Policy Analysis 18-01

The European Union in Crisis

What Challenges Lie ahead and Why It Matters for Korea

Edited by
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After months of struggle between the EU 27 and the UK over the terms of a withdrawal agreement, proceeding to an orderly Brexit remains very challenging. By ruling out any cherry-pick between rights and obligations of EU membership, the EU has restrained available options for the future relationship. Yet, British political parties remain very divided on the priorities of Brexit. With no clear majority for any scenario, the process is held hostage to the British political spasms and the probability for a "no deal" or a "remain option" increases.

To assess the impact of Brexit on the UK, the EU and trade relations with third countries, this paper starts thus by analysing the state of play of negotiations at the end of 2018 and remaining post-Brexit scenarios. It then scrutinises the stumbling blocks on the road to an autonomous UK trade strategy, notably the possibility for the UK to negotiate a transition for EU FTAs. And finally, it focuses on the impact of Brexit on South Korea's trade relations with the EU and the UK: a case study which provides with a useful reference for the prospect of a "Global Britain", as South Korea is the kind of export led economy cherished by Brexiters and can be considered as a peer trading partner.

1. Introduction

The first-ever withdrawal of a member state since the European Union's inception raises a multitude of technical and legal issues, as much for the United Kingdom (UK) and the European Union (EU), as for third countries with which the UK has to renegotiate at least 759 agreements.[10] It is, in ad-

10) These 759 agreements include 295 bilateral trade agreements, 202 regulatory cooperation agreements (ranging from competition policy to data sharing), 69 agreements concerning fisheries, 65 on transport (mainly aviation), 49 on customs controls, 45 on nuclear power, and 34 on agriculture (McClean 2017).

dition, complex to agree on the future relationship between the UK and the EU considering the conflicting motives of the referendum vote in June 2016. Beyond popular scepticism towards the European integration, the immigration of Eastern European citizens, the financial contribution to the EU budget, there is the EU's infringement upon the British sovereignty. But the willingness to recover sovereignty is twofold. By withdrawing from the EU, some Brexiters want to pull away from ever more interdependence, as much from the EU as from globalisation. While for others, Brexit will allow to engage more actively in globalisation, without what they identify as EU constraints. They look forward to shaping a "Global Britain" with an autonomous trade strategy, which will be "more ambitious" than the EU trade strategy.

To deal with this complex negotiation and facilitate an orderly Brexit, the EU has imposed a sequencing of the process – first the Exit is to be discussed and then the post-Brexit. On November 25, 2018, after months of struggle and delay, an agreement has been signed on a withdrawal deal including the terms of a transition period which will leave time to negotiate the future new relation.

However, at this stage, we remain in very turbulent Brexit waters, with the withdrawal deal and the negotiation on the future UK-EU relationship held hostage to the British political spasms. The UK should exit the EU on March 29, 2019 – two years after the UK triggered article 50 of the TEU – but British political parties remain divided on the priorities of Brexit and crashing out with no deal is still possible, if the deal does not pass the decisive test of a vote in the House of Commons. It would be the most chaotic scenario.

The most contentious issue in the withdrawal negotiation was to agree on a backstop solution preventing the return of a border and potential conflicts between Northern Ireland and the Republic of Ireland, if in the end the post-Brexit deal does not provide an efficient alternative solution. Like all the previous proposals of backstop, the option put forward in the withdrawal deal would have strong implications for the whole UK and has provoked immediate negative reactions from all sides of the British political spectrum and increased tensions within the political parties.

At the time of writing this paper, there are still a lot of moving pieces and uncertainty as to how things might play out. Whether the withdrawal deal is voted or not, and whatever interpretation is given to the political declaration setting out the framework for the future relationship between the UK and the EU, there is still room for diverse scenarios. We can thus usefully explore the many potential outcomes of this Brexit conundrum and in particular its impact for third countries.

For trade partners, the attractiveness of the post-Brexit UK depends, first of all, upon the new EU-UK relationship agreed to, in other words on the loss of access to the European market that Westminster is ready to accept in exchange for a restored British sovereignty. The closer it remains to the Single market, the more attractive it remains.

For many years the UK has been considered by third countries as a gateway to Europe offering competitive advantages to international firms and it has been appealing for inward foreign direct investment (FDI). The weight of the UK's economy on "the day after" will thus be directly downgraded from the world trade "premier league" – the US, the EU and China – to the second division trade powers.

After exiting the EU in 2019, the UK will only represent 2.19% of global GDP, and it will hardly remain the sixth largest economy in the world (after India),[11] representing 1.9% of global trade in goods and 4.9% in global trade in services. Meanwhile, the EU, with or without the UK, should remain the world's second largest economic power after China in terms of GDP (on a PPP basis). Together, China, the EU (minus the UK) and the USA, com-

11) The UK and the France remain shoulder to shoulder in the global economic ranking (IMF 2018). https://www.imf.org/external/datamapper/PPPSH@WEO/OEMDC/ADVEC/WEOWORLD/GBR.

mand 48% of the global GDP (PPP),[12] 42% of global trade in goods (not counting internal EU trade), and 43% of global trade in services.

Whatever successful economic policies conducted, the UK will have lost bargaining power in its trade negotiation with third countries, notably with the three big powers: the EU, the US and China. Exploring the feasibility of an ambitious "Global Britain" after Brexit is even more complex at a moment of strong turbulences in global trade with Donald Trump's offensive protectionism and the rising risk of a global trade war.

As the future EU-UK relationship will have a strong impact on UK trade relations with third countries, the paper starts by assessing the state of play of EU-UK negotiations. It then analyses the stumbling blocks on the road to an autonomous UK trade strategy and finally provides an assessment of the potential impact of Brexit on a specific case study, the EU-South Korea FTA. A closer analysis of this FTA is indeed particularly interesting, not so much because South Korea (ROK) is the first Asian country with which the EU implemented a trade agreement in 2011, but because South Korea's economic development is based on the kind of export-led, hi-tech, skills-based economy cherished by Brexiters. Its booming economy which managed to maintain a 3% GDP growth in 2017 has allowed an improvement of standards of living at a very high speed although – a key point for Brexiters – South Korea is not part of a major trading bloc[13] and has no access to natural resources of its own. Beyond the very important and sustained investment in education and skills, this achievement could be attributed to the implementation of a series of ambitious bilateral agreements,[14] allowing South Korea to trade actively with the most important economies in the world. South Korea is notably the only OECD country which has trade deals with

12) Idem.

13) South Korea is considering joining the TPP (Trans-Pacific Partnership) and it is part of the RCEP (Regional Comprehensive Economic Partnership) negotiations.

14) With the EU in 2011, with the USA in 2012, China in 2015, Canada in 2012, Australia in 2015.

the three major trade powers (EU, USA and China). Brexiters could thus consider South Korea as a role model for the post-Brexit period.

In addition, after Brexit, the UK will be a second-tier economy like South Korea. Its expected 2.19% of global GDP (PPP) in 2019 would get closer to the current 1.58% of global GDP (PPP) of South Korea. The UK's combined trade volume (exports plus imports) in goods and services in 2016 reached €1.700bn and is as well close to the South Korea's €1.400bn.[15) South Korea looks thus at the UK as a peer trade actor rather than a giant akin to the big three. Their bilateral negotiations will be between two peers rather than a negotiation with a bigger, more powerful partner. The new trade relations that the UK will succeed to negotiate with South Korea could thus be taken as a key reference for the prospect of a "Global Britain".

2. State of play of Brexit negotiations

The ratification of the withdrawal deal would mitigate the immediate economic consequences of Brexit. It would prevent the UK from jumping from the edge of a cliff into chaos and uncertainty - the so-called "no deal" scenario. The long-term economic impact of Brexit would itself depend on the future relation of the UK and the EU negotiated during the transition period. Article 50 of the Treaty of the European Union requested to complement the withdrawal deal with a common understanding of such relationship, without specifying how detailed this framework has to be.[16) It thus remains to be seen how much room for interpretation has been left in the final political declaration agreed on the 25 November 2018.

