

5 STEPS TO PROTECT SERVICES POST-BREXIT

08.03.2018

The UK services sector is a great British success story. Accounting for 80% of the UK's GDP and 4 in 5 jobs across the country, the UK is the world's second largest exporter of services.¹ UK services are in demand all over the world, but the EU is the single largest destination for them – worth £90 billion annually to the UK economy – with hundreds of thousands of jobs of companies and individuals benefitting from the services UK firms provide on both sides of the Channel.

As negotiations on the UK's exit from the EU progress to the next phase, attention is turning to the real prize: the future relationship between the world's 5th largest economy and the European Union. Getting the right deal for services trade will be critical to the success of this new relationship. But the trade in services is complex and will require an agreement of unprecedented depth to ensure trade between the UK and the EU remains as frictionless as possible.

While the future of the UK services trade is bright, the threat of the UK exiting the EU without an effective agreement is real. Under a “no services deal” scenario, companies in some of the UK's most successful exporting sectors could lose the legal basis to export to the EU, leaving cross-border trade in disarray and hitting hundreds of thousands of contracts, jobs, customers and companies in the UK and the EU.

Action is needed quickly to avoid disruption for businesses and stop them from carrying out costly Brexit contingency plans that will create lasting damage to jobs and the wider UK economy. In the long-term, a smooth and open relationship will ensure consumers on both sides of the Channel can continue to access a variety of services, and employees of companies on both sides can continue providing them competitively.

Through consultation with its members of all sizes providing services of all kinds up and down the country, the CBI has established 5 steps that negotiators will need to take to secure a strong future for services businesses after Brexit:

1. Remove the cliff-edge for trade in services, by:

- Quickly agreeing comprehensive transitional arrangements
- Taking legislative steps in the withdrawal and transition agreements to ensure contracts agreed before Brexit are still valid in the days after
- Smoothly transposing the UK's stand-alone WTO schedule of commitments
- Re-signing the 2005 Hague Convention

2. Ensure access to talent and the mobility of people on both sides of the Channel, by:

- Negotiating a reciprocal agreement on intra-company transfers and posting of workers
- Negotiating a dynamic mutual recognition agreement for professional qualifications
- Adopting a preferential route for EU migration that allows UK services to continue to access the people and skills they need to thrive

¹ IMF, Direction of Trade Statistics, 2016.

3. Secure an adequacy decision for the UK's data regime to maintain the free flow of data between the UK and EU

4. Negotiate ambitious mutual market access for service businesses by:

- Aligning with the rules of the EU Single Market for some important sectors
- Ensuring mutual access to public procurement markets

5. Invest in regulatory cooperation between the UK and the EU, and the UK and the rest of the world, by:

- Negotiating a mechanism for continued regulatory and supervisory cooperation between the UK and EU
- Remaining committed to the use of international standards and regulations across the globe
- Striving to lead the way globally in emerging areas of services trade

By taking these steps, UK negotiators will protect the country's strong services base for years to come, avoiding damage to some of the country's most promising trading industries and allowing trade to thrive not just with the EU but with the rest of the world. And EU negotiators will avoid unintended consequences for its own consumers and businesses benefiting from access to the UK market or from UK services today.

For more information, please contact:

Russell Antram
Principal Policy Adviser, EU Negotiations
Russell.Antram@cbi.org.uk

Yong Jing Teow
Financial Services Brexit Lead
Yong.Jing.Teow@cbi.org.uk

Introduction to Trade in Services

The UK services sector is a great British success story. Accounting for 80% of the UK's GDP and 4 in 5 jobs across the country, the UK is the world's second largest exporter of services. Covering everything from business and financial services, technology, including software and gaming, television, music and film, fashion and design, education and health services, travel, tourism and culture - the UK is a remarkably successful exporter of services, accounting for 45% of the UK's total exports.² Given the importance of services, getting the right deal will be critical to the success of the future economic relationship between the UK and the EU.

But getting the right deal for services is not just important for companies in service sectors. These businesses are deeply interlinked with every kind of manufacturing activity, the retail industry, and indeed with each other. A single goods company in any sector is supported by a range of services: architects and engineering services design office space; professional and business services advise on legal issues and help in the recruitment of staff; financial services provide capital, insurance and manage investments and pensions; creative industries, travel and technology companies help design and sell goods across the globe.

UK services are in demand all over the world, but the EU is the single largest destination for UK services. 40% of UK services trade goes to the EU, worth £90 billion annually to the UK economy.³ That is the equivalent of the UK Government's spend each year on transport, housing, the environment, industry, agriculture and employment combined. And hundreds of thousands of companies and individuals in the EU currently benefit from the services that UK firms provide, creating the impetus for both sides to secure a relationship that ensures as much of this can continue as possible.

Services businesses are optimistic about the future, but they are also deeply apprehensive about the possibility of the UK exiting the EU without an effective agreement in place. Under a "no deal" scenario, some of the UK's most successful exporting sectors – airlines, broadcasters, and a range of financial, professional and business service providers – could lose the legal basis to export to the EU, leaving cross-border trade in disarray and hitting hundreds of thousands of contracts, jobs and companies on both sides of the Channel.

The trade in services is complex, and will certainly be one of the most complicated parts of the negotiations ahead

Cross-border services trade is complicated, and it can be carried out in a number of ways – as laid out in Exhibit 1. The WTO defines these different kinds of services trade in a treaty called the General Agreement on Trade in Services (GATS). Some forms of services can be traded across border remotely, for example a UK-based consultant can provide strategic business advice online to a client based in Sweden. However, this is only one form of services trade. People supplying and consuming services often need to be in physical proximity. This may mean firms establishing offices abroad, individual professionals travelling to and from the location of foreign clients, or consumers travelling to other countries to receive services abroad.

The barriers affecting services trade are also complex, negotiators must focus on the web of rules that allow services to be traded across borders.

In the negotiations, the biggest challenge in securing smooth UK-EU trade in services will be agreeing on the future of the UK and EU's rules in these areas and what it means for access for

² ONS, *Pink Book 2017*. Based on latest available data for 2016.

