

# Trade and settling future UK-EU disputes

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As a bloc, the EU is the UK's largest trading partner, while the UK stands with the US and China as the EU's equivalent in terms of its total trade.<sup>1</sup> Unsurprisingly, increasing trade barriers between the UK and EU is forecast to lead to significant economic losses.<sup>2</sup> However, trade has rarely been at the forefront of either side's considerations, as seen by the recurrent possibilities of a no-deal outcome.

Leading Brexit supporters both inside and outside the UK government have not had a settled view on the importance of EU trade. They have variously argued that the theory of greater trade with nearby partners, according to the gravity model, is exaggerated,<sup>3</sup> or developments in technology are reducing its importance;<sup>4</sup> that the Single Market's impact on UK-EU trade has been exaggerated;<sup>5</sup> or that new trade barriers after Brexit will not be so economically significant.<sup>6</sup> More recently, it has been suggested that any losses resulting from Brexit will be unnoticeable due to the COVID-19-related economic crisis.<sup>7</sup>

Nevertheless, the more common approach of Brexit supporters and the UK government is to suggest that the crisis has made exiting the transition period and a floundering EU more urgent than ever.<sup>8</sup>

Mainstream trade economists have challenged these views, to which Brexit supporters often suggest that politics is more important than trade. As an added complication, the 'Global Britain' phrase has stuck, particularly in trade. As such, a significant part of the Brexit narrative is now about the UK's ability to strike new trade deals with the US<sup>9</sup> and others, at the expense of close UK-EU trade relations.

The EU side has generally considered increased trade barriers with the UK a regrettable necessity caused by the UK's referendum and the EU's need to protect the Single Market. Even member states who were like-minded

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partners of the UK (e.g. Sweden) tend to agree.

This chapter considers the current UK-EU trading relationship and how it may develop. At the time of writing, a zero-tariff trade deal is being discussed between the two. However, the UK has been clear that they prioritise absolute regulatory freedom over zero tariffs, and expect border checks as of 1 January 2021.<sup>10</sup> In global terms, the resulting relationship will be an unusually loose relationship between neighbours,<sup>11</sup>

and the chances must be that deal or no-deal, a closer trading relationship will evolve from this low point.

In part, the likelihood of a closer relationship comes from both sides seeking to resolve trade frictions without using dispute settlement,<sup>12</sup> which will be discussed in the last section of this chapter. Experience suggests that problems in the trade relationship will be best handled politically, and it will be through this that the rationales for future agreements will develop.

## UK-EU trade

UK-EU trade figures (2019)

	Exports (£bn)	Exports (%)	Imports (£bn)	Imports (%)	Balance (£bn)
<b>Goods</b>	170,568	45.79	265,456	52.86	-94,888
<b>Services</b>	129,779	39.79	106,744	48.01	23,035
<b>Total</b>	300,347	42.99	372,200	51.37	-71,853

Source: Office of National Statistics (2020)<sup>13</sup>

The EU accounts for 47.26% of the UK's trade. This understates the importance of the EU to the UK, though: the figure rises to 53% when including countries which are intimately linked with EU trade (i.e. Turkey, Switzerland, Norway).

By way of comparison, the percentage of the EU's external trade in goods that is with the UK is 12.6%,<sup>14</sup> while, for services, it is around 20%.<sup>15</sup> This discrepancy, along with the UK's balance of trade figures (see Table 1), seems best explained by the UK's phenomenal strength in service exports. Services figures are difficult to disaggregate, so it is unclear what exactly drives UK strength and how much reflects accounting transactions within companies. Nevertheless, the UK is considered a leading global player in sectors as diverse as film production, financial and business services, and advertising.

On current plans for the UK to leave the Single Market and European regulatory agencies at the end of the year, we can expect to see increased barriers to trade from that point, which would usually lead to declining trade.<sup>16</sup> However, as neighbours, the UK will remain an important market to the EU and vice versa – gravity effects are still key determinants of trade relationships.<sup>17</sup> The UK may also struggle to increase non-EU trade to their desired level,<sup>18</sup> particularly if some UK exporters choose to relocate to the EU. Predicting future trade flows is difficult even without political developments, and such uncertainty is likely negatively impacting, for example, investment in the UK.