15) World Bank, 2016, constant US 2010 dollars.

16) From General Affairs Council on Article 50 (Background Document), held in May 2018, (http://www.consilium.europa.eu/media/34594/background-gac-art-50-en.pdf).

2-1. The deal on the withdrawal and the transition period agreement

2-1-1. A withdrawal conditioned by the Irish issue

At the turn of the summer 2018, Michel Barnier, the EU's Brexit negotiator considered that 80% of the withdrawal deal was done. The financial settlement (the UK should pay an average €40bn to the EU for its previous commitments as a member state) and most aspects of citizens' rights were agreed upon. However, to strike a deal, negotiators had to solve a number of pending important issues, including the protection of personal data sent to the UK while it was a member state, an arbitration system to resolve any dispute between the parties, as well as the protection of European geographical indications and above all the sensitive Irish border issue.

The UK and the EU share the same imperative to avoid restoring physical borders between the Republic of Ireland and Northern Ireland. In 1998, the Good Friday agreement supported by the EU put an end to three decades of violence and killings between Catholics and Protestants. It notably secured the Common Travel Area (CTA) shaped in the wake of the creation of the Irish Free State, in 1922, as a border-free space comprising Ireland, the UK and the "Crown Dependencies" of the Isle of Man and the Channel Islands. This area provides social, economic and political rights which tend to a mutual recognition of the Irish and British citizenships (Gouez 2017).

While the return of borders splitting villages is seen as a direct threat to the peace process, the way to avoid that remained the backbone of the withdrawal negotiation.

As a withdrawal deal could not be ratified by the EU-27 without a clear guarantee that no Irish border would be restored in a case of no deal at the end of the transition period, the backstop solution plans to keep Northern Ireland closely aligned with the EU.

It will build a single customs territory between the EU and the UK, with the latter maintaining the EU's common external tariff on third countries. There would be no tariffs or quotas for goods traded between the UK and EU, and no need for proof of origin. Northern Ireland will be part of the same customs territory as the UK, but unlike the UK would have to apply EU customs law as set out in the Union's Customs Code.

Northern Ireland will become an EU rules taker. To avoid regulatory checks in Northern Ireland, Ireland will stay in line with EU Single market rules in particular in areas such as technical regulation of goods, agriculture and environmental production. This will require some products being brought to Northern Ireland from the rest of the UK to be subject to checks and controls. As the EU insisted on protecting itself from unfair competition, the whole UK will also have to align with EU future changes in taxation, environmental protection, labour and social standards, state aid and competition policy.

While the rest of Britain could diverge on EU regulation, there will need to be some checks on goods moving from Great Britain to Northern Ireland, but both sides agree to look at ways of easing the compliance burden.[17] In addition, leaving the backstop cannot be decided unilaterally by the UK but by a decision from the Joint committee stating that the alternative agreed does not lead to restore an Irish border.

However, this backstop would only enter into force at the end of the transition period if the UK and the EU do not reach a deal that prevents from restoring an Irish border.

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17) The British government initially agreed on December 2017 on Brussels' "backstop" solution that would keep Northern Ireland in "full alignment" with the EU's Single Market and Customs union rules. But an amendment of the House of Common on the Custom Bill opposed in July 2018 the idea of a sea border between Northern Ireland and the rest of the UK. The new border checks should thus be managed in such a way it does not re-establish a sea border.

2-1-2. A most needed transition

A transition period became also mandatory to mitigate the blow of an abrupt Brexit and to leave time to negotiate the future relationship between the UK and the EU. Downing Street had therefore little choice but to conform with the EU27 terms. The transition will thus allow the status quo to prevail until December 2020, with the UK participating and financially contributing to EU policies, but having no say in EU-level decisions. Any extension of the transition period for one or two more years, until the ultimate deadline of December 2022, would compel the UK to contribute to the EU budget (most probably with no rebate).

The future relationship is even less subject to a negotiation between the UK and the EU. It is rather a domestic British negotiation. The EU is above all a legal construction and the 27 Member States are not ready to compromise on the indivisibility of the four freedoms in the Single Market (the free movement of goods, services, capital and people) or on any other EU redline. The UK will remain a special partner for the EU but as a third country, it will not be allowed to cherry-pick between EU legal constraints and benefits. The trade-off is between domestic UK priorities: a restored British sovereignty and the loss of access to the Single Market.

2-2. Post-Brexit scenarios

Will the UK deviate from European standards, to the benefit of its legal autonomy, sacrificing its preferential access to the Single Market? With less access to the Single Market, the deterioration of the UK status as a financial hub and the drop in FDI inflows will probably go along with a decrease in trade.

Or will it give priority to the Single Market and align its standards and regulations with the EU, thus sacrificing its legal autonomy (while maintaining some form of border controls), as practiced by countries in the European

Economic Area? The more the British gain in terms of sovereignty, the higher the economic cost will be. Conversely, the more they attempt to limit the economic cost, the more they will have to align themselves with EU rules, without being able to influence them.

Building domestically a compromise that is politically acceptable and economically viable remains a very slow and painful process. In the light of the political declaration on the future EU-UK relationship attached to the withdrawal agreement and agreed with the EU27 on November 25, 2018, what can we expect?

Are the custom territory and the dynamic regulatory alignment drafted in the backstop solution, the closest economic ties the Prime Minister can sell to the Conservative Party? Is the political declaration giving way to a long gradual journey to "Brino", closer to the UK remaining completely in the Single Market? Or will the increasing risk of a political crisis leading to a "no deal" scenario at the end of the transition period, give way to a hard Brexit scenario that would only be mitigated by an FTA+ agreement?

2-2-1. A political declaration vs the cherry picking temptation

On July 2018, the pressure of already decreasing foreign direct investments and calls from the business community to maintain close economic ties with the EU pushed the Prime Minister, Theresa May, to put forward a White paper, the so-called "Chequers plans", preserving free access to the Single Market at least for goods. The EU made it very clear from the start that this plan was not compatible with EU redlines.[18] The idea to keep the

18) In July 2018 White paper priority was given to:

- Free trade for all goods, including agri-food products based on no tariffs and an alignment on the EU rulebook, to protect the existing integrated supply chains and 'just-in-time' processes.
- Facilitated customs arrangement (FCA) – based on technologies not yet available on shelves – intended to allow the UK to keep an autonomous trade policy with other third countries: if tariffs differ, the UK would collect tariffs on EU-bound goods on its

UK in the Single Market for goods alone and in "a" Customs Union, without the external dimension of "the" EU Customs Union, which in particular provides the European Commission with the competence of trade policy with third countries, could not be accepted by the EU.

The political declaration attached to the withdrawal agreement remains thus vague on the future concrete plans and at the same time clear on opposing any form of cherry picking: e.g. for financial services the UK will only rely on equivalences. The willingness on both sides to keep the future relationship as close and co-operative as possible is limited by the fact that the two parties will remain "separate markets and distinct legal orders". Anything that is negotiated must be consistent with the Single market's integrity (i.e. the EU's four freedoms), and should not threaten the sovereignty of the UK. Yet, on many issues, such as services opening, security, and others, cooperation remains very open. In addition, the political declaration is not binding and it does not prevent significant changes in position from either side. Rather than resolving the fundamental choices of the future relationship, the political declaration preserves the principle of a close cooperation, notably the development of "an ambitious, wide-ranging and balanced economic partnership" (article 17).

With the many grey zones of this declaration, there could hardly be any meaningful assessment of its impact on business, except that it is going in the right direction, limiting bilateral trade frictions. Despite having an autonomous legal order, the UK's unilateral alignment on the EU rulebook would lead to fewer physical inspections on goods than no alignment.