³ ONS, *Pink Book 2017*. Based on latest available data for 2016.

services across borders. This is further complicated because these rules are not just set by the EU but by individual member states and by the WTO.

Exhibit 1: How trade in services works

There are 5 different “modes” of international trade in services

1

When a UK company sells computer software to a customer in Poland

This is an example of “Mode 1” services trade – defined as when the supplier and consumer are based in different countries, and the service is provided without travel being needed

2

When Dutch tourists visit the UK and spend money in a hotel or restaurant Or when Hungarian students study at a UK university

This is an example of “Mode 2” services trade – defined as when the consumer travels to the supplier’s country to purchase their services

3

When an Italian architecture firm opens a branch in the UK

This is an example of “Mode 3” services trade – defined as when the supplier moves to the consumer’s country and sets up an office staffed by local employees to provide services

4

When a UK lawyer flies to Paris to advise a French client on UK or international law

This is an example of “Mode 4” services trade – defined as when the supplier travels to the consumer’s country to provide services, either on a temporary or permanent basis

5

When a UK company provides engineering services as part of the production of a German car

This is an example of “Mode 5” services trade – defined as when services are “inputs” in the manufacturing goods

NB: This is not currently defined in the WTO GATS

While much of the debate on the future economic relationship between the UK and the EU has focused on the key “at the border” issues that affect the trade in goods, like customs and tariffs, the barriers to free and open trade in services are more complex and focus on “behind the border” issues like rules and regulations. These are often put in place to protect domestic industries or to reflect different rules between countries.

These rules can be broad and cut across different service sectors. For example, rules on establishment which set out the requirements for companies from abroad to establish an office within a country; or rules on provision, which establish the requirements for companies from abroad to provide their services with another country. Rules on mobility lay out the requirements necessary for people providing services to enter the country and conditions and length of stay to

provide them; and rules on procurement set out conditions companies from abroad must meet to sell their services to Governments.

But the rules on cross-border service trade can also be very specific. For example, rules on the types and country of qualifications that allow individuals to work in certain professions across borders. There are also rules on individual sectors, establishing detailed rules for in highly regulated industries as well as rules on data flows that lay out the requirements necessary for protecting data as it crosses borders.

Getting the right deal for services trade will be critical to business on both sides

Services industries – in particular – would not be able to rely on WTO rules. Under a ‘no deal’ scenario, companies in some of the UK’s most successful exporting sectors would be unable to export specific types of services at all. Those industries could include financial services, airlines, broadcasting and a range of professional and business services.

The EU’s most ambitious free trade agreement (FTA), the Comprehensive Economic and Trade Agreement (CETA), agreed between the EU and Canada, is patchy when it comes to services trade. While the EU and Canada have agreed free trade of postal, telecommunications, energy and maritime transport services, and mutual access to public procurement contracts, CETA does not provide anything like barrier-free access for some important sectors. That includes some aviation services, electricity and cultural services. If the UK and EU were to agree nothing more than the ‘global standard of free trade deals’, it would – in the words of the Secretary of State for Exiting the EU’s special advisor, Raoul Ruparel, in his former role at OpenEurope – fall ‘far short’ of current arrangements.⁴ In particular, the UK’s 758 TV channels that broadcast to the EU⁵, and the 5,476 UK and 8,008 EU financial service firms⁶ would be unable to provide services across borders from their current locations.

While this may be an acceptable state of affairs for Canada and the EU, such an agreement would be unacceptable for the UK and the EU. Just 5% of Canada’s output is services compared to 12.1% for the UK.⁷ Whereas the UK’s top exports to the EU are financial services and business services, Canada’s are pearls, semi-precious stones and precious metals.

Although overall estimates are few and far between, research by NIESR suggests the reduction in UK-EU trade in services under an FTA would be the same as if the UK and EU were trading under WTO terms.⁸ This concern is concentrated in specific sectors more than others, but these are sectors that are particularly important to the UK economy. The concern is also concentrated in particular regions of the UK. While most service exports originate from London and the South East, the North East and West Midlands send about half of their services exports to the EU, making them more proportionally exposed.⁹

⁴ House of Lords European Union Committee, *Brexit: the options for trade*, December 2016.

⁵ European Audiovisual Observatory, *Audiovisual services in Europe: Focus on services targeting other countries*, June 2017.

⁶ Letter from Financial Conduct Authority to Chairman of the Treasury Select Committee, August 2016.

⁷ Grant Lewis and Samuel Lowe, *Can Britain Defy Gravity*, April 2017.

⁸ NIESR, *Will New Trade Deals Soften the Blow of Hard Brexit?*, January 2017.

⁹ UK Trade Policy Observatory, *Brexit and Regional Services Exports: A Heat Map Approach*, January 2018.

The 5 steps to ensure cross-border services trade continues operating smoothly after Brexit

In consultation with members, the CBI has identified five key steps negotiators can take to protect firms on both sides of the Channel. Fulfilling all five steps requires an ambitious agreement, one that avoids the cliff-edge and secures trade in services in both directions that is as frictionless as possible.

1. Remove the cliff-edge for trade in services

Businesses in all industries have concerns about a cliff-edge in March 2019 if the UK exits the EU without a sufficiently comprehensive transitional arrangement, or if it leaves without a suitably comprehensive deal. Goods sectors are concerned about the sudden imposition of tariffs, delays at ports, and multiple sets of regulation and non-tariff barriers, but service providers also have considerable fears about disruption that may be invisible to the public but could be dramatic in terms of operational costs and complexities.

There are three actions the negotiators need to take to remove the cliff-edge. To avoid two expensive sets of adjustment costs as the UK leaves the EU, businesses on both sides need a smooth, single transition to the new future economic relationship. To end uncertainty over UK judgements in cross-border disputes, legislative steps must be taken to preserve existing contracts. And as a contingency, the UK must also ensure the smooth transposition of its stand-alone WTO schedule of commitments to provide a minimum level of provision on which services trade can occur.