# Evolving UK and EU trade policy

The EU has been such an active proponent of preferential trade agreements, going beyond World Trade Organization (WTO) terms, that it has more than any other country or trade bloc.<sup>19</sup> These come in three major forms (although the terminology is inconsistent): (i) Free Trade Agreements (FTAs) with distant countries like South Korea and Canada, focusing on tariff elimination and the recognition of EU products in particular (i.e. geographical indications); (ii) Association Agreements with closer countries, such as Ukraine, that include compliance with parts of the EU *acquis*; and (iii) Economic Partnership Agreements with developing countries.

While new agreements with New Zealand and Australia are under negotiation, and one with the South American bloc Mercosur awaits ratification, the EU trend is away from sealing new agreements to enforcing existing ones. Its creation of the position Chief Trade Enforcement Officer confirms this trend.<sup>20</sup> This trend is further backed by a joint non-paper between Netherlands and France – traditionally on opposing sides of EU trade policy – published in May, and the EU's commitments to enter trade agreements only with countries which have signed the Paris Agreement. All of this means that the UK cannot expect special treatment.

Meanwhile, UK trade policy is far from settled, with a number of different approaches discussed across government. Brexit encompassed free traders and protectionists, supporters of joining the European Free Trade Association, advocates of greater Commonwealth trade, and those for whom a US trade deal was an opportunity to join interests attacking EU regulations. At present this means that the UK's main expressed interest is tariff-free trade with the EU – as long as the UK does not have to adhere to its regulations (which may include level playing field provisions) –; and a deal with the US, protecting UK food standards but moving away from EU regulations.

The UK is unlikely to be offered their desired deal by the EU or US, which means making difficult choices by the end of 2020.<sup>21</sup> The economic turmoil caused by the COVID-19 pandemic and uncertainty surrounding its long-term impact will complicate these choices.

The longer-term trade policy picture was unclear even before the pandemic. The UK government has talked of domestic

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economic rebalancing – implying a revival of manufacturing – when the UK’s obvious global strengths are in services, in which it is fiercely competitive.<sup>22</sup> Manufacturing exports in sectors like automotive and pharmaceuticals are dependent on EU markets and, without appropriate deals with the EU, will be subject to tariffs and regulatory barriers. Meanwhile, services are not generally well covered in FTAs.<sup>23</sup>

Future changes in UK government could also have a major impact on trade policy. A Labour-led government would be more supportive of an EU agreement than one with the US, whereas the Conservatives seem set to continue opposing close ties with the EU, 2016 having marked a reversal of a 70-year policy.<sup>24</sup>

Much will depend on the public perception of trade policy effects. There are likely to be many future stories of the UK being disadvantaged in trading with the EU. While most will initially be blamed on the EU or COVID-19, major manufacturing losses would be more difficult for the government to justify. Similarly, a UK-US trade deal which affects UK farmers will be more controversial than one that simply fails to deliver new exports.

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## Evolving trade agreements

Given the geographical proximity and high chance of a more EU-friendly government taking office in the UK at some stage, it seems unsustainable for mutual trade not to be underpinned by agreements. Even fervent supporters of Brexit envisaged this, but their proposed deals were so biased towards the UK that they could not happen.

It seems reasonable to think that the shape of the upcoming agreements would be based on negotiations to date. While making standard offers, the EU will demand level playing field reassurances for fair competition from the UK – more than what it has asked of others – due to the latter’s proximity and size, and a lack of trust. The UK will ask for more than a basic trade agreement while suggesting otherwise, without accompanying fair competition provisions. These positions do offer plenty of scope for deals to be reached through both side compromising, but it may take some time for that negotiating rhythm to be established.

