EXPLANATORY NOTE

UK – EU COMPREHENSIVE FREE TRADE AGREEMENT LEVEL PLAYING FIELD

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27 December 2020

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EU-UK FTA LPF and Rebalancing Mechanism

General Principles

The measure under Level Playing Field ("LPF") is in Title XI of the FTA. Title XI is rooted in open and fair competition principles. Fair and open competition is a defining and governing principle for the whole Title. The UK-EU FTA as a whole includes references in it whereas clauses to consumer welfare, and to ensuring no unjustified restrictions on trade and investment between the Parties. In other aspects of the agreement, notably the express delivery and telecommunications chapters in the services text, there are specific provisions prohibiting anti-competitive cross subsidisation. The Good Regulatory Practices chapter includes disciplines on economic, social and environmental impact assessments, and specifically notes that the Parties should reduce unnecessary regulatory burdens on SMEs.

The LPF provisions in Title XI specifically links fair and open competition with sustainable trade and investment (Article 1.1). Article 1.1.4 expressly calls on the Parties to "prevent distortions of trade and investment." Article 1.1.4 also specifically states that the intent of the Parties is "not to harmonise the standards of the Parties." Article 2.1 refers to "free and undistorted competition in their trade and investment relations."

Article 1.2.2 refers to the Precautionary Principle, but it should be noted this is a reference to the general principle itself (which is widely accepted) as opposed to the EU's interpretation of it (which is not).

The LPF title starts with requirements on both sides to maintain their own competition laws and policies which is not controversial as both parties have their own competition laws and competition agencies now.

Subsidy Control

The FTA includes high level subsidy control at a principles level. These principles include:

(i) Subsidies may be used when there is a specific public policy objective or to remedy a market failure;

(ii) They must be proportionate and limited;

(iii) The Parties must weigh the subsidy's positive contribution to achieve a valid public policy objective against its negative effect on trade or investment.

(iv) The Parties need to ask whether they can achieve that public policy objective through another (i.e. less distortive) means.

Certain subsidies will always be prohibited and here the FTA draws on the Agreement on Subsidies and Countervailing Measures ("ASCM"). Prohibited subsidies include:

(i) Export subsidies;

(ii) Unlimited state guarantees

(iii) Subsidies for insolvent economic actors without a credible restructuring plan. These will only be allowed in any event in exceptional circumstances to satisfy a public interest objective or to remedy a severe market failure.

(iv) Subsidies contingent on the use of domestic content.

It is envisaged that both parties will have their subsidy control regimes, run by an independent body, and where dispute settlement is by local courts. The remedy for violation must include disgorgement of an illegal subsidy (except where the subsidy has been granted by an Act of the UK or EU parliament.

There is only dispute settlement under the FTA (the "dispute settlement mechanism" or DSM) if the parties cannot resolve their differences through consultation. In the event of such a dispute, or where a party seeks to apply a tariff, then they can only do so if there is a serious risk of a significant negative effect on trade (which must be predictable from the subsidy not speculative or a remote possibility). Any remedial measure must also be strictly necessary and proportionate in order to remedy the significant negative effect. Any such measures must be based on evidence and cannot be just conjecture or a remote possibility. The Parties are expressly precluded from invoking WTO agreements to prevent such actions so this LPF remedy exists outside of the WTO system. This is sure to attract questions from WTO members, but it is likely the only way that such a mechanism could be implemented. Any subsidy related measures are remedial and different from the rebalancing mechanism for non-subsidy related areas (see below) (Article 3.2.15).

The arbitral mechanism shall not have jurisdiction over individual subsidies, except for:

a) Unlimited state guarantees;
b) Rescue and restructuring;
c) Export subsidies
d) Subsidies contingent on use of domestic content.

The implication is that the DSM is for principle level violations by the Parties.

Tax measures can be subsidies but only if they are specific, i.e. only those that apply differentially to economic actors in a comparable position (e.g. same sector). Thus, a specific measure which would be a subsidy and therefore subject to control would include a tax break given only to one company in a specific sector. There is a general exception for special purpose levies (if needed to satisfy non-economic public policy objectives). There is also an exception for Services in the General Economic Interest ("SGEI") which is similar to the one that exists in EU state aids law. The SGEI test in EU state aids law is not a blanket exemption but seeks to ensure that the public funding is limited to what is strictly necessary in pursuit of a clearly stated public interest goal.

