Key aspects of the EU-UK Trade and Cooperation Agreement

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Theme

Brexit represents a major setback for European integration. Over the coming months, the costs will cease to be theoretical and will begin to manifest in practice.

Summary

Following the political withdrawal of the UK from the EU in February 2020, the two parties reached an eleventh-hour trade and cooperation agreement at the end of the transition period. The agreement covers the economic aspects of Brexit, laying the foundations for bilateral trade over the coming decades. The good news is that the EU and the UK managed to avoid a no-deal outcome, which would have proved disastrous for many sectors and harmed bilateral cooperation. Yet despite generally respecting the negotiating objectives of both parties, it is a minimal agreement limited to liberalising trade in goods (including agriculture and fisheries), with considerable friction and a lack of ambition on services and the movement of people. In short, the agreement represents a major setback for European integration. Moreover, over the coming months, its costs will cease to be theoretical and will begin to manifest in practice.

Analysis

(1) Introduction: what has been agreed?

From the EU perspective, the **EU-UK Trade and Cooperation Agreement** is an association agreement under article 217 of the Treaty on the Functioning of the European Union (TFEU). It is an international agreement that cannot be interpreted in accordance with domestic law, and is markedly different from the Withdrawal Agreement, leaving scant room for the EU Court of Justice.

The agreement has seven parts: (1) common and institutional provisions; (2) trade, transport, fisheries and other arrangements; (3) law enforcement and judicial cooperation in criminal matters; (4) thematic cooperation (health and cyber security); (5) participation in union programmes, sound financial management and financial provisions; (6) dispute settlement and horizontal provisions; and (7) final provisions. The 400 pages of the main text of the agreement are supplemented by a further 600 pages with almost 50 annexes covering specific aspects, such as rules of origin, fisheries, cars, chemicals, medicine, organic produce and wine, specific services, energy, the movement of people, short-stay business visas and the exchange of information, in

addition to a further 200 pages setting out three protocols on cooperation on VAT fraud, customs and social security. All in all, the text runs to over 1,200 pages, which –ironically– serve to loosen economic integration between the EU and the UK.

Under article 218 of TFEU, the treaty must be approved by the European Parliament but, given the time constraints, it has been provisionally applied until at least 28 February pending approval, although this deadline can be extended by mutual agreement. In contrast to the Withdrawal Agreement, which does not expire (except for the Protocol on Ireland and Northern Ireland, and, even then, only under specific circumstances), each of the parties can withdraw from the agreement subject to a notice period of one year.

(2) Tariff-free trade in goods

The agreement is ambitious on trade in goods, since it is unusual for a free trade agreement to include farming and fisheries products. It provides tariff- and quota-free access for all products, although it should be noted that the term 'tariff-free' here refers to goods classed as originating in the EU or UK, in line with the rules of origin defined in the agreement. As such, by default goods entering the EU from the UK are subject to tariffs unless they meet the rules of origin.

While this may seem a simple matter, the devil is in the detail: the agreement contains a lengthy list of rules of origin for products (over 50 pages in annexes ORIG 1, 2 and 2B), to which careful attention must be paid. While the agreement is notably generous for its inclusion of non-originary processed raw materials as 'British' products (technically known as full cumulation) and allowing businesses to self-certify the origin of goods, compliance with the rules will be complex for a number of specific sectors, where much stricter rules apply. For example, an electric car produced in the UK and exported to the EU would only be exempt from tariffs if 45% of its added value is European or British and its battery is wholly of EU or British origin. This means that a British electric car with a Chinese battery would be subject to tariffs. Proving the origin of individual shipments will be a bureaucratic nightmare, with many small and medium businesses often choosing to pay the tariffs to avoid the administrative burden of proving the origin of their products.

The issue of rules of origin has come into sharp focus in the initial days of Brexit: many British distributors have found out the hard way that Chinese imports re-exported to the EU are subject to dual tariffs, once on entry to the UK and again when they enter the EU, since directly re-exporting goods without their transformation preserves their Chinese origin, meaning the preferential tariff arrangements of the agreement do not apply. Through their own experience, British distributors are now seeing the advantages that would have come from accepting the customs union proposed by Theresa May (a customs union acts as a single zone of origin). To avoid these double costs, they will need to use alternatives such as transit arrangements or customs warehouses, each with its corresponding drawbacks and costs, or simply shift their distribution facilities to the continent.

We should not underestimate the importance of agreeing to remove tariffs for sectors that are key to bilateral trade (and also to Spain), such as agri-foods and cars, which would have suffered from high tariffs. Nonetheless, daily trade flows will be much

diminished. Agri-food trade will be subject to obtaining health certificates, which were previously not required and will now be systematically checked, alongside periodic inspections. Industrial goods must bear the CE mark, guaranteeing they meet the technical requirements of the EU, meaning UK manufacturers will now need three marks: one for Great Britain, another for products destined for Northern Ireland and a third for products destined for the EU). Certain products like chemicals or pharmaceuticals must now be reregistered and will face additional hurdles to approval. Similarly, VAT and special taxes will accrue at the point of each import (including for online shopping), not as part of periodic declarations of intra-community transactions.

