

CPA Guide to Understanding the Implications of a 'Hard Brexit'

Theresa May has stated that she wants the forth-coming exit from the EU to place the UK in a beneficial position such that British companies have the maximum freedom to trade with and operate in the single market. But, at the same time, the Prime Minister has insisted that Britain, after Brexit, would become a fully independent, sovereign country, able to make its own decisions on all issues.

For the UK to be able to negotiate its exit from the EU requires the remaining 27 Member States being able to agree a common position for their side. If they cannot arrive at a united position, then the UK may be forced to walk away with no agreed exits terms. This would be the hardest of a 'hard Brexit' with the UK having to trade initially under the rules set by the World Trade Organisation.

Such a scenario would see the UK in the position of being a completely free agent with a clean sheet from which to initiate a fresh approach to its economic future. While it is highly uncertain what the UK's future will look like following a hard Brexit, this information paper attempts to examine the potential *hard Brexit* landscape following the UK's leap into the unknown.

What has the Government stated it wants from Brexit?

- There will be no “half-in, half-out of the EU or hold onto bits of membership as we leave” – Theresa May.
- Mrs May has stated that she wants the UK to reach a *new* customs union deal with the EU while still allowing other trade deals to be negotiated.
- The UK does not want an “off the shelf deal” - Theresa May.
- Immigration curbs will be an essential part of the Brexit package.
- We want to be free to sign our own trade deals – Liam Fox.
- “We are not leaving the European Union only to give up control of immigration again. And we are not leaving only to return to the jurisdiction of the European Court of Justice” – Theresa May.

Bearing in mind what the UK government has stated it wants from Brexit and the fact that the government White Paper on Brexit makes it clear that the UK is seeking some form of hard Brexit, the question of the transition to this new trading regime becomes highly significant for the UK. However as the UK moves from its present arrangement to the new trading relationship after its withdrawal from the EU, it is imperative for both sides that a smooth and orderly transition takes place.

There appear to be three possible interpretations of what a “transitional arrangement” means in practice. There are some who think of transitional arrangements as a deliberate way for the UK to delay leaving the EU. There are those who believe that two years will not be sufficient time for officials to conclude the full range of issues for the UK to exit the EU and the CPA's construction industry forecasts assume that there will be a five-year transition agreement on this basis.

However, Theresa May and the Chancellor, Philip Hammond, are both of the view that the UK will have completed negotiations by March 2019, but to avoid the “cliff edge” for the British economy, it will be necessary for the UK to conclude some form of transitional arrangement with the EU to allow businesses in the UK adequate time to adjust and for implementation of the practical changes required.

While this information paper answers the question of what a hard Brexit may look like, we also need to recognise that some form of transitional arrangements could materialise.

Facts to be borne in mind

1. Proximity to new markets?

- International trade and investment falls substantially with distance, so proximity to markets has a positive effect on economic performance.
- Thus, it is geography rather than purely policy that has traditionally made the EU the UK’s most important economic partner and simply reorienting the focus of the UK’s trade policy away from Europe will not change this underlying reality.
- Whatever agreements are reached with countries outside Europe, the most important decision facing the UK government following Brexit will still be the future of the UK’s relationship with the EU.

2. Parity of new markets to that offered by the EU

- Will new overseas markets offer the UK the same potential for the variety and volume of exports that the EU does?

3. Re-negotiation Facts

- During negotiations the UK faces an unavoidable trade-off between economic benefits and political sovereignty.
- The UK has benefited from closer economic integration with the EU, however, the price for this continued integration is allowing the EU control over some areas of policy.

Potential landscape after a Hard Brexit

1. UK leaves the Single Market

This would result in:

- An end to the “four freedoms” – free movement of people, goods, services and capital - between the EU and UK.
- The introduction of the “common external tariff” by the EU on UK exports.
- The introduction by the UK of reciprocal import tariffs for EU goods which would raise the landed cost of goods in the UK.
- Potentially, a reciprocal agreement with the EU on import tariffs may cancel each other out?
- There will be a time lag while UK industry gears up production to eliminate the need for imported products (currently approximately 20% of UK construction products are imported of which 61% originate from the EU).