The political declaration opens the way to a close cooperation, somewhere

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behalf.

- End of the freedom of movement but no visa would be requested for short business stays, tourists and students, in addition to mutual recognition of qualifications.
- End of European Court of Justice (ECJ) jurisdiction over the UK and a new joint committee established instead.

between the frictionless option of EEA membership – estimated as having the lower negative impact on post-Brexit UK economy and a Free Trade Agreement, thus corresponding to an average loss of 3% in GDP over 15 years.[19)]

By preserving a flexible interpretation of the final text, the negotiators intended to win support from the largest number of MPs at the time of the vote. Would this help to win the withdrawal vote, it could as well turn to be a trap for the next stage of the post-Brexit negotiation, as beyond the call for a close cooperation it does not yet clearly point to a specific scenario.

While the Swiss model based on multiple bilateral agreements is considered to be too complex to be replicated[20)] there would be essentially two alternative options: a new-generation FTA (FTA+) like the CETA agreed with Canada, or the "Norwegian model" based on the European Economic Area (EEA) membership. The EU and the UK will then adapt to the thickness of border chosen by the British government. The only clear fact six months ahead of the Exit, is that a "no deal" scenario" remains the worst case scenario.

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19) The National Institute of Economic and Social Research has however released on 26 November 2018 an estimate of a loss of 3.9% of GDP by 2030 (compared to remaining in the EU) for the scenario of a positive vote on the November deal plus an FTA; while the loss would be reduced to 2.8% of GDP by 2030 for a scenario of a positive vote on the November deal plus the Backstop entering into force at the end of the transition period (Hantzsche *et al.* 2018).

20) The complex nature of the more than 120 bilateral agreements governing EU-Swiss relations invalidates this model from the outset. It should be noted, however, that while the access of Swiss goods to the single market is still the most similar to that of EEA companies (including for the rule of origin which would also be applicable), there is no bilateral EU-Swiss agreement for services. This means, therefore, that Swiss financial services do not enjoy access to the single market. Moreover, this model as well as the Norwegian model detailed below provide substantial access to the Single Market which is conditioned by the adoption of European regulations, not only by economic sectors but also across the board (environmental regulation, or regulations on data protection and public subsidies, etc.).

2-2-2. Everything but the "no deal" scenario

A "no deal" scenario can happen at different stages. If the withdrawal and transition agreement fails to pass the vote in the House of Commons[21] before March 29, 2019, if there is no agreement on the future EU-UK relationship during the transition period, or if the British parliament, the European parliament or any EU member state, does not ratify the Post-Brexit agreement.

By rejecting the withdrawal deal, the British MPs would impose on the UK the worst economic cost and many unknown consequences. In the absence of an agreement, the UK would have to comply with the conditions negotiated at the WTO to access the Single Market for goods (tariff quotas) and services; conditions which are, by definition, much less favourable than the Single Market ones.

Customs controls would have to be restored between the UK and the EU-27 to ensure the tariffs collection and compliance control. The mobilisation of the technological and human resources required to restore these controls is a major challenge in itself. Congestion and bottlenecks at borders would result in a scenario of trade chaos. This accumulation of logistical problems, the additional supply delays, the increase in customs tariffs and new non-tariff barriers resulting from the end of regulatory alignment with the EU would seriously undermine bilateral trade, the proper functioning of value chains and the flows of FDI.

A significant impact on the British economy

As this "no deal" scenario is not a strategy, but would result from an ultimate political crisis, contingency planning on the part of the business community remains mandatory to face its highly disruptive consequences: food supply shortage, the hardening of the Irish border could provoke civil unrest,

21) A vote on December 13, 2017 in the House of Commons imposed this new vote on the final agreement that would be ratified by the EU-27.

the status of legal contracts and commercial arrangements with EU companies would be unclear, supply chains would suffer important delays and additional costs.

As early as the end of 2017, the European Commission already issued over 60 sector-specific preparedness notices[22] setting out the legal and practical implications of the withdrawal in the absence of any withdrawal agreement, and therefore briefing people on contingency planning; well in advance of first similar efforts by the British government in August 2018.

The negative impact of this scenario would naturally vary according to the economic sector and to the side of the border. The Society of Motor Manufacturers and Traders (SMMT) has warned that the comeback of WTO tariffs on finished car and vans heading across the Channel would cost the automotive industry and consumers at least €5.7 billion; at worst raising the cover price of a U.K.-built car sold in the EU by €3,000 on average, and vans by €2,000 (Posaner 2018). The shock would even be more brutal for the British economy because the UK is more dependent on trade with the EU than the EU-27 is with the UK.

In 19 member states (MS), the level of trade-related exposure to Brexit is less than 2% of national GDP, and in 12 MS it is less than 1%.[23] The estimate of the Rand Corporation is thus that the UK's GDP would be reduced by 4.9% ($140bn) over 10 years, while for the EU the loss would only be 0.7% of GDP (Ries *et al.* 2017). The estimates of the House of Commons' Exiting the European Union Committee even forecasts a loss of GDP growth of 8% over 15 years for the UK (House of Commons' EEUC 2018). For Swati Dhingra, professor of economics at the LSE, a "no-deal" would result in a 30-40% drop in EU-UK trade over ten years (Dhingra and de Lyon 2018).

22) https://ec.europa.eu/info/brexit/brexit-preparedness/preparedness-notices_en
23) The UK in a Changing Europe (2018), "Cost of a No Deal Revisited," September 3, p. 18. Available at: https://www.statista.com/statistics/270452/united-kingdoms-share-of-global-domesitc-product-gdp/

WTO schedules of concessions: a leverage for third countries

While being a full WTO member, the UK still needs to agree with the EU and all other WTO members on its own schedules of concessions (trade regime with regard to WTO members) once it has left the EU. The UK and the EU already agreed in early October 2017 on a splitting of tariff quotas for agricultural products set on the basis of average trade flows over the last three years. However, the other WTO members, who would be easily satisfied with the alternative option of the UK continuing with the EU's schedules of concessions, may prove to be warier of the splitting option. Twenty countries[24] have already objected that they were not consulted and that it may disrupt the delicate balance of the current quotas. Other WTO members may also use this leverage.

If in December 2018, it is a pragmatic "everything but the no deal" approach that prevails when the British MPs vote on the withdrawal agreement, it will still leave Theresa May with the difficult task to assess if for the post-Brexit deal she can keep the UK closer to the EU than with an FTA +.

2-2-3. An FTA +: pragmatism by default

An FTA based on the model of the EU-Canada agreement, which provisionally entered into force in September 2017, would reintroduce a harder border between the EU and the UK than the Norwegian model. CETA is presented as a new-generation free trade agreement, as, in addition to tariffs removal, it also deals with other issues such as procurement contracts, intellectual property protection and to some extent services.

A CETA + version going beyond concessions granted to Canada could ensure the removal of customs tariffs for most goods and keep access to procurement contracts on all levels open. On the other hand, the lack of full regulatory alignment with the EU would prevent the application of mutual

24) Argentina, Brazil, Canada, China, India, Japan, New Zealand, Russia, Thailand, Uruguay, USA, etc.

recognition of conformity assessments to all sectors. Non-tariff barriers and certification checks would be restored to trade, with a significant additional cost for value chains.

It would thus have to be seen how far the UK would engage in unilateral regulatory alignment with the EU, as suggested in the November 25, 2018 political declaration, to assess the limitation of those additional costs.

Moreover, CETA covers only partially services (mutual recognition of qualifications, maritime transport, portfolio management, among others). Commitments vary according to the four modes of provision[25]. While CETA is less restrictive in terms of services than the Swiss model, it does not grant a financial passport and maintains the local licence requirement, which remains the main barrier to cross-border financial services. A CETA+ version providing the UK with greater openings for services would hardly be digestible by the EU as it would force to grant the same concessions to Canada (James and Bryant, 2016) and other countries with which the EU has FTAs including MFN clauses.[26]

The UK government estimates that this scenario would generate a 5% drop in UK GDP growth over 15 years (House of Commons' EEUC 2018).

