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POSSIBLE IMPACT OF UK'S POST-BREXIT SCENARIO ON PAKISTAN-UK TRADE

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Any conclusion, interpretation, and analyses of the Impact of Post- Brexit Scenario on Pakistan-UK trade is the responsibility of the authors and do not necessarily reflect the opinion of the Ministry of Commerce (MOC) and Trade Development Authority of Pakistan (TDAP). Although every effort has been made to analyze the original draft of the EU-UK Brexit Agreements.

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ACYRONYMS

BREXIT: Withdrawal of the UK from the EU

TCA: Trade & Cooperation Agreement between the EU and the UK

GSP: Generalized System of Preferences

SPS: Sanitary and Phytosanitary

CET: Common External Tariff of the EU

UKGT: United Kingdom Global Tariff

MRA: Mutual Recognition Agreement

FTA: Free Trade Agreement

EU: European Union

UK: United Kingdom

VAT: Value added Tax

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1. INTRODUCTION:

Brexit was the withdrawal of the United Kingdom (UK) from the European Union (EU) at the end of January 31, 2020. To date, the UK is the first and only country to formally leave the EU after 47 years of membership within the EU bloc, having first joined its predecessor, the European Community (EC), on January 1, 1973. It continued to participate in the European Customs Union and European Single Market during a transition period of eleven months starting February 1, 2020 that ended on December 31, 2020.

The European Union and its institutions developed gradually over 47 years of the British membership of the EU and grew to be of significant importance to the UK. The public had previously approved membership of the EC in a 1975 referendum. The UK held a referendum in 2016 on whether to leave the EU, which passed by 51.9%.

This led to four years of negotiations between the UK and the EU on the terms of departure and future relations. The trade deal negotiations continued to within days of the scheduled end of the transition period on December 31, 2020 culminating in the Trade and Cooperation Agreement. The agreement that took effect on Jan. 1, 2021 has three main pillars: trade, cooperation, and governance and does not cover foreign policy and defense.

2. SCOPE OF THE STUDY:

With the end of the Brexit transition period the UK and EU practically became independent customs territories effective January 1, 2021 with separate external tariffs and the Trade and Cooperation Agreement (TCA) entered between the UK and the EU became effective. The purpose of this study is to gauge the overall impact of separation of the UK from the EU on the trade between Pakistan and UK. Accordingly, the study will attempt to consider all relevant factors that could directly or indirectly have a bearing on the post-Brexit trade flows between Pakistan and the UK rather than remaining confined to the TCA.

Key factors that could impact post-Brexit trade between Pakistan and UK beyond January 1, 2021 are being listed below in the order of their significance which would subsequently be dealt under respective headings:

i. UK leaving the EU Single Market and Customs Union and UK & EU forming an ambitious free trade area by entering into a Trade and Cooperation Agreement (TCA).

ii. The Most Favored Nation (MFN) tariff regime of the UK, i.e., the UK Global Tariff replacing the EU Common Customs Tariff (CCT).

iii. The UK GSP scheme replacing the EU GSP scheme.

iv. UK entering into new Free Trade Agreements.

v. Changes in UK's compliance/ conformity assessment requirements.

vi. Changes in economic variables influencing UK's trade.

3. KEY FACTORS INFLUENCING POST BREXIT PAKISTAN-UK TRADE:

3.1 Trade and Cooperation Agreement between the UK and the EU:

As of January 1, 2021, the UK has left the EU Single Market and Customs Union. As a result, it no longer benefits from the principle of free movement of goods. To preserve their mutually beneficial trading relationship, the two sides have agreed to create an ambitious free trade area. The Trade and Cooperation Agreement foresees the most ambitious commitments towards liberalizing market access for goods ever to feature in an EU free trade agreement, including zero tariffs and zero quotas on all goods from day one, as well as modern rules to avoid certain barriers in bilateral trade. The Agreement also limits the fees that customs may charge for services rendered and includes several modern disciplines that go beyond standard World Trade Organization commitments, with regulatory and customs cooperation mechanisms, as well as provisions ensuring a level playing field for open and fair competition, as part of a larger economic partnership.

