EU-UK relations: There is no steady state

by Sam Lowe, 26 October 2021

The current crisis over the Northern Ireland protocol will pass, but tensions between the EU and the UK are not going away.

As is fast becoming an autumn tradition, Brexit is back in the news and EU and UK officials are back huddled around a negotiating table. This time the disagreement is over the UK's treaty commitments in respect of Northern Ireland, and how best to make them work in practice. But this is not the first time the EU and UK have fallen out, nor will it be the last. Those hoping that Brexit was behind us are in for a disappointment. A litany of future flashpoints, over issues such as financial services, the EU's carbon-border adjustment mechanism and data adequacy threaten to sour relations further.

But the relationship between the EU and its third largest trading partner was never going to be static – and as time goes on there will inevitably be ups and downs. What matters is whether differences of opinion are managed as part of a structured process, or as a never-ending series of crises. Here much depends on domestic politics and incentives. On the UK side, what matters is whether picking fights with Brussels is still viewed as politically beneficial. On the EU side, it depends on whether the UK continues to be viewed as a competitor and a threat, or as a potential ally vis-à-vis the EU's wider geo-economic objectives. Regardless, in the short-to-medium term it would be best to brace for turbulence.

The Northern Ireland protocol

The current animosity between the EU and UK centres on the implementation and impact of the withdrawal agreement's Northern Ireland protocol. The UK contends that the protocol is creating trade diversion and societal disruption in Northern Ireland, and needs to be radically overhauled in order to ensure its sustainability. The EU suspects the UK is deliberately stoking political tension in Northern Ireland in order to wriggle out of treaty commitments it never intended to honour. Both can be true at once. The UK did sign up to the protocol with no intention of fully honouring its obligations, and the protocol does need amendment in order to ensure it lasts for the long haul. Negotiations are made all the more tricky due to the EU being far from certain that Lord Frost, the UK minister tasked with implementing the protocol, actually wants to find a solution. On the one hand, Frost is identifying and trying to resolve real issues regarding the internal flow of goods within the UK. On the other he is pandering to his eurosceptic support-base within the Conservative party by attempting to re-litigate already settled issues, such as the European Court of Justice's (ECJ) continued jurisdiction in Northern Ireland.

At its core the protocol avoids the need for a regulatory and customs border on the island of Ireland, by leaving Northern Ireland de-facto within the EU's customs territory and single market for goods. This decision necessitates some sort of customs and regulatory border within the UK, applied to goods entering Northern Ireland from Great Britain. The UK argues that these controls were only ever meant to be light touch, with some basis – Michel Barnier, the then EU chief Brexit negotiator, did promise that checks on goods entering Northern Ireland from Great Britain could be "de-dramatised". However, despite the existence of a number of border grace periods (which the UK unilaterally extended in some instances) for some of the checks, the new processes – which require businesses to register with a new trader support scheme, lodge customs declarations, and in some instances obtain veterinary health certificates for food products facing inspection upon entry – have proven disruptive for internal UK trade.

As such, alongside threats to trigger the protocol's safeguard clause, Article 16, the UK has tabled a proposal that would overhaul the fundamental assumptions underpinning the protocol. Currently, goods entering Northern Ireland from Great Britain are treated as if they are destined for the EU, unless the importer can prove they will remain in Northern Ireland. The British government wants to flip the burden of proof. Instead, goods entering Northern Ireland from Great Britain would be assumed to remain in Northern Ireland, unless they are declared, or found, to be intended for the EU market. The UK also wants to remove the ECJ from the protocol – under Article 12 it currently has direct jurisdiction in Northern Ireland and can make rulings in respect of the application of EU rules – and limit the application of subsidy rules, but it is less clear why these issues pose a problem for the sustainability of the protocol in practice, as opposed to the continued embarrassment of the politicians who signed up to it.

