

# BREXIT 'THE VIEW FROM BRUSSELS' - DEVELOPMENTS IN JULY

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Legal Briefings - By **Eric White and Lode Van Den Hende**

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On 12 July 2018 the UK government finally published its [White Paper](#) on the future relationship between the United Kingdom and the European Union including a proposal for the establishment of an economic partnership between the UK and the EU. At the core of this proposal is the establishment of a free trade area for goods which is intended to avoid friction at the border, preserve economic prosperity and allow commitments with respect to the border between Northern Ireland and the rest of the island of Ireland to be respected. It is accompanied by proposals for far-reaching cooperation in numerous areas (many of which will facilitate trade in services) and a new institutional framework. We summarise the contents of the UK proposals in updates to our [Brexit Legal Guide](#).

The White Paper has been politely welcomed in Brussels as a useful contribution to the debate but also with scepticism and requests for clarification. In this View from Brussels we review the proposed economic partnership and comment on the EU's reaction to its various components so far.

## THE FACILITATED CUSTOMS ARRANGEMENT (FCA)

The White Paper describes the idea behind the FCA as being that the EU and the UK should be "as if in a combined customs territory". In order to remove the need for customs processes between the UK and the EU, including customs declarations, routine requirements for rules of origin, and entry and exit summary declarations, the UK would commit to apply the EU's tariffs and trade policy for goods intended for the EU and its own tariffs and trade policy for goods that can be "robustly demonstrated" to be intended for consumption in the UK.

It claims that in practice the latter regime would apply to finished goods and that only in the case of intermediate goods will it have to apply the possibly higher EU requirements at its external border and provide for a refund of duties once it is demonstrated that the goods have remained in the UK.

A large number of existing and to be developed mechanisms are envisaged to make this system workable ranging from the application of a "trusted trader" scheme to extensive cooperation including data sharing and to the application of "future advances in technology". In addition, it is recognised that a tariff revenue formula will be needed in order to share tariff revenue equitably between the UK and the EU (presumably based on consumption data). The White Paper expressly stated that the UK was not proposing that the EU apply the UK's tariffs and trade policy at its border. However, a government-agreed amendment to the [Taxation \(Cross-Border Trade\) Bill](#) requires reciprocity in the accounting for customs duty which at the very least will complicate the negotiation of this feature.

The UK appears to accept the FCA will not be operational immediately but introduced in phases. Pending the operational readiness of the FCA, it is implicit (but not stated) that the UK will need to stay in a traditional customs union with the EU.

The other components of the new free trade area would be:

- no tariffs or quotas on all goods (manufactured goods, agricultural, food and fisheries products) between the UK and EU;
- no routine requirements for rules of origin between the UK and EU; and
- "cumulation" of origin with current and future Free Trade Agreement (FTA) partners. This would allow EU content to count as local content in UK exports to its FTA partners for rules of origin purposes, and UK content to count as local content in EU exports to its FTA partners and also allow "diagonal cumulation" making UK, EU and FTA partner content interchangeable in trilateral trade.

The combination of the FCA with the absence of tariffs, quotas and rules of origin comes close to constituting a customs union (which is defined in Article XXIV:8(a) of the GATT as comprising “the substitution of a single customs territory for two or more customs territories” and the elimination of substantially all “duties and other restrictive regulations of commerce” between the constituent territories).

The purpose of the complex and yet to be developed arrangements described above compared to a simple traditional customs union is to allow the UK the freedom to negotiate its own free trade agreements with other countries around the world. Even if the close alignment and cooperation with the EU reduces the scope for concessions to be made to third countries that differ from what the EU is prepared to offer, it is hoped that there will still be sufficient margin of manoeuvre for an independent UK trade policy.

## **THE EU REACTION**

The FCA is considered by the EU to be unworkable. Indeed in the European Commission [press release](#) following the first high level discussion of the proposals, the EU chief negotiator, Mr Barnier, said that "the EU cannot – and will not – delegate the application of its customs policy and rules, VAT and excise duty collection to a non-member, who would not be subject to the EU's governance structures".

