



Board of Academic Advisors
to the
Bundesministerium
für Wirtschaft
und Energie

Board of Academic Advisors to the Federal Ministry for Economic Affairs and Energy • 10119 Berlin

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Brigitte Zypries
Federal Minister for Economic Affairs and
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– The Chairperson –

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Reorganising economic relations with the UK

SUBJECT

Dear Minister,

Negotiations are about to begin between the European Union (EU) and the United Kingdom on the latter's withdrawal from the Union under Art. 50 TEU. There is an inherent risk that the negotiations may cause unnecessary harm to our economic relations. This should be averted. At the end of the process, there ought to be a comprehensive free trade agreement (FTA) between the EU and the UK.

The Single Market of the European Union (EU) and the European Economic Area (EEA) is a key accomplishment of European integration. Thanks to this liberalisation of markets, trade in goods and services has grown by a much larger extent than would have been possible under a mere FTA. This has benefitted all Member States. As far as relations with the United Kingdom are concerned, our aim ought to be to try and keep as many of these benefits as is possible. It would be wrong to believe that keeping markets open to both sides would mainly serve the national interest of the UK, as it will allow UK companies to retain access to the large market of continental Europe. Open markets likewise benefit German consumers, companies and government institutions that are currently purchasing services from the United Kingdom. Open markets also benefit German companies that export goods and services to the United Kingdom. And they benefit the overall economy, as open markets provide better opportunities for an economy to specialise in those goods and services where it has a comparative advantage, and to import others at a lower price. This particularly applies to the large European market, which allows firms to generate economies of scale.

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A key objective must be the cohesion of the remaining EU-27. Therefore the UK should not be allowed to opt out of selected parts of the Single Market whilst retaining others (*Brexit à la carte*) – a principle that has been acknowledged by the UK government. In the interest of safeguarding as many achievements of the Single Market as possible, it is important that a deep and comprehensive free trade agreement be concluded. By its very nature, a free trade agreement of this kind will be less conducive to trade than the Single Market¹, which is fully accessible, and will therefore not allow for *Brexit à la carte*. Experience with negotiations for other free trade agreements has shown that the 2-year period stipulated in Art. 50 TEU is likely to be too short to allow for a free trade agreement to be concluded. For this reason, the Board of Academic Advisors holds that it is important to provide for viable interim solutions that allow for a smooth transition for economic actors. Any unnecessary disruption to trade should be avoided.

In the following, you will find the proposals tabled by the Board of Academic Advisors as to how to manage this transition before an agreement has been reached. The Board also advocates a pragmatic approach to regulating access to the services markets after the UK leaves the EU. Furthermore, the Board suggests considerably streamlined procedures for handling tariffs on third country imports under an EU-UK agreement, and, if such an agreement is not concluded, a tariff procedure between the EU and the UK which draws on the joint institutions that still exist.

Transitional solutions for incremental Brexit

To provide legal certainty during the Brexit process, safeguard the rights of EU citizens living in the UK and of UK citizens living in the EU, and prevent unnecessary disruptions to economic relations, a regulatory framework is needed that will govern the transitional period from 2019 until a new agreement on trade between the EU and the UK is ratified. Now that the United Kingdom has committed to leaving the European Single Market and the Customs Union, there are two main options.

- Extending the deadline pursuant to Art. 50 (3) TEU. Under this scenario, the UK's exit from the EU would only take effect upon expiry of a longer deadline or ratification of an agreement.
- Re-entry of the UK into EFTA (European Free Trade Association). Under this scenario, the UK would join EFTA and possibly (and for a limited time only) the EEA upon leaving the EU; final negotiations on the rules governing UK-EU relations would be held afterwards.²

Joining EFTA seems like a highly suitable solution for the UK, given that it would provide for legal certainty without imposing a deadline by which a permanent solution has to be found, and allow for Brexit to take place incrementally.

¹Cf. Speech delivered by German Foreign Minister Sigmar Gabriel before the German Bundestag on the subject of Britain's filing for withdrawal from the EU, 30 March 2017, http://www.auswaertiges-amt.de/sid_9124479AEE8C39A309238E55AF1B0539/DE/Infoservice/Presse/Reden/2017/170330-BM-BT-Brexit.html, last accessed 21 April 2017.

² A similar proposal was made by the president of the EFTA Court, Mr Carl Baudenbacher, in an article published in the FAZ newspaper on 27 April 2017.