Comprehensive transitional arrangements must be agreed quickly

The global economy is growing, and UK services are in demand the world over. But while businesses in the sector are optimistic, they are also deeply apprehensive. The lack of information has forced 61% of businesses in the UK into planning for a worst case, 'no deal' scenario, with the most disruptive consequences for the UK economy.¹⁰

Service businesses are often at the most advanced stages of planning, and those that will no longer be able to provide their services to the EU without a deal are the most likely to be moving jobs outside the UK. Real estate companies, financial services firms, and IT firms are among the sectors dedicating most resource to getting ready for a real cliff-edge in March 2019, and many have begun taking steps to relocate parts of their businesses to the EU – often their only option. That includes going as far as finding schools for the families of their employees and providing support in securing accommodation for staff.

The UK Government can go a long way to allaying fears over a cliff edge exit by urgently agreeing transitional arrangements that would help businesses properly plan for Brexit and halt the implementation of their contingency plans. 75% of the country's largest firms say the agreement of transitional arrangements would stop their preparations for a 'no deal' scenario.¹¹

Legislative steps in the withdrawal and transition agreements are needed to ensure contracts agreed before Brexit are still valid in the days after

Securing the future of existing contracts is of paramount importance to the continuity of services trade. The ability to make and enforce contracts, and resolve disputes related to those contracts when there are disagreements, is fundamental for trade in both goods and services. The legal recognition and enforceability of contracts means both partners in an agreement are clear in their rights should there be a disagreement. This is particularly important to support business done

¹⁰ CBI, *Survey: How businesses are preparing for Brexit*, January 2018.

¹¹ CBI, *Survey: How businesses are preparing for Brexit*, January 2018.

across borders, where operating within different legal jurisdictions are inevitable, and when business partners are new to each other.

At present, there is a lot of uncertainty about whether cross-border contracts signed before Brexit and in force for some time afterwards will be valid after the UK's exit from the EU. A good example of these are cross-border insurance and financial contracts, which can span decades. For instance, agreements providing insurance for work-related injuries can provide protection for 10 years, to make sure they cover health conditions that could develop years after an employee has left a company. Currently, insurance for UK employees can be provided by EU insurers, and agreements for EU employees by UK insurers. The scale of this problem for both sides is significant: there are 6 million UK policyholders holding insurance policies from EEA providers, and 30 million EEA policyholders holding policies from UK providers.¹²

If a solution cannot be found, firms will not have confidence they can conduct cross-border service activities they have committed to through their contracts following Brexit. Companies could be forced to choose between breaking their promise to customers or risk breaking the law. For example, before Brexit a UK-based pensions provider may have signed a contract committing to pay a pension to an EU national residing in Spain. After Brexit, the British pensions provider may no longer be allowed to make these payments despite having promised to do so.

To protect existing contracts, the UK and EU should include protections for existing contracts as part of transitional arrangements and the withdrawal agreement. Contracts agreed between partners before Brexit should be "grandfathered": the original terms should be allowed to continue until the contracts are complete. It is important that the UK and EU work together to achieve this continuity, because time is running out and many larger firms have warned the CBI that they will not be able to independently solve this problem by December 2020, let alone by March 2019. A CBI survey of businesses found 77% of large businesses have started planning for the UK's departure, compared with just 47% of companies with 250 employees or less. Many smaller companies have reported they have not even started considering issues such as contracts.¹³

For continuity, the UK should ensure the smooth transposition of its stand-alone WTO schedule of commitments to provide a basic level on which services trade can occur

The agreement the UK and EU establish for its future economic relationship is not the only agreement that matters for services businesses: the future of the UK's position at the WTO also matters. That is because the rules permitting access to services trade are laid out in each country's schedules at the WTO, and the UK's position at the WTO will be changing as it leaves the EU.

While the UK is an independent member of the WTO in its own right, it is currently part of the EU's schedules. As it leaves the EU, the UK will need to establish its own schedule of commitments at the WTO – including the rules it wishes to establish for other countries wanting to export services to the UK. These will be set out in a UK-specific Annex on Article II (Most Favoured Nation Treatment) exemptions under GATS to determine the UK's approach to basic market access for services.

Services businesses in the UK, the EU and indeed the rest of the world will be looking for a smooth transposition of the UK's schedule of commitments at the WTO. It is important for UK consumers and businesses that the basic level on which non-EU services businesses provide services is not disrupted.

The UK will also need to ensure it remains part of the WTO Government Procurement Agreement (GPA). This does not include all WTO members, but confers certain extra market access for

¹² Bank of England, *Financial Stability Report*, November 2017.

¹³ CBI, *Survey: How businesses are preparing for Brexit*, January 2018.

businesses to a market worth up to £1 trillion annually.¹⁴ Although this agreement is not as deep as that provided by the EU's single market rules, it would be necessary for the UK to accede to this so that it can maintain access to procurement opportunities not just in the EU but also to other GPA member countries such as the US, Canada, Japan and South Korea. This agreement enables many services businesses, such as engineering design firms or cleaning companies, to bid for specific government contracts in other markets on the same terms as domestic providers. Because the UK is currently a member of the GPA through its membership of the EU, it will need to seek support from the EU and other members of the agreement to accede independently to the agreement to ensure continuity of access to this vital market area for services.

The UK will need to re-sign the 2005 Hague Convention to provide certainty

The UK is viewed as a reliable, fair and efficient place to do business. English law governs 40% of global disputes involving arbitrations, and a large number of UK, EU and international businesses have chosen to use English law to govern their commercial relationships and contracts. Ensuring that UK judgements continue to be recognised and enforced in the EU is an important step to preserving the continuity of these contracts. This is currently provided by the 2005 Hague Convention – of which the UK is a signatory through its membership of the EU.

The UK will need to re-sign the agreement as an independent party when it leaves the EU to provide certainty for UK and EU businesses and the continued widespread use of English law for commercial relationships across the world. Unless the UK unilaterally signs the Hague Convention, UK judgements will no longer be automatically recognised and enforced across the EU, creating confusion and putting the UK's legal sector on the backfoot in future.