The November 2018 political declaration gives also room for a gradual journey towards a "Brino", in other words towards the Norwegian model.

2-2-4. A gradual journey towards a "Brino"

The so-called Norwegian model would be the least harmful for companies. Full alignment with the Single Market legislation would allow companies to trade goods (with the exception of agricultural and fisheries products) and services without customs tariffs. Freedom of movement would also reassure UK companies with regard to a lack of manpower in certain sectors.

25) Cross-border supply (mode 1), consumption abroad (mode 2), commercial presence through a subsidiary or office (mode 3) and presence of natural persons (mode 4).
26) South Korea, Singapore, the Caribbean islands and Japan.

Maintaining the UK's participation in the Horizon 2020 programme - the European research networks – would protect UK and EU-27 companies' innovation potential. This model also includes agreements regulating competition policy, consumer protection and education.

However, in this model, UK companies would have to ensure compliance with EU rules of origin. As the European Free Trade Association (EFTA) members – including Norway - do not form a customs union with the EU and each has its own trade policy, border controls are maintained: exporters from these countries must prove the origin of their products and comply with preferential criteria, thereby not conducting trade diversion. IT systems, joint control zones and authorised economic operators (AEOs) simplify these controls. Yet if the customs control system implemented between Sweden and Norway is considered the most advanced worldwide, the circulation of most goods takes an average amount of time ranging from 3 to 9 minutes, with additional delays during busy periods. Conversely, lorries currently take a few seconds to clear the UK port of Dover and it is estimated that an additional time of 2 minutes due to customs controls would result in 17-mile queues. It should also be noted that EFTA members do not take part in the Common Agricultural Policy or the Common Fisheries Policy. According to the British government's estimate, this scenario would result in

Table 1. Impact assessment of three post-Brexit scenarios

SCENARIOS	LOSS IN GDP GROWTH (over the next 15 years)
No deal scenario (WTO regime)	–8%
Comprehensive EU-UK FTA	–5%
EEA membership	–2%

The analysis assumes in all scenarios that the UK will conclude a trade deal with the US that would benefit GDP by about 0.2% in the long term.

Source: "EU Exit Analysis – Cross Whitehall Briefing", House of Commons Exiting the EU Committee, January 29, 2018, p. 16.

UK GDP losses of 2% over 15 years (House of Commons' EEUC 2018).

2-2-5. The cost of "British spasms"

As finding an alternative solution to the Irish backstop remains challenging, the fear to be trapped in a common custom territory with the EU at the end of the transition period, continues to spark internal spasms in the Conservative party, as well as it had led the Labour party, the Northern Ireland's Democratic Unionist Party to declare that they would vote against it. While there is no clear majority in Parliament for any scenario, a rejection of the Withdrawal agreement by the House of Commons cannot be excluded.

A "no deal" scenario could then be stoically confronted by the British people. Or to avoid this fall from the edge of the cliff, the UK could unilaterally revoke Article 50 with the intention of triggering it again after a period of time leaving further time for renegotiation of a new agreement (the legal feasibility of this action under EU laws is highly debated). Members of Parliament could ask the PM to renegotiate a new deal. The UK could thus request from the EU an extension of Article 50 that would have to be approved unanimously by all EU Member States. Finally, this extension could also leave time for a second referendum allowing the British people to choose between the "no deal", the withdrawal deal or to remain in the EU. This diversity of scenarios and the large interpretation of the political declaration increase the Brexit uncertainty and is already impacting UK's trade.

The cost of uncertainty

It is well known that trade agreements play a major role in reducing trade policy uncertainty and trade flows adjust in anticipation of trade agreements (Limao and Maggi 2015; Carballo *et al.* 2018). Reciprocally, the Brexit limbo is already impacting UK's trade. There are signs of diversion of UK exports and imports in goods, as well as shift from third country. According to the estimates by Douch *et al.* (2018), there is already an aggregate drop in exports to the EU of around 16 % across the post-referendum period, and around 13 % to non-EU countries. The authors consider it a prolonged negative demand shock, rather than an adjustment issue. While substantial parts of the British electorate may have chosen 'the wide open sea', there is little evidence of the world outside Europe switching to British exports – in fact, it is rather the reverse. Trade exports with third countries (sample of 14 countries including South Korea) lowered by 13.3% in comparison with synthetic Britain (without the Brexit vote effect). However, with South Korea, UK trade performed well – as with China and New Zealand.

The additional uncertainty that third business has to consider is the one concerning the UK's status in the 759 international agreements which have been signed by the EU and which apply to the UK, starting with all the trade agreements that the EU has signed with third countries. As Michel Barnier reminded on December 20, 2017 "legally speaking, mechanically, the day after the U.K. has left the EU institutions, the U.K. will no longer be covered by our international agreements". What are then the available alternatives?

3. Potential scenarios for EU FTAs' transition

On January 2017 faced with the need to build an autonomous trade strategy for the UK outside the EU, British PM Theresa May endorsed the vision of a "Global Britain" "always acting as the strongest and most passionate advocate for free trade right across the globe". Declarations from high-level officials have made clear that the UK stands ready to offer the same market access conditions they have now to trading partners and that the international response has already proven to be positive. New FTAs with third countries could be agreed quickly, allowing the UK to reap new economic benefits. The British government had thus prepare a customs bill (taxation bill), and a trade bill laying the post-Brexit regulatory framework for replication of current trade agreements the UK is party to as an EU member.

Yet, the UK cannot conclude any new FTA before the end of the Transition period, as the integrity of the customs union (CU) would be compromised: any British concession of preferential tariffs to third countries which are more favourable than EU tariffs would undermine the CU.

If at the end of the Transition period, the UK faces a "no deal" – applies the backstop solution and remains thus in a custom union with the EU – it would limit its scope of trade negotiations with third countries: they could only cover services, intellectual property, public procurement, data and regulatory barriers to trade in goods, without the leverage of tariffs concessions.

Alternatively, if the UK favours the Norwegian model or an FTA +, while avoiding to restore an Irish border, it will be able to negotiate FTAs with third countries.[27] The priority would therefore be to deal with the existing FTAs. Legally speaking, the day after the UK leaves the EU on the March 29, 2019, it will no longer be covered by the EU's international agreements. On top of that, the integrity of the CU during the Transition implies that current FTAs continue to apply to the UK without reciprocity.

3-1. Avoiding the asymmetry of the Turkish regime

If the transition period does not come with an equivalent transition period for the withdrawal from FTAs, the UK would find itself in an asymmetrical regime with third countries, similar to that of Turkey with the EU. As a member of the CU, the UK would have to maintain the same EU common external tariff with regard to third countries, while third countries would not have to bear the same obligation. UK exporters would be subject to less favourable WTO tariffs and it would increase the negative impact of leaving

27) The FTAs signed by Norway are nevertheless constrained by its alignment on the EU's regulatory model.

the Single Market.

If the EU-Japan FTA enters into force before March 2019, UK's market would be hit twice: in addition to not being able to enjoy the FTA preferential access to Japan's market, it would lose attractiveness in Japan's view for no longer being part of the Single Market.

Yet, British companies are not the only ones concerned. European companies, which are part of the same value chains as British companies, would be affected by the UK's exit from the current rules of origin of these FTAs. If, when leaving the EU, the British content of European exports is no longer considered as "EU" content, some products may no longer enjoy preferential access to the third country in question, thus being subject to higher tariffs.[28)]

It is thus in the UK's and the EU's mutual interest to maintain the status quo during the transition period, allowing the UK to continue to benefit from these FTAs, and not merely being constrained by them.

The UK would merely have two options to avoid the risk of this worst-case scenario: grandfathering and replication.