In particular, it would mean that the UK would be able to exit the EU and leave the jurisdiction of the ECJ in a single initial step. EFTA has its own jurisdiction and operates a Joint Committee in relation to the EU. The same is also true for the EEA, as the ECJ has in the past ruled it has no jurisdiction over countries that are not Member States of the EU. Managing Brexit within the EFTA framework may also help speed up the negotiations for a new EU-UK agreement. The question of whether the United Kingdom would remain a member of EFTA or withdraw upon the completion of Brexit would be left to the negotiations.

Keep markets as open as possible

The EU Single Market is not only about free trade in the traditional sense of not having tariffs and import quotas, but also about limiting the scope for national governments to impose regulations, for example safety and quality standards on imported goods and services. In the past, many of these regulations had the effect (often not unintentionally) of erecting non-tariff trade barriers. This effect was much reduced by the Internal Market Programme, under which a product or service that meets legal requirements in one EU Member State (or one member of the EEA) is automatically deemed to meet legal requirements in all Member States. In this context, an important role is played by the possibility that European legislation can prevent national legislators from engaging in a race to the bottom, lowering safety and quality standards to unconscionably low levels. Upon the United Kingdom's departure from the EU, this corrective instrument will no longer be available. The new agreement should nevertheless aim at keeping markets as open as possible, restricting deviations from the home country principle as a basis for market access to cases where essential needs for protection are involved.

These considerations are particularly important for the financial sector, though they apply to others as well. As one of the world's major financial centres, London is very important for the EU. The concentration of financial institutions and financial activities in London generates large economies of scale and scope and agglomeration effects that benefit customers, including customers from Germany such as German exporters who are able to obtain better and cheaper hedges for their foreign exchange risks because the London derivatives markets work extremely well. At the same time, regulation of this sector is very important for consumer protection and financial stability. In negotiating future EU-UK relations, care should be taken to preserve the efficiency gains from this financial centre as much as possible. Any restrictions of market access in either direction ought to be limited to those areas where there is a significant need for protection. Protection of financial stability may involve a right of competent European and national institutions to intervene in a timely and effective manner when a systemically important financial institution is in difficulties.

We warn against giving in to the temptation of massively restricting British companies' access to the EU market so as to provide domestic competitors with new opportunities. The cost of any such strategy would be borne by domestic consumers and producers who would find less attractive offers in the market if offers from British suppliers are restrained

Substantial streamlining of customs procedures

In the absence of common external tariffs, a free trade agreement would generate significant costs for the control of third-country origins, e.g. through country-of-origin certificates. These costs would impose unnecessary damage to value chains that have evolved over 40 years. The Board of Academic Advisors proposes that country-of-origin certificates would not be required for imports from third countries whenever tariff rates for imports from third countries are the same; the invoices issued by the third-country suppliers would be sufficient for a proof of origin. A provision to this effect would reduce trade barriers in a future EU-UK agreement below those in other agreements, such as in the Canada-EU Agreement (CETA). It would also create incentives for harmonising tariff rates.

If the negotiations end up with customs barriers between the EU and the UK, for transit trade within a free-trade zone or for bilateral trade, there would be significant costs on both sides. Trade impediments arise not only from tariffs but also from customs procedures and waiting times at borders. Therefore it is desirable to have customs procedures that can take place anywhere, not just at the actual borders.³ Throughout the EU, including the UK, VAT on imports is already being levied on recipients far from the borders. The European VAT Information Exchange System (VIES) involves exchanges of information between the different tax authorities as well as simplified proofs of origin. This electronic procedure could also be used for customs purposes. Under no circumstances must it become possible for WTO-compatible punitive tariffs (e.g. anti-dumping tariffs) to be imposed.

Concluding remarks:

The negotiations with the UK about the latter's withdrawal from the EU and the design of future EU-UK economic relations will have to deal with several highly controversial issues, including the issue of mutual financial claims. These controversies may well result in considerable delay in concluding an agreement.

³This is similar to the electronic CDS (customs declaration services system) envisaged by the UK for its border with the Republic of Ireland, under which customs would also be paid by suppliers and recipients, but not *en route*. "Virtual' Ireland border seen as template for Brexit customs deal. Most lorries would cross without checks after online notification about loads," Financial Times of 23 February 2017.

The Board of Academic Advisors proposes that you, Minister, advocate for transitional rules to be put in place early enough, for instance provisions that make use of EFTA, and to plead for the conclusion of a comprehensive EU-UK agreement on free trade.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Hans Gersbach', with a stylized flourish at the end.

Professor Dr Hans Gersbach
(Chairman of the Board of the Academic Advisors)

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