Although the parties are currently working on developing the concept of an "ambitious Free Trade Agreement" combined with "ambitious customs arrangements", Mr Barnier stated that the EU is open to a customs union with the UK including, in principle, an extension of the proposed Northern Ireland regime to the whole UK. Work on this is apparently going to continue in August.

## **THE ARRANGEMENTS FOR TRADE IN DIFFERENT KINDS OF GOODS AND SERVICES**

To facilitate trade between the EU and the UK, the UK proposes the establishment of "common rulebooks" and to commit to update these rulebooks as EU law develops. If the UK should decide not to incorporate new relevant EU law in the future, it accepts that this would have consequences (penalties or partial exclusion from access to the single market).

It appears that the UK is proposing differing degrees of alignment for customs, manufactured goods, agri-foods and services.

For customs the UK is proposing strict alignment with the Union Customs Code as part of the FCA.

## **MANUFACTURED GOODS**

For manufactured goods the objective is to include in the common rulebook not only rules that are necessarily checked at the border but all those that are needed to preserve the existing integrated supply chains. One of the examples highlighted in the White Paper is that of mutual recognition of type approvals for motor vehicles and their parts.

Similarly, the UK proposes that arrangements would be developed to ensure that tests and conformity assessment would be mutually recognised (and so not need to be duplicated). The UK is also seeking active participation in EU agencies (a voice but not a vote) together with access to their IT systems. In particular it requests:

- that the UK become a third country member of the European Aviation Safety Agency (EASA), as is already the case with Switzerland
- that UK businesses be enabled to register chemicals directly with the European Chemicals Agency (ECHA)
- that UK regulators be able to act as a "leading authority" for the assessment of medicines at the European Medicines Agency (EMA).

These are ambitious demands and are likely to be subject to long and difficult negotiations. The EU is attached the integrity of the single market and allowing more third country participation in its functioning will create a troubling precedent.

### **AGRI-FOOD (INCLUDING FISHERIES)**

In relation to agri-foods, the UK is proposing that the common rulebook only apply to rules that must be checked at the border such as sanitary and phytosanitary rules, which safeguard human, animal and plant health. Rules relating to wider food policy, such as marketing rules that determine how agri-food products can be described and labelled are said not to require border checks and to best be enforced where the products are marketed. The UK says that it will be seeking the same sort of equivalence regime as is provided for organic production rules in agreements with Canada, Chile, Israel, Japan, the Republic of Korea, Tunisia, the US and New Zealand. However, it appears to want the equivalence concept to be applied also in other areas.

The UK includes rules on Geographical Indications (GIs) in this category of wider food policy and announces that it will be introducing its own regime which will provide continuity of protection for UK GIs in the UK and be open to new applications from all applicants. Significantly, nothing is said about continuity of protection for GIs from other Member States and the UK appears to be reserving this as a negotiating chip. The EU has designated this a withdrawal rather than a future relationship issue. GIs are a politically sensitive issue for the EU.

The UK is specifically proposing to leave the Common Agricultural Policy (CAP) and the Common Fisheries Policy (CFP) and develop its own rules relating to domestic production. Interestingly, it recalls the EU's view as expressed at the WTO that direct payments under CAP are not "market distorting" suggesting that tariffs or trade defence instruments should not be applied as a result of differing subsidy regimes.

However, there is a suggestion that the production policies in Northern Ireland may be more closely aligned with those of the Republic of Ireland.

## **SERVICES**

The UK's proposals for free trade in services are less ambitious and more sector specific than what is proposed for goods and there is no reference to the concept of common rulebooks. Building on precedents in other agreements, it is proposed that the economic partnership include:

- general provisions that minimise the introduction of discriminatory and non-discriminatory barriers to establishment, investment and the cross-border provision of services, with barriers only permitted where that is agreed upfront;
- a system for the mutual recognition of professional qualifications, enabling professionals to provide services across the UK and EU (based on EU's Mutual Recognition of Qualifications Directive);
- additional, mutually beneficial arrangements for professional and business services; and
- a new economic and regulatory arrangement for financial services.

