical may see that as a de-facto tariff. It also means that the Norway is unable to influence the EU rules (although it may make comments), so to follow this model would mean that the UK loses its place at the top table and also becomes a rule taker rather than a rule maker. The influence of the ECJ is also at stake, but EFTA has its own court and it is not bound by the ECJ.

But there is yet a greater political problem: Norway has to accept the Four Fundamental Freedoms of the EU: goods, services, capital and people. It is the last of these, the freedom of movement of people that causes the main problem with Brexiteers, who made control of immigration one of their cornerstones. So, like it or not, we would still have to accept immigration from EU countries.

Yes, there are some get out of jail cards in the EEA Treaty. The first is under Article 112, permitting members to take 'safeguard measures' to address any 'societal or environmental difficulties of a sectorial or regional nature'. This is the article that

Liechtenstein has taken advantage of on the basis that excessive immigration would swamp a small country. The second is Article 28 (3), which allows for freedom of movement ‘subject to limitations justified on grounds of public policy, public security or public health. The Norway model fans do not see this as a problem hurdle to stop immigration, but others may disagree,

The adherents of the Norway model also make the claim that the divorce bill would be substantially reduced as we would not be leaving the internal market. A variation of the Norway model, called ‘Norway for now’ surfaced recently as a stop-gap solution. In this variant, the UK would jump back into EFTA for a limited period, until it could negotiate free-trade deals outside the EU.

The latest variant is 'Norway plus', where we stay in the internal market and stay in the EU Customs Union, thus avoiding the Northern Ireland backstop issue.

2. The Swiss Model

Switzerland is not a member state of the EU and although it is an EFTA state, it did not sign up to the EEA; instead, it conducts its relations with the EU on the basis of bilateral sectoral agreements. The EU is far and away Switzerland’s biggest trading partner, for both imports and exports. Switzerland knows only too well that its relationship with the EU is of paramount economic importance. It is almost completely surrounded by EU states.

It has signed a number of bilateral agreements, in particular the 1999 Bilateral Agreements, which contains that all important free movement of people.

This is a sticky problem for the Swiss Government as the Swiss electorate narrowly voted to curb immigration in 2014 and it has been dragging its feet on the issue ever since.

It does pay into the EU pot, although it carefully says that it is part of Switzerland’s contribution to an enlarged Europe, and is designed to support former communist block (and now EU) states.

3. The Canadian WTO model

The other model that has been widely trumpeted is the so-called Canadian model – sometimes trumpeted as ‘Canada plus, plus, plus!’

So what does the Canadian model offer? The Canada model is based on free-flowing World Trade Organisation (WTO) rules. There are a number of ways of looking at the World Trade Organization (WTO). It is an organization for trade opening. It is a forum for governments to negotiate trade agreements and it is a place for them to settle trade disputes. It operates a system of trade rules.

So, here’s a question – do we need a WTO agreement in order to trade with another country?

The short answer to that is ‘No!’ There are plenty of examples of trading outside of formal agreements – a good example is EU/USA trading – although a formal trading agreement has been worked on, it was shelved when Donald Trump became US President, so arguably the negative comments from Barack Obama back in 2016 about the UK having to wait in the queue for a trade agreement miss that important point.

Is the Canadian model workable? At face value, there is something here. The WTO rules are designed to free up trade and reduce barriers. But objections include the fact that it takes years to negotiate formal WTO agreements and another objection to the Canadian model is that Canada is by no means free to make its own agreements.

Canada is a party to the Canadian/USA/Mexican trading block (formerly the North American Free Trade Association, which is giving way to the US-Mexican, Canadian Agreement –the USMCA) and it may not be too cynical to say that it’s the US that wears the trousers.

4. Turkey: Is Turkey an alternative trading model?

Turkey is the only major country outside the EU that has a Customs Union with it (the EU does have CUs with Andorra and San Marino).

Turkey has been mentioned as a possible model for a post-Brexit UK: some think it shows how the UK might remain in the Customs Union and still be able to strike its own trade deals with countries outside the EU.

So, this is different to a Free Trade Agreement (FTA) such that the EU has with EFTA. It’s important to emphasise that a CU is a trade bloc within which members both remove tariff barriers on each other’s goods and also adopt a common external tariff and trade policy for countries outside the union.

Conversely, with an FTA (like the EEA agreement), countries remove tariffs on each other's goods but they do not have a common policy for third countries. So within a FTA, you need customs barriers and 'rules of origin' to check whether a product really comes from your preferred trade partner or whether it is from another country, in which case it is not entitled to tariff-free access under the agreement. The CU that the EU has with Turkey is incomplete. It covers some goods – industrial goods, but not agricultural goods and it does not cover services.

It has been argued by critics, that Turkey has little or no freedom to develop trade policy with other countries across the world and its relationship with the EU is therefore rather one-sided. Turkey has to open its markets to any country the EU strikes an agreement with, but has no say in how the agreement is shaped and it is limited in its duty-free access with that country.

If the UK were to follow the Turkey model, it would be deprived of a fully independent voice when dealing with other trade partners and at the WTO.

Conclusion

We don't currently know where we will end up. Just about anything could happen in the next four months and the immediate problem is trying to get the deal through Parliament, so any of these models or hybrids thereof, may resurface in the future after Brexit.