For its part, despite saying it will not re-negotiate the protocol, the EU has tabled a number of proposals that would significantly soften the customs and regulatory border between Great Britain and Northern Ireland. These involved simplified customs procedures, changing EU regulation to allow medicines authorised by the UK regulatory authority to be placed on the market in Northern Ireland, and simplified certification and less frequent checks on agrifood products entering Northern Ireland from Great Britain. While not quite the overhaul the UK desires, it is now possible to see an off-ramp towards a UK-EU compromise that would benefit those trading across the sea border. In respect of subsidies, perhaps something akin to a proposal made by lawyers George Peretz QC and James Webber, which would align the subsidy provisions in the protocol with those of the Trade and Co-operation Agreement (TCA), would prove tolerable to both the EU and UK.

More difficult to address is the UK's demand to remove the ECJ from the protocol. So long as EU single market rules apply in Northern Ireland, which is required to avoid a regulatory border between Northern Ireland and Ireland, the EU will not countenance the removal of all ECJ involvement. At best, a compromise could see ECJ involvement kicked up a level, and as is the case in the rest of the withdrawal agreement, its opinion only sought by independent arbitrators in the event a dispute between the EU and UK centres on the interpretation of EU law. However even this compromise would be tricky for both, with the EU currently facing an internal crisis over the rule of law and the exact role of the ECJ in the context of Poland, and the UK having taken such an absolutist stance.

Despite solutions being technically available, the politics means that the dispute over Northern Ireland will probably get worse before it gets better. The likelihood of the UK triggering Article 16 is high. But we should be cautious about pre-judging the EU's response. Article 16 – which allows for either the UK or EU to take limited safeguard measures in the event of trade diversion or serious economic, societal or environmental difficulties – is a legitimate tool of the Northern Ireland protocol, and much depends on what the UK actually does under its cover, and whether the EU views its use as proportionate to the

problems identified. If, for example, the UK were to suspend the entire Northern Ireland protocol, and in effect dare the EU to either enforce a border between Ireland and Northern Ireland or between Ireland and the rest of the EU, we should expect the EU's response to be explosive. Irrespective of the exact legal justification, this could involve the EU suspending many elements of the TCA, if not the whole agreement.

However, if, as is more likely, the UK instead uses Article 16 as cover to enact its preferred approach to implementing the protocol, but still enforces some controls on goods entering Northern Ireland from Great Britain, the EU's response will probably be more measured. In terms of immediate response, any EU rebalancing measures would need to be proportionate, and "strictly necessary to remedy the imbalance". These caveats limit the scope of the EU's immediate (legal) response, although they would not stop the EU making threats and drawing up a hit list of products the EU might target with reciprocal tariffs. Any bigger response would then be conditional on eventual arbitration under the dispute settlement provisions of the withdrawal agreement. While using Article 16 certainly raises the political temperature, assuming the UK doesn't opt for self-immolation, in the short-term it probably means only more negotiation.

Ultimately, the current dispute around the protocol will conclude only when Boris Johnson decides it is no longer in his interest for hostilities to keep rumbling on. In both the withdrawal agreement and TCA negotiations, he eventually decided to rein in his chief negotiator and opt for compromise. However the context is now different, in that there is no real deadline or cliff-edge to both grab the prime minister's attention, and force him to make a decision.

Future flashpoints

The current crisis in Northern Ireland will eventually end, but it will not be the last. The ever changing political and regulatory nature of both the EU and the UK means that friction, re-negotiation and occasional hostilities will be a permanent feature of a relationship that will inevitably evolve over time. Already a number of issues could easily generate further tension:

1. Financial services has so far been the dog that hasn't barked. Despite the UK failing to achieve any significant EU market access for its financial institutions in the TCA, the exodus of jobs and investment predicted by some has not taken place. But these predictions were borne of a fundamental misunderstanding of the EU's approach. While the EU, and certain member-states in particular, are keen to pull EU-focused financial services activity into the EU's territory, regulators at both the EU and member-state level have taken a gradual and softly-softly approach to doing so. In the first instance, UK-based financial firms that have established a new presence within the EU have been allowed to continue carrying out a number of functions in London. But the regulatory noose is starting to tighten.