- The availability of skilled immigrants for the work force would be affected due to the UK introducing of some form of quota or points system.
- There is the likelihood that there will be a divergence between economic regulations in the UK and the EU which will increase non-tariff barriers to trade between the UK and the EU.

2. UK leaves the EU Customs Union

This would result in:

- An end to the benefits arising from the common tariff system – EU imports from the UK will be subject to the “common external tariff”. Similarly, EU exports to the UK will also be subject to import tariffs set by the Westminster government. Parity between these two sets on tariffs could be maintained by mutual agreement.
- The UK could theoretically unilaterally scrap import tariffs which would reduce the cost of construction products on the market, however, this could lead to job losses in UK industry if imported products ended up at a lower cost than those manufactured in the UK.
- The UK will be forced to re-establish independent membership of the World Trade Organisation as a first step to agreeing a trade deal with the EU.
- There will be physical delays at sea ports and air terminals for customs clearance to take place.
- The UK is the largest single customer for exports from the remaining EU’s 27 members. It would not, therefore, be in anyone’s short-term economic interest to re-impose tariffs. German cars, French wine and Italian shoes are all pushing the UK trading deficit on goods with the EU to record levels – some £30bn per quarter. However, long-term political interests may override this. For instance, the EU may choose to prioritise ensuring that other countries do not also have an incentive to leave the EU by ensuring that the UK does not have a good deal even where there are also adverse economic impacts for the EU.

3. UK having to initially fall back on the World Trade Organisation (WTO) option

- If the UK fails to reach a trade deal with the EU after Brexit, it would have to trade solely under rules set by the WTO which govern tariffs and quotas. Although the UK is already a member of the WTO it would no longer be subject to deals operated through the EU and would have to establish its own set of schedules for tariffs and quotas that would apply to other countries.
- These new UK schedules could be exactly the same as the old EU schedules, however, this does not offer enough flexibility for changing the schedules as future policy may require. Any modification to these schedules would require lengthy negotiations and while these were underway, the UK’s status within the WTO would be in legal limbo.
- It has been suggested that the UK will keep its schedules precisely as they are under the EU including maintaining the EU’s “common external tariff”. Current WTO trade agreements assume that the EU is a coherent economic block and that goods are moved freely across national borders. After Brexit, if the UK kept the external tariff in place, then a company moving products between the EU and UK could potentially face a tariff charge every time a border was crossed. EU Member States whose manufacturers were hit by this development could make life difficult elsewhere for the UK negotiators.
- As a WTO member, the UK’s exports to the EU and other WTO members would be subject to the importing country’s “Most Favoured Nation” tariff. Compared with EU or EFTA membership this would raise the cost of exporting to the EU for UK firms.

- The UK's service trade would also be subject to WTO rules and since the WTO has made less progress than the EU in liberalising trade in services, this would mean reduced access to EU markets for UK service providers.
- The UK government is going out of its way to ensure that the country's large exporters do not suffer from Brexit (e.g. assurances given to Nissan that it will not suffer). However, if the UK were to agree bilaterally with the EU not to apply tariffs to a particular product, the WTO "most favoured nation" principle might force the UK to offer tariff-free access to other countries as well. Also, the channelling of government money to boost exports is something the WTO would disapprove.
- While the WTO agreements uphold the principles of "Most Favoured Nation" status, it does permit exceptions – anti-dumping, anti-subsidy and safeguards to limit imports. The UK will have to develop its own trade defence policy which is an opportunity to design a regime that supports domestic producers, reduces prices for consumers or makes the UK a more attractive country with which to trade.
- The free movement of labour between the UK and the EU would cease as there is no provision for this under WTO rules.
- The free movement of capital between the UK and the EU would probably continue as the EU prohibits restrictions on capital mobility not only within the EU but also with countries outside the EU.
- The WTO option is not straight forward. The EU treats non-members as a third country. As such, the UK would have to negotiate being listed as a country permitted to export into the EU. Individual companies would then have to be approved and individual consignments of goods will have to be cleared before they are allowed on the EU market. If these areas are not agreed then we fall into a legal void. No major player trades with the EU on pure WTO-only terms, they all strike preferential agreements. In addition, they also strike more minor equivalence agreements e.g. financial services equivalence.
- Would having to resort to WTO rules lead to less trade and therefore a fall in national income with the knock on effects for the general economy and house building in particular?
- In short, if the UK did not agree a withdrawal agreement from the EU, the UK and the EU would still have an automatic deal under the all-embracing WTO rules. With both being members of the WTO in their own right, they must offer each other "Most Favoured Nation" terms. While this would cost both sides in tariffs, even with this worst case scenario, the UK would still be financially better off.
- Working to the WTO rules will almost certainly lead to additional inflationary pressure.

