Outstanding multiple dilemmas after UK withdrawal from the EU

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As of January 1, 2021 the UK is fully out of the EU. It is a fully fledged third country.

The EU is still the largest UK trading partner. 43% of all UK exports in 2019 landed on the EU single market and 52% of its import came from the EU. UK has a trade deficit with the EU in goods, but a surplus in services. Behind the trade data there are strong dependencies across the entire economy.

The Brexit negotiations were a damage-control process. There are no winners in this process. These were unprecedented negotiations, aiming at reducing existing relations built over more than 45 years.

They were carried on against UK self-imposed deadlines. Fortunately, the choice was made to reach a deal. For the EU "no deal" has never been an option, neither in case of withdrawal agreement nor for the trade and cooperation agreement on the future relationship. The main difference between the two parties throughout the negotiations was that the EU's focus was on protecting the single market of 450 mln people, while the UK dream was to replace the EU law with the British law. Sovereignty, the buzzword on the British side was underestimated by the EU.

The outcome of the negotiations that started on June 19, 2017 is, first, the Withdrawal Agreement, whose major purpose is to provide legal certainty to all those affected by Brexit. This Agreement has been completed in terms of its implementation and made operational before the end of transition. This is particularly important for the issue of citizens' rights and the protocol on Ireland and Northern Ireland.

The second outcome is the Agreement on Trade and Cooperation (TCA) providing framework for the future relations. The process is not yet finalized as the consent to the TCA will most likely be voted by the European Parliament in March. It will be followed by the final act of conclusion. This agreement is not only about trade, it covers many other issues: transport, energy, judicial cooperation, internal security, fisheries, institutional issues, including dispute settlement. The agreement is provisionally implemented as of January 1, 2021. On that day UK has become a third country with a strong political intention of continued divergence from the EU systems, policies and standards. On the basis of the Council decision it is an EU competence only agreement and not a mixed one. That implies that there is no need for

ratifications by national parliaments.
Its legal basis is article 217 of the TFEU which makes it a sort of association agreement. This in turn implies that potentially, within a review process or through partial negotiations, which we will see in the months to come, its scope can be extended to all areas covered by the treaties.

Geography matters, both UK and the EU will stay where they are, European market will remain huge and important for UK producers and consumers, so the choice of this legal basis was a smart decision. The European Parliament has always supported this approach.

It is important to realize that it is an unprecedented situation when a big economy voluntarily leaves a preferential trade area and a global standard setting power.

It is also clear that assessing the impact of the new agreement on the EU-UK relations after the first week of its functioning is not possible because the past week was a time of rather limited cross border flows due to accumulated stocks, Covid restrictions and seasonally justified lower level of border movements.

In general, I would say it is a fair deal but what the British Prime minister was saying that there were no barriers to trade is not correct. We see here a rather skinny FTA, the choice of the British government. There are barriers to trading, there are frictions and there will be frictions.

My understanding is also that in reality, due to incredibly short time for the negotiations as a result of purely political UK decision on 10 months only transition, this agreement on trade and cooperation provides a kind of skeleton, or scaffolding if you wish, with unfinished business and often some vagueness regarding procedures and instruments to be used.

This leads actually to an observation that this agreement is not a British victory over European bureaucracy. Goods moving between UK and the EU will be subject to customs, food safety, VAT, regulatory checks and the rules of origin regime allowing for zero tariff access.

The choice of a shallow FTA formula implies a lot of bureaucracy, which means costs for hundreds of thousands of companies that never traded beyond single market.

There are complexities in many areas, including in institutional structures and regarding several dedicated dispute settlement approaches. The British proposal regarding the Irish border has also required a complex structure.

The solution replacing the dynamic alignment rejected by UK with a rebalancing procedure in particular in the context of new regulations to be adopted in the future is another example of complexity of the deal. It is not at all clear how rebalancing mechanism will work and what will be the nature of subsequent negotiations.

It is an example of issues that will lead to further negotiations, potentially to future conflicts, generating uncertainty, impacting certainty.

While celebrating the achievement of the zero tariff zero quota trade relations we have to bear in mind that trade depends on much more than tariffs and quotas.

There are also elements in the agreement which are coped with in a very restricted way or are entirely missing. An example are financial services which are treated in a very restricted way in line with GATS and in particular the financial services. In the text there is basically the issue of the right of establishment and some prudential carve outs.

In this area equivalence decisions and regulatory dialogue are supposed to bring further progress through a process of regulatory cooperation signalled in one of the attached joint declarations.

It is still to be seen whether the situation will create incentives for market participants to move into the EU. Indeed, we might see some drifting of activities toward continental Europe.

