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A LOOK AT EU-UK TRADE RELATIONS IN LIGHT OF BREXIT, PANDEMIC AND THE TRADE AND COOPERATION AGREEMENT

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ABSTRACT: *A few months after the UK definitive departure from the EU, this work offers a comprehensive analysis of the trade relations between the two Parties and of their future perspectives in light of the scenario disclosed by the Covid-19 pandemic and by the Trade and Cooperation Agreement (TCA). The analysis highlights the deep commercial links between the two areas, characterized by the juxtaposition between the EU's large surplus in goods trade and the UK's dominance in the exchange of services. The outcome of the 2016 referendum had a modest impact on trade between the two blocs, although on both sides of the Channel a process of adaptation to the new setting is ongoing since several years also through the research for new trading partners. The TCA represents a good result compared to the dreaded alternative of a no deal, but a reduction in business at the EU-UK border seems still inevitable. On the one hand, goods producers and traders now have to comply with product-specific rules of origin to be exempted from duties: additional costs and efforts will be therefore needed to deal with customs red tape and to re-arrange production systems and supply chains. On the other hand, the vagueness of the TCA provisions on trade in services leaves crucial issues unsettled, as in the case of equivalence determinations. The overall picture looks more favorable to the EU than the UK, but the medium-to-long term effects on both Parties will mostly depend on their willingness and ability to restore a climate of mutual confidence and cooperation.*

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1. After a long negotiation, at the end of December 2020 the European Union and the United Kingdom finally reached an agreement that will govern their bilateral relations starting from 2021.

Over 1200 pages long, the Trade and Cooperation Agreement (TCA) addresses a vast number of issues ranging from trade in goods and services, to digital commerce, to guarantees for a leveled playing field, to cooperation in law enforcement, health, science and dispute management.

Despite its limitations (on many topics there are only general provisions, which will have to be completed following further negotiations between the two Parties), the TCA represents an almost unexpected result, given the difficulties encountered up to the last weeks of negotiations, which led to fears of a no deal.

The most important result of the Agreement is that of having avoided the application of quotas and tariffs in the exchange of goods between the two sides of the Channel, which could have been entailed by the UK's exit from the single European market. Taking into account the deep economic and commercial integration between the two Parties, the transition to the basic structure envisaged by the WTO standards would have hit hardly the respective economies already battered by the Covid-19 pandemic. To access the exemption from duties and quotas, the TCA requires goods traded at the EU-UK border to comply with a detailed set of rules of origin, which are aimed at granting the preferential treatment only to goods that are (mainly) originating from the country of the exporter, be it either Britain or a EU country. The Agreement allows for bilateral cumulation on preferential rules of origin; yet it is inevitable that the new UK status as third-country with respect to the EU will engender trade frictions that so far were unknown between the two blocs. In fact, trade operators will have to comply with a previously inexistent customs red tape and producers will need to modify their supply chains if they want to benefit from preferential rules of origin. Furthermore, the problem of the Irish border is still far from being settled: UK domestic policy issues overlap with economic and trade ones, resulting in a continuing source of with the European Union.

With regard to the exchange of services, the provisions of the TCA are rather sparse and, from the United Kingdom's standpoint, far from the objectives it had tried to achieve during the long negotiations with the European Union.

In the field of financial services, the Agreement is practically negligible, especially if one considers that they are the most important component of the UK trade in services with the EU, with an annual surplus on average over 20 billion euros. Fundamental issues – such as the equivalence determination between the regulations in force in the EU and those in force in the UK – remain unsolved as relations between the two Parties continue to be undermined by mutual mistrust.

The EU has made it clear that it is in no hurry to settle the issue, considering instead it is appropriate to carefully evaluate the extent to which the United Kingdom will make use of the newly found regulatory autonomy to move away from the European discipline.

For its part, Britain is unlikely to accept a role of rule-taker, given that the recovery of regulatory sovereignty was one of the workhorses of the pro-Brexit campaign. Not coincidentally, in fact, it has already started a profound revision of its financial regulations, in order to strengthen the attractiveness of the City as an international financial centre and minimize the loss of capital and human resources resulting from the definitive departure from the EU.

The present work explores the evolution of trade relations between the EU and the UK over the past two decades, with the aim of gaining greater awareness of the degree of interdependence between the two economic areas, assessing the impact of the 2016 Brexit referendum and commenting on possible future developments in the light of the TCA.

The work is organized as follows. Section 2 offers an overview of the trade in goods and services between the EU and the UK, which highlights how the two Parties are extremely important to each other as business partners. Section 3 provides a focus on bilateral trade in goods, analyzing the main UK partners within the EU, the most relevant product categories and the innovations introduced by the TCA. Section 4 focuses on the exchange of services between the European Union and Britain; also, in this case the paper provides an in-depth analysis on the main UK partners within the EU bloc, on the most important types of services in the trade between the two Parties and on the most relevant attention profiles for the future developments of the trade in services in light of the TCA and the open issues it has left on the table. Section 5 concludes.

2. The European Union and the United Kingdom share a strong trade interdependence. Clearly the intensity of these trade links must be assessed taking into account the different order of magnitude of the two economic areas, given that the EU is an aggregate that includes 27 different nations.

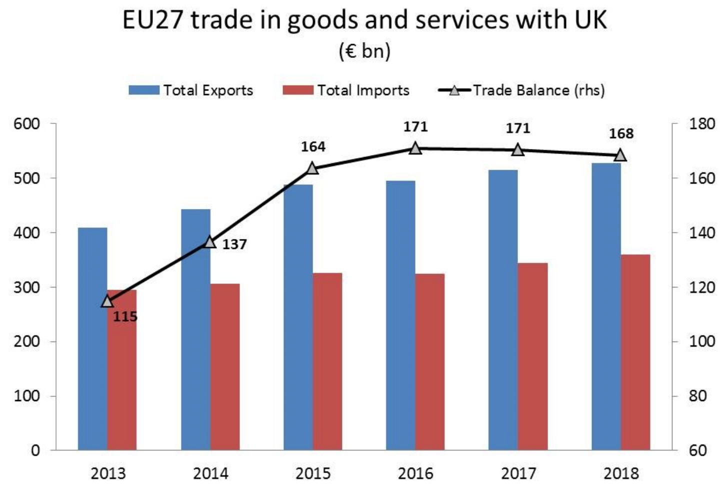
For the EU, the UK is one of the main trading partners on a global scale along with the US and China, while for the UK the EU ranks first as a trading partner.

In aggregate terms, the net balance of trade in goods and services between the two sides of the Channel is in favor of the European Union and over the last years (apart from 2020) hovered around to 100 billion euros per year.

The precise quantification of these balances depends, as it is often the case, on the subject reporting the bilateral trade data. In fact, due to trade asymmetries, especially with regard to services, the overall EU surplus (goods and services) with Britain varies depending on the use of data communicated by the 27 countries of the European Union or, instead, those reported by the United Kingdom.

Using only data collected by the EU (Fig. 1), the overall trade surplus against the UK averaged € 154 billion per year between 2013 and 2018.

Figure 1

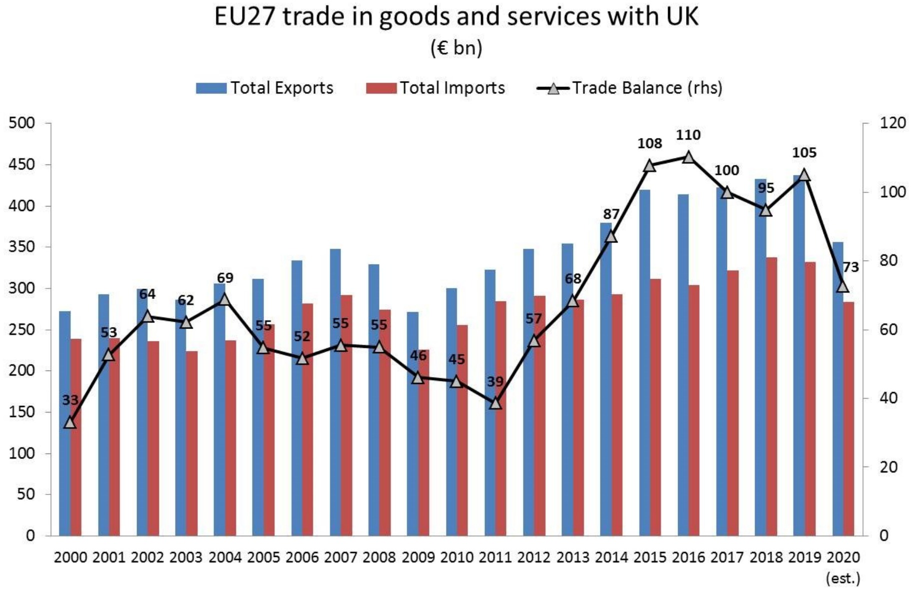


Source: Eurostat

With regard to international trade in services, official data of the 27 EU countries only cover the period from 2013 to 2018 with annual frequency. On the other hand, those of the UK Office for National Statistics (ONS) are available quarterly from 2000 to the third quarter of 2020.