3-2. Grandfathering of the EU trade agreements

The first option would be to apply the principle of acquired rights, known as grandfathering (Holmes and Gasiorek 2017), which would imply that the clauses of these agreements would remain applicable to the UK, even after its exit from the EU. Grandfathering would allow these agreements to continue to apply to the UK and the third countries concerned, the latter accepting to consider the UK to be a signatory of these agreements via the EU during the transition period. In this framework, the UK and the EU would still be considered as a single entity.

It would not be a mere formal procedure: beyond the EU's "green light",

28) While the Turkish case limits the impact of the rule of origin issue through the country's membership in the pan-Euro-Med cumulation of origin area.

consent must also be obtained from the third countries who have signed these FTAs via an exchange of letters or a protocol to be incorporated into the treaty in question. Yet the UK government seems to favour the grandfathering option, leaving time to prepare a replication or a renegotiation during the Transition period.

3-3. Replication of the EU trade agreements

The idea of copying and pasting the texts of existing treaties between the EU and third countries into new international agreements and signing them one minute after the UK's exit from the EU is not as easy as it may seem.

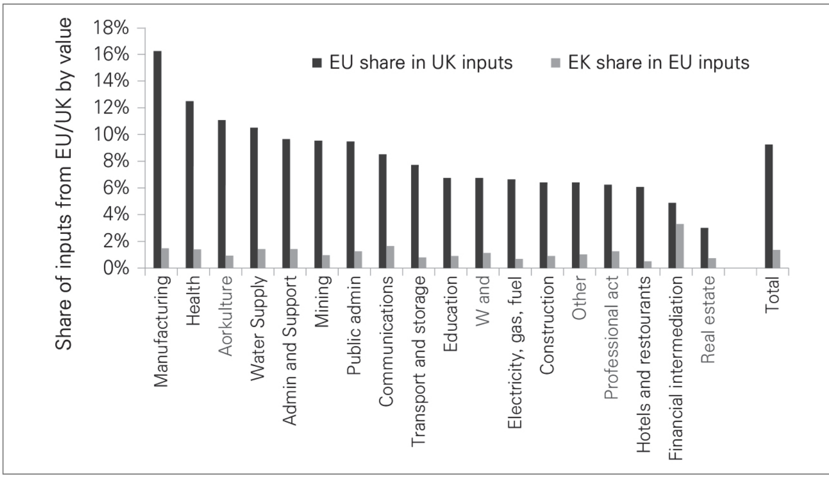
3-3-1. The rules of origin challenge.

A Customs Union operates without rules of origin (RoO) because the parties apply a common external tariff and a common trade defence regime, while an FTA requires those rules to avoid trade diversion via a lower tariff regime. All European preferential agreements include a bilateral cumulation of origin (materials originating in country A which are processed in country B are considered to originate from country B when the end product is intended for export to country A); whereas, an FTA does not generally include a diagonal cumulation clause of the RoO between three or more countries.

The EU-ROK FTA does not provide for this cumulation. This is particularly worrying for car makers as the current FTA currently requires them to show that 55% of any vehicle is made of "local" EU content, in order to qualify for preferential access to ROK.

A UK-ROK deal which would contain similar 55% "local content requirement", would penalise UK car makers whose cars, manufactured via pan-European supply chains, are only 41% UK-made. This would mean, that cars manufactured in the UK would be subject to an 8% tariff (i.e. the current WTO MFN level) when exported to South Korea, even if the UK and South Korea agreed to continue to apply the current EU-ROK FTA.

Figure 1. Share of inputs from EU (for UK) of from UK (for EU) by value



Source: Peter Levell, Firms' supply chains form an important part of UK-EU trade: what does this mean for future trade policy?, Institute for Fiscal Studies, 8 January 2018.

If the UK wished to maintain the same access to the Single Market for goods using ROK components, it would have to shift manufacturing to the EU or to negotiate a diagonal cumulation of origin with the EU and ROK in order to allow businesses to comply with ROs. And it would still have to prove that these British goods actually originate from the UK to the extent required by the RoOs. This cumulation would have to be negotiated also with other EU's FTA partners, if the UK wants to avoid the negative impact on its market of the loss of preferential market around the world.

It could be in the interest of the EU to agree on a diagonal cumulation clause with FTA partners.[29] Yet its consent, most needed by the UK, would

29) At the moment the EU only accepts such a diagonal cumulation on the basis of an alignment of third countries on its RoOs and only in two cases: as part of the pan-Euro-Med area and with the Western Balkan countries.

increase the EU's leverage in the overall Brexit negotiation.[30)]

3-3-2. Tariff quotas renegotiation

FTAs impose a quota limiting the number of units for some products which may enter the market tariff-free or with a preferential tariff. Should the EU quota be continued in the new bilateral agreements between the UK and third countries, or should it be renegotiated with the third country in accordance with the volume of UK-third country trade on a given date – which would also have to be agreed upon? Such renegotiations would result in the EU and third countries reassessing their current quotas.

These two issues, RoO and quotas, already demonstrate that copying and pasting current FTAs into bilateral agreements between the UK and third countries would require trilateral negotiations (between the EU, the UK and third countries) which could extend beyond the deadline of March 2019.

Furthermore, the replication option further increases pressure on the UK to make concessions to third countries as the new FTAs may well apply even beyond the transition period. In leaving the EU, the UK will become a market far less attractive for third countries than the vast EU Single Market.

As they will be accessing a more limited market, they may not want to make the same concessions to the UK as those granted to the EU, or demand a greater price for maintaining the same concessions, depending on their leverage.

Three countries — South Korea, Chile and South Africa — have already raised objections to a mere replication and may be followed by others. A Chilean official said that Santiago was "in principle in favour of preserving the commercial flows" during transition but demanded concessions in the agricultural sector, which would apply to a future deal with the country. The

30) It should be noted that in May's Chequers plan, which keeps the UK out of a common external tariff with the EU, the Facilitated Customs Arrangements proposed does not eliminate the rule of origin control.

EU-Chile FTA includes, indeed, safeguards that Europe enforced to protect sensitive agriculture sectors.

In the case of a trade partner which has a trade deficit with the UK, could it be tempted to let the current FTA expire during the transition? Trade threats during the transition period might provide extra leverage to third countries on future deals, potentially forcing in return longer-term concessions from the UK.

London has however received encouraging signals from Japan and Canada, willing to keep the status quo, since any renegotiation of British market access terms would be too time intensive, and they prefer to preserve a stable and predictable trading relationship.

The status quo, based on grandfathering, could thus prevail during the transition period. Yet, the simultaneous renegotiation of the 40 EU FTAs before the end of 2020 remains difficult not only for the UK. Third countries will want to assess the new EU-UK partnership before committing into bilateral negotiations. Despite the optimism of Liam Fox, the International trade secretary, the obvious lack of time to negotiate them and ratify them by March 2019, raises concerns. If grandfathering is not applied, it could lead the UK to refocus on securing four of five major EU deals, including with South Korea, Canada, South Africa and Switzerland.

The UK may also simply not be powerful enough to make the replication demands on its own and would then need the EU to be its broker to get trade partners on board for a transitional plan.

The EU has not publicly indicated if it is willing to help: Michel Barnier, the EU chief negotiator, has only warned that it will be ultimately up to third countries to let the UK benefit from the FTAs after March 2019. But if Brussels was going to use all its weight to convince its FTA partners, it would provide Brussels with more leverage in the bilateral negotiation on the future EU-UK relations.

The UK could then use the transition period to replicate FTAs into new bilateral agreements. If this involves preserving the current terms of the agreements, the UK and third countries would have the option of revising these agreements in accordance with their respective interests at a later stage.

