

The iron cage revisited: How Brexit constrains the UK

*In recent weeks, the Trade and Cooperation Agreement between the UK and the EU has once again been making headlines. **Bob Hancké** reports on a recent study which suggests not only that the agreement has made trade in goods between the UK and the EU very difficult, but that it has also severely limited Britain's ability to conclude free trade agreements with the rest of the world.*

Taking back control, especially in international trade, was one of the perhaps few tangible benefits that Brexit conferred onto the UK economy. In a [new report](#) for the French *Hauts-de-France* region, my co-authors and I unpack in great detail what the Trade and Cooperation Agreement (TCA) between the UK and the EU implies for the export markets of British business.

We wrote about some of the problems of the TCA in a [previous EUROPP post](#) in July this year. But one aspect seems to have eluded many observers: the UK can, of course, conclude free trade agreements with countries beyond the EU – as it has done since the TCA entered into force. However, it cannot do so without large repercussions on UK-EU trade, which makes sovereign free trade agreement negotiating extremely difficult.

The reason is simply that the UK is forced to abide by standards and norms set in Brussels for the free movement of goods (and even services); if new trade agreements conflict with those standards, the EU can unilaterally suspend its free trade on those goods and services. Given the relative size of the EU as the UK's main trading partner, accounting for almost 50% of UK exports, the EU's shadow therefore hovers over all trade talks. The below takes a closer look at three areas to explore different dimensions of the problem: labour and environmental standards, agricultural and food product standards, and trade in digital services.

The extraterritorial effects of environmental and labour standards

In the TCA, the UK has committed to maintaining labour and environmental standards that are broadly equivalent to those of the EU. Wages and working conditions should be deemed to be broadly equivalent – though it is unclear who exactly will make that call, and recent noises about suppressing the ECJ's role in those processes make the situation more and not less complicated.

Similarly, the environmental credentials of exported UK products will be evaluated by the EU (and vice versa, though very few observers see that as a problem) but it is, again, unclear who exactly will be involved in that process. This lack of clarity regarding the enforcement mechanisms is not nearly as helpful as militant Brexiteers would like it to be, since it introduces a degree of political discretion into an area that is usually ruled by soft and hard law to avoid trade becoming a political football.

But there is more. The condition of broadly equivalent labour and environmental standards as a prerequisite for tariff-free trade makes the pursuit of an export model based primarily on cost competitiveness – the main viable short-term strategy for an economy with a highly deregulated labour market and a persistent productivity problem – almost impossible.

The reason: it would make little sense for most companies that export to the EU to develop a parallel lower-regulation model to export to the rest of the world. All things being equal, the company is better off adopting the same standards everywhere since higher standards will never violate lower standards but that is not true the other way around.

EU standards thus impose important extraterritorial constraints, in the sense that their effects can be felt outside the territories explicitly covered by its rules. UK companies exporting to the US or Australia – the two leading contenders for free trade agreements – will have to do so while continuing to adopt the 'cumbersome' and 'uncompetitive' EU labour and environmental standards (assuming they do not want to lose the lucrative EU markets), even though the EU is not a party to the free trade agreement.

Product standards: where's the beef?

A similar problem emerges in product standards, where the TCA's internal logic produces a direct, and very sharp, dilemma for the UK. The UK faces a relatively simple choice. It can stick to EU standards to preserve trade with European counterparts, or the country can adopt different standards to facilitate new free trade agreements with non-EU countries. In the latter case, however, the UK runs a significant risk of cutting off its companies from the single European market as a result.

The oft-cited case of US beef illustrates the problem. The UK can negotiate a free trade agreement with the US in which US hormone-treated beef can be freely traded (in exchange, one would guess, for free US access by UK products such as whisky). But hormone-treated meat is prohibited in the EU.

Once the US-UK agreement is signed and ratified, therefore, those parts of the TCA between the EU and the UK that deal with beef exports and imports are effectively suspended: if beef can travel freely between the US and the UK, and between the UK and the EU, there is no way for the latter to stop the import of hormone-treated beef (at least not unless tests or strict labelling are agreed – but that would, of course, imply a substantial reduction of free trade), which goes against the current EU regulatory framework.

Suspension of trade is the only possible answer to avoid breaking EU laws, unless the UK pre-empts that by adapting to EU constraints when negotiating a free trade agreement with the US. Again, the EU's constraining power is felt in areas where the EU is not directly involved.

Trade in digital services

While the digital trade section in the TCA is seen as best in class, its success is largely contingent on the EU's data adequacy decision. Non-EU member states must be afforded data adequacy to store and process the data of EU citizens. Although the UK has secured a [positive decision](#) from the EU Commission, this is limited to four years, after which the EU will re-evaluate the equivalence of data protection mechanisms.

The expiration date and the Commission's warning that they could revoke the decision at any point if data were not accurately protected gives the EU further leverage in an important area. Regulators in Brussels will monitor any attempt to change the UK data protection legislation carefully, thus limiting the UK government's ability to deregulate a policy area that is growing in importance and is likely to find a place in new free trade agreements. If things go wrong, the UK will have to choose between EU approval by sticking to its standards or foregoing the benefits of digital trade with the EU in favour of trade elsewhere. Either way, the loss is almost entirely asymmetric, and the EU can unilaterally decide to impose restrictions.

The long shadow of the EU

These three areas suggest that the UK has painted itself into a corner with the TCA. By explicitly remaining outside the Single Market, the country has not only thrown up a host of regulatory and governance problems – such as Northern Ireland and the ECJ – or economic difficulties – empty supermarket shelves and a lack of lorry drivers – but it has also made itself vulnerable to the extraterritorial powers of the EU.

EU-UK trade depends on the UK adopting EU standards; if the UK were to negotiate a free trade agreement with a third country that violates EU standards, the EU can suspend the parts of the TCA that govern free trade in these markets – with significant losses for UK businesses and potentially the economy as a whole. Avoiding those problems means choosing the lesser evil between the (EU-related) losses and (non-EU related) gains in trade. The size of the EU, and the weight in the UK's trade basket, almost invariably leads to one conclusion for the now sovereign UK: minimise the EU-related losses by adopting EU standards.

According to a wry joke in Central Europe, socialism was the long road between capitalism and capitalism. Is Brexit the long road between the EU and the EU?

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