4. If the UK re-joins EFTA?

- The question has to be asked whether the UK would be allowed to re-join EFTA. If so, it will re-join EFTA and benefit from its large network of free trade agreements working to WTO rules. However, the UK would need to remain outside the EEA to avoid still being subject to the rules of the Single Market to facilitate the free movement of people, goods, services and capital.
- As the UK wishes to remain outside of the Single market, by re-joining EFTA this would probably result in a gradual divergence between economic regulations in the UK and the EU. This would increase non-tariff barriers to trade between the two market areas.
- There is a view that the costs of Brexit to the UK economy would come primarily from increases in non-tariff barriers between the UK and the EU and not from changes in tariffs. This suggests there would be an economic price to pay for joining EFTA.
- The success of the WTO, the EU and other regional and bilateral trade agreements in lowering tariffs has shifted the focus on current trade negotiations from lowering tariffs towards non-tariff barriers and trade in services and capital. EFTA is not designed to

promote integration in these areas.

- The UK re-joining EFTA is not a standalone solution of what should follow Brexit.

5. Labour/Migration

- By gaining control of immigration, the UK would still need to satisfy the shortage of skilled labour required by the construction industry, in particular, and the economy at large so it would be forced to introduce an immigration system that would not impede this necessary flow of human resources in addition to improving training skills within the UK.
- The UK would largely need to retain those immigrants who are already employed in the UK. If they were forced to return home, then the UK economy would be likely to suffer for several years until such time as UK citizens were trained up in adequate numbers and possessed equal or better skills.
- It also raises the issue of UK citizens living and working inside the EU.
- It is assumed that the mutual recognition of each other's nationals would be beneficial to both sides and will, therefore, be concluded to avoid significant economic consequences.
- On 28 February 2017 Theresa May announced that EU citizens arriving after the 15 March 2017 will not be entitled to live permanently in the UK, but the 3.6 million EU citizens already in Britain and others who come before this cut of date would have their rights protected, provided the same was true for UK citizens living in the EU.
- Any changes to the immigration rules will add significantly to the administrative burden of satisfying visa requirements. This would slow the recruitment process, and increase costs for construction employers, potentially seeing further time lags in construction and infrastructure.
- It must also be recognised that there is also a large number of UK-born workers in construction which will be retiring in the next decade and will need replacing (500,000 – 750,000 workers) – loss of experienced personnel. Immigrants help mitigate this negative effect of an aging workforce.
- If immigrant labour in the UK was repatriated then the exchequer would suffer due to reduced income tax and national insurance contributions.
- A persistent shortage of skilled labour would necessitate a change to the current building process used on site, potentially in favour of off-site manufacturing.
- Labour shortages would also lead to an upward pressure on wages which in turn will push up the overall cost of projects before changes in the construction process are put in place.

6. EU legislation

- The Great Repeal Bill will rescind the European Communities Act and enshrine all existing EU legislation into UK law thus maintaining the status quo.
- This would allow Government to examine overtime any necessary changes deemed beneficial to the UK.
- All EU Directives are already transposed into UK law either through primary or secondary legislation which can be at a more stringent level than the EU's original Directive.

All EU Regulations which automatically became applicable in the UK by 2020 will be covered by the Great Repeal Bill.

7. EU Funded Programmes

- It is assumed that there will be an impact on the international cooperation between industry, research institutes and government on innovation, R&D and new technologies.

