

# UK Retail Brexit and Trade: The Brexit Negotiating Mandates

## What Are They, What Do They Mean for Retail and What Happens Now?

### Key Points

- Both sides share a common ambition for a free trade agreement (FTA) that will avoid tariffs and quotas altogether
- Significant differences on “level playing field” issues will need to be overcome in order for the FTA to go ahead
- Under any FTA, new costs will be inevitable, with the food sector at greatest risk from new regulation
- UK exporters are at greater risk of new costs than UK importers
- Highly likely that new regulation will develop friction at borders for food products

**During the last week in February, the EU and the UK published their respective negotiating mandates, which outlined a framework for their upcoming negotiations on the future trading relationship.**

These documents set out the scope of issues the negotiations should cover, what ambitions and objectives the negotiations should seek to achieve and any preconditions either side might attach to the negotiations.

A comparison of key issues impacting the cost of sourcing retail goods from the EU (e.g. the provisions on market access and wider regulatory issues collectively described by the EU as the “level playing field”) are summarised in the table.



### A Comparison of Mandates

| Issue Mandate   | UK  | EU Mandate   |
|---|---|--|
| Trade Issues and Regulations Enforced at the Border                                 |   |  |
| <b>Tariffs and Quotas</b>   | <ul style="list-style-type: none"> <li>• Tariff-free, quota-free treatment for all traded goods</li> </ul>  |  |
| <b>Customs</b>  | <ul style="list-style-type: none"> <li>• All trade will need standard customs documentation</li> <li>• Goods must meet rules of origin (local content requirements) to benefit from tariff-free trade</li> <li>• Physical customs checks on some trade at the border</li> </ul> |  |
| <b>Trade Defence</b>  | <ul style="list-style-type: none"> <li>• Parties may take trade defence actions (e.g. additional anti-dumping or anti-subsidy duties) to protect against unfair trade</li> </ul>  |  |
| <b>Sanitary and Phytosanitary Measures</b><br>(i.e. human, animal and plant health) | <ul style="list-style-type: none"> <li>• UK to develop its own SPS measures “reflecting our existing high standards”</li> <li>• Risk-based approach to implementation and enforcement</li> </ul>  | <ul style="list-style-type: none"> <li>• Both sides to maintain at least the same level of protection as at end of transition period</li> <li>• Approach based on precautionary principle</li> </ul> |
| Level Playing Field Measures  |   |  |
| <b>State Aids</b>   | <ul style="list-style-type: none"> <li>• “The UK will have its own regime of subsidy control”</li> </ul>  | <ul style="list-style-type: none"> <li>• “Application of Union State aid rules to and in the UK”</li> </ul>  |
| <b>Competition</b>  | <ul style="list-style-type: none"> <li>• “Both parties should have regulatory freedom....in these areas”</li> <li>• No dispute settlement</li> </ul>  | <ul style="list-style-type: none"> <li>• Prohibition of anticompetitive agreements, abuse of dominant position and concentration of undertakings if these threaten distortions in trade</li> </ul>   |
| <b>Labour Law</b>   | <ul style="list-style-type: none"> <li>• “Reciprocal commitments not to weaken or reduce the level of protection afforded by labour/environmental laws in order to encourage trade or investment”</li> </ul>  | <ul style="list-style-type: none"> <li>• Level of protection for labour/environment should not fall below the level that applies at end of transition period</li> </ul>                              |
| <b>Environment</b>  |   |  |

Green – Broad agreement | Orange – Manageable differences | Red – Fundamental disagreement

There is broad agreement on the terms of a free trade agreement (FTA). However, significant diverging views exist on how to deal with all the level playing field issues that the EU insists must be covered in the agreement in order to allow the FTA to proceed, as well as important differences regarding the form of the agreements, dispute resolution mechanisms, remedies and other governance issues.

In most of the level playing field areas, it is possible to see a compromise that will, on the one hand, allow the UK to claim regulatory autonomy and, on the other, give the EU enough assurance its market will not be undercut by UK producers operating to lower standards. It is only regarding state aids in which opposing positions appear to be fundamentally incompatible.

## What Would an FTA in Line With the Mandates Mean for UK Retail and Its EU Sourcing?

If the two sides agreed an FTA in line with the mandates, UK retailers would:

- Be able to source **all consumer goods from the EU free of customs duties and quota restrictions.**
- Face **some new administrative costs on imports from the EU** arising from compliance with customs requirements which are often relatively straightforward. Typically, these involve lodging a customs declaration that classifies goods for customs purposes, records the value of the goods and confirms their origin. Such customs declarations are already required for any imports from outside the EU and the cost of compliance can be modest (a recent study for HMRC concluded that the average cost of completing a customs declaration is £32.50 per consignment).

Both mandates emphasise the need to develop measures that reduce unnecessary costs for traders, including trusted trader programmes and mutual recognition of Authorised Economic Operator status.

- **Face higher administrative costs for importing** goods subject to additional non-customs regulatory checks at the border. These would most notably apply to **food products** which need to demonstrate compliance with SPS rules at the border. However, UK food importers should be encouraged by the UK mandate stating it will apply a risk-based approach to enforcement that aims to minimise the number of physical border inspections and simplify other administrative procedures.
- Experience **delays at the border resulting from physical inspections on some imports.** Nevertheless, the UK currently only physically inspects a fraction of consignments from the rest of the world (2% – 3%) and the mandates suggests the UK would adopt a similar approach to EU imports.



