

Brexit: trade implications of the draft withdrawal agreement and the draft declaration on the future relationship between the European Union and the United Kingdom

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INTRODUCTION

On 14 November 2018, after almost twenty months of intensive negotiations, a [draft agreement on the arrangements for the United Kingdom's withdrawal from the European Union](#) ("the draft withdrawal agreement"), including a Protocol on Ireland/Northern Ireland was made public. Whilst on that same day, the parties also published [an outline for a draft declaration on the future relationship between the United Kingdom and the European Union](#), on 22 November 2019, the [full text of that draft declaration](#), containing further details on the economic partnership that both parties will seek to negotiate, was published ("the draft declaration").

As of 30 March 2019, the United Kingdom will no longer be a Member State of the European Union. From that date, according to the draft withdrawal agreement, a transition period will start. During that transition period, all of EU law, including international (trade) agreements to which the European Union is a party, would continue to apply to and in the United Kingdom as if, in essence, the United Kingdom were still a Member State.

The transition period would end on 31 December 2020 unless the parties agree on an extension. After the end of the transition period, the draft withdrawal agreement envisages two options. Either the parties will have finalised their future relationship, and, in particular, the economic partnership envisaged in the draft declaration, in a new agreement that would enter into force at the end of the transition period. Or, in the absence of such an agreement, a fall-back mechanism creating a temporary customs union between the United Kingdom and the European Union, with a special status for Northern Ireland, would become effective. The latter is the so-called "backstop" solution.

Following the publication of both draft texts, the United Kingdom, on the one hand, and the European Union and the 27 Member States, on the other hand, now need to consider, according to their respective political processes, whether they will consent to the draft withdrawal agreement and agree with the details of the draft declaration on the future relationship. On 19 November 2018, the 27 Member States signalled their support for the draft agreement and for the European Union's position that the negotiations will not be reopened.

This client alert discusses the implications of both draft texts on trade.

THE IMPACT OF BREXIT ON TRADE DURING THE TRANSITION PERIOD

As things stand, as of 30 March 2019, the United Kingdom will no longer be a Member State of the European Union. However, as a result of the terms of Part Four of the draft withdrawal agreement (Articles 126 to 132), a transition period would start on the day of the entry into force of the agreement, which is likely to be 30 March 2019. In accordance with Article 126, that period would end on 31 December 2020. However, the transition period could be extended by a joint decision taken prior to 1 July 2020 (Article 132(1)). The text of the draft withdrawal agreement signals that the transition period could be extended once, for up to one or two years. A decision to extend should be made by 1 July 2020.

During the transition period, EU law will, subject to a number of limited exceptions in the draft withdrawal agreement, continue to apply to and in the United Kingdom (Article 127(1)). That means that the United Kingdom would remain in the single market and in a customs territory with the European Union. Furthermore, the United Kingdom would remain bound by the international agreements that the European Union has concluded, including the WTO agreements and bilateral trade agreements (Article 129(1)). Although the United Kingdom would remain bound, as a matter of EU law, by the international agreements, including bilateral trade agreements, which the European Union has concluded with third countries, those agreements would not necessarily bind third countries in relation to the United Kingdom, which loses its status of an EU Member State on 30 March 2019. In general, as a matter of international law, a third country would need to give consent for the continued application of that treaty with respect to the United Kingdom during the transition period. Such consent could take the form of a protocol to, or an amendment of, the existing international agreement.

As a result, during the transition period, goods would continue to enter the market, comprising, after Brexit, the territories of the United Kingdom and the 27 EU Member States, under the terms set or agreed by the European Union (such as import duties, import licence regimes, tariff-rate quotas and veterinary standards). Once they have entered the market, those goods would be able to circulate freely within that market. Likewise, EU law on free movement of services and the right of establishment would

continue to apply in the bilateral relations between the United Kingdom and the European Union.

The draft withdrawal agreement addresses certain implications of the end of the transition period. For example, EU law on public procurement would continue to govern public tender procedures that were launched but not finalised before the end of the transition period (Article 76). Furthermore, the European Commission would retain its competence, for a limited period of four years after the end of the transition period, to initiate state aid inquiries with respect to any state aid granted before the end of the transition period (Article 93). In addition, for all types of administrative procedures either concerning compliance by the United Kingdom or by a UK-based natural or legal person (for example, state aid granted to UK-based enterprises) with EU law or relating to competition in the United Kingdom, the European Union would continue to be competent where procedures are initiated before the end of the transition period (Article 92). In addition, trade marks, designs, databases, plant variety rights and geographical indications, including geographical indications for wine, that were registered or granted prior to the end of the transition period, would continue to enjoy protection under EU law, without any requirement of re-examination. UK authorities would be required to re-register those rights free of charge and their protection in the United Kingdom would be equivalent to that under EU law (Articles 54-61).