2. Ensure access to talent and the mobility of people on both sides of the Channel

The prospect of new immigration rules and uncertainty over the status of EU workers are top priorities for many UK services businesses. In 2017 more than two-fifths of businesses (43%) viewed access to skilled migrants as a threat to competitiveness.¹⁵ But looking ahead this rises to more than two thirds of businesses (69%) who see difficulty in recruiting skilled migrants as a threat to competitiveness in five years' time.¹⁶ A large proportion of businesses (61%) also do not believe there will be enough people with the skills necessary to fill skilled roles in the future.¹⁷

Maintaining access to the right skills and the mobility of employees both ways across the Channel is critical to UK-EU service trade, particularly for the provision of Mode 4 services, but also for all types of cross-border service business.

A reciprocal agreement on intra-company transfers and posting of workers is needed so companies can continue to easily move their staff between the UK and EU

Cross-Channel travel, not only for short business trips but often longer secondments is vital to trade in services and to foreign direct investment into the UK. Underpinning much of the modern-day trade in services, it allows businesses to respond to the needs of their clients in a flexible and agile way to remain competitive. For example, management consulting, architecture and legal services are regularly provided between the UK and the EU on a "fly in fly out" basis, allowing workers to travel overseas to service European clients on a temporary basis. This short-term provision could last a day, week or even months – enabling firms to expand their operations

¹⁴ WTO, *Agreement on Government Procurement*, 1994.

¹⁵ CBI/Pertemps, *People and partnership: Employment Trends Survey 2017*, December 2017.

¹⁶ CBI/Pertemps, *People and partnership: Employment Trends Survey 2017*, December 2017.

¹⁷ CBI/Pearson, *The Right Combination: Education and Skills Survey 2016*, July 2016.

between the UK and the EU depending on demand or new contracts. The need to serve clients in a responsive way requires travel at very short notice which, under existing rules, is possible.¹⁸

Defaulting to mobility provisions under WTO rules (GATS Mode 4) would significantly hamper investment into the UK, and would not even be comprehensive enough to support cross-border service provision.¹⁹ For example, France, Belgium, the Netherlands, Spain and Italy are not committed to GATS Mode 4 for legal services. As a result, unless there is an agreement that changes this, a UK lawyer would not have an automatic right under GATS to fly to Amsterdam to give a Dutch client advice on UK law. In some jurisdictions, local legislation or regulations would prohibit this altogether. The EU's GATS commitments for legal services also only apply to home state and public international law, which excludes EU law.²⁰

Negotiators must seek a more comprehensive agreement on mobility. Given the geographical proximity and level of economic integration between the UK and the EU, there will continue to be a strong degree of cross-Channel collaboration between the UK and EU services industry. Only a negotiated agreement can ensure that British, European and global firms are still able to receive services from a combination of UK and EU service providers after the UK's withdrawal.

Growth and prosperity would be best served by the negotiation of a reciprocal agreement on intra-company transfers (ICTs) and posting of workers which enable businesses on both sides of the Channel to continue to move their staff across-borders on temporary assignments as freely as they currently do under EU legislation. Businesses recognise the need for a new approach to migration policy, not least to restore public confidence that it is controlled. But it is also clear that there is a strong business case and limited public concern for the intra-company transfers that underpin investment and the UK's services industry.

Exhibit 1: The benefits of cross-border mobility case study

A medium-sized UK based law firm is currently able to offer its clients UK legal advice using UK lawyers in any EU Member State. It regularly advises clients over the phone and by email, but for major transactions or disputes, clients will often choose to receive advice in person. The firm relies on being able to send its lawyers to provide EU clients or UK clients doing deals in the EU with "fly in fly out" legal advice – requiring lawyers to travel and stay in EU member states on a short-term basis, often for just a single day or week.

Because only a limited number of EU Member States currently allow foreign lawyers to give legal advice in person under WTO rules (GATS Mode 4), the firm would lose its ability to send UK lawyers to the EU without an effective agreement – even if that advice is limited to UK law.

The firm is extremely worried by the prospect of their lawyers being prevented from travelling to the EU to provide legal advice in person after the UK has left. If their lawyers are unable to take part in negotiations in person, or are limited to using video conferencing to offer advice, they believe EU clients will feel the level of service falls below the requisite standards and will transfer their business to competitors.

¹⁸ These professionals may request recognition of their qualifications if they can demonstrate they are fully qualified in their home-country. However, in such cases if the authorities of the host country find significant differences between the training acquired in the country of origin and that required for the same activity in their country, they can require the individual to undertake an adaptation period or an aptitude test, in principle at the choice of the individual. Specific EU legislation applies to certain regulated professions, such as legal services (regulated under Directive 77/249/EC and 98/5/EC).

¹⁹ CBI, *Brexit and industrial strategy: CBI response to the Migration Advisory Committee's call for evidence*, November 2017.

²⁰ Professional and Business Services Council, *Brexit and the Legal Services Sector in the EU*, July 2017.

The UK and EU should secure a dynamic mutual recognition agreement for professional qualifications, to simplify process of highly-skilled workers providing services across borders

Businesses welcome the UK Government's position that EU citizens with professional qualifications obtained in the EU27 prior to the UK's withdrawal will continue to have those qualifications recognised in the UK. Businesses also welcome the Commission's negotiations guidelines that call for the continued protection of recognised professional qualifications obtained in the UK prior to the withdrawal date in EU countries. It is critical these assurances are given legal force as part of the withdrawal agreement.

The freedom for workers to perform their profession across the EU has been key in supporting services trade between the UK and the EU, with businesses on both sides of the Channel benefitting from rules on the recognition of professional qualifications. These rules are limited to a small number of professions, and provide for the practitioners' professional qualifications, or the national regulatory body that governs their profession, to be recognised by the relevant authorities in other member states.

Doctors, healthcare professionals and architects currently benefit from automatic recognition across the EU. In practice, this means an architect who studied and qualified in France can work on a project in Madrid and establish their own architectural practice in Birmingham. Qualifications for lawyers, auditors, insurance intermediaries, commercial agents and other professionals go through a general process for mutual recognition. For example, lawyers qualified in the UK can shuttle back and forth on the Eurostar providing advice to clients in Brussels on both English corporate and finance law and EU competition law.