We understand the following situations exist regarding the funding programmes listed below:

- EU structural and investment fund projects signed before the 2016 Autumn Statement and the Horizon 2020 research funding granted before the UK leaves the EU will all be guaranteed by the UK government even when projects continue post Brexit.
- The European Investment Bank does lend outside of EU members states so, theoretically, new funding may still be available following the UK leaving the EU. However, EIB non-member state lending must be ‘in the interests of EU member states’.
- We await a decision on the future of the £5.3bn in EU regeneration funding promised to local areas by 2020?
- EU regional development funding will no longer be available to the UK.

8. State Aid/Control of Subsidies

- State Aid will still be subject to some form of controlling influence in the UK.
- The concept of State Aid is enshrined in World Trade Organisation (WTO) policies and agreements aimed at encouraging the free flow of goods between countries through the prevention of subsidies. Specifically this would come under the WTO’s Agreement on Subsidies and Countervailing Measures.
- Under this WTO Agreement on Subsidies and Countervailing Measures, EU State aid rules would no longer apply to the UK. Thus, it would still be possible for the UK to make a complaint about State Aid granted by EU member states, but EU companies would not have a similar mechanism for UK government subsidies.
- Under WTO rules there is no procedure under which subsidies or other forms of state support have to be notified and approved.
- Under the WTO regime, only member states are responsible for enforcement – private parties are not able to take action against measures that harm them.

9. Borders & Customs Control

- The UK opt-out from the main Schengen Agreement coupled with the Republic of Ireland having not joined, raises the question whether this is legally sufficient for no physical border control between the Republic and Northern Ireland, or more likely there will have to be a physical border at all points between UK and EU member states.
- This issue also holds true for shipments and flights taking place directly from the Republic to Wales, Scotland and England.
- It is the wish of both the Irish and UK governments to maintain the Common Travel Area without border controls.
- The likelihood that the UK border will have to be moved back from Calais to Dover.
- Customs clearance of UK exports would take longer as they pass through numerous border controls across Europe.
- Customs clearance of UK imports will take longer as goods from the EU are added to the HMRC work load.
- Delays at immigration desks at air, sea ports and the channel tunnel would similarly increase as fresh controls would be introduced.

- WTO members have agreed a new trade facilitation agreement that seeks to speed up border crossings by publishing fees and charges online, introducing a fast-track scheme for perishable goods, processing of documents before goods arrive at the border and the right to appeal against customs decisions. This would considerably help UK exports and imports to reach their destination as quickly as possible.

10. EU Trademarks/European Patents and Copyright

- Brexit may mean that EU registered trademarks may no longer be recognised in the UK and vice versa.
- UK based companies that own EU trademarks will probably have to register those rights with the relevant national registry offices across Europe.
- Existing International Registrations (IR) designating EU trademarks will more than likely require a separate UK designation.
- New International Registrations (IR) will need to designate both the EU and the UK in the IR in order to obtain full protection in these countries.
- UK based companies filing a new IR based on EU Trademarks will be required to prove that they have a “real and effective commercial establishment” in an EU member state in order to rely on the EU trademark as a base mark for the IR.
- A European Patent is really a bundle of national patents accessed through a central application process.
- The UK is a member of the European Patent Convention which is not linked to EU member status so it will continue as normal whatever the outcome of Brexit.
- The UK will continue to protect copyright in accordance with the Berne Convention. Copyright in general is not subject to EU harmonisation, however, EU competition law impacts on how copyright works are licensed within the EU so some changes may occur to the UK system once Brexit is complete.
- It is not known whether the Great Repeal Bill will also cover Intellectual Property Rights.

11. Environmental Legislation

- It is assumed that the UK will, at some time in the future, still want access to EU markets so it will still need to meet EU environmental standards and, therefore, will initially maintain the status quo.
- Please see the CPA’s EU Regulations and Directives Guidance Document for greater detail on individual pieces of legislation.

12. Value Added Tax (VAT)

- EU VAT law would cease to apply in the UK.
- The Supreme Court would supplant the European Court of Justice for VAT matters.
- Intrastat, the EU’s system for collecting statistics on the trade in goods between EU member states, would no longer apply to arrivals of goods in and the despatch of goods from the UK, thus simplifying VAT returns for many VAT registered businesses.
- The requirement to submit EC Sales Lists (VAT101) to HMRC would be abolished. These lists provide information about supplies of goods and services to VAT registered customers in EU member states.