## Is a Deal Possible?

**Ostensibly, the two sides are far apart on many issues. The EU insists that a comprehensive FTA is only possible if the UK continues to follow EU rules (or very similar) on a range of issues, while the UK insists that the objective of leaving the EU is autonomy over its own regulations.**

However, there are three key reasons underlying the possibility of a deal.

Firstly, the UK and the EU commence positions in complete alignment on regulation, so de facto on Day 1 of any new trade agreement, the EU and the UK will be operating on a level playing field. This gives the EU confidence from the outset that UK trade will not unfairly disrupt competition within the EU market.

Secondly, in most areas of the level playing field, the mandate wording is sufficiently vague to allow compromise whereby the UK retains regulatory sovereignty, but assures the EU it will not exercise regulations enabling UK producers to undercut EU producers. Dispute resolution provisions would be key to enabling this to work, which may be why the UK mandate contains such firm rejection of any role for the European Court of Justice in any dispute mechanism governing the relationship.

Thirdly, numerous devices and mechanisms exist, some explicitly referenced in both mandates, that would allow either side to compensate for any cost advantage (distortion to trade arising from changes to future regulation), including:

- **Product exclusions from the FTA.** There may be some products which are extremely sensitive (politically, economically and culturally) that both sides simply cannot agree on regulatory issues. Hence, such products could be excluded from the FTA altogether. This is entirely commonplace in other EU trade agreements, all of which include some exclusions and exceptions, mainly (but not exclusively) on agricultural and food products. The EU has already excluded audio-visual services from any future FTA with the UK, due to cultural and political sensitivities in certain EU member states. Importantly, such exclusions would not mean that trade in those products is banned – instead, trade would be conducted on standard WTO terms (i.e. using MFN tariffs).
- **Standard trade defence measures.** The two sides could use standard trade defence measures to compensate (i.e. apply additional duties) for distortions arising from state aids or competition policy.
- **New trade instruments might be negotiated to deal with other areas of competitive advantage gained as a result of diverging regulations.** For example, the EU has considered a “border adjustment mechanism” which would apply special duties to imports from other countries enjoying lower production costs from lower environmental standards/carbon pricing. This idea could be developed, allowing the EU to apply additional duties to imports of goods possibly benefitting from reduced costs as a result of lower environmental or climate change standards in the UK.

If these measures were applied to a UK/EU FTA, we could expect a gradual introduction of new tariffs on certain trade where EU/UK regulation diverges and where that divergence has caused a cost advantage in the market. It is most likely that any new tariffs will be applied by the EU to imports from the UK and not vice versa.



## Will Any New Burdens and Costs Arising From an FTA Affect UK Imports and Exports Equally?

Probably not. The two negotiating mandates are strikingly different – in tone and approach. The EU mandate is extremely focused on ensuring UK producers cannot gain a cost advantage in EU markets. Consequently, the mandate has a strong emphasis on enforcement and control, implying that checks and inspections on the EU side are likely to be more onerous and intensive than checks and inspections on the UK side. The emphasis throughout its mandate is on finding measures that ease and facilitate trade.

## Will All Products Be Equally Affected by New Costs in an FTA?

Almost certainly not. New costs on trade with the EU are likely to be concentrated on a few products, most of them likely to be food related. This is because:

- Where tariffs apply, they are higher for food than non-food
- Food products are more likely than non-food to attract tariffs, even in an FTA
- Food products must comply with SPS and customs rules, multiplying costs for traders
- Physical inspections on consignments are more frequent for food than non-food

## Next Steps

Negotiations commence in March 2020, continuing intensively until the end of June, whereby the EU hopes a deal on fisheries will have emerged and a decision made on whether to extend the current transition period by one or two years, allowing additional time for negotiations. At the end of June, the UK will ascertain whether an EU trade deal is possible by the end of this year and, if not, it may walk away from negotiations to concentrate on preparing for a WTO-based relationship with the EU on 1 January 2021 instead.

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Matthew Kirk, International Affairs Advisor at Squire Patton Boggs, says:

“So we’re off on the next leg of our journey, towards our new relationship with the EU. This will be a unique set of negotiations – about divergence rather than convergence, and at least as much about form and governance as substance. So it’s hard to draw precedents from other such negotiations. A deal can certainly be done in the time available, but for that to happen both sides will need to look beyond ideologically-driven positions and find pragmatic solutions that bridge some important conceptual differences. And then there’s the problem of fish – not part of the FTA, but with the potential to disrupt the negotiations, and if threats of blockades come to anything even to disrupt trade. So buckle up for a bumpy ride – plenty of drama to come.”

Matthew Lewis, head of Retail at Squire Patton Boggs, says:

“Both sides now face the huge challenge of trying to strike a trade deal and reach agreement in a range of areas over the next few months. As this is the first time the European institution has lost a member, there is no precedent to follow, so neither party is bound by anything that has gone before. These are uncharted waters. The Brexit process plunged the UK into its worst political crisis for 50 years, but there are now more positive signs and a comparison of the UK and EU Mandates suggests there is the potential for a deal to be done. A deal could mean that retailers would be able to source all consumer goods from the EU free of customs duties and quota restrictions, though there will be some new administrative costs on imports from the EU. It won’t be plain sailing!”