Exhibit 2: Mutual recognition of qualifications case study

Under current EU rules, UK accounting practitioners only require an aptitude test or adaptation period if they move to another Member State to provide regulated services, such as statutory audits. This has benefitted EU firms and clients by enabling access to a wider pool of sectoral expertise, and has also facilitated cross-border audits.

UK professional qualifications in accounting are respected worldwide, which means that many EU nationals come to the UK to study, or study for a UK qualification in their own Member State. Around 30,000 students from the EU (except the Republic of Ireland) are registered with UK professional bodies. Many professionals are attracted by the high quality of work experience in the UK, and often begin their careers in the UK to build up their experience post-qualification before returning to their home countries to share their knowledge and expertise.

If there is no mutual recognition of qualifications after Brexit, individuals who are in the process of acquiring their qualifications would face great uncertainty, and potential practitioners would be less likely seeking a UK qualification in the future. In addition, the barriers to professional mobility caused by the lack of mutual recognition would impact the ability of accounting firms to deploy expertise effectively across the UK and the EU, to the detriment of businesses and investors on both sides.

The mutual recognition of professional qualifications post-Brexit is therefore essential to preserve the ability of UK-qualified accountancy professionals – whether from the UK or the EU – to provide services across borders.

Without an agreement on mutual recognition of qualifications, some individuals will be unable to apply their services cross-border. For example, UK lawyers will have to qualify in the EU to provide advice to clients in the EU. This will have knock-on consequences for the value of the UK's higher education system: if British universities can only provide diplomas qualifying individuals to practice

their trade in the UK, they will be less attractive to international students that contribute significantly to the sector and local economies. Some businesses have already started taking steps to ensure their professionals qualify in the EU as well as in the UK to mediate this risk, but this is a costly and time-consuming process.

As far as possible, negotiators should take a liberal approach on professional qualifications to widen the pool of highly-skilled expertise the UK and EU can draw upon after Brexit. Specifically, businesses would be very concerned to see changes to current intentions to ensure that professional qualifications obtained in the UK and the EU before the withdrawal date continue to be recognised across-borders. Reassurance is needed for individuals who have already achieved qualifications to a standard deemed acceptable on both sides.

In the long-term, the UK and EU should look to secure a dynamic mutual recognition agreement for professional qualifications, to simplify the process of highly-skilled workers providing services across borders. This agreement should include diplomas, certificates and other evidence of formal qualification. After its exit from the EU, the UK should also look to negotiate similar agreements with other third countries as appropriate, to increase services trade on a global stage.

The UK government should adopt a preferential route for EU migration that allows UK services to continue to access the people and skills they need to thrive

Accessing people and skills from across Europe has been critical in the success of UK and EU services firms. The ability to attract individuals – without complex visa processes or entry restrictions – who can bring invaluable market awareness and knowledge, unique cultural understanding and native language skills has enabled services firms on both sides of the Channel to expand into each other's markets.

For example, the UK is a world leader in advertising and a hub for global media companies thanks to the ability to easily access both European and British talent. In the year from October 2016 to 2017, more than half (53%) of all new arrivals to London's advertising and marketing workforce were from overseas, with over a third (37%) coming from the EU. Without such diversity, creativity suffers, and the UK becomes a less attractive place for the industry to do business.²¹

The UK government should adopt a preferential route for EU migration that allows UK services to continue to access the people and skills from Europe needed to thrive. Any attempt to extend the costly and complex Tier 2 non-EEA work permit for EEA nationals would only serve to undermine the UK's global standing in services, with knock-on effects for other businesses in both the UK and the EU that rely on UK services.

3. Secure an adequacy decision for the UK's data regime to maintain the free flow of data between the UK and EU

In an increasingly interconnected world, data is integral to the relationship between businesses, consumers, products and services. The flow of data increasingly underpins global economic integration and international trade. In fact, data flows now generate more economic value than global goods trade.²² Cross-border data flows are a key component of e-commerce, from downloading software products and purchasing goods online, to enabling payments to be made from buyers to sellers located in different countries. And the growth of cloud computing has enabled individuals and businesses to store data remotely and to access it from any location. The continued free flow of data is also key to maintaining the UK's attractiveness as a hub for R&D and digital innovation.

²¹ Advertising Association, *Advertising Pays 6: World Class Talent, World Class Advertising*, October 2017.

²² McKinsey & Company, *Digital globalization: The new era of global flows*, March 2016

Three-quarters of the UK's cross-border data flows are with EU countries, supporting a data economy worth £240 billion.²³ Maintaining the free flow of data between the UK and the EU is therefore crucial to facilitating not just digital businesses, but the seamless flow of goods and services across borders. The UK government should therefore seek an adequacy decision for the UK's data regime as a priority in the Brexit negotiations. It must also look to ensure that data transfers are covered through any transitional arrangement to avoid a disruptive cliff-edge. This is important for all modes of services trade.

It is crucial an 'adequacy decision' is obtained for the UK's data regime to maintain uninhibited data flows to and from Europe

Businesses welcomed the UK government's intention to seek an 'adequacy decision' on data flows, which would ensure data could flow freely between the UK and the EU beyond Brexit. This adequacy decision would come from European Commission, which has the power to determine whether third countries provide an adequate level of protection of citizens' data and therefore whether data transfers to and from these countries should be allowed to occur without further safeguards. It has recognised several countries in this way, including Canada and Israel. For the free flow of data to continue to and from the UK and for companies to have confidence in the legality of processing EU citizens' data, the UK requires a similar adequacy decision.

The free flow of data between the UK and the EU is currently regulated by a single set of data protection rules. This has been recently updated under a new data protection package – the General Data Protection Regulation (GDPR), which provides the harmonised conditions under which personal data can be transferred within the EEA and sets clear standards for its transfer outside this area.

