

# Ensuring a post-Brexit level playing field

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# Ensuring a post-Brexit level playing field



The European Policy Centre (EPC) is an independent, not-for-profit think tank dedicated to fostering European integration through analysis and debate, supporting and challenging European decision-makers at all levels to make informed decisions based on evidence and analysis, and providing a platform for engaging partners, stakeholders and citizens in EU policy-making and in the debate about the future of Europe.

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# Ensuring a level playing field after Brexit

Fabian Zuleeg and Larissa Brunner

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# Introduction

Soon after the referendum that decided the UK would leave the European Union (EU), concerns were raised about the level playing field (LPF) that would or would not prevail in the economic relationship between the UK and the rest of the EU post-Brexit. In essence, LPF considerations focus on the notion of unfair competition, with a level playing field being defined as “a state in which conditions in a competition or situation are fair for everyone”<sup>1</sup>. These concerns relate both to firm-level/sectoral interventions through, for example, state aid and subsidies, and more horizontal public policy interventions with systemic impact, such as corporate taxation, labour standards or environment/climate change policies.

Despite the very close economic relationship that will continue to exist even after the UK leaves the EU,<sup>2</sup> the UK will no longer automatically be bound by EU rules after Brexit unless the UK remains subject to single market rules, for example if the UK were to remain a member of the European Economic Area. This has raised concern among EU leaders that UK businesses could gain an unfair competitive advantage, accidentally or by design, if the regulatory and policy environment were to create a more favourable (lower costs, less stringent regulation) environment in the UK post-Brexit. *In extremis*, the worry is that over time, the UK could move away from the European economic model and shift towards a ‘low tax, low regulation’ economy. EU leaders fear that this would trigger a regulatory race to the bottom, undermining competitiveness in the remaining member states and imposing costs on EU citizens and companies, for example through cross-border air pollution if the UK slashes environmental regulations.

Based on the principle that Brexit creates an unprecedented situation that requires special rules, and given the uniqueness of the status/position of the post-Brexit UK (in terms of its large market size and integration, high level of competitiveness and geographic proximity),<sup>3</sup> these concerns have led to the inclusion of LPF conditions in the considerations and the negotiation position of the EU27:

► The European Council highlights in its April 2017 guidelines four areas (state aid and competition, environment, labour, and tax) in which a level playing field should be preserved after Brexit: “[Any free trade agreement] must ensure a level playing field, notably in terms of competition and state aid, and in this regard encompass safeguards against unfair competitive advantages through, *inter alia*, tax, social, environmental and regulatory measures and practices.”<sup>4</sup>

► Slides published in January 2018 by the European Commission stress that the “LPF has to be seen in the context of the future trade relationship”. They propose building a system based on three pillars: substantive provisions (based on the principle of non-lowering of standards), an enforcement mechanism, and a dispute settlement system. The enforcement mechanism will comprise two elements: domestic structures (which includes public enforcement through independent bodies and private enforcement through domestic courts) and joint structures (which includes a joint monitoring and review mechanism, and cooperation procedures). Regarding the dispute settlement system, the slides raise two key questions: the ‘when and how’ (subject to the constraint that only the European Court of Justice (ECJ) can interpret EU law in a binding way), and sanctions. Regarding the latter, the slides state that several options already exist, such

as the suspension of obligations, temporary compensations, financial sanctions, cross retaliation and ‘guillotine clauses’. The slides also mention EU autonomous measures (not specific to Brexit but with “a clear preparedness angle”) including blacklisting jurisdictions that are non-cooperative on tax issues, state aid (possible for aviation but not for goods), World Trade Organization (WTO) exceptions to promote sustainable development and the ongoing review of EU trade defence instruments (slides 12-13).<sup>5</sup>

► The March 2018 European Parliament resolution stresses that it will approve a framework for the post-Brexit EU-UK relationship only if it ensures a level playing field in many areas: *“A level playing field, in particular in relation to the United Kingdom’s continued adherence to the standards laid down by international obligations and the Union’s legislation and policies in the fields of fair and rules-based competition, including state aid, social and workers’ rights, and especially equivalent levels of social protection and safeguards against social dumping, the environment, climate change, consumer protection, public health, sanitary and phytosanitary measures, animal health and welfare, taxation, including the fight against tax evasion and avoidance, money laundering, and data protection and privacy, together with a clear enforcement mechanism to ensure compliance.”*<sup>6</sup>

► The March 2018 European Council guidelines build on the April 2017 document by calling for substantive rules, enforcement and dispute settlement mechanisms and remedies: *“Given the UK’s geographic proximity and economic interdependence with the EU27, the future relationship will only deliver in a mutually satisfactory way if it includes robust guarantees which ensure a level playing field. The aim should be to prevent unfair competitive advantage that the UK could enjoy through undercutting of levels of protection with respect to, inter alia, competition and state aid, tax, social, environment and regulatory measures and practices. This will require a combination of substantive rules aligned with EU and international standards, adequate mechanisms to ensure effective implementation domestically, enforcement and dispute settlement mechanisms in the agreement as well as Union autonomous remedies, that are all commensurate with the depth and breadth of the EU-UK economic connectedness.”*<sup>7</sup>

## EXISTING MECHANISMS TO PREVENT UNFAIR COMPETITION

Unfair competition has always been a legitimate concern in trade. One of the WTO’s fundamental principles is more competitive trade: “discouraging ‘unfair’ practices, such

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In extremis, the worry is that, over time, the UK could move away from the European economic model and shift towards a ‘low tax, low regulation’ economy. EU leaders fear that this would trigger a regulatory race to the bottom, undermining competitiveness in the remaining member states and imposing costs on EU citizens and companies.

The WTO framework is not sufficient to guarantee a level playing field. It has been designed to facilitate trade among a diverse and geographically dispersed group of developed and developing countries. Its rules and approaches are not apt for governing trade between developed countries or catering for the specifics of the Brexit situation.

WTO rules do little to tackle differences in standards in production methods; on the contrary, they recognise different levels of economic development and standards among countries.

as export subsidies and dumping products at below cost to gain market share; the issues are complex, and the rules try to establish what is fair or unfair, and how governments can respond, in particular by charging additional import duties calculated to compensate for damage caused by unfair trade.”<sup>8</sup>

It could thus be argued that the EU should simply rely on existing mechanisms, such as the WTO Agreement on Subsidies and Countervailing Measures<sup>9</sup> that sets out rules regulating the provision of subsidies and the use of measures by other countries to offset damage caused by subsidised imports. Concerns about labour and environmental standards could be addressed by non-regression clauses included in Free Trade Agreements (FTAs). For example, the Comprehensive Economic and Trade Agreement (CETA) contains the following provisions:

*“1. The Parties recognise that it is inappropriate to encourage trade or investment by weakening or reducing the levels of protection afforded in their labour law and standards.*

*2. A Party shall not waive or otherwise derogate from, or offer to waive or otherwise derogate from, its labour law and standards, to encourage trade or the establishment, acquisition, expansion or retention of an investment in its territory.*

*3. A Party shall not, through a sustained or recurring course of action or inaction, fail to effectively enforce its labour law and standards to encourage trade or investment.”<sup>10</sup>*

Similarly, the EU-Japan Economic Partnership Agreement includes the following clause:

*“2. The Parties shall not encourage trade or investment by relaxing or lowering the level of protection provided by their respective environmental or labour laws and regulations. To that effect, the Parties shall not waive or otherwise derogate from those laws and regulations or fail to effectively enforce them through a sustained or recurring course of action or inaction in a manner affecting trade or investment between the Parties.”<sup>11</sup>*

However, the WTO framework is not sufficient to guarantee a level playing field. It has been designed to facilitate trade among a diverse and geographically dispersed group of developed and developing countries. Its rules and approaches are not apt for governing trade between developed countries or catering for the specifics of the Brexit situation. In particular, WTO rules do little to

tackle differences in standards in production methods; on the contrary, they recognise different levels of economic development and standards among countries. Moreover, WTO rules on state aid are also not sufficient:

- The rules only apply to goods, not services. This is significant given that services account for around 80% of the UK's GDP and 40% of its exports to the rest of the EU.<sup>12</sup>
- The rules would require the EU to demonstrate that UK state aid has damaged trade. This would be difficult in practice, not least because there is no *ex ante* notification system or stand-still obligation under WTO rules.
- Any remedies would be limited and would not involve the recovery of the subsidy. For example, the EU could launch an investigation into the subsidised imports and impose import duties to offset the damage to its own economy. But this does not restore the original situation or address the underlying problem.

Non-regression clauses suffer from weak implementation and enforcement mechanisms; nor have current frameworks been designed for the unique challenge that is posed by Brexit. International frameworks such as multilateral environmental agreements, International Labour Organisation (ILO) conventions and Organisation for Economic Co-operation and Development (OECD) standards tend to be less stringent than EU regulations.

## MUCH ADO ABOUT NOTHING?

But even if there are no very effective existing remedies, how likely is it that the UK will diverge significantly? At the outset, the UK will, in essence, have identical rules to the EU, enforced through the domestic legal system. It is likely that it would take some time before these rules or their implementation start to diverge significantly, whether by accident or by design. In some areas there are clear EU regulatory standards (e.g. data protection/GDPR) which can be enforced in the context of future trade relations (e.g. market access only if in compliance with EU standards, potentially assessed through equivalence mechanisms). The UK would also have to consider any tit-for-tat reaction in the case of direct limitations for EU companies.

It is also unlikely that the UK will diverge drastically from EU standards in the foreseeable future for domestic political and economic reasons:

At the outset, the UK will, in essence, have identical rules to the EU, enforced through the domestic legal system. It is likely that it would take some time before these rules or their implementation start to diverge significantly, whether by accident or by design.

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► There is no indication that UK policy preferences will change suddenly. This also implies that any radical changes would be met with domestic political resistance.

► The UK government will have limited capacity to implement costly new policies due to, for example, fiscal constraints. In addition, if the UK starts to provide support to a company or a sector, pressure will be strong to expand that support further, making it fiscally unviable.

► Existing economic and legal structures create inertia. It is far from straightforward, for example, to alter existing labour or environmental standards in a significant, horizontal way.

The impact of any changes to the regulatory/policy environment (with the possible exception of large-scale tax changes) would probably be limited. Other factors such as exchange rate fluctuations are likely to play a much larger role in companies' decision-making than environmental or labour regulations, given the more limited impact these have on companies' costs and bottom lines.

However, these considerations may not be enough for the EU. The low likelihood of the UK diverging is unlikely to be accepted as the basis of an FTA that is supposed to be in place permanently (or at least until further renegotiation). It is likely that the EU will insist on a hard commitment not to diverge, or not to diverge beyond a certain degree.

## A MORE MERCANTILIST UK?

In addition, some comments from UK government figures, and especially Brexiters, have raised concerns about the future strategic direction of UK economic policy:

► In January 2017, Chancellor Philip Hammond suggested that in the case of a

no-deal Brexit, the UK could move away from a 'European-style model' and lower taxes and deregulate in order to regain competitiveness after Brexit.<sup>13</sup>

► In February 2017, the Economists for Brexit group called on the UK government to unilaterally remove all tariffs on imports after Brexit to boost the economy, even if it damaged some businesses.<sup>14</sup>

► In September 2018, former Foreign Secretary Boris Johnson called for following the United States' example and lowering taxes to create a "happy and dynamic economy" after Brexit.<sup>15</sup>

► Several days later, Reuters reported that International Trade Secretary Liam Fox intended to lower food standards to facilitate a trade deal with the US after Brexit.<sup>16</sup>

► The same month, Prime Minister Theresa May said she wanted a "low tax and smart regulation" post-Brexit economy with the lowest corporation tax rate in the G20.<sup>17</sup>

It might well be that the economic realities of Brexit and the pressures the UK will face when negotiating FTAs with third countries such as the US will drive the UK to a far more mercantilist approach to international trade. The EU is, therefore, looking for ways to safeguard a level playing field after Brexit to prevent unfair competition, regardless of the direction the UK takes. And as long as the EU27 see this as a significant issue that has to be included in the negotiations, it will need to be addressed.

## THE UK POSITION

The UK has argued that unless there is a special deal that provides the UK with far greater market access than other third countries, there is no justification to have special level playing field provisions. In her Mansion House speech in March 2018,

Prime Minister Theresa May said “we will not accept the rights of Canada and the obligations of Norway.”<sup>18</sup> ‘Taking back control’ has been a key objective driving Brexit, so concessions would be politically difficult, especially on horizontal issues, such as taxation, environment and labour standards, where many Brexiters believe that one of the crucial benefits of leaving the EU is to be free of its shackles in these policy areas.

Nevertheless, the UK government has sought to reassure the EU27 and there has been a marked evolution of its position:

- In her Florence speech in September 2017, May emphasised that her government was committed to high regulatory standards and indeed wanted to strengthen them.<sup>19</sup>
- In February 2018, the then Brexit Secretary David Davis sought to reassure the EU27 that the UK would not engage in a “Mad Max-style” regulatory race to the bottom.<sup>20</sup>
- In her Mansion House speech in March 2018 May proposed committing to EU rules on competition and state aid (possibly to tie the hands of a future Labour government). On environmental and labour standards, May said the EU should be “confident that we will not engage in a race to the bottom” although it offered little further detail.<sup>21</sup>
- The July 2018 White Paper echoes May’s Mansion House speech by proposing “to incorporate [the UK’s] domestic choice to maintain a robust state aid regime into its future economic relationship with the EU” and to commit to non-regression of environmental and labour standards. However, it made no explicit concessions on tax, stating that “the UK’s proposal for its future economic partnership with the EU would not fetter its sovereign discretion on tax, including to set direct or indirect tax rates, and to set its own minimum tax rates.”<sup>22</sup>

## COMPLEXITIES AND CHALLENGES

Although a blueprint for LPF provisions has been agreed upon in the context of the Withdrawal Agreement, the LPF question is likely to come up again in the context of the negotiations on the future EU-UK relationship, or if the UK leaves without a deal. But designing rules and governance mechanisms is tricky when addressing such horizontal issues. When it comes to broad policy interventions (e.g. cuts in corporation taxes or setting the level of minimum wages), it can be difficult to distinguish between legitimate

Some distortions between EU member states are considered legitimate to allow, for example, poorer regions to catch up (for example, allowable state aid) and to account for different policy preferences and economic conditions (e.g. minimum wages in the EU range from €261 in Bulgaria to €1,999 in Luxembourg as of July 2018).

Would level playing field provisions only aim to ensure non-regression, or would the UK have to follow if the EU adopts stricter standards?



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public policy and unfair competition. Even if a particular intervention has an impact on competitiveness, it might still be justified by other policy objectives (for example, interventions in energy markets to ensure security of supply). This raises the broader question of whether a policy action's intent or result matters, and, if it does, how this could be determined.

When it comes to access to each other's market post-Brexit, the key questions are which policies sovereign countries should decide to coordinate, and to what extent to allow for such access, taking into account the increased scope for legitimate divergence in domestic horizontal policies once a country has left the EU and its single market. In the single market, several horizontal measures are regulated to the necessary extent for ensuring mutual fair access. While such coordination does not necessarily negate legitimate public policy objectives, it can lead to tensions, which could also arise in any mutual market access arrangements.

There is also significant heterogeneity within the EU when it comes to horizontal, economy-wide provisions, arguably also in areas that affect the functioning of the single market. In many cases (e.g. the organisation of the labour market or general business regulations), the legal framework is patchy, depending on uneven EU competences, and based on directives, opening up different margins of interpretation and implementation, which frequently have to be tested judicially. Many directives specify minimum or maximum allowable levels, implying a variance in the implementation within the EU. In some areas, there are no minimum requirements to begin with, for example, there is no EU-wide minimum wage provision. Given that the UK has an overall high level of standards (with many over the years accusing the UK government of gold-plating, i.e. introducing EU rules more stringently than necessary), it raises the question whether non-regression should simply apply to the existing minimum standard within the EU or to the already achieved level in the UK. It is unlikely that more stringent rules can be applied to the UK than those applying to existing member states, but this raises the possibility of the UK reducing existing standards to the minimum allowable under EU rules, altering its competitive position.

In addition, some distortions between EU member states are considered legitimate to allow, for example, poorer regions to catch up (for example, allowable state aid) and to account for different policy preferences and economic conditions (e.g. minimum wages in the EU range from €261 in Bulgaria to €1,999 in Luxembourg as of July 2018).<sup>23</sup> However, this is



not without controversy within the EU; for example, when it comes to corporation tax, there has been a long-term debate whether some countries in the EU gain an unfair advantage by keeping the corporate tax rate at low levels. From a competition point of view, it might be attractive to impose stringent high standards on the UK but that would not reflect fair competition principles. Moreover, regional inequality in the UK is likely to be exacerbated by Brexit, which could prompt policy action (especially since May has tried to appeal to those ‘just about managing’ and wants her legacy to be about more than just Brexit). Would measures framed as helping disadvantaged people and regions be legitimate public policy, or lead to unacceptable, unfair competition?

There is also the challenge of designing rules that are dynamic and adaptive over time. Would level playing field provisions only aim to ensure non-regression, or would the UK have to follow if the EU adopts stricter standards? For example, if progress is made on the Common Consolidated Corporate Tax Base (CCCTB), will these provisions have to be applied within the UK? The latter would essentially render the UK a rule-taker with little influence – which would be politically very difficult. Would there be an effective legal mechanism through which the UK could challenge regression of standards in parts of the EU, i.e. how reciprocal would arrangements be? If they truly are, this would give the UK (asymmetric?) powers to intervene in EU27 policy decisions. It is far from clear whether all EU member states really want this.

Governance and dispute settlement are potentially the most challenging aspects of future LPF provisions, especially given the limitations of the UK’s domestic capacity to make long-term constitutional commitments. As a general point, the Withdrawal Agreement stipulates that a joint committee shall be set up to monitor implementation of the agreement and to prevent and resolve disputes. Unresolved

disputes will be referred to an arbitration panel comprising five members, with the EU and the UK nominating two members each and the fifth member selected from a mutually agreed list. However, this arbitration mechanism will not apply to the provisions outlined in the Withdrawal Agreement on taxation (except in relation to EU directives that will be transposed into UK law). In relation to environment, labour and social standards, the UK will be responsible for enforcement, with arbitration on enforcement foreseen in case of disputes.<sup>24</sup> Provisions on state aid will be enforced by a new UK independent authority, except when trade between Northern Ireland and the EU is concerned. Under the backstop, the Commission would take action if subsidies affect Northern Ireland and the EU, for example if an English firm exporting through Northern Ireland to the Republic of Ireland received state aid. This might give rise to disagreement between the new UK authority and the Commission that would need to be resolved on the basis of the backstop, which provides for a consultation mechanism and the ultimate primacy of EU decisions.

In the context of the longer-term relationship, some sort of institutional framework and provisions for implementation are likely to be necessary to bind future UK governments. The Political Declaration states that the Withdrawal Agreement including the backstop will be the basis for any future agreement. However, if the UK leaves without a deal, the scope for an agreement on LPF would be reduced and the EU would be left with autonomous unilateral measures. At the same time, the UK’s access to the single market would be significantly affected by customs tariffs and duties.

## OUTLOOK AND RECOMMENDATIONS

It seems clear that the unique situation of an EU member state leaving the EU poses unique challenges to the concept of a

**The unique situation of an EU member state leaving the EU poses unique challenges to the concept of a level playing field in international trade.**

level playing field in international trade. The UK is fully economically integrated and, in the absence of a chaotic no-deal Brexit, will remain economically close after Brexit, regardless of which model is chosen for the future UK-EU relationship. Yet, at the same time, any bilateral agreement between sovereign countries is about framing their sovereignty so as to achieve commonly agreed goals. The concept of a level playing field and of sovereignty therefore demands that the UK retain the ability to set its own rules and policies as long as these don't interfere with fair competition, even if these convey a competitive advantage to the UK.

There is, however, one further area of complication: the border between Northern Ireland and the Republic of Ireland. A special arrangement included in the Withdrawal Agreement ensures that this border remains free of friction and without any physical border infrastructure. At the same time, it has to be ensured that businesses on neither side of the border gain an unfair competitive advantage from this arrangement. The fact that the backstop arrangement encompasses the whole of the UK makes this even more important.

It is crucial to recognise that the level playing field should not be tilted in favour of either side. Arguably, the UK will be in a much weaker position both within the negotiations and in the long-term trading relationship. Reciprocity might mean little if the costs of losing market access remain asymmetrically distributed. The EU27 have to avoid using their leverage to impose conditions that simply serve to limit the UK's ability to compete, whether this is out of a misplaced fear of the UK's strength or out of a deliberate strategy to support their own businesses. But at the same time, the UK government has to resist playing to the domestic audience, emphasising its future as a free trading, low tax and low regulation 'buccaneer', which will inevitably prompt a reaction from the EU27.

It is also crucial to maintain the fair trade focus in these negotiations when it comes to LPF considerations. Integration within the EU goes much further than economic integration, let alone trade/single market integration. The vast majority of the EU *acquis* in areas such as environmental and labour standards are not trade-related. While the backstop provisions do not go as far as to cover those and the Political Declaration makes clear the distinction between LPF considerations and cooperation in key policy areas such as climate change, the EU27 need to resist any temptation to use LPF provisions in the future to

enforce other policy objectives, no matter how important these are in their own right.

The difference between and within horizontal policies (insofar as these are coordinated or harmonised at the EU level and do not entail state aid) and direct support to industries and sectors also implies the need for ‘horses for courses’, i.e. different mechanisms and depth of commitment for different policy areas. While the remaining chapters in this publication go into more detail, it seems clear that there is a significant difference between specific support mechanisms for businesses and wider horizontal policies. As a general rule, specific support mechanisms inevitably distort trade and serve to increase the competitive advantage of specific economic actors. Horizontal policies, on the other hand, predominantly pursue broader policy objectives and their competitive/trade-distorting effect will differ significantly depending on the specific policy.

However, the distinction between specific support mechanisms and horizontal measures can be difficult to draw in practice, and measures may need to be assessed on a case-by-case basis. The importance of convergence in regulatory standards, and hence the importance of horizontal measures, varies among sectors depending on their specificities. For example, in financial services openness is limited unless there is unilateral equivalence recognition. In transport, any trade agreement would be suboptimal compared to the EU internal market. In energy, it would be impossible for the UK to participate in the EU internal energy market without applying the EU *acquis*. Moreover, it needs to be recognised that taxation raises very specific issues, given the direct connection taxation has to sovereignty considerations but also the significant trade distortion potential of business taxation in particular.

The Withdrawal Agreement specifies that during the transition period and under the backstop arrangement, EU rules on state aid will continue to apply. On environmental as well as labour and social standards the UK and the EU commit to non-regression clauses, agreeing that standards should not fall below the level applicable at the end of the transition period. Provisions on taxation are more limited: the UK and the EU agree to implement the principles of good governance, including international and OECD standards. In addition, the UK will transpose into domestic law EU directives on administrative cooperation, reporting on investment firms and anti-tax avoidance. It will also continue to interact with the EU in the so-called ‘code

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of conduct' group aimed at preventing harmful business taxation measures.

While arrangements in law might be reciprocal, in reality the ability of the UK to enforce any provisions will be limited by the asymmetric nature of costs that are created by any disturbance in the trading relationship.

Assuming that the negotiations result in a Canada-style EU-UK relationship, which many see as the most likely outcome given the UK's red lines of leaving the single market and customs union, the likely post-transition LPF arrangements will be based on the provisions included in the Withdrawal Agreement, while taking into account the breadth and depth of the future relationship and the level of connectedness. This means that the most likely outcome is concrete commitments on competition and state aid, with less precise provisions on the other issues identified by the EU27. The EU27 must accept that the UK as a third country will not be bound by the same high standards of rules and implementation that govern those inside the single market. But, given the close integration that will continue to prevail, the UK will not be allowed to simply exclude policy areas (taxation) or merely state high aspirations, except with reference to domestic enforcement (labour and environmental standards).

For the EU27, a crucial consideration relates to reciprocity and asymmetry. While arrangements in law might be reciprocal, in reality the ability of the UK to enforce any provisions will be limited by the asymmetric nature of costs that are created by any disturbance in the trading relationship. Paradoxically, this implies that the UK has actually more to gain from truly reciprocal arrangements as a safeguard against uncompetitive practices by the EU27, collectively or by individual member states.

The only viable long-term option seems to be to build on the commitments made in the Withdrawal Agreement, with long-term governance provisions carefully considered.

The remainder of this publication discusses potential options in the different policy areas. The narrowest option, a *de minimis* arrangement with somewhat tighter competition/state aid provisions and essentially declarations of intent on other issues with domestic enforcement, combined with (ineffective) regression clauses, seems to be ruled out by the Political Declaration. There are limits to the application of competition/state aid rules in horizontal policy areas because while state aid provisions apply across the board, they only apply insofar as state resources flow directly (or indirectly) to companies. But a more ambitious arrangement would require overarching governance mechanisms, with an arbitration panel and sanctions.

In the end, the only viable long-term option seems to be to build on the commitments made in the Withdrawal Agreement, with long-term governance provisions carefully considered. Although the governance provisions in the Withdrawal Agreement are far-reaching and clear, the provisions in the final agreement may differ. The EU27 may have preferred to cover taxation in any agreement but this issue has been dealt with in the backstop. The EU cannot contest horizontal policies including taxation, particularly as member states cannot even agree internally on a common position on tax. The question then becomes not what tax rates the UK might set, but rather how the EU system will evolve over time and how the agreement with the UK will fit into that. Pushing the UK beyond the commitments it made in the Withdrawal Agreement and the Political Declaration would mean pushing member states to certain commitments too, which would be an unappealing prospect for the EU27.

All of this depends, however, on the orderly exit of the UK, with an agreed deal. Whether this will happen or not is far from clear at this moment in time. If the UK leaves without a deal or if a different deal were to be on the table, the issue of LPF competition between the UK and the EU would resurface. While the Withdrawal Agreement and the Political Declaration would, most likely, be the starting point for any discussion of LPF provisions, most definitely from the EU side, there would be no guarantee that an agreed solution could be found, taking into account, for example, that there might be political change in the UK. The uncertainty surrounding Brexit thus also creates significant uncertainty over the future of LPF provisions between the UK and the EU, potentially hindering progress in agreeing a new economic relationship.

The uncertainty surrounding Brexit thus also creates significant uncertainty over the future of LPF provisions between the UK and the EU, potentially hindering progress in agreeing a new economic relationship.

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- <sup>1</sup> Merriam-Webster dictionary.
  - <sup>2</sup> More accurately, after the UK exits the transition period as during the length of the transition period the UK will still be bound by EU law and jurisdiction, despite having left the EU.
  - <sup>3</sup> The chapter 'The EU27-UK pre-Brexit trade relationship' expands further on existing trade flows between the UK and EU.
  - <sup>4</sup> European Council Guidelines for Brexit negotiations
  - <sup>5</sup> European Commission, Slides on level playing field.
  - <sup>6</sup> European Parliament resolution on the framework of the future EU-UK relationship.
  - <sup>7</sup> European Council, Note to Delegations, European Council (23 March 2018) – Guidelines.
  - <sup>8</sup> World Trade Organization, What we stand for.
  - <sup>9</sup> World Trade Organization, Agreement on Subsidies and Countervailing Measures ("SCM Agreement").
  - <sup>10</sup> European Commission, CETA Article 23.4.
  - <sup>11</sup> European Commission, EU-Japan Article 16.2.
  - <sup>12</sup> UK Parliament, Research Briefing.
  - <sup>13</sup> Gersemann, Olaf; Grabitz, Ileana, "Philip Hammond issues threat to EU partners", *Welt*, 15 January 2017.
  - <sup>14</sup> See <https://uk.reuters.com/article/uk-britain-eu-economy/pro-brexit-economists-urge-uk-to-unilaterally-scrap-tariffs-idUKKBN15V2FW>
  - <sup>15</sup> Milliken, David, "Pro-Brexit economists urge UK to unilaterally scrap tariffs", *Reuters*, 16 February 2017.
  - <sup>16</sup> Patnaik, Subrat, "Liam Fox planning to scrap EU food standards", *Reuters*, 20 September 2018.
  - <sup>17</sup> Dickson, Annabelle, "Theresa May pledges lowest business tax rate in G20 post-Brexit", *POLITICO*, 25 September 2018.
  - <sup>18</sup> "In full: Theresa May's speech on future UK-EU relations", *BBC*, 2 March 2018.
  - <sup>19</sup> UK Government, PM Theresa May's speech on a new era of cooperation and partnership between the UK and the EU.
  - <sup>20</sup> Asthana, Anushka; Boffey, Daniel and Elgot, Jessica, "David Davis, Brexit will not plunge Britain into 'Mad Max dystopia'", *The Guardian*, 19 February 2018.
  - <sup>21</sup> UK Government, PM Theresa May's speech on our future economic partnership with the European Union.
  - <sup>22</sup> UK Government, The future relationship between the United Kingdom and the European Union.
  - <sup>23</sup> European Commission, Statistics on variations in national minimum wages.
  - <sup>24</sup> For further detail please see the chapters by Emily Lydgate and Marley Morris.







# The EU27-UK pre-Brexit trade relationship

Larissa Brunner<sup>1</sup>

2

# Introduction

The UK and the other 27 EU member states enjoy a close trading relationship, thanks to their deep economic, political and cultural ties and geographical proximity. Their economies have similar characteristics – typical of wider legal frameworks, which include, *inter alia*, a common rulebook, standards, data rules and product checks. This relationship has been facilitated and driven by common membership of the EU’s customs union and single market. Depending on the scale and scope of its impact, Brexit is likely to disrupt these close ties.

## UK-EU trade

In 2017, trade with other EU member states accounted for around 44% of the UK’s exports, or £274 billion, and 53% of its imports, or £341 billion (Table 1). This implies a UK trade deficit of £67 billion.

**Table 1: UK trade with EU and non-EU countries, goods and services, 2017**

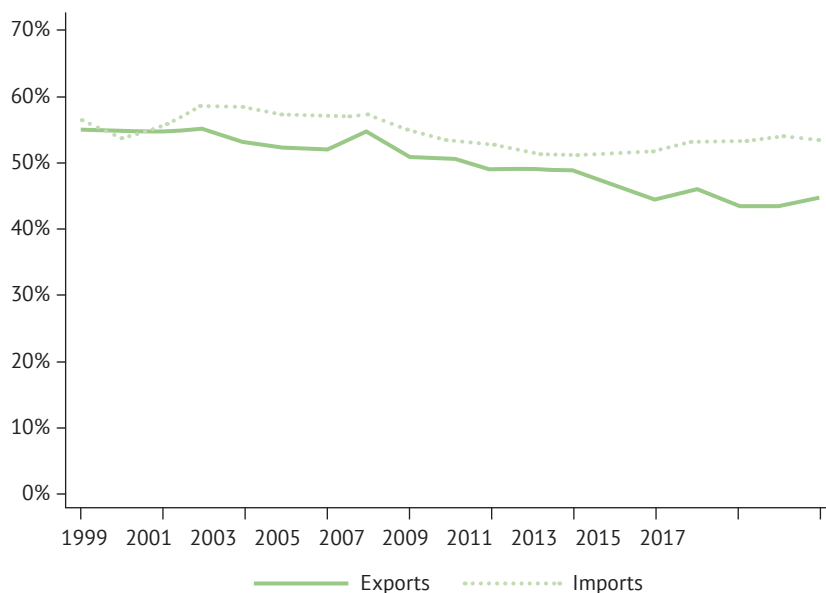
UK trade with EU and non-EU countries, goods and services, 2017 (GBP billion)

	Exports		Imports		Balance
EU	274	44.5%	341	53.1%	-67
Non-EU	342	55.5%	301	46.9%	41
Total	616		642		-26

Source: ONS series, Commons Library Briefing, Statistics on UK-EU trade.

The UK-EU export share has decreased over time from around 54% in 1999, as exports to non-EU countries increased at a faster rate than those to the rest of the EU. Meanwhile, the share of imports from the EU has remained relatively stable, at around 50-55% (Figure 1).

**Figure 1: UK trade in goods and services with EU countries, 1999-2017**



Source: ONS series, Commons Library Briefing, Statistics on UK-EU trade.

These figures may slightly overstate the importance of the EU as a trading partner for the UK due to the ‘Rotterdam effect’, where goods dispatched from or going to third countries pass through an EU port. While the UK Office for National Statistics (ONS) underlines that “it is not possible to quantify the Rotterdam effect precisely”, it estimates that it could be around two percentage points.<sup>2</sup> At the same time, the above figures do not include trade with countries that are part of the European Free Trade Association (EFTA) or otherwise have comprehensive FTAs with the EU (e.g. Turkey).<sup>3</sup>

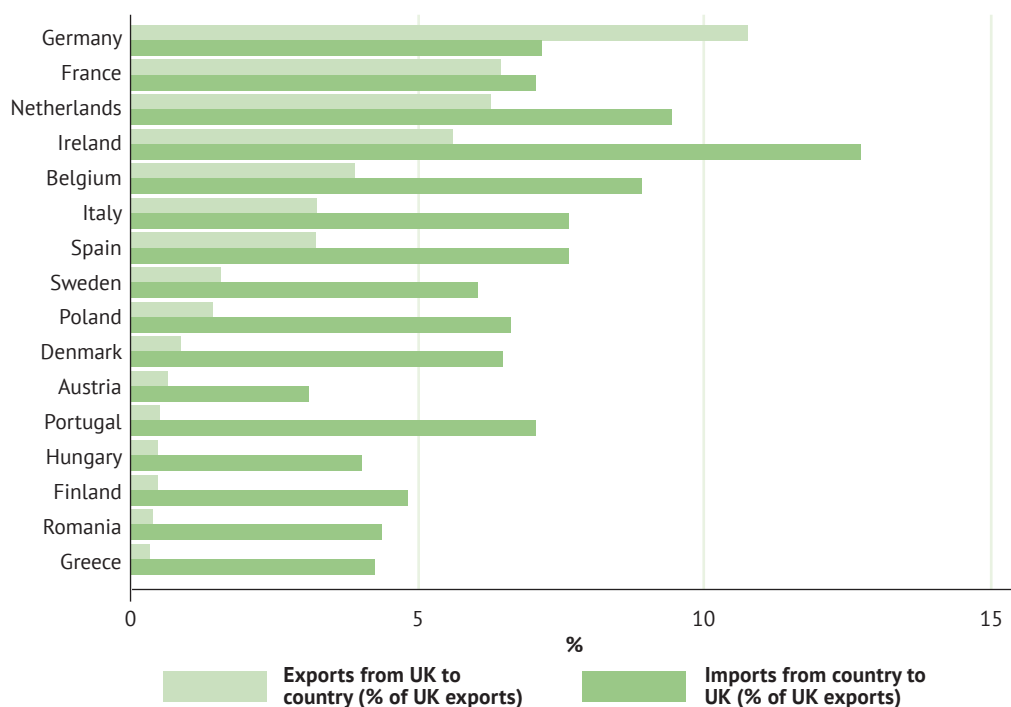
## LEVELS OF INTERCONNECTEDNESS ACROSS MEMBER STATES

The importance of the UK as a trading partner varies across member states. Overall, around 8% of the EU’s total exports to EU and non-EU countries went to the UK in 2016. As a proportion of exports to non-EU countries, the UK would have accounted for 18%.<sup>4</sup>

In 2017, the UK recorded the largest trade deficit in goods and services with Germany (£21.3 billion), followed by Spain (£15.2 billion) and Belgium (£9.5 billion). The largest trade surplus was with Ireland (£12.2 billion), followed by Sweden (£2.0 billion) and Luxembourg (£0.3 billion).

