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**CENTRE FOR BREXIT**  
POLICY

# USING NEGOTIATING LEVERAGE TO ACHIEVE A SOVEREIGNTY- COMPLIANT EXIT FROM THE TRANSITION PERIOD

SEPTEMBER 2020





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# THE CENTRE FOR BREXIT POLICY

The Centre for Brexit Policy (CBP) is a new think tank backed by cross-party politicians who support the UK leaving the EU. It has been formed to propose the critical policy changes enabled by Brexit that will boost national prosperity and well-being in years to come, as well as help ensure that Britain fully 'takes back control' when it leaves the European Union.

The CBP aspires to trigger a deep and wide debate about what Brexit should mean for the UK over the next decade or two. By providing a focus for the development of post-Brexit public policy, the CBP hopes to help formulate an overarching framework for the UK that maximises the opportunities Brexit affords. This will be promoted to Government, Parliamentarians, and the public welcoming contributions from those who want to see Brexit open a new and fruitful chapter in our country's life.

The CBP has three core objectives:

- **Identify the benefits and opportunities of Brexit across the full spectrum of economic, trade, social, foreign, defence and security policy areas proposing new policies for the Government's agenda**
- **Continue to make the intellectual, evidence-based case for a 'real' Brexit and provide the Government with clear and constructive advice on how to deal with ongoing negotiation and implementation issues. A 'real' Brexit means regaining full control over our laws, borders, seas, trade, and courts**
- **Check any attempts to dilute a real Brexit, as well as serving as a catalyst and rallying point for positive news stories that, over time, will be able to persuade and demonstrate the many substantial advantages of Brexit**

Delivery of these objectives is based on professional, substantive fact-based research by experts in their fields leading to authoritative reports, short papers, OpEds, events, and briefing meetings - both within and without Government.

The CBP is supported by a cadre of expert CBP Fellows drawn from multiple disciplines to provide additional expertise and experience in developing an agenda for policy change that will ensure the British people benefit from Brexit. Additional support is provided by a CBP Business Forum to bring a business perspective to shaping CBP's agenda, provide input to policy proposals, and deliver a pro-Brexit business voice.

## CONTRIBUTING AUTHORS

<b>David Collins</b>	Professor of International Economic Law, City University of London
<b>Martin Howe</b>	QC (Intellectual Property and EU Law), Chairman Lawyers for Britain
<b>Hans Maessen</b>	Independent Customs Adviser for business and government; Member Alternative Arrangements Commission
<b>Edgar Miller</b>	Managing Director Palladian Limited, Convener Economists for Free Trade, Senior Visiting Fellow Cass Business School
<b>Barnabas Reynolds</b>	Partner and Global Head of Financial Institutions Shearman & Sterling
<b>Sammy Wilson</b>	MP for East Antrim; Minister of Finance and Personnel and Minister of the Environment, Northern Ireland Executive; former Lord Mayor of Belfast
<b>Nick Wood</b>	Chairman Media Intelligence Partners

## EXECUTIVE SUMMARY

- **Following eight rounds of Brexit negotiations, the EU continues to offer a future trade agreement that represents poor value for the UK, is very advantageous to the EU's trading interests, and subjects the UK to 'colony status' as it**
  - Covers only goods, not services, and then only in ways that suit the EU
  - Demands that the UK agree to terms not contained in any comparable trade agreements, including
    - » Wide-ranging controls over the UK's future State aid
    - » So-called 'level playing field' controls
    - » De-facto annexation by the EU of the NI economy
    - » A large share of the UK's natural fisheries resources
- **The UK seeks to agree a win-win FTA that respects the entirety of UK sovereignty and properly addresses services, including financial services. It is rightly resisting the EU's demands - willing, if necessary, to 'walk away' either with no trade deal or a very limited deal on the UK/EU future relationship**
- **Recent events have increasingly questioned the acceptability of the concluded and ratified Withdrawal Agreement and Northern Ireland Protocol that encroach on UK sovereignty by imposing EU law, European Court of Justice jurisdiction, uncapped liabilities and other EU demands on the UK**
- **It might be thought, in the event of a 'no' or a 'limited' deal at the end of this year, that these EU imposed legal constraints would simply fall away when the Transition Period ends. However, this is not the case.**
- **The flaws and inconsistencies in the EU's position need to be grasped and addressed, not acquiesced in, whether wittingly or unwittingly. The Government's Internal Market Bill, while addressing some conflicts in the WA, does not achieve a sovereignty-compliant exit from the Transition Period**

**Therefore, the UK Government must take the following proactive steps:**

### **I. RECOGNISE THE REALITY OF THE UK'S CURRENT POSITION AND BUILD ON RECENT LEGISLATIVE INITIATIVES**

- 'Walking Away' or agreeing a 'limited' deal cements the WA/NIP in place
- Addressing WA/NIP issues after 31 December is not practicable
- Suspending and terminating - or voiding - the WA/NIP must be done before 31 December
- Recent legislation is a significant and helpful step in the right direction but is not sufficient

### **II. TERMINATE AND REPLACE - OR VOID - THE WA/NIP BEFORE 31 DECEMBER WITH A WIN-WIN FTA**

1. Terminate the WA and NIP - or declare them void - because the EU is in breach of its commitments
2. Offer the EU a comprehensive FTA for goods and agriproducts explaining why such an FTA built around the NI North-South border is the only viable solution for the EU
3. Proffer an appropriate enhanced future UK-EU financial services arrangement (eg, Enhanced Equivalence, with ancillary services pulled along with it) in lieu of the UK (and US) imposing punitive capital, collateral, and liquidity requirements on all global exposures to EU financial institutions



### III. MOTIVATE EU COOPERATION BY EMPLOYING NEGOTIATING LEVERAGE AVAILABLE TO THE UK, US, AND OTHER COUNTRIES

- Employ remedies for EU trade dumping and unfair subsidisation as leverage to motivate EU agreement on a comprehensive FTA in goods and services
- Apply international financial regulatory standards to EU (including Eurozone) bodies and financial institutions to motivate EU agreement for a comprehensive financial services deal
- Work in tandem with the US and other countries to motivate the EU's cooperation

### IV. APPRECIATE THE CONSEQUENCES OF FAILING TO ACT BEFORE 31 DECEMBER

**Failure to scrap the WA/NIP by 31 December 2020 would mean the UK giving up sovereignty over:**

- The NI economy
- The State-aid regime in respect of matters the ECJ determines in its discretion to have an impact (even theoretical) on trade across the North-South border
- Finances - by leaving its balance sheet to be tapped for EU liabilities
- EU citizens resident in the UK, in respect of which the UK will remain exposed to constant bickering, with the position ultimately falling to be decided by the EU (through the ECJ)

**Such an outcome could likely permanently affect the legal, political, and basic structure of the country leaving it facing a series of devastating events such as**

#### **Year One (2021)**

- **European Commission states that numerous UK business subsidies are improper under EU State aid law.** The UK challenges the position in the ECJ, which decides for the EC.
- **The EU interferes with UK internal trade,** making food and other exports across the Irish Sea increasingly unviable and forcing many stores in NI to be stocked from within the EU
- **EU creates obstacles for City firms trading in Europe,** constantly threatening court action against financial firms seeking to service customers within the EU; and also threatening to withdraw unilateral equivalence determinations, plunging the financial markets into turmoil
- **Fish wars break out in Channel**

#### **Year Two (2022)**

- **The UK retaliates by (finally) raising the capital and collateral required for UK financial institutions in their dealings with EU financial institutions**
- **ECJ rules that the UK's new employment laws violate the rights of EU citizens** under the WA Treaty and must be repealed

#### **Year Three (2023)**

- **EU citizens living in UK take cases to ECJ,** claiming discrimination/special rights. They win.
- **The EU imposes financial and trading penalties against the UK** for persistent breaches of the WA and NIP

#### **Year Four (2024)**

- **EIB loans turn sour** - UK is on the hook for a bailout
- **The Eurozone starts to appear at greater risk of imploding. The EU tells the UK that it is already liable through the EIB system so it should look to contribute to the tune of its percentage share** (calculated by relative size of its then GDP) to the Eurozone bailout programme in order to preserve its position through the EIB.

**It is difficult to envisage how any rational international observer could regard this as reasonable, let alone for a country of the stature of the UK**

# INTRODUCTION

The Brexit negotiations, having completed the eighth round, are now proceeding on an informal basis following a summer during which no discernible progress has been made toward an acceptable deal. While rumours abound of ‘progress’, essentially the EU is still offering a future trade agreement that represents poor value for the UK and is very advantageous to the EU’s trading interests, covering goods not services, and only then in ways that suit the EU. The EU is also making extraordinary demands that the UK agree to terms not contained in any comparable trade agreements. These include wide-ranging controls over the UK’s future State aid and other so-called ‘level playing field’ issues and de-facto annexation by the EU of the Northern Ireland (NI) economy, as well as of a large share of the UK’s natural fisheries resources.

The UK government is rightly resisting these demands, and is willing if necessary to ‘walk away’, either with no trade deal or with a very limited deal on the future UK/EU relationship. As recent events have shown, this increasingly raises the question of the acceptability of the concluded and ratified Withdrawal Agreement (WA) and the NI Protocol (NIP).<sup>1</sup> We have previously reported in depth on the multiple problems riddled throughout these documents.<sup>2</sup>

The WA and the NIP encroach on UK sovereignty by imposing EU law, European Court of Justice (ECJ) jurisdiction, uncapped liabilities and other EU demands on the UK. The quid pro quo for the UK - the only one - was that this year was meant to be spent agreeing a future relationship arrangement that respected UK sovereignty and replaced the initial unequal obligations with a durable solution. It might be thought that in the event of a ‘no’ or a ‘limited’ deal at the end of this year, those EU-imposed legal constraints would simply fall away when the Transition Period ends. However, this is not so. The UK must take firm and proactive steps for that to happen.

The UK also wishes to reach a win-win future relationship deal, durable enough to be worthwhile. For this, the deal needs to respect the entirety of UK sovereignty and properly address services, including financial services. EU propositions involving ongoing EU control over aspects of UK law and its economy, such as through the EU’s State aid laws and its politicised ECJ, cannot form part of any such arrangement. Nor can the UK be subject to ongoing liabilities to the EU, as determined by the EU.

The errors of Theresa May’s administration, and the political earthquake they caused, are lessons for the future. The flaws and inconsistencies in the EU’s position need to be grasped and addressed, not acquiesced in, whether wittingly or unwittingly. The Government’s controversial UK Internal Market Bill, while addressing some conflicts in the WA, does not achieve this.

This paper addresses how the UK should tackle the remaining period of negotiation to optimise any future trading relationship with the EU and ensure that we achieve a sovereignty-compliant Brexit.

In order to achieve such an outcome, the UK must

- I. **Recognise the reality of its current position and build on its recent legislative initiatives**
- II. **Terminate and replace - or void - the WA/NIP before 31 December 2020, replacing it with a win-win UK-EU FTA**
- III. **Motivate the EU to cooperate by employing negotiating leverage available to the UK, the US, and other countries**
- IV. **Appreciate the legal, political, and national consequences of failing to act before 31 December**

1 Art 182 WA provides that the NIP (as well as the other Protocols on Gibraltar, Cyprus etc) form an “integral part” of the WA.

