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THE EU-UK TRADE AND COOPERATION AGREEMENT  
(TCA)

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## ABSTRACT

On 20 December 2020 the European Union (EU) and the United Kingdom (UK) signed a Trade and Cooperation Agreement (TCA) setting the terms on which trade relations between both areas will be based. This article describes the essential points of the agreement, in both the trade and financial areas, and the governance framework that will regulate its fulfilment. It further analyses how the TCA will affect both areas' GDP, and which adjustment measures are being taken to offset potential adverse effects.

**Keywords:** Brexit, trade agreement, economic cooperation, regulatory equivalence.

**JEL classification:** F15, F53.

## THE EU-UK TRADE AND COOPERATION AGREEMENT (TCA)

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### Introduction

On 30 December 2020 the EU and the UK concluded a trade and cooperation agreement (hereafter "the Agreement" or "TCA") setting the terms of a new relationship between both parties on four areas: a free trade agreement; cooperation on economic, social, environmental and fisheries issues; a partnership on citizens' security; and an overarching governance framework for the overall Agreement.<sup>1</sup> The TCA entered provisionally into force on 1 January 2021, to avoid major disruptions arising from the end of the transitory period envisaged in the Withdrawal Agreement. Whereas the UK formally approved the TCA on 31 December, in the case of the EU it has still to be approved by the European Parliament and formally adopted by the Council of the EU (see Figure 1).

The following section briefly describes the Agreement. Next, the initial economic effects following the Agreement are set out. Finally, the article draws some brief conclusions on the possible medium-term effects, in particular in the financial sector. It also includes two boxes: one on the Agreement in the financial services realm, and the other on the adaptation measures adopted by the Spanish Government.

### Description of the Agreement

In trade in goods, the TCA ensures zero tariffs and zero quotas on all goods. Had no agreement been reached, these would have been significant in some sectors, such as agriculture and the automotive sector. The TCA also includes measures to smooth customs procedures and to remove unnecessary technical barriers by simplifying conformity assessment procedures and relying on international standards, among other means. Further, the TCA lays down similar rules of origin to those of other trade agreements,<sup>2</sup> while providing for compliance-facilitating mechanisms.

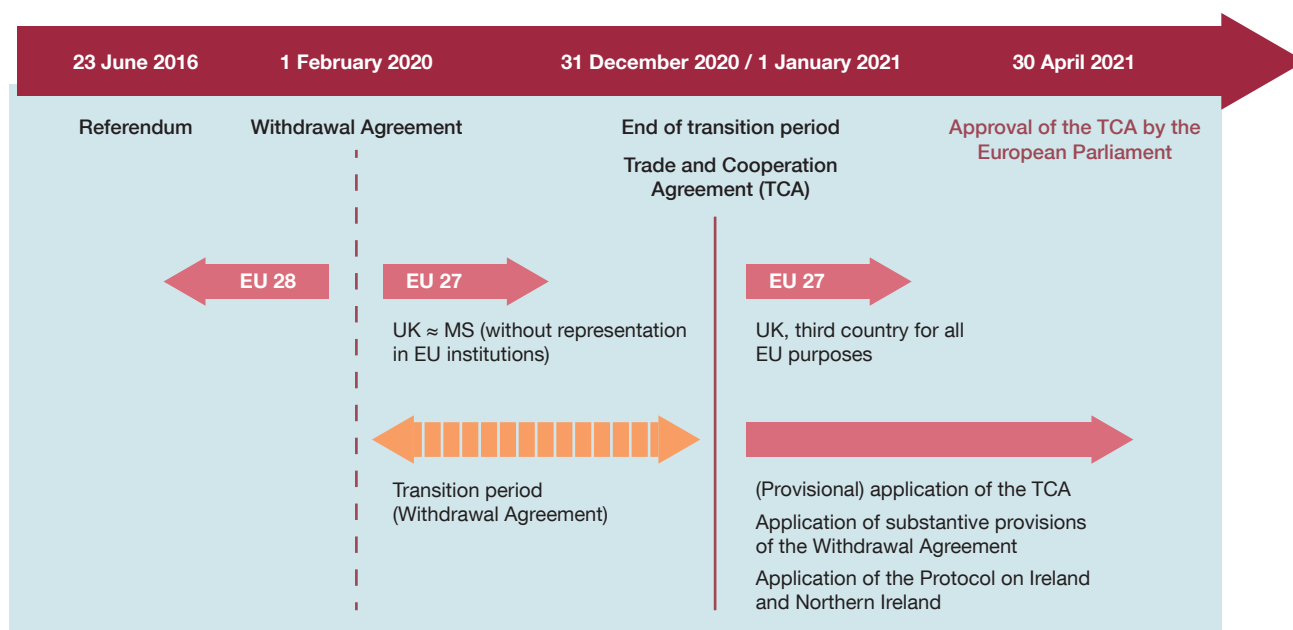
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1 The TCA is not applicable to Gibraltar, which is subject to an understanding between Spain and the UK on 31 December 2020. The understanding considers the fundamental elements of the future EU-UK agreement regarding this territory. Trade with Northern Ireland, meanwhile, is governed by the provisions of the Protocol on Ireland and Northern Ireland annexed to the Withdrawal Agreement.