Some member states are much more closely intertwined with the UK than others. More than 10% of UK exports go to Germany alone. Meanwhile, the UK is an especially important export market for Ireland, the Netherlands and Belgium.

**Figure 2: Exports of goods between the UK and individual EU member states (2016)**



Source: E.CA Economics, based on IMF Direction of Trade Statistics.

Some member states are much more closely intertwined with the UK than others. Figure 2 illustrates this for goods. More than 10% of UK exports go to Germany alone. Meanwhile, the UK is an especially important export market for Ireland, the Netherlands and Belgium.

## SECTORAL DIFFERENTIATION

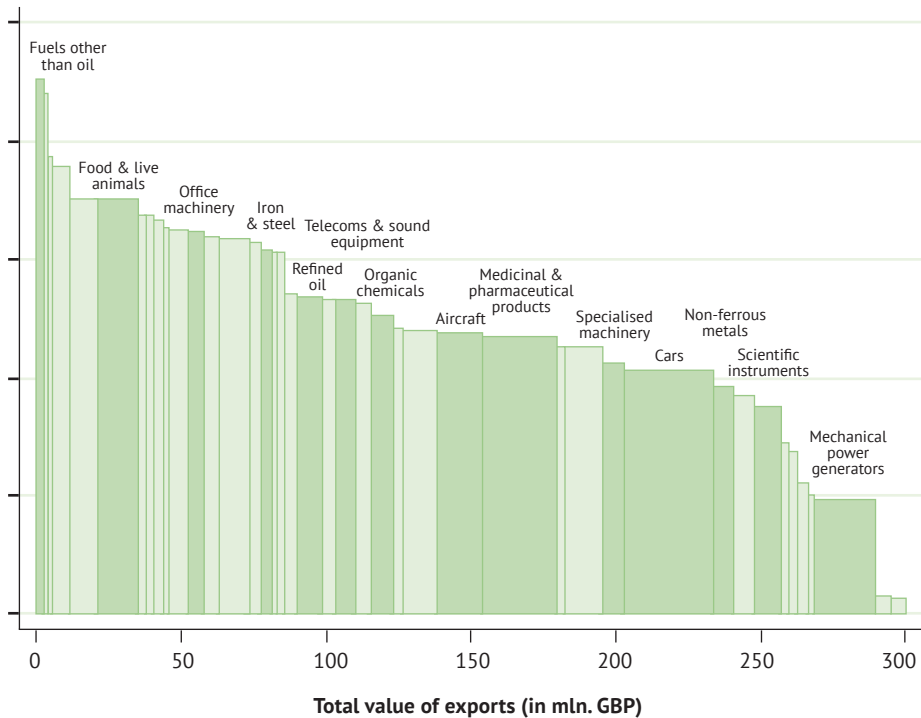
However, trade patterns differ for goods and services. While the UK recorded a trade surplus of £28 billion in trade in services with the rest of the EU in 2017, this was outweighed by a trade deficit of £95 billion in trade in goods.

In 2017, the largest categories of UK goods exported to the EU were:

- road vehicles, accounting for 11.2% of goods exports and worth £18.3 billion;
- petroleum and petroleum products, accounting for 9.2% of exports and worth £15.0 billion; and
- medicinal and pharmaceutical products, accounting for 7.8% of exports and worth £12.8 billion.<sup>5</sup>

UK-EU export shares to the EU vary widely by sector (Figure 3), with the highest recorded in fuels other than oil.

**Figure 3: UK trade in goods with EU countries, by sector, 2016**



Source: E.CA Economics, based on ONS data.

The most significant categories of UK goods imports from the EU were:

- road vehicles, accounting for 18.1% of imports and worth £46.8 billion;
- medicinal and pharmaceutical products, accounting for 7.9% of imports and worth £20.3 billion;
- electrical machinery and appliances, accounting for 4.4% of imports and worth £11.5 billion.

Services make up around 80% of the UK's economy but only 40% of its exports to the EU. Three categories accounted for over half of the UK's services exports to the EU in 2017:

- 'other business services' (comprising legal, accounting, advertising, research and development, architectural, engineering and other professional and technical services), accounting for 28.2% of services exports and worth £31.0 billion;
- financial services, accounting for 23.6% of exports and worth £25.9 billion; and
- travel, accounting for 17.4% of exports and worth £19.1 billion.

The largest UK services imports from the EU were:

- travel, accounting for 42.8% of imports and worth £35.0 billion;

- other business services, accounting for 18.9% of imports and worth £15.4 billion; and
- transportation, accounting for 14.1% of imports and worth £11.6 billion.

## PROSPECTS FOR POST-BREXIT TRADE

Trade flows after Brexit will be shaped by the future EU-UK relationship. Analysis by the UK government published in November 2018 outlines four scenarios (notably not including the deal negotiated with the EU).<sup>6</sup> It estimates that long-term<sup>7</sup> trade costs will rise in all four cases, compared to current arrangements (Table 2).

**Table 2: Estimated change in trade costs compared to current arrangements**

% change compared to current arrangements	Modelled EEA-type scenario	Modelled White Paper scenario	Modelled average FTA scenario	Modelled no deal scenario
Trade costs for manufactured goods	+3 to +7	0 to +1	+5 to +11	+9 to +17
Trade costs for services	+1 to +4	+4 to +12	+4 to +14	+5 to +18

Source: UK government.

**UK trade with the rest of the world is expected to increase moderately in all four scenarios, but this increase will not be sufficient to offset the lost trade with the EU.**

All other things being equal, the rising trade costs are expected to result in lower trade volumes in all four scenarios (Table 3). Both UK exports to and imports from the EU are likely to fall compared to current levels. The decrease is expected to be largest in the case of a no-deal Brexit (-42 to -32% change in total UK-EU trade volumes compared to current arrangements), followed by an average FTA scenario (-31 to -19), an EEA-type model (-11 to -4) and the White Paper scenario (-9 to -3). UK trade with the rest of the world is expected to increase moderately in all four scenarios, but this increase will not be sufficient to offset the lost trade with the EU.

Proponents of Brexit have argued that the UK's close trading relationship with the EU could be replaced with deeper ties to other countries. As the expected moderate increase in UK trade with the rest of world illustrated in Table 3 suggests, this argument has some merit. However, it is also true that, all else being equal, distance is a key

**Table 3: Estimated change in trade volumes compared to current arrangements**

% change compared to current arrangements	Modelled EEA-type scenario	Modelled White Paper scenario	Modelled average FTA scenario	Modelled no deal scenario
UK-EU total trade volumes	-11 to -4	-9 to -3	-31 to -19	-42 to -32
UK exports to EU	-9 to -2	-8 to -2	-30 to -17	-40 to -30
UK imports from EU	-12 to -5	-10 to -4	-32 to -20	-43 to -34
UK-rest of world total trade volumes	+4 to +4	+3 to +4	+5 to +6	+6 to +7
Total trade volumes	-3 to 0	-3 to 0	-13 to -7	-18 to -13

Source: UK government.

determinant of trade – in line with the principle of ‘economic gravitation’.<sup>8</sup>

This principle states that trade flows between two economies depend on the product of their size and (inversely) on their distance from each other. Empirical research suggests that the economic gravitation principle explains relatively well-observed trade patterns across the globe. This implies that expanding trade with the ‘rest of the world’ may not be enough to offset losses in EU-UK trade, as the rest of the world is typically located at greater distances. This applies to the EU too, though the relative impact of reduced trade flows with the UK will be smaller.

## NO DEAL PLANS

The UK government has proposed a temporary tariff schedule that would apply in the event of a no deal Brexit, which marks a significant shift from the status quo.

While in terms of import value the plans would not lead to a significant increase in the degree of tariff liberalisation – the UK government estimates that 87% of imports by value would be tariff-free,<sup>9</sup> up from currently around 80% – it would change the tariff structure profoundly. The share of tariff-free imports from the EU, currently 100%, would fall to 82%, while for countries with which the UK trades on Most Favoured Nations terms, the proportion

Proponents of Brexit have argued that the UK’s close trading relationship with the EU could be replaced with deeper ties to other countries.

would increase from a current 26% to 95%.<sup>10</sup> Tariffs would continue to be applied on certain products, such as cars (but not car parts), beef and certain dairy products.

The UK government's proposal reflects a desire to protect certain industries, such as car manufacturing and some sectors of agriculture, while limiting possible price increases that could ensue from greater barriers to trade (potentially aggravated by a depreciation of the pound) in the immediate aftermath of a no deal Brexit. However, low/zero-level tariffs might leave the UK with less leverage in upcoming trade negotiations. Furthermore, although the tariff schedule is intended to be temporary, the government might find it difficult to increase or reintroduce tariffs in future. Firms will have already adapted to the positive and negative consequences and might oppose further changes that would cause yet more uncertainty and disruption.

The economic impact will be asymmetric. While neither side will remain unscathed, proportionally, the UK will be hurt much more than the EU. Even if more trade with other countries can offset some of the lost EU-UK trade, it is unlikely that this will compensate either side, especially the UK, in full.

## INDIRECT IMPACTS

The uncertainty created by Brexit has also impacted value chains. According to the Institute for Fiscal Studies, goods or services used in supply chains accounted for 69% of UK exports to the rest of the EU in 2014.<sup>11</sup> Similarly, over half of EU exports to the UK are intermediate inputs. Additional friction through tariff or non-tariff barriers could disrupt those supply chains and threaten 'just in time' business models. This could impact EU companies' decisions on where to invest in new capacity. Moreover, due to the uncertainty over the future EU-UK relationship, EU companies could replace their UK suppliers with firms based in remaining member states. Both developments – less investment in the UK and the cutting out of UK suppliers – would have negative knock-on effects on a variety of measures, including GDP, jobs, tax returns, innovation and long-term competitiveness.

One factor that could mitigate these developments somewhat is the falling value of the pound, which makes UK exports more competitive. However, any depreciation raises the cost of imports, pushing up prices and inflation. This affects both consumers and UK businesses with suppliers based in the Eurozone. It remains to be seen whether a possible boost to exports will outweigh the negative consequences associated with Brexit.



## CONCLUSION

It is virtually certain that the close EU-UK trading relationship will be interrupted as a result of Brexit. The scale of the impact will depend on the future relationship. A ‘Norway plus’ model would minimise the damage, while a no-deal Brexit would be the worst-case scenario. The economic impact will be asymmetric. While neither side will remain unscathed, proportionally, the UK will be hurt much more than the EU. Even if more trade with other countries can offset some of the lost EU-UK trade, it is unlikely that this will compensate either side, especially the UK, in full.

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<sup>1</sup> The author acknowledges research input by Simon Miegielsen, as well as comments on the paper by Fabian Zuleeg and Vincent Verouden. Any errors remain those of the author.

<sup>2</sup> UK Office for National Statistics, UK Trade: March 2016.

<sup>3</sup> ONS, “Who does the UK trade with?”, 3 January 2018.

<sup>4</sup> Full Fact, “Everything you want to know about the UK’s trade with the EU”, 28 august 2018.

<sup>5</sup> UK Parliament, Statistics on UK-EU trade, (30 November 2018).

<sup>6</sup> UK Government, “EU Exit. Long-term economic analysis”, November 2018.

<sup>7</sup> For this purpose, the long term is interpreted as being around 15 years after the UK’s new relationship with the EU comes into effect.

<sup>8</sup> The economic gravitation principle stipulates that bilateral trade flows are proportional to relative economic size (as measured by GDP) and inversely proportional to geographical distance. See Verouden and Ibanez Colomo (2019) in their contribution to this volume and the references to the economic literature contained therein.

<sup>9</sup> UK Government, “Temporary tariff regime for no deal Brexit published”, March 2019.

<sup>10</sup> Gasiorrek, Michael; Magntorn Garrett, Julia; Winters, Alan L., “What should we make of the UK’s No-Deal tariffs?”, *UK Trade Policy Observatory*, 14 March 2019.

<sup>11</sup> Levell, Peter, “Firms’ supply chain form an important part of UK-EU trade: what does this mean for future trade policy?”, *Institute for Fiscal Studies*, 8 January 2018.



# Environmental standards and regulation

Emily Lydgate<sup>1</sup>

3

# Introduction

As environmental regulation imposes costs, there is an incentive for governments to give their industries a competitive advantage through deregulation.

The Withdrawal Agreement links environmental non-regression to a specific UK-EU customs union. However, if the UK and EU go beyond this, pursuing deep regulatory alignment, it will also prove a source of fundamental disagreement.

Both the UK and the EU have called for non-regression of environmental standards and regulation in their future relationship.<sup>2</sup> As environmental regulation imposes costs, there is an incentive for governments to give their industries a competitive advantage through deregulation. The EU has tried to prevent this problem in existing trade agreements by including a requirement for non-regression of environmental standards. The draft Withdrawal Agreement of November 2018 also includes requirements for non-regression of environmental standards that would apply, as part of the so-called backstop, if a future relationship agreement were not concluded by the end of the transition period.<sup>3</sup> Even if (and when) the backstop is superseded by the future relationship, the UK and the EU have indicated that this relationship will build on these commitments.<sup>4</sup>

In this note I first describe why this ‘environmental backstop’ is an innovative hybrid between the full alignment with environmental legislation required in EU Association Agreements and the European Economic Area (EEA) Agreement, and the arm’s length non-regression requirements that the EU has negotiated in its trade agreements with countries such as Canada and Korea. It also has some unique features. Notably, successful implementation would require substantial reform in UK environmental monitoring and enforcement. I thus examine how it might function in practice, focusing on challenges with enforcement. Finally, I analyse its applicability to different models for the future relationship. The Withdrawal Agreement links environmental non-regression to a specific UK-EU customs union. However, if the UK and EU go beyond this, pursuing deep regulatory alignment, it will also prove a source of fundamental disagreement. The UK’s current position is to push for non-regression to stand in for regulatory alignment, whilst the EU will likely reject such an approach.

# Innovative environmental governance between the EU and UK

With respect to environmental regulation, the UK-EU relationship is unique. It is most likely that their future relationship will diverge from existing regulatory alignment, rather than attempting to increase it, the objective of most trade agreements. Yet the UK aims to transpose existing EU regulation. This shared starting point, combined with the current degree of trade integration, means that derogations will be watched more closely and felt more keenly.

The environmental backstop reflects this unique situation through innovative elements. It provides a hybrid between ‘shallow’ (standard EU FTA) approaches to environmental non-regression and ‘deep’ (EEA or Association Agreement) alignment with environmental regulation. In the former, the EU has attempted to secure an environmental ‘level playing field’ through non-regression clauses in Trade and Sustainable Development (TSD) chapters. Broadly speaking, these prohibit the weakening, or poor enforcement, of existing environmental laws in order to benefit trade or investment. Such non-regression clauses have limited aspirations, as they are included in FTAs with countries with whom the EU has little or no existing bilateral environmental cooperation or legislative alignment. Marx, et al., argue that *“the main added value of TSD chapters may ... not lie in the ‘harmonisation’ of social and environmental standards between the partners, but rather in fostering dialogue and cooperation to achieve sustainable trade in the long run.”*<sup>5</sup>

In contrast, in its European Neighbourhood Policy, the EU has required partner countries to align gradually with a broad array of EU environmental legislation. The Ukraine Association Agreement, for example, requires Ukraine to adopt EU environmental regulation covering air quality, climate change and environmental impact assessment, among others.<sup>6</sup> Whilst such agreements also contain broad non-regression requirements, these are superseded by substantive alignment, which takes place in the context of overall harmonisation with EU legislation.

With respect to environmental regulation, the UK-EU relationship is unique. It is most likely that their future relationship will diverge from existing regulatory alignment, rather than attempting to increase it, the objective of most trade agreements.

## INNOVATIVE ELEMENT: BREADTH

EU environmental non-regression requirements base shared commitment to environmental protection on economic motivations. The Commission makes this explicit in its presentation on the Level Playing Field with the UK, which concludes that continued UK derogation from the Industrial Emissions Directive ‘best available technologies’ requirement, or reduced UK ambition in national emissions ceiling standards, could provide UK industry with a €4.7 billion per year gain.<sup>7</sup>

Clearly not all environmental regulation is equally likely to provide competitive advantages. For this reason, in existing EU TSD chapters, the requirement not to lower environmental standards is qualified by a causal link with trade and investment. As an illustrative example, the EU-Korea FTA states that Parties shall not “weaken or reduce environmental...protections...to encourage trade and investment....”<sup>8</sup> In contrast, in the environmental backstop the requirement not to regress is absolute: there is no need to establish an effect on trade. Parties commit to non-regression of the level of protection provided by ‘common standards’ in listed areas. The list covers the most relevant areas of the EU environmental *acquis* and is nearly comprehensive in scope; though excluding purely local issues such as noise pollution and bathing water quality. It includes “laws, regulations and practices”, encompassing not only formal regulation but also its implementation. The comprehensiveness of the coverage makes plain that, due to the connectedness between the UK and the EU, the EU views UK competitive environmental deregulation as a particularly pressing concern. By including “nature conservation and biodiversity” on the list, it surpasses all other EU trade agreements, even the EEA Agreement, in thematic coverage.<sup>9</sup> (Though it should be underlined that, in covered areas, the EEA Agreement requires EU regulatory alignment, whilst the environmental

backstop only requires that the same level of protection be achieved.)

However, the agreement also makes targeted commitments in areas that the Commission identified as posing a particular threat to the level playing field. Parties will negotiate emissions limits in three areas: certain atmospheric pollutants, sulphur content of marine fuels and industrial emissions; underscoring the concerns highlighted in the Commission’s presentation, the latter also includes a commitment to ‘best available practices’.

As an environmental non-regression requirement, this is unique. It contrasts with the Association Agreement model of requiring the UK to substantively align with EU environmental legislation, though in a narrower scope of thematic areas. It also departs from existing FTA non-regression requirements, which remain thematically open-ended, but rely upon a causal link between environmental protection and trade and investment.

## INNOVATIVE ELEMENT: ENFORCEMENT

The non-regression commitments above, outlined in Article 2, are exempted from arbitration under the dispute settlement mechanism of the Protocol. This means that there can be no sanctions for non-compliance. However, the monitoring and enforcement commitments of Article 3 *are* enforceable. They are also unilateral, applying only to the UK, and not the EU. Noting that the EU has the Commission and the Court of Justice to uphold the ‘common standards’ identified above, Article 3 of the environmental backstop commits the UK to ensure “effective enforcement of... its laws, regulations and practices”. This includes enabling administrative and judicial proceedings by public authorities and members of the public. It also commits the UK to providing for effective remedies

including sanctions that are effective, proportionate and dissuasive and have a real and deterrent effect”. It states that this UK body should be able to initiate inquiries of breach by the government, and bring legal action with a view toward an ‘adequate remedy’.

Again, this contrasts with existing models. TSD chapters emphasise domestic enforcement as the primary means to uphold non-regression requirements. For example, EU-Korea Article 13.7(1) requires that “A Party shall not fail to effectively enforce its environmental ... laws, through a sustained or recurring course of action or inaction, in a manner affecting trade or investment between the Parties.”

However, the EU excludes TSD chapters from state-to-state dispute mechanisms, enforcing them instead through a panel of experts which can make non-binding recommendations.<sup>10</sup> Commitments to uphold labour and environmental standards function through the FTA’s establishment of monitoring bodies and committees of government officials, civil society, business and trade union representatives. For these reasons, such commitments to environmental protection are often described as soft or cooperative.<sup>11</sup>

## Implementation and enforcement

### ESTABLISHING ‘LEVEL OF PROTECTION’

The innovative nature of the environmental backstop makes its implementation and enforcement somewhat unpredictable. Environmental regulation is a dynamic area, and in the absence of ongoing harmonisation it is possible that divergence would take place; indeed, in the UK, the very act of leaving the EU necessitates a degree of domestic regulatory reform, an issue discussed further below. Thus, establishing whether ‘common standards’ have been breached may prove challenging, particularly over time. Article 2 specifies that these are the common standards at the end of the transition period, which fixes them to existing EU legislation. Yet in the future, determining that the UK and EU are achieving the same ‘level of protection’ would require establishing that diverging environmental regulation is equivalent. Presumably there will be communication

Environmental regulation is a dynamic area, and in the absence of ongoing harmonisation it is possible that divergence would take place; thus, establishing whether ‘common standards’ have been breached may prove challenging, particularly over time.

Much EU environmental regulation is complex and process-oriented, focusing on ecosystem or life-cycle management, and including public participation requirements and economic instruments.

These practical problems with assessing level of protection suggest that enforcing a broad non-regression requirement is effectively impossible.

In sum, to uphold common standards, the UK must not just replicate lost EU bodies and institutions – it must better its current practice. The backstop provides the EU a means of scrutiny. In this sense, it is ambitious.

to establish this in the Joint Committee that implements the Agreement, and between EU and UK environmental regulators. While ongoing communication would not aim at harmonisation, it might make harmonisation more likely, partly in order to avoid potential conflict.

As stated above, the non-regression requirement is exempted from direct dispute settlement via arbitral tribunal; disputes must be settled via the Joint Committee. However, the EU can pursue a perceived derogation from common standards under Article 2 as a failure of UK monitoring and enforcement under Article 3. Article 3(1) states that the benchmark for UK effective enforcement is its ability to uphold the common standards referred to in Article 2(1). Thus, while a substantive failure to uphold level of protection can prompt a dispute, its outcome is determined on procedural grounds, through assessing whether the UK has met the requirements for monitoring and enforcement.

To some extent, this shows a clear-eyed view of the limitations of an arbitral tribunal. Much EU environmental regulation is complex and process-oriented, focusing on ecosystem or life-cycle management, and including public participation requirements and economic instruments. This gives rise to questions that would strain the expertise of an arbitral tribunal: is the level of protection outcome-based, or does it encompass procedural requirements? If the UK adopted different regulatory strategies – moving from emissions limits to tradeable permits, or giving manufacturers greater scope to self-certify that they had met emissions limits – would the EU be able to argue that this constituted a lower level of protection? What if the UK decides to ‘cut red tape’ and reduce costs by reducing the requirements for monitoring and the frequency of public consultation? As I have argued in the context of WTO dispute settlement,<sup>12</sup> environmental problems pose challenges for trade tribunals precisely because their causes – and results – are often diffuse and scientifically complex. This would complicate evidence-based approaches to establish ‘equivalence’ between approaches.

A further, though less fatal, problem is the discrepancy between level of protection in law and in practice. The Commission’s Environmental Implementation Review makes clear that many member states fall short. Thus, assessing derogation from non-regression requirement risks imposing stricter standards on the UK than on existing EU member states. To avoid this, enforcement of a non-regression clause would need to rest upon EU levels of



protection in practice. But if the UK were only compared to the EU's worst actors, or its own level of protection at the time it leaves the EU, this lessens the rigour of the requirement. The existing structure avoids these problems by calling for the UK to establish a domestic system of administrative enforcement and judicial review that is equivalent to that imposed in the EU.

These practical problems with assessing levels of protection suggest that enforcing a broad non-regression requirement is effectively impossible. Yet the requirements to negotiate specific quantitative standards for industrial emissions and pollution avoid these problems, and the rationale for exemption is less clear.

## UNILATERAL ENFORCEMENT

Meeting the environmental backstop's monitoring and enforcement requirements outlined in Article 3 will necessitate significant domestic reform in the UK. The environment is a closely integrated EU policy area, and the UK government has stated that it will be unable to transpose a third of EU environmental regulation due to inability to replicate the functions of EU bodies and agencies.<sup>13</sup> Even when the UK successfully transposes EU regulation, it will not be the same. Many environmental directives provide significant flexibilities for member states' implementation, and rely upon ongoing reporting and evaluation from the Commission. The UK must replicate the EU's monitoring functions.<sup>14</sup>

With respect to judicial enforcement, environmental infringement cases are the most likely of any category to end up before the Court of Justice of the European Union (CJEU), and the UK has lost the majority of these cases.<sup>15</sup> In the absence of the CJEU, Article 3 requires the UK to establish an environmental body that can bring legal action for an 'adequate remedy'. At the time

of writing (before the publication of the UK Environmental Principles and Governance Bill) this arguably goes beyond its stated commitment.<sup>16</sup> Article 3 also commits the UK to enabling administrative and judicial proceedings by members of the public. The Aarhus Convention Compliance Committee has raised concerns regarding the UK's high threshold for initiating judicial review of environmental decisions of public bodies, which allows scrutiny only on procedural grounds, rather than examination of the substantive legality of these decisions.<sup>17</sup> The environmental backstop commits Parties to implement effectively the multilateral environmental agreements to which they are party. This includes the Aarhus Convention, some of whose requirements for rights of access to information, public participation and access to justice for environmental matters are replicated in Article 3 of the environmental backstop. However, listing compliance with the Aarhus Convention, including recommendations of its Compliance Committee, would have provided another yardstick to measure the effectiveness of UK environmental enforcement.

In sum, to uphold common standards, the UK must not just replicate lost EU bodies and institutions – it must better its current practice. The backstop provides the EU a means of scrutiny. In this sense, it is ambitious.

Despite its broad scope, it still seems most likely that the EU would utilise this enforcement mechanism only if its competitive interests were clearly at stake. That is to say, deregulation concerns about industrial emissions and pollution that motivated these provisions are also most likely to prompt a contentious dispute. In this sense, it is unlikely to function as a broad environmental protection instrument. Its enforcement in practice will probably implicitly incorporate a 'causal link' between lowering protection and benefitting trade and investment.

There could be significant divergence in environmental regulation *between* countries within the UK. In Wales, Scotland and Northern Ireland, environmental protection is a devolved competence. This could lead to difficulties in enforcing Article 3, if for example Scotland decided to continue aligning its regulation with that of the EU whilst England diverged.

Yet avoiding the requirement to establish this causal link explicitly makes better environmental protection outcomes more likely. While determining ‘level of protection’ would likely prove challenging for an arbitral tribunal, establishing a causal link is similarly challenging. A recent dispute under the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) illustrates the point. In the dispute, the US argued that Guatemala had failed to enforce its own labour laws by, *inter alia*, preventing workers from forming unions, resulting in a competitive advantage over US workers. The Tribunal failed to establish that the weakening took place “in a manner affecting trade”, arguing that “attempting to establish that an effect on prices is due to a failure to enforce and not to ... other factors would often be so fraught with difficulty as to make proof of trade effects impossible.”<sup>18</sup> Further, it argued, it is impossible to establish that companies respond to such effects by lowering their prices. There is scope to soften the approach. Notably, more emphasis could be placed on the intent of the lowering of protection, rather than requiring that a competitive effect be evidenced, which may be (as the tribunal noted) virtually impossible. However, establishing discriminatory intent is not necessarily any more straightforward, as there may not be clear evidence; evaluating intent has long proved a source of controversy, for example, for the WTO.<sup>19</sup>

Thus, establishing a causal link may be so difficult that even established derogation does not meet with any consequence. Alternatively, the environmental backstop could have stipulated that, due to the geographic proximity and economic connectedness of the UK and EU, any derogation would automatically constitute a benefit to trade and investment. Given the wide scope of coverage, this would far exceed the concerns regarding competitive deregulation that motivated the environmental backstop. The current approach avoids these pitfalls.

A final point is that there could be significant divergence in environmental regulation between countries within the UK. In Wales, Scotland and Northern Ireland, environmental protection is a devolved competence. This could lead to difficulties in enforcing Article 3, if for example Scotland decided to continue aligning its regulation with that of the EU whilst England diverged.

# Environmental non-regression in the UK-EU future relationship

## IN A CUSTOMS UNION OR FREE TRADE AREA

The level playing field requirements, including the environmental backstop, were introduced in conjunction with the UK-EU customs union (more precisely, the ‘arrangements for a single customs territory comprising the EU, Northern Ireland and Great Britain’), to ensure its ‘proper functioning’.<sup>20</sup> However, it would be a mistake to view them simply as offsetting the competitive threats resulting from the relatively high level of market access that a customs union would preserve.<sup>21</sup> In fact, the environmental backstop will likely comprise an EU baseline even in the absence of a customs union. EU member states’ desire to introduce LPF guarantees is motivated by divergence from the regulatory status quo. As Chief EU Negotiator Michel Barnier has stated:

*The mechanics of divergence should not lead to unfair competition, because if we do not answer this question... It will be said that Brussels is conducting negotiations with the UK to downgrade environmental and social standards.... If that happens, everything is over.*<sup>22</sup>

The Political Declaration on the future relationship also affirms that it will ‘...[build] on the level playing field arrangements provided for in the Withdrawal Agreement ....’<sup>23</sup>

As compared to a customs union, an FTA would provide the UK with greater scope for an independent trade policy. Normally, non-regression requirements do not impose restrictions on traded products. However, the breadth of the requirement encompasses some product-related

regulation. The most direct clash would result from its non-regression requirement for common standards for “the prevention, reduction and elimination of risks to human health or the environment arising from the production, use, release and disposal of chemical substances”. This corresponds thematically with EU REACH regulation, which applies to a wide range of products and sectors.

The EU could interpret this requirement as limiting the UK’s ability to align with differing third party regulation, such as that of the US, in areas affected by REACH. The point is largely academic, however. The UK has consistently expressed an interest in maintaining alignment with the EU in highly regulated sectors, a point discussed further below. Also, the EU regulates the import of goods from third countries to ensure compliance with its own standards, which include those related to production process.

## IN A DEEP REGULATORY ALIGNMENT (SINGLE MARKET) MODEL

The environmental backstop likely comprises a minimum standard for a future FTA. Unless its position evolves, the UK government will argue that non-regression requirements should also feature in a future agreement that involves deep regulatory alignment, in place of alignment with the EU environmental *acquis*. This is likely to comprise a significant axis of disagreement. In their future relationship, the UK has proposed that its trade with the EU be governed by a common rule-book<sup>24</sup> for product-related regulation ‘necessary to provide for frictionless trade at the border’, but that non-product-related regulation

The UK's proposal, likely shaped by the imperative of maintaining an open intra-Irish border, provides an instrumentalist understanding of regulatory integration as concerning the removal of border barriers.

There is no reason to believe that the EU would enable derogation in environmental regulation and suspend EU monitoring and enforcement whilst the UK achieved frictionless market access for its product-related regulation. Nor would it be straightforward to draw a line between the two.

should not be harmonised. Instead the UK proposes a non-regression requirement to maintain high environmental standards.<sup>25</sup> The UK's proposal, likely shaped by the imperative of maintaining an open intra-Irish border, provides an instrumentalist understanding of regulatory integration as concerning the removal of border barriers.

With respect to intra-EU environmental law, the distinction between product-related and non-product related environmental regulation has some salience. Many environmental directives that focus on national environmental protection – for example, water and air quality, species protection, waste disposal – proscribe a minimum level of protection. This serves to prevent competitive advantages between EU member states. The concept of minimum level of environmental protection has been codified as an EU principle in Article 193 TFEU:

*The protective measures adopted pursuant to Article 192 shall not prevent any Member State from maintaining or introducing more stringent protective measures. Such measures must be compatible with the Treaties. They should be notified to the Commission.*

On the other hand, EU directives tend to impose total harmonisation, that is, a uniform rule from which derogation is impermissible when there is greater potential of infringing upon the functioning of the internal market, such as regulatory standards for products where differences between member states could create barriers to free movement of goods. Member states can justify such restrictions under Article 36 TFEU. Once these requirements are harmonised under an EU directive, such derogation is no longer permitted.<sup>26</sup>

In some respects, this mirrors the UK's proposed distinction between rigid harmonisation with respect to product-related regulation and minimum levels of protection for domestic environmental regulation. Yet the parallel is limited, and it is extremely unlikely that the EU would support such an approach. Within the EU, member states can only derogate upward, and in the context of a commitment to implementing the specific aims of the legislation, as well as broad, and increasing, harmonisation of environmental regulation. The UK's proposal for non-regression, on the other hand, aims to substitute harmonisation with a simpler and more basic commitment. There is no reason to believe that the EU would enable derogation in environmental regulation and suspend EU monitoring and enforcement whilst the UK

achieved frictionless market access for its product-related regulation. Nor would it be straightforward to draw a line between the two.<sup>27</sup>

## CONCLUSION

In its uniqueness, the environmental backstop poses a challenge to the EU's characterisation of the UK's options for the EU-UK trade relationship as bi-modal: either EEA-style (full) or Canada-style (shallow) regulatory integration.<sup>28</sup> Instead, it demonstrates that the EU and UK are willing to negotiate new arrangements that accommodate their conflicting 'red lines'. This suggests that the future relationship could result in real innovation.

Whilst this innovation resolves conflicting positions, it also entrenches compromise. For environmental advocates, the environmental backstop will prove disappointing in that, in practice, there are only a limited range of circumstances in which the EU would likely hold the UK to account for environmental lapses. Yet, in its enforcement powers and the fact that it does not require establishing a causal link to trade and investment, it improves upon existing EU FTAs.

Advocates of a more distant relationship will be infuriated that the EU can unilaterally scrutinise whether UK monitoring and enforcement lives up to 'common standards', particularly if (and, as I argue, when) such requirements are incorporated into their future relationship. In the end, no amount of clever drafting can bridge the divide between those in the UK who argue for the benefits of EU environmental regulation, monitoring and enforcement, and those who are eager to cast it off. Whilst the environmental backstop calibrates well between these two positions, the challenge facing the UK is that such compromises seem to please no one.

In the end, no amount of clever drafting can bridge the divide between those in the UK who argue for the benefits of EU environmental regulation, monitoring and enforcement, and those who are eager to cast it off.