What has not been finalized and requires further negotiations is the data adequacy mechanism, defining ability to transfer information across borders.

An example of a restrictive solution is the recognition of professional qualifications where UK will face twenty seven national regimes and the need to negotiate bilateral agreements.

Taking into account a relatively small share of manufacturing, agriculture, and fisheries in particular in the economy of UK and the EU, the agreement actually affects limited part of economy.

The impact of leaving single market and customs union on the GDP growth will be substantial, stronger for UK, but also for the EU, where we will face asymmetric consequences not only across sectors but also across member states.

Of course what matters strongly is what the agreement means for businesses.

It is difficult for businesses because normally FTA introduces in a stable way a change leading to closer relations and reducing barriers. While normally FTAs liberalize trade, here the FTA introduces barriers between the EU and UK.

And there is uncertainty and gaps. Moreover on some issues individual member states can introduce additional requirements.

If I read correctly the agreement there is a non-regression principle there regarding labour market and climate rules .

The agreement has impact on individual companies but also specifically on supply chains. There are certainly gaps in border readiness of businesses. Normally FTAs do not cover border structures. Here there is not much either, actually border issue is very close to a no-deal situation.

In the first week there were news that 25% of trucks in UK were turned away from the border. This was the situation when very little trade was taking place. Another example of the insufficient border readiness can be trucks trying to enter Ireland from the Northern Ireland without health certificate.

It is certainly legitimate to ask whether companies are indeed prepared.

My impression from talks I had over the last months was that many firms were hoping for a miracle to happen.

Now we hear from some businesses that guidance came very late, often the day before the end of the year.

The list of barriers to trade for businesses that have never traded beyond the single market and customs union is long. It includes customs documents, SPS, VAT complexity, which is a particular barrier as UK is not any more part of the EU VAT area, product regulations, labelling, putting goods on market, permits, licenses, rules of origin. There are more than 150 000 companies that never exported outside the single market, and many more in the EU27.

Impact of all those measures will be particularly strong and long term with regard to supply chains. Definitely one of the most serious barrier will be related to ROO. There might be companies choosing to pay tariffs rather than benefitting from zero tariffs with ROO procedure.

It will be easier for the EU able to source their components from across EU 27 and still export it to UK tariff-free. UK will not be able to source most of the components from UK only, so tariffs might apply.

Goods moving from the EU to UK and then to Ireland not as a sheer transit might lose the EU-originated status. This in particular will affect value chains.

The message I would like to leave with you is the need for all levels of government to engage with businesses, including possibilities of fiscal support. Many firms were in a wait-and-see mode before the end of transition. Those that could were stock piling. Of course Covid had impact, including absorption of funds that otherwise could have been spent on preparedness to Brexit. It probably slowed down the preparation.

What we hear from business community, in particular smaller companies, is that information and guidance were coming relatively late.

I think that for public authorities at local or regional level it is important to make themselves aware of problems that their companies face. Companies need guidance and advice. All border issues are very complex and specific for the firms.

There are always risks for firms to use inadequate advice not reflecting their specific situation. Local authorities can help firms in reaching out locally to chambers of commerce, help them to get very specialized advice.

What are the challenges ahead of us now?

First, we can expect changes in policies in reaction to changing competitiveness environment due to new situation.

Secondly, we have to take into account dynamic nature of the agreement. The agreement will evolve.

There will be ongoing negotiations, new policy measures, like equivalence, that will be adopted.

Third, political atmosphere will be important.

We do not know yet what will be the reactions of individual member states to the Agreement.

On both sides politics will be shaping the relations between the UK and the EU.

Also, there are some new issues still to be discussed

They are not politics-free and will be shaped by political will.

I think here of data adequacy where so far we found the British law not sufficient. Here, I believe, however, both sides have interest in ensuring data adequacy.

Fourth, when I think of what will happen this year regarding financial services, impact on daily services will be important.

Passporting is gone. When it comes to equivalence, we do not know what and when will come in practical terms.

Retail services will be worked out, banks will be established on both sides. The real challenge is the wholesale market.

London will stay and survive, it has natural comparative advantages as financial centre, it is a global industry. And the EU will be building its resilience. There will be a lot of competition, but for the long term we will need cooperative spirit.

Fifth, the ROO issue is a fundamental challenge. But it is a standard element in FTA. The problem here is that we have never had an FTA, a skinny one, for economies so closely intertwined.

Sixth, there will be new governments in the UK.

Is this agreement and its structure sufficiently flexible to be used as a framework for future closer relations?

My bet would be that one day there will come a temptation to bring the customs union into it. Territorial proximity will continue to matter.