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# BREXIT: YES… BUT WHERE TO?

## HOW TO AVOID THE RE-INTRODUCTION OF BORDER CONTROLS AND A SCENARIO OF "MUTUALLY ASSURED DISRUPTION"

POLICY BRIEFING

by Mogens Peter Carl

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# Some simple solutions to complex problems or how to maximise mutual economic relations after Brexit and minimise economic disruption

## ABOUT THE AUTHOR

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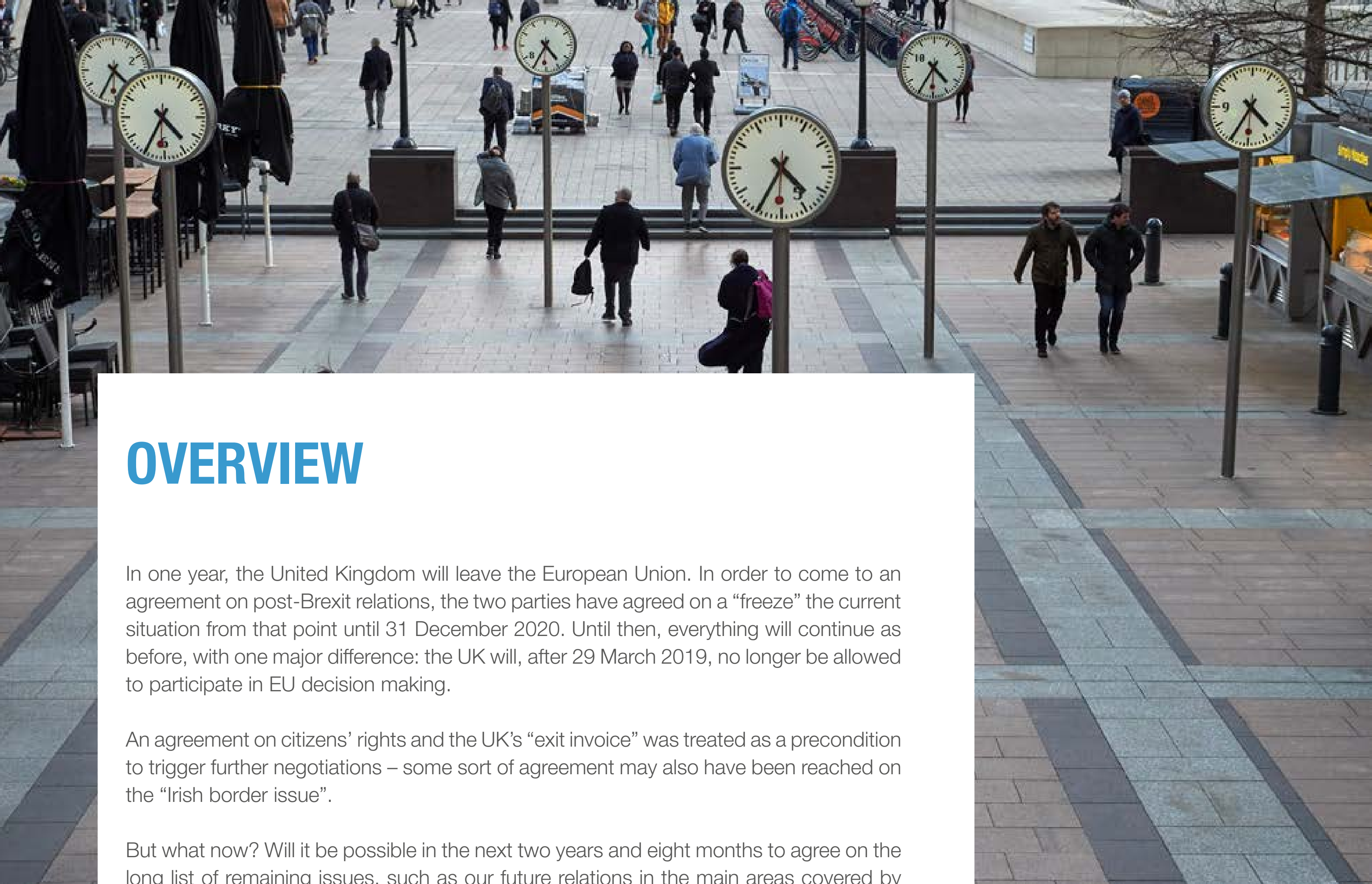

# OVERVIEW

In one year, the United Kingdom will leave the European Union. In order to come to an agreement on post-Brexit relations, the two parties have agreed on a "freeze" the current situation from that point until 31 December 2020. Until then, everything will continue as before, with one major difference: the UK will, after 29 March 2019, no longer be allowed to participate in EU decision making.

An agreement on citizens' rights and the UK's "exit invoice" was treated as a precondition to trigger further negotiations – some sort of agreement may also have been reached on the "Irish border issue".

But what now? Will it be possible in the next two years and eight months to agree on the long list of remaining issues, such as our future relations in the main areas covered by EU law and agreements laboriously negotiated over the past 45 years? The suggested answer is "yes …but". This paper - and the cautious "yes …but" - is exclusively focused on the "commercial" relationship between the two parties, namely trade in goods and services.

There are four reasons for writing this paper, one year after suggesting a blueprint for post Brexit relations[1]:

1. Important decisions regarding investment are being postponed because of the impenetrable London fog surrounding the British government's approach to basic issues, like its preferred future trade relations with the EU. This is, inter alia, aimed at those whose economic interests are at stake, i.e. traders, investors, and producers. One may hope that officials on either side may also find some inspiration here.

2. The UK and the EU have agreed that they should avoid the creation of a "hard border" between the Republic of Ireland and Northern Ireland. This adds a major problem that must be resolved.

3. The apparent impossibility of hiring and training enough qualified UK customs officials by 1 January 2021 will create an enormous problem with the prospect of long delays and disruption of supply chains.