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- <sup>2</sup>. Barnier, M "Is Brexit a threat to the future of the EU's environment?", 10 April 2018; HM Government, Framework for the UK-EU Partnership: Open and fair competition, 25 July 2018.
- <sup>3</sup>. European Commission, Protocol on Ireland/Northern Ireland, Article 6(1), and Annex 4.
- <sup>4</sup>. HM Government, Draft Political Declaration setting out the framework for the future relationship between the EU and UK, 22 November 2018, Article XIV para 79.
- <sup>5</sup>. Marx, A. et al. (2016), "Dispute Settlement in the Trade and Sustainable Development Chapters of EU Trade Agreements", Leuven: Centre for Global Governance Studies, p. 15.
- <sup>6</sup>. See [https://trade.ec.europa.eu/doclib/docs/2016/november/tradoc\\_155103.pdf](https://trade.ec.europa.eu/doclib/docs/2016/november/tradoc_155103.pdf)
- <sup>7</sup>. European Commission, Slides on a Level Playing Field, p. 37.
- <sup>8</sup>. Article 13.7, EU-Korea FTA. It should be noted that some TSD chapters include unqualified commitments to high levels of environmental protection in the form of aspirational best endeavours clauses; eg, in the EU-Canada Comprehensive Economic and Trade Agreement (CETA), Parties "...shall seek to ensure [their] laws and policies provide for and encourage high levels of environmental protection and shall strive to continue to improve such laws and policies and their underlying levels of protection" (Article 24.3).
- <sup>9</sup>. The EEA Agreement excludes the Habitats and Birds Directive.
- <sup>10</sup>. European Commission non-paper, 2017, "Trade and Sustainable Development (TSD) Chapters in EU Free Trade Agreements (FTAs)"; Harrison, J. et al., (2018) "Governing Labour Standards through Free Trade Agreements: Limits of the European Union's Trade and Sustainable Development Chapters", *Journal of Common Market Studies* pp. 1-18; Marx, et al., above n. 5, pp. 1-102.
- <sup>11</sup>. European Commission non-paper, *ibid*.
- <sup>12</sup>. See, e.g., Lydgate, E. (2013) "The EU, the WTO and indirect land use change" 47(1) *Journal of World Trade*, 159-186; Lydgate, E. (2012) "Biofuels, sustainability and trade-related regulatory chill" 15(1) *JIEL* 157-180; Lydgate, E. "Is it rational and consistent? The WTO's surprising role in shaping domestic public policy", 21(2) *JIEL*, 1-22.
- <sup>13</sup>. Environmental Audit Committee, "The Future of the Natural Environment After the EU Referendum", Sixth Report of the Session, 14 December 2016, p. 18.
- <sup>14</sup>. For a useful discussion of this topic, see: Hogarth, R., Stojanovic A. & Rutter J. (2018), "Supervision after Brexit: Oversight of the UK's future relationship with the EU", Institute for Government.
- <sup>15</sup>. Hogarth R and Lloyd L. (2017), "Who's Afraid of the ECJ?" Institute for Government.
- <sup>16</sup>. See Harvey, F. "Lawyers say Gove proposals for Brexit environmental watchdog are useless", *The Guardian*, 7 August 2018.
- <sup>17</sup>. Aarhus Convention Compliance Committee, Communication ACCC/C/2008/C33.
- <sup>18</sup>. Dominican Republic – Central America – United States of America, *In the Matter of Guatemala – Issues Relating to the Obligations Under Article 16.2.1(a) of the CAFTA-DR*, Final Report of the Panel, circulated June 14 2017, pp 58-60.
- <sup>19</sup>. For a discussion of intent versus effect in WTO non-discrimination case law, see: Lydgate E. (2016), "Sorting out mixed messages under the WTO national treatment principle: a proposed approach", *World Trade Review* pp 1-28.
- <sup>20</sup>. Above n. 3, Article XIV, para. 79.
- <sup>21</sup>. This market access would result from removing the need for border checks verifying the origin of goods; regulatory border checks would still take place and regulatory divergence between the UK and EU would be permitted, although Northern Ireland would maintain broad regulatory alignment with the EU.
- <sup>22</sup>. Michel Barnier, Corrected Oral Evidence: Scrutiny of Brexit negotiations, House of Lords EU Committee, Q8, 12 July 2017, response to Q 8.
- <sup>23</sup>. Above n. 4 at Article XIV, para 79.
- <sup>24</sup>. Its common rulebook will cover manufactured goods and agri-foods, but only applies to regulations 'necessary to provide for frictionless trade at the border'. With respect to agri-food, the UK states that, alongside the 'common rule book' in animal and plant health (Sanitary and Phytosanitary 'SPS') regulation, it wants to maintain 'equivalence' (rather than harmonisation) on 'wider food policy rules'. Areas for 'equivalence' include marketing and labelling requirements (Section 1.2.4). Areas for divergence include the Common Agricultural Policy and Common Fisheries Policy.
- <sup>25</sup>. The White Paper states that the UK will commit to "high regulatory environmental standards through a non-regression requirement".
- <sup>26</sup>. Jan H. & H.B. Vedder (2012), "Harmonization, in 'European Environmental Law', Groningen: Europa Law Publishers, p. 99.

<sup>27</sup> A number of cases in EU law concern precisely the boundary between environmental and product-related regulation, notably whether member states are permitted to impose restrictions on free movement in service of environmental objectives that go beyond minimum standards imposed in EU directives. In this context, the ECJ determined that all waste is to be regarded as goods. This in itself would make it difficult to ring-fence product regulation. See Kramer, L (2008), "Environmental judgments by the Court of Justice and their duration", Research papers in law, No 4/2008.

<sup>28</sup> European Commission, Slide presented by Michel Barnier, 19 December 2017.





# Technical regulation and standards

Jacques Pelkmans

4

# Introduction

This paper is concerned with a very large and crucial area of EU goods regulation, namely technical regulation, standards and conformity assessment, and its impact on the Brexit negotiations for a future trade and investment relationship.

Strictly speaking, the area is not part of the discussion on the level playing field (LPF) because it has not been classified as such in the provisions on LPF so far. However, the UK's insistence on 'regulatory autonomy' and the Brexiter mantra of 'taking back control' raises a number of complex issues. One of which is the frequent allegation that the EU is guilty of overregulation. 'Taking back control' would imply lowering the stringency and quality of what is inherited from the EU technical regime for goods, once the UK is out. Given the huge importance of the value chains reaching across the Channel, this prospect has generated some nervousness in EU business and consumer circles.

As will be shown, the EU's general position with respect to its technical regulatory regime is clear, but what about the details and sectoral specifications? And how has the UK government so far positioned itself? The basis for this positioning is the proposal from the UK – in the White Paper of 12 July 2018 (also called the Chequers paper)<sup>1</sup> – to have the UK-EU27 trade in goods be governed by a 'common rulebook', but only insofar as this would be required for 'frictionless trade' over borders.

The first section sketches the situation in early 2019, following the agreement (but not yet the ratification) of the Withdrawal Agreement and of the Political Declaration. The second section gives an exposition of – what the Commission calls – the "unique ecosystem" of the EU internal market. This is key to understanding how and where a common rulebook and the EU internal market

(technical regulation) regime are likely to differ. The third section sets out the common rulebook proposal in the Chequers White Paper, which seems to go some way towards harmonisation and dynamic alignment. The fourth section provides some detail on compliance issues in the UK proposal, critical for the credibility of the Chequers proposal. The fifth section discusses the heavily regulated sectors, where the EU regulatory regimes tend to be inflexible precisely because of the higher risks for workers and consumers. This has been a problem with third countries close to the EU, such as Switzerland, Turkey or even in some modest respects the EEA-3 countries. This might well be true for the UK as well. The discussion will cover motor vehicles, chemicals, medicines and agri-food. The sixth section deals with the main provisions of FTAs or customs unions – without too much detail, however – juxtaposing this with the ideas of the common rule book.

## THE WITHDRAWAL AGREEMENT, THE POLITICAL DECLARATION AND THE TECHNICAL REGULATORY REGIME

In the post-Brexit trade and investment relationship between the EU27 and the UK, the EU insists on a level playing field (LPF). This is recognised in the Political Declaration between the UK and the EU27 from 22 November 2018<sup>2</sup> in paragraphs 22 and 17 respectively with the words:

*"...underpinned by provisions ensuring a level-playing field for open and fair competition." And "It should facilitate trade and investment between the Parties to the extent possible, while respecting the integrity of the Union's Single Market and the customs union as well as the UK's internal market, and recognising the development of an independent trade policy by the UK beyond this economic partnership."*

Another provision is the short paragraph 79 of the Declaration, devoted to LPF, but principally<sup>3</sup> specifying the areas where it should apply: state aid, competition, social and employment standards, climate change and relevant tax matters.

It does, however, refer to the Withdrawal Agreement,<sup>4</sup> which – at first sight – might appear to be incorrect because that Agreement is not about the future trade and investment agreement between the EU27 and the UK. The reason for this ‘bridge’ between the Withdrawal Agreement and the Political Declaration is found in the Protocol on Ireland/Northern Ireland. Since the post-Brexit relationship will, for a while until the solution for the Northern Irish border has been agreed and ratified, be governed by the Protocol, the Agreement has been structured almost ‘as if’ it were a deep trade and regulatory accord in goods. In doing so, it overlaps with the Political Declaration, which is basically a Memorandum of Understanding on what and how to negotiate that future relationship between the EU27 and the UK. There is a major difference, however, because the Protocol retains (for as long as it takes) a customs union and other far-reaching applications of EU-based regulatory obligations in goods, the text of the Protocol is very detailed and includes numerous references to EU directives and regulations. In Article 6(1) the LPF is brought up and Annex 4 (of the Protocol) is referred to for the conditions required for “the proper functioning” of the LPF. The lengthy and detailed Annex 4<sup>6</sup> provides fairly precise guidance. However, technical regulations and technical standards are not part of these LPF areas and detailed guidance because – in goods – market access from the UK to the EU27 single market during the transition period and under the Protocol on Ireland/Northern Ireland<sup>5</sup> is strictly governed by the EU regulatory *acquis*. This regulatory *acquis* is referred to by means of long lists of the relevant regulations and directives over a total of 60 pages.<sup>7</sup>

The European Council Guidelines of April 2017 prescribe that a “...level playing field must be ensured... and encompass safeguards against unfair competitive advantages through [...] regulatory measures and practices”. The Commission Task Force on Article 50 TFEU has published extensive background considerations with respect to state aid, taxation, social and environmental measures but not on “regulatory measures and practices”.<sup>8</sup> On 21 February 2018, however, the Task Force published a comprehensive slide presentation on “Regulatory Issues”,<sup>9</sup> focusing on the ‘gaps’ between FTA regulatory approaches and the internal market *acquis*. Although the Commission does not discuss the LPF

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as such in these slides, it is relevant for the analysis of the LPF in technical regulation and standards.

Moreover, in an annex to COM(2018) 556 of 19 July 2018 “Preparing for the withdrawal of the UK”, a list of “Brexit Preparedness Notices” is spelled out,<sup>10</sup> nine of which comprise regulatory aspects of the break-up for (industrial) goods and another eight for SPS-type rules for agri-food. The question of regulatory disparities, including technical standards, differs from the four other areas mentioned above in that UK industrial goods exports to the EU27 after Brexit will have to respect EU internal market rules, irrespective of what the UK might wish to regulate once it is no longer an EU member state.

It seems, therefore, that experiences and agreements with other third countries via FTAs and customs unions or even Mutual Recognition Agreements (MRAs)<sup>11</sup> with the EU might be insightful to appreciate the kind of issues at stake for Brexit in the area of technical regulation and standards. But they are *not* treated as LPF issues since, strictly speaking, disparities affecting the competition inside the single market cannot occur. In actual practice, the dividing line is sometimes rather blurred, causing or rendering permanent a degree of fragmentation of the single goods market in very specific instances.

In addition, for trade in goods with third countries, some association agreements and FTAs<sup>12</sup> provide different degrees of market access, coupled to distinct degrees of commitments to align with EU law and harmonised European technical standards.

## **HARD GENERAL PRINCIPLES OF THE EU SINGLE MARKET**

The EU single market is attractive because it is a set of deep and robust commitments based on ‘pooled sovereignty’ between member states. The UK has traditionally

– and indeed, until very recently – been a strong proponent of the single market, always pushing to strengthen, deepen, widen and modernise it in light of new technologies and digitalisation. Why the UK of today insists on three red lines that go against their erstwhile enthusiastic pursuit of the single market is therefore puzzling, here in goods; leaving the customs union; regulatory autonomy; and the rejection of the supremacy of the CJEU.<sup>13</sup>

The establishment and proper functioning of the internal market is a function of four elements working together: free movement (of goods, services, persons and workers as well as capital – this is a right to access all EU national markets and be mobile within the EU); common regulation (correcting market failures, mostly about risks of health, safety, environment, saver and investor protection and consumer protection); EU competition policy (specifically about the market failure of competitive distortions); and mutual recognition (no EU regulation, only national and yet free movement). For the EU, it is critical that the integrity and proper functioning of the internal market is preserved,<sup>14</sup> which renders it close to impossible to allow sector-by-sector participation.

Another red line is that the EU’s decision-making autonomy and the role of the CJEU is fully preserved; the first is inconsistent with any form of co-decision with the UK (or any other third country) whereas the second is inconsistent with one of the UK’s Brexit red lines. It follows that the EU internal market is a quasi-federal system given the radical right of free movement (otherwise, only found in unitary states or federal countries) and a common regulatory regime<sup>15</sup> guided by subsidiarity and proportionality, ‘good regulation’ principles and a federal (or, multi-level) governance of legal and enforcement functions. From a legal point of view, this governance or (in the Commission’s wording) the ‘ecosystem’ of the EU internal market comprises three

blocks: apart from the treaty rules and secondary EU law, a judicial block (judicial review by courts and the CJEU and its enforcement); a supervisory block of what actually happens in markets (including market surveillance); and an administrative block (typically at two levels of government, including implementation and enforcement e.g. at member state level). Unravelling this system, even partially, or finding exceptions or “creative arrangements” (Theresa May) that have no basis in the treaty or amount to cherry-picking is likely to be regarded by the EU as a ‘systemic issue’. It hinges on the quasi-constitutional commitment underlying the EU single market. Such a commitment is not ‘transactional’ – an attitude that considers that certain ties and written promises are always inherently negotiable. Truly deep market integration is easier to reach when negotiability of commitments is almost completely excluded, because this generates trust and mutual expectations in the long run. Repeated attempts to obtain exceptions, carve-outs or opt-outs (while maintaining opt-ins) reflects a transactional approach that is quite normal for routine trade or other negotiations, but is at odds with the quasi-constitutional idea of the EU single market, i.e. unconditional free movement. This is also reflected in the governance of the single market, which is indeed quasi-constitutional.

From this single market founding principle, one can turn to the post-Brexit UK-EU trade relations in goods, with a focus on technical regulations, standards and conformity assessment.

## THE COMMON RULEBOOK IN THE CHEQUERS PROPOSAL

The Chequers proposal to the EU was a result of the rejection by the UK of the two options offered by the EU: a kind of EEA-plus or a standard FTA, be it in combination with Northern Ireland in the EU customs union (hence, a border between Northern Ireland and Great Britain).<sup>16</sup> A third outcome is also proposed in Chequers. With respect to goods, it consists of the Facilitated Customs Arrangement (FCA) and a common rulebook for all industrial and agro-food goods including fisheries. The FCA is a UK attempt to avoid any border checks between the EU27 and the UK, whilst not being part of the existing customs union anymore. The idea behind this is that the customs union would severely curtail ‘taking back control’ in the form of an independent UK trade policy with third countries, also in light of Turkey’s experience in the customs union with the EU.<sup>17</sup> The FCA is unlikely to work as proposed<sup>18</sup> and, not least for this reason, has been rejected by the EU27.

The UK has traditionally – and indeed, until very recently – been a strong proponent of the single market, always pushing to strengthen, deepen, widen and modernise it in light of new technologies and digitalisation.

Repeated attempts to obtain exceptions, carve-outs or opt-outs (while maintaining opt-ins) reflects a transactional approach that is quite normal for routine trade or other negotiations, but is at odds with the quasi-constitutional idea of the EU single market, i.e. unconditional free movement.

The remainder of the paper will focus on the (technical) EU goods regulation issues.

The UK offers a common rulebook for manufactured and agri-food goods. However, it “would cover only those rules necessary to provide for frictionless trade at the border”. It would not cover environmental aspects, unless it concerns the environmental requirements of the good itself. In other words, the UK distinguishes environmental aspects relevant for the *inputs* of manufactured goods from environmental requirements of specific goods themselves – the latter would be in the common rulebook as these would be traded goods.

For environmental aspects of inputs as well as for labour and employment rules (influencing labour costs as inputs, too), the LPF would be maintained by means of non-regression clauses. As other authors in this volume (Marley Morris, David Baldock, and Emily Lydgate) show in considerable detail, non-regression clauses in FTAs typically offer a rather weak protection for assuring an LPF, especially over time and in terms of secure enforcement. These clauses would therefore have to be much more robust to engender the sort of trust required for an LPF to be retained after Brexit. However, this robustness would bring in precisely the kind of detailed and strict EU-style governance the UK wishes to avoid in the name of regulatory autonomy. Paragraph 79 of the Political Declaration evades even the slightest detail on the future LPF provisions in the later trade treaty and is therefore not helpful at this stage. But Annex 4 of the Protocol on Ireland/Northern Ireland does provide considerable detail for all the areas involved. I refer here to the contributions of the other authors in this volume.

Focusing on technical regulation and related governance, the UK goes much further in the proposed common rulebook. For manufactured goods, it would imply that goods in circulation meet the necessary requirements, including environmental

requirements such as maximum energy consumption. It therefore advocates harmonisation and dynamic alignment. Technical harmonisation is relatively easy because the day after the break-up, all technical rules and European standards referred to are still the same – a unique situation that is incomparable to any other FTA, no matter how deep and comprehensive. The specific language would seem to leave little to no wiggle room for LPF issues, for several reasons. First, the UK advocates a one-test approach for the EU27 and the UK post-Brexit. Second, it wants arrangements covering all compliance activities.

Third, it seeks continued UK participation in three EU agencies with a regulatory mandate:<sup>19</sup> the European Chemicals Agency (CHA), the European Union Aviation Safety Agency (EASA) and the European Medicines Agency (EMA). The UK accepts that it will have no vote in the agencies.<sup>20</sup> Fourth, the Chequers paper speaks of “strong reciprocal commitments” and a “robust institutional framework”. Fifth, the UK continues its traditional advocacy of the EU’s ‘single standard model’ (where a single voluntary European standard is used to support EU regulation). As a corollary, the UK seeks participation in EU technical committees (without a vote) and to contribute as an ‘active participant’. Although, on occasional invitation, this would be possible, it is quite another matter to count on a *de facto* membership of the many EU technical committees. Given the far-reaching proposals for a common rulebook, the continued membership of the British Standards Institute (BSI) in CEN-CENELEC (the European Committee for Standardization and the European Committee for Electrotechnical Standardization, respectively) should not present a problem. This would also help the UK to influence the global standardisation scene via the European Standardization Organizations (ESOs),<sup>21</sup> which traditionally have been highly influential in the world standardisation bodies ISO (International Standardization Organization) and IEC (International Electrotechnical Commission)

because of a long-standing practice but even more as a result of the Dresden and Vienna agreements on joint and simultaneous standard setting at EU and world level. How important the latter are can be gauged as follows: 34% of CEN standards and 78% of CENELEC standards are meanwhile identical to ISO and IEC standards. Therefore, many thousands of European technical standards are world standards and accepted in all continents as a basis for regulation or testing. In other words, for the UK, staying with the European standardisation system ensures a high probability that technical standards are also accepted worldwide – a critical advantage in an era of globalisation.

There can be little doubt that the UK's 'common rulebook' proposals in goods should be very helpful in greatly 'facilitating' the post-Brexit market access to the EU and the EU companies' market access to the UK. Nevertheless, upon further reflection, what exactly does this proposal mean from the point of view of the EU's ecosystem? Does it – at least for goods – give the UK the market access 'as if' the UK had never left the EU internal goods market? Not really. In order to understand that, we discuss two issues: the EU ecosystem and the formulation used in the Political Declaration.

As emphasised in the second section, the EU ecosystem is quasi-constitutional in terms of commitments and governance. Stepping out of these very deep commitments – basically non-negotiable, unless by the heavy and common route of treaty amendment – as the UK intends to do, leads to a break that cannot be fully and permanently 'repaired' by a one-sided voluntary alignment of the exiting country. The shared objective(s) of the EU translate into systemic commitments and adherence to all the consequences as well as the governance of the entire (here, technical) regime, which by definition requires EU membership. Of course, the UK Chequers proposals help in the search for solutions that will minimise (what economists call) 'trading costs' – both ways, and this can only be applauded. Nevertheless, once outside the ecosystem, the very foundation of 'shared overall objectives' is affected and (unconditional) free movement, for example, can no longer be taken for granted. Hence, for non-EU countries, no matter how close, mutual recognition becomes a very high hurdle as well, and has so far not been allowed unless the ecosystem is fully taken over (cf. the EEA). But the UK proposes unilateral alignment via the common rulebook, sets its own limits due to its red lines (i.e. does not include what is not checked at frontiers), and does not propose a common decision-making mechanism to oversee the alignment in such a way that it is truly congruent with the EU regime.

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These formulations clearly reflect the UK status of a third country desiring good market access, rather than the suggestive language in the Chequers paper (at least for goods) that a common rule book amounts to automatic frictionless trade 'as if' the UK were still in the single (goods) market.

All of this explains the language in the Political Declaration. Paragraph 3 speaks of a "...deep and flexible partnership." and paragraph 4 of ensuring "the sovereignty of the UK and the protection of its internal market". This formulation already renders it virtually impossible to mimic the quasi-constitutional approach of the regulatory regime of the EU based on "pooled sovereignty". Paragraph 18 says that "The Parties will retain their autonomy and the ability to regulate economic activity..." Paragraph 20 speaks of "facilitating the ease of legitimate trade", repeated in paragraph 22 for goods separately. Paragraph 21 confirms that "the Parties will form separate markets and distinct legal orders". Paragraph 24, on "regulatory aspects", starts with "preserving regulatory autonomy", and continues to affirm that "regulatory approaches [should be] compatible to the extent possible". The Parties will also "explore the possibilities of cooperation of the UK authorities with Union Agencies". Even more telling is paragraph 25, stating that "the UK will consider aligning with Union rules in relevant areas". Finally, in paragraph 28, the Parties "envisage" that UK commitments and alignment of rules "would be taken into account" for checks and controls as a factor reducing risk.

It hardly needs underlining that these formulations clearly reflect the UK status of a third country desiring good market access, rather than the suggestive language in the Chequers paper (at least for goods) that a common rule book amounts to automatic frictionless trade 'as if' the UK were still in the single (goods) market.

## SEPARATION AND COMPLIANCE ISSUES IN THE COMMON RULEBOOK

There will be a few separation issues that imply a cost to the UK but they should not present any special difficulty. Thus, EU Notified Bodies (for EU recognised certification) cannot exist outside the EU. Therefore, the UK bodies of today will be turned into "UK approved bodies" and existing harmonised European standards (that is, relevant for EU regulation, hence also for the common rulebook) into "UK designated standards" in the event of a 'no-deal',<sup>22</sup> unless a treaty commitment can be agreed upon to maintain their current role given the common rulebook. Note that, for Notified Bodies, this might be similar to the Mutual Recognition Agreements (MRA) in the Comprehensive Economic and Trade Agreement (CETA) with Canadian conformity assessment bodies, which can certify (as if they are Notified Bodies) the conformity of Canadian goods destined for the EU. For European standards, it would be artificial and pointless to treat them differently



under a common rulebook: in this respect the UK would become like Switzerland, the EEA-3 countries and possibly Turkey, as they all have extensively aligned technical regulations to the EU regime and all are active members of CEN-CENELEC, writing the European standards under Commission mandates flowing from EU regulations and directives.<sup>23</sup>

Because the common rulebook proposal suggests the fullest possible participation in the EU single goods market in so far as technical regulations are concerned, the overall EU governance regime of compliance, legal interpretation, enforcement and administrative implementation would be relevant. If not, or not fully, suspicions of undermining the LPF might resurface. The Chequers paper lists six critical aspects, which include a short specification on

motor vehicles, a few references on three EU agencies, specifications on agri-food regulation and compliance (e.g. at the border) and a note on market surveillance. The six aspects on compliance of manufactured goods are listed in Table 1.

Although Table 1 does not exhaustively list all compliance activities, it seems reasonable to conclude that the UK is serious in pursuing a genuine common rulebook, also for compliance. One suspects that the UK White Paper could not be burdened with endless regulatory detail, short of losing readers interested in the post-Brexit relations with the EU. Inevitably, therefore, one can raise technical queries which will undoubtedly be tackled over the transition period when the UK-EU27 relations will have to be negotiated in the requisite detail. Nevertheless, the spirit can be regarded as

**Table 1: UK proposed compliance activity necessary for sales in UK and EU27**

1.	Testing products	conformity assessments, type approval for vehicles as well as other tests and declarations; also the relevant labels and marks (CE mark, one presumes) indicating that the product meets the (EU) requirements
2.	Accreditation of CABs	conformity Assessment Bodies in the EU must be accredited by the European Accreditation system (EA); proposed is a jointly agreed accreditation framework
3.	Quality assurance	such as GLP (Good Laboratory Practices, these are world standards) and GMP (Good Manufacturing Practices, an OECD standard); with GLP and GMP, other compliance activities are far less costly due to traceability
4.	Nominated individuals	‘responsible persons’ to interact with authorities (incl. EU agencies); presumably also the function of ‘importer’ or ‘own representative’ registering substances under REACH
5.	Idem for medicines	e.g. qualified person for pharmacovigilance, or, for the release of individual batches
6.	Licensing regimes	where applicable, including export licences for ‘restricted products’

constructive and respectful of the EU requirements. The Withdrawal Agreement, especially Annex 5 of the Protocol on Ireland/Northern Ireland, provides a useful first idea of what it would imply.

But in one respect, the Chequers White Paper glosses over a basic distinction: that between the NLF (New Legislative Framework, formerly called the New Approach, applicable to numerous types of machines as well as many other goods such as toys, etc., in combination with the extensive reference to European standards) and the heavily regulated sectors such as motor vehicles, chemicals, medicines, aerospace, measuring equipment, pesticides and cosmetics as well as high-risk medical devices. The latter group hardly leans on voluntary standards. Some of these sectors have EU regulatory agencies, which creates extra hurdles because these agencies have statutes that do not foresee or simply ignore the option of a common rulebook with a third country, no matter how close. All of these heavily regulated sectors have strict regimes for the simple reason that risks for consumers, patients and workers are higher than would be the case under the NLF. This renders them much less flexible for the purposes of Brexit.

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## THE HEAVILY REGULATED SECTORS AND THE UK PROPOSAL

One gets the impression when reading section 1.2.3. of the Chequers paper (on manufactured goods) that, in July 2018, the UK government was less well prepared for Brexit in some heavily regulated sectors. Or, alternatively, that the government was suffering from wishful thinking, considering that a common rulebook amounted to a major concession (in the eyes of Brexiters), for the purpose of avoiding customs borders anywhere, including for Northern Ireland, without being fully aware of the consequences for heavily regulated sectors. The Chequers box on motor vehicles<sup>24</sup> (p. 21) suggests that mutual recognition of Vehicle Type Approvals would be included in the common rulebook. In fact, the box suggests that current practices (now that the UK is still inside the EU) would be continued, on all the technical routine approvals but even if non-conformities were identified and appropriate action required to rectify them. However, the Commission's TF50 slides on regulatory issues (see note 8, slide 30) deny such an option: after first establishing that the UK can no longer issue new approvals or revisions (after Brexit) and no longer perform any supervisory functions, it confirms that Brexit means the end of recognition of UK-type approvals for motor vehicles

and excludes mutual recognition. Type-approvals can only be issued by a competent EU27 authority. All that would seem to be possible (without further negotiation), while assuming that the UK on its own would join the United Nations Economic Commission for Europe (UNECE) WP.29 (on cars)<sup>25</sup> after Brexit, is mutual recognition of *non-whole* type-approvals based on UNECE commitments, which is a subset of what is required under EU type-approval legislation.

However, there appears to be an inconsistency here. In the Swiss/EU bilaterals, equivalence is granted by the EU based on full alignment by Switzerland with the relevant *acquis* for example for motor vehicles and tractors (slide 26). The Commission explains that by citing the historical context of the EEA negotiations (also conducted at the time by Switzerland). The upshot is that the MRA with the Swiss applies not only to typical NLF goods (as under CETA) but also to type-approvals of cars and tractors. The analogy with the UK is interesting. The UK begins Brexit with completely identical rules, plus EU type-approval experience since 1996 (when it was introduced) and competent national institutions, so it would not be far-fetched for the EU to accept mutual recognition similar to that which the Swiss enjoy, as long as the automotive *acquis* is retained by the UK.

In chemicals, however, the problem is much more serious. When reading the Commission's formal position (slide 41), it appears to be similar to that of the automotive sector. Registration of chemical substances (and mixtures and substances in articles) can only be done by registrants established in the EU. This must imply that UK manufacturers will need to establish an 'only representative' in the EU, as REACH requires, in order to avoid their registrations becoming null and void in case of 'no-deal' or at the end of the transition period. However, far worse is the loss of access to ECHA's database and the EU's refusal to let the UK take part in rule-making in the REACH committee and in the assessment

of risks (precisely because it is often about substances of very high concern) and of the socio-economic context in the case of possible restrictions or bans. In an alarming House of Lords report,<sup>27</sup> it becomes clear that the UK is at best ill-prepared for the consequences of breaking out of REACH.

Although Switzerland and Turkey have enacted laws mirroring REACH, they cannot participate in the programme; only the EEA-3 countries participate as formal observers but they do have access to the REACH database. Instead, the Commission excludes participation in REACH and any form of mutual recognition or even equivalence (slide 45) for countries other than the EEA-3. The UK's understandable preference for a one-approval mechanism for both the UK and the EU27, as expressed in the Chequers White Paper, and for "ensuring UK businesses could continue to register chemical substances directly, rather than working through an EU-based representative" (p. 22) contradicts current EU rules. And, in this case, recourse to a Swiss precedent is not possible. Worse, whereas Switzerland recognises REACH authorisations and restrictions in its own system, the EU does not reciprocate: Swiss firms have to register substances through an EU-based company. The present author suspects that this distinction between the EEA-3, on the one hand, and Switzerland (or, for that matter, the UK) on the other, is a consequence of the continued lack of a fully satisfactory governance regime by Switzerland (see below).

For the UK, its red lines prevent such a governance regime from being fully satisfactory because it would imply that CJEU rulings are respected at all times, which amounts to a loss of regulatory autonomy. This led to great confusion in the House of Lords (and the UK government) as to whether UK companies could appoint an only-representative before 'Brexit day' (probably not, because such companies are EU manufacturers until Brexit) so as to prepare re-registration; or whether (say) a French

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company could act as an importer of UK chemicals (probably not because it only becomes an importer after Brexit); or whether the database could be copied (probably not, due to ownership and intellectual property rights (IPR) questions); or whether data in which UK companies might have invested heavily in order to prepare for registration (in SIEFs, for data sharing) can actually be used outside the EU REACH system i.e. for a UK REACH (again, probably not). It also became clear that the UK government has no local ECHA agency (only a ministerial department) and, so far, no plan to substitute for crucial risk and socio-economic context committees, for example. Finally, the costs of re-registration, delays and duplicative work might turn out to be sizeable and a burden for SMEs. In short, it seems that the UK government has suffered from tunnel vision by focusing solely on negotiating a common rulebook while sticking to its overall red lines, without verifying the nature and costs of breaking out of REACH, let alone preparing for it properly.

In medicines, the UK proposal reads as if the UK would still be in the EU single market after Brexit, “ensuring that all current routes to market for human and animal medicine remain available”, with “UK regulators still...acting as ‘leading authority’ for the assessment of medicines” and participating “in other activities” of EMA. As can be read from a Notice from DG SANCO and EMA of 23 January 2018, as well as from a detailed Q&A from the same source published on 19 June 2018, the proposal from the UK is far from self-evident. Similar to REACH, marketing authorisation holders have to be established in the EU27 and some specific activities have to be performed in the EEA-30. Moreover, UK exports to EU27 become ‘imports’, which has a number of consequences (such as appointing an authorised importer and e.g. specification of batch control in the EU as well as changing location – to the EU27 – of the marketing authorisation holder to the EU27, for centrally authorised – that is, by the EMA). These are just examples – the Notices provide many more specifications of consequences which, on the whole, can be regarded as technically or administratively inconvenient and costly for UK private parties and even for the authorities. As for REACH, there is no Swiss precedent: all the Swiss/EU bilaterals provide for is mutual recognition of the inspection of GMP in medicines production.

In agri-food, the problems are considerable too. Domestically, the UK has devolved administration and legislature (agriculture, animal health and welfare, food safety, plant health and fisheries) to Wales, Scotland and Northern Ireland. The UK proposes three broad categories of rules: those to be checked at borders, in particular Sanitary and Phytosanitary

(SPS) measures. These would be part and parcel of the common rulebook; those of ‘wider food policy’, including marketing rules (e.g. labelling) and geographical indications (GIs);<sup>28</sup> and those relating to domestic production and subsidies such as the Common Agricultural Policy (CAP) and the Common Fisheries Policy (CFP). That the UK would want to leave the CAP cannot be surprising – it is a large net importer (70% of imports from the EU!) and the net transfers to the EU implicit even in the reformed CAP are large. In doing so, a major domestic subsidy issue will emerge, however, as the adjustment shocks to many farmers and agri-food companies would be very serious in the case of no or low subsidies right after Brexit. The other reason to leave the CAP is that it would facilitate FTAs with third countries, almost certainly generating a net welfare benefit due to large and cheaper agri-food imports. For the CFP, the departure is also hardly a surprise as strict rules and demarcations about fisheries have always been a sensitive question in the UK – nonetheless, the North Sea countries have become accustomed to intensive cooperation and sharing, and the UK expects this to continue.