2 See *Replacing the Withdrawal Agreement*, published by the Centre for Brexit Policy, July 2020.



# I - RECOGNISE THE REALITY OF THE UK'S CURRENT POSITION AND BUILD ON RECENT LEGISLATIVE INITIATIVES

It is not widely understood that unless the WA/NIP is terminated and replaced - or voided - parts of the UK and its economy will be controlled by the EU as of 1 January 2021, regardless of whether a 'limited' trade deal is negotiated or the UK 'walks away'. Consequently, the UK must swiftly suspend and terminate, or void, the WA/NIP. This is because

- **'Walking Away' or agreeing a 'limited' deal cements the WA/NIP in place**
- **Addressing WA/NIP issues after 31 December is not practicable**
- **Suspending and terminating - or voiding - the WA/NIP must be done before 31 December**
- **Recent legislation is a significant and helpful step in the right direction but is not sufficient**

The following sections explain these points in depth, detailing the underlying legal rationale.

## 'WALKING AWAY' OR AGREEING A 'LIMITED' DEAL CEMENTS THE WA/NIP IN PLACE

The UK cannot permit the WA/NIP to remain in effect after 31 December 2020 in any form. Both options of 'Walking Away' and agreeing a 'limited' deal leave the WA/NIP in place with no redress - and a 'limited' deal is likely to give the EU everything it wants in terms of a trading relationship and would perpetuate the UK's long-existing trade imbalance.

### UK Legal Position After 'Walking Away'

Contrary to widespread impression, 'Walking Away' leaves the WA/NIP in place and the UK with no redress in the face of an EU that cannot be expected to have the UK's best interests at heart. After the Transition Period ends on 31 December 2020, even if there is 'no deal' on the future relationship, significant areas of EU law will continue to

- Have direct effect within the UK
- Prevail in UK domestic courts over UK laws (including even over future Acts of Parliament)
- Be bindingly interpreted (and in practice unpredictably expanded) by judgments of the ECJ
- Be enforceable by direct actions by the EU Commission, in the ECJ and in an international arbitral body which will be bound by ECJ rulings.

This will be the legal position, both under international treaty law and under current UK legislation within the UK's domestic legal order. Unless positive action is taken to change this situation, the UK will be subject to the above areas of EU law for the indefinite future, and subject effectively to all the same interpretation and enforcement mechanisms as if it were still a member state -- with the difference that the UK will have no representation, vote or veto in any of the EU institutions. As a matter of political reality, these institutions will have little or no concern to protect the interests of the UK.

The main areas of EU law that will continue to apply to the whole United Kingdom, and will have direct effect, supremacy and be subject to ECJ jurisdiction, are:

- **EU citizens' rights** under Part Two of the WA. These are not just the core rights of continued residency,

but also extensive and complex rights of equal treatment on all matters within the scope of the Treaty on the Functioning of the EU (TFEU).<sup>3</sup> This will provide a rich field for future interpretation by the ECJ.

- **Continuing financial obligations** to pay large sums to the EU budget, the amounts to be decided by the ECJ in the event of disagreement, and **continuing liabilities for the EU assets and interests**
- **State aid control** under Article 10 of the NIP. This is **not** limited to “the UK in respect of NI”, unlike the areas of law in the next paragraph of the NIP. Instead, the limitation is by reference to a possible effect of measures on trade under the NIP, regardless of where in the UK any aid is given. But in any event it would be unacceptable were it only to apply to NI.

Under the NIP, wider areas of EU law will continue to apply to NI, which will be subject to direct effect, supremacy and ECJ jurisdiction. The most important of these are:

- A very long list of EU single market laws relating to goods (Art.5(4) and Annex 2 NIP)
- EU VAT laws concerning goods (Art.8 and Annex 3 NIP)
- EU laws relating to the wholesale electricity market (Art. 9 and Annex 4 NIP)
- EU customs legislation (Art. 5(3) NIP)

The application of the State aid provision in Art.10 across Great Britain (GB) is a matter of particular future concern, in the event of either a “no-future-relationship-deal” or even in the event of a deal from which the UK government successfully excludes EU State aid rules. The State aid Article in the NIP can then be used by the EU Commission to control and restrict the grant of many forms of State aid across GB, including for example tax reliefs in future primary legislation that fall within the ECJ’s wide and ever expanding definition of State aid.

Annex 5 of the NIP lists effectively the full corpus of EU State aid laws, rules and Commission guidance, and Art.10 applies those rules to the United Kingdom<sup>4</sup> *“in respect of measures which affect that trade between NI and the Union which is subject to this Protocol.”* That means not just trade across the Irish land border, but all trade in goods between NI and any part of the EU27.

Thus, a subsidy given to a car plant in Sunderland that allows it to ship cars to the NI market more cheaply, so competing with German cars in NI, would appear to fall within the scope of Article 10 and be notifiable to the EU Commission. This problem is exacerbated by the fact that the ECJ’s jurisprudence on State aid counts a theoretical or indirect effect on trade as sufficient to bring a measure within EU State aid control. Moreover, the application of EU State aid law in NI itself is unacceptable since it annexes economic policymaking to the EU for NI.

As noted above, Art.5(3) NIP applies EU customs legislation to NI. EU customs legislation is defined in Art.5(2) of Reg 952/2013 as the Union Customs Code (UCC), the Common Customs Tariff, EU customs reliefs legislation and EU external agreements. The UCC is an EU Regulation that has direct internal legal effect within member states without the need for national implementing legislation, and, by virtue of the NIP, it will continue to apply directly within NI and will, for example, directly bind HMRC in the same way as an Act of Parliament would (or arguably even more effectively since its provisions will prevail over all UK legislation).

This means, for example, that Ministers cannot lawfully direct HMRC to narrow the field of checks on goods passing between GB and NI if that runs counter to HMRC’s own legal interpretation of the NIP and the UCC. This is likely to undercut severely the UK’s negotiating position regarding what goods are to be treated as ‘at risk’ of passing from NI into the EU27 and subject to duty on being imported from GB into NI. The Government’s announced intention to legislate in the Finance Bill to give itself powers to override the direct effect of this aspect of the NIP is therefore very welcome.

<sup>3</sup> Art 23 WA applies Art 24 of Directive 2004/38/EC to EU citizens, which requires equal treatment with nationals “within the scope of the Treaty”, subject to limited exceptions for some social security rights. The “scope of the Treaty” for this purpose has been widely interpreted in the past by the ECJ, but the boundaries could be pushed even wider.

<sup>4</sup> Not just to Northern Ireland in contrast to the other provisions of the NIP.

However, if the present situation is left unaddressed and the WA and NIP are left in force, it is likely that the Commission will take legal steps to enforce them and to secure judicial sanction for their widened interpretation. The Commission (and the whole EU) will have a particular incentive to do so in the event of a 'no-future-relationship-deal' scenario. Areas of particular focus are likely to be

- The wide ranging application of Art.10 NIP to **control State aid across the whole of the UK**
- **Extensive and onerous customs and other checks on trade from GB to NI** in order to prevent actual, perceived or imaginary<sup>5</sup> threats to the integrity of the EU internal market
- **The application of EU standards for goods and agriproducts (as interpreted by the ECJ)** in NI
- **Expansion of the rights of EU citizens**, a matter on which the Commission has recently issued a formal opinion against the UK as a precursor to a direct action in the ECJ

In summary, 'Walking Away' is not an antidote to the WA/NIP.

## UK Legal Position After Agreeing a 'Limited' Trade Deal

Agreeing a 'limited' trade deal not only cements the WA/NIP in place but furthermore gives the EU everything it wants in terms of a trading relationship.

Agreeing a future relationship agreement, even a poor or limited one, would undermine and make more difficult an argument by the UK that it has a right to terminate the WA under international law. Could the UK plausibly argue that the EU has failed to negotiate a future relationship agreement in good faith under Art.184 of the WA, if it signs up to such an agreement?

There are further economic issues if the UK agrees a poor or limited future relationship agreement with the EU. An agreement giving zero tariff access between the UK and EU markets, but without free trade in services, is overwhelmingly in favour of EU interests since it perpetuates tariff free entry to the UK market for the EU's vast surplus in goods trade. The EU's exports to the UK are disproportionately concentrated in high tariff sectors compared with the UK's exports in the opposite direction. Therefore, the UK's tariff concessions would be well over double the tariff concessions given by the EU; whilst the services sector (in which the UK has a modest trade surplus) would be excluded from the benefits of the free trade agreement. In addition, EU State aid law would ensure the UK could not protect itself from unfair EU trading practices, since that law is geared around the EU's own interests and not those of the UK.

If the UK enters into such a deal coming into force at the end of the transition period, it is hard to see what negotiating leverage the UK would then retain to evolve the deal in future into a services as well as goods agreement. This would be particularly damaging if the arrangements are all linked together under a 'single institutional framework', which is a governance system designed by the EU to impose control on states by making it almost impossible to negotiate improvements to parts of the deal without bringing the whole edifice crashing down. Switzerland has discovered, to its cost, the problems resulting from agreeing such a format.<sup>6</sup>

By contrast, if a deal is not done it potentially would remain open to the UK to mount a credible challenge to the WA and NIP or to void them, if, as may well come to pass, the EU seeks to exploit them to impose unfair and unacceptable constraints on the UK. However, as we shall now explain, waiting until after 31 December 2020 to address such issues makes it more difficult legally and politically.

<sup>5</sup> The EU has a strong protectionist interest in making imports of goods from GB to NI as cumbersome as possible, in order to give a clear advantage to exporters in the Republic and elsewhere in the EU in selling goods into the NI market (which will not be subject to customs controls).

<sup>6</sup> The Swiss found, even before the single institutional framework which the EU is currently seeking to impose on them, that the cross linkages between their different bilateral agreement with the EU meant that they could not curtail free movement of persons as mandated by their referendum, without bringing their agreement with the EU on free trade in goods crashing down.

## ADDRESSING WA ISSUES AFTER 31 DECEMBER IS NOT PRACTICABLE

Addressing the problem of the WA and NIP only after exiting the Transition Period would be highly undesirable. The post-transition aspects of the WA, most notably the NIP, would then come into operation from 1 January 2021.

It is true that key parts of the NIP are terminable under the so-called consent mechanism in Art.18. This requires a simple majority vote in the NI Assembly for those parts of the NIP to continue.<sup>7</sup> However, this leaves the WA and NIP operating in the background and merely requires the renegotiation of aspects of the NIP against the backdrop of the current, hugely flawed, documentation.

Moreover, the first vote under this process will not be until late 2024 and, even if there is a negative vote, those parts of the NIP (including the crucial Art.10 on State aid) will continue in force for another two years<sup>8</sup> in order to allow other arrangements to be put in their place. By that time, NI may well have evolved in meaningful ways to becoming a de-facto satellite of the EU. Thus, relying on this mechanism would not be satisfactory.