Using ONS data on trade in services and EU data on trade in goods, it is therefore possible to obtain the annual time series of the main trade variables since the beginning of the century (Fig. 2).

Figure 2



Source: Eurostat, ONS

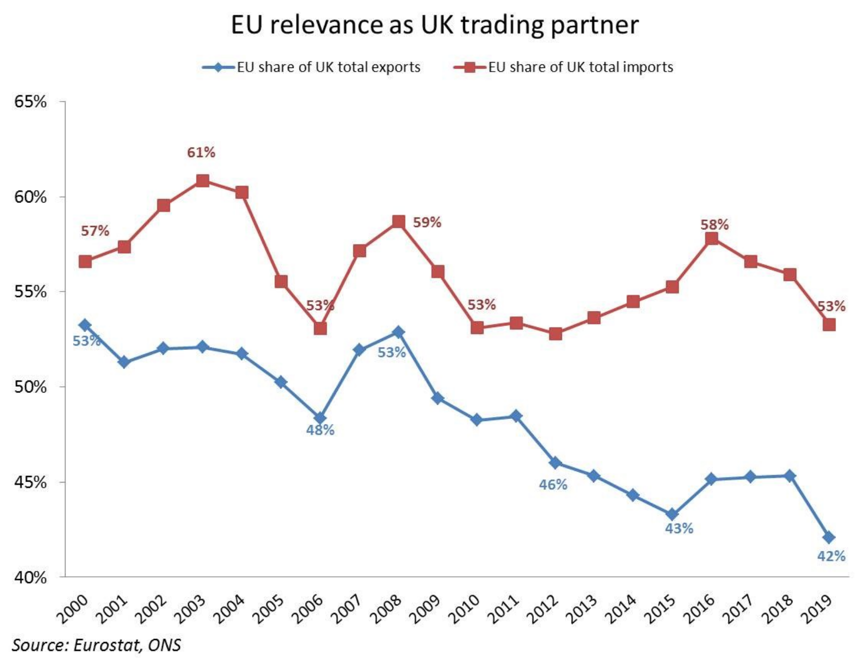
Fig. 2 shows a steady growth of the EU trade surplus towards the United Kingdom from 2012 to 2016, followed by a slowdown in the three-year period 2017-2019, and then by a collapse in 2020 (with an estimated value of 73 billion euros) mainly due to the heavy consequences of the Covid-19 pandemic on global trade.

Overall, therefore, these data support the thesis that following the 2016 referendum trade relations between the European Union and the United Kingdom have cooled down, causing a halt in the growth of the surplus of EU countries without, however, substantially compromising the trade volumes reached up to that moment. Something similar had happened between 2005 and 2011 for various reasons, including the pound devaluation against the euro between 2007 and 2008 and the recessionary effects of the global financial crisis of 2008-2009.

With specific regard to the period 2013-2018, the comparison between Fig. 1 and Fig. 2 shows that using ONS data on trade in services between the two sides of the Channel, the EU's annual trade surplus against the UK amounts on average to € 95 billion, quite below that resulting from EU data. This discrepancy indicates a considerable difference in statistics on trade in services between the two blocs.

Leaving aside the issue of bilateral discrepancies, it is interesting to relate the EU-UK bilateral trade data to those that each Party has with a wider reference universe. Exports of goods and services to the UK account for more than 17% of total EU exports to non-EU countries, while minor but still significant (over 13%) is the share of imports from across the Channel on the total EU imports from non-EU countries. In turn, the European market is the outlet market for more than 40% of British exports to the rest of the world and the market of origin for over 50% of UK imports (Fig. 3).

Figure 3



Both shares are lower than they were at the beginning of the century, as a result of repeated phases of contraction in bilateral trade relations, the last of which began after 2016. Of particular evidence is the drop of about 10 percentage points in the EU share of British exports to the rest of the world, a phenomenon that has been taking place since 2009 and that, after a break between 2015 and 2016, has resumed following the Brexit referendum.

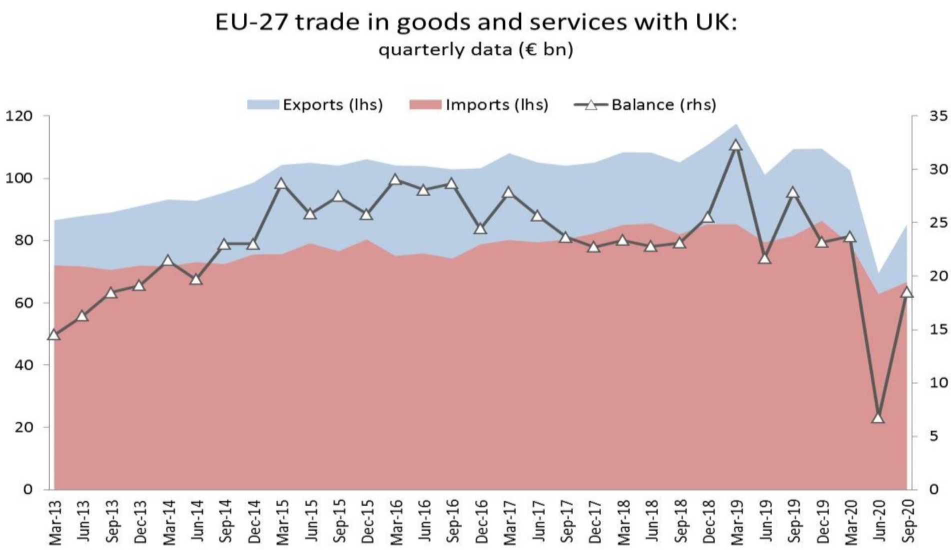
Using monthly Eurostat data of the EU member States on trade in goods and quarterly ONS data on trade in services, it is possible to build the quarterly time series for the import-export of goods and services between the EU and the UK in the recent years (Fig. 4).

Between 2013 and 2019, EU exports to the UK averaged € 102 billion on a quarterly basis, and imports € 78 billion. The EU trade surplus exhibits only a slight decline in the quarters following the 2016 referendum, which had begun to show signs of recovery between 2018 and 2019.

The real shock occurred, rather, in 2020 with a collapse in bilateral trade flows (particularly pronounced for EU exports to Britain) characterized by a rock bottom in the second quarter and a moderate rebound in the third. Although 2020 was the UK's last year within the European Union and the uncertainties over the negotiations continued until the end of the year, the observed dynamics suggest that the main drivers of trade between the two blocs during the year were the pandemic and the related contagion containment measures.

This makes reasonable to assume that the sharp decline in trade that occurred in 2020 due to Covid-19 has made a significant contribution to reaching the agreement at the end of December, at least to avoid further losses to economic operators already battered by the pandemic.

Figure 4



Source: Eurostat, ONS

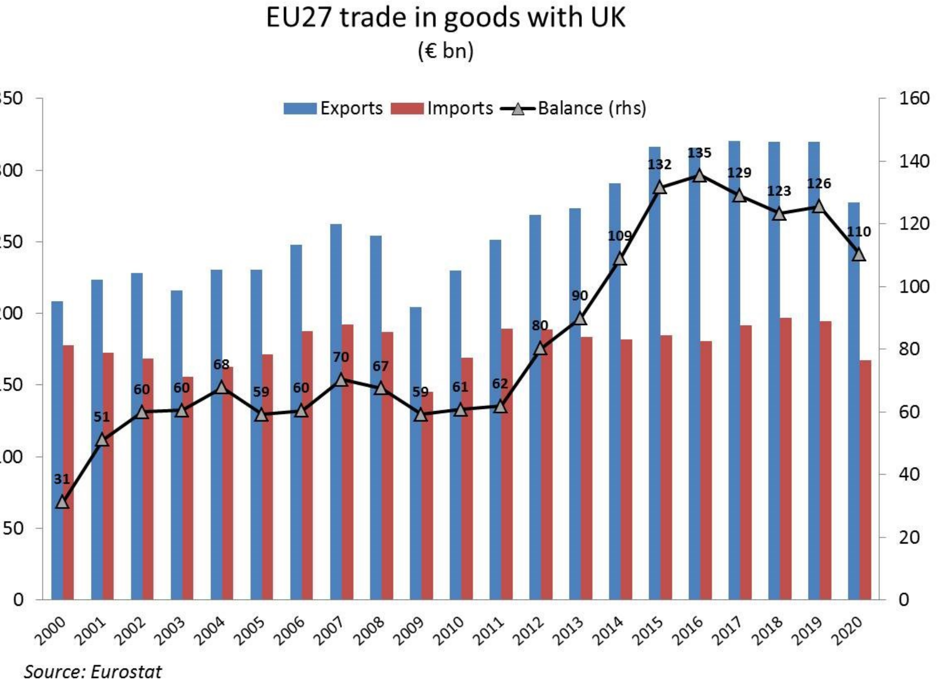
3. Trade in goods between the EU and the UK is the most important component of trade exchanges between the two economic areas, with total volumes amounting to around 500 billion euros per year.