Exhibit 3: Disruption in US-EU data flows case study

The experience from the decision of the European Court of Justice's decision to strike down the EU-US Safe Harbour Agreement offers an example of the cost of disruption to data flows. The Safe Harbour Agreement was a data processing agreement made in 2000 between the EU and the US, which facilitated the flow of personal data between the EU and the US. However, in 2015, this framework was struck down by the European Court of Justice.

Following this decision businesses had to revert to "standard contract clauses" (SCCs) to transfer data on a case by case basis, which undermined digital trade and introduced a costly and resource-heavy process for companies to deal with, including small and medium sized businesses that do not have the technical resources or capacity to set up SCCs for every contract.

These rules enable firms to process and handle data seamlessly across borders. For example, pharmaceutical and life sciences companies often rely on the sharing of individual patient data from clinical trials between universities, companies and research charities to discover and test ground-breaking and innovative treatments and medicines. Similarly, a music company can establish a data processing centre in the UK can move personal customer data between their operations in the UK and the EU freely, provided it complies with EU data protection rules in doing so. Many firms that have outsourcing arrangements between their EU and UK operations also rely on continued cross-border data flows, such as the transfer of personal data to process and verify insurance claims.

²³ House of Lords European Union Committee, *Brexit: the EU data protection package*, July 2017.

To secure an adequacy decision and the free flow of data, the UK would need to maintain alignment with these rules. An adequacy decision is not granted automatically and is a complex process, but the adequacy assessment should recognise the UK's high standards for data protection. At the time of Brexit, the UK's legislative framework for data protection will align to Europe's, because the GDPR will be fully in effect and the principles of the GDPR will also be enshrined into UK law by the Data Protection Bill. In addition, the UK already compares favourably to other Member States on the quality of data protection in some areas.²⁴

However, the process of securing an adequacy decision is still likely to be a lengthy and complex one: it has historically taken around 1-3 years to achieve. It is therefore crucial the Government rises to the challenge as soon as possible and establishes the ongoing free flow of data to and from the EU as a priority in the Brexit negotiations. It must also look to ensure that data transfers are covered in any transition arrangement agreed in advance of a final Brexit deal. The UK should also seek to preserve the continuity of existing 'adequacy decisions' negotiated while part of the EU with other global partners, for example, the EU-US Privacy Shield which underpins EU-US data-sharing.

The disruption to the cross-border flow of data following the European Court of Justice's decision to strike down the EU-US Safe Harbour Agreement offers a cautionary example of what is at stake if the UK does not get this right.

If the UK and EU do not agree adequacy on data flows, businesses will face significant disruption. For example, without a deal to secure the free flow of data between the UK and the EU, life sciences companies based in the UK would have to attach a set of European Commission-approved Standard Contractual Clauses (SCCs) to service agreements with their European partners. This involves a lengthy and repetitive process which may only provide short-term legal certainty as the use of SCCs is currently facing legal challenge in the Irish High Court.²⁵

Exhibit 4: Disruption in UK-EU data flows case study

A British company provides an e-learning platform. The learning resources they host can be accessed by customers anywhere in the world if they log in. Without a deal to secure the free flow of data, in order to process this information across borders, the company will need to obtain consent from each individual user. Consent must be freely-given, informed and specific to each operation. This will create a huge amount of complexity for both the business and its users.

4. Negotiate ambitious mutual market access for service businesses

Retaining continued market access across important services sectors, including in public procurement, will be critical for business in the UK and the EU. Any new trading relationship must reflect the importance of cross-border trade between the UK and the EU to every sector and the level of integration between the two economies.

The EU's rules have led to an estimated 60% boost to services trade between member states, which has taken years to build up to a strong base.²⁶ And the UK service industry will continue to see the EU as an important base for its exports, not least because it is a large, close and wealthy economy. This proximity matters for services trade just as it does for goods: a 10% increase in

²⁴ PwC, *No adequacy decision, no panic - PwC comments on the latest European Commission statement on Brexit and EU Data Protection Law*, January 2018.

²⁵ Data Protection Commissioner v. Facebook Ireland Limited & Maximilian Schrems.

²⁶ NIESR, *Assessing the impact of trade agreements on trade*, November 2016.

distance between countries reduces services trade by 7%.²⁷ This makes continued alignment between UK and EU rules in important sectors vital.

Not all services trade will need to rely on continued alignment of rules to remain competitive. Services that are unregulated, such as management, education or strategy consulting services, can still be provided across borders post-Brexit. However, the success of these sectors will still depend on other factors such as the UK's ability to attract and move international talent.

Alignment with the rules of the EU Single Market for some important sectors will be crucial for the continued smooth flow of services trade

The EU Single Market for services is not complete, but it goes significantly further than the WTO GATS provisions for all cross-border service trade, and goes even deeper for some specific, important sectors. Alignment of rules across countries, combined with the principle of mutual recognition, makes it possible for individuals and businesses to provide services in other member states. If they comply with overarching EU rules or meet the required standards in their own Member State, they can – by and large – do so across borders.

The EU Single Market for services goes far further than GATS, which does not provide for “positive integration” measures, such as harmonisation of rules, or the mutual recognition of rules by default. If the UK fell out of these measures and services trade fell back on WTO rules, some of the UK's most successful exporting sectors could lose the legal basis to export to the EU, leaving cross-border trade in disarray.

The barriers services businesses could potentially face include nationality requirements for service providers, requirements for businesses to have a minimum number of locally-resident staff for different roles, restrictions on the number of establishments and foreign ownership, and authorisation requirements that are subject to economic needs assessments.

There are some sectors which would be particularly vulnerable to these barriers without alignment of rules. For example, in the broadcasting and audiovisual sector, member states have agreed through the EU on a single set of rules for this industry. Under these rules, providers need only apply the rules of the host country but can automatically operate all over the EU, and UK industry has taken great advantage of this, broadcasting over 700 TV Channels internationally.²⁸

Exhibit 5: What are services businesses saying?