A UK Act of Parliament cannot restrict the EU's treaty rights on the international plane. In particular, such an Act could not prevent the Commission from initiating a direct action at the ECJ. If the ECJ were to rule against the UK on such a direct action (a very likely scenario), the next step - short of a humiliating climb-down by the UK - would be for the UK to defy the judgment. This would likely lead to a political conflict and could lead to the EU taking further action at the international level. Such actions could include asking the ECJ to issue further judgments imposing financial penalties, or asking the bilateral arbitral panel set up under the WA to make similar rulings.

If the UK defies an ECJ judgment or arbitral ruling against it, it would be open to the EU to take retaliatory measures suspending the UK's rights under the WA and the NIP, under Art.178(2) WA. Such suspension can apply to any provision, other than the rights of EU citizens in the UK or UK citizens in the EU, which are protected. For example, if the UK were held by the ECJ to be in breach of Art.10 NIP on State aid, the EU might suspend or restrict tariff-free access into the EU market for goods made in NI, arguing that would be a proportionate response to the UK's breach.

Under such an outcome, the political pressures on the Government would be immense and a humiliating climb-down not difficult to imagine. Furthermore, if the Government had not been able to summon the political will to challenge the WA/NIP prior to this coming December, it could find it harder to do so after 31 December, when the stakes would be even higher and the required courage greater.

## SUSPENDING AND TERMINATING - OR VOIDING - THE WA/NIP SHOULD BE DONE BEFORE 31 DECEMBER

The arguments above explain why positive action should be taken before 31 December 2020 in order to end or mitigate the continued long term subordination of the UK to a foreign power with adverse interests to our own. The required positive action can be only one or a combination of the following options:

1. Negotiating a replacement for the WA and the NIP
2. Changing UK legislation to curtail the direct effects of the WA and/or NIP
3. Suspending and terminating - or declaring void - the WA and NIP as a matter of international law

<sup>7</sup> Paragraph 3(b) of the UK's Unilateral Declaration referred to in Art.18(2) NIP.

<sup>8</sup> That is, until the end of 2026.

**Option 1: Negotiating a replacement for the WA and the NIP is problematical, as things currently stand.** Legally, the simplest and most straightforward way to end or at least curtail these areas of jurisdiction would be by agreement with the EU to modify or replace the WA or NIP. The modifications required would be so significant that in essence it would mean a complete replacement, since (due to the surviving aspects from the May Government's negotiation) there is hardly anything of benefit to the UK in either document.

However, the obvious question is what negotiating leverage does the UK have to achieve this, particularly in the event of a 'no deal' or 'near no deal' scenario. Even if such leverage were somehow obtained, given the current corpus of the WA, it is difficult to envisage how the sweeping changes required could be negotiated so as to achieve an acceptable replacement in the short time remaining before 31 December. The starting point is so complex and adverse that it amounts to a Gordian knot that must be cut in order for the UK to be released.

**Option 2: Changing UK legislation to curtail the direct effects of the WA and/or NIP - while useful domestically - does not impede challenges under international law.** The direct effect and supremacy of these areas of EU law within the UK arise from the combination of treaty provisions (notably Art.4 of the WA) that provide for direct effect and supremacy, and of the UK's own internal law that gives effect to those treaty provisions. This is the same mechanism as for EU law when the UK was a member of the EU, where legal effect of EU law within the UK's internal legal system was given to the Treaty doctrines of direct effect and supremacy by virtue of section 2 of the European Communities Act 1972. The WA and NIP are similarly given internal legal effect within the UK by provisions in the European Union (WA) Act 2020, which are effectively identical in wording and substance to these parts of the ECA 1972.<sup>9</sup>

It is a consequence of these provisions that a later Act of Parliament that contradicts the WA or NIP would - as things currently stand - be over-ridden by the UK courts.

However, it is possible by employing an Act of Parliament using clear and explicit words<sup>10</sup> to restrict or oust their application as a matter of UK internal law. Parliament always retained this ultimate power during our EU membership, and section 38 of the 2020 Act (on Parliamentary sovereignty) makes this ultimate power explicit.

Therefore, it is possible, for example, in a UK Internal Market Act that provides for the UK's own State aid regime to apply across GB, to legislate that this internal regime applies to any aid given to entities in GB to the exclusion of the regime under Art.10 NIP and notwithstanding section 7A or any other provision of the 2018 or 2020 Acts. This is the basis of clause 43 of the Government's UK Internal Market Bill. Such a provision could not be challenged in UK courts, and UK courts would be bound to give effect to it, even if (as seems possible) some of the judiciary might not like it. That, at least, would prevent injunctions being issued in UK courts suspending tax reliefs or other State aid measures in GB for alleged breach of Art.10 of the NIP.

The two override clauses (42 and 43) in the Government's UK Internal Market Bill, together with its announced intention to include a similar clause in the Finance Bill to deal with threatened tariffs on goods imported from GB into NI, represent limited steps in this direction. However, a major problem with this approach is that such measures do not have any effect in international law, thereby leaving the UK open to adverse ECJ or arbitral body judgments or to EU retaliatory actions as described above. Thus, this legislation can be considered as necessary but not sufficient action.

<sup>9</sup> See section 7A of the EU (Withdrawal) Act 2018 providing for "general implementation" of the WA (including the NIP). Section 7A was inserted by the EU (Withdrawal Agreement) Act 2020.

<sup>10</sup> Which would have to be sufficiently clear and unambiguous not to be mangled and disregarded by potentially hostile courts.



**Option 3: Suspending and terminating - or voiding - the WA and NIP as a matter of international law has promise but must be credibly justified.** Employing this option requires that the UK should have a credible position justifying the action. Simply saying that the UK does not agree with or like a wide interpretation of Art.10 NIP if, as is very likely, the ECJ gives it a wide interpretation,<sup>11</sup> is difficult to justify as a free-standing measure since the UK has agreed and ratified the substantive terms of both the WA and the NIP. Unfortunately, the unprecedentedly one-sided jurisdictional arrangements they contain for their interpretation have also been agreed and ratified. This suggests that a path of accepting the WA and NIP in principle, while seeking to wriggle out of a full implementation of their terms, is fraught with difficulty.

Therefore, a credible defence against the EU's likely exploitation of the Carthaginian terms<sup>12</sup> of the WA and NIP must involve challenging not only their interpretation, but also their validity and binding effects in international law, including the validity and binding effects of their jurisdictional clauses.

There are, however, various potential grounds for taking such a step that are discussed in the first section of the next Chapter. The key point to note is that there is no international court or tribunal with jurisdiction to rule on this issue, other than those under the WA itself (the ECJ and the bilateral arbitral tribunal).<sup>13</sup> Thus, the key question in such a scenario would be whether the UK would be seen to have a credible case in the court of international opinion for its actions. It is obviously a serious step to tear up a treaty, and an argument against doing so might be that it could undermine the credibility of the UK in entering into future treaties (eg, trade agreements with non-EU countries).

However, the UK-EU WA is wholly exceptional, both in its extraordinary and one-sided terms and in the circumstances in which the UK was pressured into acceding to it. The intention was that it should act as a bridge to a satisfactory future relationship that respects UK sovereignty (Art.4 of the Political Declaration, which Art.184 of the WA requires the EU to seek to achieve, using good faith and best endeavours). Now that the EU has not negotiated properly for such an outcome, it is necessary to terminate - or declare void - the WA and NIP so that the EU does not cherry pick from those aspects of the (intended to be temporary) arrangements that it prefers.

Other global partners are likely to regard the UK's actions in defying the terms of the WA and NIP as a one-off event and will not consider them as a guide to the UK's future actions with treaties generally. But it is vital that such actions by the UK be accompanied by a carefully planned and well backed-up international public information campaign to explain and justify the UK's legal position.

## RECENT LEGISLATION: USEFUL BUT NOT SUFFICIENT

The Internal Market Bill goes some way to preserving UK sovereignty in the face of the most detrimental aspects of the WA and NIP. Most notably it takes the position that EU State aid law should not generally apply to GB. However, this is only a first step in reclaiming full UK sovereignty and is by no means the ultimate destination. It leaves EU law applicable to goods and agriproducts in NI. It leaves the ECJ's role in place, for instance in relation to citizens' rights. It fails to address the UK's liabilities for EU projects. And it fails to address matters of international law.

In fact, the only way to address all of these and the many other shortcomings of the WA and NIP easily and cleanly is to replace them in their entirety by sovereignty compliant arrangements - or to terminate or declare them void. We have explained this in detail in our recent paper, *Replacing the Withdrawal*

11 This decision would almost certainly be taken by the ECJ rather than by the bilateral arbitration panel under the WA. This is because Art.12(4) of the NIP gives power to the Commission to enforce, and the ECJ to adjudicate on, all the key parts of the Protocol (including Art.10) against the UK as if it were a Member State. Even if the matter were somehow brought before the bilateral arbitration panel, it would be bound to defer on any issue of interpretation of EU law or concepts of EU law to the ECJ under Art.174 of the WA (the "Ukraine" clause).

12 The effective annexation of Northern Ireland by the EU for the purposes of the above areas of EU law having its parallel in the annexation by Rome from Carthage of the province of Sicily.

13 Art.168 WA specifically excludes the parties from having recourse to disputes procedures other than those provided for in the WA.



*Agreement.* Arrangements for the North-South border in Ireland should be by Alternative Arrangements or Mutual Enforcement, which we explained in that paper. Both are achievable and neither would encroach on UK - or EU - sovereignty.

The fact is that the WA and NIP were entered into on the assumption embodied in Article 184 of the WA that the UK would, by the end of this year, have a new all-encompassing relationship with the EU that respects the UK's sovereignty and internal market. None of the WA's or NIP's transitional arrangements do so.

The UK negotiators made clear at the outset that Michel Barnier's plan to split off these issues from the ultimate trading arrangement was impossible. They were right then and remain so now.

It is only when the future trading relationship is delivered on the terms set out in the framework contained in the Political Declaration (PD) (as envisaged by the Article 50 withdrawal process itself) that it will be possible properly to address such matters. Conversely, if such a relationship is not forthcoming, the EU cannot cherry pick and expect to be able to walk away from the table with the lopsided transitional arrangements of the WA and NIP being stretched into the indefinite future.

This is not the outcome that formed the basis for the UK agreeing to such an arrangement. Nor could the UK Parliament agree to that as a matter of its sovereignty.

## II - TERMINATE AND REPLACE - OR VOID - THE WA/NIP BEFORE 31 DECEMBER WITH A WIN-WIN FTA

Taking the considerations in Chapter I into account, there is a way forward that preserves UK sovereignty, protects the UK economy, safeguards the UK and global financial services industry, and achieves a win-win UK-EU FTA by year end. This approach involves exerting leverage by addressing head-on the EU's flawed position and thinking, as well as recognising that

- The EU is in breach of the commitments it made with regard to the Brexit negotiations and that it cannot cherry-pick from the agreement, retaining the bits that suit it while failing to honour key parts for the UK
- Unfair EU trading and non-compliant financial practices in the incomplete Eurozone structure invite the possibility of non-EU countries taking action against the EU and its member states in the form of punitive tariffs and duties on goods, as well as punitive regulations on EU financial institutions <sup>14</sup>

This approach comprises three elements:

1. **Terminate the WA and NIP - or declare them void - because the EU is in breach of its commitments.** These documents cannot remain in force after 31 December 2020 because the EU has failed to negotiate in good faith using best endeavours to maintain UK sovereignty and to recognise the UK's internal market
2. **Offer the EU a comprehensive FTA for goods and agriproducts** explaining why such an FTA built around the NI North-South border is the only viable solution for the EU
3. **Proffer an appropriate enhanced future UK-EU financial services arrangement** (eg, Enhanced Equivalence, with ancillary services pulled along with it) in lieu of the UK imposing punitive capital, collateral, and liquidity requirements on all global exposures to EU financial institutions in order to mitigate the damage caused to the UK and the rest of the world by the incomplete Eurozone structure

**If executed with careful planning, strong discipline, and iron political will**, this approach is the only legitimate option for the UK to leave the Transition Period at the end of the year with full sovereignty and a highly attractive (win-win) trade deal.