4. Time will be required to solve these and other problems. Some have expressed the hope that the UK could be granted yet another transition period. This is highly unrealistic: why should the EU agree, and how could this be acceptable to Brexiteers, given that the UK will lose its right to participate in EU decision-making on 29 March 2019? Any delay beyond 2020 would only prolong that very uncomfortable position for the UK, subject, as it would be, to decisions made in Brussels five years after the referendum.

The focus of this paper is on what needs to be agreed by 31 December 2020, when the transition period ends. For an excellent analysis of the questions that need to be addressed during the transition period, see a recent publication by the Jacques Delors Institute[2]

*This paper demonstrates the feasibility of an innovative approach to ease the way forward and avoid some of the most disrupting consequences of the 31 December 2020 cliffhanger. In particular, it focuses on what could be done to postpone the re-imposition of "hard borders" between the EU and the UK, and therefore also between the Republic of Ireland and Northern Ireland, by agreeing on a number of difficult, connected issues.*

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Last year's "How to (Br)exit: A Guide for Decision-Makers" paper defined ways to maximise mutual advantages and minimise mutual "pain", *without taking sides*, and by accepting at face value the "red lines" announced by either party. These were described as follows:

**Major British red lines:**

- An end to the free movement of people between the EU and the UK after Brexit;
- No direct applicability in the UK of decisions made by the European Court of Justice, or in EU legislation; regulatory autonomy;

The recovery of UK sovereignty in all areas, such as international trade policy (such as the right to conclude trade agreements with third countries).

**Major EU red lines:**

- The integrity of the EU *acquis* and decision making process; no cherry picking.

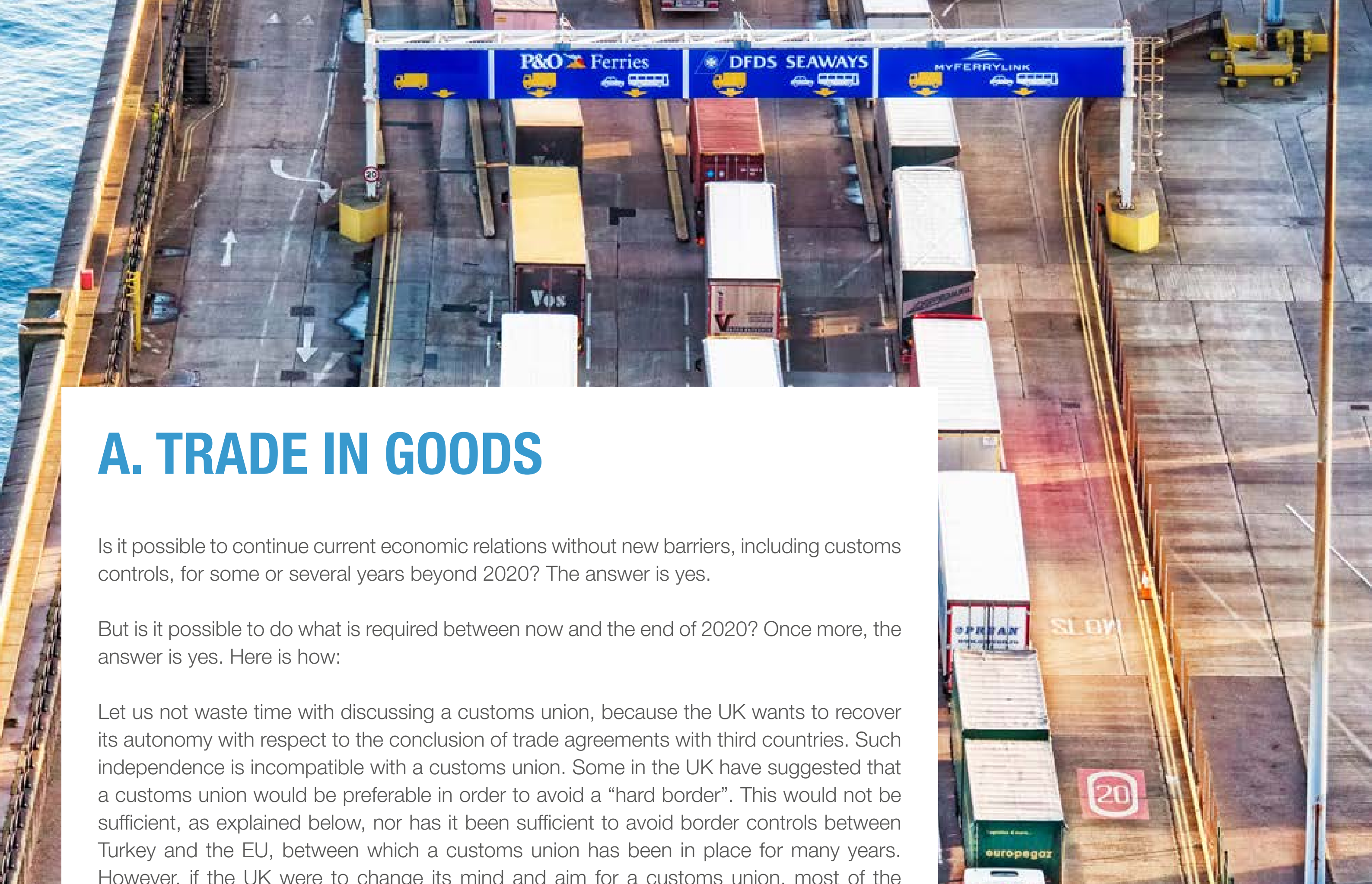
There is no apparent reason to review these red lines, but the question of free movement of people until 2021 and their rights and obligations after that date has been resolved

An important common red line has emerged:  the avoidance of a hard border in Ireland.

Since the questions of "people" and "money" have been resolved, let us focus on future trade relations.

1. http://www.friendsofeurope.org/policy-briefing/how-to-brexit-guide-for-decision-makers

2. Elvire Fabry and Marco de Toffol, "The Hitchhiker's Guide to the Brexit Galaxy", in English and French, http://institutdelors.eu/publications




# A. TRADE IN GOODS

Is it possible to continue current economic relations without new barriers, including customs controls, for some or several years beyond 2020? The answer is yes.