Between 2010 and 2019, thanks to the progressive appreciation of the pound against the euro (the most widespread currency within the EU), the net balance of these trade exchanges almost doubled compared to the 2000-2009 period, reaching an average value of 105 billion euros per year in favor of the European Union. Currently the United Kingdom ranks second after the United States in terms of largest deficit in goods trade with the EU bloc.

Following the Brexit referendum, the EU surplus has left the growth path posted in the previous years, experiencing a decline of 7.3% between 2016 and 2019 (Fig. 5) also because of a new phase of weakness for the UK currency. A much more significant decline occurred in 2020 due to the pandemic and the approaching UK's final departure from the EU: compared to 2019, the EU's surplus towards Britain fell by more than € 15 billion, corresponding to a 12% reduction on an annual basis.

As a first approximation, therefore, Brexit seems to have had a relatively limited impact on the trade in goods between the two economic areas, also taken into account that, during the period considered, the escalation of tensions on global trade and the uncertainties related to the protectionist attitude of the US foreign policy under the Trump administration may have impacted on trade relations between the EU and the UK. After all, over the same period, the EU's goods trade surplus with non-EU countries other than the UK also experienced a downsizing, falling from € 129 billion in 2016 to € 66 billion in 2019.

Figure 5



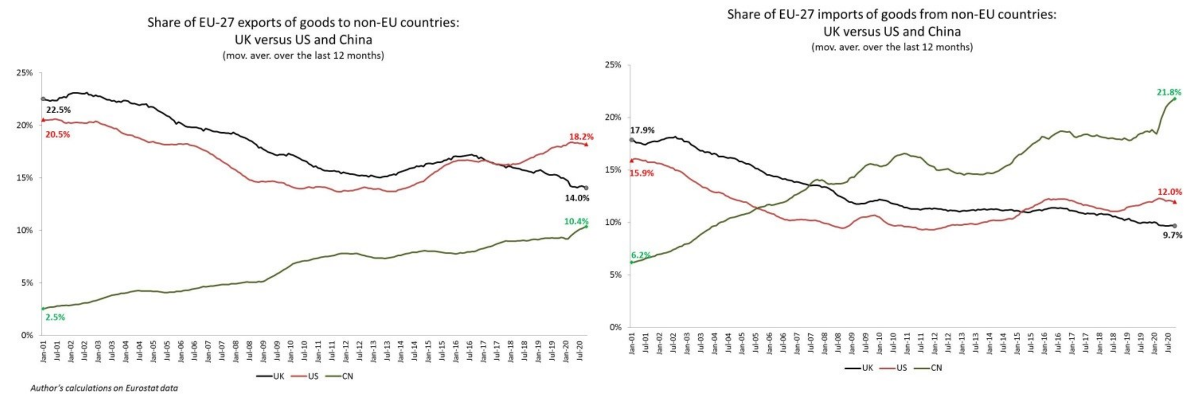
The analysis of monthly data confirms that after the referendum the bilateral balance of the trade in goods stabilized at around € 125 billion per year. However, monthly data also suggest that as of 2016 both the European Union and (to a lesser extent) Britain have scaled down their bilateral trade in goods and tried to intensify exchanges with other partners such as the United States and China.

With regard to the EU, data highlight a long-term trend towards a reduction in the UK's share on the bloc's total exports and imports of goods from non-EU countries. After a break between 2012 and 2016, this trend has regained strength following the Brexit vote result.

In detail, over the past 4 years the UK's relevance as an outlet market for European goods has fallen from 17% to 14% (Fig. 6), while its share of EU goods imports has fallen less (from 11.5% to 9.7%) as a result of the exchange rate dynamics, which have favored British exports to the EU. At the same time, the importance of the US and China as trading partners of the European Union has increased. Until 2015 the behavior of the UK and the US trade exchanges with the

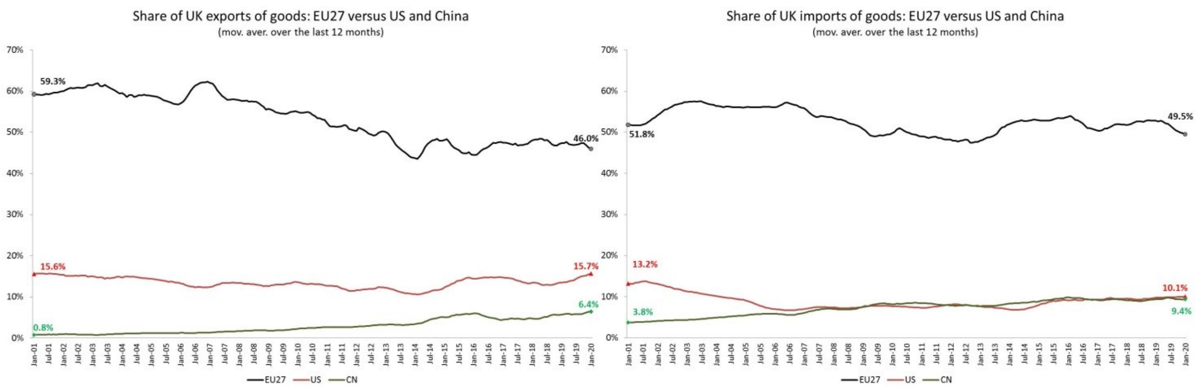
EU had been very similar; instead, starting from 2015-2016, it took place a decoupling, which led to a diverging trend in the relevance of the two countries as EU's trading partners. A sort of substitution effect has emerged, which helps to understand why, since 2018, the United States have overtaken the United Kingdom in terms of largest deficit in the trade in goods with the EU. Conversely, the growing importance of China as a trading partner of the European Union appears only weakly related to Brexit; in fact, this phenomenon was clearly underway before 2016, and its speed up during 2020 reflects the enormous competitive advantage that the Chinese economy was able to enjoy compared to the rest of the world for having brought timely the pandemic under control.

Figure 6



From the UK's standpoint, data need to be examined taking into account the EU's manifest dominance over any other foreign partner in the exchange of goods. Nevertheless, the British economy has also been showing a reorientation towards extra-EU markets for several years, especially as regards goods exports. After peaking at the end of 2006, the EU has absorbed a gradually smaller share of the total British exports of goods (Fig. 7) with a 16% decrease (from 62.3% of 2006 to 46.3% of 2019). Conversely, the US share has remained overall stable and it has even experienced a positive drift in recent years, and China's share has grown almost continuously over the last two decades. However, it should be remarked that the diminishing relevance of the EU as an outlet market for British goods is essentially a long-term phenomenon, to which Brexit seems to have contributed marginally.

Figure 7



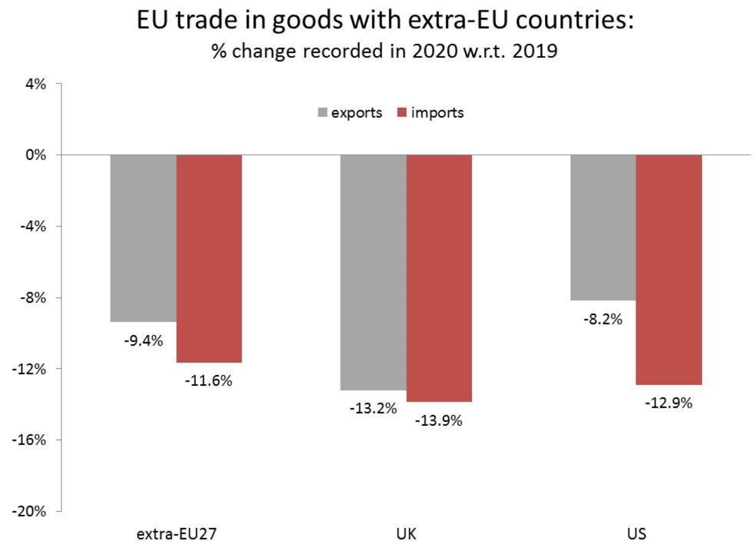
Author's calculations on Eurostat data

Also with regard to UK imports of goods, data highlight a long term trend of reduction in the reliance on EU countries, although less pronounced than the one regarding exports. At the end of 2019, the EU's share of total UK imports was around 50%, a large value but still 7 percentage points lower than the peak reached in 2003 (Fig. 7). Again, this phenomenon is only marginally related to Brexit, and it rather needs to be interpreted in the light of the broader picture of the recent developments in global trade with China's growing influence as a supplier of goods to the rest of the world. It should be noted, however, that as of 2019 the UK appears to have intensified its efforts to cut imports from the EU, with a substitution effect to the benefit of other foreign markets such as the US and especially the Chinese one.

A further in depth-analysis deserves what happened in 2020, the year in which – as mentioned above – the huge shock to international trade caused by the Covid-19 pandemic and related containment measures added to the imminence of the UK withdrawal from the EU. In 2020, exports of EU goods to the UK fell by € 42 billion (-13.2%) and imports by € 27 billion (-13.9%) compared to the previous year (Fig. 8).