### 1 - TERMINATE - OR VOID - THE WA AND NIP FOR BREACH OF EU COMMITMENTS

The NIP as part of the WA was meant to be only a temporary bridge toward agreeing a full trading agreement between the EU and the UK. The underlying political understanding was that the NIP was due to come into effect only if both parties had (1) used good faith and best endeavours to achieve a sovereignty-compliant deal by year end but (2) had nevertheless failed in this objective and a small further period was needed in order to finalise the deal and replace the NIP.

However, the EU is in breach of its commitments. Therefore, if the EU fails to agree a future relationship that properly respects UK sovereignty, the UK can and should tear up the WA, including the NIP, on the basis that the EU is in breach. To prepare for this action, the Government should

- **Assemble the strong evidence for the EU being in breach of its commitments under the WA**

<sup>14</sup> See *Managing Euro Risk: Saving Investors from Systemic Risk*, Barnabas Reynolds, David Blake, Robert Lyddon, Politeia, February 2020; *How to Level the EU's Playing Field: Trade Remedies for a Trade Deal*, Politeia, April 2020.

- **Explain why the WA/NIP - not the Internal Market Bill - is the real threat to the Belfast Agreement** (otherwise known as the 'Good Friday Agreement')
- **Frame the arguments properly and communicate them to the 'court of world opinion'**

It is notable that Lord Trimble, who received the Nobel Peace Prize for his work leading to the Belfast Agreement, has stated, "The Withdrawal Agreement clearly rips the Good Friday Agreement apart".<sup>15</sup>

## Assemble the Strong Evidence for the EU Being In Breach of Its Commitments

There seems to be a general assumption by the commentariat that any refusal or failure by the UK to implement the WA and its attached Protocols to the letter would automatically equate to a breach of international law. This is not so. There are serious and credible legal arguments that the UK is not bound in international law.

These arguments fall into two categories:

- **The circumstances in which the WA/NIP was negotiated and concluded**, taken together with the unusual terms which they contain and the underlying rights of the people of NI to self-determination and to elect their legislature
- **The behaviour of the EU since the conclusion of the WA**, most notably its behaviour in the negotiations on the future relationship agreement

**The Circumstances In Which the WA/NIP Was Concluded.** The circumstances in which the WA/NIP was negotiated and concluded were most unusual. The UK was not at that time a sovereign state negotiating externally, but was in many ways a captive of the EU.

The EU abused its own laws in order to pressure the UK into an agreement that would turn it into an EU colony.

- First, it breached Article 50 of the Treaty on European Union by failing to discuss the "framework" of the future relationship at the same time as negotiating the WA. Instead, the EU insisted on "sequencing" the negotiations, focusing principally on what it wanted in the WA, a course contrary to the words of Article 50.
- Secondly, the EU sought to hold the UK captive insisting, without any justification, that the UK would be in breach of its treaty obligations were it to negotiate trade agreements with other countries (to come into force after exit) while still in the notice period.

Furthermore, there are specific and powerful arguments as to why the NIP is not binding in international law.

- A core provision of the Belfast (Good Friday) Agreement is that the constitutional status of NI within the United Kingdom cannot be altered without the consent of a majority of the people. The free flow of goods (in both directions) between GB and NI is a constitutional principle that has existed since the Acts of Union between GB and NI in 1800, in which Article VI said:

*"The subjects of Great Britain and Ireland shall be on the same footing in respect of trade and navigation, and in all treaties with foreign powers the subjects of Ireland shall have the same privileges as British subjects. From January 1, 1801, all prohibitions and bounties on the export of articles the produce or manufacture of either country to the other shall cease."*

<sup>15</sup> See page 14 of *Replacing the Withdrawal Agreement* published by the Centre for Brexit Policy, July 2020

The NIP abrogates these rights, thereby altering the constitutional status of NI within the UK in breach of the Belfast Agreement. That was not only an agreement between governments, but also with representatives of the communities in NI. International law does not justify a later treaty to which these community representatives are not parties being used to override the rights they enjoy under the earlier treaty, especially where it involves overriding such a fundamental right as the right to selfdetermination of the people of NI.

- In addition, the NIP imposes a large sector of EU laws (all those laws relating to the production and marketing of goods) on NI and requires those laws to be interpreted by a foreign court and amended from time to time in line with changes to EU law. But the people of NI have no vote in any legislature that is capable of amending these EU laws. This would appear to breach the right of the people of NI to vote in elections to the legislature, contrary to Article 3 of the First Protocol to the ECHR. (The Strasbourg Court held that the people of Gibraltar had been similarly deprived of their rights because laws made by the European Parliament applied to them - a situation that was subsequently rectified by giving Gibraltarians the right to vote in European Parliament elections.)
- Article 4 of the WA purports to require the UK to give direct effect and supremacy to the WA and its Protocols, including the NIP, within the UK's internal legal system, and furthermore subjects that legal system to the binding rulings of a foreign court. This direct effect and supremacy is at odds with the most fundamental doctrine of the UK's constitution, that Parliament is sovereign and can make and unmake any law within the UK.

Under Article 46 of the Vienna Convention on the Law of Treaties, a Treaty in manifest violation of a state's internal law can vitiate a state's consent in entering into the Treaty. This needs to be a violation of a matter objectively evident to any State conducting itself in accordance with normal practice and good faith. Now, in this instance, the UK has formed part of the EU's legal order and the EU is in a unique position to appreciate the fundamental doctrines of UK sovereignty, including the sovereignty of Parliament and the fact that no Parliament can bind itself or its successors not to legislate. In fact, this is probably the most famous doctrine of constitutional law in the world, and in the specific case of the WA was reinforced by the widely publicised sovereignty clause in the Bill (now section 38 in the Act), which authorised UK ratification of the WA. It follows that, if (as the EU appears to contend) the WA purports to prohibit Parliament from exercising its legislative sovereignty, then Parliament manifestly lacked the power to authorise such a restriction on itself.

**Post-Agreement Behaviour by the EU.** One of the most important promises made by the EU in the WA (indeed, virtually the only promise of any significant positive value to the UK) was the mutual obligation in Article 184 to "*use best endeavours in good faith*" to reach an agreement with the UK on the future relationship in line with the PD. Indeed, it can be said that if a future relationship agreement is not reached, then the whole point of the transition period is destroyed.

The PD was significantly revised in Boris Johnson's negotiations with the EU away from the Theresa May version to emphasise the UK's sovereignty and to call for a FTA that respects the autonomy and sovereignty of both parties.

However, the offer made by the EU is for an FTA that is not comparable in its terms with sovereign FTAs concluded by the EU with other parties, in that the EU insists on onerous terms that differ very adversely from those in comparable FTAs. This was a point forcefully made in David Frost's letter to Michel Barnier of 19 May 2020.

But it does not stop there. The EU undertook the joint obligation with the UK to conclude a future relationship agreement in time to come into force by 1 January 2021. Instead of seeking to achieve an agreement by that time, it first attempted to pressure the UK into agreeing to an extension of the transition period by threatening to foot-drag on the negotiation process. The UK was under no obligation under the WA to seek an extension to the transition period, which would have been very costly in direct revenue terms but even more costly to the UK economically by preventing it from implementing third party trade agreements and requiring it to stay inside the EU's external tariff wall to the detriment of UK consumers and the benefit of EU exporters.

Then, despite having assumed the obligation to progress the negotiations in good faith to a conclusion in good time before the end of 2020, the EU did the opposite. It deliberately slowed the negotiating process by insisting that points that it wished to see agreed (so-called level playing field clauses, State aid control over the UK, and appropriation of the UK's fisheries resources) be dealt with first before other aspects of the agreement of interest to the UK could be progressed. And it sought to insist on terms for those matters that trampled on UK sovereign interests and applied EU law, as interpreted by the ECJ, in the UK.

This 'sequencing' approach - ie, deliberate sabotage of progress on the talks on issues of benefit to the UK and the attempt to hold the UK to ransom by "timing out" the negotiations - was itself an act of bad faith and failure to use best endeavours.

The EU's 'sequencing' approach to the negotiations for its partisan advantage has been accompanied by a number of specific refusals to countenance reasonable terms that are in other EU FTAs.

Examples are:

- **EU Refusal to allow UK "home country certification"**. One important aspect of normal trade agreements is to facilitate so-called "home country certification" for exports. Where an importing country's laws require goods or services to be certified as compliant with official standards in that country, home country certification allows certification or testing bodies in the country of export to issue appropriate certificates and conduct any necessary inspection or testing, and for those home country certificates to be recognised as valid in the country of importation.

There could not be an FTA more ripe or appropriate for home country certification than the future EU-UK FTA. There is an existing vast range of certification required under EU single market law that UK based certification bodies are used to carrying out within the EU system itself (and for which the EU has already deemed them appropriate bodies, meeting all EU standards), and there is no objective reason why they should suddenly lose their capacity to perform these tests and certifications from 1 January 2021.

However, absurdly, the EU has refused to countenance continued testing and certification by UK based bodies for avowedly protectionist reasons: see *"European Commission rejects call for UK testing labs to certify products for export to EU market"* Daily Telegraph, 14 May 2020.<sup>16</sup>

*"European Commission trade negotiators have rejected British demands to allow UK-based testing laboratories to certify cars, chemicals and pharmaceutical products for export into the EU market."*

This could mean British manufacturers would be forced to have products certified by EU-based authorities before they can be exported - something that would be prohibitively expensive for many businesses and would create bureaucratic impediments.

The EU has agreed to similar 'home country certification' provisions in recent free trade agreements with developed countries, including deals with Japan and Canada, in order to reduce the burden on businesses and remove non-tariff barriers to trade.

- **EU Refusal Of 'Diagonal' Cumulation Of Origin.** As acknowledged by the European Parliament Think Tank: *"Importantly, the EU's Rules of Origin admit the 'cumulation' of preferential origin across other existing FTAs signed by both parties."*<sup>17</sup> This cumulation of origin facilitates trade under FTAs. It means, if a car were exported from the UK to the EU, then parts sourced from other EU FTA partners (such as Japan or Switzerland) would count on top of the UK and EU content towards the required level of content to qualify the car for tariff free import under an EU/UK FTA.