But is it possible to do what is required between now and the end of 2020? Once more, the answer is yes. Here is how:

Let us not waste time with discussing a customs union, because the UK wants to recover its autonomy with respect to the conclusion of trade agreements with third countries. Such independence is incompatible with a customs union. Some in the UK have suggested that a customs union would be preferable in order to avoid a "hard border". This would not be sufficient, as explained below, nor has it been sufficient to avoid border controls between Turkey and the EU, between which a customs union has been in place for many years. However, if the UK were to change its mind and aim for a customs union, most of the conditions for avoiding a hard border described below would still apply.

An alternative solution to a customs union, economically comparable, is, by default, the negotiation of a free trade area agreement (FTA) between both parties. This would be the only means of reducing economic disruption following Brexit from the EU customs union. It should be limited to trade in goods and avoid the "Christmas tree" approach of recent EU free trade agreements, which have run to more than a thousand pages. Services and other issues should be addressed separately.

Will such an agreement suffice? Not in and of itself. With a fully comprehensive FTA, it should, however, be possible to minimise any disruption for some or several years beyond 2020, provided that additional "flanking" measures are adopted.

The current trade in goods will be able to continue unhindered, also avoiding the re-introduction of customs controls, if such measures are agreed upon. This would also by definition avoid the re-introduction of a "hard border" between Northern Ireland and the Republic of Ireland.

### CUSTOMS UNION

A customs union means that members apply the same tariffs to goods imported into their territory from the rest of the world, and apply no tariffs internally among members. The EU customs union applies common rules to imports and exports, and the EU has adopted a vast body of law governing most aspects of economic life; this has allowed it to completely remove all controls between its members. By contrast, a free trade area agreement (FTA) only removes tariffs on goods traded between the two parties and does not establish a common trade Policy and tariffs against imports from non-members. Customs controls remain necessary.

For this goal to be achieved, **an agreement must be met on six issues which are so interlinked as to be inseparable**:

1. A truly comprehensive FTA: agree on one with no product exclusions. The exclusion of one single sector would make it necessary to introduce border controls;

2. Customs controls: agree on the objective of and conditions for "no border controls";

3. Existing EU28 FTAs: negotiate with third countries in order to continue to apply existing EU28 FTAs to the UK, with the addition of a so-called "diagonal cumulation of origin";

4. Rules of origin: agree on rules of origin between the UK and EU27;

5. No additional, new UK/third country FTAs, other than those covered by current EU28 FTAs *until further notice*;

6. Regulatory convergence: all relevant EU product specific regulation would continue to be replicated in UK law, *until further notice*.

This makes for at least two "*until further notice*" conditions, but such is life - and time often solves problems that are seen as unsolvable today.

The challenge for the negotiators, *on both sides*, will be to agree on all these topics. The following section explains each of these issues in substance, including the relationship between them. Since they are closely inter-related, they should be resolved in parallel: they hang together or fall together. Both parties have a strong interest in a successful outcome.

## THE SIX PRECONDITIONS FOR OPEN BORDERS

*There is no logical sequence, no "hierarchy" between these preconditions, since they are so closely connected that one is virtually in a "chicken and egg" situation. These six questions constitute an indivisible whole. If an agreement cannot be reached on all six, the "no border control" objective cannot be achieved.*

### 1) COMPREHENSIVE FTA

Agree on a truly comprehensive FTA that covers all products, including industrial, agricultural and fisheries - all of which should be subject to zero customs tariffs. There is no reason, with one exception, why this should create any significant political problems since this is what we have had for the past 45 years. The maintenance of "zero tariffs" is necessary to preserve the current high level of economic integration, including complex supply chains, and the first and indispensable precondition to avoid the need for physical border controls.

The only significant potential disagreement will be on fisheries where the implementation of the common fisheries policy has been strongly criticised on both sides of the Channel. From a UK perspective, continental fishermen have been given excessive access to British waters and there is strong pressure on the British government to change this. Mutual trade is significant and would be severely affected if tariffs were to be reintroduced, but as mutual trade is also virtually balanced, the reintroduction of tariffs would affect both. A solution will require much give-and-take on the question of fishing waters and future cooperation on the management of fish stocks.

It is taken for granted that a compromise will be found in order to conclude an FTA that covers 100% of trade in all three sectors. One single product category being excluded would necessitate the introduction of border controls. This should put enough pressure on negotiations to avoid a new "cod war" that wreaks havoc with the rest.

To truly represent an optimal approach for both parties, and in order to avoid border controls, the FTA would also need to be combined with agreement on the five following issues.

## 2) CUSTOMS CONTROLS

Customs controls have, belatedly, been identified as a potential major obstacle to trade and thus to reaping the full benefits from a comprehensive FTA. This forgetfulness is hardly surprising: the EU is probably the only customs union in the world without border controls for goods (with the possible exception of the union between Russia and neighbouring states). We have all become accustomed to this happy state of affairs. Leaving the EU should normally lead to the re-introduction of such controls.

This problem, which is normal in terms of international trade, will be exacerbated by the very success of the EU in terms of doing away with border controls and thus significantly reducing the number of customs officials. It will be compounded by the expected continued insufficiency in the number of such officials. Subjecting trade to even the most cursory of controls will lead to costly delays. **A simple, radical solution would be to forego such controls, even after 2020, provided that full agreement is reached on each of the preconditions listed in this part of the paper.**

## 3) THE EXTENSION TO THE UK OF THE RIGHTS AND OBLIGATIONS OF CURRENT AND FUTURE EU28 AND EU27 FTAS

Once the UK has left the EU, agreements between the EU28 and third countries will cease to apply to UK trade with said such countries. It will therefore be necessary to reach a formal agreement between the UK and each of these countries that essentially applies the same conditions to their mutual trade relations that are contained in the corresponding EU28 agreement.

If this does not come to pass, problems would arise: not only for the UK but also to a lesser extent for EU27 as the bloc is a major investor in UK-based industry as well as for the third country concerned, losing free access to the UK market.