This could apply to different types of agreement, from a WTO-compliant FTA to mutual recognition, veterinary equivalence,

and other forms of cooperation. The chances of multiple types of agreements with the UK has led the EU to propose an overarching governance framework for the relationship, rather than risk the difficulties it faces in EU-Swiss relations.<sup>25</sup> Although the UK is resisting this, it should ultimately be in both parties' interests to ensure a smooth relationship with regular meetings at various levels – even if this is not in this current phase of negotiations.

In time, the UK is also likely to reverse its decision, as outlined in Chief Negotiator David Frost's Brussels speech of February 2020,<sup>26</sup> to leave all European regulatory bodies open to non-EU members (e.g. the European Aviation Safety Agency). The consequential costs, job losses, and reduced UK influence over rules as a result of leaving European regulatory structures are a heavy price to pay for refusing to accept sector-specific regulations with only limited

European Court of Justice jurisdiction, particularly given the global importance of EU rules. International investors have taken note, and the difficulty in retaining or attracting their attention in the future combined with the UK political priority attached to manufacturing will surely be decisive.

Some would hope a future UK government may consider rejoining the European Economic Area (EEA) or EU Customs Union in the future. It seems unlikely to happen in the next decade, but cannot be completely ruled out, either. Many Brexit supporters would have been happy to remain in the EEA,<sup>27</sup> and the Customs Union would help protect UK manufacturing. These factors are likely to be the subject of future conversations, particularly if the UK struggles economically post-Brexit – although the shape of its economy may well have changed by then.

## Dispute settlement

One of the odder aspects of FTAs is that in practice, often elaborate state-to-state dispute settlement mechanisms<sup>28</sup> are seldom used.<sup>29</sup> For example, the USA has 14 FTAs, from which there have only ever been 4 disputes. In turn, 3 of the latter were in the context of the North American Free Trade Agreement. Meanwhile, the EU currently lists 3 disputes among its 41 agreements. In the past, countries have chosen to take disputes to the WTO, possibly as a way of using collective pressure for compliance, rather than risk mutual retaliation which would undermine a trade agreement.<sup>30</sup>

As suggested by the creation of an EU Chief Trade Enforcement Officer, this situation may be about to change.<sup>31</sup> The EU aims to be more forceful when applying

agreements, including (and perhaps particularly) one with the UK. However, in reality, this will be far from straightforward.

Much of the language in FTAs is ambiguous, creating a framework for trade rather than a detailed legal description of all rules. For instance, commitments to labour or environmental standards, though sometimes not subject to dispute settlement, are often ambiguous and difficult to enforce.<sup>32</sup> Commitments to equivalent regulations are not to be taken literally, but provide a broad framework for the interaction of the two parties' regulatory systems with trade.

This ambiguity was demonstrated in UK-EU relations by the EU's request for an office in Northern Ireland. According to the Withdrawal Agreement,

*“Union representatives shall have the right to be present during any activities of the authorities of the United Kingdom related to the implementation and application of provisions of Union law made applicable by this Protocol [...]. The United Kingdom shall facilitate such presence of Union representatives and shall provide them with the information requested.”<sup>53</sup>*

Although there is no specific text about an office, the term “facilitate” could be interpreted as meaning this request should be granted. The UK has refused it thus far.

Entering dispute settlement every time such a problem arises would soon render the agreement unworkable. Hence the reluctance to use these in general, given that both parties are probably not following the agreement to the exact letter. Agreeing on a more tightly defined language would likely be impossible. Therefore, the UK and EU must find ways to build a working relationship without having to resort to such mechanisms.

Implementing structures to support trade relations is the strongest argument for creating a single UK-EU governance

structure, with lead officials taking charge of ongoing relations, resolving problems amicably where possible, and escalating to the ministerial level where required. Both sides have reservations about establishing such a structure – the UK, to avoid being trapped in some way; the EU, to avoid granting the UK special status post-Brexit. However, it is hard to see how else day-to-day problems could be resolved, other than by building permanent structures. From these structures, addressing ongoing problems will likely bring the impetus for deeper agreements.