“Without an unprecedented agreement on cross-border audio-visual services as part of a trade deal with the EU, we will no longer be able to broadcast a number of successful channels from our European HQ based here in the UK. It is becoming increasingly likely that we will have to move operations into Europe within the next few months,” – multinational broadcaster

"To prosper in a post Brexit world, Britain's airports and airlines need to be able to continue to provide the excellent passenger experience that they do today and provide the international connections that ensures we remain at the heart of the global economy," – major UK airport operator

"Digital trade is crucial to the UK being a globally competitive economy. Clarity and international compatibility of key regulatory issues are essential for business confidence and investment," - multinational technology company

²⁷ Keith Head, Thierry Mayer and John Ries, *How remote is the offshoring threat?*, European Economic Review, Elsevier, vol. 53(4), pages 429-444, July 2009.

²⁸ European Audiovisual Observatory, *Audiovisual services in Europe: Focus on services targeting other countries*, June 2017.

Similarly, GATS rules do not provide for air transport services, which must be agreed separately. The European Single Aviation Market has been built on a range of aligned rules, the consequence of which is that any European-owned airline that is authorised to fly may operate any intra-EU route. The rules cover protection for passengers, fares, competition, technical safety measures and more. Over the years, it has increased competition in aviation across the market, leading to lower prices for European consumers: the average leisure fares from the UK to European destinations are around a third lower than in 1993, and even lower for businesses.²⁹

Without a far-reaching deal on mutual recognition, going well beyond WTO GATS rules, professional and business service trade will also face barriers. Mutual recognition of Member States' professional rules and standards of conduct has facilitated trade in professional and business services. For example, auditors can currently provide services anywhere in the EU under the regulations of their home and host state. Continued alignment on common rules for statutory audits would be essential to enable UK-based auditors to give full legal value to their audit reports.

It is also well-understood that financial services would face major barriers to trade without regulatory alignment, with some businesses already having to undertake significant restructuring and relocation of activity to the EU. While this may mean a number of short-term gains for the EU in terms of high-skilled jobs, EU businesses would face long-term consequences on the cost and availability of finance services. Analysis by AFME has suggested that European SMEs may be the hardest hit by the effect of a hard-Brexit on wholesale banking, as they are most likely to be priced out of financial products due to a Brexit-related squeeze in capacity in the financial services sector.³⁰ Another study shows that while the EU might gain from relocation of financial services activities, ultimately there are 'no winners' from an increase in fragmentation which results in higher costs of financial services to EU27 consumers and businesses, which reduces EU GVA by -0.3%.³¹

To avoid this wide range of barriers which will affect some sectors significantly, the UK and the EU should seek to continue to maintain access to each other's markets through a comprehensive agreement on rules. This will need to be underpinned by mutual recognition and regulatory alignment. No deal on services is not sufficient, and an FTA similar to CETA would provide only patchy coverage – analysis by NIESR shows that reverting to an FTA would result in a decline in services trade of 61%. The reduction in UK-EU trade in services under an FTA is also the same if the UK and EU traded under WTO rules, which highlights the importance of reducing non-tariff barriers for services.³² Both sides must be ambitious and flexible to achieve a deal that works for businesses and consumers across Europe.

Ensuring mutual access to public procurement markets and alignment on public procurement rules will increase competition and value for money for taxpayers

Both the UK and the EU should seek to retain access to each other's public procurement markets and to maintain alignment on public procurement rules, such as on transparency. Under current EU rules, UK and EU firms have the right to compete for public contracts in other member countries. This includes transparency requirements, but also prohibits discriminatory rules against businesses on the grounds of nationality and requires procuring authorities to treat all bidders equally.

Opening up procurement markets to competition in the UK and the EU has increased transparency, competition and the quality of service provision for publicly-tendered activities. This delivers cost efficiencies and savings to taxpayers in the UK and the EU. For example, Siemens, a

²⁹ Speech by Andrew Haines, Chief Executive of the CAA, *The future of open skies post-Brexit*, December 2016.

³⁰ AFME, *Bridging to Brexit: Insights from European SMEs, Corporates and Investors*, July 2017.

³¹ PwC, *Impact of loss of mutual market access in financial services across the EU27 and UK*, February 2018.

³² NIESR, *Will New Trade Deals Soften the Blow of Hard Brexit?*, January 2017.

German company, won a £1.6 billion public contract for Thameslink trains over Bombardier, whose European operations are based in the UK.³³

It is in the interests of both the UK and the EU to negotiate continued openness in procurement markets. The European Commission estimates that (excluding utilities) public expenditure on goods, publicly-procured work and services in the EU amounted to £1.5 trillion in 2015.³⁴ Similarly, the UK has a significant public procurement market: in 2015 the value of this market was valued at over £260 billion, 13.6% of UK GDP. UK procuring entities also account for around a quarter of the value of tenders published in the Commission's public tenders database.

5. Invest in regulatory cooperation between the UK and the EU, and the UK and the rest of the world

Given the strong economic case for the UK and EU to maintain a high degree of regulatory alignment to ensure services can be traded smoothly, there is also a strong case for maintaining ongoing cooperation on rules and the supervision of those rules between the UK and the EU. Both sides will inevitably need to work together in the decades ahead as regulation, technology and businesses evolve, and negotiators should start exploring the mechanisms by which that cooperation might happen.

However, regulatory cooperation does not just happen within the EU, but on a global stage. While the WTO is obviously an important venue for international cooperation on regulation, it is far from the only one. The UN plays a major role in environmental regulation, Basel leads the way on global financial services regulations, and global maritime regulations are driven by the International Maritime Organization. After Brexit, as the UK will no longer have a joint voice with the EU at these committees, and as such it should look to boost its influence in the structures for regulatory cooperation on a global stage.

It is in the interests of the UK and the EU for continued regulatory and supervisory cooperation to continue after the UK's exit

As long as ongoing regulatory alignment is essential for the continued trade in services between the UK and the EU, mechanisms for cooperating will continue to matter. For example, the development of the Digital Single Market in the EU will help set the foundations for how digital services are traded across borders. The UK, as a leading digital economy had a significant stake in this initiative and will, of course, want to work alongside the EU on its development.