While the test generally used relates to impact on trade and investment, in the case of air carriers, there is a specific reference to effect on competition. This begs the question of how trade distortions or investment distortions are to be tested and given the rest of the chapter and its rooting in competition principles, it is certainly an argument that competition distortions are a way of measuring trade and investment distortions. This begs a further and crucial question as to how that competition distortion is to be assessed. It is likely that the UK will seek a more economically robust consumer welfare test, whereas the EU will seek a test based on impact on competitors. This is in fact long standing tension between those who believe the purpose of competition policy is to protect the process of competition and those who believe that it is about the protection of competitors. In economic circles, it is generally accepted that the former not the latter is true.

State-Owned Enterprises (SOEs) and State Privileges/Special Rights

There are extensive provisions on SOEs which build considerably on GATT Article XVII. Many FTAs now include such provisions, but there are some noteworthy points. Disciplines are introduced where the SOE is engaging in commercial activities which now includes activities which are "oriented towards profit-making". There has been a big debate under Article XVII about whether SOEs should be disciplined as if they are revenue or profit maximisers. This is a step forward in ensuring private firms and SOEs are themselves on a level playing field. Generally, these firms are subject to commercial considerations (which develops the provisions in the GATT article XVII). Commercial considerations are those that would be taken into account in the commercial decisions of a privately owned enterprise operating according to market economy principles in the relevant business or industry. There is a useful reference to the OECD Guidelines on Corporate Governance for SOEs.

Taxation

The Parties commit to good governance and the OECD Base Erosion and Profit-Sharing ("BEPS") commitments.

Labour and Environment

The Parties agree to not weaken or reduce, in a manner which affects trade or investment its labour or environmental protection below levels in place at the end of the transition period (including by failing to enforce its own laws). These non-regression clauses have been accepted by the UK in any event in the context of its other negotiations. For example, the US's negotiating mandate for the UK-US FTA is that the UK will not lower its labour and environmental standards for trade advantage a very similar test to that now enshrined in the UK-EU FTA.

The FTA includes hortatory provisions in labour and environmental areas on commitments to certain core labour agreements such as ILO Conventions which cover:

(i) Freedom of association;

(ii) Elimination of forced or compulsory labour;

(iii) Elimination of child labour;

(iv) Elimination of discrimination in employment or occupation.

In the case of the environment, both parties are required to implement those Multilateral Environmental Agreements (MEAs) which they have signed up to, which also reflect core environmental provisions. Also included are key treaties such as CITES, Convention on Biodiversity and the UN Framework Convention on Climate Change.

Regulatory Autonomy and the Rebalancing Mechanism

The rebalancing mechanism is essentially a tariffication mechanism. A tariff can be applied by an aggrieved party provided the following conditions are proved:

1. There must be significant divergence in regulation; and
2. There must be material impact on trade and investment (as in the case of the subsidy remedy, this must be based on evidence, cannot be speculative or a remote possibility); and
3. The action of the aggrieved party must be strictly necessary and proportionate.

This will require some sort of metric and test that is economically robust. Such a test is not included in the text of the FTA, but given the context of Title XI and the whole FTA itself, it is hard to imagine

a test that does not require the proof of some type of anti-competitive market distortion which gives rise to a higher level of potential exports (excess exports) than would otherwise be the case as a result of a Party's regulatory choice.

Although it would have been more economically robust to have the tariffication apply to the related product, the FTA draws from general trade sanctions principles which allow cross retaliation in unrelated sectors. This is likely to mean that certain key sectors which are deemed to be politically powerful (such as the Scotch Whisky Industry in the UK, agricultural exports in the UK, French wine and cheese and so forth) will be targeted as the goal of these retaliations is to persuade the other party to change its domestic regulation and remove the alleged distortion (in this case). This has the potential if applied overly broadly to damage the entire purpose of the agreement, and lead to substantial trade distortions and economic contraction. It is therefore important that this mechanism is subject to rigorous discipline to avoid its abuse.

It should be noted that the agreement will be reviewed in four years' time, and if it is deemed not to be workable, the rebalancing mechanism could be changed. It is therefore in the Parties' interest to ensure it is implemented in such as way as to interfere with its zero tariff, zero quota basis only in cases where there is a genuine market distortion by one Party for trade or competitive advantage, and that any remedy is proportionate, and strictly necessary.

It will require litigation under the agreement to determine where the balance lies, and this is no bad thing. It is in the pitting of different economic interests against each other that a reasonable balance might be struck which can over time give predictability and certainty to business as to how these provisions will be interpreted and will also secure political support for the deal on both sides.

27 December 2020