<sup>16</sup> <https://www.telegraph.co.uk/news/2020/05/14/europeancommissionrejectscalluktestinglabscertifyproducts/>

<sup>17</sup> [https://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS\\_BRI\(2020\)649364](https://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_BRI(2020)649364)

Such cumulation is routinely agreed by the EU and is embodied in the “Regional Convention on pan-Euro-Mediterranean preferential rules of origin” (PEM Convention), which contains all the European and near-European (North African) countries with which the EU has FTAs. The PEM Convention also allows for cumulation between all signatories to the agreement (known as diagonal cumulation in trade terms).

*Despite this, and without objective justification, and despite offering cumulation deals to, for example, Japan and Singapore, the EU has refused to offer the same deal to the UK.*

A senior EU official said: “This is an area where we do not in any way see any margin of compromise. We do not believe that it is in the EU interest.”<sup>18</sup>

- **Recognition of professional qualifications.** The Financial Times reported that

*“In recent weeks the UK has pared back its demands for extra “goodies” as part of the basic Free Trade Agreement, largely giving up on more ambitious plans for “diagonal cumulation” of rules of origin or sweeping mutual recognition agreements on professional qualifications.”*

The EU’s obduracy on mutual recognition of professional services qualifications and ancillary features flies in the face of the commitment in paragraphs 27 and 28 of the PD:

*“27. ... The Parties should aim to deliver a level of liberalisation in trade in services well beyond the Parties’ World Trade Organization (WTO) commitments and building on recent Union Free Trade Agreements (FTAs).*

*28. In line with Article V of the General Agreement on Trade in Services, the Parties should aim at substantial sectoral coverage, covering all modes of supply and providing for the absence of substantially all discrimination in the covered sectors, with exceptions and limitations as appropriate. The arrangements should therefore cover sectors including professional and business services, telecommunications services, courier and postal services, distribution services, environmental services, financial services, transport services and other services of mutual interest.”*

- **Withholding of Third Country Recognition.** The EU has also acted in bad faith, outside the scope of Article 184. According to UK negotiator David Frost, the EU’s negotiator threatened that the EU would withhold third country recognition from UK produced food, which would have the effect of prohibiting the importation of UK produced food into the EU27 but also, thanks to the terms of the NIP, the export of food from GB into NI. This is in flagrant defiance of UK sovereignty and its internal market - both of which the EU agreed to respect.

Furthermore, the point is demonstrably cynical and without merit. There is no objective justification for refusing the importation of food produced in the UK given that the standards are the same as in the EU and will remain so for the time being, and the EU does not ban food altogether from many countries that have quite different rules and standards. It amounts to a threat to breach WTO law in the most blatant way, but even more importantly to abuse the EU’s treaty rights under the NIP in order to impose what would amount to a food blockade on the people of NI.

## Explain Why the WA/NIP Is the Real Threat to the Belfast Agreement

The WA and in particular the NIP section of the WA is in contravention of - and a threat to - the Belfast Agreement. The NI Protocol runs contrary to the central premise of the Belfast Agreement, which makes clear that any change in the status of NI requires the consent of the people of NI. The principle of consent is clearly stated at the very start of the agreement. It declares that, “the present wish of a majority of people in NI, freely exercised and legitimate, is to maintain the union and accordingly NI status as part of the United Kingdom”, and relies upon that wish. It would be wrong to make any change in the status of NI save with the consent of the majority of its people.

<sup>18</sup> <https://www.express.co.uk/news/uk/1293237/BrexitnewsUKEUMichelBarniertradetalkslatestBrexitdealupdate> (The Express, 9 June 2020)



Being part of the United Kingdom means that NI laws should be made by the Government of the United Kingdom unless the powers to do so have been devolved to the NI Assembly. Yet the NIP requires that, after the UK leaves the EU, NI will remain part of the EU single market, subject to laws passed by the EU in the past, and any new laws made by the EU in the future. The list of those laws runs to nearly 100 pages - and the substance of the laws runs to many multiples of that length. This represents a radical change in the constitutional position of NI and its relationship with the UK and is in clear breach of the Belfast Agreement, since it was never consented to by the people in NI.

Secondly and just as importantly, being part of the United Kingdom has an economic aspect as stated in the Act of Union. Article six of the Act of Union of 1800 guarantees that subjects in every part of the UK are to be on the same footing with respect to trade and treaties with foreign powers, and no prohibitions on the export of articles or manufacture between England and Ireland will be permitted, and trade between the countries of the UK is to be duty free.

The NIP removes the economic guarantees in the Act of Union. It requires that NI is contained within the EU single market and subject to the EU customs regime. In practical terms this means the EU can insist that goods being imported into NI from GB will be subject to EU duties that will be only rebated if it is proven that the goods did not enter the Irish Republic or elsewhere in the EU. The NIP also requires goods that are deemed to be at risk by the EU to be inspected as they enter NI even though those goods may comply with UK regulations. If they are not in compliance with EU regulations they will not be allowed into NI. Furthermore, goods being sold from NI into the GB market will be subject to export declarations, which can be both costly and administratively complex. All of these requirements mean that the economic benefits of being part of the UK and its internal market are seriously diminished for NI. In addition, since NI will be subject to EU State aid rules it will be up to the EU Commission and the ECJ to decide what support if any the UK government can give to NI business.

So whether we look at the political implications of the WA or the economic impacts, it is clear that NI's position within the United Kingdom has been dramatically changed by the terms of the NIP. The consent of the people of NI to such a change has not been sought or given, breaking the central premise of the Belfast Agreement. A border has been placed between NI and the rest of the country to which it belongs. This is the real offence caused by the WA. It undermines the very foundations of the Belfast Agreement, yet those who proclaim to be its defenders have totally disregarded the fundamental conflict between the demands of the WA and the central principle of the Belfast Agreement.

The Belfast Agreement can be honoured only by replacing the WA and its NI Protocol. Those who demand that the Government must adhere to and implement the WA are actually insisting that the Government disregard the letter of the Belfast Agreement. If the Government accedes, then it is breaking up the UK, betraying the unionist majority in NI and allowing the EU to use NI as a means of exercising its will across the whole of the UK through splitting the UK's single market and undermining the sovereignty of the UK Parliament in its own country.

## Frame Arguments Properly and Communicate to the 'Court Of World Opinion'

The EU and the UK are now engaged in an intellectual battle in the court of public opinion. The EU has framed its position in a way that might seem, at first sight, to be eminently reasonable, but on closer inspection is entirely false. For example, the EU claims that

- Because the UK is leaving the EU, the UK must pay the consequences and sort out all of the problems that the EU identifies as arising for solution. This is flawed since the EU is merely a complex international treaty arrangement that is possible to leave - as Greenland previously did. Indeed, the EU Treaty (TEU) now provides in Article 50 for a two year notice period for leaving. This is not some bad act that needs to be penalised, but is merely the exercise of a right to leave. The UK has done so because it no longer sees adequate benefit from remaining under the EU's Treaty framework.

- The UK cannot cherry pick benefits from the EU Treaty system. The UK does not wish to do so. It merely seeks a fair, win-win future trading relationship, in conformity with state practice and indeed the EU's own practice with other non-EU states. Those in the ongoing EU surely see a benefit beyond trade in being within the EU. It would be a lamentable state of affairs if in fact the federal aspects were of no benefit at all and the cherry on the EU's internal cake would be only trade. The EU should have the self-confidence to believe in its own federal merits - not least since it is those that it is seeking to sell to its internal population.
- Only if the EU's own law applies, as adjudicated upon by its own court, will the UK be able to compete on a level playing field with the EU. However, as will be shown in this paper, it is the EU's own arrangement that tilts the playing field, not the UK's. International WTO law disciplines are perfectly capable of dealing with unlevel playing field issues and ensuring fair competition, as they in fact do for all international trade between states and with the EU itself.
- The UK cannot be trusted not to lower standards for its citizens on human rights, the environment and employment, without the benefit of EU law and ECJ oversight. Yet this is palpably absurd. The UK has been a beacon for such standards and in fact developed most of them for the benefit of the EU itself. It typically applies higher standards than the EU. But agreeing contractually with the EU as to how the UK exercises its sovereign right to craft and apply any such standards after leaving the EU is an absurdity. The EU presumably would not agree to the same in reverse, in respect of not regressing on its typically lower standards or indeed not changing them without the UK's consent and the adjudication of the UK's Supreme Court. After all, the EU's ability to apply these standards in some of the countries in its East would indicate the UK would be justified in seeking such a control when the reverse is not true at all.

Therefore, the UK now needs urgently to craft its own messaging in an all-encompassing way in order to prick the phoney thought balloon created by EU interlocutors and to ensure future discussions are properly framed.

What is happening through Brexit is quite clear. The UK is merely leaving the EU's constitutional framework and is seeking a win-win future (predominantly) trading relationship. Arguably this is all the UK ever wanted whilst within the EU, but there were others who were hell-bent on forging a federal state, regardless of the initial basis for the relationship. The UK has sadly had to depart the partnership on the basis of this fundamental difference of vision as to a desirable end state.

However, that does not mean anyone needs to be harmed economically. Those seeking the benefits of a federal EU can continue within it. The UK now wishes to have a simplified, trade-based relationship with the EU instead of the more controlling relationship that others have sought.

When other countries have left a larger unit, existing trade relations has traditionally been preserved, sometimes for many years, until new arrangements are put in place. It is highly cynical of the EU to seek to use the WTO's MFN rules and the spectre of a hard Brexit to attempt to force the UK to agree to EU terms. This is at the very least at odds with international state practice and is an unfriendly act. The WTO rules were introduced in order to lower barriers to trade between states, not to raise them. They are being wrongly invoked by the EU in this context.

The UK might be interested in a future security and defence cooperation, under the umbrella of NATO. But this is on the basis of a sovereign position that does not involve branding UK soldiers with EU badges or pre-committing to particular courses of action. Nor, if the UK gives aid monies to foreign countries, including those within the EU itself, will those be permitted to be branded as EU monies or somehow directed by the EU. Brexit means sovereignty, and sovereignty means just what it says, no more, no less.

## 2 - OFFER A GOODS/AGRIPRODUCTS FTA BUILT AROUND THE NI NORTH-SOUTH BORDER

Once the UK insists on its sovereignty and makes clear that the NIP falls away, the invisible North-South border is properly up for renegotiation (the east-west border specified by the NIP becomes irrelevant) and the dynamics change instantly. The only viable solution is an FTA built around the NI North-South land border. This is because

- **The east-west sea border currently incorporated in the NIP is problematic and not a viable solution for the EU**
- **An 'invisible' North-South land border can be achieved only through an FTA and can be realised using existing EU customs legislation and procedures**

### East-West Sea Border Problematic and Not a Good Solution for the EU

Whatever form an east-west border in the Irish Sea might take, it will infringe EU sovereignty, in addition to doing the same for the UK and NI. This is not a desirable situation for the EU.

The EU will have to trust the UK to enforce its customs legislation and procedures on its behalf. It will have to offer the UK access to its export databases to control illegal exports. The EU will have to trust the UK to refund import duties only on goods remaining in NI. Nowhere else does the EU accept such a situation. On the contrary, all EU and global customs systems are based on the execution of full control over all aspects of trade through its own authorities.

Furthermore, there are raft of practical implementation problems. For example, it will be very difficult and tedious for NI traders and NI customs to refund duties on eligible transactions. It will be difficult for importers of goods into NI to trace the distribution and sales chain of the goods they import from the UK. Refunds will apply only to goods that are not sold to businesses or consumers in the EU or to goods that do not become part of a product sold in the EU. These problems will cause immense administrative issues in NI and may lead to disputes between the EU and the UK.