Despite the fact that the transition period is primarily aimed at preserving the *status quo* as if the United Kingdom were still an EU Member State, an extension of the transition period would nonetheless alter some of the arrangements. In particular, if the transition period were extended, EU law would no longer apply to agricultural state aid. Instead, the maximum annual level of exempted support would be decided jointly by the United Kingdom and the European Union, in line with the requirements of Annex 2 to the WTO Agreement on Agriculture (Article 132). Furthermore, the United Kingdom would become obliged to make contributions to the EU budget of an amount to be determined jointly by the parties.

Finally, although the United Kingdom may already start to negotiate international agreements, including trade agreements, with third countries during the transition period, those agreements could not – unless the European Union were to authorise otherwise – enter into force before the end of that period (Article 129). In its relations vis-à-vis third countries and international organisations during the transition period, the United Kingdom could not represent the European Union or its Member States, unless agreed otherwise by the European Union. The United Kingdom would be allowed to participate in the work of international bodies (such as the WTO) but only in its own right (Article 129).

TRADE AFTER THE END OF THE TRANSITION PERIOD: A CUSTOMS UNION (THE “BACKSTOP” SOLUTION)

Should no agreement on a future relationship be in place at the end of the transition period, the so-called “backstop” solution is included in a Protocol on Ireland/Northern Ireland (“the Protocol”) to the draft withdrawal agreement for the purpose of offering a certain degree of legal certainty in terms of the customs treatment of trade in goods between the United Kingdom, including Northern Ireland, and the European Union. Any change to the backstop solution would require an agreement between both parties.

The essence of the backstop solution is that, in those circumstances, the United Kingdom and the European Union, as independent customs territories, would form a customs union (“the UK-EU customs territory”) and share a common commercial policy for trade in all goods, other than fisheries and aquatic products (Article 6 of the Protocol). That would mean that they apply a harmonized external customs tariff and that, after entering the customs union, goods could freely circulate without being subject again to customs treatment.

However, the backstop solution does not envisage the establishment of a single market for trade in goods or services between the United Kingdom and the European Union. As a result, the free movement of services and goods within the European Union would no longer apply. Although the backstop solution provides for some degree of regulatory coordination and cooperation in the areas of taxation, competition, state aid, environmental protection, labour and social standards in order to ensure that the required level playing field is maintained (Article 6(1) of the Protocol and Annex 4), regulatory barriers might be applied in bilateral trade relations between both members of the new customs union.

The backstop solution provides for separate treatment of trade in respect of Northern Ireland with the objective of keeping open the border for trade in goods between Ireland and Northern Ireland. The fact that Northern Ireland, which is part of the United Kingdom, shares a land border with an EU Member State, combined with the historical arrangements regarding that unique border, has resulted in concerns regarding how to reconcile respect for those arrangements with the consequences of the fact that the United Kingdom will no longer be an EU Member State.

The proposed solution is an attempt at maintaining a single market for trade in goods between Ireland (and thus the European Union) and Northern Ireland. For that purpose, the United Kingdom would need to ensure that EU product norms and standards continue to apply on the territory of Northern Ireland.

Trade within the UK-EU customs territory under the “backstop” solution

Within the new UK-EU customs territory, no customs duties on imports and exports, charges having an equivalent effect and quantitative restrictions would be allowed (Article 6 of the Protocol, Article 2 of Annex 2 to the Protocol). The United Kingdom would be obliged to align its legislation with, in particular, the EU Common Customs Tariff, EU rules of origin and EU rules on customs valuation (Article 3 of Annex 2 to the Protocol). Furthermore, the United Kingdom would need to respect the Common Commercial Policy to the extent necessary to ensure the functioning of the customs union. The required alignment with the Common Commercial Policy would cover duties, quantitative restrictions on imports and exports and other ‘regulations on commerce’ (Article 4 of Annex 2 to the Protocol). Whilst the text does not define the concept of regulations on commerce, its scope is potentially very wide. In addition, under the backstop solution, EU trade defence regulations and the Generalised Scheme of Preferences (“GSP”) would also continue to apply to the United Kingdom (Article 4 of Annex 2 to the Protocol, Article 7 of Annex 4 to the Protocol).