The common rulebook as proposed is to “reassure the UK and the EU that agri-food products in circulation in their respective markets meet the necessary regulatory requirements. This would remove the need to undertake additional regulatory checks at the border... [it]... would also protect integrated supply chains, trade between the UK and the EU and consumers and biosecurity”. This is – once again – far removed from what the COM Task Force concludes: the UK becoming a third country has numerous administrative and other implications, including authorisations, special ‘listings’ (for foods of animal origin), for some food products the authorisation holders, business operators or their representatives have to be located in the EU<sup>27</sup>. In the case of genetically modified organisms (GMOs), the normal application for authorisation via a competent authority of a member state to the European

Food Safety Authority (EFSA) will no longer be possible. Food can only enter the EU through approved border inspection posts. It is far from clear how the UK proposes to bridge this regulatory gap and why the EU would agree to that. There is also no mention of dynamic regulatory alignment – an oversight? – and EFSA is never mentioned anywhere. It is true that EFSA is primarily a risk assessor, although it does fulfil some administrative tasks as well. It is nonetheless hard to envisage that the UK would maintain no ties with EFSA, and yet wants to be fully part of the agri-food regulatory and compliance system. As far as the present author is aware, the Commission has not published any reaction to the separation of the common rulebook for border inspections and marketing rules, including GIs. Because the UK has been a frontrunner in GIs, FTAs or special GI treaties, the only plausible explanation for a UK GI system is the desire to negotiate independent trade deals with third countries.

#### **CAN A COMMON RULEBOOK BE PART OF EU FTAs OR CUSTOMS UNION?**

A common rulebook is not *a priori* incompatible with an FTA or customs union with the EU. But it is bound to be demanding, indeed so much so that both regulatory alignment and institutional governance have to go very far. This is clearly demonstrated by the EEA that is an FTA.<sup>29</sup> The EEA does have some exceptions (agriculture and fisheries) but otherwise the four freedoms apply, the relevant domestic laws inside the EEA-3 countries are aligned time and again, and the overall governance mimics the EU system to a very large degree. Strictly formally, the EEA-3 countries have their own EFTA Surveillance Authority and the EFTA Court, but the practical differentiation between the EU and the EEA-3 is minimal. The Surveillance Authority maintains a close, albeit informal, cooperation with the European Commission, while the Court has built up a tradition of close alignment with

the rulings of the CJEU. The basis of the EEA is the homogeneity of the single market in the widest sense of the word.<sup>30</sup> Because the single market is the very foundation of the Union as well as by far its most important economic bedrock, the EU is understandably sensitive to attempts to render the almost unfettered EEA-type ‘access’ to the single market ‘negotiable’. That is the principal lesson of the experience with Switzerland, once the Swiss people turned against EEA membership in the 1992 referendum. The EU and Switzerland simply had no plan B and began to negotiate a series of bits-and-pieces in successive bilaterals in order to make up for the “lost prospect of market access” due to the referendum. This was done at first without much of an overall institutional design, which came as an afterthought. The lack of agreed overall governance on Swiss implementation, verification, enforcement and dispute settlement was seen as damaging the ‘homogeneity’ of what would otherwise be close to an EEA arrangement (except e.g. for financial services). With this example in mind, let us now consider the EU’s current approach towards Brexit.

The TF50 starts from the fundamental idea that FTA/Customs union partners can never have the same balance of rights and obligations as EU members. This must be so that trading partners do not live up to (or ‘under’) the same obligations. Some of these are fundamental, to wit, pooling of regulatory autonomy, combined with common bodies having considerable regulatory and enforcement power, far-reaching intrusive competition and state aid regimes and the acceptance of the primacy and direct effect of EU law, together with the supremacy of the CJEU. This is also the reason why the EU has no dispute settlement as FTAs or customs unions have: an EU country has no ‘dispute’ with another member state, it might ‘infringe EU law’ and that ought to be addressed and usually solved by the common institutions. Taking this view creates a dichotomy between EU members and non-members, no matter how close.

As a result, with any trading partner or ‘associate country’, the question arises how far the EU can allow market access, given its systemic prerequisites. Take dynamic alignment. Even in ‘deep and comprehensive’ free trade areas (FTAs), of course there is no automaticity expected of harmonisation of newly introduced rules. That immediately shows how radical the EEA is because this does happen in the EEA via its so-called two-pillar system for all EEA-relevant (EU) regulation, which typically is a very high share of all EU market regulation. In principle, it ought to happen with Switzerland too, but here the weak and incomplete governance does not assure this and there is no reporting system to verify it. The systemic dichotomy between EU members and non-EU members also renders it close to impossible to expect ‘mutual recognition’ other than MRAs. Mutual recognition of substantive rules ultimately hinges on interpretation of the CJEU, hence its extensive case law on mutual recognition in goods not regulated at EU level for which free movement nonetheless applies. It has the quite radical consequence that goods may have to be given access, even though national rules would forbid or condition them (but without accounting for ‘equivalence’ of safety, health, etc., objectives in other member states, or by imposing disproportionate means, this might improperly deny free movement).<sup>31</sup> MRAs can be allowed (under precise conditions) with non-EEA conformity assessment bodies (CABs) being accredited (as with CETA) because all that such CABs do is to test a (non-EU) good on conformity with EU rules or technical European standards; there is no interpretation of national or EU law, and no equivalence issue is at stake.

The EU recognises that two attempts of dynamic alignment exist: the EEA (which works, be it with a backlog of transposed EU legislation, essentially caused by the clumsy functioning of the two-pillar system)<sup>32</sup> and the bilaterals with Switzerland. The latter are weaker in governance and incomplete, certainly compared to the EEA-3. Ideally,



the EU (via the Council) wants five accomplishments with Switzerland that were formulated in 2010 and boil down to a close copy of the EEA, but bilaterally. The current confidential negotiations with Switzerland move slowly but the Swiss seem to be more willing to accept these conditions than before.<sup>33</sup> The EU wants free movement to comprise (i) more services (this failed in 2006), it seeks (ii) full alignment of the relevant EU law including new EU law (and case law) without the Swiss having ‘flexibility’ on this, it insists on (iii) independent surveillance on implementation (like the EFTA Surveillance Authority) and on an (iv) effective judicial enforcement mechanism for the bilaterals, and it wants a (v) tribunal for disputes about the bilaterals. It is crucial to be aware of these issues because the more and better market access the UK would want, the more the EU will demand similar requirements for the preservation of the homogeneity of the single market.<sup>34</sup> It also follows that FTA/customs union partners may only have access to the EU single market “commensurate to relevant LPF risks”. Agreements with specific LPF risks are much more ambitious. As with the EEA, the role of the CJEU remains fully separate and independent.

The FTA traditions of the EU (except for the EEA and, to some extent, Switzerland, which do go further) are typically ‘only’ WTO-plus or WTO-plus-plus. This goes for technical barriers to trade (TBT)<sup>35</sup> and SPS chapters, and their annexes on sectors and specific enforcement measures. Also, regulatory cooperation (e.g. with South Korea and Canada; later with Japan and Singapore, and always ‘voluntary’) is far weaker than being an assimilated privileged partner ‘in’ parts of the single market for goods, as the UK would seem to suggest. The common rulebook proposed by the UK cannot therefore be compared with ‘deep FTAs’ such as CETA, it is bound to go beyond it. One might begin to compare it with Turkey (having adopted a mass of technical directives under the 1995 customs union agreement and using European standards) but – due to the stalled pre-accession process – the overall goods regime is still imperfect. In all cases except sometimes in the EEA-3, the heavily regulated sectors cannot fully benefit from a common rulebook without acquiring licences or authorisations inside the EU. In the Deep and Comprehensive Free Trade Area agreement (DCFTA) with Ukraine (and similarly with Georgia and Moldova), the prospect after a long period of regulatory alignment is that single market benefits may be acquired for a number of sectors – but solely after an autonomous EU decision grants them. These are the NLF industrial goods products such as machinery, electrical equipment, toys, gas appliances, etc. although on the strict condition of full implementation of a horizontal framework of conformity assessment, standardisation, and accreditation.

**The more and better market access the UK would want, the more the EU will demand similar requirements for the preservation of the homogeneity of the single market.**

Moreover, for the purpose of conformity assessment and acceptance in the EU of Ukraine products as ‘compliant’, Ukraine is expected to conclude an Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA) agreement, which would boil down to free movement rights in the specific sectors once the EU takes the autonomous decision that full alignment has been accomplished. However, it seems that ACAAs are demanding because only one example (good manufacturing practices (GMP) for medicines for Israel) has ever been accepted in actual practice.

## CONCLUSIONS

The condition that a future association agreement between the UK and the EU27 would have to guarantee a level playing field, at least in goods where the UK demands unfettered access to the single market, was not been elaborated upon in the Political Declaration of 22 November 2018. From Annex 5 of the Protocol on Ireland/Northern Ireland of the Withdrawal Agreement and previous technical publications by the TF50, it is possible to sketch a fairly clear picture of the requirements of market access for the UK in the area of technical regulations, standards and conformity assessment in industrial and agri-food goods. On the whole, it appears that the LPF issue is largely pre-empted by strict requirements with respect to alignment to technical regulation and European standards, as well as conformity assessment for goods imports into the EU. It is interesting to observe that such requirements extend to the overall governance of the regulatory regime in a bilateral with the EU and are not limited to mere technical requirements.

There are several options in the regulatory field, but the probability and scale of distortions or regulatory disparities would seem to be rather limited. Therefore, LPF problems would appear to be few and small. Indeed, the more the UK post-Brexit would wish to be fully part of the internal EU goods

market – as it is today – the more it cannot escape softening or giving up its ‘red lines’ of regulatory autonomy (‘taking back control’) and overlooking the rejection of CJEU supremacy.

The common rulebook as proposed is extensive and includes conformity assessment as well, but nevertheless does not seem to go nearly far enough, in particular not in the heavily regulated sectors. Whereas a solution might be found for type approvals for motor vehicles – as has been accepted for Switzerland – there are profound and worrying problems for chemicals, agri-food and medicines. It is quite possible that these problems would also show up in other sectors (e.g. fertilisers, pesticides, GMOs). The Swiss example is helpful for the type-approval of motor vehicles but cannot be generalised: it does not apply to REACH (even though the Swiss variant of REACH is very similar) or to medicines, for example. Only the EEA can solve this problem. Discarding the EEA option for the UK might be tantamount to creating a stalemate in the future negotiations, but given the near-constitutional approach of the EU27, the Union is most unlikely to give in. This quasi-constitutional approach is demonstrated in the current EU/Swiss negotiations on the horizontal governance of the bilaterals, including insistence on full regulatory alignment (without ‘flexibility’), controls of implementation, judicial enforcement, and a common tribunal for dispute settlement, with very close similarity to CJEU case law. As if all of this is not enough, the common rulebook only applies to goods and this avoidance of the other three free movements is firmly resisted by the EU27 as ‘cherry-picking’. Here, the Swiss precedent (carving out financial services) works against the UK.

If one were to accept the conclusions of the other contributions in this volume (i.e. making the non-regression clause much more robust, and drafting fairly intrusive common rules on tax and state aids) and would include the option of staying in the EU



customs union, also after the transition period (with some regulatory controls vis-à-vis third countries, e.g. in agri-food, or of counterfeiting and non-compliant goods), Brexit would boil down to 'BRINO': *Brexit in name only*. Unless the UK opts for a rather soft and uncommitting section on services in the eventual treaty, in which case, the only red lines left would consist of the UK having the option of limiting a sudden influx of persons/workers from other EU countries and a degree of regulatory autonomy for services. Economic analysis has shown that both have a considerable cost in terms of GDP and jobs. One can only wonder if the argument for the UK to leave the Union can still be rationalised on the basis of all of the above.

The more the UK post-Brexit would wish to be fully part of the internal EU goods market – as it is today –, the more it cannot escape softening or giving up its 'red lines' of regulatory autonomy ('taking back control') and overlooking the rejection of CJEU supremacy.

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- <sup>1</sup>. UK government, The future relationship between the United Kingdom and the European Union, Policy Brief, 12 July 2018.
- <sup>2</sup>. Council of the European Union, Political Declaration setting out the framework for the future relationship between the European Union and the United Kingdom, 22 November 2018.
- <sup>3</sup>. In addition, it merely calls for the Parties to consider the precise nature of the commitments (i.e. scope and depth) and indicating four aspects of LPF in this context: relevant EU and international standards, adequate mechanisms to ensure effective implementation, enforcement and dispute settlement.
- <sup>4</sup>. European Commission, Draft Withdrawal Agreement, 14 November 2018, TF50(2018)55.
- <sup>5</sup>. See the Withdrawal Agreement, pp. 302 and further. In Art. 1.4 of the Protocol, it explicitly confirms that the Withdrawal Agreement "is not to establish a permanent relationship between the Union and the UK".
- <sup>6</sup>. See Withdrawal Agreement, pp.354-381.
- <sup>7</sup>. Op. Cit., Annex 5 (to the Protocol), item 8 on general goods provisions, pp.391-450.
- <sup>8</sup>. Council of the European Union, European Council (Art. 50) guidelines for Brexit negotiations, 29 April 2017.
- <sup>9</sup>. With no less than 58 comprehensive slides, including e.g. automotive, chemicals and agri-food.
- <sup>10</sup>. See European Commission, Brexit preparedness, for further updates and all these Notices.
- <sup>11</sup>. Mutual Recognition Agreements (as referred to in the WTO TBT agreement) are strictly and only about the mutual recognition of the competence of certification for conformity assessment of the other Party's regulatory requirements (which could be referred technical standards, too). MRAs neither imply any harmonisation of laws nor broader recognition of technical regulation between the two (or more) Parties. See Brito, A. C. de, C. Kauffmann & J. Pelkmans (2016), "The contribution of mutual recognition to international regulatory cooperation", OECD Regulatory Policy Working Papers no. 2, January for extensive explanation and analysis.
- <sup>12</sup>. And the customs union with Turkey. Indeed, the customs union agreement implies the incorporation into Turkish law of a huge list of technical harmonisation directives and the adoption of related European standards as single Turkish standards in the relevant field. Turkey is a member of CEN/CENELEC since 2010. However, the accession negotiations with Turkey are suspended and unlikely to be resumed in the short run. Once Turkish technical harmonisation is embedded in firm pre-accession commitments, access to the single goods market could be greatly facilitated.
- <sup>13</sup>. Even the fourth red line – on limiting a sudden influx of persons/workers from other EU countries – goes against the single market.
- <sup>14</sup>. This is not to suggest that the UK does not have similar concerns. "The protection of its internal market" is wording used in the Political Declaration (para. 4) and e.g. in the Protocol on Ireland (f.i. Art. 7).
- <sup>15</sup>. For detailed elaboration, see Pelkmans, J. (2013), "The economics of single market regulation", in: A. Verdun & A. Tovas, ed.s, *Mapping European economic integration*, Palgrave-Macmillan.
- <sup>16</sup>. This account can be found in a simplified presentation of the Chequers proposal, dated 23 July 2018, see UK government, The future UK-EU relationship, pp.5 -7.
- <sup>17</sup>. However, the UK could negotiate a different arrangement with the EU27, providing for a cooperative approach when FTAs with other third countries are negotiated with the EU, without giving a veto to the UK, of course. Given the common clout of the 28, this is likely to be advantageous to the UK.
- <sup>18</sup>. See Pelkmans, J., "Shattered illusions: the new Brexit proposals on customs", *CEPS*, 17 July 2018 - and for an interesting further criticism: Winters, A. & J. Magntorn (2018), "Decoding the Facilitated Customs Arrangement", UK Trade Policy Observatory, 23 July 2018.
- <sup>19</sup>. This should not be read as 'independent' EU Agencies because the Meroni doctrine is still seen (probably mistakenly) as governing the mission of Agencies and their link with Commission and/or Council. In actual practice however, the three Agencies have enormous practical significance for regulation and compliance. For an extensive analysis, see Simoncini, M. (2018), "Administrative regulation beyond the non-delegation doctrine. A study of EU Agencies", Oxford: Hart Publishing; Vos, E. (2018), "EU Agencies, common approach and parliamentary scrutiny, study for the European Parliament", Implementation assessment; and Pelkmans, J. & M. Simoncini (2014), "Mellowing Meroni: how ESMA can help build the single market", *CEPS*, 18 February 2014.
- <sup>20</sup>. Such participation probably requires an amendment of the statutes.
- <sup>21</sup>. European Standardisation Organisations (CEN, CENELEC and ETSI).
- <sup>22</sup>. See <https://www.gov.uk/government/publications/trading-goods-regulated-under-the-new-approach-if-theres-no-brexit-deal> of 13 September 2018.
- <sup>23</sup>. See also the view of BSI (2016), European standards and the UK.
- <sup>24</sup>. Motor vehicles refer to personal cars and trucks, but also to 2 and 3 wheel vehicles as well as tractors. The Chequers paper explicitly refers to "all categories of motor vehicles".
- <sup>25</sup>. Worldwide regulation on car safety and environmental requirements is traditionally dealt with by the UN Economic Commission for Europe, Working Party 29.

<sup>26</sup>. It seems curious that the Chequers White Paper does not refer to the Swiss precedent.

<sup>27</sup>. House of Lords, Brexit: chemical regulation, EU Committee, 7 November 2018; although with less detail, this is echoed by the House of Commons in a report of 14 November 2018: *'DEFRA's progress towards Brexit'* – DEFRA is a department with responsibilities in environment, chemicals, food (including trade in animal food) and Brexit is bound to have huge consequences for UK regulation and controls via IT and on the ground.

<sup>28</sup>. Geographical Indications for food, wine and spirits.

<sup>29</sup>. For a survey, see Pelkmans, J. & Ph. Boehler (2013), *The EEA review and Liechtenstein's integration strategy*, Brussels: CEPS.

<sup>30</sup>. Except for agri-goods and fish, of course.

<sup>31</sup>. For extensive elaboration, see Pelkmans (2012), *op.cit.*

<sup>32</sup>. The two-pillar system is a direct result of the CJEU insistence that the EEA-3 could not somehow fall under the CJEU directly. For a review of 20 years of the EEA, see Pelkmans & Boehler (2013), *op.cit.*, including the backlogs and the appreciation of the system of transposition generating thousands of decisions which are not updated or cleansed and where no distinction is made between trivial administrative ones and truly regulatory ones.

<sup>33</sup>. There is a carrot and stick situation behind these negotiations. The EU has held up several arrangements (e.g. participation in the EU electricity market) in order to exercise some pressure. At the same time, it should be acknowledged that the EU/Swiss economic relations are enormously successful which cause the Swiss to 'hasten only slowly'.

<sup>34</sup>. In December 2018 a provisional draft agreement between Switzerland and the EU was published (in French). Whether this draft is politically acceptable in Switzerland is not clear at the moment of concluding the present manuscript.

<sup>35</sup>. Technical barriers to trade, the subject of a WTO Agreement.



# State aid control

Vincent Verouden and Pablo Ibáñez-Colomo

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# Introduction

Despite the uncertainty surrounding the Brexit process, one can safely assume that the future trade relationship between the European Union (EU) and the United Kingdom (UK) will provide for a system for the control of state aid. After all, provisions dealing with subsidies and similar measures feature increasingly prominently in modern trade agreements. To illustrate, the US Treasury Secretary recently sketched the contours of any (potential) future free trade agreements with its country along the following lines: “we’re ready to sign a free trade agreement with no tariffs, no non-tariff barriers and no subsidies. It has to be all three.”<sup>1</sup>

The question in practice is not whether a system for the control of state aid will be provided for in the future relationship between the EU and the UK, but how deep and close policy coordination in the field will be, and how the relevant provisions will be enforced.

The fact that the case for some form of collective discipline on the use of subsidies is largely uncontroversial does not mean that all regimes for the control of subsidies are similar in nature and scope. There are considerable differences, for instance, between the regime that exists at the EU and European Economic Area (EEA) levels, on the one hand, and the provisions on subsidies found in standard free trade agreements, on the other. In addition, the situation of the UK is rather specific in its own right. The UK has been an EU member state for almost 45 years and its economy is deeply integrated with that of the EU.

Thus, the question in practice is not whether a system for the control of state aid will be provided for in the future relationship between the EU and the UK, but how deep and close policy coordination in the field will be, and how the relevant provisions will be enforced. What is the institutional framework through which distortions of competition and trade will be avoided? What types of (beneficial) aid should still be allowed? What are the mechanisms to address divergences in the interpretation of the relevant provisions?

Both the EU Council Guidelines of 2017/2018 setting out the EU’s negotiation position and the White Paper issued in July 2018 by the UK government acknowledged that a state aid regime would be necessary after the departure of the UK from the Union, alongside measures addressing tariff and non-tariff barriers and rules on the movement of capital and labour.<sup>2</sup> Likewise, state aid control is a central element of the draft Withdrawal Agreement between the EU and the UK,<sup>3</sup> as well as the draft Political Declaration setting out the Framework for the Future Relationship between the EU and the UK.<sup>4</sup>

Specifically, the state aid provisions enshrined in the Protocol on Ireland/Northern Ireland (which will apply “unless and until” a subsequent agreement comes into force) envision, first, the continued enforcement by the EU of state aid measures in relation to Northern Ireland. In parallel, a system of domestic (as opposed to supranational) enforcement of UK measures affecting trade between Great Britain and the EU is foreseen. In this context, it is worth noting that the Protocol introduces new and reinforced mechanisms for the European Commission to preserve a level playing field in state aid. These new arrangements have, arguably, been introduced as a counterpart for accepting

a domestic state aid control system in the UK in a context where this country will have tariff-free access to the EU common market, as foreseen in the Protocol.

This paper aims to analyse some of the main economic, legal and institutional factors that will have been relevant in the formulation of the state aid provisions in the Withdrawal Agreement. The extent to which these provisions will also be maintained in the Future Relationship remains to be seen, but it is more than likely that the same policy drivers and trade-offs that led to the Withdrawal Agreement and the Protocol will also govern the negotiations for the Future Relationship.

## EU state aid control: Unique in the world

Before describing the main issues that arise in the context of a future EU-UK state aid control system, it is worthwhile to briefly recall the main principles and characteristics of the present system governing state aid in the EU (and the UK).<sup>5</sup>

The central provisions dealing with state aid control in the EU Treaty are Article 107 TFEU, as regards substance, and 108 TFEU, as regards procedure.<sup>6</sup>

Article 107(1) provides for a principle of incompatibility of all forms of state aid:<sup>7</sup>

*“Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.”*

Based on the relevant case law, it is possible to derive a number of key defining elements of the notion of state aid. In particular, state measures are only caught by Article 107(1) TFEU when they involve the use of the state resources (including government handouts, tax exemptions, public guarantees and investments by state-owned banks). Regulatory measures in favour of certain sectors which do not involve the use of state resources do not constitute state aid. Second, measures must provide a ‘selective advantage’ for them to be subject to the principle of incompatibility. ‘Selectivity’ is what differentiates measures caught by Article 107(1) TFEU from the so-called general measures, which apply equally to all firms in all economic sectors in any given member state. Whereas many nationwide fiscal measures, such as reductions in the general corporate income tax rate, will not be considered as state aid, some tax rulings issued to *individual* firms (as well as some tax exemptions to some sectors

or activities) may involve state aid when they provide a selective advantage.

Articles 107(2), 107(3) and, to some extent, 106(2) TFEU provide for an exemption mechanism.<sup>8</sup> Under Article 107(3) TFEU, in practice the most relevant provision, the European Commission enjoys considerable policy discretion to declare aid compatible with the internal market. The Commission's compatibility assessment under Article 107(3) TFEU amounts to balancing the positive impact of the aid measure (pursuing a public interest objective) against its potential negative effects (in terms of distortion of competition and the effect on trade in the internal market), while keeping these negative effects limited to the strict minimum.<sup>9</sup>

Regulatory measures in favour of certain sectors which do not involve the use of state resources do not constitute state aid.

Grounds for exemption include, for instance, aid to promote the *“economic development of areas where the standard of living is abnormally low or where there is serious underemployment”* (under Article 107(3)a), aid to promote *“the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State”* (Article 107(3)b) and aid to facilitate the development of *“certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest.”* (Article 107(3)c).

Article 108 TFEU sets out the Commission's exclusive powers to apply Article 107(3) TFEU, i.e. to declare state aid compatible. In order for the Commission to exercise its control, all measures covered by EU jurisdiction must, in principle, be notified to the Commission *ex ante*, and then approved by the Commission before they are implemented. In practice, however, the Commission does not carry out an in-depth assessment of the positive and negative effects in each and every state aid case – this would be fully impractical. Indeed, over 95% of state aid measures in the EU are (nowadays) covered by block exemptions that provide for automatic compatibility of certain aid measures if the conditions for exemption are fulfilled.<sup>10</sup>

The most important block exemption is the General Block Exemption Regulation (GBER).<sup>11</sup> The approach taken in the GBER as to the compatibility of aid programmes ('schemes') is to define a set of objectives and eligible costs on the basis of which companies may receive state aid. The amount of subsidy is specified in terms of maximum aid intensities of the eligible costs. The implicit balancing inherent in that approach is to obtain the positive impact



of the aid measure by declaring expenses eligible which target objectives of public interest, such as investment in environmentally friendly techniques or specific research and development (R&D) projects, while restricting the possible distortions of competition by limiting the aid intensity.

For the remainder of cases, which are notifiable, the Commission has issued ‘soft law’ instruments such as guidelines and assessment frameworks to enhance transparency and predictability. In the EU legal framework, these soft law instruments amount to “rules of practice from which the administration may not depart in an individual case without giving reasons compatible with the principle of equal treatment”.<sup>12</sup>

The EU system of state aid control is truly unique in the world. This is due to the following combination of factors:

First, Article 107(1) TFEU has direct effect in national law systems, meaning that interested parties (e.g. competitors) can call upon the national courts to uphold the prohibition principle of Article 107(1). In the same vein, the Commission, a supranational or ‘neutral’ entity, decides upon the compatibility of state aid. The review of the legality of its decisions is undertaken by the EU courts, which are also supranational.

Second, the *sectoral scope* of state aid control is very comprehensive. Unlike the World Trade Organization (WTO),<sup>13</sup> for instance, EU state aid control not only covers the goods sector, but also the services sector and the free movement of capital.

Third, the *concept* of state aid itself, i.e. the measures deemed to amount to state aid in the EU context, is rather wide and, in some cases, context-dependent. The concept not only covers direct grants, but also soft loans and guarantees, the sale of public land below market value, exemptions from fiscal or parafiscal charges, tax rulings, and even – in some cases – the building of infrastructure. In fact, entire statutes may satisfy the conditions of Article 107(1) TFEU.

Fourth, state aid control is undertaken *ex ante*. As a matter of principle, all measures caught by Article 107(1) TFEU have to be notified to the Commission prior to their implementation, and member states need to wait for their approval – this is known as the ‘stand-still’ obligation. This philosophy differs quite significantly from the WTO system,

The EU system of state aid control is truly unique in the world.

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which is *ex post* and relies exclusively upon state vs state enforcement.

Fifth, in terms of *remedies*, EU state aid control gives the Commission power to order the recovery of incompatible aid granted in breach of the stand-still obligation – and, indeed, the provisional

recovery of any aid unlawfully granted by a member state. This feature differs quite significantly from the WTO system, where the available remedies are the imposition of (unilateral) countervailing duties<sup>14</sup> or a decision (with no retrospective effects) to bring the measure to an end.

## The case for a continued EU-UK state aid control ‘system’

As indicated in the introduction, the case for (some form of) state aid or subsidy control is well established. Thus, the real questions relate to how comprehensive policy coordination should be in this area, and how the relevant provisions should be enforced – that is, the institutional structure. Put differently, can the discipline be enforced *ex post* (cf. the WTO system), or is a stricter *ex ante* approval regime required (cf. the current EU regime)? To answer these questions, one needs to consider two important parameters: first, the intrinsic *depth* of the trading relationship between the EU and the UK and, second, the *propensity* of trading partners to award subsidies and similar measures. These two parameters are examined in turn below. Other considerations (in particular, questions of political expediency) are beyond the scope of this analysis.<sup>15</sup>

### THE DEPTH OF THE EU-UK TRADE RELATIONSHIP

Arguably, the (potential) gains from undistorted trade are particularly high between countries which, due to the intrinsic characteristics of their economies (skill levels, natural endowments, geographic positioning, cultural proximity,

legal traditions, path dependency), are naturally inclined to trade with each other. As set out in further detail in the introductory chapter to this volume, the EU and the UK have a particularly deep and close trading relationship. This reality is unlikely to change in the future.

On aggregate, trade with the EU27 in goods and services covers 44.3% of UK exports and 53.3% of UK imports. And while the share of UK-EU exports (as a percentage of total UK exports) has gone down over the past two decades, it is also worth noting that since 2013, this share appears to have stabilised.<sup>16</sup>

It is important to note that the above figures apply to both *goods and services* (combined) at UK level. Focusing on goods only, the UK-EU export share in 2017 is higher, namely 49%. For some individual regions, this share is even distinctly higher (60% for Wales, 59% for North-East England, 56% for Northern Ireland).<sup>17</sup> At the level of individual sectors, marked differences exist as well with some sectors showing trade intensities in excess of 80%.

In spite of the above, one may be tempted to argue that the existing deep trading relationships may be replaced and replicated with equally deep trading

relationships with third countries. To some extent this may be true, depending on the number and scope of the trade agreements the UK can strike. All else being equal, however, most trade occurs with countries in close proximity. This basic insight is known as the principle of ‘economic gravitation’.<sup>18</sup> In its simplest form this principle states that the trade flows between two economies depend on the product of their size and, inversely, on their distance from each other.

Empirical research suggests that the economic gravitation principle explains relatively well observed trade patterns across the globe.<sup>19</sup> As a result, the losses resulting from more obstacles to EU-UK trade are unlikely to be compensated in full by trade with third countries.<sup>20</sup> To be sure, this insight also applies to the EU, but the impact will likely be less pronounced than for the UK.<sup>21</sup>

## THE PROPENSITY OF THE TRADING PARTNERS TO SUBSIDISE

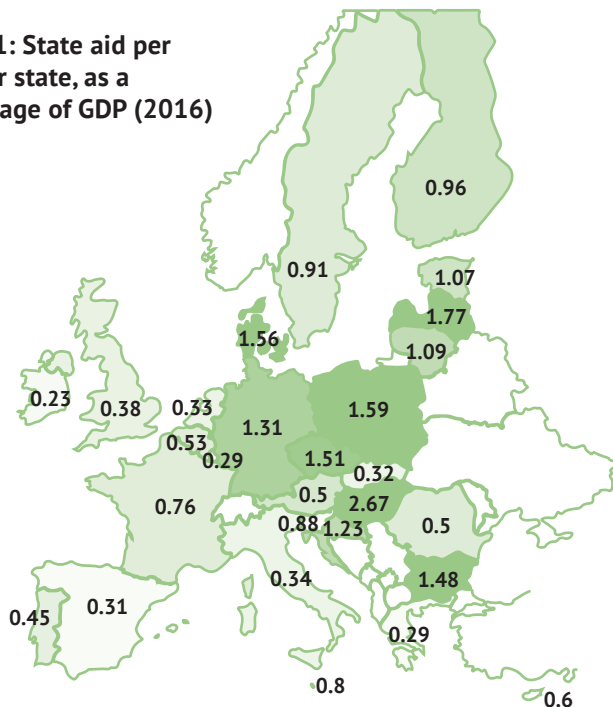
The second main factor determining whether it makes sense to have a (comprehensive) system of state aid control between trading partners is the propensity of these partners to subsidise their domestic companies. This question depends on countries’ *ability* and *incentive* to subsidise.

The former is a function of the country’s wealth and the available state budgets, now and in the future – think of state guarantees.<sup>22</sup> In this context, it is worth mentioning that public spending power in the EU is located at the level of national governments and regional/local authorities. Even if only a limited fraction of the public budgets is allocated to subsidies to firms, the annual amount of aid still amounts to approximately EUR 103 billion (2016 figures, excluding railways).<sup>23</sup> This is a substantial amount, especially considering that the entire central EU budget is about EUR 145 billion.

The incentive to subsidise depends on a complex combination of factors. In part, the inclination to give subsidies depends on national policy views as regards the usefulness of subsidies in altering company behaviour and in advancing some objectives of the state, for instance in relation to trade and the promotion of ‘national champions’.<sup>24</sup> Such views may also be influenced by the overall state of the economy and its various subsectors, as well as by political imperatives or the need to ‘do something’.<sup>25</sup>

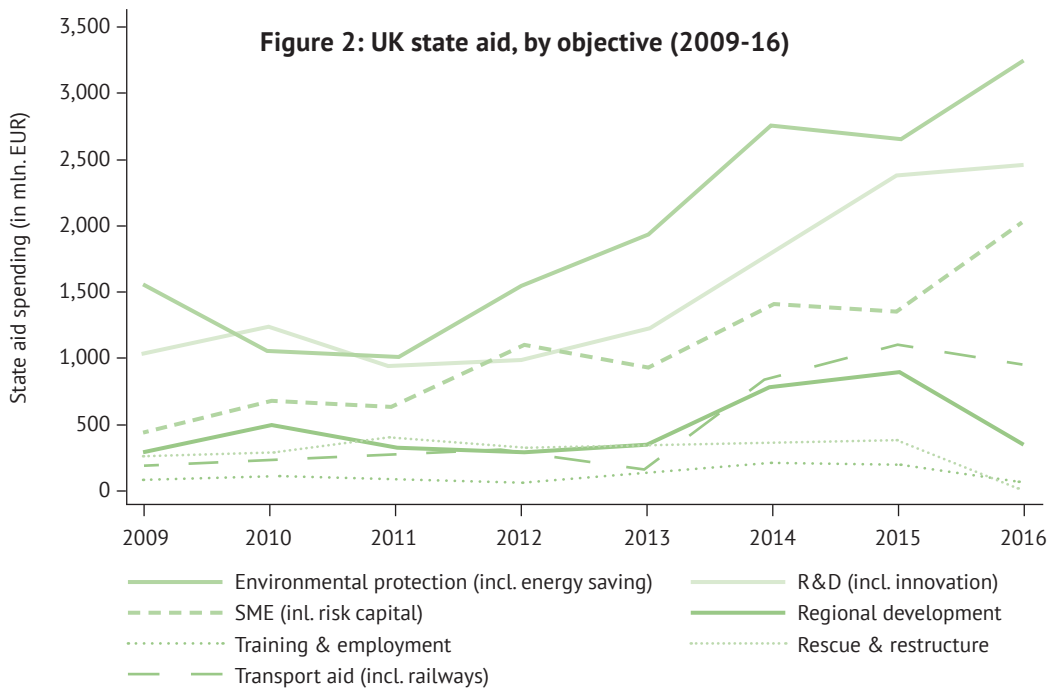
the EU and the UK have a particularly deep and close trading relationship. This reality is unlikely to change in the future.