While this extra red tape will be seen as a necessary evil for highly differentiated or premium products, for other goods that can be more readily substituted, many EU importers will prefer to switch from their British suppliers to others in the single market that can supply goods to their warehouses in just a few days, without any additional paperwork. Unsurprisingly, it is already becoming clear that red tape and non-tariff barriers are key to the competitiveness of businesses.

Nonetheless, the agreement includes a number of measures for trade in goods, such as mutual recognition schemes for trusted traders ('authorised economic operators') to facilitate customs clearance, the use of common international references in technical specifications and specific schemes for wine, organic produce, cars, chemicals and pharmaceuticals.

(3) Three sticking points: fish, governance and level playing field

(3.1) Fish

One of the clearest examples of the ideological stance the UK adopted in the negotiations was the disproportionate importance given to a sector such as fisheries. Despite making up just a fraction of the economies of both parties (around 0.1% of GDP), the issue threatened to derail negotiations right up to the last minute. The issue is easily understandable to voters and is highly symbolic of the sovereignty of the UK –a historic naval power– over its waters.

In the end, both parties had to make concessions to reach an agreement. The starting point of the EU, which sought to keep access unchanged, was too maximalist. However, neither did the UK achieve a no less radical objective of imposing annual quota negotiations for access to its waters, in line with the example set by Norway. The fact that 80% of UK catches are exported and two-thirds of these exports are destined for the continent, considerably weakened the UK's position (it faced the threat of tariffs of up to 25% on fisheries). The agreement does not, however, exempt exports from British producers from health regulations.

Similarly, the agreement also allows for EU vessels to maintain their access to UK waters over the next five years, gradually phasing in a 25% reduction in catches. Concessions from the EU are focused on species less affected by coastal fishing in an attempt to minimise the effect on fishing communities.

Yet, as in many of the areas covered by the agreement, this does not mean the end of problems. When the initial adjustment period comes to an end, new negotiations will be required, which will in principle take place on an annual basis. If EU access is reduced, it has a raft of measures available under the agreement, from imposing tariffs on fishing products or other goods to retaliation in other areas covered by the agreement. It is perhaps no coincidence that the renegotiation of UK access to the European energy market coincides with this date. Moreover, at least in theory, each party can unilaterally terminate the fishing agreement, with annual renegotiations required for the total level of catches based on scientific criteria. Essentially, the EU has secured some stability for the sector for a number of years, making it clear that the UK could pay a high price if it upsets the new *status quo*.

(3.2) Governance

The institutional architecture of the agreement itself was the source of a number of disagreements between the two parties during the negotiations. The UK has achieved its aim of fully extricating itself from the jurisdiction of the Court of Justice of the EU. The EU, on the other hand, has obtained more substantial objectives, with a single agreement covering all areas (instead of the series of separate agreements desired by the UK). This means non-compliance with one part of the agreement will give rise to countermeasures in others.

The institutional design of the governance framework is complex, establishing a Partnership Council and around 30 different specialised committees and technical working groups. The key to unblocking the negotiations lay in the mechanisms for dispute resolution and ensuring compliance with the agreement: the EU will accept the right of the UK to diverge but has a broad arsenal of instruments for retaliation, meaning any such divergence could prove costly. Stronger guarantees were demanded in light of the attitude of the UK and doubts regarding its intentions to comply with the previously signed Withdrawal Agreement, which significantly eroded trust.

Under the careful design successfully imposed by the EU, the general dispute resolution mechanism is initiated by notifying the joint Partnership Council. If a solution is not reached by mutual agreement, the dispute is submitted to binding external arbitration with the injured party entitled to take countermeasures in the event of non-compliance.

The EU is particularly worried about the potential for the UK to loosen regulations to give it an unfair competitive advantage (a longstanding dream of supporters of Brexit). The procedure for retaliation is streamlined for state aid and labour and environmental standards: if a first attempt to settle the dispute by consensus fails, the injured party can quickly impose countermeasures, which are only subsequently subject to arbitration.

The agreement also contains a general rebalancing mechanism, allowing corrective measures to be adopted and subject to retrospective arbitration if significant impacts are observed on trade or investment flows. The trade agreement will also be jointly reviewed in five years and can be terminated by either party subject to a notice period of 12 months. In light of all this, the UK would do well to tread carefully in exercising its newly acquired rights to divergence.