All parties should therefore have a strong interest in finding a solution, which would come in two parts:

Firstly, the EU28/third country FTA should be modified so as to exclude the UK from its coverage in the first place, to be simultaneously followed by the creation of a new, virtually identical, third country-UK FTA.

Secondly, this new FTA should replicate the relevant rules of origin, including, as appropriate, the principle of "(cross) cumulation of origin" (see below).

This is technically and politically feasible. Politically and formally, it will require a joint EU27/UK approach to current EU28 FTA countries, including those that are in the pipeline. This would also allow the UK to benefit from the EU's negotiating weight. These third countries would not be asked to make any new concessions, but simply to accept the formal and practical

consequences of the UK leaving the EU and to agree that the benefits and obligations of the FTA in question continue to accrue and apply to the UK as an entity independent of the EU. Because of these shared interests between the three parties, it should be possible to reach early agreement, since there would be no reason for the time-consuming haggling that is common to trade negotiations. The only inevitable exception will be some haggling over the distribution, between the UK and EU27, of quotas on agricultural and fishery products.

Lastly, the same approach should be followed with respect to those EU28 FTAs currently in the pipeline, i.e. Canada and Japan, which are being ratified, and those being negotiated with, in particular, Australia, New Zealand and Mercosur.

To conclude, this updating, extension, and modification of all existing EU28 FTAs will be indispensable to allowing the absence of physical border controls between the UK and EU27. In the absence of any one of these, goods imported into EU27 could be re-exported to the UK without the UK having concluded an FTA with the third country concerned.

## 4) RULES OF ORIGIN

In simple terms (this is an expert's paradise) it is necessary to identify the national origin of a good to determine what tariff to apply to its importation. This also applies to all trade agreements which require a definition of where a good "originates". There is no reason why the UK and EU27 should not reach agreement on one of the classical definitions of rules of origin with respect to their mutual trade.

The problem arises with respect to trade with third countries with which EU28, but not (yet) the UK, have agreed on specific rules of origin in the context of a bilateral FTA. For example, in the EU28 FTA with South Korea, this is expressed in the "sensitive" automobile sector as an automobile of which 55% is made in the other party.

The purpose of such rules of origin is to ensure that the advantages are limited to the other party, not extended "for free" to any third country. For the present purposes, it is of little if any importance to know whether such rules are expressed in quantitative terms (as in the example above) or in qualitative terms (for example through what the experts call "substantial transformation").

In the Korean example above, UK exports would not qualify for FTA treatment because less than 50% of UK auto production is actually of UK origin (i.e. below the 55% threshold agreed in the EU28-South Korea FTA), with much of the remainder coming from the EU. This would therefore also become a problem for those EU, Japanese and South Korean manufacturers that have made major investments in the UK automobile industry.

This problem can be resolved, in this and other cases, by introducing a clause on "cross cumulation of origin". In the concrete example given above, this would mean that Korea would accept that an automobile assembled in the UK was of UK origin if it contained at least 55% of combined UK and EU origin.

Since all parties stand to lose much if these problems are not solved, all three should have a strong interest in finding a solution, also essential for avoiding a "hard border"[3]. The UK in particular, needs agreement on this because of its smaller industrial base: it is much easier to arrive at, say, the 55% in automobile content in EU27 than in the UK alone.

3. The EU currently has FTAs or a customs union including cross cumulation with its European neighbours, Turkey and countries in the Middle East and North Africa and FTAs with "normal" (but sometimes complex) rules of origin with countries like Japan, Canada, Mexico, South Africa, etc. .

## 5) NEW UK FTAS

The conclusion of new FTAs between the UK and countries with which EU28 has not yet concluded any such agreements has been an oft-stated objective of the British government. If this were to happen, it would make it necessary to re-introduce a "hard" border. Otherwise, goods could be imported duty free into the UK from its new FTA partner, only to be re-exported to EU27 without the latter having concluded an FTA with the third country concerned.

The question is, of course, how urgently the UK will wish to move on this. It may decide to proceed slowly with the implementation of new FTAs on its own, with the hope that another way of dealing with the border issue could be found. Will this *festina lente* recommendation have an effect on UK ambitions for further international market opening? It should, also because the perceived economic advantages would be limited, especially if the EU succeeds in concluding FTAs with other countries on its current list, notably Australia, New Zealand and Mercosur. Once concluded, these agreements should be extended to the UK along the lines described above. What more could the UK want? A hypothetical FTA with the US and with its current government? A friendly recommendation to the UK could be to use another English version of *festina lente*, often translated as "more haste, less speed".

In simple terms, if the UK wanted to avoid a hard border with the EU - and therefore also with the Republic of Ireland - it would need to forego, for the time being, the conclusion of FTAs with countries other than those already covered by the network of EU FTAs. It would be up to the UK to decide, knowing the negative consequences, but this question need not be part of the *commitment* to the EU. The reason is that a formal commitment would be in contradiction with future UK "independence".

It will be a sovereign, difficult choice for the UK, but one that it need not make for some time. All that would have to be agreed with the EU would be a commitment by the UK to give ample notice of a future decision to implement a new FTA with a third country sufficiently in advance, so as to allow the EU to prepare for customs controls.

## 6) REGULATORY CONVERGENCE, I.E. CONTINUED UK ALIGNMENT WITH RELEVANT EU LAW.

A last and major condition to avoid a "hard" border is to ensure that products crossing the border are produced according to relevant legal (EU) standards. This therefore raises the issue of continued UK compliance with EU law. Such "convergence" is not part of other EU FTAs or of the customs union with Turkey, which is why physical border controls are necessary between the EU and these countries.

The next steps are therefore, firstly, to define what EU legislation is "product specific", and, secondly, whether the UK is prepared to maintain equivalent UK legislation and to modify it according to subsequent changes determined by EU27.

The answer to the question of what is "product specific" is, in substance, the same as the answer to the question "how to define an elephant": you recognise it when you see it. Still, a few examples should suffice to explain this (see below).

The response to the second question depends on the future political balance in the UK between those who want to modify the heritage of EU law for reasons of substance or principle, and those who see an advantage in keeping close to the "Continent". Such uncertainty may, however, be unacceptable to the EU because EU27 exporters would have no certainty with respect to future trading conditions. UK exporters would, of course, face the same uncertainty regarding the EU market.