However, the provisions in the agreement do not govern trade in goods between the EU and

Northern Ireland, where the Protocol on Ireland and Northern Ireland included in the Withdrawal Agreement will apply. In accordance with the Protocol, EUs customs code, legislation on goods, sanitary rules for veterinary controls ("SPS rules"), rules on agricultural production/marketing, or VAT and excise in respect of goods will apply to all goods entering Northern Ireland. As a result, from January 1, 2021, goods entering Northern Ireland from Great Britain will constitute "imports". This means that such goods will need to comply with EU product rules and be subject to checks and controls for safety, health and other public policy purposes, including all necessary SPS controls applicable between the EU and the UK. This solution was agreed between the EU and the UK to avoid a hard border on the island of Ireland.

Trading between the UK and the EU under the TCA will inevitably be very different compared to the seamless and frictionless trade enabled by the EU's Customs Union and Single Market. In particular:

a) *Rules of origin* will apply to goods in order to qualify for preferential trade terms under the agreement.

b) All imports will be subject to *customs formalities* and will need to comply with the rules of the importing party; and

c) All imports must meet importing country *standards* and will be subject to regulatory checks and controls for safety, health and other public policy purposes.

Under the TCA, EU and UK traders would be required to meet rules of origin comparable to those which the EU and the UK have with other trading partners. Goods not meeting the rules of origin will not be eligible for preferential treatment available under the T&C Agreement. Though the agreement includes specific mechanisms aimed at facilitating compliance with the rules of origin, namely: a provision on 'full cumulation', which allows traders to account not only for the origin of materials used, but also if their processing took place in the territory of one of the Parties. Exporters will also be able to self-certify the origin of the goods, thereby making it easier for traders to prove the origin of their products and reducing red tape.

As of January 1, 2021, the EU and the UK will be two separate regulatory and legal spaces. Therefore, all customs controls and formalities required under EU law and the EU Customs Code, including entry and exit summary declarations, will apply to all goods entering the customs territory of the EU from the UK, or leaving that customs territory to the UK. Furthermore, all products exported from the EU to the UK or vice versa will have to comply with the technical regulations of the importing country and will be subject to any applicable regulatory compliance checks and controls for safety, health and other public policy purposes.

Nonetheless, the TCA contains a number of provisions aimed at preventing and addressing unnecessary technical barriers and requirements, including through bilateral cooperation, and simplifying procedures used to demonstrate compliance with them, i.e., the conformity assessment procedures. In particular, the two sides agreed a definition of international standards that identifies the relevant international standard-setting bodies. This will ensure that both sides' domestic product standards and technical regulations are based on the same international references and are therefore compatible to the extent possible. It is expected to make compliance of products with the other party's rules easier and less costly, while safeguarding each side's 'right to regulate'.

In the field of conformity assessment, the Parties agreed to maintain simplified access to each other's markets through, in particular, the continued use of self-certification of conformity by the manufacturer where this is currently applied in both the EU and the UK. This covers a very large share of bilateral trade.

In a number of sectors, the Parties have agreed specific arrangements to facilitate bilateral trade, as well as regulatory cooperation. These sectors include automotive, pharmaceuticals, chemicals, wine and organic products.

Trade in services and investments: The EU and the UK are major partners when it comes to trade in services and investment. As an EU member the UK benefitted from the free movement of persons and services and businesses could supply services freely across the EU. The UK benefitted from the EU's Single Market ecosystem based on common rules, a single supervisory framework, and a common jurisdictional system. Post-Brexit, the UK no longer benefits from the principles of free movement of persons, free provision of services and freedom of establishment. As a result, UK service suppliers have lost their automatic right to offer services across the EU. They may need to establish themselves in the EU to continue operating and comply with the host-country rules of each EU member state.

Review and Termination: The TCA will be reviewed every five years. It can be terminated by either side with 12 months' notice, and more swiftly on human rights and rule of law grounds.

3.1.1 Possible impact on Pakistan-UK trade: Replacement of the common market arrangement between the EU and the UK with the Trade and Cooperation Agreement in the post-Brexit scenario would definitely impact the movement of goods, services, investments, persons, etc. between them that in turn would impact the trade flows between them. Resultantly, UK's trade flows with other trading partners would be impacted, particularly those enjoying preferential market access to the UK.