3-4. Prospect for a "Global Britain"

The "no deal" scenario would also have a negative impact on UK trade with EU third countries: the UK would leave the EU with no grandfathering or replication of EU FTAs, leaving the "Global Britain" with MFN WTO terms only. With less access to the Single Market, the attractiveness of the UK's economy for third countries would rely first of all on deregulation: something hardly acceptable for UK citizens and which would pull away the UK from its main export destination, namely the EU Single Market. In addition, the amount of trade depends positively on the size of the two countries' economies but negatively on the distance between them (Krugman 2018).

The "Global Britain" challenge is not only about building an autonomous trade policy. It is first about increasing trade with trade partners in order to compensate for the expected decrease in trade with the EU-27 due to Brexit.

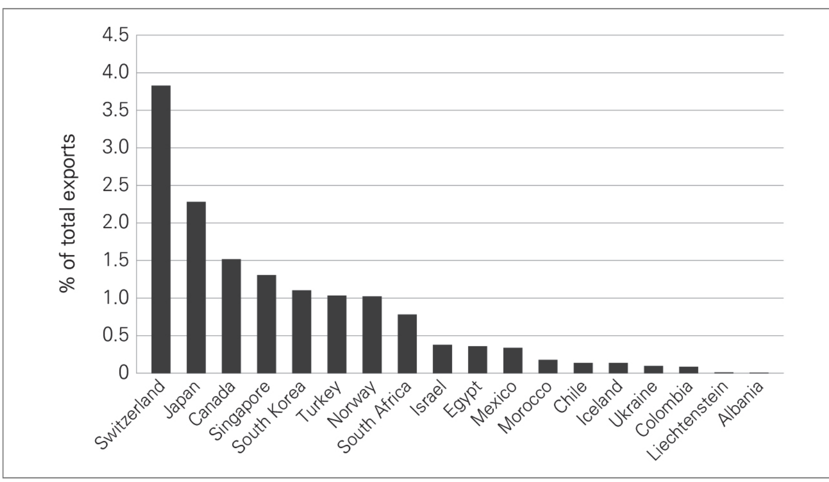
The UK government has made it clear that it could be faster and more flexible than the EU as a whole, because it would no longer be constrained by what it considers protectionist interests in other EU countries. This "Global Britain" vision has been ironically building up at a time of strong EU trade negotiation activism. The EU has already more than 36 preferential trade agreements covering 60 third countries.[31] By the time of Brexit, this number could even rise to 64 countries, as new agreements with countries including Singapore, Japan, and Vietnam might be ratified, others have been

31) Free trade agreement includes Economic Partnership Agreements (EPA), Association agreements (AA), partnership and cooperation agreements (PCA) and other EU agreements that include a trade dimension.

recently signed (Mexico) and more agreements are under negotiations (Mercosur, Australia, New Zealand, …).

Third countries with which the EU has an FTA accounted for only 17.2% of UK exports in goods on average during the period 2013-2015 (European Union Committee 2017). The UK remains very dependent on the Single Market[32], with 44% of UK goods and services exports going to the EU-27, and 53% of goods and services imports coming from there, despite a slight decrease of the share of UK-EU bilateral trade in UK's external trade in the past years (- 7% of UK exports to the EU from 2006 to 2017).

Figure 2. Percentage of total UK exports to EU FTA partners



Notes: As of publication the agreement with Singapore is yet to be ratified, and the agreement with Japan yet to be signed. Both are expected to be finalised prior to the completion of the proposed Brexit transition period.
Source: Geographical breakdown of the current account. The Pink Book: 2017, ONS.

In addition, as Joseph Stiglitz underlines, the service sector which makes up 79% of UK's GDP and 80% of its employment, and the exports of which

32) Even, if the UK is the least member state dependant from the Single Market.

double the imports, “tends to grow with regional economic and legal integration” (Woods 2018). The UK has an obvious interest in opening services market. But it remains a challenging task in FTA negotiations. Despite the steady decline in transport costs (down 11% between 1986 and 2006) facilitating access to markets further afield, geographic proximity remains important in the service sector and strengthens the Single Market’s appeal for UK exports and imports. Distance reduces the volume of trade by as much: +10% distance reduces the trading of services by 7% (Head, Mayer and Ries 2009).

Above all, intra-EU service provision has increased by approximately 60% since the creation of the Single Market, a magnitude not comparable with the profits derived from FTAs (Ebell 2016, p.37). The opening of the services market remains notoriously limited in these agreements, although the Doha’s multilateral agenda on this issue has led to some timid progress in services liberalisation in the 118 preferential agreements notified to the WTO in 2014. The Trade in Services Agreement (TISA), currently being negotiated between 23 members of the WTO representing 70% of global services trade, is the most ambitious in this field. The EU brings its full weight to bear here, with the opportunities from the regulatory alignment implemented as part of its Single Market. It remains to be seen which form of additional leverage the UK will use with third countries to negotiate a greater opening of their services market.

3-5. The interdependence of goods and services

The increasing interdependence of goods and services sectors should also be kept in mind as connectivity between production systems is growing and with it the share of services in the value-added of manufactured goods. This is estimated at 20% to 47% across all sectors (Antimiani and Cernat 2017, p.4). Goods and services are increasingly interlinked and indivisible in trade.

It has become difficult to split a production chain over two separate categories corresponding to different trade regimes. Yet, as reminded by Springford and Lowe (2018), the UK services sector is highly dependent on EU value chains for manufactured goods: the UK Trade Policy Observatory estimates that the added value of domestic services incorporated in British manufacturing exports exceeds £50 billion per year, equivalent to the amount of UK financial services exports. The prospect that ambitious FTAs with third countries covering trade in services could offset the losses resulting from Brexit, is therefore tenuous. Brexit highlights the European regulatory leadership, known as the "Brussels effect" (Beattie 2017). If the UK wished to diverge from EU regulations in some sectors, adopting those of another large key market, such as the USA, would still be more meaningful than to adopt a British only regulation.

While, as seen above, a duplication of the EU FTAs may be more complex than expected, any negotiation with the US, China, Hong Kong, Japan and India which are high on the UK's priority list, will request to start from scratch. And the UK – representing today less than one-eighth of the EU economic power – will not have outside the EU the same economic weight and attractiveness as when being part of the Single Market. Increasing the benefits of those deals to its own advantage remains a challenge.

The UK's ability to negotiate preferential agreements that would be more ambitious than EU's current FTAs, remains hypothetical. This would probably come at the cost of deregulation, creating level playing field imbalances with the EU – an issue anticipated by the political declaration with provisions ensuring the level playing between the two parties, going along with any economic partnership. Moreover, UK's leeway in future trade negotiations with third countries would be significantly limited by its inability to grant additional concessions on customs tariffs for goods, which is the traditional leverage employed by developed countries to obtain preferential access to the services markets of emerging countries.

4. A case study: Prospect for South Korea trade relations with the EU and the UK

4-1. EU-ROK: a key FTA for the EU

4-1-1. A second generation trade model

The EU-ROK FTA was concluded relatively quickly after only two years of negotiations. By 2011, the deal was provisionally implemented and entered into force in December 2015. Until the provisional implementation of the EU-Canada FTA, CETA, on September 21, 2017, the EU-ROK was considered the most comprehensive EU FTAs. Import duties were gradually eliminated on almost all products. The agreement also goes far beyond the liberalisation of services market that both parties have already implemented under their GATS (General Agreement on trade in Services) commitments. For example, the treaty includes stronger intellectual property rights (including geographical indications), regulatory cooperation, sustainable development provisions, aims to open up public procurement, as well as specific commitments to reduce non-tariff barriers in many sectors, including cars, pharmaceuticals, and electronics. As a result, the EU-South Korea agreement is often seen as a model "second generation" trade agreement.

Table 2. Regulatory cooperation in the EU-South Korea FTA

The FTA addresses non-tariff barriers in four sectors specifically: motor vehicles and parts, pharmaceutical products and medical devices, chemicals, and electronics. It also aims to increase market access in services and investments.