It is instructive that such an analysis of trade chains was at the centre of the 'Facilitated Customs Arrangement' proposed to the EU by the May Government in July 2018. It was later dismissed in Salzburg by the EU as 'magical thinking'. Now the EU proposes that the UK apply a similar system in NI on its behalf. It is only because of the political benefits of this option, desired by the EU, that it accepts outsourcing the management of its own customs territory - a fundamental breach to its sovereignty.

### Invisible North-South Land Border Achievable Only Through an FTA

The UK has already declared that, whatever happens, it will not create checkpoints at the Irish land border. Thus, the EU will be under pressure to implement an 'invisible border' with NI.

Introducing border posts is something the Republic of Ireland has also said it is not prepared to countenance and would be a breach of the principles behind the Belfast Agreement. An invisible land border on the Island of Ireland can be created only in combination with an FTA. As a consequence, the most effective way to manage the border becomes an FTA, at least with regard to goods and agriproducts.

If the EU were to refuse to agree an FTA with the UK, and proceed on the basis of unilateral 'no deal' measures, WTO rules (specifically the Most Favoured Nation (MFN) obligations of the General Agreement

on Tariffs and Trade (GATT)<sup>19</sup> and the General Agreement on Trade in Services (GATS)<sup>20</sup> would require the EU to take steps that would likely prove unacceptable to Ireland or other EU Members with external borders. Under such circumstances, the EU would have only two options:

1. Create and adopt unprecedented streamlined or light touch procedures at the NI-Irish border (most likely operating some form of 'Alternative Arrangements'). This would likely involve behind the border checks and/or the removal/lowering of many difficult to collect tariffs and/or the recognition of goods specifications (for goods regularly at risk of crossing the border) and conformity assessment procedures for health and safety. However, a similar approach previously proposed by the UK was roundly rejected by the EU.
2. For the sake of peace, ignore the border entirely. This option would be problematic for the EU because it would be granting a non-member state access to the Customs Union on the same terms as a member. Given the purist EU approach, to address this unacceptable situation, the border would have to be shifted to the border between Ireland and the EU (ie, the Irish ports) so that Ireland effectively would be pulled out of the Single Market for goods. Additional border formalities would be needed for trade between Ireland and the rest of the EU to prove that, as goods are sold from Ireland to the continent, they are of Irish and thus EU origin. Complex origin rules would apply such as now apply to goods from Switzerland that are imported into the EU. Certificates of Origin and Invoice Statements would be needed on each product. Full scale import procedures would be necessary to regulate this. Ireland would become a de facto third country, separated from the other member states in the EU by customs procedures. This would deny Ireland a key perceived benefit of its EU membership (unfettered access to the Single Market).

Furthermore, the absence of an FTA would lead to additional practical problems, further exacerbating pain to the EU. WTO MFN rules might require the EU to offer the same 'invisible border' procedures adopted in Ireland (for example, border checks taking place at the Irish ports) to all 44 countries with which the EU shares a land border. The EU would be unlikely to find this acceptable. For example, it would be inconceivable that they could accept such an 'invisible border' with the Kaliningrad region of Russia. The UK does not have this problem since it has no other land border with the EU.

Potentially, because of the historical NI 'Troubles', the EU could invoke the essential security exemption to WTO obligations, including the MFN requirement. The relevant WTO provision<sup>21</sup> allows WTO member states broad discretion to impose any measures that they deem necessary in each (security-based) circumstance.

However, the EU does not rely on this provision for any of its trade measures. Furthermore, a NI exemption on the basis of national security could lead to similar claims for such exemptions at other EU borders (eg, the Turkish-Cypriot border) that the EU would likely not welcome. The EU would be put into the difficult position of having to create a hierarchy of political tensions among its land borders (Ireland, Cyprus, Latvia etc), while attempting to justify a denial of equivalent treatment to that of the UK.

Therefore, the only viable option for the EU is to agree an FTA with the UK. This is because WTO law<sup>22</sup> would then preclude the application of the MFN obligation so it would not require the EU to offer the same border arrangements to other WTO members with which it has a border. But for that to apply, the FTA would need to cover the whole of the UK and substantially the whole of the UK economy.

Thus, an invisible land border can be achieved only through an FTA and it can be realised using existing EU customs legislation and procedures. The EU already operates barely visible borders with countries

19 Article I

20 Article II

21 GATT Article XXI

22 GATT Article XXIV and GATS Article V

like Switzerland and Norway. The legal basis and IT-systems needed to operate such borders are readily available. Digitalised customs declarations link to the customs administrations of importing and exporting companies thereby giving authorities multiple entries to check on the correct application of all relevant laws. The very reliable Transit system is used to ship goods across borders without formalities at the frontier. This system is used by traders 10 million times a year, of which the Swiss account for 2.5 million. Swiss trade across the border flourishes and the costs of formalities is minimal.

Furthermore, North-South land border trade is far less than east-west sea trade. Trade across the land border consists mainly of repetitive agricultural transactions, which can make use of customs permissions that offer administrative simplifications. Mutual recognition of standards and certifications can further simplify trade. Exemptions can be agreed for incidental small traders located near the border, as this trade is no threat to the internal markets of the EU or the UK. Almost all goods traded through NI are UK or Irish origin. And the volumes are minuscule.

With regard to illegal trade, the North-South border lies on the fringe of the EU. Under an FTA the profits on illegal EU-UK trade diminish.

But, most importantly, under an FTA, each territory can fully enforce its laws and procedures itself. There is virtually no dependence on the authorities on the other side of the border. Parties do not need to (mis)trust each other and the present good cooperation between customs and police authorities on both sides of the land border can enhance the fight against illegal trade.

We have shown separately in our earlier paper, *Replacing the Withdrawal Agreement*, that if the EU rejects these mechanisms, the UK should offer Mutual Enforcement, under which the UK would collect EU tariffs and apply EU standards across the North-South border - and the Republic would do the same for UK tariffs and standards in reverse. Each side would effectively guarantee performance, such that there would be liability for damages to true up the effects of any breaches proven to arise. This conceptually pure solution would undeniably deal with all aspects of an invisible border.

If the EU were to reject Mutual Enforcement, then nothing could be done to help the EU avoid the need to apply an invisible border unilaterally and offer the same to others. The UK would have done all that it could do to offer help, including writing what effectively would be a guarantee.

In such circumstances it is hard to see any reasonable observer as having any grounds to side with the EU or the Republic.

### 3 - PROFFER AN APPROPRIATE FUTURE UK-EU FINANCIAL SERVICES ARRANGEMENT

The Eurozone is dumping financial risk on the UK and rest of the world, at the expense of savers and investors around the world. These people effectively carry the cost of the EU's half-built Eurozone structure. As explained in Annex A, the EU operates the Eurozone in breach of international capital standards, which creates huge financial risk. Due to the natural interconnectivities of the financial market this risk is dumped on the UK and the rest of the world.

At present, the UK mitigates that risk for itself and the world by ensuring that UK-based global financial institutions offering services across the EU do so under the UK's regulatory regime, which imposes top-up requirements to mitigate Eurozone risk. If the EU were to agree to an Enhanced Equivalence chapter in

the FTA that recognises UK financial regulation,<sup>23</sup> UK-based firms could carry on servicing EU customers from the UK cross-border and the UK could carry on performing its mitigating role. Other matters such as the provision of data on Eurozone exposures, the recognition of legal services, and of data protection standards would need to be included to make this work.

If no financial services deal of this nature is agreed, the UK, the US, and other countries will be duty bound to apply international regulatory standards to the Eurosystem bodies and the Eurozone's financial institutions to protect their own markets from the huge financial risks currently stored up in the Eurozone's financial markets and regulatory system.

As explained in the next Chapter, the threat of such action would likely motivate the EU to reconsider its position, thereby leading to an agreed Enhanced Equivalence relationship.

23 A Template for Enhanced Equivalence, Barnabas Reynolds, Politeia, July 2017, a proposal subsequently adopted by the UK Government in its post-Chequers White Paper (HM Government, The future relationship between the United Kingdom and the European Union, CM 9593, 12th July 2018, available [here](#)). See also Free Trade in U.K.-EU Financial Services - How Best to Structure a Brexit Free Trade Deal, Barnabas Reynolds, Politeia, October 2018; EU-U.K. Financial Services After Brexit: Enhanced Equivalence - A Win Win Proposition, Barnabas Reynolds, New Direction / Politeia, 28 February 2018 and How to Leave the EU: What's Best for Britain, Best for the EU?, Barnabas Reynolds, New Direction-Politeia, February 2018 and March 2017.



### III - MOTIVATE EU COOPERATION BY EMPLOYING NEGOTIATING LEVERAGE AVAILABLE TO THE UK, US AND OTHER COUNTRIES

Chapter II explained how the WA and NIP can be terminated and replaced with a win-win FTA and an enhanced financial services agreement. While there are compelling reasons for the EU to cooperate with these actions, such cooperation cannot be taken for granted.

This Chapter explains the considerable negotiating leverage available to the UK and other countries that can be brought to bear against the EU. There are three aspects to this negotiating leverage:

- **Employ remedies for EU trade dumping and unfair subsidisation as leverage to motivate EU agreement on a comprehensive FTA in goods and services**
- **Apply international financial regulatory standards to EU (including Eurozone) bodies and financial institutions to motivate EU agreement for a comprehensive financial services deal**
- **Work in tandem with the US and other countries to motivate the EU's cooperation**

#### EMPLOY REMEDIES FOR EU TRADE DUMPING AND UNFAIR SUBSIDISATION

Once it is seen that there is a need to agree an FTA with the UK, the UK can deploy additional leverage in order to obtain a comprehensive FTA in goods and agriproducts. The source of this leverage stems from the implications of the partially-constructed legal structure of the Eurozone and its implications for international trade.<sup>24</sup>

The Eurozone's structure, coupled with an artificially suppressed currency value, leads to the dumping of underpriced Eurozone goods on the UK market. Eurozone exporters are also unfairly subsidised through unique mechanisms, including the highly technical TARGET2 system, as well as underpriced bank lending (through avoidance of international regulatory standards). These represent systematic breaches of WTO law (notably the Anti-Dumping Agreement (ADA) and the Agreement on Subsidies and Countervailing Measures (SCM)).<sup>25</sup>

The Eurozone's legal structure leaves fiscal arrangements at a national level whilst having monetary arrangements at a federal level. This crucial fact is ignored by EU law, which treats the entire setup as being federal. The national financing arrangements for the zone are given the full benefits of treatments that would arise under international law for federal Eurozone financing, but without the extensive liabilities for Eurozone member states that naturally would arise from those arrangements being federal. In effect, Eurozone member states are having their cake and eating it. The result of this setup is that the UK (and US) is the victim of trade dumping and unfair subsidisation from the EU in three ways:

- **Structurally depressed price of goods sold - particularly from the northern Eurozone - into non-Eurozone markets.** This is due to an artificially depressed currency value<sup>26</sup> because southern Eurozone debt burdens are not shared by the north, as would be required for a federal currency zone (which is what the Eurozone purports to be). This drags down the value of the currency, leading to lower prices of goods in foreign markets.