2 Rules aimed at ensuring that preferential terms only benefit products wholly obtained from or manufactured in the territory of one of the two parties or that have been substantially worked or processed in such territory.

Figure 1

**TIMELINE FOR THE WITHDRAWAL PROCESS AND THE NEW FRAMEWORK OF RELATIONS**



SOURCE: Banco de España.

In services and investment,<sup>3</sup> the TCA establishes greater openness compared with the WTO General Agreement on Trade and Tariffs (GATT), but without going beyond what the EU has agreed with other countries. As in the agreements with Canada and South Korea, it includes non-discriminatory obligations in respect of service and investment providers of the other party, and a “most favoured nation” clause entailing the reciprocal granting of any more favourable treatment provided for in future agreements with other third countries. Market access for each sector will depend on the way the services are provided according to GATT categorisation, with provisions laid down, in particular, to smooth the movement of natural persons for the provision of services.

The TCA also includes significant provisions in other areas. Specifically, it ensures a certain degree of interconnectivity in energy, aviation and land transport. And in fisheries, it provides for a new stocks-management framework that ensures access to EU and UK waters under the current terms for a period of five-and-a-half years, followed by a gradual reduction in quotas. It further sets in place sectoral, social security and internal security cooperation mechanisms (police and judicial

3 The TCA covers, inter alia, delivery and telecommunications services, computer-related and digital services, financial services, legal, auditing and architectural services and most transport services, whereas public services, general interest services, certain transport services and audio-visual services are excluded, as is habitually the case in trade agreements entered into by the EU. The TCA is, moreover, applicable to investment in sectors other than services such as manufacturing, agriculture, forestry, fishing, energy and other primary industries.

cooperation in criminal matters), along with ensuring access to public procurement processes on an equal footing.

There are sound commitments to ensure open and fair competition and to prevent distortions in trade and investment. In particular, the UK and the EU commit to maintaining current social, labour market and environmental standards, and sound State aid arrangements. In the tax realm, standards and rules to enhance transparency and curb tax evasion and malpractice are envisaged.

The TCA establishes its own institutional framework. This comprises a Partnership Council<sup>4</sup>, which shall be ultimately responsible for the objectives of the Agreement being met. It will be assisted by specialised committees entrusted with monitoring and overseeing the areas under their remit. The decisions of the Partnership Council and the specialised committees shall be taken by consensus. In this connection, the stance of the EU – represented by the European Commission – shall be determined beforehand at the Council of the European Union.