**Figure 1: State aid per member state, as a percentage of GDP (2016)**



Source: EU State Aid Scoreboard 2017 (figures 2016; excl. railways)

**Figure 2: UK state aid, by objective (2009-16)**



Source: E.CA Economics, data from the EU state aid scoreboard 2017.  
Crisis aid to the financial sector excluded.

As regards the use of state aid (i.e. the propensity of state aid), it can be observed that there are significant differences across the member states of the European Union. The below chart, reproduced from the EU state aid scoreboard, provides a state aid amount per member state, expressed as a percentage of national GDP. As can be seen, spending in the UK is below the EU average.<sup>26</sup>

Overall, the UK spent approximately EUR 8.5 billion in aid in 2016 (0.36% of UK GDP, EUR 126 per capita).<sup>27</sup> This compares to an amount of aid in the EU as a whole of EUR 103 billion (0.69% of EU GDP, EUR 189 per capita).

The UK has used state aid to pursue a variety of public policy objectives. From the below chart, it emerges that most aid in recent years has gone to environmental protection objectives (including energy-saving), support to R&D activities, small- and medium-sized enterprises (SME) aid and regional investment aid (i.e. financial incentives offered to attract investment to certain regions).

It is true that during most of the past two to three decades, UK spending on state aid has been below the EU average (with the possible exception of the financial crisis years). But what has been the situation in the past 20 to 30 years is no guarantee for the future. While it is perhaps unlikely that the UK, with its generally pro-market culture and tradition, will become a ‘big spender’ in aggregate terms, there is a clear risk that it will become active in selected areas.

This is so for a number of reasons. First, the UK’s likely behaviour is contingent on the exact arrangements for the future trading relationship. With reduced access to the EU internal market, certain sectors – steel, automotive, aircraft, and so on – may be particularly affected, thereby prompting calls to selectively ‘do something’.<sup>28</sup> Likewise, the effects of Brexit may vary across regions.<sup>29</sup> It is also possible, more generally, that without pan-European oversight (EU state aid control), there is greater scope for successful lobbying (e.g. tax reductions, sectoral exemptions, favourable tax rulings and more),<sup>30</sup> and for implementing policies that pursue strategic trade objectives. This would create significant risks for the EU, especially in a future context where the EU would no longer have the means to protect its businesses via countervailing measures (e.g. import duties) against subsidised imports. Accordingly, it would be naïve to assume that state aid spending in the UK will remain at historic low levels and/or will remain within the confines of the current EU state aid rules.

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# State aid control post-Brexit

As mentioned in the introduction, the White Paper issued by the UK government in July 2018 as well as the Withdrawal Agreement show that, in all likelihood, the future trading relationship will provide for a comprehensive system for the control of state aid largely inspired from the existing EU regime. In its White Paper, the UK government set out that in order to support the depth and breadth of the future UK-EU economic partnership, it is “committed to continuing the control of anti-competitive subsidies”.<sup>31</sup> Specifically, the UK proposed to make an upfront commitment to maintaining a “common rulebook” with the EU on state aid,<sup>32</sup> i.e. to commit to ongoing harmonisation with the relevant EU rules and requirements in the field. In this system, the Competition and Markets Authority (CMA) would take on the role of enforcement and supervision for the whole of the UK, while the Commission would continue to perform this task in the EU.<sup>27</sup>

The principle of a common rule base features equally prominently in the Withdrawal Agreement, in particular in relation to the Protocol on Ireland/Northern Ireland, which is intended to apply “unless and until” a subsequent agreement comes into force.<sup>33</sup> In accordance with the terms of the Protocol, which *de facto* establishes a single EU-UK customs union until the future relationship becomes applicable, the Commission would have (alongside its normal jurisdiction to control aid awarded by EU member states) jurisdiction to control the award of state aid by UK authorities affecting trade between Northern Ireland and the EU.<sup>34</sup> In addition, it provides for the setting up of a domestic UK system, supervised by an independent authority, which would apply to UK aid and thus affecting trade between the EU and the rest of the UK (i.e. Great Britain).<sup>35</sup>

However, it is important to note that just because the EU and the UK agree on the need to continue state aid control in the new environment and to apply a common rule base, this does not mean that the implementation of the regime will be straightforward in practice or lead to full policy alignment. There are two main challenges in practice, which are examined hereinafter in turn. The first relates to the specific nature of state aid provisions and the second to the very goals pursued by the respective authorities in charge of state aid control.

## A COMMON RULEBOOK: LOGIC AND LIMITS OF THE IDEA

### The specific nature of state aid provisions

It would appear to be self-evident that a state aid regime common to the UK and the EU should be aligned on substance. In the context of a deep trading relationship, it would make little sense to have a common system for the control of such measures if there were any (significant) scope for departing from the standards set by the other party. At the same time, the alignment in the interpretation and the enforcement of state aid provisions presents a number of challenges that are not always fully appreciated.

Contrary to what the term ‘rulebook’ may suggest, EU state aid law is not an unambiguous set of commands that can be applied in a mechanistic manner. To begin with, Article 107(1) TFEU, in which the principle of incompatibility is enshrined, is based on a series of (open-ended) conditions that are not immediately operational. They only become meaningful (and more precise) once they are interpreted, by the

Commission and/or the Court of Justice (ECJ), in concrete factual scenarios.

Thus, the boundaries of the conditions that make up the notion of aid are to be inferred from the case law and instruments issued by the Commission. While the Commission's *De Minimis* Regulation<sup>36</sup> – declaring very small amounts of state support not to be aid – corresponds to the vision of a rulebook, other relevant documents in this field are soft law instruments. Notably, the 2016 Notice on the notion of state aid, also issued by the Commission, is a document that intends to codify the main principles of the case law and provide guidance to stakeholders.<sup>37</sup>

Despite decades of case law and the Commission's efforts to provide *ex ante* certainty, and in spite of the fact that the notion of state aid is an objective one – in the sense that there is no policy discretion on the part of the Commission when deciding whether or not the relevant conditions are fulfilled<sup>38</sup> –, the interpretation of Article 107(1) TFEU is not always straightforward. In some cases, the very application of the concept necessitates complex economic and legal assessments.

Take the example of the so-called Market Economy Operator Principle, pursuant to which public intervention does not amount to state aid if it does not depart from normal market conditions.<sup>39</sup> The question of whether a given measure is in line with market conditions is analytically complex. For the very same reasons, it can be approached in more ways than one, thereby opening the door to divergent outcomes (even when the assessment is conducted with the utmost rigour).

The application of the selectivity condition may also give rise to frictions in practice. According to the ECJ, the question of whether a measure confers a selective advantage requires identifying undertakings that are in a “comparable factual and legal situation”.<sup>40</sup> The case law fails to provide unequivocal guidance in this regard.<sup>41</sup> Similarly, the Court has consistently held that a *prima facie* selective measure may be justified by the nature and the logic of the system, and thus fall outside Article 107(1). Again, considerable uncertainty remains around the operation of this principle in practice.<sup>42</sup>

As a result of the uncertainty and/or complexity surrounding the interpretation and application of some of the conditions enshrined in Article 107(1) TFEU, two reasonable authorities in charge of the interpretation

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of the notion of aid may not always reach the same conclusion. In fact, frictions between the Commission and the General Court,<sup>43</sup> or between the General Court and the ECJ<sup>44</sup> are not unusual and continue to this day. While this is already common within the context of a unified legal framework such as that of the EU, divergences may arise more frequently when there is a parallel application of state aid rules by different authorities.

Crucially, this is a reality that the Court of Justice acknowledged in Opinion 1/91.<sup>45</sup> It held that *“the fact that the provisions of [two international treaties] are identically worded does not mean that they must necessarily be interpreted identically. An international treaty is to be interpreted not only on the basis of its wording, but also in the light of its objectives.”*

If the policy priorities of two authorities are not identical – and it is possible that the policy priorities of the UK and EU authorities may differ in some respects –, frictions over the appropriate balancing of benefits and distortive effects can be expected to arise even when applying a common set of rules.

The substantive alignment in relation to Article 107(3) TFEU or equivalent provisions (that is, of the instances in which state aid may be allowed) may give rise to further complexities. Whereas Article 107(1) TFEU concerns an objective legal notion, Article 107(3) TFEU has a wider policy dimension. In particular, the application of Article 107(3) TFEU requires *balancing* the distortive effects of a state aid measure against the public policy benefits that are expected from it.

It is true that, to a significant extent, the application of Article 107(3) TFEU is fleshed out in a variety of instruments that work in almost every way as a ‘rulebook’ that can be followed by another authority.<sup>46</sup> This is the case, in particular, of the GBER.<sup>47</sup>

The GBER plays a pivotal role in that it captures a very large *number* of cases (especially new cases, approximately 95%).<sup>48</sup> However, even an instrument such as the GBER does not fully remove the uncertainty and the risk of friction when interpreting Article 107(3) TFEU.

Indeed, not all aid measures are caught by the GBER. Even if GBER covers the vast majority of *cases*, less than half of overall reported *expenditure* falls within its scope.<sup>49</sup> The potentially more complex and more distortive measures need to be assessed on a case-by-case basis following the opening of an ad hoc investigation.

In the sphere of compatibility assessments, the Court of Justice has always recognised that the Commission enjoys discretion when balancing the benefits of aid measures against their distortive effects.<sup>50</sup> In other words,



the Commission is able to formulate policy through the application of Article 107(3) TFEU. While guidelines and assessment frameworks will likely mitigate their occurrence, divergences in the interpretation of the rules on compatibility (or the strictness with which they are applied)<sup>51</sup> cannot be excluded in individual instances.

If the policy priorities of two authorities are not identical – and it is possible that the policy priorities of the UK and EU authorities may differ in some respects –, frictions over the appropriate balancing of benefits and distortive effects can be expected to arise even when applying a common set of rules. Much depends on objectives pursued by both contracting parties and the extent to which these objectives may interfere with each other. This aspect will be discussed in further detail in the next subsection.

### **The common interest objective: How to interpret it?**

As explained, state aid may be declared compatible with the internal market in accordance, *inter alia*, with Article 107(3) TFEU. It has been pointed out that the assessment under that provision amounts to a balancing exercise between the distortions entailed by the measures and their expected benefits.<sup>52</sup>

Crucially, the benefits of state aid under Article 107(3) TFEU are assessed on the basis of ‘common interest’, that is, not only the interest of the member state awarding the aid but also the interest of all other member states (or, if one prefers, the EU as a whole). In a sense, this is implicit in the very logic of a state aid regime, the point of which is precisely to avoid undue market distortions and preserve a level playing field. Such objectives could not be achieved if ‘beggar-thy-neighbour’ aid<sup>53</sup> were deemed acceptable. In the context of a possible agreement between the EU and the UK, this issue is of central importance. The authorities in charge of the assessment of the compatibility of the rules would need to take into account the interests of the other party to the agreement. In other words, they would be acting on behalf of all parties to the trade agreement, and not simply on behalf of one of them.<sup>54</sup>

To illustrate, in the EEA Agreement – extending the EU state aid regime to the three participating European Free Trade Association (EFTA) States Norway, Iceland and Lichtenstein<sup>55</sup> –, the ‘common interest’ is defined by reference to the EEA as a whole, and not by reference to the EU and/or the EFTA states considered in isolation.

The benefits of state aid under Article 107(3) TFEU are assessed on the basis of ‘common interest’, that is, not only the interest of the member state awarding the aid but also the interest of all other member states (or, if one prefers, the EU as a whole). In a sense, this is implicit in the very logic of a state aid regime, the point of which is precisely to avoid undue market distortions and preserve a level playing field.

To ensure real substantive convergence, i.e. convergence in terms of policy coordination or – at the very least – limiting any negative effects on the other party to the strict minimum, similar principles should apply to any future state aid regime applied by the EU and the UK. In particular, it should be clear beyond doubt that the “common interest” criterion in any future trade agreement should be understood to refer to both trading partners.

A concrete example illustrates this point well. In 2015, the EFTA Surveillance Authority (ESA) approved a series of state aid measures by the Norwegian government to sponsor the uptake of electric vehicles in the country, including a VAT exemption for such vehicles.<sup>56</sup> Having concluded that the said measures constituted a selective advantage, the ESA observed that *“there is significant trade in vehicles and electric vehicles in the EEA. According to the case law, it is not necessary that the beneficiary undertakings [in Norway] are themselves involved in intra-EEA trade, for this condition to be met. It is sufficient to find that electric vehicles are traded within the EEA. [...] The measures may have the consequence that the opportunities for undertakings established in other EEA States to offer their services in the EEA are reduced.”* Following a deeper assessment of the likely effects of the aid, the ESA subsequently concluded that the measures did not lead to *undue* distortions of competition and that the measures could be considered in the common (i.e. EEA) interest.

The guidelines on regional aid issued both by the ESA and the Commission illustrate this point further.<sup>57</sup> Article 61(3) (a) EEA refers to regional aid and provides that “abnormally low” standards of living may justify the award of such aid. The question of whether the standard of living is abnormally low is not assessed by reference to the (relatively wealthier) EFTA states that take part in the agreement, but by reference to the EEA.<sup>58</sup> In the EFTA guidelines on regional aid, therefore, the ESA explains that no single region within the EFTA states qualifies for aid under Article 61(3)(a), and this is because no EFTA-state region has a GDP per capita below 75% of the average of the EEA taken as a whole.<sup>59</sup> Likewise, the Commission’s Regional Aid Guidelines (RAG) specify that where the aid leads to the beneficiary closing down the same or a similar activity in another area in the EEA (i.e. not just the EU) and relocating that activity, this is considered to be a negative effect that is unlikely to be compensated by any positive elements of the aid.<sup>60</sup>

The same conclusion follows in relation to other forms of horizontal aid. For instance, aid to R&D activities may distort competition in the sense that, in addition to (or instead of) achieving their objective, they may have the additional effect of shifting the location of some activities from one place to another. Again, the ESA decision implementing the guidelines for R&D and innovation<sup>61</sup> makes explicit reference to location effects, which are assessed by reference to the EEA as a whole. Thus, if the only effect of a state aid measure is to shift production from one part of the EEA to the other, then it is unlikely to be considered compatible – the distortive effect would not outweigh any alleged benefits in such a case.<sup>62</sup>

To ensure real substantive convergence, i.e. convergence in terms of policy coordination or – at the very least – limiting any negative effects on the other party to the strict minimum, similar principles should apply to any future state aid regime applied by the EU and the UK. In particular, it should be clear beyond doubt that the “common interest” criterion in any future trade agreement should be understood to refer to both trading partners. Likewise, it should be clear that state aid rules should be enforced, at the domestic level, with a view to advancing the common interest of both contracting parties. As we will see in the next subsection, the Withdrawal Agreement has indeed embraced this broad principle, coupled with some enhanced safeguards as regards enforcement by UK authorities and courts.

## MODELS OF STATE AID ENFORCEMENT

Achieving the substantive alignment in the interpretation and implementation of state aid rules is a major challenge. A common rulebook is, in and of itself, not enough. Where there are two or more authorities in charge of the implementation of these rules, it is necessary to introduce an institutional structure aimed at ensuring that rules are interpreted in a uniform and consistent manner. Similarly, cooperation mechanisms between the authorities in charge of the rules need to be put in place.

Two broad mechanisms can be envisioned for this purpose. Under one model (*supranational enforcement*), the authorities and courts in charge of the enforcement and/or the review of the legality of state aid measures are supranational. This is the model that currently applies in the context of the EEA. Under a second model (*national enforcement*), the UK would implement state aid rules via a national administrative authority, the acts of which would be subject to judicial review before UK courts and tribunals. This model was proposed by the UK in its White Paper and is enshrined, in

combination with additional safeguards, in the Withdrawal Agreement. These different models are examined in turn below. The section concludes with a brief outlook on the Future Relationship.

### Supranational enforcement: The EEA framework

The EEA model, in the current political landscape, is not considered a viable option as it appears to be rejected by the UK government. It would not put an end to the free movement of persons, and would involve a supranational court. In addition, it cannot be taken for granted that it is in the EFTA states’ best interest to accept the UK into the EFTA bloc.<sup>63</sup> However, the model still serves as a useful benchmark by which to compare the various enforcement models that are implementable and that have been proposed.

#### *The EEA model*

In the EEA model, the Commission reviews the state aid measures adopted by the EU member states, and the ESA those of the participating EFTA states. Originally, the EEA was conceived to revolve around a unified court system. However, Opinion 1/91 closed the door to that option:<sup>64</sup> the ECJ took the view that, where an international agreement concluded by the EU concerning matters that are central to the EU legal order – and state aid is one of them –, the creation of a supranational court can become a threat to the autonomy of the EU legal order and is thus incompatible with the EU treaties.<sup>65</sup>

Thus, the EEA model eventually endorsed a system of parallel courts, the Court of Justice of the EU (CJEU, which is made up of the ECJ and the General Court) and the EFTA Court. The former has the power to review the legality of decisions adopted by the Commission, and the EFTA Court has the same power in relation to decisions adopted by the ESA.

The risk of substantive divergence between the ECJ and the EFTA Court is addressed via cooperation and practical arrangements, which, taken together, appear to give some pre-eminence to the case law of the former. Pursuant to Article 6 EEA, provisions that are identical in substance to those found in the TFEU are to be interpreted in conformity with the case law of the ECJ “prior to the date of signature of this Agreement”. In addition, Article 3(2) of the Agreement between the EFTA states on the establishment of a Surveillance Authority provides that the ESA and the EFTA Court shall pay “due account” to the case law of the ECJ “given after the date of signature of the EEA Agreement”.<sup>66</sup>

At the administrative level, the risk of substantive divergence is addressed in three main ways. First, the Commission is, in practice, in charge of the elaboration of the common rulebook – that is, the GBER and the soft law instruments implementing Article 107(3) TFEU. These instruments are adopted by the Commission and subsequently implemented by the ESA for their application in the EFTA states.<sup>67</sup>

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Second, the EEA Agreement provides for cooperation mechanisms that allow the contracting parties to address any actual or potential divergences at an early stage. Protocol 27 provides for a set of detailed rules that apply to the interaction between the Commission and the ESA.<sup>68</sup> Among the obligations that Protocol 27 imposes upon the two authorities it is worth mentioning the frequent and systematic exchange of information and views, the notification of the opening of the formal procedure in cases notified to one of the authorities, and of the adoption of individual decisions.

Article 64 EEA, in turn, provides for a formal mechanism that applies in instances in which there is a disagreement between the two authorities as to the interpretation and/or implementation of state aid rules. In such circumstances, it is possible for an authority to adopt interim measures in case they fail to come to address the disagreement and avoid the distortions of competition that are alleged to result from the divergent approach. The matter may be eventually elevated before the EEA Joint Committee, with a view to finding a commonly acceptable solution.<sup>69</sup> In the field of state aid, this option has – to the best of the authors’ knowledge – not yet been used.

Third, it is important to note that the ESA, being itself a supranational body in charge of enforcing state aid rules in three different countries, shares many of the same ‘reflexes’ as the Commission when it comes to assessing the compatibility of national aid measures.

### *A variant: The docking system*

The participation of the UK in the ESA and the EFTA Court can take place even if it does not join the EEA. It is possible to conceive a scheme, known as ‘docking’, in which the EFTA institutions would apply two sets of rules: the EEA Agreement, on the one hand, and the UK-EU Agreement, on the other. Whenever issues arise in relation to the latter, there would be one member of the College and the Court – or possibly two, taking the UK’s relative size into consideration<sup>70</sup> – appointed by the UK.

This model has been championed by Carl Baudenbacher, a former President of the EFTA Court.<sup>71</sup> It was originally conceived as a means to address substantive divergences in the relationship between the EU and Switzerland. This relationship exposed the limits of enforcement by means of joint committees. In this context, docking has been presented as one of the options which could replace the existing enforcement structure and which would be acceptable to Switzerland and the EU.<sup>72</sup>

### **National enforcement: The UK White Paper**

In its White Paper of July 2018,<sup>73</sup> the UK government proposed an institutional regime in which state aid rules would be applied by a national (as opposed to supranational) authority. More precisely, the UK government envisioned a system with parallel authorities: the EU institutions (namely, the Commission and the CJEU) on the one hand; and the UK institutions (for our purposes, the Competition and Markets Authority, or CMA, and the system of courts and tribunals in the country) on the other.

In addition, the White Paper had in mind a committee structure to resolve disagreements that mirrors the cooperation mechanisms provided for in the EEA Agreement. More importantly, the document already conceded that, inevitably, the ECJ would be the body to decide ultimately on the interpretation of the relevant provisions, even if indirectly.<sup>74</sup>

The obvious difference between the EEA system and the ideas floated in the White Paper lies with the fact that the latter entails a move away from the system of supranational authorities. Unlike in the case of the EFTA states or EU member states, state aid measures granted by UK authorities would be vetted by a domestic authority, the CMA, under the control of national courts and tribunals.

The obvious difference between the EEA system and the ideas floated in the White Paper lies with the fact that the latter entails a move away from the system of supranational authorities.

This move away from enforcement by supranational institutions is not a minor point. There is a fundamental difference between having state measures controlled by a supranational authority overseeing action by several governments and having government action controlled by an authority of the same state.

It is true that national and independent regulators and supervisors are active in various domains of the economy. One can think of national banks, national competition authorities (NCAs) as well as sector-specific regulators in the network industries. These authorities have built-in mechanisms to ensure their independence and to avoid political pressures. For instance, to cut the interest rates in the case of a central bank, or to favour domestic incumbents in the case of an NCA or a sector-specific regulator. In some specific cases, regulators have also been given enforcement powers against government.<sup>75</sup>

Nevertheless, the idea that an administrative authority could interpret and apply the rules relating to broader public policy measures adopted by its own government (insofar as they involve the use of state aid) is problematic. It is likely to be resisted by some governments and stakeholders. It is true that NCAs, while typically addressing acts of companies rather than government, may also address acts of public bodies and have been the subject of a recent directive (ECN+) aimed at strengthening their independence.<sup>76</sup>

Even so, when different national authorities deal with the same subject matter, provisions may be needed to clarify their scope of activities and distinguish their powers to avoid conflicts.<sup>77</sup> As already pointed out, the point of a state aid regime is precisely to avoid cross-border distortions of competition and ‘beggar-thy-neighbour’ policies. From this perspective, it seems more sensible to control the award of state aid through a supranational enforcement structure.

Non-supranational enforcement of state aid is not unprecedented, however. Such enforcement models have been included in association agreements between the EU with, for instance, the Ukraine<sup>78</sup> and other (previously) pre-accession member states. One must bear in mind, however, that the circumstances of the latter differ from those of the UK in that they have a clear incentive to follow the case law and the Commission’s administrative practice. As a result, convergence can safely be expected, over time, with respect to these countries.

In the case of the UK, substantive divergence cannot be ruled out, despite the UK’s 45 years of experience with EU state aid control. After all, the incentives to follow the case law and/or the Commission’s practice are less pressing. What is more, UK authorities – and the UK government – may see the value of divergence in some areas, and the need to streamline some aspects of state aid. The CMA, for instance, may believe that some guidelines are unduly rigid or formalistic, or it may be inclined to take the view that greater legal certainty could be achieved by reinterpreting the notion of aid in another way.<sup>79</sup>

This might result in a situation of asymmetry in which the EU and EFTA member states would be bound by the rules on state aid and strict enforcement mechanisms, whereas the UK would obtain a degree of flexibility allowing it to free ride on the collective Europe-wide effort to eradicate harmful state aid and the resulting distortions. Especially in a context where the UK is to have, for goods, tariff free access to the EU/EEA market, this should be seen as clearly problematic for the EU/EEA member states.

## The Withdrawal Agreement: National enforcement with additional safeguards

### Overview

In November 2018, the EU and the UK agreed, at working level, on a draft Withdrawal Agreement featuring a very significant body of rules on state aid, as well as other level playing field aspects. It is against the background of the potential drawbacks of the national enforcement models described in the previous section that one can make sense of the provisions introduced in the Withdrawal Agreement.

In itself, this enforcement model can be regarded as non-supranational in nature in that it provides for the setting up of a domestic UK system, supervised by an independent authority, that would apply to aid granted by UK authorities affecting trade between the EU and Great Britain (see further below). In some respects, and for the same reason, this text also introduces guarantees that are not seen, for instance, in the EEA model and which foresee an enhanced role for the Commission in the domestic UK regime. Arguably, this must be understood as a counterweight or guarantee to ensure that state aid enforcement in the UK and the EU remains convergent in context where the two trading partners form, *de facto*, a customs union (single customs territory) and remain highly integrated in other dimensions as well.

As mentioned in the introduction to this section, the Withdrawal Agreement provides for a Protocol that would apply “unless and until” it is superseded by a new trading arrangement between the EU and the UK as part of the Future Relationship. The logic behind the Protocol is to ensure that no hard border is erected between Northern Ireland and the Republic of Ireland.

The mechanism to achieve this goal is, first, the singling out of Northern Ireland which, for the purposes of the Withdrawal Agreement, is referred to as “the part of the territory of the United Kingdom to which Regulation (EU) No 952/2013 applies by virtue of Article 6(2) of this Protocol”.<sup>80</sup> Pursuant to Article 12(1) of the Protocol, state aid affecting trade between Northern Ireland and the EU (and, in particular, the Republic of Ireland) will continue to fall under the relevant provisions of EU law (specified in Annex 8 to the Protocol).<sup>81</sup> Pursuant to Article 14(4), such aid will be monitored and enforced by the Commission, under the scrutiny of the EU Courts. This applies to all aid measures affecting trade between Northern Ireland and the

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EU; both those of the UK authorities and those of the EU member states.<sup>82</sup>

Perhaps understandably, because the British government also sought to avoid the erection of a hard border between Northern Ireland and the rest of the UK, Article 6 of the Protocol provides for the creation of a single customs territory between the EU, Northern Ireland and the rest of the UK (i.e. Great Britain). In order to ensure a level playing field in this context, a separate state aid regime (inter alia) is put in place for measures affecting trade between the EU and (in effect) Great Britain.

This regime is found in Annex 4 to the Protocol (specifically, in Part Four, Articles 7-15). Pursuant to Article 7(1) of this Annex, the relevant body of EU state aid law (specified in Annex 8 to the Protocol) will also apply to aid measures affecting trade between the EU and (in effect) Great Britain.

**On substance, given that the relevant body of EU state aid law will apply both in the EU itself and in the UK (in respect of Great Britain as well as Northern Ireland), a common legal framework is essentially assured.**

In the latter context, it envisions the creation of an independent UK authority to enforce the state aid rules in respect of measures implemented by the UK (Article 9 of the Annex). It is worth noting that this authority – which the UK has announced will be the CMA – will have the same powers as the European Commission in enforcing the state aid rules. As noted by other commentators,<sup>83</sup> this is a rather far-reaching power, in particular from the perspective of UK constitutional law. Ultimately, it appears to give the independent authority the power to declare Acts of Parliament that confer state aid to be unlawful when they go against the (EU) state aid rules. As regards measures implemented by EU member states, the European Commission remains in charge.<sup>84</sup>

On substance, given that the relevant body of EU state aid law will apply both in the EU itself and in the UK (in respect of Great Britain as well as Northern Ireland), a common legal framework is essentially assured, both in static sense (as from the date of the UK's departure from the EU) and dynamically, given that also new or revised versions of EU state aid law would form part of the “common rulebook”.<sup>85</sup>

Finally, it is worth pointing out that Article 12(1) of the Protocol is likely to cover many measures taken by the devolved administration in Northern Ireland, but that it will most likely also include any (central) UK government measure that extends to Northern Ireland, e.g. nationwide business support measures or tax exemptions.<sup>86</sup> It may theoretically even bring in UK measures benefiting UK businesses that also produce goods in Northern Ireland.<sup>87</sup>



Such measures would give rise to a parallel review process: the measures concerned would be vetted not only by the independent authority (insofar as GB-EU trade is affected) but also by the European Commission (insofar as NI-EU trade is affected). In this context, Article 15(1)(b) of Annex 4 specifies that any decision by the independent authority would be “without prejudice” to the legal effects in the UK of decision of the Commission. This appears to be a rather strong safeguard: ultimately the Commission decision would, in all likelihood, take precedence.

Another noteworthy aspect of the Withdrawal Agreement is that it provides for mechanisms to enhance the transparency of the award of state aid (and the traceability of state aid measures) and the application of the relevant provisions in the UK.<sup>88</sup> Such a mechanism would be introduced by virtue of Article 12, which requires the UK to “maintain a system of transparency of aid granted for individual state aid grants above EUR 500 000”.

### ***The advancement of the common interest of the UK and the EU***

As regards the notion of common interest, and how to interpret it, it follows from Article 7(1) that the independent authority will have to apply the criteria of Article 107(3) TFEU to approve UK aid measures. This means – given the EU Courts’ interpretation of the concept of “common interest”<sup>89</sup> – that the compatibility assessment by the independent authority will need to consider the adverse effects on the EU27 member states as well. Thus, as a matter of law, this authority will have an obligation, by virtue of the Agreement, to consider the “common interest” as encompassing that of the UK and the EU.

*Prima facie*, there would not appear to be a similar provision in the Protocol that expressly provides that the European Commission is, as a matter of law, required to consider the common interest in a reciprocal way, i.e. to take into account the negative effects on the UK when it is assessing the compatibility of measures implemented by one of the EU27 member states. One could be led to assume that the interest of the UK would not be taken into consideration, as a matter of law, by the European Commission.

A careful overview of the Withdrawal Agreement and the Protocol tends to suggest, however, that such an obligation can be inferred from its various provisions. According to the letter of Article 7(1) of the Withdrawal Agreement, “all references to Member States and competent authorities of

*Prima facie*, there would not appear to be a provision in the Protocol that expressly provides that the European Commission is, as a matter of law, required to consider the common interest in a reciprocal way, i.e. to take into account the negative effects on the UK when it is assessing the compatibility of measures implemented by one of the EU27 member states.

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Member States in provisions of Union law made applicable by this Agreement shall be understood as including the United Kingdom and its competent authorities (...). One could reasonably infer from this provision that the European Commission, when applying Articles 107 and 108 TFEU, is required to treat the UK “as if” it were an EU member state, and thus to take its interest into account.<sup>90</sup>

In the same vein, one cannot fail to note that the UK would not be devoid of instruments to take measures if it believes that its interests are not duly taken into consideration. In particular, Article 18 of the Protocol allows the Union and the UK to unilaterally adopt safeguard measures, *inter alia*, where the application of the Protocol leads to the diversion of trade. Even if such safeguard measures can be seen as a mechanism to be used only in exceptional circumstances, they appear to suggest that the Withdrawal Agreement and the Protocol is crafted on the assumption that the common interest, as interpreted by the European Commission, will take the UK into account.

### ***The asymmetry of rights and obligations***

It is clear that the mechanisms put in place to ensure the consistent interpretation and application of state aid provisions reveal a certain asymmetry. Article 10 of the Annex to the Protocol, for instance, requires the independent authority to inform the Commission of its plan to open proceedings, to consult the Commission before adopting any draft decision and to take the “utmost account” of the Commission’s comments. No similar obligation is imposed on the Commission vis-à-vis the independent authority.

Similarly, there is a consultation procedure that can be opened by the EU (not the UK) where it believes that the application and implementation of state aid provisions by

the UK “threatens to seriously undermine the equal conditions of competition between the parts of the single customs territory” (Article 13 of the Annex). Article 14, in turn, allows the EU (and again, not the UK) to adopt interim measures.

Further guarantees are foreseen in Article 11, which extends to the UK the system of judicial remedies found in the EU system for the control of state aid. In addition to entrusting UK courts and tribunals with the requisite powers to effectively enforce state aid provisions and review the legality of administrative action, Article 11(2) gives the Commission standing before UK courts and tribunals; and Article 11(3) gives it the right to intervene in cases involving the application of these rules. Again, these are mechanisms that go beyond what the EEA system provides.

This relative asymmetry, which is not observed in the EEA model,<sup>91</sup> can be seen as an inevitable consequence of the choice of a non-supranational enforcement mode (for measures affecting trade between the EU and Great Britain). Where an authority controls the measures taken by the public bodies of its own country, there is a higher risk that it will not take into account adverse effects on the other trading partner – the EU in this case. As a result, these safeguards can be seen as mechanisms to ensure that the “common interest” is interpreted by the independent authority as encompassing both the UK and EU interest.

At the same time, as noted above, the UK would not be devoid of instruments to take measures if it believes that its interests are not duly taken into consideration by the Commission.

Likewise, it is important to observe that any UK company, when it considers itself to be negatively affected by an aid measure implemented in any of the EU member states, to apply for the annulment of a Commission decision before the EU Courts

or, where relevant, to challenge the legality of the measure before a national court. Pursuant to Article 4(1) of the Withdrawal Agreement, the provisions of this Agreement and the provisions of Union law made applicable by it “*shall produce in respect of and in the United Kingdom the same legal effects as those which they produce within the Union and its Member States. Accordingly, legal or natural persons shall in particular be able to rely directly on the provisions contained or referred to in this Agreement which meet the conditions for direct effect under Union law.*”

## Outlook: Beyond the Withdrawal Agreement

The state aid regime introduced by virtue of the Protocol on Ireland/Northern Ireland is not intended to be a lasting one. Instead, it was conceived to be superseded by a lasting trade agreement between the EU and the UK. The question is whether this trading agreement would differ significantly from the existing principles found in the Protocol. There are some ways in which this agreement may differ.

For instance, it may not provide for the creation of a single customs territory. Conversely, it may be wider in scope in the sense that it may not be confined to trade in goods. In any event, it looks like the fundamental principles of the Protocol would be maintained in any future relationship. This is at least the very clear conclusion that stems from a reading of the Political Declaration, which express a clear commitment to a level playing field “building on the arrangements provided for in the Withdrawal Agreement and commensurate with the overall economic relationship”.<sup>92</sup>

Accordingly, the additional guarantees that are introduced in the Protocol can be expected to remain if the UK continues to focus on a non-supranational enforcement model while seeking significant access to the EU internal market. One is unlikely to see a looser substantive state aid regime being adopted in such a context.

If the UK is set on a ‘lesser grip’ of the European Commission in its domestic state aid regime than foreseen in the Withdrawal Agreement in the future (while retaining market access), it may perhaps be possible for it to envision participating in supranational forms of state aid control, e.g. as a member of the EEA or in ‘variant’ of the EEA model, e.g. the docking model. Whether the UK or, for that matter, the EFTA states would be willing to contemplate such an approach is difficult to predict.