As a result, the surplus in goods trade with Britain fell by 12.2% (€ 15 billion), a very high value, especially considering that EU net exports to non-EU countries increased by 13.5% over the same period compared to 2019. The data, therefore, suggest that the persisting uncertainties about the outcome of Brexit negotiations have made the negative effect of the pandemic shock on bilateral trade with the UK particularly tough for the EU.

Figure 8



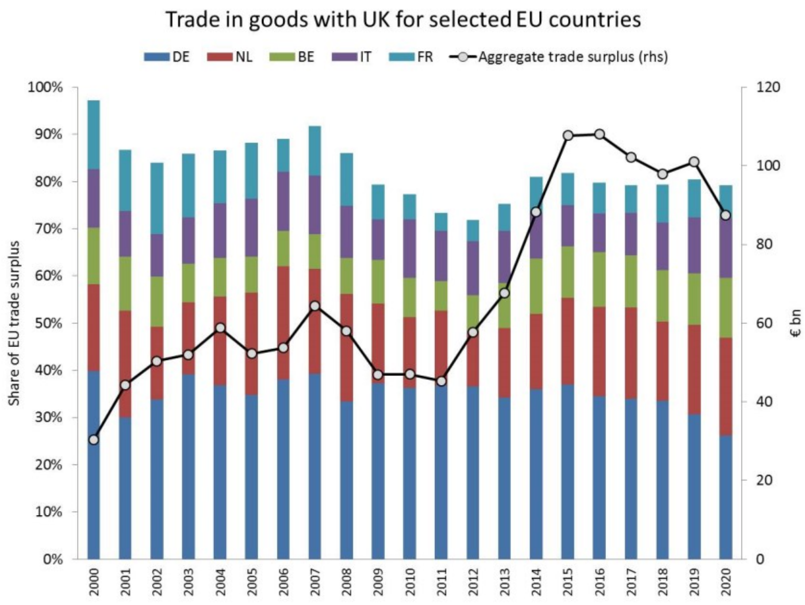
Source: Eurostat

From the UK's standpoint, ONS data on trade in goods show that the decline occurred in 2020 was more or less similar, in percentage terms, both with respect to the EU bloc and with respect to non-EU countries. The main difference is that, in absolute terms, imports of goods from the EU fell more than exports (resulting in an improvement in the deficit with the EU), whereas the opposite happened in trade with non-EU countries, leading to a slight worsening of the UK deficit towards this group of countries compared to 2019. It is worth stressing the significant surge (+22.3 billion euros) of the UK deficit towards China, a sign that the aggressiveness of Chinese mercantilism and the pandemic are affecting bilateral trade between the two sides of the Channel much more than Brexit.

3.1. Most of the trade in goods between the EU and the UK concerns a limited number of European countries: Germany, the Netherlands, Belgium, Italy, France and Ireland. Excluding the latter, all the countries just mentioned record a surplus in the import-export of goods across the Channel, which in aggregate terms accounts for the 80% of the entire EU surplus towards Britain.

The aggregate surplus of this group of countries to the UK increased significantly between 2011 and 2016 rising from 45 to 108 billion euros (+138%). It stabilized at an average annual value of around € 100 billion in the 3-year period following the vote on Brexit, and then experienced a 13% decline in 2020 (Fig. 9).

Figure 9

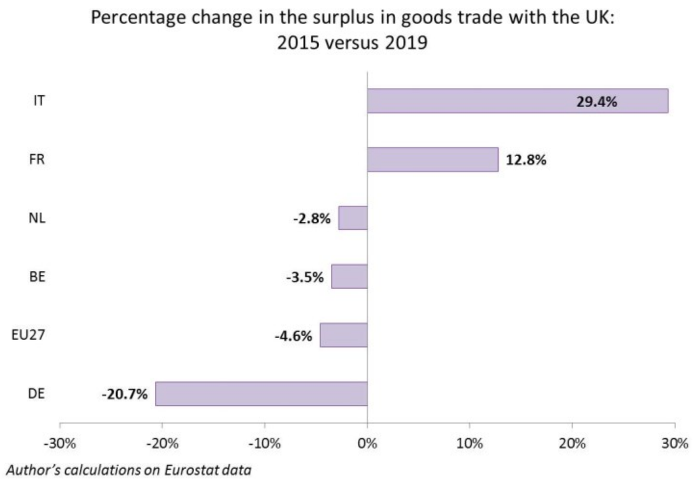


Source: Eurostat

Germany is by far UK's largest partner in the EU: its surplus in goods trade with Britons accounts for 26.2% of the overall EU surplus. The Netherlands rank second (20.7%), followed by Italy and Belgium (both with a 12.7% share) and, in the end, by France (7%).

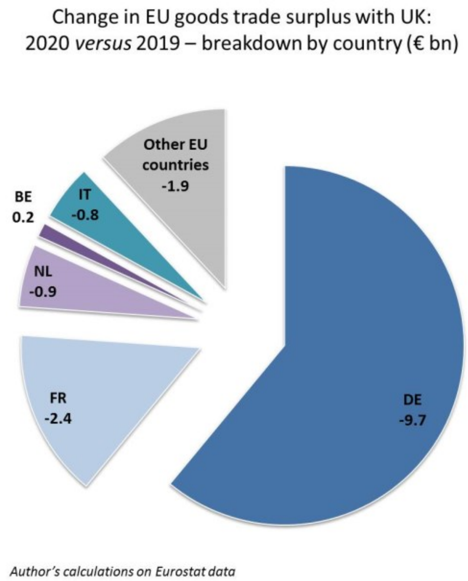
Among the countries considered, Germany is also the most affected by the downsizing in trade with the UK following the Brexit. By the end of 2019, its surplus to the Kingdom had fallen by 20.7%, compared with an overall decline in the EU surplus of 4.7%. The surpluses of the Netherlands and Belgium fell as well – although much less – while France and, especially, Italy increased their net exports across the Channel by 12.8% and 29.4% respectively (Fig. 10).

Figure 10



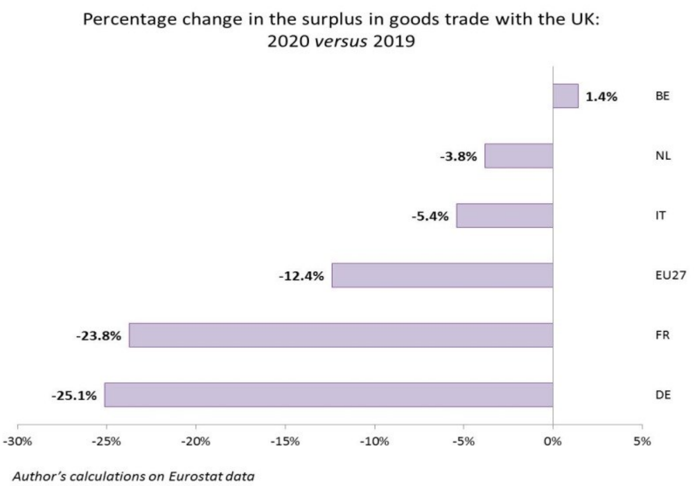
In 2020, all countries considered except Belgium suffered a decline in the goods surplus with the UK (Fig. 11).

Figure 11



Germany was the most affected: its surplus in goods trade with Britain fell by almost € 10 billion compared to 2019, accounting for about 2/3 of the total decline in EU net exports to Britain. In percentage terms, this is a 25% decrease, well above the reduction (-13.3%) of the German trade surplus towards all non-EU countries in the 2020 compared to the previous year. France scored second worse after Germany, with net exports to UK shrinking by € 2.4 billion, equivalent to a variation of -23.8% in percentage terms. The Netherlands and Italy kept below 10% the decrease in their surplus with the United Kingdom (Fig. 12), with values of -3.8% and -5.4% respectively, and Belgium even managed to achieve a small increase of 1.4%.

Figure 12



Another major partner of Britain within the European Union is the Republic of Ireland, which – unlike the other EU countries considered so far – has a permanent deficit in goods trade with the UK[1], with a value of € 9-10 billion per year. Ireland represents a strategic partner for the UK: it is the third largest export market for British goods globally (after the United States and Germany), and ranks ninth as the country of origin for UK goods imports. Until 2020, trade relations between the two countries had not been affected by Britain's decision to leave the European Union; in the future much will depend on their ability to find a new equilibrium in the post-Brexit framework and on the solution that will be implemented on the Irish border.

The relations between the United Kingdom and the Republic of Ireland represented one of the most controversial points of the negotiations on Brexit, as economic issues are intertwined with a delicate balance on the political and social

[1]Other EU countries that have modest deficits in goods trade with the United Kingdom are: Malta, Cyprus, Greece, Croatia and Estonia [Ward, 2020].

level. The Withdrawal Agreement signed between the EU and the UK government in 2019 includes a specific Protocol on Ireland and Northern Ireland that, in order to avoid a hard border on the island of Ireland and to protect the Good Friday Agreement (also Belfast Agreement), places the border for trade in goods on the Irish sea. Therefore, goods entering Northern Ireland from mainland Britain will be considered imports and will need to comply with EU products rules and be subject to controls for safety, health and other public policy purposes. After the ratification of the Withdrawal Agreement, the EU and the UK have agreed to certain flexibilities that will help limit disruptions caused by the implementation of the Protocol on trade between Great Britain and Northern Ireland [EU Commission, 2020], including specific provisions for grace periods on customs checks at the Irish sea border.