In the new scenario, trade dynamics between the UK and EU, as well as third countries involves a host of factors that could have varying degrees of impact on their bilateral trade depending upon how UK and EU businesses adjust themselves to new movement restrictions and the extent of support made available by respective governments. Secondary data covers a wide range of options and approaches that are available to businesses for maintaining cross-border supply chains. Apparently, it could be easier for UK and EU businesses to adjust existing supply chains rather than going for fresh ones with third countries where cross border factors could have even greater impacts. However, final decisions are expected to rest on costs. The impact of Brexit on the UK-EU trade as well as third countries will become clearer in a few months as the business increasing tackle practical challenges. In the above scenario with a very liberal T&C Agreement in place, third country imports for the UK are not expected to be significantly impacted. Which would also be the case for Pakistan that has a very small share of around a quarter percent (0.245 %) in UK's global imports,

3.2 UK global tariff replacing the EU Common External Tariff:

In the post-Brexit scenario, the UK created its own 'Most Favored Nation' tariff regime which was announced on May 19, 2020 as the UK Global Tariff (UKGT). It replaced the EU's Common External Tariff effective January 1, 2021 upon expiry of the Brexit's transition period. It is claimed to be simpler, easier to use with a lower tariff regime than EU's Common External Tariff (CET) and is in pound sterling. The Northern Ireland / Ireland Protocol in the Withdrawal Agreement makes clear that Northern Ireland will remain part of the customs territory of the UK. The new UK Global Tariff will apply to goods imported into the UK unless an exception such as a preferential arrangement or tariff suspension applies.

The UK Global Tariff almost doubles the number of products that are tariff free relative to EU's CET, with 47% of products now at zero tariff, compared to 27% under the CET. Where tariffs have been kept, the UK Global Tariff reduces tariffs for over 3,500 products, increasing market access and improving transparency for traders. As a result, the average overall tariff under UKGT has been reduced to 5.7% from 7.2% applicable under the EU's CET. In developing the UK Global Tariff, the government has made a series of amendments to the EU's Common External Tariff as follows:

i. Simplifying the tariff by: (a) removing tariff below 2% (nuisance tariff), (b) undertaking tariff banding by rounding tariffs to the nearest standardized band (multiples of 2% for tariff under 20%, multiples of 5% for tariff between 20% to 50%, and multiples of 10% for tariff above 50%), and (c) simplification of complex agricultural tariff to single percentages.

ii. Removing tariffs on: (a) key inputs to production, (b) goods for which UK has zero or very limited domestic production, (c) environmental goods to meet UK's Green ambitions or Net Zero obligations. Tariff on nearly 2,000 lines have been removed, including removal of nuisance tariff on around 500 lines.

iii. Retaining tariffs in several sectors to support UK businesses and meet UK's wider strategic objectives. Nearly 5,000 tariff lines have been retained based on this consideration. This includes agricultural goods where tariffs have largely been retained, goods on which preferential access exist for developing countries (GSP scheme), most vehicles, etc. The tariff schedule has also been moved from Euros to Pound Sterling.

Despite a reduction in the average custom tariff rate, the new regime developed in consultation with businesses and international stakeholders is expected to serve the UK economy better. Comparisons of average tariffs and number of tariff-free lines in the UKGT in relation to EU's CET for key sectors of the UK economy have been summarized under Table-1 and Table-2, respectively.

Table-1: Average Tariff for Key Sectors

Item	UK Global Tariff	Common External Tariff
Average Tariff (%)	**5.7%**	**7.2%**
Agriculture	16.1%	18.3%
Fish	11.0%	11.7%
Processed Agricultural Products	10.6%	15.9%
Industrial Goods	2.5%	3.7%

Table-2: Number of Tariff Free Lines for Key Sectors

Item	UK Global Tariff	Common External Tariff
Tariff-free Tariff Lines (%)	**47%**	**27%**
Agriculture	23%	16%
Fish	8%	8%
Processed Agricultural Products	41%	29%
Industrial Goods	57%	31%

The UKGT offers many differences to the European Union's CET for agricultural products, however, it continues to offer the same level of tariff level protection to UK farmers. The UKGT liberalizes or reduces the tariffs applied to products that UK farmers do not produce.