All future British exports to the EU will be subject (as they are today) to compliance with EU legislation. The same will be true in reverse: EU exports to the UK will become subject to UK laws and regulations that may, over time, diverge from those of the EU. The UK government has announced its intention to carry over into UK law most current EU laws and regulations, *until further notice*.

British manufacturers and farmers that export will naturally prefer their products to be subject to identical requirements in the EU and the UK *as they are today*, and they will try to persuade the British government to continue to apply current and future EU standards on an 'autonomous' basis. The UK may decide to do so, but it may also choose to adopt different legislation, tightening or relaxing EU product standards for its own market. In the former, EU exports would be exposed to a barrier. This is a classic problem in international trade, giving rise to the creation of a 'non-tariff barrier'. In the case of a lowering of UK standards, EU exports may also be at a disadvantage compared to those from other third-country exporters or British competitors. The same applies in reverse to UK exports to the EU in the case of (inevitable) future modifications or additions to EU standards,

There is no obvious long-term solution to these future, potential problems. However, the problem may, at least for a time, be more theoretical than real, and the accent is on the words 'future' and 'potential'. As suggested above, it seems that (most) current EU legislation will be carried over into UK law for the foreseeable future, if for no other reason than the time it would take to modify thousands of regulations, and presumably, that changes would only be made for a real purpose, not simply in order for it to be "anglicised". The question would therefore not need to be resolved immediately.

However, a problem would arise if one or the other party were to wish to modify its legislation. This could, in theory, be addressed and perhaps resolved through a classical consultation clause, but this is unlikely to be acceptable for political reasons, at least to the EU. It is only included here for reasons of completeness (and because it is a classic approach between "real third countries"):

For example, one could in theory agree on an obligation, binding to both parties, to accept the principle of subjecting future regulatory changes to notification and 'consultation'. This could include commitment by both parties to notify each other of their intention to modify relevant legislation before its adoption and to accept that such modifications become the subject of 'consultations', i.e. negotiations.

This may sound attractive in theory but it would hardly be acceptable to the EU because it would provide a back-door entrance for the UK to EU decision-making, nor is it likely that a unilateral clause applicable only to British legislation would be acceptable to the UK. This issue is therefore not only technical, but also deeply political, and with significant practical, economic implications.

## HAZARDOUS SUBSTANCES (ROHS)

An example: the EU Directive on restrictions of hazardous substances (RoHS) lays down rules on the presence of dangerous substances in various types of equipment, such as a limit of 0.1% on lead. If the UK were, in the future, to decide to tighten this limit to, say, 0.01%, the consequence would be the creation of a barrier to exports to the UK from the EU at a level that had not been negotiated between the two parties.

Another approach must be invented. The two parties could, for example, envisage a provision that would allow them to make a unilateral decision to exclude a whole sector or sub-sector from the FTA if the other party were to adopt legislation that would render access to its market significantly more difficult in that sector or sub-sector. If limited to a sector, or even better a sub-sector, such a threat would be politically and economically credible and very dissuasive, at least for the weaker party.

But the risk will most often be theoretical rather than real: in view of the overwhelming interest of British manufacturers, farmers and fishermen in selling their products in the EU according to the same standards as those applicable to EU27 exports to the UK, the problem is likely to arise only in very limited, specific circumstances. This is clearly the case in the industrial sector, but a greater risk of future conflict may arise in agriculture on issues such as genetically-modified organisms, animal welfare or pesticides.

Negotiations may become bogged down on this kind of question, where issues of sovereignty come into conflict with commercial interests. However, as suggested above, problems caused by divergent product legislation are not for the immediate future, and this potential problem arises between all trading nations. Another option would be – quite simply – to ignore it and to count on domestic pressure in the UK to remain "aligned" with the EU without a formal, politically difficult commitment for the UK to do so.

Just as importantly, if not more, both parties would be faced with the risk and repercussions of having to re-introduce hard border controls: once a sector or sub-sector had been excluded from the FTA, border controls would become necessary. To drive the point home, this would, in terms of "game theory", at least for the next few years, be the economic equivalent of the "MAD" (Mutually Assured Destruction) strategies which have avoided nuclear war for the past 72 years.

The livelihood of hundreds of thousands of workers and consumers would be at stake if trade relations were not to continue as largely as before. A new, economic version of "MAD" indeed. "Pressing the button" would consist of one of the two parties, be it the UK or the EU, taking action to break any of the six conditions for free and border less trade outlined above, because this would lead to the re-introduction of border controls. This includes, for the UK, the introduction of significant changes to its legislation. However, to repeat and insist: we are likely to move well into the 2020s before significant problems are likely to arise.

## A TENTATIVE CONCLUSION ON AVOIDING A HARD BORDER

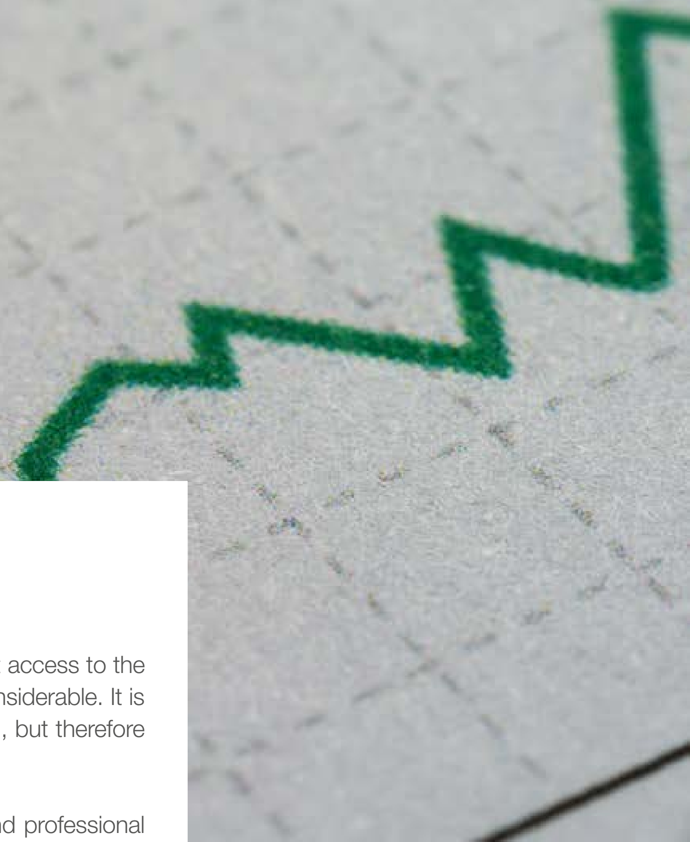
If these conditions are met, it should be possible to avoid a “hard border” for some time beyond 2020. Will it be possible to negotiate what is required between now and the end of 2020? The answer is yes, including time-consuming questions like fisheries and the transformation of existing EU28 FTAs into UK/third country FTAs.