Ultimately, it is geography and, therefore, the volume of trade which dictates that the UK and EU need a formal trade relationship. However, emotion and politics suggest that it will take some time before sufficient consensus can emerge within and between the two parties. The UK has never internally resolved their desired balance between market access and independence; the EU still has an underlying tension between wanting the success or failure of an ex-member. Both dilemmas must be answered satisfactorily for there to be a stable relationship. Until then, more difficulties can be expected.

- <sup>1</sup> European Commission (2020), [Top Trading Partners 2019 – Trade Statistics](#); Eurostat, [“Trade in services with non-member countries \(extra EU\), main partners, EU-27, 2017 and 2018”](#) (accessed 05 June 2020). The two documents suggest that the UK is marginally behind the US and ahead of China in terms of the EU’s largest external trading partners.
- <sup>2</sup> Springford, John (2019), [“How economically damaging will Brexit be?”](#), Centre for European Reform.
- <sup>3</sup> See e.g. Gudgin, Graham; Ken Coutts; Neil Gibson and Jordan Buchanan (2017), [“Defying Gravity: A critique of estimates of the economic impact of Brexit”](#), London: Policy Exchange.
- <sup>4</sup> For example, the then Secretary of State for International Trade wrote, “New technologies, in both physical and virtual infrastructure, are producing truly global products and services in a world where geographical boundaries matter much less than before.” Fox, Liam, [“Brexit is a golden opportunity for us to regain our power over international trade”](#), *The Independent*, 28 March 2018.
- <sup>5</sup> See e.g. Burrage, Michael (2016), [Myth and Paradox of the Single Market: How the trade benefits of EU membership have been mis-sold](#), London: Civitas.
- <sup>6</sup> See e.g. Collins, David (2018), [“Brexit and the ‘No Deal’ scenario”](#), Lawyers for Britain.
- <sup>7</sup> N.B. This opinion has mostly been expressed by opponents of Brexit. See e.g. Behr, Rafael, [“Will Johnson smuggle a bad Brexit through the coronavirus crisis”](#), *The Guardian*, 06 May 2020.
- <sup>8</sup> Singh, Arj, [“Despite Coronavirus, No.10 Won’t Extend the Brexit Transition. Here’s Why”](#), *Huffington Post*, 27 April 2020.
- <sup>9</sup> See e.g. Paterson, Owen, [“Why Brexit is great for the UK and USA”](#), 05 October 2017.
- <sup>10</sup> Under the Protocol on Ireland/Northern Ireland, there will be no goods checks between the EU and Northern Ireland.
- <sup>11</sup> An example of successful market integration between neighbours is the Single Economic Market between New Zealand and Australia. However, there are several customs unions around the world. For example, the Agreement between the United States of America, the United Mexican States, and Canada provides a basis for deeper cooperation. “Since [the North American Free Trade Agreement], the three countries have made efforts to cooperate on issues of mutual interest, including trade and investment, and also in other, broader aspects of the relationship, such as regulatory cooperation, industrial competitiveness, trade facilitation, border environmental cooperation, and security.” Villarreal, Angeles and Ian F. Fergusson (2020), [“NAFTA and the United States-Mexico-Canada Agreement \(USMCA\)”](#), Congressional Research Service, p.4.
- <sup>12</sup> “The Dispute Mechanism Systems (DMS) in many trade agreements have lain dormant because countries preferred to use the World Trade Organization (WTO), with its Appellate mechanisms”. Szyszczak, Erika, [“Dispute Resolution in EU Trade Agreements: A Preliminary Glimpse of a New World Order”](#), *UK Trade Policy Observatory*, 26 June 2019.
- <sup>13</sup> *Office for National Statistics*, [“UK total trade: all countries, non-seasonally adjusted”](#) (accessed 05 June 2020).
- <sup>14</sup> European Commission (2020), *op.cit.*
- <sup>15</sup> Eurostat, [“Trading partners’ share of EU-27 international trade in services with non-member countries \(extra- EU\), 2018”](#) (accessed 05 June 2020).
- <sup>16</sup> See e.g. United Nations Conference on Trade and Development, [“Post-Brexit UK exports could fall by \\$32 billion due to non-tariff measures and tariffs”](#), 25 February 2020.
- <sup>17</sup> See e.g. Estrin, Saul; Christine Cote and Daniel Shapiro, [“It will be cheaper for the UK to trade with EU countries after Brexit – at least in the near term”](#), *British Politics and Policy*, 23 August 2018.
- <sup>18</sup> Brakman, Steven; Harry Garretsen and Tristan Kohl, [“Global trade can’t replace the value of the EU Single Market for the UK”](#), *LSE Brexit*, 22 May 2017.
- <sup>19</sup> *European Commission*, [“EU trade agreements: delivering new opportunities in times of global economic uncertainties”](#), 14 October 2019.
- <sup>20</sup> Luyten, Ann-Evelyn and Jin Woo Kim, [“Could the EU’s Chief Trade Enforcement Officer enforce sustainable development commitments under EU trade agreements against non-compliant third countries?”](#), *EU Law Live*, 13 May 2020.
- <sup>21</sup> Henig, David, [“Coronavirus response sheds light on tough UK trade choices ahead”](#), *UK Trade Forum*, 30 March 2020.
- <sup>22</sup> Morita-Jaeger, Minako and L. Alan Winters (2018), [“The UK’s future services trade deals with non-EU countries: A reality check”](#), Brighton: UK Trade Policy Observatory.
- <sup>23</sup> Hoekman, Bernard M. and Aaditya Mattoo (2013), [“Liberalizing trade in services: Lessons from regional and WTO negotiations”](#), San Domenico di Fiesole: European University Institute.
- <sup>24</sup> Shrimley, Robert, [“Brexit: the Conservatives and their thirty years’ war over Europe”](#), *Financial Times*, 14 December 2018.
- <sup>25</sup> “Swiss-EU relations are based on more than 120 bilateral contracts negotiated since a 1992 referendum”. Atkins, Ralph; Jim Brunsden and Philip Stafford, [“Switzerland faces stark choice on EU integration deal”](#), *Financial Times*, 06 December 2018.
- <sup>26</sup> In particular, Frost said, “Sovereignty is about the ability to get your own rules right in a way that suits our own conditions”, a definition that, taken literally, rules out virtually all international