But continued regulatory cooperation it is also within the interests of the EU, for a number of reasons. Firstly, working together would mean both the UK and the EU can continue sharing and adopting best practices in standards and regulations to the benefit of European firms and consumers. The UK's technical expertise has been instrumental in shaping EU regulations across various sectors, including in aviation, where the UK provides around 25% of all safety data gathered by EASA annually (around 15,000 occurrences) and leads around two-thirds of all EASA's safety rulemaking. Secondly, cooperation allows both UK and EU to ensure that regulations are appropriate for their respective economics, while respecting the desire of both the UK and the EU to maintain autonomy. And thirdly, cooperation will allow both sides to ensure that fairness can be maintained with a major trading partner.

The mechanisms by which cooperation can operate will need to be established as part of negotiations. There are already ways for non-EU countries to input into some regulatory process in the EU, for example representations from EEA countries and beyond play a part in many EU

³³ Institute for Government, *Public procurement*, May 2017.

³⁴ European Parliament, *Consequences of Brexit in the Area of Public Procurement*, April 2017.

agencies and bodies. UK businesses have identified several strategic bodies and organisations where they would welcome the UK's continued involvement, including the Article 29 Working Party, the European Aviation Safety Agency and the European Payments Council.³⁵ But not all sectors and issues are represented in this way, the creative industries, for example, do not have a specific agency engaged in their regulation. Other mechanisms may be required, such as regulatory cooperation fora or routes for UK regulators and EU counterparts to maintain a close relationship.

The UK and the EU should therefore agree a model for future regulatory and supervisory cooperation, to underpin the deep and integrated trading relationship they currently share. As well as facilitating continued cooperation, this model would need to provide a framework to monitor and constructively address potential regulatory divergence, including the use of dispute resolution mechanisms, where appropriate.

The UK should remain committed to and continue to champion the use of international standards and regulations across the globe, and strive to lead the way in emerging areas of services trade

While cooperation with the EU on regulatory matters is important, the UK should also continue to play a leading role in shaping global rules and standards, from financial regulations and accounting standards, to maritime services regulations. Many EU regulations originate from international commitments. Continuing to play a leading role in shaping those rules provides a way for the UK to continue to influence EU standards and regulations post-Brexit.

At present, the UK is currently represented on the International Accounting Standards Board (IASB), the body that is responsible for setting IFRS accounting standards. It has also influenced global standards and regulations in financial services through its membership of the international standards setting bodies such as the Financial Stability Board (FSB), International Organization of Securities Commissions (IOSCO), the Basel Committee on Banking Supervision and the International Association of Insurance Supervisors. The UK's voice was critical in the Basel Committee when the post-crisis banking reforms were shaped and implemented.

The UK, through the British Standards Institution, is one of the leading members of the International Organization for Standardization, ISO, and provides one of the Vice-Presidents of the organization. UK has long been a driver of international business standards, used by service and other businesses, such as quality management, environmental management, business continuity and anti-bribery management systems. All of these standards started as British Standards.

Through its networks, the UK has also played a key role in enhancing the EU's influence on environmental and climate policies, even enhancing the EU's influence as an international negotiator. Examples include the UN Framework Convention on Climate Change, the Convention on Biodiversity, and the WTO's treatment of environmental requirements – all of which are relevant not just to firms that produce things, but also to firms supplying energy, water and environmental services.³⁶

The UK should remain committed to, and continue to champion the use of international standards and regulations. It should also take the lead in setting the standard for others to follow in new and emerging areas of services trade, such as in fintech and digital. For example, the world's most widely used cybersecurity, standard is ISO/IEC 27001, which originated as a British Standard in the 1990s.

³⁵ CBI, *The Room Where It Happens: A guide to the EU bodies and regulators that matter to business in the Brexit negotiations*, December 2017.

³⁶ House of Commons Environmental Audit Committee, *EU and UK environmental policy*, April 2016.

Conclusion and Recommendations

The future of UK-EU services trade matters. The services industry accounts for almost 80% of the UK's GDP and 4 in 5 jobs across the country. UK services are in demand all over the world, but the EU is the single largest destination for UK services – worth around £90 billion a year to the UK economy.

Services industries – in particular – would not be able to rely on WTO rules if no deal is agreed. If the UK is unable to secure an agreement covering access to the single market in services, companies in some of our most successful exporting sectors would be unable to export specific types of services to the EU at all. Those industries include airlines, broadcasters, and a range of financial, professional and business service providers.

But getting the right deal on services is not just important for companies in the services industries. These businesses are deeply interlinked with every kind of manufacturing activity, the retail industry, and with each other across the EU. Hundreds of thousands of companies and individuals in the EU are currently benefitting from the services that UK firms are providing, creating impetus for negotiators on both sides to secure a relationship that ensures as much of this trade can continue as possible.

An agreement of unprecedented depth will be needed to ensure trade in services that is as near to frictionless as possible. Protections are needed urgently to avoid disruption to businesses. In the long-term, negotiators should agree a smooth and open relationship that will ensure consumers can continue to access a variety of services, and employees of companies in the UK and EU can continue providing them competitively.

The roadmap to this smooth and open relationship is clear. Negotiators need to take 5 steps to secure it:

- 1. Remove the cliff-edge for trade in services.** Urgent agreement of comprehensive transitional arrangements is needed to help businesses plan for Brexit and halt the implementation of their contingency plans.
- 2. Ensure access to talent and the mobility of people on both sides of the Channel.** Access to the right skills and mobility of employees both ways across the Channel is critical to UK-EU services trade.
- 3. Secure an adequacy decision for the UK's data regime to maintain the free flow of data between the UK and EU.** In an increasingly interconnected world, data flows are integral to the relationship between businesses, consumers, products and services.
- 4. Negotiate ambitious mutual market access for service businesses.** Close alignment with the rules of the EU Single Market will be needed for some important areas for the continued smooth flow of services trade.
- 5. Invest in regulatory cooperation between the UK and the EU, and the UK and the rest of the world.** The UK should play a leading role internationally in shaping new and emerging areas of services trade, as well as cooperating closely with the EU.