Binding mechanisms are also set in place both for the implementation of the Agreement at the domestic level and for resolving differences between the parties. In the event of dispute, the TCA provides for an arbitration tribunal (or a panel of experts when the application of provisions to ensure open and fair competition is involved). The tribunal's decisions shall be binding and, if not complied with, may entail suspension of the commitments laid down in the Agreement, including the possibility of imposing tariffs and quotas. The adoption of unilateral measures is also envisaged, among other reasons to mitigate substantial adverse effects on trade and investment between the EU and UK arising from the granting of State aid or from significant divergence on social, labour market and environmental matters.

The entry into force of the TCA will not fully avoid the frictions associated with the split into two separate markets subject to different legal arrangements after the end of the transition period. From 1 January 2021, all products shall observe the technical standards applicable in the territory of import and they shall be subject to customs procedures and to regulatory and product-origin checks and controls (mainly for product and consumer health and safety reasons). In services, providers shall cease to benefit from mutual recognition (or from the European passport in the case of financial services). Accordingly, they shall be subject to the rules of the country in which they provide such services and, in some cases, they shall be obliged to establish a presence in order to be able to continue providing services (see Box 1).

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4 The Partnership Council comprises EU and UK representatives, and is co-chaired by a Member of the European Commission – Maroš Šefčovič, Vice-President of the European Commission for Interinstitutional Relations and Foresight – and a representative of the UK Government at ministerial level, the Minister for Relations with the EU, David Frost. Along with overseeing the application and implementation of the agreement, the Partnership Council is conceived – inter alia – as an information-exchange forum to resolve disputes at the political level.

The end of the transition period also means that the EU's trade agreements with third countries will cease to have effect for these countries' trade with the UK. For this reason, the UK has approved different trade agreements which, in most cases, will replace the agreements from which they were benefiting by virtue of their EU membership. These include most notably those entered into with Switzerland, Japan and Norway, the UK's three main trade partners after the European Union, the United States and China. In financial services, the UK has recognised the Swiss stock market for regulatory equivalence purposes (recognition which the EU had withdrawn from Switzerland), which will enable British investment companies to trade on the Swiss stock market.

In the case of the EU, various adaptation measures have been taken to ensure an orderly transition (see Box 2 for Spain's case). Moreover, ahead of the impact that Brexit may have on the economic activity of certain regions and sectors, the European Council approved a Brexit Adjustment Reserve (BAR) in July 2020. The draft regulation for the BAR is currently under discussion and is expected to come into force in June 2021. The Reserve will have a Budget of €5 billion,<sup>5</sup> intended to provide financial support to the Member States (MSs) – especially those most affected by Brexit – for implementing measures aimed at mitigating the economic, social and territorial impact of the UK's exit from the EU. So it may be effective as soon as possible, the proposal establishes that 80% of the BAR funds be distributed in the form of pre-financing in 2021. The remaining 20% will be allocated in 2024, once the measures adopted by the MSs<sup>6</sup> have been evaluated by the European Commission. The proposal includes a distribution of the pre-financing that takes into account each country's exposure to the UK in terms of bilateral trade in goods and services and, specifically too, in terms of fishing. The MSs to most benefit from this pre-financing would be Ireland and the Netherlands.

## Initial economic effects

Despite its scope, the TCA entails a fall-off in the degree of bilateral openness – and not only in trade – between the EU and the UK that will foreseeably exert an adverse economic impact. Quantifying this impact is subject to high uncertainty. According to the estimates of the Office of Budget Responsibility (OBR),<sup>7</sup> the disruptions to trade between the two areas might subtract around 0.5 pp from UK growth in 2021 Q1. On the 2022 horizon, and on some recent estimates, the adverse effect on economic growth might be around 0.2 pp and 1.5 pp for the euro area and for the

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5 In 2018 euro.

6 The measures shall be geared, among other purposes, to supporting those local sectors and communities particularly affected, to sustaining employment and to adapting customs controls. The eligibility period will run from 1 July 2020 to 31 December 2022.

