

## Consultation response

# Response to House of Commons International Trade Committee Inquiry on “Continuing application of EU trade agreements after Brexit”



AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate US investment in Europe totalled more than €2 trillion in 2016, directly supports more than 4.5 million jobs in Europe, and generates billions of euros annually in income, trade and research and development.

## About AmCham EU

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## AmCham EU's response to the inquiry on, "continuing application of EU FTAs after Brexit"

1. What would be the potential consequences if the UK ceased to be a party to the Free Trade Agreements (FTAs) and other trade-related treaties to which the EU is a party?
  - 1.1. The primary consequence would be that the UK would have to negotiate new free trade agreements with the rest of the world – an extraordinarily complex and time-consuming endeavour, likely taking many years.<sup>1</sup> In the meantime, the UK would revert to international trading arrangements organised under World Trade Organization (WTO) rules. This would erect tariff- and non-tariff barriers where previously there were none, at least until such time as new agreements are concluded and in force.
  - 1.2. It is true that the UK as an independent country would not be confined by some of the constraints of negotiating as part of a 28 member group. However, successful trade negotiations require leverage. Leverage in trade negotiations is first and foremost retaining an attractive domestic market. From a purely trading perspective, as a single country in negotiations, the UK could expect to find it more difficult to negotiate preferential terms – as opposed to being a member of the EU, which remains the world's largest trading bloc, and which represents 500 million consumers with considerable purchasing power. This is particularly true for prospective negotiations with dominant economic players such as India, China and the United States.
  - 1.3. Meanwhile, the consequences for local and international businesses operating in the UK would be profound. As a member of the EU, the UK is a part of some 38 bilateral and regional trade agreements covering 60 countries, as well as multiple ongoing negotiations with third countries such as Japan, Indonesia and Vietnam. Businesses have come to rely on these agreements for preferential access – they are dependent on the certainty that intermediate and final goods can be obtained duty free and in compliance with both markets' regulatory environments.
  - 1.4. In today's highly integrated economy, businesses' supply chains, innovation models and strategic deployments are highly integrated across the region and globally. Indeed, global value chains have in part been stimulated by the UK being a party to these FTAs. If the UK does not remain a party to the FTAs that the EU has concluded with a significant number of third countries, businesses would face multifaceted disruption. Such disruption would have an immediate impact on companies and their supply chains. Companies would face increased duties and would have to comply with divergent rules, increasing costs and administrative burdens, while goods could face increased delays at the border. Meanwhile, consumers could expect to encounter reduced choice and increased prices for their goods and services in both the UK and the EU.

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<sup>1</sup> This is predicated on the assumption that an automatic grandfathering into UK law of all EU FTAs is unlikely. On the other hand, it ought to be possible for the UK to remain party to EU FTAs during a transitional period, provided that these arrangements reflect the current status quo, including UK membership of the Customs Union during that time.

- 1.5. From an EU-only perspective, it should be noted that the UK has been a leading proponent for free and fair trade throughout its membership of the EU, as well as being a powerful player in the world economy. The UK's departure could therefore affect the EU's ability or even willingness to promote free trade and conclude trade deals with third countries. It could also act as a brake on EU efforts to carry out important trade-related economic reforms.
  - 1.6. From a third country perspective, it should be noted that third countries have entered into negotiations and concluded FTAs with the EU based on the UK being a member, thereby achieving increased access for their countries to the UK market. The UK's departure from these FTAs disturbs the balance of compromises that have been struck between the EU and the third country, compromises that might not necessarily be re-balanced even with the UK replicating the FTA with the third country in question.
2. What particular issues arise in respect of the Regional Convention on Pan-Euro-Mediterranean Preferential Rules of Origin, Mutual Recognition Agreements and bilateral trade facilitation agreements?
    - 2.1. Under any trade agreement, the possibility to import goods under preferential tariffs is subject to compliance with rules of origin (ROO). Generally speaking, origin is conferred based on where a good was obtained, manufactured, or where the last substantial transformation took place. Cumulation of origin is one of the ways to allow for greater flexibility when it comes to using raw and semi-manufactured materials in the production process. It allows a member of a trade agreement to use originating products from other members. Currently, as an EU member state, the UK benefits from the Pan-Euro-Med (PEM) cumulation zone,<sup>2</sup> in which its 23 members (the EU, EFTA States, Turkey, etc.) have identical ROO.
    - 2.2. When the UK leaves the EU, it will lose access to the PEM cumulation zone. Even if an EU-UK FTA is negotiated and in force before this occurs, the UK would also need to have agreements in place with PEM countries in order to benefit from access to the cumulation zone. In the case of an EU-UK FTA with separate ROO, the products manufactured in the UK would still need to comply with these rules to be able to access the EU markets. However, if, following the signing of such an FTA, the UK negotiates a similar agreement with any other PEM country, cumulation of origin between these two agreements would in principle not be possible without renegotiating the EU-UK FTA ROO protocol.
    - 2.3. Mutual recognition agreements (MRAs) and bilateral trade facilitation would help to somewhat reduce disruption, but should not be expected to provide a silver bullet solution in terms of customs formalities. MRAs acknowledge the differences in two different regulatory regimes but permit one party to test and certify that a product complies with the other parties' regulations, or that the manufacturing and other regulatory standards are mutually recognised, notably for pharmaceuticals (e.g. Good Manufacturing Practices (GMPs)). For pharmaceuticals, MRAs with the EU also provide a waiver for the testing of products upon importation into the EU.<sup>3</sup> However, separate production lines may have to be operated to meet regulatory requirements in different markets.
    - 2.4. Beyond MRAs with third countries, an MRA is one of a number of key elements needing to be in place between the EU27 and the UK post-Brexit, given the closely integrated nature of regulatory systems and the scale of trade. Technically, the step of evaluation, mutual recognition and confidence between the EU27 and the UK could be relatively easy to perform. At a practical level, it will be important to ensure that in the short-term, resources are in place on both sides for the technical evaluation process required to establish an MRA, especially regarding audits of both parties. There are also likely to be further challenges in terms of the political will to achieve this. In this context, it should be noted that

