Divergence, at what cost?

The EU-UK Trade and Cooperation Agreement is a free trade agreement like no other: the first between parties negotiating from a position of regulatory convergence; the first trade deal in which the EU has accepted the principle of no tariffs and no quotas, but also the first trade deal which not only incorporates provisions that can broaden and deepen the Agreement's scope, but also narrow it. However, at what cost are the parties willing to increase divergence, asks ***Totis Kotsonis*** *(Pinsent Masons LLP)?*

The deed is done. After an intense and unprecedented short period (nine months) of trade negotiations, the UK and the EU have agreed on a Trade and Cooperation Agreement (TCA). The TCA makes provisions for the Parties to review jointly the deal's implementation every five years, and the joint Partnership Council which sits at the apex of a complex permanent governance structure, has the power to amend certain aspects of the Agreement.

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More crucially perhaps, under certain conditions, each Party has the right to take swift unilateral trade defence measures to counter the significant negative effects of subsidies that the other Party might decide to grant to its domestic industries or businesses. In principle, such unilateral remedial measures may include the imposition of tariffs or quotas or even the suspension of parts of the Agreement.

More drastic measures might, in fact, be possible under a separate "rebalancing" mechanism for which the Agreement also provides. According to this, where there is significant divergence in the policies of the Parties in areas such as labour and environmental standards or subsidy control, the Party which considers that this divergence has a material impact on UK-EU trade or investment, can seek to "rebalance" the Agreement, again, by revising unilaterally its own commitment to grant, for example, tariff and quota-free access to its market.

To be clear, unilateral trade defence measures must be appropriate and proportionate at all times and are ultimately subject to independent oversight, in the guise of binding arbitration in the event of a dispute. Nonetheless, their incorporation in the TCA has the effect of introducing a potentially significant element of uncertainty for businesses, should either Party decide to diverge. This is quite unique for a free trade agreement, as free trade agreements normally seek to bring signatory parties closer and facilitate further trade between them.

Indeed, whilst rebalancing measures under the TCA would normally be expected to be temporary, after four years – or earlier if such measures have been frequent or imposed for periods longer than a year – either Party may request a review of the Agreement so as to take into account on a more permanent basis the divergence that has emerged in the Parties' respective regulatory policies and standards.

Finally, the Agreement also incorporates a number of provisions that can lead to the termination of certain key parts of the Agreement or the termination of the Agreement in its entirety. Some of these termination provisions provide for a notice period of as little as three months, whilst certain others, allow the termination of the Agreement by either Party at will; without the need for any specific issues to have arisen or special circumstances to have occurred.

The deed is done? Perhaps. In principle, there is no obvious reason why the UK would wish to diverge substantially from the labour, environmental or subsidy standards it helped so much to shape as a member of the EU. However, there are two crucial unknowns at this stage: first, the extent to which UK regulatory policy is likely to be shaped by the desire to diverge as a means of asserting our sovereign right as a country to formulate our own regulatory policies. The second, and perhaps more complex factor, is the extent to which the need to facilitate trade agreements with other strategic partners might require the UK to diverge substantially from its current regulatory policies. If that were to materialise, it would have the effect of putting the UK in the unenviable position of having to prioritise one trade relationship over another, requiring it to decide whether the imposition of tariffs or quotas or the narrowing in scope of the TCA is a price worth paying for a deeper trading relationship with other strategic partners.

Substantial divergence from current TCA level playing field commitments would have another, perhaps less immediately obvious, ramification: distinguishing further between the regulatory frameworks of Northern Ireland and the rest of the UK. Political considerations aside, such a state of affairs can increase further costs for businesses needing to comply with two distinct regulatory systems within the country.

Ultimately, the question is whether the benefits of significant regulatory divergence can ever outweigh its potentially significant costs. Perhaps we will have the answer in due course.

This post represents the views of the author and not those of the Brexit blog, nor LSE. This is an updated version of an article first published on the Pinsent Masons blog.

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