7 See OBR (2021).

UK, respectively [see Buesa et al. (2020)].<sup>8</sup> The lesser aggregate effects in the case of the euro area mask, however, significant cross-country heterogeneity. The impact will be greater for those MSs with more significant exposure to the UK economy, both because of trade (via goods and services imports and exports) and financial ties, a reflection of the weight of bilateral foreign direct investment (FDI). In the case of the Spanish economy, trade ties are relatively close, especially in the tourism, agrifood and automotive sectors, and FDI is particularly important in the financial and telecommunications sectors.

Following the entry into force of the TCA, some news sources say there have been delays and supply problems, and disruptions to the value chain in the most affected areas, such as Northern Ireland and the English Channel. Generally, in January and February, merchandise flows have been much disrupted in terms of volume and time taken to exit the EU.<sup>9</sup> According to a recent survey of UK and EU firms,<sup>10</sup> 60% of importers incurred delays in receiving goods in January, compared with a figure of 45% reported by exporters in delivery; customs controls were the most frequent cause of the delays. Further, almost 20% of firms had resorted to stockpiling in the months prior to the withdrawal date,<sup>11</sup> which would lead to a temporary reduction in transited goods in the period immediately following this date. If the disruptions persist over a prolonged period, the situation might worsen once such stocks are run down and the volume of bilateral trade increases.

British firms appear to have incorporated the withdrawal from the EU into their normal activity, as illustrated by the Bank of England's *Decision Maker Panel* figures for January. In this survey, the Chief Financial Officers of firms from all sectors, in response to questions on Brexit, perceived a slight easing in uncertainty over withdrawal in the final months of 2020 (see Chart 1.1), and a considerable improvement in the readiness of respondent firms to continue trading with the EU under the framework of the new relationship (see Chart 1.2). In any event, once agents have adjusted to less uncertainty over the terms of the future relationship, this might have a positive impact on both areas.

## Conclusions

In short, by eliminating goods tariffs in UK-EU trade, among other measures, the TCA reduces uncertainty over future trading relations between both areas, which

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8 The numbers refer to a scenario that can be assimilated to the TCA; Buesa et al. (2020) approximate to an ambitious free trade agreement similar to the Comprehensive Economic and Trade Agreement (CETA) with Canada. The results are in line with those obtained in other studies (see, for example, Flach et al., 2021).

9 On official data, UK exports to the EU fell by 38% in January compared with the same month a year earlier. Imports declined by 16%. The greater fall in UK-related flows was also felt in Spain: exports to the UK were down by over 20% year-on-year in January, while imports slumped by more than 60%.

10 Conducted in January by the Chartered Institute of Procurement and Supply (CIPS) with 185 UK and EU firms.

11 Stockpiling was also seen in the months prior to the previously envisaged withdrawal dates (March and October 2019), according to the UK Office for National Statistics [see ONS (2021)].

Chart 1

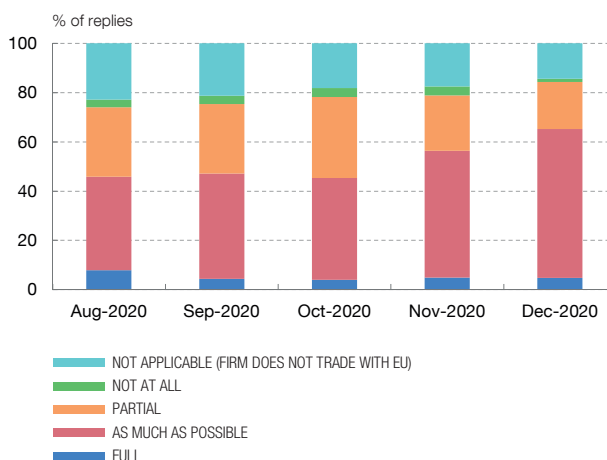
### THE READINESS OF UK FIRMS AHEAD OF BREXIT

The TCA will enable uncertainty in trade relations between both areas – which has held high since 2016 – to be lowered, and it will help firms be ready for the new situation.