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It seems safe to conclude, however, that other regimes do not seem appropriate models for the Future Relationship. As discussed, there are provisions dealing with subsidies and similar measures in other trade agreements concluded by the EU, for instance with Canada, Japan or South Korea. The light institutional systems put in place by virtue of these agreements – including those at national level – do not seem to account, however, for the tightly interconnected relationship between the UK and the EU member states.

Equally unworkable is the Swiss model, which has sometimes been, explicitly or implicitly, advanced as a template for the future relationship – at least in the UK.

This is so for several reasons. First and foremost, the system for the resolution of disputes revolves around Joint Committees, which, for the reasons explained above, do not appear to be suitable for the concerns and issues raised in the field of state aid. Second, while this model has a (limited) system for the control of aid, it is, by and large, moot, as there is no institutional framework in place to enforce it, not even at a Swiss level. Finally, there is every reason to believe that even this regime will, sooner or later, be superseded, as far as its institutional dimension is concerned, by one that looks similar to the EEA/docking model or that negotiated in the context of the Withdrawal Agreement.

## Conclusion

The analysis above leads to the conclusion, first, that state aid can be expected to feature prominently in the future relationship between the EU and the UK. This appears inevitable not only due to the volume of trade between the two, but also because of the declared political willingness to adhere to a strict regime for the control of subsidies and similar measures. In this sense, the Political Declaration made in the context of the Withdrawal Agreement is rather unequivocal.

The second conclusion is that the inevitability of the state aid regime does not mean that its implementation is straightforward in practice. Due to their nature, it appears indispensable to introduce mechanisms to guarantee the substantive alignment in the field. This implies, *inter alia*, the introduction of an institutional framework in which the interpretation of the provisions and cooperation between the authorities takes place.

One can think of two main institutional models: supranational and non-supranational. The UK government appears to express a preference for the non-supranational model, whereby state aid provisions would be interpreted and enforced at the domestic level by a national authority subject to the review of a national court. This model calls for the application of extra guarantees to preserve a similar degree of protection on both sides of the Channel.

The Withdrawal Agreement, in particular its Protocol, provides a template for how these extra guarantees might look in practice. Even if the Protocol is not intended to be enacted or to become permanent, the fundamental principles underpinning it – which include giving standing to the Commission in UK proceedings, requiring the UK authority to submit drafts of decisions or to introduce transparency measures – are likely to feature in the future lasting relationship between the EU and the UK.

<sup>1</sup> The statement was recorded in the context of the G7 talks in Canada, June 2018. Cf. BBC, "Trade war a reality, French finance minister warns", 22 July 2018.

<sup>2</sup> European Council (Article 50) guidelines for Brexit negotiations, 29 April 2017; European Council (Article 50) guidelines on the framework for the future EU-UK relationship, 23 March 2018; UK Department for Exiting the European Union, White Paper on the future relationship between the United Kingdom and the European Union, July 2018.

<sup>3</sup> European Commission, Draft Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community, as agreed at negotiators' level on 14 November 2018.

<sup>4</sup> Council of the European Union, Draft Political Declaration setting out the Framework for the Future Relationship between the EU and the UK, 22 November 2018.

<sup>5</sup> This section draws on Vincent Verouden and Philipp Werner, "Introduction – The Law and Economics of EU Aid State Control", in Vincent Verouden and Philipp Werner (2016, eds.), *EU State Aid Control: Law and Economics*, Kluwer.

<sup>6</sup> The legal framework of the EU is based on a number of treaties. In the economic domain, the Treaty on the Functioning of the European Union (TFEU) contains the central provisions. It is based on the 1957 Treaty of Rome which established the European Community (EC).

<sup>7</sup> In the European context, the term internal market stands for the European (EU) market.

<sup>8</sup> Measures under Article 107(2) TFEU are compatible as such: they primarily relate to social measures aimed at individuals, as well as measures addressing damage due to natural disasters. State aid measures may further be declared compatible on a special legal basis such as Article 106(2) TFEU (in the context of public service provision) or Article 93 TFEU (aid measures in the transport sector).

<sup>9</sup> Cf. Judgment of the General Court of 15 June 2010, *Mediaset v Commission*, T177/07, para.125; Judgment of the General Court of 12 July 2018, *Austria v Commission*, T-356/15, para.48; Judgment of the General Court of 18 September 2018, *HH Ferries and others v Commission*, T68/15, para.205 and 211–212.

<sup>10</sup> European Commission, State Aid Scoreboard 2017. Expressed as a share of aid expenditure, the coverage of GBER is 46% (average per member state; weighted average at EU level is 32%). The GBER accordingly tends to focus on the smaller (and potentially less problematic) aid schemes.

<sup>11</sup> Commission Regulation (EU) No. 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, 26 June 2014, p.1.

<sup>12</sup> See e.g. Judgment of the Court of 8 December 2011, *KME Germany AG and others v Commission*,

C-272/09 P, para.100.

<sup>13</sup> For a more detailed discussion, see e.g. Rubini, Luca (2009), *The Definition of Subsidy and State Aid: WTO and EC Law in Comparative Perspective*, Oxford University Press.

<sup>14</sup> A WTO member country may not impose a countervailing measure unless it determines that there are subsidised imports, injury to a domestic industry, and a causal link between the subsidised imports and the injury.

<sup>15</sup> The analysis thus abstracts away from wider (political) aspects that may have also played a role in the negotiation process, such as the need for the EU to find an appropriate balance of rights and obligations in the future relationship with the UK, both taking into account the rights and obligations assumed by the EU member states themselves and those assumed by other external trading partners (e.g. Switzerland, Canada and South Korea). These other constraints co-determine how comprehensive (or not) a future EU-UK state aid control system *can* be realistically.

<sup>16</sup> It is also worth noting that the above figures do not include exports/imports to EFTA countries, mainly Norway and Switzerland, or other countries linked to the EU by way of free trade agreement (e.g. Turkey, South Korea, Ukraine). The extent to which these exports occur precisely because of the current trade EU agreements in place is difficult to measure, but it may well be significant. At the same time, the figures do not take into account the 'Rotterdam effect', which may inflate the EU-UK numbers provided somewhat.

<sup>17</sup> House of Commons Library, Statistics on UK-EU trade, 31 July 2018.

<sup>18</sup> See e.g. Anderson, James E. and Eric Van Wincoop (2003), "Gravity with Gravitas: A Solution to the Border Puzzle", *American Economic Review*, Volume 93, Number 1, pp.170-192; Baier, Scott L. and Jeffrey H. Bergstrand (2001), "The growth of world trade: Tariffs, transport costs, and income similarity", *Journal of International Economics*, Volume 53, Number 1, pp.1-27; Redding, Stephen and Anthony J. Venables (2004), "Economic geography and international inequality", *Journal of International Economics*, Volume 62, Number 1, pp. 53-82.

<sup>19</sup> Ibid.

<sup>20</sup> Numerous studies have attempted to quantify the effects of different degrees of future obstacles to trade: a hard, 'no deal' Brexit; a soft Brexit, and so on. For an overview, see e.g. Ergen, Hugo *et al.* (2017), *Assessing the economic impact of Brexit: Background report*, Rabobank.

<sup>21</sup> Ibid.

<sup>22</sup> Former Commissioner Joaquín Almunia has referred to the resulting distortions in the location of economic activity as the "deep-pockets distortions". Almunia, Joaquín, "Doing more with less – State aid reform in times of austerity: Supporting growth amid fiscal constraints", speech delivered at King's College London, 11 January 2013.

<sup>23</sup> EU State Aid Scoreboard 2017.

<sup>24</sup> In the line of Brander, James A. and Barbara J. Spencer (1985), "Export Subsidies and International Market Share Rivalry", *Journal of International Economics*, Volume 18, Numbers 1-2, pp.83-100.

<sup>25</sup> See also Dewatripont, Mathias and Paul Seabright (2006), "'Wasteful' Public Spending and State Aid Control", *Journal of the European Economic Association*, Volume 4, Numbers 2-3, pp.513-522, who note that politicians sometimes use state aid as an instrument to 'signal' to voters that they actively pursue their interest.

<sup>26</sup> Some caution in interpreting these data is needed, e.g. the data for Germany are strongly driven by the important renewable energy support schemes, the state aid character of which has recently been cast in doubt (Judgment of the Court of 28 March 2019, Germany v Commission, C-405/16 P).

<sup>27</sup> EU State Aid Scoreboard 2017 (figures 2016; excluding railways). About EUR 1.8 billion (21%) of UK state aid fell under a block exemption, compared to 32% for the EU as a whole.

<sup>28</sup> As has recently become public, in October 2016 the UK offered a support package to Nissan of up to GBP 80 million (later revised to GBP 61 million) if the carmaker agreed to produce the next Qashqai and X-Trail models at its Sunderland plant post-Brexit. Sabbagh, Dan and Jasper Jolly, "Nissan was offered secret state aid to cope with Brexit, minister concedes", *The Guardian*, 4 February 2019.

<sup>29</sup> It is not unlikely that the regions with the deepest trade relationships with the EU (Wales, North-East England, ...) will be affected more strongly than other regions, e.g. large urban areas like London.

<sup>30</sup> Lyons, Bruce; David Reader and Andreas Stephan (2017), "UK competition policy post-Brexit: taking back control while resisting siren calls", *Journal of Antitrust Enforcement*, Volume 5, Number 3, p.362.

<sup>31</sup> UK Department for Exiting the European Union (2018), op.cit. See point 110.

<sup>32</sup> The White Paper also stated in point 111, however, that this proposal was without prejudice to the UK's intention to develop new tailored arrangements in relation to payments to farmers and other land managers for environmental benefits, and the UK's future public procurement policy.

<sup>33</sup> European Commission (2018), op.cit., Protocol on Ireland/Northern Ireland in the Withdrawal Agreement, Article 1(4).

<sup>34</sup> Ibid., Article 12.

<sup>35</sup> See ibid., Annex 4.

<sup>36</sup> Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 TFEU to de minimis aid, 24 December 2013, p.1.

<sup>37</sup> European Commission, Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union,

19 July 2016, p.1.

<sup>38</sup> Judgement of the Court of 22 December 2008, British Aggregates Association v Commission and UK, C-487/06 P, para.111.

<sup>39</sup> See also Conte, Giuseppe and James Kavanagh, "Advantage", in Vincent Verouden and Philipp Werner (2016, eds.), op.cit, p.77.

<sup>40</sup> Joined Cases Judgement of the Court of 21 December 2016, Commission v World Duty Free Group and others, C-20/15 P; and Commission v Banco Santander and Santusa, C-21/15 P, para.31.

<sup>41</sup> Buendía Sierra, José Luis (2018), "Finding Selectivity or the Art of Comparison: Joined Cases C-78 to 80/08 (Annotation)", *European State Aid Law Quarterly*, Volume 17, Number 1, pp.85-92.

<sup>42</sup> For a discussion of this principle (and the difficulties it raises in practice), see Lenaerts, Koen, "State Aid and Direct Taxation", in Heikki Kanninen, Nina Korjus and Allan Rosas (2009, eds.), *EU Competition Law in Context: Essays in Honour of Virpi Tiili*, Oxford: Hart Publishing; Honoré, Michael, "Selectivity" in Vincent Verouden and Philipp Werner (2016, eds.), op.cit.

<sup>43</sup> See for instance Judgement of the Court of First Instance of 18 December 2008, Gibraltar, UK and N. Ireland v Commission, T-211/04 and UK v Commission, T-215/04; and Judgement of the General Court of 7 March 2012, British Aggregates v Commission, T-210/02 RENV.

<sup>44</sup> Case C-487/06 P, op.cit; Joined Cases Judgement of the Court of 15 November 2011, Commission and Spain v Gibraltar and UK, C-106/09 P and C-107/09 P; and Joined Cases C-20/15 P and C-21/15 P, op.cit.

<sup>45</sup> Opinion of the Court of 14 December 1991, Draft agreement between the Community, on the one hand, and the countries of the European Free Trade Association, on the other, relating to the creation of the European Economic Area, Opinion 1/91.

<sup>46</sup> This is not to say that questions of technical interpretation cannot arise, but in general the clauses of the GBER are quite precise and straightforward to interpret.

<sup>47</sup> Commission Regulation (EU) No 651/2014, op.cit.

<sup>48</sup> State Aid Scoreboard 2017.

<sup>49</sup> State Aid Scoreboard 2017. This is the case even today, even if the share of GBER coverage is still rising, following the 2014 State Aid Modernisation (SAM) programme. For the UK, the GBER figure in 2016 was just 21%.

<sup>50</sup> Judgement of the Court of 17 September 1980, Philip Morris Holland v Commission, Case 730/79, para.17.

<sup>51</sup> For instance, an important element of the compatibility assessment is to check whether the aid is *effective*, i.e. provides for an incentive effect. This assessment is typically not straightforward. Different degrees of rigour in the analysis of the incentive effect by the controlling authority concerned may well



lead to different outcomes as regards compatibility.

<sup>52</sup> Cf. Case T-356/15, *op.cit.*

<sup>53</sup> Aid that pursues domestic policy goals but which (knowingly or unknowingly) comes at the expense of other countries.

<sup>54</sup> Taking into account each other's interests resembles the more general 'comity' arrangements as they exist, e.g. in the context of EU-US cooperation in the field of antitrust.

<sup>55</sup> Article 61 the EEA Agreement is virtually identical to Article 107 TFEU, including the exemption mechanisms.

<sup>56</sup> ESA, EFTA Surveillance Authority Decision of 21 April 2015 on the State aid measures in favour of electric vehicles.

<sup>57</sup> ESA, ESA Guidelines on regional State aid for 2014-2020, 23 November 2013.

<sup>58</sup> The EU Court of Justice explained in *Philip Morris* that the question of whether the standard of living is low cannot be assessed by reference to the Member State in question but considering the Union as a whole; see Case 730/79, *op.cit.* The same applies in the context of the EEA.

<sup>59</sup> See in this sense para.144: "The Authority considers that the conditions laid down in Article 61(3)(a) of the EEA Agreement are fulfilled if the region, being a Statistical region at level 2, has a per capita gross domestic product (GDP), measured in purchasing power standards (PPS), of less than 75% of the EEA average. The GDP per capita of each region and the EEA average to be used in the analysis are determined by reference to the relevant official statistical. There is however no Statistical region at level 2 in the EFTA States that currently fulfils this condition. Hence, no region in the EFTA States qualifies for the Article 61(3)(a) EEA derogation".

<sup>60</sup> European Commission, Guidelines on regional State aid for 2014-2020, 23 July 2013, para.122.

<sup>61</sup> ESA, EFTA Surveillance Authority Decision No 271/14/COL of 9 July 2014 amending for the 97th time the procedural and substantive rules in the field of State aid by adopting new Guidelines for research and development and innovation [2015/1359], 06 August 2015.

<sup>62</sup> *Ibid.*, para.116-118. The Commission's R&D&I Framework contains similar provisions even if it does not explicitly refer to the EEA perspective; European Commission, Communication from the Commission – Framework for State aid for research and development and innovation, 27 June 2014, para.105 and 116-118.

<sup>63</sup> Nordby Lunde, Heidi, "Take it from a Norwegian MP: we don't want Britain in the EEA", *The Guardian*, 7 December 2018.

<sup>64</sup> Opinion 1/91 (1991), *op.cit.*

<sup>65</sup> Specifically, the Court held that an international agreement which provides for its own system of courts, including a court with jurisdiction to settle disputes (and, as a result, to interpret its provisions),

is in principle compatible with Community law.

However, this is not the case when the agreement at issue "takes over an essential part of the rules – including the rules of secondary legislation – which govern economic and trading relations within the Community and which constitute, for the most part, fundamental provisions of the Community legal order." Such an agreement has the effect of "introducing into the Community legal order a large body of legal rules which is juxtaposed to a corpus of identically-worded Community rules." Consequently, it will determine "not only the interpretation of the rules of the agreement itself but also the interpretation of the corresponding rules of Community law" (para.40-45).

<sup>66</sup> EFTA, Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice, 07 March 2012.

<sup>67</sup> See *ibid.*, Article 24.

<sup>68</sup> Protocol 27 on Cooperation in the Field of State Aid, 03 January 1994.

<sup>69</sup> If within three months the EEA Joint Committee has not been able to find such a solution, and if the practice in question causes, or threatens to cause, distortion of competition affecting trade between the EEA Contracting Parties, the interim measures may be replaced by definitive measures. Priority is to be given to such measures that will least disturb the functioning of the EEA (Article 64).

<sup>70</sup> One could possibly also envision judges from the different devolved entities of the UK, to maintain a balanced composition.

<sup>71</sup> Baudenbacher, Carl, "After Brexit: Is the EEA an option for the United Kingdom?", 42nd Annual Lecture of the Centre for European Law delivered at King's College London, 13 October 2016.

<sup>72</sup> The docking option is also discussed in Hogarth, Raphael, Alex Stojanovic and Jill Rutter (2018), "Supervision after Brexit. Oversight of the UK's future relationship with the EU", London: Institute for Government.

<sup>73</sup> UK Department for Exiting the European Union (2018), *op.cit.*

<sup>74</sup> UK Department for Exiting the European Union (2018), *op.cit.*, para.42.

<sup>75</sup> For a more elaborate discussion of the various challenges that domestic enforcement and supervision entail see also "Supervision after Brexit", *op.cit.*

<sup>76</sup> For more details, see the European Commission's Empowering National Competition Authorities site.

<sup>77</sup> It is worth noting that where intra-EU trade is affected, the Commission has the right to take over antitrust proceedings of NCAs pursuant to Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Article 81 and 82 of the Treaty, Article 11.

<sup>78</sup> The Deep and Comprehensive Free Trade Agreement (DCFTA) concluded by the EU with the

Ukraine; cf. Council Decision 2014/145/CFSP of 17 March 2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of UK.

<sup>79</sup> See in this sense Peretz, George QC., Kelyn Bacon QC and Isabel Taylor (2017), "Bringing State aid home: Could an effective domestic State aid regime be devised for the UK?", UK State Aid Law Association; who take the view that "given the size of the UK economy compared to those of the EEA/ EFTA Member States, the risk of divergent approaches emerging in the case of the United Kingdom is rather greater than has been the case for the ESA."

<sup>80</sup> See Article 12 of the Protocol.

<sup>81</sup> Annex 8 of the Protocol codifies the existing EU State aid regime.

<sup>82</sup> Cf. Article 14(4) and Article 12(1) of the Protocol. As regards aid measures of the EU member states, the Commission obviously retains the power under Article 107(1) TFEU to control these measures when they affect intra-EU trade. Article 14(4) extends these powers to measures affecting *trade between the EU and Northern Ireland* (measures under Article 12(1) of the Protocol) and, as we will discuss later, to measures affecting *trade between the EU and Great-Britain* (measures under Article 7(1) of Annex 4 to the Protocol).

<sup>83</sup> Cf. Peretz, George QC (2018), "State Aid and the Withdrawal Agreement: Key Points", UK State Aid Law Association.

<sup>84</sup> Article 14(4) of the Protocol.

<sup>85</sup> Article 15(4) of the Protocol specifies that "where this Protocol makes reference to a Union act, the reference to that act shall be read as referring to it as amended or replaced." This implies an alignment of state aid rules which is not only *dynamic* in nature, but also *automatic*. In other words, future versions of, say, the Commission's regional aid guidelines will automatically become part of the UK rulebook as well. This goes further than the present arrangements in the EEA where such automaticity does not exist. Article 15(5) of the Protocol, by contrast, relates to situations where the EU adopts a new act that falls within the scope of this Protocol, but neither amends nor replaces an existing EU act. In that case, the UK has the option to bring the matter before the Joint Committee.

<sup>86</sup> Cf. Peretz (2018), op.cit.

<sup>87</sup> Ibid.

<sup>88</sup> This is a point raised by Lyons, Reader and Stephan (2017), op.cit., p.366; who took the view that "it would be wise [for the UK] to find politically acceptable ways to commit to limit [the freedom to grant State aid]. This might require legislation that not only enforces self-discipline, but does this in a transparent way that is visible to trade partners". See also Hogarth, Stojanovic and Rutter (2018), op.cit., for a more detailed discussion.

<sup>89</sup> Cf. T-356/15, op.cit.

<sup>90</sup> Note that the relevant EU state aid provisions are "made applicable" by the Withdrawal Agreement in respect of aid measures of the EU member states insofar as they affect trade between the EU and Northern Ireland (under Article 12(1) of the Protocol) or trade between the EU and, in effect, Great Britain (under Article 7(1) of Annex 4 to the Protocol).

<sup>91</sup> Article 64, which is comparable to Article 11 of Annex 4, is symmetric in nature. In addition, there is no provision comparable to the requirement on the independent authority to consult on draft decisions and to take the utmost account of the Commission's feedback.

<sup>92</sup> Council of the European Union (2018), op.cit.







# Labour and social standards

Marley Morris

6

# Introduction

The EU and the UK are expected to agree a set of provisions on labour and social policy as part of the next stage of Brexit negotiations. These provisions are meant to ensure that neither party loosens their labour or social standards to gain an unfair competitive advantage over the other. They form part of the so-called ‘level playing field’ that is meant to underpin the EU’s future relationship with the UK.

Member states in the EU are concerned that the UK will use Brexit as an opportunity to deregulate its economy and remove protections for workers as a means of gaining an unfair advantage over its EU trading partners. For its part, the UK wants to demonstrate a commitment to high employment standards in order to facilitate a close trading relationship with the EU after Brexit.

Both the EU and the UK have a strong interest in agreeing a level playing field with respect to labour and social standards. Member states in the EU are concerned that the UK will use Brexit as an opportunity to deregulate its economy and remove protections for workers as a means of gaining an unfair advantage over its EU trading partners. For its part, the UK wants to demonstrate a commitment to high employment standards in order to facilitate a close trading relationship with the EU after Brexit. Politically, the UK also stands to gain from supporting strong employment protections: as polling by the Institute for Public Policy Research (IPPR) has shown, large majorities support maintaining or strengthening employment regulations after the UK leaves the EU.<sup>1</sup>

This chapter explores how the level playing field in the EU-UK future relationship can guarantee robust protection for labour and social standards. We first set out the scope of the EU’s current social *acquis*, and then consider the purpose, content and governance of the prospective level playing field between the EU and the UK. Our analysis draws on the recently agreed provisions contained within the Irish protocol in the EU-UK Withdrawal Agreement, which are expected to form the basis for the level playing field in the future relationship.

## The EU’s social acquis

Since its inception, the EU has sought to drive progress in the area of social policy for its member states. The Treaty of Rome, which laid the foundations of the single market and the ‘four freedoms’ of goods, services, people and capital, included provisions on the harmonisation of

working conditions and equal pay, as well as a European Social Fund to improve employment opportunities and raise living standards across the bloc. The founding members intended to secure free trade, but also wanted to prevent undercutting and what later became known as ‘social dumping’. To ensure no member could gain an unfair competitive advantage over another, they aimed to secure minimum standards for labour protections.<sup>2</sup>

The process of extending EU social policy was accelerated in the mid-1980s, when Jacques Delors became President of the European Commission. He developed the idea of a ‘social Europe’, proposing a European ‘social charter’ for workers’ rights, launching a ‘social dialogue’ process with trade unions and employer groups, and adding a ‘social chapter’ to the Maastricht Treaty. More recently, the Commission’s current president Jean-Claude Juncker has put forward a new European Pillar of Social Rights, aimed at delivering a range of further protections for workers.

The core elements of the EU’s social *acquis* are contained in the treaties and in secondary legislation. The treaties outline the broad principles underpinning the EU’s social policy, stating, for instance, that the Union “*shall combat social exclusion and discrimination, and shall promote social justice and protection, equality between women and men, solidarity between generations and protection of the rights of the child*” (Article 3 TEU).

The treaties give the EU the possibility to develop social legislation in a number of fields, including occupational health and safety, working conditions, information and consultation, equal treatment between men and women, and the integration of people excluded from the labour market (Article 153 TFEU).

Secondary legislation – largely in the form of directives – implements in more detail the social rights delineated in the EU treaties. Drawing on existing studies, the following categorisation includes the main areas of legislation where the EU has advanced social protections.<sup>345</sup>

### ► Working time and holiday pay

The Working Time Directive guarantees a maximum working week of 48 hours, alongside minimum rest periods and rest breaks. Further protections are included for workers on night shifts. In addition, the directive guarantees a minimum of four weeks’ paid leave per

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year. Member states can introduce certain derogations and opt-outs to these rules under specific circumstances.

### ► **Equality and discrimination**

EU legislation has helped to entrench the principles of equality and non-discrimination in its member states. The EU treaties have guaranteed the right to equal pay for equal work. The Framework Equality Directive prohibits discrimination in employment on the basis of religion, age, disability, and sexual orientation. Further legislation tackles specific forms of discrimination. The Gender Recast Directive ensures equal treatment for men and women in employment opportunities, working conditions and pay, and occupational social security schemes. The Race Equality Directive prevents discrimination on the basis of race or ethnic origin in areas such as employment, social protection, and access to goods and services.

### ► **Workplace restructuring**

The 2001 Transfers of Undertakings Directive protects employees' contractual entitlements when they are moved to a different organisation due to a merger or legal transfer. It aims to ensure that workers do not lose out through lower pay or working conditions as they are transferred to their new employer. The EU has also passed legislation to guarantee payment of outstanding claims in the case of insolvency.

### ► **Information and consultation**

The EU has introduced a significant body of legislation to improve workers' rights to information and consultation. The 2002 Framework on Information and Consultation Directive sets out principles for worker engagement – for instance,

requiring information and consultation on an organisation's activities and economic situation. The 1998 Collective Redundancies Directive ensures that employers considering collective redundancies consult ahead of time with employee representatives to try to find common agreement. Moreover, the 2009 European Works Council Directive enables employees in transnational organisations to set up employee bodies ('European Works Councils') to represent members at the European level.

### ► **Occupational health and safety**

The EU has had an important influence on occupational health and safety in its member states. The 1989 Occupational Safety and Health (OSH) Framework Directive introduces a series of general principles of prevention, including avoiding risks, adapting work to the individual, and developing a coherent prevention policy. Subsequent legislation has introduced rules in a number of specific areas and sectors, including manual handling of loads, temporary construction sites, surface and underground mining, artificial optical radiation, and asbestos.

### ► **Atypical work**

EU law has also guaranteed protections for workers outside the typical employer-employee relationship. The 1997 Part-time Workers' Directive ensures that part-time workers cannot be less favourably treated than full-time workers and protects workers from being dismissed if they refuse to switch between part-time and full-time work. Similarly, the 1999 Fixed Term Work Directive ensures that employees on fixed term contracts cannot be treated less favourably than permanent employees and prevents employers from abusing successive fixed term contracts with the same employee for the same work. Finally, the 2008 Temporary

Agency Work Directive extends equal treatment with respect to pay and essential employment conditions to agency workers.

#### ► Posted work

The recently revised Posted Workers Directive extends employment protections to posted workers (i.e. workers temporarily posted to another EU member state), guaranteeing them equal pay and working conditions with local workers in the host country.

#### ► Parental rights

The 1992 Pregnant Workers Directive aims to strengthen health and safety rules at work for pregnant women and for women who have recently given birth. The directive protects pregnant and breastfeeding women against being obliged to carry out work that would endanger their health and guarantees 14 weeks of maternity leave. In addition, the 2010 Parental Leave Directive guarantees four months of leave for parents (either mothers or fathers) after the birth or adoption of a child and ensures the right to the same or equivalent employment after the period of parental leave ends.<sup>6</sup>

#### ► Contracts

The 1991 Written Statement Directive guarantees the right of employees to a written statement of the essential aspects of the employment relationship, including the place of work, the nature or category of the work, the start date and duration, the amount of paid leave, the notice period, the pay schedule, the length of the normal working day, and details of any collective agreements.

#### ► Children and young people

The 1994 Young People at Work Directive sets minimum requirements for the protection of young people in employment. It prohibits child labour by requiring that the minimum working age is no lower than either the national minimum school-leaving age or 15, whichever is higher. It also prohibits the employment of young people (defined as people under the age of 18) where there are particular risks to occupational health and safety.

#### ► Social security

For the most part, social security is a national competence. However, the EU has introduced legislation on the coordination of social security regimes with respect to freedom of movement. For instance, the 2004 Regulation on the Coordination of Social Security Rights aims to ensure that mobile EU citizens maintain their entitlements and are treated without discrimination as they move between member states. As discussed above, certain equal treatment legislation also covers social security; for instance, the Race Equality Directive prohibits ethnic discrimination in the field of social protection.

In the analysis below, we first considers the purpose of the level playing field with respect to labour and social standards in the UK-EU relationship post-Brexit; second, we analyse the potential content of the level playing field provisions; and third, we look at the possible governance arrangements underpinning the agreement.

# Purpose of the level playing field

As a longstanding and proximate economic partner of the EU, the UK presents some unique concerns for the European Council. In particular, the EU is concerned that the UK could seek to gain a competitive advantage over its neighbours by undermining current levels of social protection. To militate against this risk, the EU wants robust provisions in place to prevent undercutting.

In the words of the European Council guidelines for the future partnership:

But to what degree is there a meaningful risk that deregulation of labour and social policy will in fact distort trade? This is a pertinent question for determining the scope and strength of any level playing field for labour and social standards.

*“The aim should be to prevent unfair competitive advantage that the UK could enjoy through undercutting of levels of protection with respect to, inter alia, competition and state aid, tax, social, environment and regulatory measures and practices. This will require a combination of substantive rules aligned with EU and international standards, adequate mechanisms to ensure effective implementation domestically, enforcement and dispute settlement mechanisms in the agreement as well as Union autonomous remedies, that are all commensurate with the depth and breadth of the EU-UK economic connectedness.”<sup>7</sup>*

Implicit in the above statement is that concerns about deregulation relate only to common EU standards; the EU is not concerned about the UK loosening purely domestic standards, given this could be done whether or not the UK is an EU member.

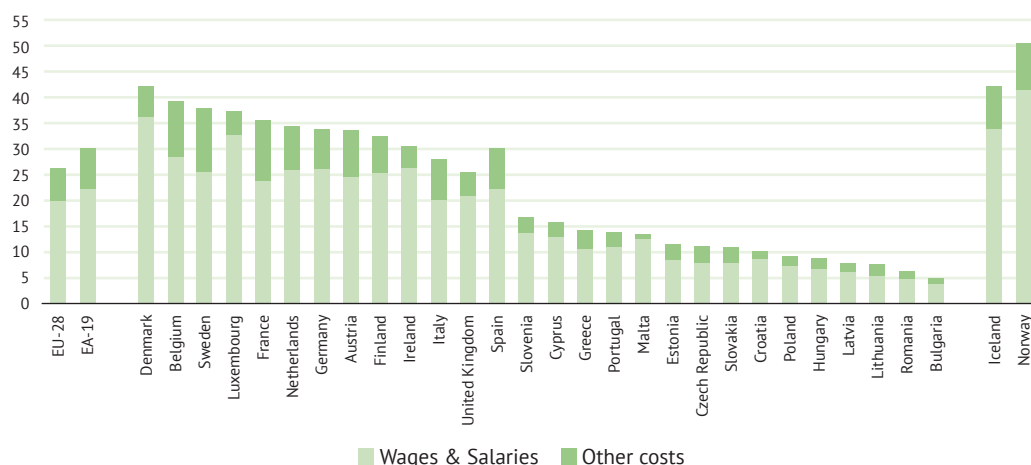
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On the one hand, a common argument is that removing labour and social regulation can make countries more competitive by reducing unit labour cost growth. In fact, this analysis is oversimplified: over the long run, deregulation risks proving counter-productive as it can reduce labour productivity growth and thereby cancel out the competitiveness effects of reducing labour cost growth. In the long term, then, deregulation is not in either party's economic interest. Nevertheless, deregulation may give



**Fig 1: Estimated hourly labour costs by EU member state (2017)<sup>8</sup>**

**Estimated hourly labour costs, 2017**  
(EUR)



Note: whole economy (excluding agriculture and public administration);  
in enterprises with 10 or more employees. Provisional data.

Source: Eurostat (online data code: lc\_lci\_lev).

a country a short-term competitive advantage over its trading partners and distort trade flows.

Moreover, in the short term, it could be argued that removing protections would have a particular impact on competitiveness vis-à-vis similar economies and close trading partners in Western Europe, such as Sweden and Denmark, where labour costs are already somewhat higher. This is clear from Fig 2.1, which shows that hourly labour costs in the UK are in fact similar to the EU28 average, but lower than most Western European economies.

During discussions among the Level Playing Field working group, it was suggested, however, that the additional cost of some EU-derived social legislation is likely to be limited. Given this legislation largely involves setting broad minimum standards – and does not generally impinge on areas such as the minimum wage or social security, which have more direct cost implications – it is argued that some areas of social policy do not have a strong bearing on competitiveness. Developing a robust set of level playing field provisions therefore rests on identifying the areas of EU social policy where deregulation carries the greatest risks of trade distortion.

**Developing a robust set of level playing field provisions therefore rests on identifying the areas of EU social policy where deregulation carries the greatest risks of trade distortion.**

**The most obvious candidates relating to competitiveness are working time and holiday pay.**

Some of the biggest reductions in working hours since the introduction of the Working Time Directive have taken place in certain tradable sectors, such as agriculture and fisheries and manufacturing. If the UK chose to remove its maximum working week requirement, these sectors may be particularly well-placed to gain a competitive advantage.

As recently as 2013, the Confederation of British Industry (CBI) called for a permanent opt-out from the Working Time Directive due to its members expressing frustration over the costs of the rules.

Based on the list of EU social legislation above, the most obvious candidates relating to competitiveness are working time and holiday pay. The Working Time Directive introduces a maximum working week of 48 hours and minimum daily and weekly rest breaks. While the UK has included an opt-out for individual workers, the evidence suggests that the directive has helped to reduce working time in the UK since its introduction.<sup>9</sup> Removing the maximum working week requirement could allow businesses to recruit fewer workers for longer hours, thereby potentially making savings on hourly wages and recruitment costs. (Though it is possible that any reductions in labour costs would partly be offset by falls in labour productivity.)

Similarly, the Working Time Directive also facilitated the extension of paid leave entitlements in the UK.<sup>10</sup> While this change did not impact all businesses, studies suggest that those affected experienced an increase in labour costs.<sup>11</sup> Removing or weakening these requirements could encourage UK businesses to scale back their holiday entitlements and thereby reduce their labour costs.

