Toward A New UK-EU Relationship:
The Importance of Transitional Arrangements

Introduction

The U.S.-UK Business Council welcomes the opportunity to offer our views on the subject of transitional arrangements as the United Kingdom exits and then resets its relationship with the European Union. There is a clear need for a sufficient transition period to provide the private sector—including third-country investors—sufficient time to avoid increased transactional costs and major operational disruptions caused by sudden restrictions to supply chains and access to talent, as well as widespread regulatory divergences.

The American business community has a significant stake in the outcome of the UK-EU negotiations. U.S. firms' investments in Britain are worth nearly $600 billion, and they employ roughly 1.2 million Britons directly and millions more indirectly. Many of these U.S. investments were made to reach both British and other consumers across the EU. U.S. subsidiaries in the rest of Europe are equally interested in seeing minimal disruption to their supply chains and business ties across the Channel.

Business Needs Time to Transition

U.S. companies are rightly concerned about the prospect of sudden changes in the UK's terms of trade, investment, and regulatory policy once it formally exits the European Union. To foster necessary certainty for businesses to continue to invest, it will be vital to avoid such a "cliff edge" scenario by establishing a clearly delineated transition period for implementation of both market access in both goods and services and regulatory provisions. We are encouraged that officials in London and Brussels increasingly recognize that such a transition is in the common interest of both sides.

Each aspect of the transition period carries with it complex choices. For exporters with supply chains that cross the Channel, a key question will be how the UK is treated vis-à-vis the terms of existing EU free trade agreements. It would make sense for the UK to continue to enjoy the terms of existing EU free trade agreements with third countries until London concludes its own bilateral treaties with those countries.

Existing EU FTAs should be amended to allow UK content to be included under rules of origin requirements to account for the UK's integral role in the European supply chain. Countries including Canada, South Africa, South Korea, and other EU trading partners will seek similar assurances, and UK and EU officials should work in good faith to ensure these agreements are properly updated and enforced. A similar opportunity exists in the area of air service agreements, which facilitate commercial air transport between territories. Similar to the recommendation on FTAs, the UK should continue to benefit from existing 'Open Skies' agreements between the EU and third countries or regions. This continuity will remain important for U.S. investors far beyond the date of Britain's exit from the EU.

Services companies will also need to make specific adjustments, which should be taken into account as the negotiations move forward. Currently, services companies enjoy specific benefits from EU law granting them the freedom of establishment and freedom to provide services across the EU, regardless of their national domicile within the Union. U.S. firms take advantage of both of these rights either from their UK affiliates into the rest of the EU, or via other affiliates located in other member states to provide services into Britain. These firms will need time to adjust to a new reality, post-UK exit.

In addition to the broad trade implications, all firms will need time to adjust their internal structures and policies. Foreign national employees will need to be accommodated, and some may need to be relocated. Information technology infrastructure will need to be updated to reflect new compliance, tax, and financial rules. Real estate contracts may need to be revisited. New organizational structures and subsidiaries may need to be established. Building in a sufficient transition period will help businesses continue to invest and will be necessary to ensure continued compliance.

Transition-related measures may vary by sector, to reflect specific regulatory or other provisions. Above all, such measures should be clearly articulated and provide sufficient time for companies to adjust their operations accordingly.

Governments Also Need Time to Adjust

Both the UK and EU will need time to adjust to a new trading relationship. It seems unlikely that a free trade agreement can be agreed between the UK and EU in the same two year period as the exit will be negotiated. Thus, governments will need time to adjust as well. Customs officials will need to be hired, trained, and properly equipped. New tariff rates and quotas will need to be established. New regulatory agencies will need to be established and their policies set.