1 BREXIT UNCERTAINTY INDEX (a)



2 READINESS FOR POST-BREXIT TRADE WITH THE EU



SOURCE: Bank of England, Decision Maker Panel (DMP) survey, February 2020.

a The index is based on the following DMP question: "How much has the result of the EU referendum affected the level of uncertainty affecting your business?". The figures prior to September 2016 are imputed using betting data.



had borne on their economic decisions since 2016. However, the presence of non-tariff barriers and the regulations on rules of origin might lead certain activities with a strong trade component to cease to be profitable in their current format.

Similarly, in the financial arena, the absence of equivalence decisions means, among other aspects, that it will be impossible to operate with euro-denominated assets from the UK, which will require the relocation of financial services to within the European Union.<sup>12</sup> In the long run, potential regulatory divergence between the EU and the UK would hamper the mutual recognition of both trade and financial activities, resulting in less integration between both areas.

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<sup>12</sup> On CBOE Global Markets data, there was already a shift in activities from London to European centres such as Amsterdam, Frankfurt and Paris in January 2021. See also ECB (2020).



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**FINANCIAL SERVICES**

As in other trade agreements, the provisions of the TCA in respect of financial services are very limited. Accordingly, as from 1 January 2021, the conditions for the provision of these services are substantially more restrictive compared with the European passport arrangements.

In the TCA, the UK and the EU undertake to keep their respective markets open to operators wishing to provide services through an establishment, and to apply in their territory the international standards on prudential, money-laundering and tax evasion matters. They also reserve the right to adopt or maintain measures for prudential reasons to safeguard financial stability or market integrity. The TCA has no provisions on regulatory cooperation, nor on the respective equivalence frameworks.<sup>1</sup> To this end, the EU and the UK intend to sign a Memorandum of

Understanding which, inter alia, provides for a transparency and dialogue framework in relation to the process of adopting, suspending and withdrawing equivalence decisions.

Against this background and in order to safeguard financial stability at the end of the transition period, on 21 September and 25 November the Commission adopted two Implementing Decisions. These stipulate equivalence under the regulatory framework applicable in the UK to UK central counterparties and central securities depositories for a time-limited period of 18 months and 6 months, respectively. In the other relevant areas, the European Commission reserves itself the possibility of adopting at a later stage the related equivalence decisions in the interest of the EU.

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<sup>1</sup> Equivalence is the process whereby, in the EU, the Commission evaluates and determines whether a specific foreign regulatory and supervisory framework is equivalent to that of the EU. The decision on equivalence enables the competent authorities of the EU to recognise the third-country framework for the purposes of assessing compliance with specific EU regulatory and supervisory standards and, in some cases, it enables access to EU markets. Many core banking or financial services, such as deposit taking, granting loans and the provision of investment services to retail customers, are not covered by an access regime based on equivalence.

**SPAIN: ADAPTATION MEASURES**

On 29 December 2020, the Government approved Royal Decree-Law (RDL) 38/2020, adopting measures for adaptation after the expiry of the transition period provided for in the Withdrawal Agreement for the UK's exit from the EU.

The RDL envisages a series of time-limited measures, in some cases subject to reciprocity by the British authorities. The measures relate, in the main, to the labour market, social security, healthcare provisions, public procurement, professional qualifications and financial services.<sup>1</sup>

In the financial arena, Art. 13 of the RDL establishes a framework to ensure the continuity of contracts for financial

services provided in Spain by UK-domiciled entities. This is a temporary arrangement to avoid disruption to the provision of services as a result of adaptation to the arrangements for third countries. At the same time, it facilitates the termination or transfer of the contracts to entities duly authorised to provide financial services in Spain, with the attendant authorisations remaining in force until 30 June 2021. The RDL does not foresee any other adjustment measure in this area. This means that British institutions should bring all activity in Spain requiring authorisation from 1 January 2021 to a halt, except that activity necessary for the orderly termination or transfer of the contracts entered into prior to that date.

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<sup>1</sup> Some of these measures are extensive to Gibraltar, though this is not the case for financial services-related measures.