Similarly, many tariffs remain in place to protect sensitive or strategic industries. In particular, the motor vehicle manufacturing industry is expected to receive continued government support, as the UKGT maintains the 10% tariff applied in the CET to support domestic production. Similarly, an effort has also been made to avoid any significant dilution of the preferential market access available to the developing and least developed countries under the GSP scheme of the UK.

3.2.1 Possible Impact on Pakistan-UK trade:

Coming into force of the UK Global Tariff effective January 1, 2021 brings in two significant changes to UK's import tariff that could have an impact on exports from developing countries like Pakistan having preferential access for the UK market under the GSP scheme. These are as follows:

a) Removal of tariff on nearly 2,000 tariff lines resulting in an increase in the number of zero tariff lines from 27% to 47%. Of these, around 500 were tariff lines that previously had a tariff of up to 2%.

b) Reduction in tariff on around 3,500 tariff lines.

Both the above changes in the UK Global Tariff would result in improvement of market access in general for all the countries trading with the UK. For GSP countries, the effects depend on two offsetting forces. On the one hand, the small reductions in the UK's tariffs resulting from the UKGT stimulate some developing country exports because they reduce the tariff that those exports face. On the other hand, other exports, on which developing countries currently receive preferential rates, could face increased competition because their competitors face lower tariffs as their margins of preference are reduced, which could reduce developing country exports.

How any developing country is impacted overall depends on the spread of its exports to the UK over the two groups of products mentioned above. Least developed countries that currently face no tariffs, as well as countries with deep trade agreements with the EU are expected to lose from the changes. Furthermore, the extent of trade loss in such cases could be directly proportional to the depth of preferential market access previously being enjoyed by such countries for the UK.

For Pakistan, a beneficiary of the enhanced framework under the UK-GSP scheme, tariff reductions under the UK Global Tariff regime may lead to some dilution of the market access being enjoyed by it previously under the EU's Common External Tariff regime. Though, the UK government has stated to have paid specific attention to safeguard preference dilution for the GSP countries under the UKGT. Nevertheless, a more precise assessment of any negative impact on Pakistan's trade due to preference dilution or a positive impact due to tariff reduction or elimination requires a more detailed analysis based on study of specific tariff lines effected from the above two changes and the volume of Pakistan-UK trade under these lines.

3.3 UK-GSP scheme replacing the EU-GSP Scheme:

The GSP scheme of the UK replaced the EU's GSP scheme from January 1, 2021. The UK has adopted the EU's GSP scheme, almost as is, along with the related rules of origin and implementing regulations. The UK made all out efforts to reproduce the effects of trading agreements that previously applied to it as an EU member state to ensure continuity for UK businesses effective January 1, 2021. Accordingly, it has formalized Free Trade Agreements (FTAs) with most of the GSP-eligible countries maintaining FTAs with the EU on equivalent terms. Where the agreements have not yet been ratified, provisional application or bridging mechanisms have mostly been put in place to ensure continuity of trade. Accordingly, the UK now has equivalent arrangements with almost all the GSP-eligible countries maintaining FTAs with the EU.

Additionally, the UK has also signed Mutual Recognition Agreements (MRAs) with some countries that include Australia, New Zealand, and USA to assist in conformity assessment with these countries. Through MRAs, partner countries recognize the results of one another's conformity assessments. A conformity assessment is a set of processes that confirm whether a product meets the specified legal requirements. This can include testing, inspection, and certification.

Furthermore, market access to the UK for all the remaining GSP-eligible countries has been kept at the same level by placing these into three equivalent frameworks as the EU-GSP. These are the general, enhanced, and LDC frameworks corresponding to the standard, plus, and EBA frameworks of the EU-GSP, respectively. Cumulation with the EU is allowed for all materials and inputs, though cumulation with Turkey is not permissible, which is the only difference with the EU-GSP scheme in respect of cumulation. The UK-GSP scheme does not rely on the REX system for origin certification, however, the process still remains a self-declaration by the exporter through use of the Form-A.