<sup>2</sup> The pan-Euro-Mediterranean cumulation and the PEM Convention, European Commission. Available at [http://ec.europa.eu/taxation\\_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin/arrangements-list/paneuromediterranean-cumulation-pem-convention\\_en](http://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin/arrangements-list/paneuromediterranean-cumulation-pem-convention_en).

<sup>3</sup> For pharmaceuticals, an MRA should include not only elements such as avoidance of duplicative GMP inspections and a waiver for the mandatory testing/batch release on importation into the EU, but also recognition of GCP (Good Clinical Practice), and the scope extended to include biologics, steriles, vaccines and APIs manufacture.

any regulatory divergence by the UK may reduce the likelihood of re-establishing an MRA. Maintaining parity between the two systems will therefore be vital.

- 2.5. Finally, all WTO Members will have to implement the Agreement on Trade Facilitation (TFA). Although separate bilateral trade facilitation agreements may ensure more effective implementation of the obligations of the TFA, their negotiation will require resources that may be better put to use elsewhere.
3. By what mechanism is it legally possible for the UK to seek continuing application of EU FTAs and other trade-related treaties after Brexit?
    - 3.1. The simplest and least disruptive method by which the UK could continue to be a party to EU FTAs and trade-related treaties would for the UK to remain a member of the Customs Union.
    - 3.2. Should the UK decide not to remain in the Customs Union, a number of more complicated options are available. Ultimately, continued application of EU FTAs may be more of a political decision, rather than a rules-based one, although this is a matter of debate.<sup>4</sup> In the best-case scenario, the UK upon exiting the EU would seek to adopt the EU's existing free trade agreements, with the UK together with third countries agreeing that the concessions and commitments agreed in the EU's free trade agreements be replicated in an agreement between the UK and the third country.
    - 3.3. The UK, in its recently published Trade Bill<sup>5</sup>, pledged to follow the above-mentioned approach. This ambition, in principle, is admirable. However, the practicality of this approach is not so clear, particularly in light of the very careful compromises that have been struck between the EU, the EU Member States' and third countries. If an FTA is replicated, these concessions and commitments may not be automatically accepted by third countries, as the balance may have been disrupted. This balance includes not only tariffs, but also non-tariff barriers, services schedules and tariff rate quotas.
 

Any negotiation is therefore subject to the aims and interests of the other negotiating party/parties. Convincing the other negotiating partner to retain the existing commitments from the original EU FTA – without renegotiation of the text – may, whilst preferable, be ambitious. Any negotiating party will ultimately prioritise its own interests in any negotiation with the UK, and the advantages and disadvantages the UK brings for that country will be different from that which the EU offered.
    - 3.4. Countries who signed FTAs with the EU had the EU market in mind. The motivations of each third country will vary, which might have an impact on the willingness or reluctance to replicate or negotiate new FTAs with the UK. At each end of the spectrum are (i) countries that have opened their domestic market to EU products in order to get access to the UK market, and (ii) countries that have accepted to open their domestic market to UK goods in order to get access to the EU-27 market. The UK is likely to face the following dilemma: the countries that are most willing to conclude FTAs with the UK are likely to be countries whose markets are the least interesting for UK exports, and whose imports are most sensitive to UK domestic industries. Countries whose markets are of special interest to UK exports are more likely to be reluctant to extend their FTAs to the UK post-Brexit.
  4. Which FTAs or other treaties should the UK prioritise in seeking continuing application? Are there any that should be allowed to lapse?
    - 4.1. In order to avoid diplomatic and economic tensions, the UK ought to have a "catch-all" approach to all FTAs – in keeping with the principles of free, open and non-discriminatory trade that the UK

<sup>4</sup> A convincing legal argument could be made that, under the rules of public international law as laid down in the Vienna Convention on the Law of Treaties, and the rules of customary international law on which that convention is based, the UK would continue to be party to a mixed EU-FTA that has also been ratified by the EU member states individually. Under this argument, the third country party to an EU FTA would be required to continue giving preferential treatment to goods originating in the UK and vice versa. In any event, it is true that a pragmatic solution based on a political decision would provide traders and business with the largest degree of certainty.