(3.3) Level playing field

Fair competition, or a 'level playing field', was a precondition of the EU for any agreement. There is strong logic behind this idea: the EU cannot allow an economic power like the UK, located just 200 km from Brussels, to lower its standards on labour regulations, the environment, tax and state aid in order to entice businesses from the EU to set up in the country with the promise of tariff-free access to the single market under lower standards than in the EU. Through its Green Deal, the EU aspires to lead clean production and must thus guarantee that imports from the UK conform to these standards.

However, a level playing field does not mean the UK must maintain the same standards as the EU (as would have been the case with an agreement that kept the UK in the single market) but that it must maintain a similar level of requirements and adapt as regulations change. Naturally, the EU would have preferred automatic compensation through tariffs in the event of regulatory divergence, or at least for this to be interpreted by the Court of Justice of the EU. However, in the end it has settled for a complex bilateral procedure to assess divergence, with arbitration if no agreement can be reached. This means that if UK environmental, labour or state aid standards diverge and the EU believes this creates elements of unfair competition, there will be bilateral negotiations to resolve the matter. If the two parties fail to reach an agreement, the matter will be subject to arbitration, which may result in compensation via tariffs (or even, for example, the repayment of unfair state aid received by businesses). The system of bilateral negotiation, arbitration and retaliatory measures is especially complex for labour and environmental standards and state aid.

On taxation, however, the EU has accepted that standards will be defined by third parties, as part of the Base Erosion and Profit Shifting initiative of the Organisation for Economic Co-operation and Development to prevent the erosion of tax bases and the transfer of profits to more favourable jurisdictions. In light of frequent threats by the UK to transform its economy into a sort of 'Singapore on Thames' or promote free ports (which the European Parliament wants to see abolished, given they often serve to enable tax evasion), it is surprising that the EU-UK agreement expressly excludes tax matters from the dispute settlement mechanism.

(4) A thin agreement for services

Although the agreement reached at the end of last year includes elements for the liberalisation of trade in services, by no stretch of the imagination can it be described as ambitious. While the UK sought to include the liberalisation of telecommunications, road and air transport and financial services, the EU has held firm, avoiding a carve up of the single market that would set a dangerous precedent.

(4.1) Road and air transport

The agreement allows bilateral road transport activity (point-to-point transport) but excludes UK firms from cabotage operations (internal journeys within the EU territory), except in a small number of exceptional cases. Provisions have been agreed on working conditions, road safety and competition.

The EU has also taken a hard line on aviation, only allowing unlimited point-to-point traffic between EU and UK airports (third and fourth freedom traffic rights) but disallowing British companies from fifth and in successive freedoms (ie, the possibility of cabotage). Nonetheless, there are two concessions and a promise. The first concession is that companies can also be classed as British even if they are majority-owned by EU interests, provided their licence was granted prior to 31 December (this provision does not apply to newly created companies). However, there is no flexibility on the general rule that only airlines that are 'effectively owned and controlled' by EU interests can make journeys within the EU. This means that companies like IAG must be able to prove their subsidiaries are European (much less straightforward than often assumed) or undertake complex and costly restructurings of shareholdings. The second concession allows Member States to bilaterally agree the fifth freedom with the UK but only for cargo flights outside the EU (eg, between Paris, London and New York).

Thirdly, there is a promise to review the requirements for effective ownership and control after a year, (perhaps replacing them with criteria related to the principal place of business). The agreement also includes provisions on ground handling and time slots (non-discrimination and access) and passenger rights, as well as level playing field clauses.

Regardless, transport aside, UK service providers will no longer benefit from the 'country of origin' approach or the concept of 'passporting', which allowed automatic access to the whole of the single market. The only concessions are a guarantee that service providers or investors will not be treated less favourably, the elimination of unjustified barriers to digital trade (including the prohibition of requirements on the location of data) and a reciprocal opening of public procurement markets, including for small contracts.

(4.2) Financial services

The secondary nature of financial services, a highly strategic sector for the UK (generating some 21% of all service exports), in the negotiations is surprising. This can perhaps be explained by the UK's confidence in its international competitiveness and size. Hopes that looser regulations will be able to attract innovative financial activities to the City, such as certain investment or fintech funds may also have played a part. Regardless, the absence of financial services from the agreement is risky –at least from the British perspective– and leaves the EU with a powerful instrument to exert pressure.

UK financial entities will no longer be able to operate in the single market with the same ease as at home via passporting, which allowed them to provide the majority of their services directly in the continent from their base in the UK. In contrast, the new relationship will be based on equivalence decisions adopted by the EU, which recognise the equivalence of the regulations of third countries for certain specific activities. Equivalence is granted unilaterally by the EU and can be revoked at any time with a notice period of just 30 days. Moreover, it does not cover retail activities, such as deposits and bank loans.