However, the developments that took place during 2020 made it clear that the Irish border issue was far from being settled, essentially because of the discontent among Northern Ireland's unionists. In an attempt to manage the issue, in September 2020 the UK government published a Bill (so-called Internal Market Bill) with the aim of preventing internal barriers between the constituent countries of the Kingdom. As promptly challenged by the EU Commission, some provisions of the Bill were in contrast with the commitments made by the UK in the 2019 Withdrawal Agreement, and in particular with those provided for by the Protocol. In the end, the UK government had to withdraw some of the contested provisions in order to get the approval of the Parliament, but the core issue remained unsolved.

Northern Ireland's unionist politicians claim that the 2019 Protocol needs a judicial review because its current version introduces an unwarranted difference in treatment between Northern Ireland and the other countries of the Kingdom. In the umpteenth attempt to manage the internal political tensions arising from these positions, in early March 2021 the UK government extended the grace period on customs checks for agricultural and food products at the Irish sea border from end-March 2021 to October 2021. The European Union promptly reacted by denouncing yet another non-compliance by the United Kingdom with its commitments and postponing the ratification of the Trade and Cooperation Agreement by the national Parliaments of the 27 member countries, originally due by 30 April 2021. Although it is unlikely that the Agreement is torn apart, what happened in the first months of 2021 opened a new phase of tension and mutual distrust between the EU and the UK, which will require a lot of work and endeavors by both Parties to re-establish a climate of authentic cooperation in post-Brexit bilateral relations.

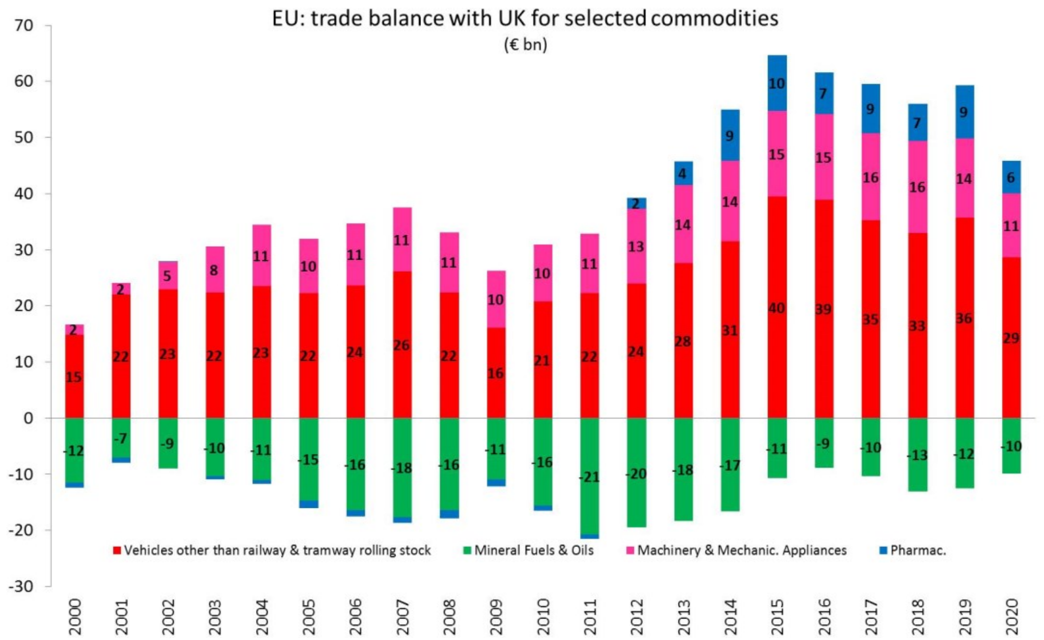
3.2. The most traded goods between the European Union and the United Kingdom are vehicles other than railway or tramway rolling stock, machinery and mechanical appliances, pharmaceutical products and mineral fuels and oils[2].

For both economic areas, these are strategic commodities in international trade, representing a total between 35% and 40% of their import-export of goods, even if with a different relevance for the EU and the UK.

Figure 13 shows the EU's net exports to Britain for the four goods considered in the period 2000-2020.

Figure 13

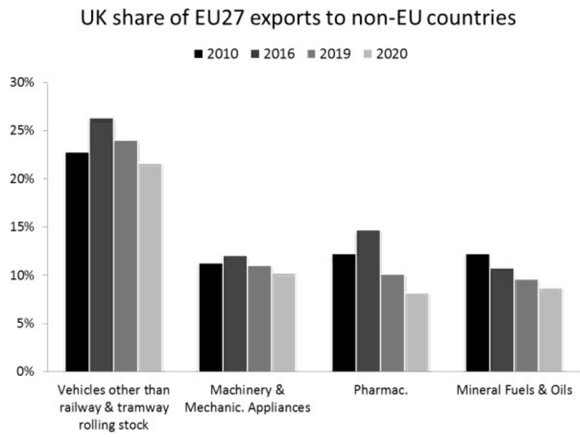
[2]The four types of goods were selected using the *Harmonized System* (HS) for tariff codes. In detail:
- *vehicles other than railway or tramway rolling stock* correspond to Chapter 87 in the HS codification, and their full description is: vehicles other than railway or tramway rolling stock, and parts and accessories thereof;
- *machinery and mechanical appliances* correspond to Chapter 84 in the HS codification, and their full description is: nuclear reactors, boilers, machinery and mechanical appliances and parts thereof;
- *pharmaceutical products* correspond to Chapter 30 in the HS codification;
- *mineral fuels and oils* correspond to Chapter 27 in the HS codification, and their full description is: mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes.

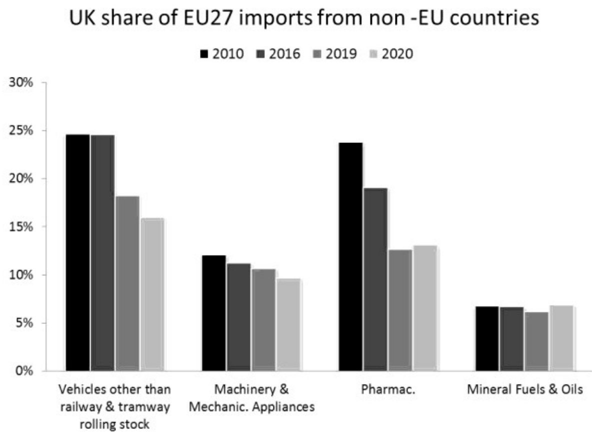


The European Union enjoys a high and consolidated surplus in the trade of road vehicles and mechanical appliances, to which, from 2012 onwards, pharmaceutical products have been added. Together, these three macro-categories contribute about € 60 billion per year to the European surplus towards the United Kingdom (apart from 2020). For its part, Britain boasts a stable surplus with the EU in the trading of mineral fuels and oils, with annual net exports of between 10 and 15 billion euros over the last years.

Road vehicles are undoubtedly the most important commodity for the EU trade with the UK, with an annual surplus between € 35 and € 40 billion up to 2019. Sales to Britain account for almost 25% of the EU's exports of road vehicles to non-EU countries (Fig. 14) and 18% of the bloc's total exports of goods to the UK. Britain is also a large exporter of vehicles to the EU: cars and other road vehicles sold to the continent absorb the 17% of the EU demand of this commodity to non-EU countries (Fig. 14) and in 2019 represented over 10% of all UK goods exports to the EU.

Figure 14





Author's calculations on Eurostat data

After the 2016 referendum, trade in vehicles between EU and UK embarked on a path of moderate decline, which affected mainly European sales across the Channel resulting in a drop of a few billion euros in EU net exports (Fig. 13).

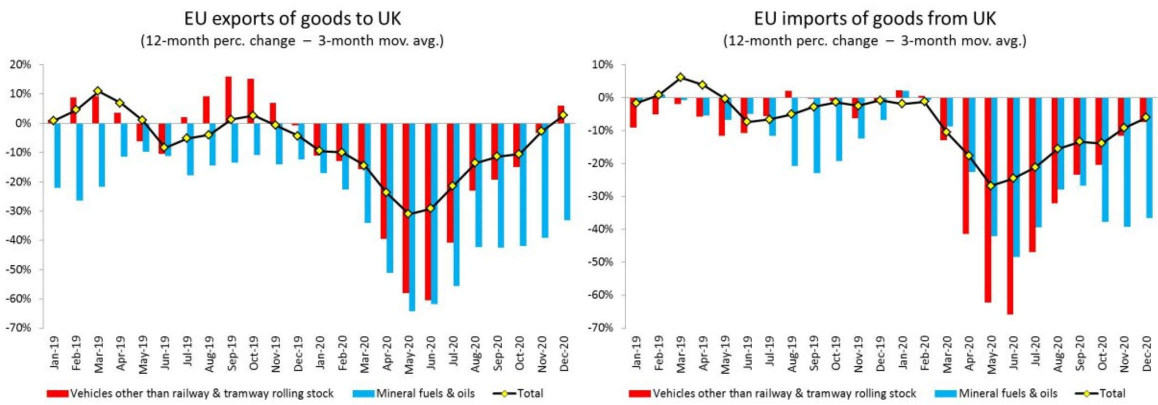
Machinery and mechanical appliances are another commodity that contributes significantly to the EU's goods surplus to the UK, with net exports of about € 15 billion per year until 2019. Britain absorbs about 10% of the total trade of this merchandise between the EU and non-EU countries (Fig. 14), a share that remained fairly stable over the past decade and was little affected by the outcome of the Brexit vote.