In view of the above features, the new GSP scheme of the UK, in itself, is not expected to have any significant impact on UK's trade with the GSP countries in the post-Brexit scenario. Still, the non-manipulation rule of the GSP schemes of both the EU and the UK requires direct shipment from a beneficiary country. Indirect consignments routed through the EU or the UK will be eligible for preferential GSP tariffs only if the eligibility conditions laid out for transit consignments are fully adhered. Hence, free movement of GSP-eligible goods across the UK-EU border is no longer permitted.

3.3.1 Possible Impact on Pakistan-UK trade:

Since the UK-GSP scheme is mainly a replication of the EU-GSP scheme, switchover of UK from the EU-GSP to UK-GSP is not expected to have a significant impact on the post-Brexit Pakistan-UK trade under the GSP arrangement. However, based on feedback received during the extensive stakeholder consultation sessions for Brexit organized by the TDAP in Karachi, Lahore, Faisalabad, and Sialkot, post-Brexit restriction on free movement of imported GSP-eligible goods across the UK-EU border was identified as a significant issue by the exporters. To what extent such movement restriction could have an adverse impact on the Pakistan-UK, or even the Pakistan-EU trade under the GSP could be studied in further detail in consultation with concerned exporters.

However, separation of the UK from the EU could have an implication for Pakistan in the context of its eligibility for the enhanced framework of the UK-GSP. One of the eligibility requirements for UK's enhanced GSP framework, expressed under the vulnerability criteria, states that the ratio of the GSP eligible imports from the beneficiary country to overall GSP eligible imports of the UK should not exceed 7.4%. Because of the much higher share of Pakistan's exports to the UK verses the EU, the share of Pakistan's GSP covered imports into the EU is expected to go down as a result of Brexit, while it could significantly go up for the UK. Value for the parameter as worked out for 2019 by the European Commission for EU (28) that included UK, was 6.7%. Nevertheless, the UK-GSP scheme provides a graduation period of at least three years before removing a country from the relevant GSP framework. Accordingly, Pakistan is expected to remain eligible for availing preferential market access to the UK under the Enhanced GSP framework till the end of 2023, at least, which could also be the expiry of the current GSP scheme valid for ten years till end of 2023.

In view of the impending risk of loss of eligibility for the Enhanced Framework of the UK-GSP beyond 2023, Pakistan entering into an FTA with the UK could be an advisable option as a longer-term strategy. Accordingly, there is a need for the concerned quarters to initiate a feasibility study for exploring the prospects of Pakistan entering into an FTA with the UK, its third largest trading partner.

3.4 UK Entering into new Free Trade Agreements (FTAs):

One of the rationales often expressed behind UK's intent of moving out of the European Union was to purse an independent trade policy focusing on UK's trade interests alone. This also puts due emphasis on UK's entry into new FTAs with its important trading partners. The prospects and impact of new FTAs of which the UK was not a part as an EU member state needs to be studied in some detail in the short to middle-term perspective to have an assessment of future Pakistan-EU trade in the post-Brexit scenario.

3.5 Changes in UK's standards and compliance requirements:

As part of EU's single market, the standards and compliance requirements for the UK were the same as the EU. However, as per a joint field study published in June 2020 by the ITC and the World Bank and covering around 1140 Pakistani exporters, compliance requirements for the UK, in some cases, have been stated to be more stringent than that of some of the developed countries like Japan and the USA. With the UK now going for its own standards and compliance requirements, these could have an impact on UK's international trade, in particular with developing countries like Pakistan where the manufacturers and exporters have their own limitations in meeting the standards and compliance requirements of developed markets. However, this aspect requires further study in relation to the new standards and compliance requirements of the UK market, specifically for products of Pakistan's interest.

3.6 Changes in economic variables influencing UK's trade:

With the UK no more a member of the EU, a host of changes are expected to take place in its economy in the post-Brexit scenario that would indirectly have an impact on Pakistan-UK trade. Changes in two of the UK's key economic variables, i.e., in the exchange rate and the overall purchasing power of its population will be discussed under this heading.