Most of the other conditions are relatively straightforward. The UK may thus wish, for reasons of domestic politics, to use its new-found “independence” to negotiate and put into effect new FTAs, but it would know that this would mean the end to the absence of border controls. Also, at some moment in the future, the UK may decide to no longer align itself with certain product-specific EU regulations, but it would know that this would have the same effect, i.e. the introduction of a “hard” border.

Nevertheless, such decisions would be for the (distant?) future, and one would still buy more time for the training of customs officials and the invention of new methods of control that would reduce the time lost in customs   or, as some would have it, until the UK had applied to and succeeded in re-joining the EU.

Once these conditions are no longer met, there would be a cost to be borne, but no higher than what is born in trade between the EU and Turkey or Switzerland. The only difference is that in the case of these other countries, border controls have always existed, and traders have adjusted themselves, and their supply chains, accordingly. In the present case, Brexit means going back on 45 years of ever closer economic integration and erecting new barriers. This paper tries to show have to minimise the cost of the divorce.

In any event, independence comes at a price. It will be for the UK government to choose at some future stage how high a price it is willing to pay, and when to press the button that sets off the “MAD”.



# B. TRADE IN SERVICES

This is an area in which the UK has a significant interest in maintaining current access to the EU to the greatest extent possible . The importance of financial services is considerable. It is an important part - around one quarter - of British services exports to the EU, but therefore still only part of the services story.

The remainder consists of business services, including accountancy, legal and professional services, architects and a host of other professions – that have been successful on the EU market, sometimes because of their link to the provision of financial services (implying that if financial services are made subject to restrictions in the EU, this will drag with it a reduction in exports of related services), and often because of their link to trade in goods.

From a regulatory perspective financial services are subject to approaches and rules different from those applicable to non-financial services because they are very different and, above all, because of the importance of applying appropriate rules to ensure financial stability in the EU, which will be a must for any future agreement between the EU and the UK. Financial services are therefore addressed separately below.

## 1) NON-FINANCIAL SERVICES

From a British perspective, it will be important to preserve trade in services to the greatest possible extent. The income generated by trade in services provides the livelihood of hundreds of thousands of people in the City of London and beyond. From an EU perspective there is also significant economic interest in maintaining access to the UK and there is unlikely to be much opposition in principle to continued 'free trade' in non-financial services, provided that the UK continues to abide by the rules – the EU rules. This is, of course, where problems may arise.

The present degree of intra-EU service sector liberalisation has been hard-won, and relies on a high degree of convergence and harmonisation of EU and national legislation, through the Services Directive and associated pieces of legislation, regulations and agreements, such as rules on recognition of professional qualifications. This is, incidentally, an extraordinary achievement when you consider the starting point: more than 20 different national approaches and traditions, each considering itself to be better than the neighbours'.

Two approaches are possible: either the UK accepts *de facto* the continued implementation in and by UK law of all relevant EU services legislation, by maintaining and/or transposing it within its national legal system, or it tries to pick and choose. The latter choice would lead to extremely difficult and protracted negotiations that are likely to fail, and certainly would take

several years beyond 2021. The EU could afford this uncertainty and waste of time: there are enough lawyers, accountants and architects in Europe to fill the gaps left by the UK. The relative cost to the UK on the other hand, would be much higher.

However, as in the case of trade in goods, an optimum outcome is perfectly possible on one condition: the continued application to and by the UK of current and future EU regulation of trade in non-financial services. The problem here is not one of substance: this body of law has been common to both parties for years and has been adopted by common consent in the European Council and European Parliament. The problem is rather political, legal and practical, and even more so with respect to the application to and by the UK of future changes to EU regulation. **But this is the pill that the UK must swallow if it wants continued free trade in non-financial services – more poetically, it is 'the cost of independence'.**

How can this be done in practice, without appearing to put the UK in a Norway/EEA-type situation and without it appearing as a humiliating defeat for the British government? One approach could be to include in a future EU-UK treaty the principle of continued 'free trade' in non-financial services, subject to an obligation for both parties to abide by rules identical in substance to those of the *acquis communautaire* (e.g. the Services Directive). This would be presented as a sovereign decision by the UK, which would undertake the application of such rules through its domestic legislation.

It would be more difficult to openly present an obligation for the UK to apply future changes to EU legislation since it would have no say in their elaboration and because the continued application of the principle of free provision of services would apply to the whole *acquis* – present *and future*, therefore also as modified by the European Court of Justice. One, somewhat radical approach, could be the following: if either party were to change its rules in such a way as to modify the right to provide the relevant services in a significant manner, the other party should first consider aligning its own rules to those of its partner. If it did not, either party would be free to put an end to 'free trade' in services of (sub-)sectors concerned.

In practical terms, if the EU were to change important conditions regarding the profession of architects, and the UK did not do the same, either or both could stop applying the various 'services freedoms' to architects from the other party. Such a deterrent may be enough to ensure continued "voluntary" UK alignment with EU law. Such a requirement would also include the application of future decisions by the European Court of Justice.