Pharmaceutical products are another key item in bilateral EU-UK trade: exports from the European Union to Britain take up to 8%-10% of EU drug exports to non-EU countries (Fig. 14) and to around 6% of EU total goods exports to the UK. Pharmaceuticals were among the protagonists of the boom in the EU's goods trade surplus with UK occurred from 2012 to 2015, with net exports reaching a peak of 10 billion euros in 2015. Since then, EU net exports recorded a small decline until 2019; a bigger fall occurred in 2020, which shrank their value to 6 billion euros.

Mineral fuels and oils are the flagship of British trade in goods with the EU, with a surplus of more than € 10 billion per year in favor of the UK. Until 2016, exports directed to the other side of Channel accounted for about 70% of the global UK exports of these type of commodities. Since the referendum, this share has shrunk to around 60% until 2019. As a percentage of the entire British export of goods to the European Union, mineral fuels and oils contribute 12% (equal to 22 billion euros per year).

As seen in § 3., in 2020 the shock to international trade caused by the Covid-19 pandemic has severely affected trade between the EU and the UK. Above all, stand out road vehicles and mineral fuels and oils: the collapse in the import-export of these goods from March to June was much more severe than the one occurred at the level of the aggregate trade in goods, resulting in an over 60% contraction compared to the same period in 2019 (Fig. 15). In the following months there were some signs of recovery (especially in EU exports to UK) in sync with the developments in the health emergency and the related containment measures.

Figure 15



Author's calculations on Eurostat data

For the EU, the greatest criticality arising from the pandemic was the almost complete freeze on sales of road vehicles to Britain in the second quarter of 2020; in the whole year gross revenues fell by € 12.6 billion and net exports by € 7 billion (-19.6%) compared to 2019, that is almost half of the reduction in the overall EU surplus towards the UK recorded in 2020.

Most of these losses hit Germany, whose net exports of road vehicles to the UK shrank by € 5.6 billion, over 50% of the drop recorded in 2020 by the

German trade balance in goods with Britain (see § 3.1.).

For its part, the United Kingdom was heavily affected by the decline in trade in mineral fuels and oils with the European Union: gross exports fell by 31% and net exports by 21%, resulting in a € 2.6 billion reduction in the surplus on this product category.

Trade in machinery and mechanical appliances also contracted significantly (-17%) in 2020, although less than the one in vehicles and fuels. To be most affected was the European Union – traditionally a net exporter of such goods versus Britain – whose surplus fell by over € 3 billion compared to 2019.

As for pharmaceuticals, 2020 led an improvement in the UK's position: EU exports dropped by 14.6% compared to 2019, whilst its imports from the UK rose by 5.7%. The net effect was a thinning of the EU surplus towards Britain estimated at around € 3.5 billion for the whole of 2020 compared to the previous year.

3.3. With the withdrawal from the European Union, the United Kingdom lost access to the single market and the status of a member of the customs union. Therefore, starting from 1 January 2021, it is considered a third country by the European Union and vice versa, with consequent restrictions on access to the respective domestic markets.

However, with regard to trade in goods, the Trade and Cooperation Agreement (TCA) represents a good starting point for redesigning trade relations between the two sides of the Channel in light of the new legal framework.

In fact, the TCA is first and foremost a free trade agreement that governs the import-export of goods between the European Union and the United Kingdom, with the sole exception of Northern Ireland which – based on the Protocol on Ireland and Northern Ireland – remains in the EU's single market for goods.

Unlike what would have happened in the event of a no deal and consequent application of the WTO standards, the TCA has made it possible to avoid the application of quotas and tariffs on goods that comply with a set of product-specific preferential rules of origin, which are stated in the Annex ORIG-2 of the Agreement.

Basically, a product qualifies for preferential treatment (and it is thus exempted from duties) if it complies with its specific rules of origin, which – depending on its HS code – are defined according to one of the following types or a combination of them:

1. *wholly obtained*: the product must be made only from materials from the country of the exporter;
2. *change in tariff code*: non-originating components used to assemble the product must be classified in a chapter, heading or subheading other than that of the final product;
3. *value added*: the exporter has carried out substantial processing in the production of the considered good;
4. *valued or weight percentage*: non-originating materials cannot exceed a maximum percentage either of the total weight or of the ex-works price of the product;
5. *specified processes*: only applies to specific products or industries – such as chemical, tyres and textiles – and requires that some well-identified processes participating in the production of the considered good take place in the country of the exporter.

The Agreement allows for bilateral cumulation, meaning that the intermediate components of a UK good that come from the European Union can be considered as originating components and vice versa for the purposes of qualification for preferential treatment. On the other hand, the so-called diagonal cumulation (desired by the United Kingdom) is not allowed, which would have made it possible to consider as local components also those from third countries provided that they were assembled in the exporter's country.

To access the preferential treatment, in addition to the customs declaration, a proof of origin is required, alternatively constituted either by the exporter's statement of origin or by the importer's knowledge. In some cases, the exporter's statement of origin must be accompanied by a supplier's declaration, whereas if the proof of origin is based on the importer's knowledge, the latter must have documentation that substantiates his declaration and must keep it for four years.

In order to mitigate the impact of the new rules, self-certification on the origin of the goods will be allowed. Furthermore, in the first half of 2021, the United Kingdom will not ask EU exporters to display the customs declaration at the point of import; and for the whole 2021 it will not ask for the supplier's declaration, which, however, can be requested retrospectively from 2022.

Obviously, the new set-up based on the rules of origin will entail additional costs for producers and traders on both sides of the Channel. Yet, as remarked by both parties, goods that meet the criteria for accessing preferential treatment will be exempted from tariffs, which represent a major hurdle to trade. For instance, without the TCA, cars would have been hit by tariffs of 10%, while textiles and footwear would have been subject to tariff peaks of 12% and 17%, respectively [EU Commission, 2020].

Moreover, it should be observed that the thresholds provided by the TCA's rules of origin are more favorable to UK exporters than those provided in other free trade agreements the EU has with other countries and, certainly, than those provided by WTO standards. Indeed, under the TCA the share of originating materials is typically set equal to the 55%-60% of the ex-works price, against the 80% set in the EU-Canada free trade agreement and the 90% usually required by WTO standards.

A special system of rules of origin is envisaged for the automotive sector and for the (related) sector of electric accumulators. The importance of vehicles in import-exports between the EU and the UK and the politically recognized priority given by both Parties to the issue of energy transition have led to the agreement of a six-year transitional period on the rules of origin for these product categories. Until 2026, therefore, less stringent rules of origin will be applied than those that will enter into force later. In particular, for road vehicles the maximum permitted percentage of non-originating materials will be equal to 60% of the ex-work price in the period 2021-2023 and to 55% in the period 2024-2026, and then it will definitively decrease to 45%. This phasing-in is particularly favorable to the EU car industry – especially the German one – whose supply chains are much less dependent on components manufactured abroad than that of the United Kingdom.

This disparity could, however, increase in the coming years due to the growing diffusion of electric or hybrid vehicles, in which batteries alone account for around 50% of the ex-work price. In order to secure exemption from duties in the exchange of vehicles at the EU-UK border, it will thus be essential to be able to rely locally on power accumulator production plants, and possibly located near the car factories. In this context European dominance is clear, with Germany in the lead [Hancké and Mathei, 2021].

Numerous batteries giga-factories are already in operation within the EU (many of them in Germany such as the one of the Chinese giant CATL) and many others are in the pipeline (such as the one that Tesla is completing in Berlin-Brandenburg and the half a dozen recently announced by Volkswagen). Compared to the EU, the UK lags far behind, with little ability to attract EV business-related investment. Nissan is currently considering opening a battery production plant to support its production of electric vehicles in Sunderland, and in late 2020 Britishvolt announced the intention to open the UK's first giga-factory, a project that, however, is unlikely to be completed before 2023.

The future of the UK car industry in trade with the EU (and beyond) therefore appears linked to the ability to quickly and efficiently make the transition to electric vehicles, in terms of on-site production of accumulators and, also, of adaptation of the plants and production-assembly chains of vehicles to the characteristics of the EV supply chains.