In the absence of other agreements, EU regulations for entities from third countries generally facilitate their establishment in the EU to allow them to operate within it. The big players in UK finance have already adapted by relocating some of their assets and staff to the continent, although so far we have not seen the mass exodus predicted by some analysts.

(4.3) Energy and climate

The UK will remain connected to the EU single energy market, albeit with third-country status, with exchanges still allowed. This suits the EU, which has a surplus in this area, supplying 12% of gas and up to 10% of electricity consumed by the British market.

While both parties will now pursue independent energy policies, this is one of the areas in which future ties have been strengthened, partly due to its relationship to climate change, an issue to which both signatories have made serious commitments. The UK will continue to set a price for carbon emissions and the door has been left open to linking it to the continental system further down the line.

Other parts of the agreement, such as nuclear energy and non-regression on environmental standards have their own implications for the strategic energy sector.

(5) The end of free movement

The provision of services and the free movement of people have always gone hand in hand, meaning it was only logical the EU would not accept restrictions on the movement of people while allowing the free circulation of services. The lack of ambition on services is reflected in the fact that the free movement of people has all but ended.

Logically, there is a bilateral waiver on the requirement for visas for short visits of up to three months for the purpose of tourism, with a passport –once again mandatory– all that is needed for such trips. However, residence or work visas will be required for any stays over 90 days within a 180-day period, a major blow to those who had become accustomed to long stays. Aware that the UK does not see immigration from certain European countries in the same light, the EU has held firm in its insistence on the same visa regime applying to all EU citizens, without distinction, meaning the UK will not be able to discriminate based on country of origin.

In terms of business travel, the activities permitted without a visa is limited to the short list in article 8 of annex SERVIN-3, which covers conferences, training seminars, market research, trade fairs, tour guides, interpreters and negotiating contracts. However, a photographer covering an event, a model appearing at a fashion parade or a musician performing at a concert in the EU (70% of musicians do so at least once a year) will generally all require a work visa from now on.

Closely related to professional activities is the recognition of professional qualifications. Naturally, the UK, a major power in higher education, would have liked to have seen automatic or semi-automatic recognition of degrees and qualifications (as is the case with Member States) but the EU was unwilling to grant this condition. While the door

remains open to negotiating mutual recognition further down the line, logically this would require reciprocity.

Likewise, there is no automatic recognition of professional qualifications: doctors, nurses, dentists, pharmacists, vets, engineers and architects will all need to have their qualifications recognised by each Member State in which they wish to exercise their profession.

(6) Other areas of cooperation

(6.1) Data protection and security

The agreements reached allow continued cooperation in the areas of policing and justice between the UK and the EU, albeit with less intensity than before. The two parties will continue to exchange information on digital footprints, DNA, number plates, criminal records, passenger registers, lost property and missing persons. However, the UK will no longer participate as a member in EU databases in these areas and will no longer have unrestricted, real-time access. Instead, information will either be exchanged on request by either party or sent on their own initiative. Going forward, the UK will cooperate with Europol and Eurojust, although from outside. Arrest warrants and extradition requests will have a lesser degree of automation than at present.

Security cooperation is now underpinned by a series of requirements to guarantee the protection of personal data. The UK has rejected any continued role of the Court of Justice of the EU in upholding these rights and has refused to give a firm commitment to remaining a signatory to European Convention on Human Rights. As such, the agreements will be suspended should the UK government decide to withdraw from the convention or if the European Commission rules that the country does not provide a sufficient level of data protection.

This new context has the potential to render the fight against crime less effective, despite claims to the contrary by supporters of Brexit. Finally, the agreement says nothing on the readmission of illegal migrants and unaccompanied minors, which will be harder going forward.

(6.2) Participation in EU programmes

The agreement allows the UK to continue to participate in a number of EU programmes, subject to the corresponding payments. This arrangement also suits the EU, given the potential of British universities and research institutes.

The UK will continue to participate in the following programmes: Horizon (the main EU scientific research programme), Euratom (for research and exchange on nuclear energy), ITER (the international programme for research on fusion), Copernicus (the study of the Earth from satellites) and SST (the system for tracking orbital debris to prevent collisions).

However, the UK has shunned other major programmes, such as Galileo (the EU GPS system) and the flagship Erasmus student exchange programme. Once again, its

absence in the latter is symptomatic of the ideological stance adopted by London in negotiations.

Conclusions

Despite being reasonable on trade in goods, the EU-UK Trade and Cooperation Agreement represents a bare-bones agreement on services and the free movement of people. It represents a setback, going from an integrated and productive relationship to an exercise in damage limitation. Without a doubt, its main advantage is that it keeps bilateral communication and negotiation channels open, thus allowing a more pragmatic attitude –as the economic costs of Brexit become more apparent and the ideological charge that has characterised the UK negotiating stance subsides– to translate into much more reasonable levels of economic integration for two partners whose proximity means they are obliged to work together.