## **FINANCIAL SERVICES**

The most developed proposals are for financial services given their importance for the UK economy. There is a clear recognition that the existing mutual recognition regime (known as "passporting") cannot continue and also that decisions on access to each party's market must be autonomous. However the UK is seeking coordination and cooperation.

The starting point proposed by the UK is that there should be reciprocal recognition of equivalence under all existing third country regimes, taking effect at the end of the implementation period. This is justified by the fact that the existing degree of alignment and cooperation is greater than with any third country and that the conditions for a (non-discriminatory) recognition of equivalence must be considered fulfilled.

However, the UK goes on to propose that although future determinations of equivalence would be an autonomous matter for each party, the new arrangement should include provisions through the bilateral arrangement for common principles for the governance of the relationship, extensive supervisory cooperation and regulatory dialogue and predictable, transparent and robust processes.

It is proposed that the UK and the EU would set out a shared intention to avoid adopting regulations that produce divergent outcomes in relation to cross-border financial services. To this end the UK-EU arrangement should include common objectives, such as maintaining economic relations of broad scope, preserving regulatory compatibility, and supporting collaboration – bilaterally and in multilateral fora – to manage shared interests such as financial stability and the prevention of regulatory arbitrage.

On the basis of these principles it is proposed that a structured consultative process of dialogue at political and technical level take place so as to allow equivalence to be maintained over the long term.

In parallel there would be close cooperation in supervision including reciprocal participation in supervisory colleges.

The application of this enhanced equivalence regime would be based on a mix of autonomous and agreed processes providing business a degree of transparency and certainty.

There would be transparent methodology for assessing equivalence based on clear and common objectives. There should be a requirement to consult with stakeholders and possibly have recourse to expert panels. The parties should be entitled to withdraw equivalence but be required to consult and seek possible solutions to maintain equivalence. If this fails, there should then be clear and sufficient timelines and notice periods and safeguards for acquired rights, financial stability, market integrity and consumer protection. The parties should also commit to long term stability and avoid unilateral changes that narrow the terms of existing market access regimes, other than in exceptional circumstances in relation to services.

## **THE EU REACTION**

Reactions to the UK proposals on the alignment of rules and cooperation in their application have been less detailed than on the FCA.

The UK proposals for cooperation in data sharing have been welcomed and it has been said that the proposals on the common rule book, confined as they are to goods, are insufficient in scope to ensure a level playing field. In particular, the EU seems to be arguing for more extensive alignment in services because of their importance in the modern production of goods.

The proposals for "enhanced equivalence" in financial services have been the subject of the most detailed comment. Here the EU appears to be rejecting the limited constraints on EU decision making that would be result from the proposed cooperation. Indeed, Mr Barnier is reported to have said that they are inconsistent with the (supposed) principle that access rights to the EU's financial services market are "a gift from Brussels" that can be freely withdrawn. Of course, any international agreement reduces autonomy and these objections seem exaggerated. Indeed, the WTO General Agreement on Trade in Services (GATS) already provides limits on EU autonomy since it provides that where equivalence regimes exist, even if "autonomous", all WTO Members must be provided with "adequate opportunity" to participate. In other words, although the EU may be free to terminate its equivalence regimes completely, it cannot refuse to apply them to the UK or withdraw equivalence arbitrarily from the UK. Since the UK has the closest alignment of rules and cooperation of any WTO Member, it is difficult to see how these regimes could be justifiably withdrawn from the UK alone. Even if all current EU equivalence regimes were promptly extended to the UK post-exit, however, this would still offer a far from comprehensive EU market access solution relative to the UK's "enhanced equivalence" proposals, which are intended to cover all key financial services and products.

[Brexit hub](#)

## KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



**ERIC WHITE**  
CONSULTANT,  
BRUSSELS  
+32 2 518 1826  
eric.white@hsf.com



**LODE VAN DEN  
HENDE**  
PARTNER, BRUSSELS  
+32 2 518 1831  
Lode.VanDenHende@hsf.com

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