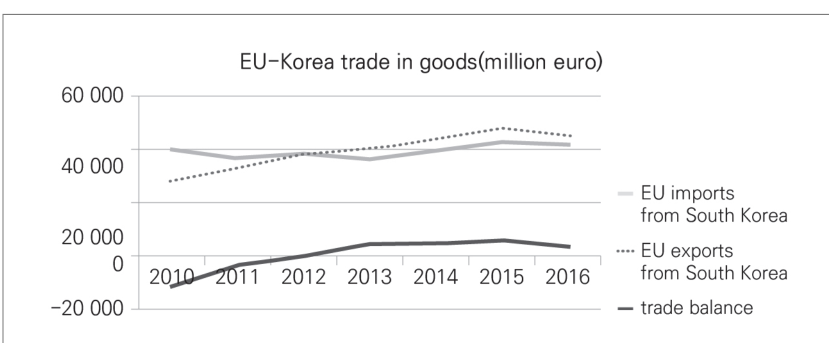
Motor vehicles and parts
The EU and South Korea have agreed to align their regulations with the World Forum for Harmonisation of Vehicle Regulations (WP.29). The WP.29 is in the framework of the United Nations Economic Commission for Europe (UN ECE). Both sides have also committed to providing full market access by eliminating tariff and non-tariff barriers.

Table 2. Continued

Compliance with these commitments is being monitored by a working group established under the FTA. Korea has agreed to accept 'EURO VI' certificates for heavy duty commercial vehicles, as well as simplified electronic documentary procedures for imports of E-marked tyres in 2016.
Pharmaceutical products and chemicals The EU and South Korea have agreed to make immediately available to the other party any laws, regulations, procedures, administrative rulings and implementing guidelines related to pharmaceutical products. Such laws and regulations will take into account, as appropriate, international provisions, practices, and guidelines. For chemicals, there are a number of initiatives including protection of public health and the environment, implementing appropriate regulatory mechanisms, and developing best practices on chemicals assessment and management. For both pharmaceutical products and chemicals, working groups have been established to monitor areas of the agreement and to exchange updates on regulations.
Electronics (part of capital goods and machinery in this report) For electronics, the EU and South Korea agree to recognize three international standard-setting bodies, which are to be used as the basis for any standards, technical regulation or conformity assessment procedures: the International Standards Organisation (ISO), the International Electro-technical Commission (IEC) and the International Telecommunication Union (ITU). To facilitate conformity assessments, a list of approved testing laboratories must be notified to the other party under the FTA. Unlike the sectors above, no working group has been established on electronics.

Source: House of Lords - Brexit: trade in goods - European Union Committee, 2017. https://publications.parliament.uk/pa/ld201617/ldselect/ldeucom/129/12910.htm#footnote-176

Figure 3. EU Exports to and Imports from Korea, 2010-2016 (billion EUR)



Source: Evolution of trade under EU-ROK FTA (COM (2017) 614 final)

4-1-2. EU's positive trade balance with ROK

The EU's €11.6 billion trade deficit with Korea in 2010 has turned into a trade surplus of €3.1 bn in 2016. In 2010, EU exports to ROK were €28.0 bn, and imports from ROK were €39.5 bn ; while in 2016, EU exports were €44.5 bn, and imports were €41.4 bn. The current level of EU exports to ROK would have generated duty payments of approximately €2 bn had the FTA not been in place.[33)]

Between 2015 and 2016 total EU trade with ROK declined: exports to ROK declined by 6.9%, while imports declined by 2.2%. The EU trade surplus thus decreased from 5.4 to €3.1 bn. EU exports decreased in particular on machinery and appliances (by 8.2%) and transport equipment (by 6.4%). These two sectors represent more than 50% of EU exports to Korea.

The decline is in line with the overall pattern of trade for the EU in 2016. Between 2015 and 2016 total EU exports to the world declined by 2.4%. EU imports from the world declined by 1.2%.

South Korea was the EU's 8th largest import originator (with imports from Korea remaining relatively stable: 2.6% of total imports in 2010 an still 2.7% in 2017) and the 8th largest export market in 2017 (EU exports to ROK represented 2% of total EU exports in 2010, and 2.7% in 2017).[34)]

On the Korean side, the EU's share in total Korean imports increased from 9.1% before the start of the FTA implementation to 12.8% in 2016, making the EU the 2nd largest Korea's import originator (after China). Over the same period of time, the EU's share in total Korean exports declined from 11.5% to 10.9%,[35)] making the EU the 3rd largest Korean export market. The EU is Korea's 3rd largest partner in terms of total trade (after

33) This calculation is based on Korean imports from the EU at HS6 level, in the fifth year of the FTA implementation (ITC data).

34) From http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113448.pdf

35) The EU's share in total Korean imports refers to Korea's imports from the EU as a share of Korea's imports from the world. The EU's share in total Korean exports describes Korea's exports to the EU as a share of Korea's exports to the world.

China and US).

To summarise, the EU business sector has taken advantage of this FTA as demonstrated by the high preference utilisation rate, reflecting to what extent EU exporters are using the FTA preferences.[36] In 2016, the overall EU Preference Utilisation Rate on the Korean market was as high as 71% (while only 61.1% in 2012).

In addition, in late November 2018, this FTA remains the only EU FTA in force in East Asia. The EU-Vietnam is not yet signed and the very promising EU-Japan is not yet ratified.

4-1-3. Brexit's potential impact on the EU-ROK FTA

The EU-ROK FTA resulted from a delicate compromise between a very large and powerful economy, the EU, and an economy and trading power less than one-tenth of the size of the EU. As a result, the EU had a stronger negotiation position than South Korea, and the latter had even to make more concessions to secure an agreement in the European Parliament, including a new "safeguard" clause to protect European industry and a guarantee that new Korean car emissions limits would not be detrimental to European car manufacturers.

South Korea could thus seize the opportunity of Brexit to ask the EU for a review of this FTA which turned its positive trade balance with the EU into a deficit. The review could concern the automobile sector, as well as the services market, and in particular the legal services. As underlined by Simon Hix and Hae-Won Jun (2017), the terms of the EU-ROK FTA for the legal services were first of all for UK interests, since, along with the US, the UK continues to dominate the ranking of the top 50 law firms in the world.

However, if the UK pressures South Korea into giving a better access to

36) It is equal to the following ratio:

$$\frac{\text{Korea's preferential imports (the value of EU exports to Korea that enter Korea under the preferential rates)}}{\text{Korea's preference eligible imports (the value of EU exports to Korea that are eligible for preferential rates).}}$$

its services market than what it gave to the EU, Seoul would have to offer the same to the EU in application of the WTO MFN clause on services, and reciprocally. The EU cannot give a better access to its services market without giving the same access to other countries with which it also has an FTA. In addition, if South Korea extends market access to the UK, the US may demand a similar level of access under its agreement with Korea. Ever since Korea negotiated FTAs with the EU and the US in parallel, the US has tried to make sure that it gets a similar level of market access to Korea than the one granted to the EU. As a result, it is unlikely that South Korea would be willing to offer better service market access to the UK than that currently granted under the EU-South Korea FTA.

It should also be underlined that, despite the fact that the EU is a major investor in South Korea (in 2015 its FDI stocks amounted to €49.8bn), the current EU-ROK FTA does not include an investment chapter. Its negotiation started before the FDI became an exclusive competence of the EU. The EU is thus willing to amend the FTA to include provisions on investment protection standards and the Investment Court System agreed with Canada in CETA.

4-2. UK-ROK new FTA: trade amongst "equal" partners

In 2017, South Korea is only the UK's 14th largest trading partner. While the UK is the second EU Member State exporting to South Korea (after Germany), there is only a small portion of UK exports going to the ROK. But the British exports to ROK more than doubled in the first three years of the EU-ROK deal, and the UK has a positive trade balance with South Korea, which would make the duplication of the current FTA very attractive for the UK.