While the overall costs of the Working Time Directive are relatively small – estimated to be less than 0.5 per cent of the UK's annual labour bill, according to the UK government at the time of its introduction<sup>12</sup> – the impacts could be more strongly felt in particular sectors. Evidence from the Labour Force Survey (LFS) indicates that some of the biggest reductions in working hours since the introduction of the Working Time Directive have taken place in certain tradable sectors, such as agriculture and fisheries and manufacturing (IPPR analysis of LFS). If the UK chose to remove its maximum working week requirement, these sectors may be particularly well-placed to gain a competitive advantage.

Moreover, legislation on working time and holiday pay is perhaps the area where the UK government is most likely to seek to remove protections and lower standards. While the current government – and the wider public – is supportive of the Working Time Directive, there are indications that some UK business leaders and politicians have a strong interest in changing legislation in this area. For instance, in as recently as 2013, the Confederation of British Industry (CBI) called for a permanent opt-out from the Working Time Directive due to its members expressing frustration over the costs of the rules.<sup>13</sup>

There are potentially other areas where the UK could gain a competitive advantage over the EU by loosening labour and social standards. EU legislation has helped to boost pay and working conditions – including access to occupational pension schemes – for part-time workers; removing this legislation could save employers wage and non-wage costs. Relatedly, removing the Temporary Agency Work Directive could help some businesses to reduce labour costs by hiring agency workers on poorer terms and conditions than permanent employees. This is particularly the case in the manufacturing sector, where agency work is concentrated.<sup>14</sup>

In addition, the European Commission has highlighted the risks of the UK opting out of provisions related to workplace restructuring (such as the Transfers of Undertakings Directive and the right to information and consultation in relation to collective redundancies), occupational health and safety (on, for example, chemicals and carcinogens), and collective bargaining rights. It also notes that the UK could set up ‘export processing zones’ (EPZs) – specific areas where looser trade, regulatory and customs rules apply – and could remove employment protections for workers based in these zones in an attempt to boost trade.<sup>15</sup>

Other areas of social policy, such as equality and discrimination law, appear on the face of it to have less of a direct impact on unit labour costs (although they can increase adjustment costs in some instances). Nevertheless, given the limited research on the impact on competitiveness in these fields, a vigilant approach to the level playing field would also include these areas within its scope.

Some aspects of social policy, notably working time and holiday pay, are likely to have more of a direct impact on competitiveness than others, given they have a closer relationship to unit labour costs. But given the limited research in this field, a maximal approach to guaranteeing labour and social standards – with relatively broadly defined parameters – is perhaps most appropriate for preventing potential instances of unfair trade distortion.

We now turn to the content and governance of the level playing field for labour and social standards, drawing on the recently negotiated provisions within the EU-UK Withdrawal Agreement.

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# Content of the level playing field

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The first option is for the level playing field to require a 'common rulebook' between the EU and the UK on labour and social standards. A 'common rulebook' would require alignment of the UK's labour and social legislation with the relevant parts of the EU acquis. The UK would need to maintain current EU-derived labour and social legislation and follow its interpretation by the Court of Justice of the European Union. Moreover, the UK would also have to dynamically align its legislation with that of the EU – i.e. it would need to update its labour and social legislation in line with future developments in EU law.

While the common rulebook is not a typical part of EU trade agreements, it resembles the content of some high-integration relationships, such as the EEA Agreement and the EU-Ukraine Association Agreement. It is also a key pillar of the UK's Chequers approach, as outlined in its white paper on the future partnership.<sup>16</sup> (The UK's proposed common rulebook, however, only applies to certain areas of trade – such as state aid and much of goods regulation – and does not apply to labour and social standards.)

A 'common rulebook' would require alignment of the UK's labour and social legislation with the relevant parts of the EU acquis.

Second, the level playing field could be underpinned by a non-regression clause on labour and social standards. This is the typical approach taken in the EU's free trade agreements with third countries. The principle behind a non-regression clause is that each party commits to not lowering its domestic standards. Labour and social standards need not be aligned between parties; instead, the agreement is simply for each party to uphold its own standards.

Of course, in the case of the EU and the UK, the context of a non-regression clause is unique, because each party's labour and social standards are already aligned by virtue of the UK's EU membership. A non-regression clause does not mean, though, that the UK would be required to maintain EU-derived standards in full; instead, it is expected that there would be some flexibility for the UK to adapt its labour law, provided that any new legislation was equivalent to the EU's.

A typical example of a non-regression clause for labour law is from the Trade and Labour chapter of CETA, the free trade agreement between the EU and Canada. This clause states the following:

*“1. The Parties recognise that it is inappropriate to encourage trade or investment by weakening or reducing the levels of protection afforded in their labour law and standards.*

*2. A Party shall not waive or otherwise derogate from, or offer to waive or otherwise derogate from, its labour law and standards, to encourage trade or the establishment, acquisition, expansion or retention of an investment in its territory.*

*3. A Party shall not, through a sustained or recurring course of action or inaction, fail to effectively enforce its labour law and standards to encourage trade or investment.”<sup>17</sup>*

This non-regression clause therefore contains three parts: a ‘soft’ assurance recognising that it is inappropriate to encourage trade or investment by weakening standards; a specific commitment on derogation from existing standards; and a specific commitment on effectively enforcing existing standards. Crucially, both the commitments are restricted to only apply in cases where either party is encouraging trade or investment. This means that the application of a typical EU non-regression clause is in practice limited, as it requires proof that the party is lowering standards to encourage trade or investment.

The content of the level playing field will clearly depend on the closeness of the overarching future relationship between the UK and the EU. A deeply integrated relationship, as exemplified by the EEA agreement, would require a ‘common rulebook’ for at least some aspects of labour and social policy. However, in the context of a looser Free Trade Agreement, where both parties have considerable regulatory autonomy, the EU has signalled that it considers a non-regression clause to be more appropriate.

Given that (at least on the basis of the agreed Political Declaration) the future relationship is currently understood to take the form of a Free Trade Agreement, the EU and the UK are expected to negotiate a non-regression clause rather than a ‘common rulebook’ on labour and social standards. Yet while a non-regression clause is the expected route, the European Council guidelines nevertheless indicate that the depth of economic connectedness between the EU and the UK requires a stricter approach to non-regression than

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would normally be the case in an EU Free Trade Agreement with a third country.

This has become clear from the finalised text of the Withdrawal Agreement, where the UK and the EU have agreed certain level playing field provisions as part of the Protocol on Ireland / Northern Ireland (the so-called backstop). The backstop – designed as an insurance policy to prevent a hard border on the island of Ireland – includes a customs union between the UK and the EU, ensuring zero tariffs and quantitative restrictions on products traded between the two territories. (Fisheries products are to be dealt with separately.) This customs union in turn requires certain level playing field provisions, including a non-regression clause on labour and social standards. The Political Declaration on the future relationship suggests that the EU-UK free trade agreement will build on the level playing field provisions within the Irish protocol. This non-regression clause should therefore be seen as the starting point for the future discussions.

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The non-regression clause in the Irish protocol is notably stricter than normal non-regression clauses in EU trade agreements. The core text in Article 4 of Annex 4 of the Irish protocol makes the following commitments:

*“With the aim of ensuring the proper functioning of the single customs territory, the Union and the United Kingdom shall ensure that the level of protection provided for by law, regulations and practices is not reduced below the level provided by the common standards applicable within the Union and the United Kingdom at the end of the transition period in the area of labour and social protection and as regards fundamental rights at work, occupational health and safety, fair working conditions and employment standards, information and consultation rights at company level, and restructuring.”<sup>18</sup>*

There are three main areas where this non-regression clause goes beyond the norm. First, as illustrated above, the text of a non-regression clause often refers to ‘derogation’ from existing standards rather than straightforward divergence. This implies that lowering of labour standards may be legitimate if it involves wholesale policy change rather than an exemption from an existing law. In this non-regression clause, however, the commitment is much stronger; rather than simply preventing derogation, it requires no reduction below the level provided by the common standards applicable within the EU and the UK at the end of the transition period. This in effect means

that the level of protections in the UK delivered through EU law cannot be reduced after Brexit. The text also refers to the level of protection provided for by “law, regulation and practices” – a notably broad understanding of the maintenance of current standards.

Second, as previously noted, typically the EU’s non-regression clauses are constrained in their application to instances where either party is encouraging trade or investment. In this case, however, there are no such limitations. This means that the normal test for applying a non-regression clause – demonstrating evidence of encouraging trade or investment – can be bypassed, thereby simplifying the non-regression requirement significantly.

Third, typical non-regression clauses are vaguely worded, often simply referring to “labour laws and standards” rather than specific policy areas. The non-regression clause in the Irish protocol, however, specifies particular areas of labour and social policy where there is a high risk of unfair competition. As well as referring broadly to “the area of labour and social protection” (apparently a catch-all requirement to cover areas not otherwise listed), it refers to specific policy areas such as occupational health and safety, fair working conditions and employment standards, information and consultation rights, and restructuring. While these references do not delineate specific EU directives, they can clearly be traced to relevant areas of EU legislation. By stipulating a number of policy areas directly, the non-regression clause makes it significantly harder for either party to undermine EU-derived rules in these areas.

It seems plausible that the future relationship, even if contained within the framework of a Free Trade Agreement, will constitute a deeper economic relationship than provided for in the Irish backstop. Under these circumstances, the level playing field provisions will need to be strengthened to correspond with the depth of the UK-EU economic relationship. But how might this be done in practice? Perhaps the most straightforward way to strengthen the non-regression clause would be to identify more clearly and more comprehensively those policy areas where standards should not be lowered. For instance, the non-regression clause could stipulate that current levels of protection in working time, holiday pay, and equal treatment for atypical workers must be maintained. In addition, the level playing field provisions on labour and social policy could mirror some of the stronger content in the level playing field provisions on environmental

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policy. For instance, they could include specific numerical commitments on the maximum number of working hours or the minimum level of holiday pay required, reflecting current EU legislation.

A final question relates to how to interpret the non-regression clause's commitment to not reduce the level of protection. In the context of a Free Trade Agreement, a non-regression clause does not require the UK and the EU to maintain the exact same standards; instead, it requires these standards to be equivalent. Equivalence typically means alignment of objectives, even if these are reached by different means. In the context of an environmental non-regression clause, judging equivalence is particularly complex, because the EU's environmental legislation is intricate and multifaceted. In the context of the non-regression clause on labour and social standards, however, this is less problematic, since in any case EU employment directives tend to set objectives and then allow for considerable flexibility in their implementation by member states. More concerning is the possibility that the term 'level of protection' is interpreted loosely, allowing for lowering of protections in one area provided that the overall balance of protections remains broadly the same. While this may not have been the original intention in the drafting of the provisions, there is a risk that one party could interpret them differently in an attempt to lower protections. This makes the governance of the agreement, which we turn to in the next section, of particular importance.

There are two key elements to the governance of the level playing field with respect to labour and social standards: enforcement and dispute resolution.

## Governance of the level playing field

Aside from the content of the non-regression clause, there are a number of important questions surrounding how it is effectively governed. There are two key elements to the governance of the level playing field with respect to labour and social standards: enforcement and dispute resolution.

### ENFORCEMENT

Non-regression causes are typically enforced at the domestic level, alongside a joint EU-UK monitoring committee. For the UK's part, there are a number of



domestic institutions that govern labour rights. Individuals can bring cases on matters of employment law before industrial tribunals or domestic courts. A number of bodies are also responsible for enforcing employment protections, including:

- ▶ HMRC's national minimum wage enforcement team (responsible for enforcing the minimum wage)
- ▶ The Gangmasters and Labour Abuse Authority (responsible for licensing gangmasters in agriculture, horticulture, and food processing)
- ▶ The Employment Agency Standards Inspectorate (responsible for enforcing agency workers' rights)
- ▶ The Health and Safety Executive (responsible for enforcing occupational health and safety).
- ▶ The Director for Labour Market Enforcement (responsible for the government's overall strategy on the enforcement of labour rights)

The UK's current enforcement architecture has been criticised, however, for its piecemeal approach and its limited scale and capacity. The resources for labour inspection in the UK do not meet ILO guidelines and fall far below those in comparable European countries.<sup>19</sup> (There are signs, however, that the government is improving its approach; most recently, it announced plans to unify a number of its labour enforcement bodies.)

In the case of environmental protections, the UK government has recognised that the UK's withdrawal from the EU leaves an enforcement gap. The Department for Environment, Food and Rural Affairs is now developing an independent environmental watchdog to replace the role of the European Commission in monitoring and enforcing environmental objectives. Moreover, the EU is likely to expect the introduction of such a body as part of the level playing field agreement (and has included such provisions within the Irish protocol). Arguably, a similar agency could be introduced to replace EU structures in the enforcement of employment protections. But given that enforcement of employment rights is largely left to member states and the Commission's role is relatively limited, a new enforcement body is unlikely to be judged necessary for the level playing field on labour and social standards.

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There are, however, limits to the enforcement requirements within the level playing field provisions of the Irish protocol. Notably, there is no reference to social partners or to trade unions, which is somewhat concerning given the important role they play in the effective protection of labour rights in the EU and the UK.

The level playing field provisions within the future relationship could remedy this omission.

In the context of a Free Trade Agreement, then, much of the enforcement of the non-regression clause on labour and social standards will be the responsibility of domestic authorities. But the EU-UK agreement can nevertheless impose requirements on the effectiveness of these enforcement processes. In CETA, the parties make specific commitments to maintaining effective labour inspection systems and judicial processes. The non-regression clause in the Irish protocol goes further, making the following commitments:

*“Noting that within the Union the effective application of Union law reflecting the common standards referred to in Article 4(1) is ensured by the Commission and the Court of Justice of the European Union acting under the Treaties, the United Kingdom shall ensure effective enforcement of Article 4 and of its laws, regulations and practices reflecting those common standards in its whole territory, without prejudice to Article 4(2).*

*The United Kingdom shall maintain an effective system of labour inspections, ensure that administrative and judicial proceedings are available in order to permit effective action against violations of its laws, regulations and practices, and provide for effective remedies, ensuring that any sanctions are effective, proportionate and dissuasive and have a real and deterrent effect.”<sup>20</sup>*

As with the content of the non-regression clause, the Irish protocol’s enforcement requirement is notably strong. Aside from requiring an effective system of labour inspections and effective administrative and judicial proceedings, the text also references EU principles on labour enforcement – in particular, ensuring sanctions are “effective, proportionate, and dissuasive” and have a “real and deterrent effect”. These principles have proved particularly important in the UK in preventing limits or caps on compensation (e.g. for discrimination claims).<sup>21</sup> Highlighting these principles in the agreement therefore guards against the UK weakening its compensation rules.

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The level playing field provisions within the future relationship could remedy this omission. For instance, the agreement could include a role for domestic advisory

groups (DAGs). These are civil society forums – comprised of a balance of business organisations, trade unions, and other stakeholders – that typically provide advice, submit opinions, and make recommendations on aspects of trade and labour agreements. As with other FTAs, the EU-UK agreement on labour and social standards could include the introduction of DAGs for each party to advise on the social provisions within the agreement. But it could also strengthen the role of the DAGs by granting them powers to make submissions to the joint committee where they have reason to believe either party is contravening the non-regression agreement. The joint committee would then be required to consider the evidence, issue a response, and, where necessary, take action within a pre-determined time period.

## DISPUTE RESOLUTION

The final key consideration for the level playing field on labour and social standards is how to manage disputes between the parties where they arise. Typically, the processes for dispute resolution in free trade agreements are very weak. In the first stage, the parties are meant to resolve the dispute through consultations. As a last resort, disputes can be brought to an ad hoc 'panel of experts', which can issue recommendations for either party.<sup>22</sup> If a party does not comply with these resolutions, there are usually no provisions for sanctions.

These processes are set aside for an agreement's 'trade and labour' or 'trade and sustainability' chapters; they do not apply to the rest of the free trade agreement, which is normally governed by a more formalised state-to-state dispute resolution mechanism. The governance measures for labour standards in EU trade agreements are therefore often weaker than for other trade issues.<sup>23</sup> Moreover, in practice the EU is reluctant to enforce non-regression clauses in trade agreements because they are not seen as a priority for the EU's wider trade agenda.<sup>24</sup>

Given the size and proximity of the UK and the importance of the level playing field for the future EU-UK relationship, these procedures are inadequate for ensuring a level playing field in labour and social standards.

The level playing field provisions in the Irish protocol therefore stipulate stricter dispute resolution mechanisms than is typical. In the Irish protocol, the non-regression clause itself is exempted from the agreement's arbitration

The key consideration for the level playing field on labour and social standards is how to manage disputes between the parties where they arise. Typically, the processes for dispute resolution in free trade agreements are very weak.

In practice, it is somewhat unclear how this process might work. The EU could argue that by reducing its level of protection the UK is in effect contravening the enforcement requirement. This is because the enforcement requirement is explicitly worded in reference to the original non-regression clause.

The UK might retort that it has not lowered its level of protection and that its reform of the working time directive offers the same level of protection as the original legislation. The EU might dispute this, but then the dispute would arguably centre on the interpretation of the non-regression clause itself, rather than its enforcement. In such a scenario, the EU might struggle to bring its dispute to arbitration.

mechanism; disputes on the clause itself can therefore only go to consultations, and they cannot be subject to sanctions. However, the provisions for domestic enforcement discussed above are not subject to the same exemption. This means that where there is a dispute over the enforcement of the non-regression clause and this cannot be resolved through consultations in the joint committee, there is the option to take the dispute to arbitration.

The formal arbitration process outlined in the Withdrawal Agreement specifies the formation of a five-person arbitration panel to decide the matter. Where the matter raises a question of the interpretation of EU law, the panel must refer this question to the Court of Justice of the European Union to decide. The ruling of the arbitration panel is binding on both parties; where they refuse to comply, sanctions can be issued. These sanctions can include lump sums or penalty payments or, where the party continues to refuse to comply, suspensions of parts of the agreement.

The governance arrangements for the non-regression clause on labour and social standards therefore reflect the prioritisation of domestic enforcement in the agreement. In the first place, the parties are meant to enforce the non-regression clause at the domestic level – hence the exemption of the non-regression clause from the arbitration process. But where domestic enforcement fails, there is an option to bring a dispute on the enforcement of the non-regression clause to arbitration.

In practice, it is somewhat unclear how this process might work. Where there has been a breach of the enforcement provision – e.g. through significantly reducing labour inspections or restricting the ability of employees to bring claims to domestic courts – then there is an option of taking a dispute to arbitration. But where a party has lowered its level of labour or social protection – e.g. the UK limiting the applicability of the working time directive – while maintaining the same enforcement architecture, the process is less clear. The EU could argue that by reducing its level of protection the UK is in effect contravening the enforcement requirement. This is because the enforcement requirement is explicitly worded in reference to the original non-regression clause; both parties are expected to ensure effective enforcement of Article 4 (i.e. the non-regression clause). Therefore, if the non-regression clause is breached, then its effective enforcement is in turn also breached. However, the UK might retort that it has not lowered its level of protection and that its reform of the working time

directive offers the same level of protection as the original legislation. The EU might dispute this, but then the dispute would arguably centre on the interpretation of the non-regression clause itself, rather than its enforcement. In such a scenario, the EU might struggle to bring its dispute to arbitration.

This issue becomes particularly important in a scenario where the UK and the EU negotiate a deeper economic relationship than a basic customs union. Here the UK would have extensive market access, but the EU may have limited recourse to effective enforcement of the level playing field provisions. In order to protect against this risk and strengthen the dispute resolution process, the future relationship could build on the text in the Irish protocol by removing the arbitration exemption from the non-regression clause on labour and social standards. This would mean that either party could bring a dispute to arbitration on the question of the non-regression clause itself, rather than indirectly via its enforcement. Under this system, there would be a clearer shared understanding about the process for enforcing the non-regression clause on labour and social standards and so there would be less room for either party to surreptitiously lower levels of protection.

## Conclusion

It is expected that the EU and the UK will agree a level playing field with respect to labour and social standards as part of the future relationship. The aim of the level playing field should be to prevent either side from gaining an unfair competitive advantage over the other by loosening (EU-derived) labour and social legislation. Our analysis suggests there should be a particular focus on the loosening of legislation on working time and holiday pay, because they represent the greatest risks to fair competition.

For the content of the level playing field, there are two broad approaches: a non-regression clause, which ensures the maintenance of current levels of protection, and a common rulebook, which ensures alignment of legislation over time. The common rulebook provides the widest scope and strongest governance arrangements for a level playing field. As things stand, however, the EU and the UK are planning to agree a non-regression clause on labour and social standards, as this is judged to be the most appropriate

Nevertheless, both parties intend to secure a particularly robust non-regression clause to reflect the close trading relationship between the EU and the UK.

But there is still scope to go further in the future relationship – for instance, by expanding its coverage to specify further areas of EU labour and social legislation, or by bolstering its governance to allow disputes over the non-regression clause to be taken to arbitration.

means of securing a level playing field in the context of a standard Free Trade Agreement.

Nevertheless, both parties intend to secure a particularly robust non-regression clause to reflect the close trading relationship between the EU and the UK. The non-regression clause negotiated as part of the Irish protocol (the so-called backstop) is already significantly stronger than previous examples in the EU's trade agreements with third countries. But there is still scope to go further in the future relationship – for instance, by expanding its coverage to specify further areas of EU labour and social legislation, or by bolstering its governance to allow disputes over the non-regression clause to be taken to arbitration. This approach could help to strengthen the scope and functioning of the level playing field and help to alleviate the risk of a European 'race to the bottom' on labour and social standards.

Regulations on the UK labour market: A review of evidence, BIS analysis paper number 5.

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# Addressing the environment

David Baldock and Martin Nesbit

7

# Introduction

**The environmental consequences of the United Kingdom's (UK) intended departure from the European Union (EU) could stretch far and wide and will be influenced by a cascade of decisions yet to be taken.**

**Given the uncertainties surrounding the UK's policies and economic strategies, the EU has a clear interest in securing provisions in the agreements arising from Brexit that manage and contain the risks of either reduced standards in the UK, or a diminished commitment to compliance with environmental legislation.**

The environmental consequences of the United Kingdom's (UK) intended departure from the European Union (EU) could stretch far and wide and will be influenced by a cascade of decisions yet to be taken. At this rather early stage, with the negotiations focused on the terms of the UK's departure, the frame within which the environment has been addressed is that of the level playing field (LPF). Both sides have agreed that environmental standards, and environmental regulation more generally, can be an LPF issue.

Whilst the agenda for future environmental cooperation and cohabitation should go far beyond this, there are several reasons for the focus on competitiveness and trade-related concerns. The extensive range and in some cases economic sensitivity of the expanding corpus of EU environmental and climate law opens up a wide front from which one side could (be seen to) gain competitive advantage, purposively or otherwise, by lowering standards or weakening legislation in other ways. Environmental policy is increasingly concerned with altering economic structures for example by promoting the "circular economy" approach to improving resource efficiency or by making major changes in both infrastructure and product characteristics in pursuit of decarbonisation. Consequently, the sensitivity of this issue is unlikely to diminish.

Given the uncertainties surrounding the UK's policies and economic strategies, the EU has a clear interest in securing provisions in the agreements arising from Brexit that manage and contain the risks of either reduced standards in the UK, or a diminished commitment to compliance with environmental legislation.

Following precedents in other recent EU trade agreements, the mechanism of the non-regression principle has been deployed in an effort to mitigate the risk (see Chapter 3 by Emily Lydgate on non-regression clauses). The principle is included in the Backstop provisions of the pivotal, but not yet adopted, Withdrawal Agreement, as published in late 2018. The Agreement breaks new ground by elaborating a number of mechanisms for securing non-regression, not least by covering the compliance aspect of maintaining environmental standards.

Some of the attributes of EU environmental law and their implications for the LPF are considered in the first part of the paper. This offers a context for the later focus on the non-regression clause and its uses, particularly with regard to the Brexit negotiations, the Withdrawal Agreement and subsequent debate. Governance arrangements will be a central issue in determining the effectiveness and transparency of any future agreement. The final part of the paper considers this dimension of the issue.

## ENVIRONMENTAL LAW AND THE LEVEL PLAYING FIELD

At present, a large proportion of environmental law applied within the member states is established and overseen at the EU level. In only relatively few environmental policy areas, such as land use planning, is legislation of national or local origin dominant. Consequently, there is a high level of alignment of environmental law between the UK and the EU as a whole. The laws are not completely identical, however.

There are some areas where member states have considerable discretion, notably in the means that they select to achieve a required outcome. The majority of EU legislation in this sphere consists of directives rather than regulations. These vary in the level of specificity of the obligations that they create. Nearly all environmental legislation (with a few notable exceptions) applies within the European Economic Area (EEA) as well as the EU, itself signifying that divergence from the EU *acquis* in countries with a close relationship with the EU is potentially sensitive, even when the substantive LPF issues are not prominent.

Impacts on the LPF of potential divergences in environmental law post-Brexit are one important area of sensitivity. However, there are other legitimate reasons for concern about future divergences in environmental law and the way that it is applied, such as:

- the concern that the overall standard of environmental protection should be maintained and improved. The environment and management choices in other member states can be affected directly by UK practice, and in more than just environmental terms. Pressure could arise, for example, in relation to the UK's air pollution control or management of the North Sea, Irish Sea and other shared waters. Trade in waste products is highly sensitive to differences in regulatory regimes. Conversely, the UK is

Since its inception, the EU has sought to drive progress in the area of social policy for its member states. The Treaty of Rome, which laid the foundations of the single market and the 'four freedoms' of goods, services, people and capital, included provisions on the harmonisation of working conditions and equal pay, as well as a European Social Fund to improve employment opportunities and raise living standards across the bloc.

potentially vulnerable to transboundary impacts from the EU27. As it will no longer have a voice in the process of agreeing on EU legislation after Brexit, its own environmental and economic interests are unlikely to carry much weight in future EU decisions.

- the differing environmental standards within Europe that could result in a fragmentation of effort when addressing an issue, and slower technological or market development. This can lead to increased costs for market suppliers and consumers, regardless of where they are based, as well as potential delays in addressing problems.

- the weakening of political support for progress in environmental policy within the EU, due to the existence of alternative and less ambitious models in other leading countries, as has been the case with the US. As a relatively large economy and significant actor in the environmental sphere, lower standards – or even the perception of them being adopted – in the UK could exert a ‘regulatory chill’ within the EU. This ‘political chilling’ effect could be encouraged by industry lobbyists and supporters of deregulation, especially if they can point to a level of access to the European market, enjoyed by UK-based manufacturers operating to demonstrably lower standards.

These factors are closely related, and concerns of this kind will arise in the political debate on regulatory alignment and divergence in post-Brexit agreements, for example within the European Parliament. For some time, environmental commentators and NGOs within the UK have been alert to the potential dangers of lower standards being adopted in the national environments of one or more of the four nations in the UK, without necessarily worrying much about the LPF. Such concerns could reverse if the UK became a frontrunner on environmental issues and the EU were to lag behind.

Whether the post-Brexit agreements in the environmental sphere are, in the end, formally determined mainly within the economic rubric of a LPF – as has occurred up to now – or not, this is only part of the picture. The LPF must be seen against a broader and more politically complex canvas, one accentuated by the close proximity of the territories and actors involved. However, the LPF issue gives EU negotiators clear legitimacy in exercising leverage over the UK during negotiations.

### **WHICH ASPECTS OF EU ENVIRONMENTAL LAW ARE OF GREATEST RELEVANCE TO THE LEVEL PLAYING FIELD?**

Environmental legislation often imposes standards or processes, which may involve costs and influence the competitiveness of businesses in various ways. At one end of the spectrum, it may become impossible to continue a manufacturing process because the final product has become banned. At the other end, entirely new markets can be created by environmental laws setting demanding new standards, and companies moving into the field may obtain a first-mover advantage. Distortions to a LPF can arise when environmental requirements in one jurisdiction create costs for local producers that are not mirrored in another jurisdiction, where less stringent environmental requirements apply.

It should be acknowledged however that the LPF concept and its application within the 28 member states is not absolute; there are at present varying levels of deviation. Many are explicitly sanctioned, while others are not. The closeness of the economic relationship between the UK and the EU after Brexit and the level of market access made available to the UK will have a bearing on the stringency with which LPF issues are viewed at the Brussels end. However, independent of any agreement made, it is also true that the geographical

proximity of the UK and the EU, the integrated nature of many economic sectors, the currently common corpus of environmental legislation and the high level of communication between the two parties is likely to give greater prominence to LPF issues than they might attract otherwise.

With more than 200 pieces of significant EU environmental legislation in place and many more in total, there are questions surrounding the areas in which LPF considerations would be most likely to arise if there were to be substantive differences in standards between the UK and the EU. Divergence might come about in relation to the environmental objectives laid down, or the detailed provisions applied in national legislation to deliver those objectives, or the level of implementation in practice. All three are potentially relevant and are briefly considered here.

There is no clear typology or guide to differentiating between individual items of EU environmental legislation for the purpose of picking out those with a higher probability of (real or perceived) distortion to the LPF if trade partners take a different approach. In fact, a large number of environmental directives and regulations have as their legal basis the single market provisions of the TFEU, and many adopted under the environmental provisions of the Treaty could be classified as having some implications for the single market. Most are included within the EEA Agreement. Those excluded from the agreement include the Birds and Habitats Directives and directives on bathing water, fish and shellfish waters and surface freshwater. Yet some of the measures on the EEA list are relatively unlikely to raise significant LPF issues while some that are excluded could raise competitiveness concerns.

For example, during the Fitness Check of the Birds and Habitats Directives between 2014 and 2015, concerns were raised about the impact of the two nature directives on the costs of operating ports close to protected sites, including constraints on channel dredging and development. To some degree, ports within the European continent can compete with each other and are sensitive to differences in development and maintenance costs. In principle, a laxer approach to habitat protection in the UK could have competitiveness impacts in certain circumstances, such as major port development, although in most cases the impact would be more local.

One response to the sheer scale and breadth of EU environmental legislation would be to narrow the scope

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of any agreement on non-regression in standards to those measures where enforcement would be relatively straightforward. Directives introducing more complex processes and consultation requirements could be excluded. The same argument could be applied to dynamic alignment – a relationship beyond non-regression – whereby regulatory regimes keep in step with each other as they become progressively more stringent to meet future environmental objectives, for example on greenhouse gas (GHG) emissions.

However, there are strong arguments to not narrow down the scope of any agreement on non-regression or dynamic alignment to a limited spectrum of environmental legislation. There are likely to be specific requirements in environmental law on topics that appear as outliers in thematic terms; for example in relation to noise pollution, marine management or environmental impact assessment, which nonetheless have LPF impacts because of the economic impact of the obligations they introduce. The example of site protection under Article 4 of the Habitats Directive underlines this point. Including a relatively wide range of measures is appropriate if LPF protection is to be reasonably comprehensive.

A second question concerns which elements of EU and UK environmental law should be under the greatest scrutiny when seeking to assess any important differences between the two and whether they have implications for the LPF. Whilst all elements of legislation may be relevant to some degree, a focus on specific substantive provisions – such as a requirement to meet a quantified standard or to introduce an outright ban on the production of a substance – will be key to avoiding unfair competition and to operationalising a non-regression agreement.

Further examples of substantive provisions could include:

- industrial process requirements, as in the Industrial Emissions Directive.
- obligatory planning processes with measures intended to achieve future targets, such as the basin management plans in the Water Framework Directive.
- the designation of areas vulnerable to pollution and within which certain levels of resource protection need to be applied, as in the case of Nitrate Vulnerable Zones.
- the reporting and monitoring of requirements intended

to establish the nature and scale of environmental conditions or challenges; and the action taken to address them, make them transparent and publicly available. Such provisions appear in many directives but are not uniform. Clearly, they are also relevant to the transparency and enforceability of any future agreement pertaining to the LPF.

Such substantive provisions of potential LPF relevance can be found in nearly all parts of the environmental *acquis*. An initial overview is offered in an earlier paper.

Different approaches to reaching similar objectives are legitimate within a non-regression framework. However, the substantive provisions in place need to be adequately robust as a means of meeting the required outcome, and sufficiently transparent to allow a credible independent judgement of their equivalence in LPF terms and their compliance with a non-regression agreement. Clearly, it is not sufficient to consider only the overall environmental objectives that may be established in future UK legislation – for example on water pollution, which may be broadly similar to those in EU law – without assessing the substantive provisions and how they compare with those in EU legislation.

A particular challenge arises in relation to obligations to meet a specific numerical target at national level – for example, GHG emissions under the Effort Sharing Regulation, or the transboundary pollutants covered by the National Emissions Ceilings Directive (sulphur dioxide, nitrous oxides, ammonia, and so on). This is because ceilings are set within the EU on the basis of a process that is both technical (‘What is the most economically efficient way of achieving a given overall objective?’) and political (‘How should the allocation of responsibility for emissions take into account GDP, and the ability to

pay for emission abatement?’). With the UK outside this decision-making process, special arrangements may be needed to assess what a ‘fair’ contribution looks like. Both the United Nations Economic Commission for Europe (UNECE) process that underpins the National Emissions Ceilings Directive, and the United Nations Framework Convention on (UNFCCC) process for GHG targets might help; but neither is capable of ensuring equal stringency of the targets accepted by parties.

## THE COMPLIANCE DIMENSION

A third question concerns the effective implementation of and compliance with environmental law, a task which covers a range of activities, both legal and practical.

Imperfect implementation has been a feature of environmental legislation in the EU for several decades and is certainly not confined to the UK. It often takes the form of late or incorrect transposition on the one hand, or a range of practical implementation and enforcement shortcomings on the other. Where legislation requires a long-term programme of concerted action and investment coupled with significant expenditure, as in the case of the Ambient Air Quality Directive, failures of implementation can be particularly widespread. Environment-related infringement cases initiated by the European Commission have fallen in recent years, but there were still 333 cases reported to be open at the end of 2018, including 16 against the UK and similar numbers for France, Germany and Italy. Of the total, 71 relate to air quality, 70 to water issues and 68 to nature-related obligations.

Complaints about non-implementation and referrals to the Court of Justice to the European Union (CJEU) regarding the environment are more frequent than for the majority of other areas of EU law.

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**If compliance within the UK, or the EU, were to become significantly weaker – whether in a generic or selective way – then distortions to the LPF could arise, irrespective of whether or not it could be demonstrated conclusively enough to convince an independent panel or a court that it was affecting trade or investment in the short term.**

Reasons for this probably include the extent of public expenditure required to meet certain obligations and the lack of pressure from commercial interests to comply: as is often said, the environment cannot speak for itself.