   As well as applying greater pressure to banks to move capital and staff to the EU, the European Central Bank has started to crack down on the so called back-to-back model, which saw EU-based entities effectively continue to manage risk from the UK. EU regulators have also started to look critically at practices such as 'chaperoning' – when EU-based workers sit in on calls between customers and UK-based traders, so an EU-based firm can say it is undertaking the regulated activity – in an effort to force firms to build up a bigger presence within the EU. And it would surprise no one if the EU limited the ability of asset managers to manage EU funds from the UK or required clearing houses to move into the EU in the coming years. In deciding not to grant broad-based financial services equivalence to the UK, the EU lost a lot of leverage – it cannot threaten to rescind

equivalence. However, the impact of a number of isolated measures could eventually spark conflict with a UK concerned over the steady erosion of its financial-services base.

2. Trade in goods between the EU and UK will be further disrupted if/when the EU introduces its carbon-border adjustment mechanism (CBAM). The CBAM will see EU imports of certain products (at the time of writing iron, steel, aluminium, cement, fertiliser and electricity) subject to additional bureaucracy and an additional charge, proportionate to the amount of CO_2 embedded within them. While importers can account for any carbon price paid in the product's country of origin when calculating how much money is owed to the EU, the compliance burden can only be avoided if a country is fully exempted from the CBAM. As it stands, the EU CBAM proposal only exempts four countries which are either part of, or link their, Emissions Trading Systems (ETSs) to the EU's – Norway, Iceland, Liechtenstein and Switzerland.

   The UK is one of the countries most exposed to the EU's CBAM. In practice the new compliance burden would mean that importing CBAM goods into the EU from the UK would be less attractive than now, even though the UK's own high domestic carbon price means that the additional EU import charge would be small or non-existent. CBAM could also re-inflame tensions over the Northern Ireland protocol. The EU has already deemed the CBAM Northern Ireland protocol-relevant – which means that it could need to be implemented in Northern Ireland, which would require the consent of the UK government. In theory, CBAM could result in an additional regulatory border between Great Britain and Northern Ireland, with CBAM goods moving across the sea subject to EU controls. An obvious way to avoid this confrontation would be for the UK to link its ETS to the EU's – a possibility that the TCA leaves open – and therefore be fully exempt. But so far the UK has shown no signs of wanting to do this – despite general business support – and thus increased tension between the EU and UK appears inevitable.

3. Earlier this year the EU decided to grant two adequacy decisions for the UK, allowing the personal data of EU citizens to be stored and processed on servers located in the UK, and transferred for the purpose of investigating, preventing and detecting crime. However, as Camino Mortera-Martinez and I have previously argued, these adequacy decisions stand on shaky ground. The European Parliament is traditionally sceptical of such arrangements, and if EU-UK political relations further deteriorate, the EU side may call adequacy into question, using it as leverage over the UK.

   More structurally, the UK has signalled its intention to differentiate itself from the EU when it comes to the regulation of data. In practice this will probably mean tweaks to the existing GDPR framework. Adopting a different approach to data regulation while retaining an EU adequacy decision is technically possible – both Japan and New Zealand benefit from EU adequacy decisions despite having different domestic approaches. But fairly or unfairly, what the EU deems allowable for friendly countries further afield cannot be relied on as a template for its interactions with the UK, which it currently views as hostile to its interests.

   Of greater concern to the EU will be any UK decision to allow the free transfer of personal data to countries, such as the US, that do not already have an EU adequacy arrangement in place. The EU fears this would allow personal data of EU citizens to be transferred, via the UK, to countries that the EU does not recognise as providing adequate data protection. Here the UK is walking a political tightrope, and if (or rather, when) the EU adequacy decision is called back into question, sparks could readily fly.

There are many other examples of where future EU or UK regulatory objectives are likely to cause tension. Proposed EU rules on foreign subsidies will probably catch UK investors in their net; UK plans to embrace gene editing technologies could lead some EU member-states to push for tougher import controls on British food products. But if tension is inevitable, what matters is how problems are managed and resolved. Are they treated procedurally, contained within the structures and committees of the TCA without putting other aspects of the relationship in question, or do the EU and UK perpetually lurch from crisis to crisis? As the EU and the UK learn to co-exist, economic interdependency will probably stop the relationship breaking down altogether in the near future, but those hoping for a steady state will need to wait a while longer.

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