In order to ensure a smooth implementation of the backstop solution, the United Kingdom and the European Union would need to develop close regulatory cooperation between their respective administrative authorities, including customs authorities (Article 5 of Annex 2, Annex 3 to the Protocol) and authorities dealing with state aid matters (Article 7 of Annex 4 to the Protocol).

Should it become necessary to use the backstop solution, Article 6 envisages that the Joint Committee would develop, by 1 July 2020, more detailed rules for the new UK-EU customs territory. In the absence of a decision on such rules, Annex 3 to the Protocol would apply. That Annex provides rules on customs formalities for goods produced in the United Kingdom or in the EU, or goods from third countries that would be in free circulation in the customs territory (Annex 3 to the Protocol).

The establishment of a customs union without a single market is unlikely to ensure frictionless trade between the United Kingdom and the European Union. The European Union’s customs union with Turkey illustrates this point. Unless the United Kingdom fully aligns its regulatory framework affecting trade in goods with EU law, goods of EU origin would need to comply both with the EU and UK regulations, and could be made subject to border checks and controls. Although various degrees of (close) alignment with EU regulations exist in bilateral EU trade relations (for example, with Switzerland), the draft withdrawal agreement is silent on this question.

Finally, the backstop solution does not address issues pertaining to trade in services, intellectual property or government procurement. Consequently, during the period of application of the backstop solution, WTO rules would govern these issues in the bilateral relations between the European Union and the United Kingdom.

Trade to and from Northern Ireland under the “backstop” solution

Within the UK-EU customs territory, trade to and from Northern Ireland would be treated on separate terms. In particular, EU customs legislation, including the EU Customs Code and the Common Customs Tariff, would apply directly. Between the European Union and Northern Ireland, quantitative restrictions, tariffs and discriminatory internal taxes would be prohibited (Article 6(2) of the Protocol).

In addition, Northern Ireland would to some extent remain *de facto* part of the EU single market with respect to trade in goods. In order to achieve that result, it would be necessary for the United Kingdom to apply, in respect of Northern Ireland, a comprehensive list of EU legislation, so as to align the regulatory framework applicable to trade to and from Northern Ireland with that which applies, as a matter of EU law, in the single market (Article 6(2) of the Protocol, Annex 5 to the Protocol). As a result, placing goods originating in other parts of the United Kingdom on the Northern Ireland market would, in essence, need to comply with EU law, as implemented by UK law. Placing goods of EU origin on that market, on the other hand, would be directly subject to EU law. This special regulatory framework in respect of Northern Ireland might prove difficult to implement, because two separate sets of rules and standards would apply to trade within Great Britain (UK law) and with respect to Northern Ireland (EU law). At the same time, in the absence of a single market between the United Kingdom and the European Union, some type of border would be inevitable.

Trade between third countries and the UK-EU customs territory

The backstop solution ensures that once goods from third countries would have cleared customs and entered the UK-EU customs territory, those goods would be in free circulation in that customs territory and therefore not be subject to customs duties on imports and exports or charges having equivalent effect (Article 1(2) of Annex 2 to the Protocol). Imports from third countries into the UK-EU customs territory would continue to be subject to, in essence, EU customs treatment. Where tariff preferences have been granted under free trade agreements with the European Union, goods would continue to benefit from such preferences.

By contrast, the backstop solution is silent on exports from the United Kingdom to third countries other than the European Union. After the end of the transition period, the United Kingdom would no longer enjoy the benefits of the European Union’s trade agreements with third countries. In the absence of a new agreement on the future economic partnership between the United Kingdom and the European Union, that trade will be subject to WTO terms. Furthermore, in practice, as a result of the UK-EU customs territory, the United Kingdom would need to take the Common Commercial Policy into account in negotiating trade agreements with third countries. However, it appears likely that, during the transition period, reciprocal solutions for the continued application of existing EU trade agreements or the conclusion of new agreements will be agreed upon between the United Kingdom and third countries.