trade coordination. Frost, David, "[David Frost lecture: Reflections on the revolutions in Europe](#)", Université Libre de Bruxelles, 17 February 2020.

<sup>27</sup> "The Leave Alliance is no fan of Boris Johnson and our preferred outcome ([European Free Trade Association, European Economic Area]) now seems improbable". *The Leave Alliance*, "[The Brexit Party is gambling Brexit away](#)", 02 November 2019.

<sup>28</sup> Not to be confused with the separate investor state dispute settlement mechanism, which is not covered in this section.

<sup>29</sup> Szyszczak (2019), *op.cit.*

<sup>30</sup> Vidigal, Geraldo (2017), "[Why is There So Little Litigation Under Free Trade Agreements? Retaliation and Adjudication in International Dispute Settlement](#)", *Journal of International Economic Law*, Volume 20, Issue 4, pp.927-950.

<sup>31</sup> The breakdown of the Appellate Body of the World Trade Organization (WTO) is a more recent issue that affects taking disputes to the WTO. The EU and a number of other countries have agreed to a multi-party interim appeal arbitration arrangement; the UK has not signed it.

<sup>32</sup> Gammage, Claire (2018), "[A critique of the extraterritorial obligations of the EU in relation to human rights clauses and social norms in EU free trade agreements](#)", *Europe and the World: A law review*, Volume 2, Issue 1.

<sup>33</sup> Task Force for the Preparation and Conduct of the Negotiations with the United Kingdom under Article 50 TEU (2019), [The Revised Protocol on Ireland/Northern Ireland included in the Withdrawal Agreement](#), TF50 (2019) 64, Art.12(2).