Depending on the results of Parliament's consideration of EU regulations pursuant to the Great Repeal Bill, dozens of regulations may ultimately be amended or eliminated. Over the course of several years, the UK will need to establish a clear and predictable regulatory framework. In some cases, the Parliament may decide to fully adopt the EU regulatory approach, amend the EU regulation, or significantly diverge, depending on the specific regulation in question. All of this will take time and should include proper stakeholder engagement to ensure that the views of the business community are taken into account and, in some instances, cost-benefit analysis to help devise the path forward. During any transition period before the UK's exit, there will need to be grace periods to accommodate compliance with a changing regulatory environment.

Without a sufficient transition period, the UK could also be cut off from the digital market and the data flows which are the lifeblood of the modern transatlantic economy. As the process to conclude the EU-U.S. Privacy Shield agreement made clear, demonstrating functional equivalence in data protection and consumer data privacy can take months, if not years. Without a similar EU agreement with the UK, British businesses and consumers could be shut out.

To prevent disruptions, we recommend that the UK continue to abide by the rules of the EU's General Data Protection Regulation (GDPR), which will come into effect in May 2018, before the UK's exit occurs. Continuing to enforce the GDPR will be essential for the UK to receive a positive adequacy decision from the EU on data flows. If an adequacy decision is not achieved, U.S. companies in the UK may need to shift investments and make alternative arrangements to ensure their data can continue to flow across the Channel.

Similarly, the complex approval process of the EU-Canada Comprehensive Economic and Trade Agreement should serve as a cautionary tale for those who believe it will be easy for Britain to negotiate a free trade agreement with the EU. Moving such a measure through the European Parliament and 38 national and regional parliaments will be extremely difficult, especially in the face of increased trade skepticism in many member states.

Possible Consequences if No Transition Agreed

Failure to secure an agreement on transitional arrangements would carry significant consequences for U.S. investors. The oft-cited fallback option of reverting to WTO rules for UK-EU trade is a considerably more difficult scenario than is commonly realized. It may take several months or even years for the UK to agree upon new tariff rates and negotiated quotas with the other WTO members. An immediate loss of financial services passporting rights may require U.S. financial services providers to move portions of their operations to other jurisdictions, with significant employment consequences across Britain. Short of passporting, even a move toward a model of regulatory equivalence will take significant time to implement effectively. Similarly, U.S. investors with headquarters in other member states may be unable to service UK-based customers in a dramatically changed regulatory environment.

A *minimum transition period of 3-5 years will be necessary* to provide certainty to the business community, allow them time to plan, and prevent major disruptions to inbound investments into the UK. Without these assurances, it is likely that companies will soon begin to seek assurances and access to the broader EU market by other means, including by shifting investments away from Britain and moving operations into other EU member states. It is in the common interest of the UK, EU, and U.S. businesses active across Britain and Europe that these disruptions are minimized and economic growth not be hampered by a disorderly UK exit.

Conclusion

Establishing transitional arrangements which minimize uncertainty for international businesses is vitally important across all sectors. Manufacturers must make investment decisions years in advance, with certainty regarding market access rules, to maximize the efficiency of supply chains. Services companies must understand the rules of the road so they can continue to provide seamless service to their consumers.

Transitional arrangements are in the interest of both the UK and the EU to secure a new relationship that is mutually beneficial—ensuring the tariff-free flow of goods and services and keeping regulatory regimes equivalent. Companies that serve the UK market will need time to adjust to a new regulatory reality. At the same time, European firms and consumers depend on inputs and financial services coming across the Channel. Policymakers must take into account the deep interlinkages between the British and European economies and endeavor to leave these connections intact wherever possible.

The U.S. business community looks forward to actively engaging with the UK government, European Union institutions, and other member state governments to avoid disruption of longstanding trade and investment relationships and promote future engagement between the United States and its closest partners and allies.

About the U.S.-UK Business Council

The U.S.-UK Business Council is a Washington-based business advocacy organization dedicated to strengthening the commercial relationship between the United States and the United Kingdom. The Council's mission is to promote a mutually beneficial bilateral economic relationship, as well as ensure that the voices of the private sector are heard as the UK resets its relationship with the EU.