SHUTTERSTOCK

In search of a new accord

AS THE UK'S VOTE ON EU MEMBERSHIP DRAWS CLOSER, SO THE NEED TO LOOK AT IMPLICATIONS GROWS MORE PRESSING. STEVE BASEBY LOOKS AT FUTURE TRADING MODELS FOR THE UK

The UK hosts domestic business, multinationals with worldwide interests, branches and subsidiaries of multinationals. These organisations import and export goods and services, and are staffed by UK, other EU and non-EU employees.

Next month, the UK voting population will decide whether the UK is to leave or remain in the EU; debate and public opinion are deeply split as to the implications.

A key point to bear in mind is that if the UK votes in favour of leaving the EU, the UK will need to maintain equivalence if the financial services sector is to continue to be able to operate within the remaining EU. The financial services regulatory structure is most likely to remain in place, and this is reinforced by the UK's membership of G20, the source of most of the post-2008 regulation.

Staying in does not mean 'no change'

The UK prime minister's decision to call the referendum was made after agreeing with the other EU heads of state certain changes governing the UK's relationship with the EU.

In the UK, the press has tended to concentrate on changes to social welfare rights obtained by David Cameron, but the changes that affect financial markets are critical for treasurers and, in essence, recognise the ring-fencing of non-EU states from EU states going forward and the creation of a two-tier EU.

For example, banking union and resolution of banking issues only applies to eurozone states, thereby recognising that the European Central Bank's remit is limited to eurozone members. Similarly, further economic and monetary union can progress within the eurozone, but must respect the rights of non-eurozone member states to opt out.

Essentially, irrespective of the outcome of the UK referendum, the EU will become fragmented, comprising a eurozone bloc and some other non-eurozone countries.

But leaving does not mean regulatory freedom

'Leave' campaigners frequently make reference to the wish to be free from Brussels-originated regulation. However, it should be noted that with regard to financial regulation:

- The basic terms of the Capital Requirements Directive, Bank Recovery and Resolution Directive, European Market Infrastructure Regulation, and MiFID arise from the Pittsburgh commitments by the G20, which, as a matter of legal process, have been implemented through the EU. As the UK is a member of G20 and is not voting on 23 June on whether to remain in the G20, these regulations will still apply in the UK.
- Equivalence is a crucial word. The UK financial community is able to operate across the world's financial centres, including those of the rest of the EU, because the UK's financial regulation is similar in substance and enforcement to that of other global financial centres. Changing substantially from the current form would lose the UK's equivalence status and those markets would be closed to the UK. Losing equivalence would lose a substantial export market (and potentially the very people who populate much of the City of London as they decamp to other financial centres, with a knock-on effect on back-office jobs, the service sector in London and housing prices).

The vote itself creates volatility

The immediate concern for corporate treasurers

has been the volatility in financial markets caused by the decision to call a referendum.

This volatility makes it more important for businesses to manage their financial exposures to hedge transactions that span the referendum.

What does leaving mean?

A useful approach when considering what form the UK relationship with the remainder of the EU might take in the event of a 'leave' decision is to consider the span of arrangements already in place. The UK could negotiate its own agreement and not follow any of these models.

The Norway model: European Free Trade Association with European Economic Area membership

- As a member of the European Economic Area, Norway has access to the single market and follows EU legislation in areas such as the free movement of goods, services, people and money.
- It is not bound by EU laws governing things like agriculture and fisheries or monetary union, but it does have to make a financial contribution to the EU budget. It is also liable to tariffs on exports of a number of agricultural products to the EU.
- An independent study commissioned by the Norwegian government has calculated that Norway has had to incorporate approximately 75% of EU laws into domestic legislation in return for access to the EU market, but with no vote or veto on the creation of those rules.

The Switzerland model: European Free Trade Association membership

- Access to the single market is governed by a series of bilateral agreements, which cover some, but not all, areas of trade. For example, Switzerland has agreements in place for goods, but not services.
- It makes a financial contribution to the EU, although it has no vote or veto over the creation of EU rules.
- This model is coming under pressure as Switzerland voted to limit immigration from the EU and does not automatically update its own rules to match those of the EU.

The World Trade Organization model: free trade agreement

- The World Trade Organization (WTO) sets out rules for international trade that apply to all members, so this is what the UK would adopt, after a period of transition, if no bilateral agreements were made following an EU exit.
- It would mean that the UK would not have to accept free movement or contribute to the EU budget, but goods exported to EU countries would have to meet EU standards.
- WTO trade agreements mean that the UK would have to apply to have a single universal set of tariff rates, covering imports from the EU and the rest of the world alike. Under WTO rules, the UK would not be allowed to treat any of the WTO's 161 other members differently, unless there was a trade agreement in place.

An exit will lead to a debate about trade

The UK business world has long been the home of multinational organisations. The London Stock Exchange's liquidity, and the UK's open and stable regulation, have made the UK a natural home for big business. Ease of access to the broader EU real economy and financial markets has made the UK a point of entry to the EU.

The longer-term uncertainty of leaving is that the continuing trade relationships with the remainder of the EU would have to be renegotiated. The freedom with which UK-based businesses import from, and sell to, other EU member states and that their staff have to move across EU borders, cannot be assumed to continue. For example, businesses based in the UK need to begin to consider how to operate in a world where similar customs duties and business visas are required to trade with and work in Germany as are required in the US.

In the event of a UK vote to leave the EU, each member state would wish to maximise its position. For example, Emmanuel Macron, France's economy minister, has already proposed that financial services could move from London to Paris.

How long will a renegotiation take?

The short answer is: nobody knows. The Treaty of the European Union, Article 50, is the much quoted source of the answer: two years to renegotiate, but: a) that period can be extended by mutual agreement; and b) any renegotiation requires a qualified majority of member states.

A TRADING SUMMARY

- The EU remains by far the UK's biggest trading partner, accounting for **45%** of UK goods exported and **53%** of imports.
- In 2014, the UK imported **27%** of its food from the EU; while it exported £18.8bn of foodstuffs.
- The UK energy Net Import Dependency in 2014 was **46.2%** – that is, we imported **46.2%** of our energy when converted to 'thousands of tons of oil equivalent'.
- We imported **85%** of coal used in the UK in 2014, according to the Disasters Emergency Committee, which was sufficient to meet all coal used in electricity generation; but little of this energy originates in the EU.
- The UK runs net internal and external deficits. Its government debt at the end of January 2016 was £1,581.6bn, equivalent to **82.8%** of GDP; an increase of £52.7bn compared with January 2015. Approximately one quarter of this is funded by foreign lenders.

Source: UK government departments and research notes

The above is an edited extract from the ACT's briefing note on the implications of Brexit, which can be found at **www.treasurers.org/brexit-briefing**

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