A bitter pill to swallow? For the UK, it would be the choice between an abstract but respectable principle of sovereignty, that is, the choice between autonomous decision making, on the one hand, and continued access to a services market of 450 million people on the other.

## 2) FINANCIAL SERVICES

UK considers its exports of financial services to the EU to be a major objective. From a purely economic perspective, this exaggerates the importance of financial services exports as compared to other UK exports to the EU. It also exaggerates, in sometimes apocalyptic tones, the impact of Brexit – as if the UK's departure would bring all exports of financial services to a halt. This would, of course, not be the case.

There is no denying the positive impact of Britain's EU membership on financial institutions in London (with the notable exception of Lloyd's, most large London 'exporters' are, incidentally and paradoxically, European, Asian or American, relying to a large degree on the *savoir-faire* of EU27 nationals). One should not underestimate their influence on the UK government either. The prospects of losing this part of the benefits of membership have been presented in terms of a looming disaster by some and played down by other 'experts', perhaps for political reasons linked to their respective positions on Brexit.

Admittedly, the issue is complex and the consequences of losing the famous 'passport' to provide financial services across EU borders are not clear and may vary significantly from one sub-sector to another. However, from a UK perspective, there clearly is a risk of losing large amounts of financial services exports. From an EU perspective, the services have been useful for those who have reason to ask for them and there is a high degree of interconnection between London and financial institutions in the EU. Nevertheless, the EU has ample competent financial institutions and could do without London over time, certainly by the end of 2020. Indeed, some would like to see financial services providers leave London to establish themselves in the EU, and there is strong competition between a number of Continental cities to attract potential "emigrants". The consequence of a sort of "*Révocation de l'Edit de Nantes*" in reverse.

If the British government decides that it must obtain an ambitious agreement on financial services with the EU, this would provide the EU with a significant negotiating edge. The EU would only limited by the fact that it will, presumably, not be willing to make significant concessions, also because of the overriding concern with maintaining and developing rules that will ensure financial stability in Europe.

Tactics and substance will clash, because this is the most important area where interests are not more or less equally shared. Over time, the EU can do without London and develop deep, liquid and resilient capital markets, if need be, without its own exports of banking services to the UK. The reverse is not the case to the same extent, although the importance of this is often exaggerated. One may expect that no agreement will be reached on these issues, even to disagree, until the very last stage of the negotiations.

## ON "REGULATORY CONVERGENCE"

This section only concerns the question of which regulations are sufficiently "product specific" to make "convergence" or "alignment" necessary. It does not address any wider issue such as the need for convergence in other areas of (economic) activity. The question is therefore where to draw the line. Here is a suggested "three traffic light" approach, moving from "red" (highly relevant) to "green" (irrelevant), for the purpose of trade in goods.

## “RED” LIGHT/DIRECTLY PRODUCT SPECIFIC

Let us start with the most obvious, of which one, RoHS (see box on page 11), has already been quoted. There are, of course, many others. A few examples are included here for illustrative purposes: product safety standards, human, animal and plant health legislation, such as the prohibition of using growth promoting hormones in raising cattle, animal welfare, the REACH regulation, automobile safety and emissions, energy efficiency, and so on. Each of these has a direct impact on the cost of production and the right to market the product in question.

A different type of example concerns the preservation of free access to public procurement procedures and contracts, without discrimination. This is one of several examples where the UK would have to maintain national legislation identical to that of the EU, in exchange for which the EU would, presumably, make reciprocal market access available for UK participants in such procedures. As in the case of services (see below), either party would be free to withdraw from the agreement if the other party did not live up to its obligations in terms of implementation, or modified its legislation in a manner judged to be restrictive. This is, however, one of the few examples of product specific legislation which has no bearing on border controls.

The EU Emission Trading System (ETS) is a form of sector specific levy directly relevant to the question of competitiveness. The UK will remain bound by the current ETS up to the point of exit. It also has a national commitment to the fight against climate change. A strong case could be made for this system to continue to apply to EU27 and the UK, but this would imply UK participation in EU decision-making. A viable alternative could be to set up a parallel UK-based ETS with a link to the EU ETS.

**Intellectual property** includes a multitude of very different intellectual property rights, which in turn are protected by a variety of EU and member state laws. These are highly relevant in terms of their impact on trade in goods. Agreements will therefore be necessary with respect to each type of intellectual property right. A good start has been made on trademarks in the recent draft agreement covering the period to 2021 and, in some respects, beyond.

A few other (non-exclusive) examples that are worth noting:

Under the Unified Patent Convention (UPC), patent conflicts will be judged by specialised judicial bodies established in three member states. The UK was meant to receive one of these bodies to adjudicate on pharmaceutical patent conflicts. It could, pragmatically, decide to continue to be a member of the UPC and abide by decisions made in Paris and other parts of the EU.

The EU Directive on the enforcement of intellectual property rights, and its future revision, is of major importance to the unified implementation of intellectual property rights across the EU. Will or should the UK continue to apply the provisions of this Directive, including its future revision, which will presumably be concluded after its departure?

Will both parties continue to protect geographical indications of the other party as they stand today? If not, this would be a step back from the current situation and impose an unacceptable barrier to trade.

This is an experts’ paradise. Even worse, each intellectual property right has its own experts, so negotiators need to agree on general principles and objectives. For example, would it not make sense to aim for the continued highest level of convergence between our respective intellectual property regimes, across the board?

## “YELLOW” LIGHT/DEBATABLE DEGREE OF RELEVANCE AND NEED FOR “ALIGNMENT”

There are many other issues that are of great political sensitivity and economic importance to both parties. To what extent are they of sufficiently direct relevance to the operation of an FTA, with or without border controls, to require agreement between the two parties?

For example, should or would the EU accept a high level of (continued) economic integration with the UK without the latter agreeing to adopt EU legislation in certain areas that are considered to be vital to economic competitiveness in general but not as directly “product specific” as under the “red” category above?

Some obvious cases in point are trade defence (anti-dumping, anti-subsidy) legislation applicable to imports from third countries; corporate taxation; working conditions and environment. However, many parts of environmental legislation and rules on competition could even be considered as falling into the “green light” category (see below).