- New complexities for UK businesses trading with Europe would arise with the introduction of new import and export rules. These would apply to the supply of goods and services between the UK and EU member states, together with changes to the duty deferment facility to cover import VAT on goods from EU states.
- UK businesses required to register for VAT in EU member states would have to appoint fiscal representative locally to deal with VAT returns.
- The recovery in the UK of overseas input VAT incurred in EU member states would become more onerous.
- EU constraints applied to the UK concerning VAT would no longer apply so will this lead to:
 - The UK government removing the EU minimum 5% VAT on all energy bills?
 - Similarly, will the UK remove the 20% VAT rate for energy saving measures?

13. Exit Charge & EU Assets

- The UK has already signed long term commitments to EU funded programmes which will remain legally binding for some years post Brexit.
- The figures quoted range from €25bn to €73bn.
- Gaps between payments made in the EU's annual budget and their larger commitments made under its seven year budgetary framework could be around €29bn.
- The current budget cohesive funding for poorer countries which the UK signed does not expire until 2020 with the UK's share being some €17bn.
- The EU has an unfunded pension scheme for its officials with liabilities of €60bn+. This is the joint responsibility of all Member States not their national governments. What will be the UK's share?
- The UK would no longer be a shareholder in the European Investment Bank – Britain's share amounts to 16% (approximately €39.2 million) which would have to be withdrawn.

Three points worth consideration are:

- The UK may be helped with respect to exit charges as Article 50 states that a departing country's withdrawal agreement shall take account of "the framework for its future relationship with the EU".
- Existing EU assets are estimated to be in the region of €154bn of which the UK share has yet to be determined. This amount could be offset against any exit charge.
- An assessment by UK government lawyers concludes that Brussels has no legal basis to make a claim for financial liabilities for commitments made by the UK while part of the EU. This is based on the wording of Article 50 – "The Treaties [of the EU] shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification."

14. UK courts have the supremacy

- The supremacy of the Court of Justice of the European Union (CJEU) will cease.
- However, in practice, given the extent of the task of unpicking existing EU influenced law, the UK courts are likely to continue to have regard to the rulings of the CJEU for some time into the future.
- If the UK re-joined EFTA it would become subject to the EFTA Court whose jurisdiction is very similar to that of the CJEU.

15. BSI & CEN & ISO Codes and Standards

- While the European Standardisation Committees - CEN, CENELEC and ETSI – are not EU institutions, membership of these organisations is subject to countries being member states of the EU.
- The UK's future influence over the development of new European standards will depend largely on a range of political choices made by the UK government.
- Assuming the UK commits to the continued use of European standards and the withdrawal of conflicting national standards, it is likely that BSI's membership of CEN and CENELEC will not be affected.
- If the UK refused to commit to the adoption of European standards then its membership of CEN/CENELEC would be in question.
- With the UK outside of the EEA and EFTA, then BSI would have to make a separate application to CEN/CENELEC to remain as a full contributing member of both organisations. Such a move would necessitate changes to the Articles of Association of these standardisation bodies.
- Assuming this went well, then there will be no change to the UK's involvement in the writing of new European standards nor the reviewing of existing European standards.
- At the ISO level, there would be no change to the status quo.

16. UK's Future Influence?

- The EU is the UK's largest export market so EU laws will continue to be of fundamental importance to UK industry.
- Every alternative to membership of the EU involves the UK losing its vote (and vetoes) over how EU laws are written. The UK had a significant voice in how these rules were written due to the weighted voting system.
- This loss of influence means that we shall no longer be able to protect and promote the interests of UK companies.
- This is particularly important in preventing the creation of non-tariff barriers that would cause issues for the UK service sector and manufactures dependent on cross-border supply chains.

17. Capital investment

- Most of the major UK manufactures of construction products are global multi-nationals that will now be making capital investment decisions based on the best rate of return.
- The UK is a small market compared to the EU as a whole so will this colour their decision?
- Establishing new factories to cover modern methods of construction will require capital investment to establish with a long term rate of return. Will the UK be attractive enough for investment rather than the EU?