THE FUTURE RELATIONSHIP BETWEEN THE UNITED KINGDOM AND THE EUROPEAN UNION

The United Kingdom and the European Union will endeavour to negotiate a comprehensive agreement governing their future relationship in line with Article 184 of the draft withdrawal agreement and the general guidelines set out in the draft declaration. Such a bilateral agreement will need to be negotiated expeditiously, in order to be approved and to enter into force by 31 December 2020. The alternatives would be that the transition period be extended or that the backstop solution be used. The draft declaration, nonetheless, emphasises both parties' determination to replace the backstop solution by a subsequent comprehensive agreement (paragraph 19 of the draft declaration).

That future relationship would, as specified by the draft declaration, consist of an economic partnership built on a comprehensive free trade arrangement, according to which tariffs, fees, charges and quantitative restrictions across all sectors of trade in goods would be prohibited (paragraphs 22 and 23 of the draft declaration). Although the draft declaration expresses both parties' aspiration to build and improve on the single customs territory for which the draft withdrawal agreement provides (paragraph 22 of the draft declaration), the draft agreement offers no clear assurances that there would be, in the future, a customs union comprising the territories of the United Kingdom and the 27 EU Member States. This uncertainty also results from the fact that the draft declaration recognises that the United Kingdom would be able to develop an independent trade policy (see, for example, paragraph 17 of the draft declaration). However, what is clear is that the economic partnership would not result in the creation of a single market, including for trade in goods (paragraph 4 of the draft declaration). Both parties would be entitled to impose, for example, their own regulatory standards on goods.

Although harmonisation of regulatory standards appears to be excluded, the draft declaration nonetheless envisages that, in order to ensure a high degree of regulatory convergence as regards trade in goods, the parties would negotiate solutions to ensure a high level of compatibility of the technical, sanitary and phytosanitary regulations and standards (paragraph 24 of the draft declaration). Despite the fact that the draft declaration refers to the possibility that the United Kingdom would consider aligning with EU rules in relevant areas (paragraph 25 of the draft declaration), that remains a limited commitment. Regulatory barriers to trade may, therefore, come into existence.

The draft declaration also offers further details as regards future trade in services between the European Union and the United Kingdom. It signals both parties' intention to deliver a level of liberalisation of trade in services going well beyond their commitments under the World Trade Organization ("WTO") General Agreement on Trade in Services, building on recent EU trade agreements. Apart from the need for market access and national treatment commitments (paragraph 31 of the draft

declaration), the draft declaration expresses both parties' intention to avoid unnecessary regulatory requirements and to agree on disciplines governing domestic regulation (paragraph 33 of the draft declaration). A separate section of the draft declaration seeks to respond to concerns regarding the regulation of financial services. In that regard, the draft declaration reflects the parties' commitment to agree on the conditions under which their regulation of financial services would be deemed to be equivalent (paragraph 38 of the draft declaration). These commitments are aimed at achieving a regime which goes beyond the current equivalence regimes in both scope and depth. In addition, the withdrawal of equivalence decisions would no longer be unilateral but subject to a consultation mechanism. Although the draft declaration thus signals that both parties are aware of the importance of close and structured cooperation on financial services, the draft declaration also contains various references to each party's autonomy in regulating financial services (for examples, paragraphs 37 and 39 of the draft declaration). As a result, despite the draft declaration, the extent to which regulatory barriers would restrict trade in financial services remains uncertain.

The future economic partnership would also provide for enhanced regulatory cooperation in the fields of digital trade, capital movements and payments, intellectual property and public procurement, mobility, transport, energy, fishing and to the extent necessary ensure a level playing field in terms of competition, state aid, taxation, environmental, climate change, social and employment standards. Hence, building a future relationship based on the draft declaration appears to be an ambitious endeavour. In particular, the draft declaration offers no assurances that, pursuant to a future trade agreement, the United Kingdom would need to align its legislation closely with EU law. At the same time, without such alignment, the emergence of significant barriers to trade between the United Kingdom and the European Union appear to be inevitable.

CONCLUSION

On balance, the draft withdrawal agreement ensures the application of a *status quo* during the transition period, despite the United Kingdom's withdrawal from the European Union. Whilst the backstop solution offers a certain degree of legal certainty as regards the terms under which trade in goods may occur after the end of the transition period, it might prove difficult to apply in practice. It also fails to address significant parts of world trade, such as trade in services, intellectual property and government procurement.

The draft declaration addressing the features of a possible future economic partnership between the European Union and the United Kingdom makes it clear that there will be a trade agreement but no single market. However, whether that economic partnership will also include a customs union and involve a high degree of alignment with EU regulatory standards remains uncertain.

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