At the moment there is a competitive disadvantage compared to the EU; however, the country that was the protagonist of the industrial revolution could recover the gap with the EU in the coming years. Some important signals are already there. For example, in November 2020 the UK Government announced the decision to ban internal combustion vehicles by 2030 and to launch a green revolution with public investments in hydrogen, nuclear energy and carbon capture and storage technology. These decisions represent a further incentive for the UK car industry to convert its production systems relatively quickly and look for new solutions for the low-cost supply of electric accumulators.

The green revolution could also impact the EU-UK trade in mineral fuels and oils. As seen in § 3.2., goods comprised in this category represent the 1st UK export to EU countries and generate an annual surplus of about € 10 billion for Britain. But with the strong EU commitment to a more environment-friendly and sustainable growth model, a large part of this UK business could be at risk.

Beyond rules of origin, many other non-tariff barriers, such as customs paperwork and technical barriers to trade (TBT), will apply. According to some estimates[3], the annual cost of completing customs declarations alone should be in the range between £ 7.5 and £ 15 billion for the UK economy as a whole (not including the much higher costs of complying with rules of origin), and the number of declarations made in the country is expected to climb from 55-60 million to over 250 million per year[4]. The administrative burden could drastically rise for EU

[3] See: https://ukandeu.ac.uk/the-brexit-deal-and-uk-automotive/
[4] See:https://www.independent.co.uk/news/uk/politics/hmrc-brexit-transition-business-paperwork-customs-b1767557.html

countries as well: an increase of 40% in customs declarations has been estimated for Dutch companies, and of 800% for French ones according to the respective customs offices, whereas additional customs declarations for German businesses are estimated in 15 million per year corresponding to an annual cost of 500 million euros [Business Europe, 2018].

Also technical barriers, represented by requirements related products standards in the fields of safety, conformity assessment, market surveillance, marking, labeling, etc., could prove harmful for trade at the EU-UK border. Indeed, under the TCA both Parties are free to regulate goods in the most suitable way for the respective domestic markets, whereas – as a general principle – it is not envisaged the mutual recognition of product conformity assessments certified by accredited bodies of the other Party (the UK has tried in vain for an agreement on this issue). As a consequence, products intended for export must have double certification, which clearly increases the administrative burden for both European and British exporters.

Further damages to bilateral trade could arise in case of an excessive regulatory divergence, should the internal regulatory choices taken by a Party be considered as harmful to fair competition and leveled-playing field principles. In particular, the Agreement includes the possibility of retaliatory measures to be adopted by a Party in reaction to unfair regulatory measures of the other. Such measures – to be submitted to the prior assessment of an independent panel composed by EU and UK representatives – should operate as a rebalancing mechanism to be activated unilaterally by a Party with the aim of remove trade distortions created by the other.

The whole set of the non-tariff barriers arising from the UK withdrawal from the EU and from TCA provisions will necessarily result in a significant trade loss for both the blocs. In a recent simulation on the short-term impact of the TCA on the EU-UK trade flows, the EU Commission has assumed that non-tariff barriers can be translated into an average tariff equivalent of 10.9% and 8.5% for EU and UK imports, respectively [EU Commission, 2021]. Under this assumption, the Commission estimates that by 2022 Brexit will generate an output loss of around 0.5% of GDP for the EU, and of around 2.25% of GDP for the UK. In monetary terms, these estimates correspond to a loss of over 120 billion euros for the EU bloc by the next two years, and of over 100 billion euros for the UK by the same maturity.

While it is difficult to assess the likelihood of these estimates, it is uncontroversial that huge trade disruptions are already occurring on both sides of the Channel. Limits to traffic and mobility caused by the pandemic have added to the new regulatory framework of the post-Brexit era, causing delays or even suspensions in goods shipment and delivery. On the UK side, the UK Road Haulage Association has reported that in the first months of 2021 one in five trucks has failed to cross the border; but also on the UE side, traders report a lot of inconveniences.

Still, many of these problems could prove to be a temporary phenomenon: operators need some months to get acquainted with the new rules and – to make matters worse – the pandemic has not yet been defeated. On the medium to long term, many unpredictable factors can affect EU-UK trade relations, including the dynamics of the EUR-GBP exchange rate, which, for instance, in the first months of 2021 is experiencing an unexpected trend of pound appreciation, with the British currency trading at higher values against the euro than in early 2020.

The effective additional costs of the post-Brexit border for UK and EU companies will be deeply affected by the ability of both Parties to fit their production systems and supply chains to the new rules and to implement suitable solutions of simplification in the customs red tape. Hopefully, there will be a positive learning-by-doing effect, than can deliver significant improvements with respect to the initial phase of the TCA implementation. Furthermore, to mitigate the multitude of frictions to trade deriving from the new regime, the two Parties have provided for customs cooperation mechanisms and for specific areas of mutual recognition, as in the case of Authorized Economic Operators (AEO) schemes. As a consequence, trusted traders will be given access to simpler customs procedures, waivers of certain obligations and faster clearance of goods.

In the next months the UK government is expected to make huge infrastructure investments at the border, and it has already announced bespoke measures to help domestic firms[5]. Other important interventions could soon arrive in terms of tax cuts (on VAT and excises) for UK importers (especially in case of significant pound depreciation against the euro). Meanwhile, businesses are likely to recalibrate their supply chains in order to reduce delivery delays and manage inventories in a more efficient manner [Boata and Poulou, 2021]. A higher reliance on the domestic supply of intermediate components and materials required to assemble products is expected, which – with the aim of by-passing the missed achievement of diagonal cumulation – could also lead to incentives for foreign companies to open production plants within the UK borders. It would be a kind of reverse relocation that could also have positive externalities on the competitiveness of the British manufacturing industry.

For its part, the EU is taking steps to safeguard its trade relations with the United Kingdom: facilitation arrangements have already been provided for specific products (wine, automotive[6], pharmaceutical, chemical and organic goods [TCA, 2020 and EU Commission, 2020]), most of which are among EU most traded goods with Britain and were severely hit by the pandemic (see § 3.2.).

Several EU countries are also adopting initiatives at the national level with

[5] The UK has also decided to maintain its membership in the Common Transit Convention (CTC) after Brexit. The CTC is an EU customs procedure that allows the free movement of goods between participating countries; in addition, goods from an EU member country don't lose their "unional" status even when they transit for a CTC country outside the EU. Currently, CTC members are: EU countries, UK, Turkey, EFTA countries (i.e. Switzerland, Norway, Iceland and Liechtenstein), Macedonia and Serbia.

[6] Under the TCA, the Parties have agreed the mutual recognition of approvals based on UN regulations with regard to products of the automotive sector.

the aim of favoring a smooth trade in goods with the United Kingdom, supporting logistics and easing customs formalities. France has implemented the so-called "smart border", whose pillars are the anticipation of the customs formalities before loading the means of transport and largely automated processes and checks, made possible by a dedicated information system.

French smart border also includes the "logistic envelop", a tool that groups multiple customs declarations under a single barcode, hence allowing to speed up the pairing process between documents and goods at the customs checkpoint.

Another example is given by Italy's "zero kilometer customs", a streamlined administrative procedure that allows the exporter to obtain the authorization of approved places other than the customs areas at which to carry out the formalities relating to export.

Thereby, those who have to ship goods to the United Kingdom can obtain an authorization that makes their production site an approved place for carrying out customs checks.

The authorization can be requested through a standard form that certifies the requirements of the place itself; once obtained the authorization, the exporter will simply have to submit electronically the customs declaration to the competent customs office and make the goods available for any physical inspection at the site approved for the export checks, saving the costs associated with the transport of the goods in the customs premises.

The above-mentioned measures adopted by both Parties will help to reduce the negative effects of Brexit on EU-UK bilateral trade. Nevertheless, many stakeholders maintain a pessimistic outlook on the impact of the new legal and regulatory framework. In a report of January 2021, Allianz research team concludes that Brexit could entail an average reduction of 4% in the long-term level of UK GDP.

Always in January 2021, a report from the think-tank "*UK in a changing*

Europe" estimates that over the next ten years UK exports to EU will fall by 36% with respect to EU membership, and imports by 30% [Sampson, 2021].

Expectations are not rosy even on the other side of the Channel: on February 2021, the President of the Kiel Institute for the World Economy (IfW) declared that the institute expects that in the long-term German exports to the UK will be 10% lower than the level expected without Brexit.