18. Health and Safety

- The Construction (Design and Management) Regulations 2015 have their origin in EU Construction Site Directive 92/57/EEC - It is highly unlikely that these would be abolished
- Basic Safety Standards Directive 2013 – the UK has until 2018 to transpose this into UK legislation

- Working Time Regulations (origin Working Time Directive) and Agency Worker Regulations (origin Agency Workers Directive) are possible candidates for review by the UK government.
- REACH – we cannot see this being changed

19. Conflict of laws / Jurisdiction

- The EU has in place a comprehensive body of law addressing conflicts of law, jurisdiction and the recognition and enforcement of judgements in civil and commercial matters. The application of this legislation in the UK after Brexit needs to be settled.

20. Sustainability

- Brexit may lead to a divergence in approach between the EU and UK in relation to sustainability goals and related regulatory regimes.
- It is not expected that the majority of these measures will be reversed as they are seen to have wider benefits in terms of environmental improvements.

21. Devolved administrations

- Will the Scottish government be inclined to enact and/or retain EU compliant legislation in the spheres it has jurisdiction over?
- If the UK government takes a different path this could give rise to more internal differences within the UK leading to an additional and unwelcome layer of complexity to the construction industry and its supply chain.

22. Non-tariff barriers

- There are views that the costs of Brexit to the UK would come primarily from increases in non-tariff barriers between the UK and the EU and not from changes in tariffs.

Definitions

Hard Brexit

This generally involves the UK trading with the EU like any other non-EU member country under World Trade Organisation rules but with no obligation to accept the free movement of people.

Non-tariff barriers

Refers to any measure that raises the costs of trade but does not take the form of a tariff. It covers everything from quantitative trade restrictions such as import licensing to border costs of complying with customs procedures and behind the border costs caused by regulatory or product standard differences across countries. The EU Single Market reduced non-tariff barriers between member states by removing customs procedures and harmonising regulations and product standards.

The Single Market

This refers to the European Union as one territory without any internal borders or other regulatory obstacles to the free movement of goods, services, people and capital.

The EU Customs Union

A trade bloc of nations which is composed of a free trade area with a common external tariff. The participant countries set up a common external trade policy but in some cases they may use different import quotas.

Common External Tariff

A common external tariff must be introduced when a group of countries forms a customs union. The same customs duties, import quotas, preferences or other non-tariff barriers to trade apply to all goods entering the area, regardless of which country within the area they are entering.

World Trade Organisation (WTO)

Is the only global international organisation dealing with the rules of trade between nations. The WTO agreements are negotiated and signed by the bulk of the world's trading nations and ratified by their parliaments. The goal is to help producers of goods and services, exporters and importers conduct their business.

Most Favoured Nation

A country that have been granted the most favourable trading terms available by another country.

The Great Repeal Bill

The name given to the bill to be laid before Parliament to repeal the 1972 European Communities Act which gave EU law instant effect in the UK and Parliament the power to absorb parts of EU legislation into UK law and scrap elements it does not want to keep. The aim of the legislation is to end the authority of EU law by converting all its provisions in British law on the day the UK exits the EU. At the same time the 1972 European Communities Act will be repealed.

Schengen Agreement

A treaty that led to the creation of the Europe's Schengen Area in which countries have abolished passport and any other border controls at their mutual borders thus allowing for the free and unrestricted movement of people, goods, services and capital in harmony with common rules for controlling external borders and fighting criminality by strengthening their common judicial system and police co-operation.

Common Travel Area

Is an open borders area comprising of the Republic of Ireland, The United Kingdom of Great Britain and Northern Ireland, the Isle of Man and the Channel Islands.

Court of Justice of the European Union (CJEU)

This interprets EU law to ensure it is applied in the same way in all European countries and settle legal disputes between national governments and EU institutions. It can also, in certain circumstances, be used by individuals, companies or organisations to take action against an EU institution, if they feel it has somehow infringed their rights. The CJEU has supremacy over national law.