<sup>5</sup> UK Government, Trade Bill 2017-19, Presented to the House of Commons on 7 November 2017, see Part I Section (2). Available at <https://publications.parliament.uk/pa/bills/cbill/2017-2019/0122/18122.pdf>.

government is pursuing. Having said that, negotiating entirely new FTAs with third countries will inevitably prove to be a burdensome and lengthy task. It should be noted that by attempting to replicate EU FTAs with third countries, the UK would effectively be seeking to be bound by the same levels of convergence with the EU that those countries have agreed to.

- 4.2. In the unfortunate, yet not unlikely, event that the UK is not able to grandfather existing EU FTAs into UK law, the UK may be forced to prioritise. In which case, the decision it takes will depend on the overall objective that it is pursuing. If it is to conclude FTAs quickly, then countries that are more likely to be willing to conclude new FTAs ought to be approached first. However, it is probable that these countries will be those that are especially interested in selling goods on the UK market, and are not concerned about UK exports (hence countries that are less attractive for UK industries). On the other hand, if the UK's objective is to conclude FTAs that are helping UK industries and the UK economy, then the UK should prioritise FTAs with countries whose domestic markets are of interest to UK industries, and whose exports are not threatening to key UK industries. Unfortunately, these FTAs will take time to negotiate, and might never be concluded with those countries that are not interested in the UK market or are concerned about UK exports.
- 4.3. From a US business perspective, the most ideal and also most effective course of action would be for the UK to prioritise FTAs with those countries that share its values and interests, in keeping with the principles that the EU has held in recent years. This would include countries with which the EU has already concluded FTAs such as Canada and South Korea, those that are about to be concluded such as Japan, Vietnam and Singapore, and countries which the EU and the UK have either previously entered into negotiations with or expressed an interest to negotiate with such as Australia, New Zealand and the United States.
5. Which issues are likely to be the most contentious in any negotiations around the continuing application of EU FTAs and other treaties? How should the UK address them?
  - 5.1. In general, third countries might seek to maintain or even enhance the balance of concessions that was the outcome of the negotiations with the EU. In a best case scenario, the third country will agree to a copy-paste approach. Within the WTO, however, there are already sources of potential disagreement that portend future complications with respect to future FTAs and other treaties.
  - 5.2. There are number of areas of likely contention in continuing application including: agriculture and quotas, investment protection, rules of origin and cumulation, and services schedules.
  - 5.3. Agriculture and quotas: News reports from Geneva indicate that even at the WTO-level, there is a group of agriculture exporting countries that are seeking to improve their position and insist on a renegotiation of Tariff Rate Quota (TRQ) shares with the EU. For example, the UK and the EU have come under criticism from Australia and New Zealand – two close partners and allies – for splitting their respective beef quotas without consultation from the relevant exporting countries. The EU and the UK will need to be creative and flexible in their negotiations on quotas in their prospective FTAs and within the WTO.
  - 5.4. Investment protection: The UK has a long history of supporting comprehensive investor protection measures and should continue to uphold well-established, international legal principles. In particular, the UK should maintain the broad legal consensus on the definition and scope of 'fair and equitable treatment'. The current practice on legitimate expectations is balanced and should be maintained. It is important to note that even when FTA partners have well-established, independent judicial systems, local courts often lack the ability or capacity to rule on issues touching international investment. For this reason, the UK should provide foreign investors with certainty by maintaining well-established investment protection provisions within future FTAs.
  - 5.5. Rules of origin and cumulation: Given integrated supply chains, an inability to count UK content as originating in the EU – and vice versa – could mean that EU and UK exports no longer qualify for

preferential treatment. This would create enormous problems for many companies operating in the UK and the EU, and could impact the global competitiveness of both regions. In order not to disrupt highly integrated supply chains, the UK will need to convince the EU to agree to cumulation between the EU FTAs and the UK FTAs. In addition, special attention ought to be given to transit requirements, especially non-manipulation rules, allowing goods to be stored, or shipments to be split, in the EU, while their final destination is the UK, as long as the products have not been altered or manipulated.

- 5.6. Services schedules: Considering that the EU Member States make concessions on services in an FTA on a member state level, Member States' services schedules need to be taken into account when the UK seeks to replicate EU FTAs, as these have been part of a sensitive and balanced compromise. If the UK transitions into an independent FTA with the third country, the third country might require adjustments on the UK's services schedules.
6. What staff and expertise will the Department for International Trade need to deal with the necessary negotiations in the time available?
  - 6.1. Considering the issues mentioned above, we would encourage the Department for International Trade (DIT) to gain expertise in the area of rules of origin, country profiles and sector profiles.
  - 6.2. In addition to specialists on market access in different sectors, in the long-term the DIT will also need expertise in other fields common to modern trade negotiations, such as regulatory cooperation, electronic commerce, services, competition (anti-trust), and state-owned enterprises (SOEs).