<sup>24</sup> See Managing Euro Risk, by Barnabas Reynolds, David Blake and Robert Lyddon, Politeia, February 2020.

<sup>25</sup> See How to Level the EU's Playing Field, David Collins, Politeia, April 2020.

<sup>26</sup> See The UK is the Eurozone's Dumping Ground, David Blake, Briefings for Britain, April 2020.

- **Unfair subsidisation of Eurozone producers creates distortions in international trade, through the TARGET2 system.** This effectively provides unlimited financial support to Eurozone producers by financing their purchasers and not settling the resulting balances. It is a partial redistribution mechanism with costly consequences for the UK and others.
- **Unfair subsidisation of Eurozone producers by running an undercapitalised banking system,** in breach of international Basel Rules. The banking system is in breach of Basel Rules since it is not required to be capitalised, collateralised or apply liquidity standards that would manage the risk created by Eurozone member state debt - a feature that puts non-Eurozone investors and savers at risk, given the interconnectivities of the financial markets. The primary driver of this risk is that Eurozone member-state bonds - that are ubiquitous throughout the EU financial system - are classified by EU rules as riskless, sovereign quality bonds, when they are not.

The dumping and subsidisation through the depressed currency, TARGET2 and the artificial banking system (which is able to lend to EU customers at artificially low prices) are most likely in breach of WTO law, again the ADA and the SCM.

WTO rules allow the UK and other non-Eurozone countries to apply self-help remedies to respond to these practices, imposing unilateral countervailing duties against those goods that have benefitted from the Eurozone's subsidies, as well as anti-dumping duties on various underpriced Eurozone-originating goods in a manner that allows for wide discretion in terms of the manner, mode of calculation and application of relevant tariffs/duties. The UK will no longer be prevented from taking such action once it is outside the EU law system after year end.

Faced with the possibility of the UK and other countries implementing such measures in a broad brush manner and the severe consequences on EU exports, the EU would likely agree to negotiate the comprehensive FTA for goods and agriproducts that the UK has been seeking. This FTA would still address Eurozone dumping and subsidisation, but it could do so in a more systematic and sympathetic manner, for example by including a chapter on consultations with regard to minimising distortions arising from currency manipulation and focussed on transparency, as in the recently agreed and ratified US-Mexico-Canada Agreement (USMCA).

## APPLY INTERNATIONAL FINANCIAL REGULATORY STANDARDS TO EUROZONE BODIES AND FINANCIAL INSTITUTIONS

In the case of financial services business and many of the other services that are ancillary to it, the UK should deploy the leverage that arises out of the fact that the EU falls short of international standards in a material way, by ignoring the proper application of the international regulatory rules (contained in the Basel standards) to the Eurozone.

The Eurozone is not just dumping products on the UK's valuable goods and agriproducts markets. As explained above, the Eurozone structure and associated financial regulations provide artificially cheap banking that runs itself at the expense and risk of the rest of the world, in breach of international capital standards. It is dumping vast financial risk on the UK and the rest of the world, putting the assets of savers and investors at risk. See Annex A for an explanation of how this occurs.

The UK currently mitigates that risk for itself and the world by ensuring that UK-based global financial institutions offering services across the EU do so under the UK's regulatory regime, which imposes top-up requirements to mitigate Eurozone risk. If the EU were to agree to an Enhanced Equivalence chapter in

the FTA that recognises UK financial regulation,<sup>27</sup> UK-based firms could carry on servicing EU customers from the UK cross-border and the UK could carry on performing its mitigating role. Other matters such as the provision of data on Eurozone exposures, the recognition of legal services, and of data protection standards would need to be included to make this work.

But, if no financial services deal is agreed, the UK (and the US) will be duty bound to apply international regulatory standards to the Eurosystem bodies and the Eurozone's financial institutions to protect their own markets from the huge financial risks currently stored up in the Eurozone's financial markets and regulatory system. The UK seeks to maintain an open market. However, in order to do so it needs to manage financial risk arising from elsewhere. It is demonstrable that EU law and supervision fail to address the risks they create. This approach would require assuming the worst case for exposures of UK/US financial institutions to EU financial firms, including EU financial subsidiaries of UK/US financial institutions.

Such a step would be likely to thwart EU attempts to pull financial business from the UK into the EU (as driven by certain member state interests, in apparent disregard to the consequences for other members). It would make EU-based business prohibitively expensive and force EU corporates to use the EU law concept of 'reverse solicitation' to bypass EU financial institutions and deal with UK-based firms directly, opting out of the application of EU law entirely.

The alternative for the EU would be for it to insist its corporates deal with only EU financial institutions, which would be financially ruinous for the EU:

- EU companies and governments would be significantly constrained in their access to the world's capital markets
- Being subjected to international regulatory standards in this way would be hugely costly for the Eurozone financial system and make it a regulatory pariah for failing to apply those standards to itself

If this leverage is deployed skilfully, the EU will likely agree to an Enhanced Equivalence deal in financial services that will maintain the status quo, but with UK-based financial institutions operating across the EU solely under UK law and regulation conceived entirely in the UK, thereby allowing the EU continued access to the UK's global financial centre cross-border and buying time for the Eurozone to put its house in order.<sup>28</sup> Other services sectors will be pulled along by such an agreement - eg, cross-border legal services.

Every indication is that the EU is keen to have a deal. They would prefer one that damages the UK (were the UK to agree to that) but when it becomes clear this option is not available, discussions will normalise rapidly. The only remaining point is to ensure clever transactional negotiation and sophisticated drafting of legal text.

## WORK IN TANDEM WITH THE US AND OTHER COUNTRIES TO MOTIVATE EU COOPERATION

The US is not a passive bystander in this situation. There are areas where the interests of the US are directly affected and where the US has been taken advantage of for years by Eurozone arrangements.

Like the UK, the US has been the victim of the Eurozone's dumping and subsidisation, in breach of WTO law. Unlike the UK, the US is unfettered in considering these issues now, since it is not subject to EU law.

<sup>27</sup> A Template for Enhanced Equivalence, Barnabas Reynolds, Politeia, July 2017, a proposal subsequently adopted by the UK Government in its post-Chequers White Paper (HM Government, The future relationship between the United Kingdom and the European Union, CM 9593, 12th July 2018, available [here](#)). See also Free Trade in U.K.-EU Financial Services - How Best to Structure a Brexit Free Trade Deal, Barnabas Reynolds, Politeia, October 2018; EU-U.K. Financial Services After Brexit: Enhanced Equivalence - A Win Win Proposition, Barnabas Reynolds, New Direction / Politeia, 28 February 2018 and How to Leave the EU: What's Best for Britain, Best for the EU?, Barnabas Reynolds, New Direction-Politeia, February 2018 and March 2017.

<sup>28</sup> See The Art of the No Deal, Barnabas Reynolds, Politeia, November 2017.

The UK, so long as the above path is followed, will be freed from that system as well, from the end of this year - and can negotiate now on the basis of such a position.

The US should consider addressing the EU's unfair practice of dumping and subsidisation by imposing tariffs and duties as permitted by WTO law. As with the UK after year end, these are self-help remedies and do not require the US to seek a multilateral consensus through the WTO's Dispute Settlement Body.

There is an additional consideration for the US. It is not only strategically beneficial for US financial institutions to be able to service their EU customer base from London, as now, but such a situation is to the US's advantage geopolitically. It is important for the purposes of US - and UK - security and defence. The long arm of US sanctions allows the US to take action in situations, such as Russia, through the financial markets. This relies on the power of the US dollar and the fact that businesses wish to access the dollar from all over the world. But it is also enhanced by the support of the UK. Hitherto, the UK has, while within the EU, ensured that EU sanctions policy - applicable in London - has been almost identical to that of the US. It has resisted dilution from others, eg German attempts to dilute sanctions against Russia.

The two major inconsistencies are that the EU has taken a different view on Iran and Cuba. The Cuban position is of little importance to the effectiveness of US sanctions there. For Iran, it is more significant, but this is not an ideological divergence - the UK is merely (at present) following the path agreed with the previous US administration.

After 31 December, it will be in the US's interests for the EU not to be running an anti-American foreign policy on sanctions - as it is liable to do. The UK typically has aligned interests to those of the US on many topics. Divergences do arise, but they tend to be occasional, as is the case with Iran. Some voices in the EU - including France and Germany - seek a deliberately different policy to that of the US.

Were there to be any meaningful global financial market activity taking place within the EU (particularly if it were at the expense of the UK), the US could well find it more difficult to implement its security/defence policy through its sanctions regime as events unfold. An EU seeking to show its deliberately different foreign policy is likely to seek to do so on sanctions, just as in other areas. Were the financial market to stay as it is now, predominantly (outside the US) based in the UK, the US would have a dependable ally on sanctions and foreign policy matters.

In light of these considerations, the US might consider protecting US investors and savers by ensuring any US financial institutions apply regulatory capital, collateral and liquidity treatments to exposures to EU financial institutions that reflect the true unmanaged risk those firms embody. This would help ensure all financial market activity remains as it is now, in the UK, benefitting US financial, commercial, foreign policy and defence interests.

Such actions would motivate the EU to:

- Come to the table to negotiate a favourable trade deal with the US
- Agree Enhanced Equivalence arrangements with the UK, which would allow US financial institutions to continue servicing their European, Middle East and Africa businesses entirely from the UK, which is what those institutions want. They would have to run only one major regulated entity and not incur the capital, collateral, liquidity and operational inefficiencies of running a separate EU subsidiary under the conflicted rules and supervision of the Eurozone (and EU).

## IV - APPRECIATE THE CONSEQUENCES OF FAILING TO ACT BEFORE 31 DECEMBER

Over four years ago, the UK voted to leave the European Union in a national referendum, seemingly binding on the British Government and Brussels. “Brexit means Brexit,” said the then Prime Minister, Theresa May. “Leave Means Leave” was the rallying cry of a prominent campaign group set up to ensure that there was no backsliding over the referendum result.

But now, with just over three months to go before our supposed final exit from the EU single market at the end of the year, confusion reigns. Government ministers are accused of breaking international law as they struggle to escape the EU’s tentacles. Another round of talks between the two sides is scheduled to begin with little hope they will result in an agreement acceptable all round.

The stumbling blocks are everywhere: no agreement on free trade, no agreement on State aid, no agreement on the so-called level playing field, no agreement on fisheries, no agreement on financial services, no agreement on the UK economy’s greatest strength, trade in services.

As this and our most recent papers make clear, our travails can be traced back to the failures of Theresa May’s administration. The WA and the PD that were signed and ratified after the general election last December - and which add up to an international treaty - are fatally flawed.

Indeed, a hard Brexit in January was avoided, which is what the Prime Minister promised. The agreements also provided for a further 11 months of negotiation, in an attempt to achieve a sovereignty-compliant future relationship (as promised in the WA/NIP).

All this was achieved as a result of a splendidly orchestrated coup, in which Boris Johnson’s Government succeeded in casting out the most egregious element of the May deal, the NI backstop. However, the many other traps in the WA/NIP remain untouched so far.