3.6.1 Variation in exchange rate of the pound sterling:

Following the EU referendum Act of 2015 and the Brexit vote of June 23, 2016 by the British people, Brexit-related events have been impacting UK's stock market as well as the exchange rate for pound sterling. Though the UK was never a part of the EU's common currency, variations in pound sterling's exchange rate as a consequence of Brexit-related events is bound to have an indirect impact on UK's global trade. It is difficult to predict the impact of Brexit-related future events on pound sterling's exchange rate, and in turn its impact on UK's global trade as well as trade with Pakistan. Still it could be useful to study the impact of post-Brexit exchange rate variations on Pakistan-UK trade based on secondary data review.

3.6.2 Changes in UK's purchasing power or per capita disposable income:

Depending on how UK's overall economy gets impacted through a host of changes emerging out of the Brexit, there could be changes in the near future in UK's purchasing power and per capita disposable income. As per initial studies, post Brexit events may have a negative impact on the UK's economy leading to a decline in the purchasing power which in turn could have an impact on potential Pakistan-UK trade. Accordingly, this aspect could also be studied with the help of secondary data.

4.0 CONCLUSIONS AND RECOMMENDATIONS:

Keeping in view its scope discussed under Section-2, the study aims at gauging possible impacts of various changes on Pakistan-UK trade resulting from UK's exit from the European Union that became effective on January 1, 2021. At this stage the document is in the nature of a preliminary report attempting to identify and discuss in some detail the key factors that could impact UK's trade with its partners in general and in particular Pakistan in the light of changes emerging from UK's departure from the EU based on a study of the secondary data. While further work on the study is in hand at the TDAP, it was felt appropriate to share this draft with key stakeholders to gather their views and inputs for identification of additional factors and further detailing and scoping of the impact of factors already identified with reference to Brexit's impact on the Pakistan-UK trade.

In the above context following are the initial conclusions and recommendations emerging from the study so far:

- The Trade and Cooperation Agreement between the UK and the EU is expected to facilitate free trade between the UK and the EU enabling continuation of existing supply chains with minimum adjustments. Furthermore, the emergence of customs controls and movement restrictions between the UK and the EU may contribute to some increase in the cost of doing business for the trade between the UK and the EU, however, they may not lead to any major trade readjustments that could lead to trade diversion or significantly impact Pakistan-UK trade. Nevertheless, initially businesses both in the UK as well as the EU would be required to make appropriate adjustments to remain competitive and cost effective. This might open up additional opportunities for Pakistani exporters to seek more business in the UK and the EU by acting proactively.

- On the face of it, UKGT regime looks supportive towards UK's businesses and consumers in terms of improving their access to cost effective inputs and products while reducing government revenues marginally. It provides somewhat improved market access in general for all the countries trading with the UK. However, it may also dilute the market access already available to UK's existing trade partners maintaining preferential trading arrangements with the UK, in particular those enjoying deeper market access, like the LDCs and FTA partners.

- For developing countries benefitting from the GSP, small reductions in tariffs may stimulate the export of some products, while a reduction in the margin of preference for competitors through tariff reduction could reduce the export of some other products. How any developing country would be impacted overall depends on the spread of its exports to the UK. A detailed study to identify and analyze individual tariff lines of Pakistan's interest could be helpful in provision of guidance to exporters in terms of additional opportunities becoming available and expected challenges they should be prepared to face.

- The new UK-GSP regime, which is mainly an adoption of the EU-GSP regime is not expected to impact the existing Pakistan-UK trade for GSP goods in any significant manner. Additionally, the GSP being a unilateral preference granted by the donor country, not much could be done by Pakistan for bringing about improvement in the UK-GSP regime. However, in order to cover any possible risk of Pakistan becoming ineligible for the Enhanced GSP Framework beyond 2023, there is a need to seriously explore the feasibility of Pakistan entering into an FTA with the UK proactively. This aspect deserves even greater attention when seen in the light of the possibility of Pakistan's competitors entering into FTA arrangements with the UK and the EU.

- There is also a need to study any possible changes in the compliance requirements of the UK market as a result of UK setting its own standards and compliance requirements in the post-Brexit scenario. The study could serve several useful purposes like negotiating with the UK for rationalization of compliances and establishment of MRAs and other mutual arrangements to assist Pakistani exporters; preparing and assisting Pakistani exporters in achieving the UK standards and compliances; strengthening of local testing facilities and systems to facilitate exporters in achieving UK's standards and compliances; etc.

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