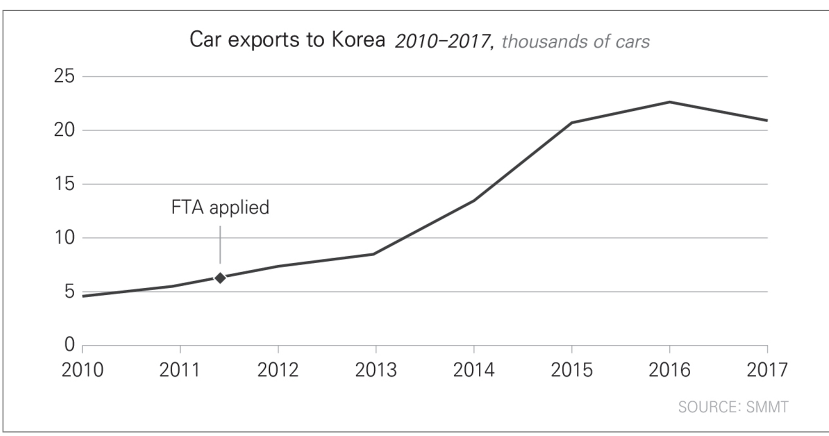
In particular, in 2017, the ROK was the UK's third-biggest importer of British North Sea crude oil, which is a significant source of revenue for the

UK. Britain's Department for International Trade said its oil exports to South Korea in 2017 earned Britain two billion pounds ($2.81 billion) and made up 14% of its total oil exports, the biggest share after the Netherlands and China.

The removal of the oil tariff has led to an annual increase of UK oil exports of 47% between 2011 and 2015. In 2015 oil accounted for one third of total goods exports and tended to increase its share while sanctions were imposed on Iran.

UK car sales to South Korea went also from below 2,000 in 2010 (a year before the deal), to almost 21,000 units in 2017. There was a major boost as well for UK pottery industry (ceramics).

Figure 4. Car exports to Korea



Source: Fears grow that South Korea may demand concessions from Britain to replicate EU trade agreement, Peter Foster, The Telegraph, 4 February 2018.

If the UK was losing the benefit of the EU-ROK FTA, UK exports of £5bn could face an average tariff approaching 9% (Institute for Government 2017). However, having an economy about the size of the UK economy, Seoul may be reluctant to simply replicate the terms of the EU-South Korea

FTA in a new UK-South Korea FTA. Seoul might expect a more equal 'partnership' with an independent UK. It could ask for more access in areas as automobiles and high-tech exports and offer less in others, including legal and

Table 3. UK trade with South Korea

	Product	Value in 2015 ($, 000's)	Annual growth in value, 2011-15 (% p.a.)	Share of UK imports (%)		Product	Value in 2015 ($, 000's)	Annual growth in value, 2011-15 (% p.a.)	Share of UK exports (%)
	UK imports from South Korea					**UK exports to South Korea**			
1	Vehicles and parts and accessories thereof	1,672,322	12	2.1	1	Mineral fuels, mineral oils and products of their distillation	2,095,006	25	6.4
2	Electrical machinery and equipment and parts thereof	844,824	-8	1.4	2	Machinery, mechanical appliances and parts thereof	1,336,682	17	2.1
3	Ships, boats and floating structures	780,494	361	45.1	3	Vehicles and parts and accessories thereof	842,101	33	1.7
4	Machinery, mechanical appliances and parts thereof	763,966	7	1.0	4	Optical, photographic, cinematographic, medical or surgical products	473,998	23	2.6
5	Mineral fuels, mineral oils and products of their distillation	675,451	26	1.3	5	Electrical machinery and equipment and parts thereof	366,730	4	1.3
	All products	6,306,250	9	1.0		All products	7,213,517	12	1.5
	South Korean imports from UK					**South Korean exports to UK**			
1	Ships, boats and floating structures	2,991,231	14	7.8	1	Mineral fuels, mineral oils and products of their distillation	1,419,686	33	1.4
2	Vehicles and parts and accessories thereof	1,697,056	24	2.5	2	Machinery, mechanical appliances and parts thereof	977,731	12	2.1
3	Machinery, mechanical appliances and parts thereof	1,121,272	11	1.8	3	Vehicles and parts and accessories thereof	828,818	39	5.5
4	Electrical machinery and equipment and parts thereof	513,484	-5	0.4	4	Electrical machinery and equipment and parts thereof	427,333	9	0.5
5	Aircraft, spacecraft, and parts thereof	226,090	44	12.1	5	Optical, photographic, cinematographic, medical or surgical products	416,043	13	2.3
	All products	7,854,429	10	1.5		All products	6,129,520	12	1.4

Note: the data are not symmetric because they are reported by UK and South Korean sources separately.
Source: ITC calculations based on UN COMTRADE statistics. UK imports/exports reported by UK. South Korean imports/exports reported South Korea.

financial services. Concessions, particularly in the area of services, which were actually to a great extent the result of UK demands in the EU FTA.

In many specific areas the EU-ROK FTA goes well beyond Korea's GATS commitments. In terms of services trade, it will not be easy for the UK to get better terms in a future UK-South Korea FTA than the current level of liberalisation, particularly in the financial and telecommunication sectors.

Seoul might also look at its other FTAs, like its FTA with Canada or the EFTA, as the starting point for negotiation with the UK. But they are much more restrictive in services than its FTAs with the EU and the USA. The UK would lose out on these significant concessions that Korea made to clinch its agreements with two of its main trading partners. It might thus give a harder work to get a bilateral deal relatively quickly and it may not be as beneficial to the UK as the EU one is.

However, as mentioned previously, there is no investment chapter in EU-ROK FTA and South Korea should welcome a bilateral investment agreement with the UK.

Brexit remains high on South Korea's agenda. The Park Geun-hye administration called to anticipate a potential economic slowdown and requested an allocation of 10 trillion won ($8.4 billion) in extra budget to create jobs and assist corporate restructuring due to Brexit. But the so-called South Korea-UK trade working group met thus only twice in 2017. A trade deal with the UK might be less a priority for ROK, than it is for post-Brexit UK which will try to sign as many agreements with the current EU FTA partners as possible. While Donald Trump's protectionist trade policy restrains access to the US market, East-Asia countries would tend even more to prioritise trade deals with the EU.

5. Conclusion

Despite PM Theresa May's initial wish to transform the post-Brexit UK into "the champion of free trade", there are many stumbling blocks on the road to "Global Britain". Even if the House of Commons were to vote the withdrawal deal in December 2018, the political declaration on the future relationship between the EU and the UK can be interpreted in a flexible way which opens the way as much for an FTA + as for a Norwegian scenario. Both scenarios would allow the UK to have an autonomous trade policy. Yet, at this stage, for the Irish border, there is no obvious alternative to the backstop solution (single customs territory with the EU) which would prevent the UK from signing trade agreements with third countries. The Norwegian model would limit the negative economic impact of Brexit and preserve the attractiveness of the British market for third countries by keeping the UK aligned on the Single Market regulation. But it would go against a core motive of the referendum vote: the end of the freedom of movement of people. This "Brino" solution would request a profound evolution of the domestic political debate during the transition period. Alternatively, an FTA+ would restore more frictions in the bilateral UK-EU trade, compared to the current situation with the UK as a member-state. It would also reduce the leverage of the UK in its bilateral negotiation with third countries.

The EU 27 has little leverage on the decisive vote of the withdrawal agreement in the British Parliament. The danger of a spill-over effect from economic to other political domains, including security matters, could contribute to mobilise the British public opinion towards "everything but the 'no deal'". Yet, the probability of a "no deal" scenario remains high − be it in March 2019 or at the end of the transition period. A strong confidence in the British resilience capacity could open the way to this cathartic "no deal" exit, unless the British people were to decide to remain in the EU.

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