If compliance within the UK, or the EU, were to become significantly weaker – whether in a generic or selective way – then distortions to the LPF could arise, irrespective of whether or not it could be demonstrated conclusively enough to convince an independent panel or a court that it was affecting trade or investment in the short term. For this reason, questions of compliance, and implementation in a broader sense, need to be a significant aspect of any serious arrangement designed to address the LPF in relation to the environment.

Weaker compliance can arise in several ways. Changes in the level, timeliness and rigour of implementation – including the deployment of enforcement mechanisms or the penalties imposed, for instance – could all contribute, especially if they endure over a significant period of time. More specific examples would include changing institutional structures and responsibilities, lowering budgetary allocations or finance-raising powers to certain activities such as water and waste treatment facilities; cutting funding to the relevant public authorities or to related scientific or advisory bodies; or reducing enforcement activity and prosecutions. Scaling back monitoring and/or reporting standards and requirements, or reducing the frequency and rigour of inspections could also lower standards of compliance. So too could failing to address legitimate complaints on a substantial scale, and complicating citizens and civil society organisations' access to data or capacity to challenge decisions. Individual changes in these areas may not be decisive in themselves but may contribute to a substantive change in the broader implementation culture and practice within a country.

There needs to be a way of evidencing any steps towards regression in the level of compliance if a formal commitment to maintain compliance standards is to become operational. Such evidence might include documented changes in rules, procedures, the formal competences of institutions, budgets and the deployment of resources for monitoring, inspection, enforcement and other functions, as well as the actions of relevant responsible bodies and the level of complaints by civil society and others.

Nonetheless, the degree of rigour with which public authorities seek to ensure compliance may not be easy



to capture precisely, especially if it arises as part of a broad shift in a political, legal or administrative culture. Consequently, a system designed to ensure that the implementation effort and machinery in any one state does not fall below an adequate level should have regard to a wide panorama of cross-cutting evidence, including a range of governance issues. In the case of the UK, developments in all four constituent countries as well as at the national level will be relevant.

There then arises the question of determining the starting point or baseline for measuring any changes in implementation or compliance with environmental law. This is needed in a binding non-regression agreement. In reality, this baseline is unlikely to be a situation of perfect compliance at the outset of the agreement. How would it be defined? Perhaps at a de facto level applying within the EU, or the other territory concerned, at the time of the agreement, presumably with any then outstanding breaches in compliance properly corrected? For EU member states, including the UK at the time of writing, this status quo would be one overseen by the EU institutions. All member states are subject to the scrutiny, complaints procedure and pressure for correct implementation exerted by the European Commission and CJEU in their respective roles in monitoring compliance and upholding EU law.

Outside the EU however, the UK will no longer be subject to the scrutiny and compliance disciplines imposed by the European Commission and CJEU. These disciplines have been a significant factor in driving compliance in recent decades. This is difficult to demonstrate in detail because of a lack of transparency within governmental processes, and the inherent difficulty in developing a counterfactual. However, judging from the accounts of those involved in public administration as well as the record regarding Reasoned Opinions issued by the Commission and related processes, it is clear that one of the main drivers for compliance with environmental law in the UK will be removed following Brexit. This would be true of other member states as well if they were to withdraw from the EU. Thus, an asymmetry in compliance arrangements arises. How does a state outside an international legal framework such as the EU establish compliance arrangements that are equivalent to those inside?

One route would be to voluntarily empower an external body to scrutinise and report on compliance – for example, a United Nations (UN) or EU institution, or the Organisation for Economic Co-operation and Development (OECD).

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Conceivably, powers could be granted to a supranational judicial body, for instance along the lines of the EFTA Court. In the case of the UK, this would be likely to require the creation of a new body, entailing significant political commitment. More straightforward but less equivalent would be a set of robust yet purely domestic mechanisms to ensure compliance of a high standard. These would need to apply to the UK and its constituent countries. A stronger system of governance in relation to compliance would need to include one or more suitably empowered public bodies with demonstrable independence from government so that it could be held accountable in some credible and meaningful way.

This appears to be a more politically realistic approach, particularly in light of the distrust of supranational courts shown by UK politicians supporting withdrawal. Furthermore, as we will explain below, the EU side in the negotiations on the Withdrawal Agreement has placed emphasis on the need for the UK to develop robust internal mechanisms; provisions which are now included in the Northern Ireland backstop arrangement. Nonetheless, it is difficult to find examples of effective independent compliance authorities in sovereign states that have powers approaching those of the European institutions. Robust individual watchdogs and guardians of the future do not always fare well in national politics, as illustrated by the case of Hungary: the Hungarian Commissioner for Future Generations, appointed by the national parliament, was created in 2008, but had his powers and mandate greatly reduced by a new constitution in 2011.

Having reviewed a number of respects in which the LPF could be affected adversely by lower environmental standards on one side, it is worth reviewing briefly whether this is at all likely to happen, before considering ways in which the risk could be mitigated.

## **MIGHT ENVIRONMENTAL STANDARDS BE LOWERED?**

The risks of lower standards are generally perceived to be far greater for the EU than for the UK. There are several reasons for this.

The EU has a formal commitment to high environmental standards in the Treaty. Among the overarching goals of the EU specified in Article 3 of the Treaty is one to establish an internal market that “shall work for the sustainable development of Europe based on [...] a high level of protection and improvement of the quality of the environment.” There is no counterpart in the UK.

The EU has an established system for making plans for the environment, including its current Environmental Action Programme, which runs to 2020. This needs to be viewed alongside other, more recent EU plans and roadmaps where the level of ambition and urgency varies – but the general tenor is to raise standards over time, rather than reduce them. Reversing aspects of this trajectory would be possible but it would be a very significant departure from the current status quo.

Less speculatively, the EU has a track record of very rarely or never reducing environmental standards. A large part of this can be attributed to the political consensus in place since the 1970s, when the process of establishing environmental law got underway in the EU. Similar trends are observable in other developed countries. Standards were not lowered when 10 new member states, mostly from Central and Eastern Europe, were admitted in 2004 despite economic challenges. Whilst there has been discontent in some member states about certain directives, for example aspects of the drinking water and habitats directives, it has proved difficult to create a strong enough consensus to overturn standards that are unpopular with

several governments. The Commission generally has not favoured such a course either, although its more recent focus on ‘better regulation’ and ensuring the “fitness” for purpose of segments of EU legislation creates some pressures in that direction. Achieving a majority for a significant change of this kind – particularly without the help of the Commission or the European Parliament and in the face of strong protests from green NGOs – has not proved easy in the past.

Many measures have been revised and some consolidated, but the lowering of standards is exceptionally rare. This pattern has been confirmed in recent years despite the more regular and probing ‘Fitness Check’ reviews launched by the Commission, which have covered many elements of environmental law alongside the promotion of Better Regulation. This does not mean that the political climate is immutable, or that no standards will be lowered. It does suggest that the barriers to lower standards are non-trivial, even if some of the more ambitious thinking of the current European institutions is not carried forward by their successors after the 2019 elections.

On the other hand, there are several reasons not to rule out a lowering of some environmental standards in the UK. They include the historical track record, the lack of legal underpinning equivalent to that in the EU treaties, the possible economic benefits that might be sought (particularly in the event of an economic shock post-Brexit, or in the context of negotiating new trade deals) and some of the political discourse associated with the referendum and Brexit debate. In governance terms, the barriers to changing standards are fewer in an individual state than in a larger grouping such as the EU, although the devolution of responsibilities for the environment to Scotland, Wales and Northern Ireland creates a more complex situation.

Historically, UK governments have tended to be sceptical about several important components of EU environmental law, such as the setting of binding and often quantified emission limits. The UK has not been comfortable with the growing use of such binding environmental targets to be achieved over a fixed period of time and has resisted a number of these, for example in relation to the circular economy.

Nonetheless, there have been some notable instances of the UK being an advocate of more ambitious approaches, such as in the setting of overall GHG emission reduction targets for the EU. The past is not always a guide to the

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future and the risks run both ways. The current UK government has set the general goal of becoming the first generation to leave the environment in a better state than they found it. More concretely, Prime Minister Theresa May has signed a 25-year plan for the environment, primarily in England, that contains some ambitious elements, for example in relation to the recovery of nature. The current Secretary of State for Environment Michael Gove has demonstrated considerable vigour in pursuing several different green agendas, not least in agriculture, and has stated his commitment to maintaining high environmental standards.

However, given the outlook for the next decade or so, the introduction of lower or more flexible environmental standards in the UK is a possibility, for a number of reasons. The grounds for caution and continuing concern include:

- the argument made by many UK politicians in the Leave camp during the referendum that their aim was to 'take back control' and be free of a slew of EU regulation, which they claimed in many cases imposed unnecessary burdens. Former Minister George Eustice, for example, has called for greater flexibility on the designation of marine protected sites under biodiversity legislation.
- more concrete measures introduced by recent governments to reduce the number of regulations within the UK by means of mechanistic formulae to cut red tape – such as one regulation removed for each new one agreed upon. The government has wide powers in this regard under the Small Business, Enterprise and Employment Act 2015. The 'Business Impact Target' for the current Parliament is to save GBP 9 billion for businesses and community bodies via a reduced regulatory burden. Up to now, EU-based legislation has been exempt from this form of red tape removal in the UK, but following Brexit, the range of environmental

legislation falling within this target seems likely to increase because it will be of domestic origin and thus amendable.

- anticipated pressures arising from putative new trading agreements with partners such as the US and Australia. This could lead to the acceptance of lower standards than at present, for example in relation to genetically modified organisms (GMOs) or chemicals, as part of a wider agreement, even if it was not welcome on its own merits. The US is likely to be one of the first countries with which the UK seeks a new trade agreement, and has already made clear its opposition to certain aspects of regulation based on EU standards. Indeed, the US' 'negotiating objectives' for a possible trade agreement with the UK, released by the office of the US trade representative in February 2019, set out an explicit aim related to Sanitary and Phytosanitary Measures. This is to "Establish a mechanism to remove expeditiously unwarranted barriers that block the export of U.S. food and agricultural products in order to obtain more open, equitable, and reciprocal market access." Regulation of GMOs in the UK might quickly come under pressure in a US attempt to increase market access for its own agricultural exports.

Consequently, although judgements on the potential scale and timing of any regulatory retreat can only be speculative, EU concern about future standards in the UK is not unreasonable.

## **The role of international agreements**

One constraint on lower environmental standards in the UK will be the continuation of environmental commitments arising from international agreements, whether regional, (e.g. the Convention for the Protection of the Marine Environment of the North-East Atlantic), European (such as those agreements under the auspices

of the UNECE) or global (such as the UNFCCC and the Convention on Biological Diversity). However, there are considerable limitations to the level of defence against regression or breaches of the LPF provided by UK ratification of international agreements. Some of these stem from uncertainties about the exact status of such agreements with respect to the UK post-Brexit. Others arise from the relatively limited nature – or absence – of provisions to enforce compliance in nearly all such international agreements, in sharp contrast to requirements under the EU acquis. A few agreements contain precise quantitative obligations, for example in relation to sulphur, nitrous oxide and ammonia emissions from individual European countries under a UNECE Protocol, but these are exceptional. The scope of international agreements on the environment is considerably narrower than that in the acquis, and so there are wide areas that are not covered at all.

## **MECHANISMS TO PROTECT THE LEVEL PLAYING FIELD WITHIN AN EU-UK AGREEMENT**

It is therefore not surprising that the importance of the environment for the negotiations on a Free Trade Agreement or other future economic relationship, and the extent to which the UK may depart from EU legislation and wider policy commitments, were flagged up early by both the European Council and the European Parliament.

The April 2017 European Council negotiating guidelines insisted that an agreement must ensure a LPF and referred explicitly to “tax, social, environmental and regulatory measures and practices”. The European Commission’s Article 50 Task Force elaborated this framing in documents on its webpage, underlining the need for a tailored approach because of the UK’s geographic proximity to the EU and the breadth and depth of economic integration. The ingredients of this approach were identified as including a general non-regression commitment, accompanied by commitments that are more specific on general principles and on substantive provisions within current EU legislation. These would need to be backed up by enforcement and dispute settlement mechanisms.

Negotiations with the UK proceeded broadly along these lines and were eventually formalised in the Withdrawal Agreement of November 2018. This contains a section on Environmental Protection within the Northern Ireland Backstop provisions which lays out a series of commitments based on non-regression and monitoring and enforcement

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**Non-regression is at the heart of the approach now on the table. In the case of environmental standards for products that are widely traded, including chemicals, there are several disadvantages to the creation of separate regimes: it potentially creates confusion, market fragmentation, higher costs for businesses and regulators and the risk of a less robust environmental outcome, even if the standards are broadly similar.**

**A system of dynamic alignment whereby EU and UK legislation follow the same model and introduce the same standards – keeping in step over time, even if there are some differences in approach, – seems to be the most attractive model.**

**Mechanisms to allow and foster cooperation and to align approaches where this is beneficial and acceptable in terms of democratic accountability need to be considered actively alongside the shorter-term priority of non-regression.**

requirements. The status of the Agreement is still unclear at the time of writing, given the lack of a parliamentary majority for leaving the EU on its terms (and it remains possible that the UK will crash out of the EU without any such agreement). However, there has been little sign that the environmental aspect of the Agreement is unacceptable to members of parliament (MPs), whatever their view of the Backstop provisions more generally. Furthermore, the approach it develops is referred to in the Political Declaration on the future relationship as a starting point for a more permanent model, if there is to be a longer-term free trade agreement between the UK and the EU.

Non-regression is at the heart of the approach now on the table, and the main focus of the rest of this paper. However, it addresses only part of the picture. Significant divergences in environmental standards could develop over time as legislation and practice evolves, even if existing standards are maintained meticulously. Environmental law is in a process of continual evolution, regularly being adapted at a detailed level. Less frequently, major new measures are adopted. Assuming that the UK has no say over the direction of EU law after Brexit and environmental legislation is developed actively by four different countries within its boundaries, anything other than some divergence would be some cause for surprise.

The consequences of divergence for the LPF, the environment and other objectives are hard to assess in advance. From an LPF perspective, some of the risks for the EU associated with a lowering of UK standards, as noted above, could arise; and there could be risks for the UK as well.

In the case of environmental standards for products that are widely traded, including chemicals, there are several disadvantages to the creation of separate regimes: it potentially creates confusion, market fragmentation, higher costs for businesses and regulators and the risk of a less robust environmental outcome, even if the standards are broadly similar. Where regulations are designed to address major transboundary issues or shared resources, such as extensive areas of the marine environment, high levels of cooperation are desirable and there is a strong case for close alignment of legislation as it goes forward.

In these and potentially other conditions, a system of dynamic alignment whereby EU and UK legislation follow the same model and introduce the same standards – keeping in step over time, even if there are some differences in approach, – seems to be the most attractive model. The



merits of alignment are especially clear from an EU perspective, from which there are few advantages of an autonomous approach in the UK, other than as a test bed for approaches that may later be adopted at a European level. Many environmental and industry stakeholders would find a dynamic alignment approach appealing as well. Those who fear that the UK will prove environmentally less ambitious once outside the EU, such as the Green 10 alliance of environmental NGOs in Brussels, have a further reason to advocate this model.

However, if there is no mechanism whereby the UK can participate in the development, refinement and amendment of EU environmental policy and law, and the UK is obliged to simply follow the EU model, the lack of influence, accountability and agency for the government, devolved authorities and other stakeholders is clear. For legitimate reasons, support for this approach would be tempered even if it has palpable advantages in economic and environmental terms. It would not prevent the UK from adopting more ambitious measures than the EU, other than in those (probably limited) cases where it would be incompatible with EU law. However, it could stop more rapid action and inhibit innovation, and be a barrier to certain effective locally tailored solutions in areas that are not trade sensitive. There could be environmental benefits from the adoption of rather different or faster pathways if levels of ambition in the UK were high.

Mechanisms to allow and foster cooperation and to align approaches where this is beneficial and acceptable in terms of democratic accountability need to be considered actively alongside the shorter-term priority of non-regression. There are some steps in this direction for restricted key policy areas in the Withdrawal Agreement, considered briefly below. However, they are limited and have received less attention than might be expected. This element of the future relationship would

benefit from further analysis and debate.

## THE NON-REGRESSION MECHANISM

The EU has experience in including earlier and more limited forms of environmental non-regression clauses in trade agreements. A recent example is the EU-Japan agreement. This includes a clause that states the “Parties shall not encourage trade or investment by relaxing or lowering the level of protection provided by their respective environmental or labour laws and regulations”. This and similar clauses, for example in the EU-South Korea agreement, seem to tie non-regression to actions taken with the purpose of encouraging trade or investment – although in practice there may be several other reasons why standards could be lowered. They fall short of an unconditional commitment to non-regression. They are less robust and less easily enforced than an absolute requirement to comply with non-regression as proposed for the UK, since the latter sidesteps the considerable practical difficulties in establishing that a government has created (let alone sought) a competitive advantage by making its environmental legislation less stringent.

The non-regression principle, whilst not elaborated, gained a place in the UK position as well. In the July 2018 White Paper on “The future relationship between the United Kingdom and the European Union”, the government’s stated aim was to rely on non-regression and the demonstration of “equivalence” in a range of regulatory areas whilst committing to a “common rulebook” only in respect of standards for certain, but not all, goods. The UK would commit to high regulatory environmental standards through a non-regression requirement that was clearly understood as being weaker than a common rulebook. However, it is notable that anxiety about the EU undercutting future environmental standards in the UK

did not seem to be present to any marked degree and this has remained the case, so the preoccupations of the two sides have been distinctively different.

By contrast, the 23 March 2018 negotiating guidelines endorsed by the European Council spell out a more ambitious approach to non-regression, including explicit reference to substantive rules, issues of domestic implementation and dispute settlement processes.

*“The aim should be to prevent unfair competitive advantage that the UK could enjoy through undercutting of levels of protection with respect to, inter alia, competition and state aid, tax, social, environment and regulatory measures and practices. This will require a combination of substantive rules aligned with EU and international standards, adequate mechanisms to ensure effective implementation domestically, enforcement and dispute settlement mechanisms in the agreement as well as Union autonomous remedies that are all commensurate with the depth and breadth of the EU-UK economic connectedness.”*

However, the provisions relating to the LPF and the environment seem likely to remain an EU requirement for a trade agreement with the UK, and will therefore continue to be of interest even if the Agreement never comes into force.

The reference to effective implementation is both stronger than that in the EU-Japan agreement, and less constrained by explicit trade or investment considerations. The EU-Japan text debars parties from waiving or otherwise derogating from environmental or labour laws and regulations or from failing to “effectively enforce them through a sustained or recurring course of action or inaction in a manner affecting trade or investment between the Parties.”

The March guidelines are largely reflected in relevant articles of the Withdrawal Agreement. Published on 14 November 2018, this was endorsed by both the UK government and the European Council on behalf of the other 27 member states. Together with the accompanying Political Declaration, it has been at the centre of political debate subsequently. The Westminster Parliament rejected the Agreement at the time of writing and whether it will play a part in a future settlement remains unclear. However, the provisions relating to the LPF and the environment seem likely to remain an EU requirement for a trade agreement with the UK, and will therefore continue to be of interest even if the Agreement never comes into force.

## THE WITHDRAWAL AGREEMENT

The principal environmental provisions are to be found in Annex 4 of the Agreement, in Part 2, which itself forms part



of the Protocol on Ireland/Northern Ireland, the renowned Backstop. If the Agreement comes into force and no further agreement has been reached on the future relationship, the Protocol will apply at the end of the transition period, 31 December 2020. However, its significance is greater than this. The Political Agreement endorsed by EU leaders in November 2018 states that any future agreement between the EU and the UK will contain provisions to cover the LPF, including environmental standards, building on the “arrangements provided for in the Withdrawal Agreement and commensurate with the overall economic relationship.” Hence, it is a model for the longer-term agreement between the two parties, assuming that this is concluded eventually.

As noted already, the draft agreement has several novel features: it goes beyond the formula established in recent Free Trade Agreements (FTAs), such as EU-Japan or EU-South Korea in several respects and travels some distance towards the EEA model. Its coverage is broad, including nearly all aspects of environmental law, climate change, nature and biodiversity conservation and environmental impact assessment legislation. Those few topics that appear to have been excluded, such as measures limiting noise pollution from various sources, seem to have been selected on the basis of having little transboundary or LPF impact, although the second part of this assumption bears investigation.

It establishes a framework based on the principles of non-regression and effective enforcement. Both parties commit to not lower the level of environmental protection provided by “law, regulation and practices”, taking as a baseline those “common standards” that are in place at the end of the transition period.

In addition, there is a special process – a form of dynamic alignment – established for a set of specific substantive requirements sensitive in both economic and environmental terms. These are reductions in emissions of certain atmospheric pollutants, understood to be those covered by the National Emissions Ceilings Directive, the maximum sulphur content of marine fuels and those “best available techniques” requirements in the industrial emissions directive. In such cases, there will be a special joint negotiation process to set standards, involving a newly formed Joint Committee that will be tasked with overseeing the implementation of the agreement as a whole. The UK must also have in place a carbon pricing system of at least the same effectiveness and scope as the

Four environmental principles taken from the EU treaties are to be respected in the UK’s environmental legislation, aiming at a level of continuity and a general approach that would be difficult to imagine if the UK was not an EU member already adapted to these principles.

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EU emissions trading system. The one-way nature of this obligation is clear.

Four environmental principles taken from the EU treaties are to be respected in the UK's environmental legislation, aiming at a level of continuity and a general approach that would be difficult to imagine if the UK was not an EU member already adapted to these principles.

Article 3 of the environmental provisions in Annex 4 of the agreement sets out enforceable governance requirements only for the UK side, under the heading of monitoring and enforcement. The UK is to ensure effective enforcement of its laws, regulations and practices, noting the corresponding role played by the European Commission and CJEU in this regard within the EU. More specific requirements for the UK flesh out this approach. First, there is an obligation to ensure that "administrative and judicial proceedings are available in order to permit effective and timely action by public authorities and members of the public [...] and to provide effective remedies [...]."

Second is a requirement to have an "independent and adequately resourced body or bodies" to be responsible for implementing a transparent system "for the effective domestic monitoring, reporting, oversight and enforcement of" environmental commitments arising from the Agreement. This provision seeks to embed many of the roles played by the Commission, in particular at a high level within the domestic governance framework. In the parlance of the UK's domestic Brexit debate, this is an innovative means of filling at least part of the 'governance gap' arising for the environment by creating one or more new 'watchdogs'. There may be several bodies rather than one, primarily because of the devolution of powers to Scotland, Wales and Northern Ireland.

In sum, this model holds back from dynamic alignment with certain exceptions,

leaving certain questions to be addressed but also introduces several more developed and UK-specific forms of non-regression. They are of the kind needed to protect the LPF and address several of the issues highlighted in the first part of this paper. How far either side would be able to enforce non-regression in practice is much more difficult to say. The effort and evidence needed to bring a successful case would be a substantial deterrent for authorities considering a complaint unless the alleged breaches were serious, economically damaging or politically salient. For the EU, the primary form of protection from compliance failings by the UK lies with the new bodies and their independence, powers, competence and success in fulfilling their duties; and these, in turn, are subject to the risks we have identified above of effective watchdogs being deprived of their powers by unhappy governments.

## RAISING GOVERNANCE QUESTIONS

The governance aspect of the draft agreement breaks new ground and intersects with the domestic debate in the UK in several respects. This debate was triggered by the referendum result and immediate concerns about how environmental law and its enforcement would be framed outside the EU. The political dialogue has developed quite rapidly, involves draft environmental legislation and will continue, irrespective of whether the agreement ever comes into force. However, the agreement provides a substantive external dimension to arguments and processes in the UK.

Before the agreement was published, the debate about filling the governance gap for the environment within the UK had been running for some time, and the government had agreed to bring forward proposals, primarily for England (acknowledging that the approach to be adopted for other parts of the UK was for the relevant devolved

decision-making bodies). Knowledge of what was set in the agreement or being negotiated may have also influenced ministers when developing their positions and bringing forward legislative proposals. Others, including the devolved governments, acted without such information.

It is interesting to note that the governance gap issue – particularly the potential for a reduced level of domestic compliance after Brexit – has been raised quite vigorously for environmental policy, but not for the equivalent social and employment law. Leaving aside the specific arrangements for ensuring the rights of EU citizens continuing to live in the UK, the governance gap debate on the environment has been the most prominent area of political concern. This was fuelled by an active civil society movement, notably Greener UK and its members, and a small group of parliamentarians, achieving a reversal of the government's initial opposition to any new governance arrangements for the environment after Brexit. It was formalised in an amendment to the European Union (Withdrawal) Act of 2018, with the new Secretary of State, Michael Gove, a key actor in this change of direction.

Subsequently, proposals have been brought forward in the form of a draft Environment Bill published in December 2018 and potentially coming into force in 2020. Among other matters, this introduces provisions for installing a set of environmental principles into English law and for establishing an independent body, the Office for Environmental Protection (OEP), to take up a monitoring and compliance role. Whilst there is a commitment to establish such a body in England with certain powers and functions, these proposals are now subject to intense scrutiny and considerable criticism, relating, for example, to its level of independence from government and the Secretary of State for the environment in particular; the extent and scope of its powers; its role in providing advice on new policy; and whether it has a formal objective and should be co-designed with devolved authorities so that some of its functions are exercised at the UK level rather than solely in England.

In this debate, the Withdrawal Agreement has reinforced arguments for a truly independent body, for example one reporting to Parliament rather than to ministers, although it does not specify what form of independence is required. Several of the powers that said body(ies) should have are set out, however. These include the power to conduct inquiries on alleged breaches by public bodies on its own initiative, the power to request information and the right

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to “bring a legal action before a competent court or tribunal in the United Kingdom in an appropriate judicial procedure, with a view to seeking an adequate remedy.” This language, whilst rather high level, provides some support for the sizeable community arguing that the current powers proposed for the OEP are insufficient. Since the Agreement would apply to climate policy, it would require an independent body to be responsible for oversight of compliance in this area. This would potentially create tension with current government policy to exclude climate change from the remit of the OEP, relying instead on the role of the established Committee on Climate Change, which does not enjoy enforcement powers.

These features of the agreement have a bearing not only on the current governance proposals for England, but also those in other parts of the UK. Further, they underline that

there will be external constraints on how devolved authorities can exercise aspects of their powers over environmental policy, and raise questions about what forms of coordination and communication are required at UK level, if any.

If the agreement, or any revised version ever comes into force – which itself is difficult to predict at the moment –, the environmental governance provisions will be one of the first tests of the level of influence it exerts over sensitive domestic decisions with long-term implications. It will also test the willingness of the EU to intervene if its provisions appear to be breached. It is clearly not entirely comfortable for a government to create machinery to hold itself to account in an effective way, and the outcome of this process will be of European and not only UK interest.

- <sup>1</sup> See European Commission (2018), Draft Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community, as agreed at negotiators' level on 14 November 2018.
- <sup>2</sup> Burns, C., Carter, N., Cowell, R., Eckersley, P., Farstal, F., Gravey, V., Jordan, A., Moore, B. and Reid, C., (2018) "Environmental policy in a devolved UK: challenges and opportunities after Brexit". Policy Brief for UK in a changing Europe programme.
- <sup>3</sup> See EEA (1994), The EEA Agreement.
- <sup>4</sup> See Council of the European Union (1992), Council Directive 92/43/EEC of 21 May 1992 on the conservation of natural habitats and of wild fauna and flora; European Parliament and Council of the European Union (1992), Directive 2009/147/EC of the European Parliament and of the Council of 30 November 2009 on the conservation of wild birds.
- <sup>5</sup> See European Parliament and Council of the European Union (2000), Directive 2000/60/EC of the European Parliament and of the Council of 23 October 2000 establishing a framework for Community action in the field of water policy; European Parliament and Council of the European Union (2006), Directive 2006/7/EC of the European Parliament and of the Council of 15 February 2006 concerning the management of bathing water quality and repealing Directive 76/160/EEC; European Parliament and Council of the European Union (2006), Directive 2006/44/EC of the European Parliament and of the Council of 6 September 2006 on the quality of fresh waters needing protection or improvement in order to support fish life; European Parliament and Council of the European Union (2006), Directive 2006/113/EC of the European Parliament and of the Council of 12 December 2006 on the quality required of shellfish waters (codified version).
- <sup>6</sup> European Commission (2016), Fitness Check of the EU Nature Legislation (Birds and Habitats Directives).
- <sup>7</sup> See Council of the European Union (1992), *op.cit.*, Article 4.
- <sup>8</sup> See European Parliament and Council of the European Union (2010), Directive 2010/75/EU of the European Parliament and of the Council of 24 November 2010 on industrial emissions (integrated pollution prevention and control).
- <sup>9</sup> See European Parliament and Council of the European Union (2000), *op.cit.*
- <sup>10</sup> See Council of European Union (1991), Council Directive 91/676/EEC of 12 December 1991 concerning the protection of waters against pollution caused by nitrates from agricultural sources.
- <sup>11</sup> Nesbit, Martin and David Baldock (2018), "Brexit and the level playing field: key issues for environmental equivalence", Brussels: Institute for European Environmental Policy.
- <sup>12</sup> See European Parliament and Council of the European Union (2018), REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on binding annual greenhouse gas emission reductions by Member States from 2021 to 2030 contributing to climate action to meet commitments under the Paris Agreement and amending Regulation (EU); European Parliament and Council of the European Union (2016), Directive (EU) 2016/2284 of the European Parliament and of the Council of 14 December 2016 on the reduction of national emissions of certain atmospheric pollutants, amending Directive 2003/35/EC and repealing Directive 2001/81/EC.
- <sup>13</sup> See European Commission (2019), "Study: The costs of not implementing EU environmental law", Brussels: European Commission; European Commission (2017), "Environmental Implementation Review 2017", Brussels European Commission; European Commission (2019), "Environmental Implementation Review 2019", Brussels European Commission.
- <sup>14</sup> See European Parliament and Council of the European Union (2008), Directive 2008/50/EC of the European Parliament and of the Council of 21 May 2008 on ambient air quality and cleaner air for Europe.
- <sup>15</sup> ENDS Report "Focus on infringement proceedings", March 2019, pp.42-43.
- <sup>16</sup> An IEEP study for the European Commission on the "development of an assessment framework on environmental governance in the EU Member States", due for publication in 2019, may provide some objective criteria against which compliance assurance performance can be measured, although it is inherently difficult to develop such criteria for governance systems.
- <sup>17</sup> See e.g. House of Lords European Union Committee (2017), "Brexit: environment and climate change", London: House of Lords.
- <sup>18</sup> See European Commission (2018), *op.cit.*
- <sup>19</sup> European Union (2012), Consolidated Version of the Treaty on European Union, Article 3.
- <sup>20</sup> See European Commission's 7th Environment Action Programme website.
- <sup>21</sup> See Haigh, Nigel (2015), *EU Environmental Policy: Its journey to centre stage*, Routledge.
- <sup>22</sup> HM Government (2018), "A Green Future: Our 25 Year Plan to Improve the Environment", London.
- <sup>23</sup> For example in oral evidence to the House of Commons Environmental Audit Committee on 11 July 2018.
- <sup>24</sup> Office of the United States Trade Representative (2019), "United States-United Kingdom Negotiations: Summary of Specific Negotiating Objectives", Washington DC, p.2.
- <sup>25</sup> See e.g. UKELA (2017), "Brexit and Environmental Law: The UK and International Environmental Law after Brexit", Bristol: UKELA.
- <sup>26</sup> E.g. the (amended) 1999 Protocol to abate Acidification, Eutrophication and Ground-level Ozone (Gothenburg Protocol) to the Convention on Long-range Transboundary Air Pollution.

- <sup>27</sup> See European Council (2017), European Council (Article 50) guidelines for Brexit negotiations (29 April 2017).
- <sup>28</sup> See the European Commission Article 50 Task Force website. Negotiating documents on Article 50 negotiations with the UK. Eg Slides on Regulatory issues.
- <sup>29</sup> See European Commission (2018), op.cit.
- <sup>30</sup> Council of the European Union (2018), Draft Political Declaration setting out the Framework for the Future Relationship between the EU and the UK, 22 November 2018.
- <sup>31</sup> European Commission (2017), “EU-Japan Economic Partnership Agreement”, Article 2(2).
- <sup>32</sup> See European Commission (2011), “EU-South Korea Fair Trade Agreement”.
- <sup>33</sup> Lord Peter Lilley (2018), “Statements on UKEU White Paper”, UK Statistics Authority. See UK Department for Exiting the European Union (2018), White Paper on the future relationship between the United Kingdom and the European Union.
- <sup>34</sup> European Council (2018), European Council Guidelines for the negotiations with the UK (23 March 2018), Article 12.
- <sup>35</sup> European Commission (2017), “EU-Japan Economic Partnership Agreement”, Article 16(2).
- <sup>36</sup> See European Commission (2018), op.cit.
- <sup>37</sup> Council of the European Union (2018), op.cit., para.79.
- <sup>38</sup> See European Parliament and Council of the European Union (2016), op.cit.
- <sup>39</sup> HM Government (2018), European Union (Withdrawal) Act 2018.
- <sup>40</sup> See HM Government (2018), Draft Environment (Principles and Governance) Bill.
- <sup>41</sup> European Commission (2018), op.cit., Article 3.

The European Council's guidelines for the Brexit negotiations, published one month after it received the Article 50 notification from the United Kingdom, state that "any free trade agreement [...] must ensure a level playing field, notably in terms of competition and state aid, and in this regard encompass safeguards against unfair competitive advantages through, inter alia, tax, social, environmental and regulatory measures and practices."

This reflects that the UK's decision to leave the Union has created significant uncertainties and concerns. No longer bound by EU rules after Brexit, the UK could, if it so chooses, lower social, environmental and labour standards to give its businesses an (unfair?) advantage vis-à-vis EU competitors. The EU27's main concern is that the UK could turn into a 'low tax, low regulation' economy, which will undermine the European economic model. To prevent this from happening, the EU has pushed for the inclusion of commitments covering several policy areas in the Withdrawal Agreement.

This publication analyses the proposals that are on the table to ensure a level playing field between the UK and the EU after Brexit and assesses in how far the objectives laid out in the European Council guidelines have been met. It does so in relation to different crucial policy areas, including environmental standards, labour and social standards, technical regulations and standards, and state aid control.

Are the commitments in the Withdrawal Agreement sufficient to prevent unfair competition? What do they imply for the longer-term EU-UK relationship? And how will all of this impact the Union?