We are now grappling with the dreadful consequences of a treaty that, if left unchanged, reduces the UK to the status of an EU colony. Unless we tear up the WA/NIP, as we are entitled to do, and replace it with a sovereignty-compliant arrangement, we face a situation where in many key areas EU law will reign supreme and the EU’s own court, the highly politicised ECJ, will be the final arbiter in the many disputes that would inevitably follow.

A failure to scrap the WA/NIP would mean the UK giving up sovereignty over

- The NI economy
- The whole-UK subsidisation regime in respect of matters the ECJ determines in its discretion to have an impact (even theoretical) on trade across the North-South border (because of the application of EU State aid law under the NIP)
- Its finances - by leaving its balance sheet to be tapped for EU liabilities
- EU citizens resident in the UK, in respect of which the UK will remain exposed to constant bickering, with the position ultimately falling to be decided by the EU (through the ECJ)

The rallying cries endorsed by the British public in the 2016 referendum and the 2019 general election, which put paid to the paralysis of the last Parliament, would ring hollow. “Take back control” and “Get Brexit done” would be exposed as mere slogans betrayed by a failure to define the national interest and pursue it unswervingly.

The political consequences, especially for the Conservative Party, would likely be severe. Back in June the Centre for Brexit Policy commissioned Savanta ComRes to poll opinion among people living in the so-called “Red Wall” seats in the Midlands and the North that fell to the Conservatives in December and gave the Prime Minister his stunning 80-seat majority.

The survey demonstrated a powerful appetite among this critical demographic group for a real Brexit that freed Britain from EU control. The issue at the time was Remainer calls for the Transition Period to be extended beyond the end of this year because of the pandemic and because little progress was being made in the UK-EU future relationship talks.

By a strong majority - 51 per cent to 42 per cent - this argument was rejected. Among "Switchers", former Labour voters who opted for the Tories in 2019, the margin was even greater. The survey also found that a Brexit delay would make a significant number of Red Wall constituents less favourably disposed towards the Conservatives and less likely to vote for them in a future election.

But, without change before 31 December, the position we would face is so unacceptable, it goes far beyond the electability of a particular political party. A Tory betrayal of Brexit might provide a marginal Labour boost in Red Wall seats. But, as the Labour leader is a Remainer, Red Wall Labour-Tory switchers would be unlikely to find much solace there. More likely, is the resurgence of a UKIP or Brexit Party 2.0 with damage inflicted on both major parties, but more to the Tories. We then head back into hung Parliament territory.

More fundamentally, such an outcome would likely permanently and detrimentally affect the UK as a country. The country could find itself facing a series of devastating events as outlined below:

#### Year One (2021)

- **European Commission states that numerous UK business subsidies are improper under EU State aid law.** The UK challenges the position in the ECJ, which decides for the EC.
- **The EU interferes with UK internal trade,** making food and other exports across the Irish Sea increasingly unviable and forcing many stores in NI to be stocked from within the EU
- **EU creates obstacles for City firms trading in Europe,** constantly threatening court action against financial firms seeking to service customers within the EU; and also threatening to withdraw unilateral equivalence determinations, plunging the financial markets into turmoil
- **Fish wars break out in Channel**

#### Year Two (2022)

- **The UK retaliates by (finally) raising the capital and collateral required for UK financial institutions in their dealings with EU financial institutions**
- **ECJ rules that the UK's new employment laws violate the rights of EU citizens** under the WA Treaty and must be repealed.

#### Year Three (2023)

- **EU citizens living in UK take cases to ECJ,** claiming discrimination/special rights. They win.
- **The EU imposes financial and trading penalties against the UK** for persistent breaches of the WA and NIP.

#### Year Four (2024)

- **EIB loans turn sour** - the UK is on the hook for a bailout.
- **The Eurozone starts to look at greater risk of imploding. The EU tells the UK that it is already liable through the EIB system so it should look to contribute to the tune of its percentage share** (calculated by relative size of its then GDP) to the Eurozone bailout programme in order to preserve its position through the EIB.



With this, future generations would be left wondering why the UK had lacked the intellectual and political strength at the time to leave the EU properly, instead hanging onto its coat tails.

It would be an absurd form of exit, walking out of the door with less than we walked in with. The EU would not have been the sovereignty-pooling arrangement it purports to be, but rather a Club, which once joined, requires you to be tethered for ever more if you wish to leave - and to leave items of your clothing as you attempt to walk out of the door.

It is difficult to envisage how any rational international observer could regard this as reasonable, let alone for a country of the stature of the UK.

# ANNEX A - THE EU/EUROZONE/MEMBER STATE LEGAL AND FINANCIAL SHELL GAME

In international affairs, the EU plays a legal shell game, switching between legal categories - the EU, the Eurozone and individual member states. It treats each actor as legally sovereign when not all can be so at once; nor is each interchangeable. The key consequences arise from the inconsistent treatment of the Eurozone. The currency operates in law on a federal basis, but unlike normal currency zones, the fiscal underpinnings for the zone operate entirely at member state level, barring, potentially, a relatively insignificant amount raised through a recent EU (not Eurozone) agreement for the funding of future-looking Covid-19 related grants.

In law, the Eurozone has been only partially constructed. The difficult bit, which involves member states assuming legal liability for each other's debt, has not yet been completed. Yet this is the bit that is legally vital for the zone to be truly a sovereign currency zone (which is what it purports to be).

Meanwhile, its member states get the benefit under EU law of assuming the job is done and that the Eurozone is collectively sovereign, buttressing member debt in full, but without taking on the necessary (and hugely expensive) liabilities that would make this so.

## HOW EU LAW ARRANGEMENTS FOR THE EUROZONE CREATE SYSTEMIC RISK<sup>29</sup>

- There is no joint and several liability of Eurozone member states for the Euro currency. Each state is liable separately for a stated percentage.
- Member states have given up sovereignty over their currency, since it is issued by the European Central Bank (ECB), which they do not individually control. So they cannot guarantee to print more money to repay their debts.

### How the EU has Created this Problem

- EU law treats member state debt as of sovereign quality, and therefore risk-free.
  - Sovereign quality debt of an OECD country (ie, with a proper tax base) is risk-free and is treated as such under the Basel Rules since, technically, the sovereign need never default. It can print more money to repay its debts.
  - There is a lesser sovereign treatment for debt issued in a foreign currency (eg Argentina) that classifies the debt as having a low-level risk. The reason is the sovereign can still print domestic currency at will, but needs to convert this into the currency of its borrowings in order to repay its debt so there is a foreign exchange risk that it will not be able to do so in practice if its own currency falls dramatically in value.
- However, Eurozone member debt is different since states cannot order the production of more euros to repay their debt. They have to apply to the other Eurozone states and hope there is an agreement to allow the ECB to print more euros and to lend to them. There is no guarantee this will happen.

<sup>29</sup> This Annex contains a summary of the effects of the Eurozone shell game. A more detailed explanation is to be found in *Managing Euro Risk*, by Barnabas Reynolds, David Blake and Robert Lyddon, Politeia, February 2020.

## What Is the Result?

- Eurozone member debt is essentially sub-sovereign and carries meaningful risk
- This means member-state counterparty risk is unaddressed by the EU's regulatory capital rules, allowing unmanaged and unmitigated risk into the EU's financial system.
  - Holders of member debt are treated by EU law as holding sovereign quality paper but, in fact, their paper is one level riskier than that of a sovereign country: it is more akin to public sector entity debt (or municipal bond debt in the US), the holdings of which attract a regulatory capital charge (ie, banks, investment firms, insurance companies and others have to hold a certain amount of loss-absorbing capital to match the possibility of a default on the debt, as determined by the Basel Rules). The EU ignores this proper characterisation.
  - In turn, holders of true public sector entity and, arguably, bank/corporate debt of Eurozone states are also holding paper that is one level riskier than provided for by EU law, since in each case the presumed sovereign backing does not exist
- As a result the EU financial system is undercapitalised
- It also is undercollateralised and less liquid than it purports to be. The same member-state paper is allowed to be used as risk-free collateral and liquid paper (ie, paper that can be cashed out in a hurry) by financial institutions across the EU
- Plus the central institutional system itself is undercapitalised, undercollateralised and less liquid than it purports to be
  - The EU, ECB, EIB are backed by the same sub-sovereign member states, whereas EU law assumes sovereign backing.
  - The ECB and EIB also soak up member paper as collateral, which is treated as of full strength and fully liquid
- On a conservative estimate, there is at least €1 trillion missing from the system in terms of capital and collateral
- In addition, EU accounting treatments mask the true position - for example,
  - Non-performing loans are treated as partially performing to the extent of the possibility of borrower repayment, despite no renegotiated loan agreement
  - The Eurosystem runs 4 sets of accounts, all of which assume intra-Eurosystem netting (ie, netting of payments between Eurozone member states), which does not clearly exist
  - Many exposures of the Eurosystem are off balance sheet and not taken into account in ratings - eg, European Investment Fund (EIF) liabilities and EU taxpayer exposures through the EIF
  - Eurosystem accounts are opaque - lots of key data are missing

## What Is the Bottom Line?

- A massive unmanaged build-up of non-publicised financial risk in the Eurozone
- This risk pollutes the rest of world due to the interconnectivities of the global financial system
  - Through exposures of global financial institutions to EU subsidiaries
  - Through dealings from the US and UK (post-Brexit) with EU financial entities

## HOW THE RISK IS MANAGED CURRENTLY

### Risk Currently Managed in the UK but Not in the EU

- The Bank of England runs stress tests for all UK-incorporated institutions, neutralising the problem, and requires top-up capital under Basel Pillar 2 (a discretionary capital heading)
- Eurozone risk is mitigated as it emerges into the global financial market through the UK's global financial centre, thereby benefiting the US
- Notably, the EU doesn't do this - the European Banking Authority (EBA) (the pan-EU bank oversight authority) runs stress tests for Eurozone (Single Supervisory Mechanism, SSM) banks that ignore the sub-sovereign issue and assume the Eurozone is legally complete, with joint and several member backing
- Current arrangements for the UK's mitigation of Eurozone risk will change after Brexit since the EU passport falls away and EU law requires some financial business to be conducted onshore in the EU, under EU law and supervision

### Could the EU Remove the Risk?

- Only by applying the Basel Rules properly - which would be prohibitively expensive for member states: where would the money come from?
- Or by adopting joint and several liability of members for each other's debt
  - Germany has made clear it won't do this.
  - Minimalist Covid-19 grants are only a minor fix
- Both solutions are unlikely, so there is a problem for the global financial market that needs to be managed after Brexit from outside the EU.
- The UK could continue to perform its current service of mitigating the risk for the world, since it is in the UK that the EU meets the global financial market. But in order to do so, as explained in this paper the UK would need a reliable, predictable, Enhanced Equivalence arrangement for financial services, plus ancillary services (eg. legal) and other matters (such as data protection recognition), and adequate ongoing provision of Eurozone financial information, including from the EU itself, the ECB and Eurozone financial institutions.



## USING NEGOTIATING LEVERAGE TO ACHIEVE A SOVEREIGNTY-COMPLIANT EXIT FROM THE TRANSITION PERIOD

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34 South Molton Street  
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