**Social legislation:** largely because of British resistance, the acquis communautaire on tax and social policy is relatively limited. The reluctance of the UK, for example, to accept obligations on working conditions is well known.

With the notable exception of the recent introduction of a minimum wage in the UK, the UK and EU27 have been drifting further apart on social issues. The Working Time Directive, limiting the working week to 48 hours, was on former British prime minister David Cameron’s initial list of EU legislation that was unacceptable to the UK.

The distortion of competition arising out of a relaxation of UK social legislation after Brexit would be irrelevant in the case of hospitals (to use Cameron’s example), but could be significant in industry.

**Taxation:** Will it be acceptable to the EU that the UK use its future level of corporate taxation to attract investment and therefore production to the UK? Even more acutely, if there were to be an agreement on financial services, would the EU accept British levels of corporate taxation of 15%, which would inevitably attract much banking activity to London, or keep it there?

**Dumping and subsidies:** Should the EU insist on the application of its anti-dumping and anti- subsidy measures in the UK market? It has not done so in the context of its customs union agreement with Turkey, but Turkey is not the UK that has much greater economic weight and a larger market. For example, if Chinese-dumped steel exports were to eliminate British and EU producers from the UK market, this would have a clear negative impact on significant EU export interests. The UK would, however, hardly agree to the application of EU anti-dumping or subsidy measures unless it could participate in EU decision-making and legislation – and this should be unacceptable to the EU, if for no other reason than because of the well-known UK opposition to using anti-dumping measures, even to protect its own industry

A consensual solution is far from obvious. The EU would presumably, after 2021, include imports from the UK in future anti-dumping or anti subsidy procedures, if this was warranted by the facts. This could then lead to the imposition of border controls which would also become necessary, in any event, to protect the EU from circumvention of its trade defence measures through transhipment through the UK. This would therefore militate in favour of a comprehensive agreement on the application and administration of trade defence measures.

These are non-exhaustive examples of issues of considerable importance on which the EU and the UK have often failed to agree over the past four decades. One may ask why they should be able or willing to agree now, in the context of a free trade area and with the UK being excluded from participation in internal EU decision-making. But these issues are of considerable importance and, from a negotiating perspective, the situation is radically different: in the current institutional set-up, the UK has the right to veto new legislation on taxation and social policy, areas that are largely subject to unanimity; on trade defence measures, it sometimes succeeds in mobilising a sufficient number of other member states to block the European Commission's proposals.

Now, in the context of the divorce proceedings, the UK will be a *demandeur on services*, among other issues. This would allow the EU to insist on quid pro quos. Only its own dissensions, with some member states playing the same game of fiscal dumping and others fearing for their own fiscal sovereignty, would prevent it from doing so.

There is no obvious solution to these problems other than, perhaps, a process of give-and-take. Does this mean that overall agreement should or would be made hostage to the resolution of these thorny questions? The answer will depend on the strength of the overall EU-27 negotiating position and on each side's tactics.

## "GREEN LIGHT": LITTLE OR NO NEED FOR CONVERGENCE

**Competition policy:** The UK would be less directly subject to the common competition policy, but it should be noted that EU competition policy is applied with extraterritorial effect whenever a restraint on or distortion of competition occurs with a significant effect on the EU market. It is therefore difficult to see why it would be necessary to insist on an obligation to align UK law with that of the EU.

There are two categories of EU legislation on the **environment**: EU legislation on the protection of the environment as such; and product-specific legislation (referred to above). On the former, a substantial body of law has been adopted over the years, often with the purpose of circumventing national opposition by adopting difficult decisions at European level. Examples include the quality of air, water and soil as well as marine pollution. Maintaining some of this would be of future mutual interest, at least to the EU as prevailing winds come from the West, including the question of trans-border air and maritime pollution, where the UK has had to reduce the levels of emissions of pollutants from coal-fired power stations. Such issues, of a trans-border character, would presumably be part of the EU27's demands but would be largely irrelevant to the question of trade in goods. This would leave the UK free to decide on the remainder.

# THE FUTURE ROLE OF THE EUROPEAN COURT OF JUSTICE

Finally, in a category of its own is the question of the future role of the **European Court of Justice**, with respect to many of the issues covered in this section. EU law is not static and it evolves due to the frequent recourse to the European Court of Justice, which interprets EU law as the highest judicial body in Europe. This role constitutes one of the red rags for UK Brexiteers and will in principle be expressly revoked by the UK from 2021 onwards. This may create a major problem, as it would lead to de facto diverging rules in a growing number of areas over time. It is worth noting that a similar problem has arisen in relations between the EU and Switzerland and that a solution has been found with the EEA/Norway.

For the questions covered by the (draft) transition period agreement of 19 March focusing mainly on "people" and "budget", the text - not yet formally approved - states, "*The provisions of this Agreement referring to Union law or concepts or provisions thereof shall in their implementation and application be interpreted in conformity with the relevant case law of the Court of Justice of the European Union handed down before the end of the transition period. In the interpretation and application of this Agreement, the United Kingdom's judicial and administrative authorities shall have due regard to relevant case law of the Court of Justice of the European Union handed down after the end of the transition period*."

Any negotiator knows the meaning of an obligation to "have due regard to". It means a situation where the other party, often for domestic political reasons, cannot expressly accept an obligation to do something. This text may, however, provide the basis for an agreement on this thorny issue, if combined with the "MAD" analogy described in earlier parts of this paper.

For example, one could aim at an agreement that would commit the UK authorities to have "due regard" to relevant case law of the European Court in all relevant areas of the future comprehensive Brexit agreement. If, in the eyes of the EU, the UK authorities did not abide by such a commitment, the EU would be at liberty to suspend the application of the corresponding part of the agreement, FTA or other parts, presumably at a more or less considerable cost, to either or both. Hence the "MAD" analogy: the UK would be well advised to act with "due regard" and would presumably only act otherwise for really important reasons. Similarly, the EU would also be under pressure to suspend parts of the future agreement only for important reasons. This would replace the balance of "MAD" with a balance of common sense.

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