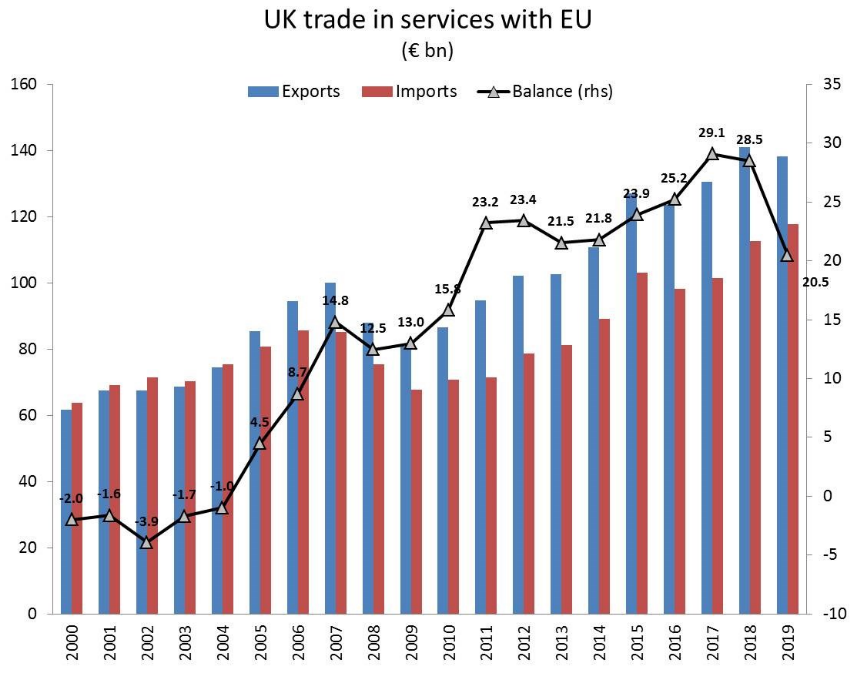
Time will say whether these forecasts are too pessimistic. Of course, both the EU and the UK are aware of the respective strategic relevance as trading partners. But nobody knows whether this awareness will be sufficient to curb the UK's hunger for regulatory independence and the EU's commitment to protecting fair competition, even with the use of protectionist measures.

4. Trade relations between EU and UK are very intense also in the exchange of services, with total volumes ranging between 250 and 300 billion euros per year. Unlike what seen for goods (see § 3.), in the case of services, Britain is a net exporter to the EU, with a surplus of about 20 billion euros in 2019 according to ONS data[7].

The 2019 figure is 29.5% lower than the peak of 29.1 billion euros reached in 2017, after over ten years of almost uninterrupted growth (Fig. 16).

[7]Data on trade in services with the United Kingdom reported by individual EU countries and available on Eurostat show an aggregate EU surplus of 43 billion euros for 2019. The huge discrepancy with ONS data suggests the presence of relevant trade asymmetries between the various reporting countries and confirms the importance of a greater shared commitment at the international level for the maximum harmonization of data collection and classification standards. In this work, ONS data were privileged as they are more complete in terms of depth and frequency of the time series.

Figure 16



Source: ONS

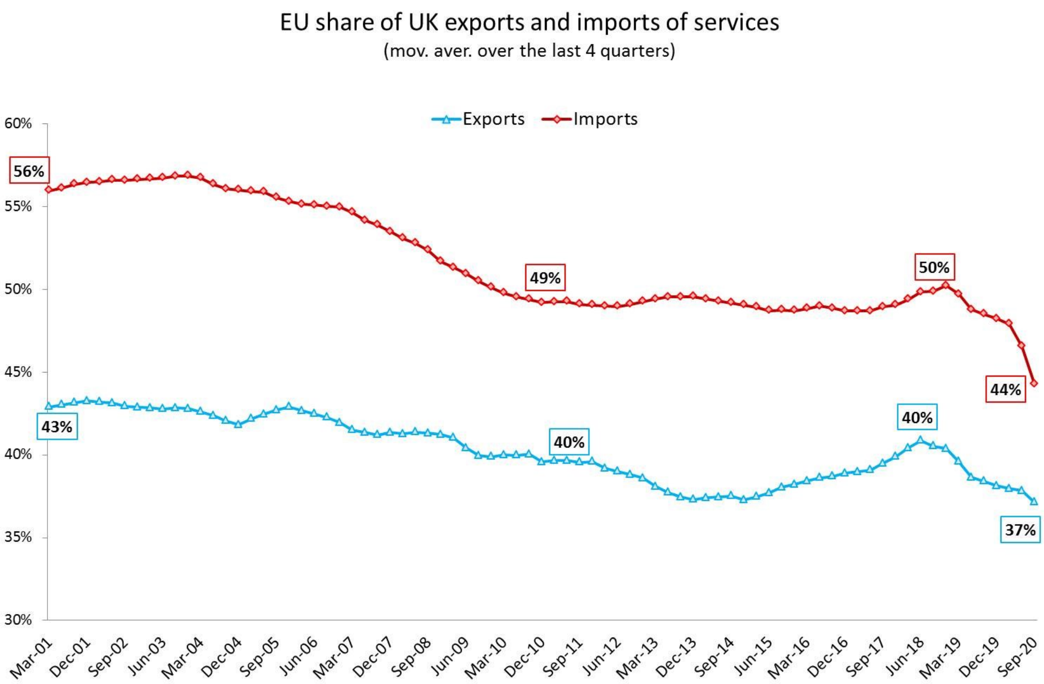
This pattern is in line with the excellent performance in the UK trade in services with the rest of the world and reflects its characterization as a service-intensive economy (equal to 81% of the country economic output), especially in the financial, insurance and real estate sectors (so-called "*fire economy*").

The 2016 referendum does not appear to have had a negative impact on the exchange of services with EU countries, while the reduction in the British surplus occurred in 2019 could be related to that year general decline in the UK's net exports of services to the rest of the world (133 billion euros compared to 146 in 2018).

In the first three quarters of 2020, the cumulated UK service surplus with the EU was over € 28 billion; therefore (barring surprises in the last quarter), 2020 may mark a rebound compared to the disappointing figure of 2019, despite the shock due to the pandemic.

Using ONS quarterly data, it is possible to analyze the time evolution of the EU share of the UK trade in services with the rest of the world (Fig. 17). In general terms, it is confirmed the primary role of the EU as Britain's partner in the exchange of services. However, while exports to the EU represent a fairly stable share (around 40%) of all UK service exports, in the long term a trend seems to be taking shape towards the progressive downsizing of EU countries as service providers to Britain. More in detail, between 2001 and 2020, the EU share of UK service imports from the rest of the world fell from 56% to 44%, with an acceleration in the last two years. A possible explanation is that, in view of the impending departure from the EU bloc, Britain has progressively redirected its demand for services towards non-EU countries.

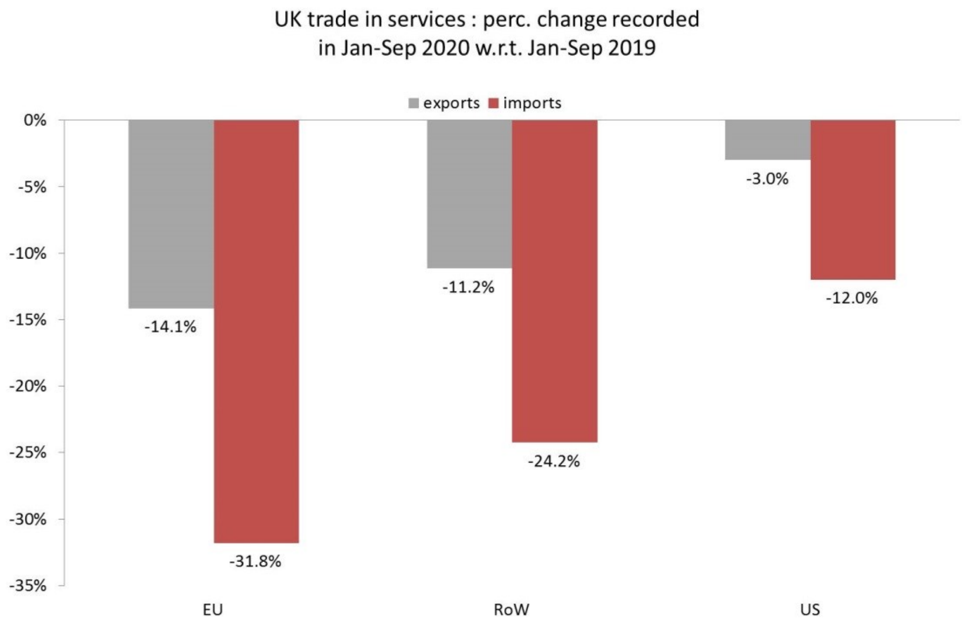
Figure 17



Author's calculations on ONS data

In 2020, the decline in the exchange of services with the EU was exacerbated by the overlapping of the economic emergency caused by the pandemic with the difficult negotiations on the free trade agreement. In the first three quarters of the year, imports of services from the EU fell by 27.5 billion euros (-31.8%) compared to the same period one year earlier, while exports of British services to EU countries shrank by 4.4 billion euros (-14.1%). The joint effect of these changes was an improvement of 13.1 billion euros in Britain's surplus towards the EU. The decrease in the UK's import-export of services with the EU was far superior to that overall experienced in the same period with the rest of the world (Fig. 18). In particular, numbers on bilateral trade with the United States highlight a modest contraction in UK service exports (-3%) and a more marked contraction (-12%) in its services imports from the US, but in any case, much lower compared to that recorded with the EU.

Figure 18

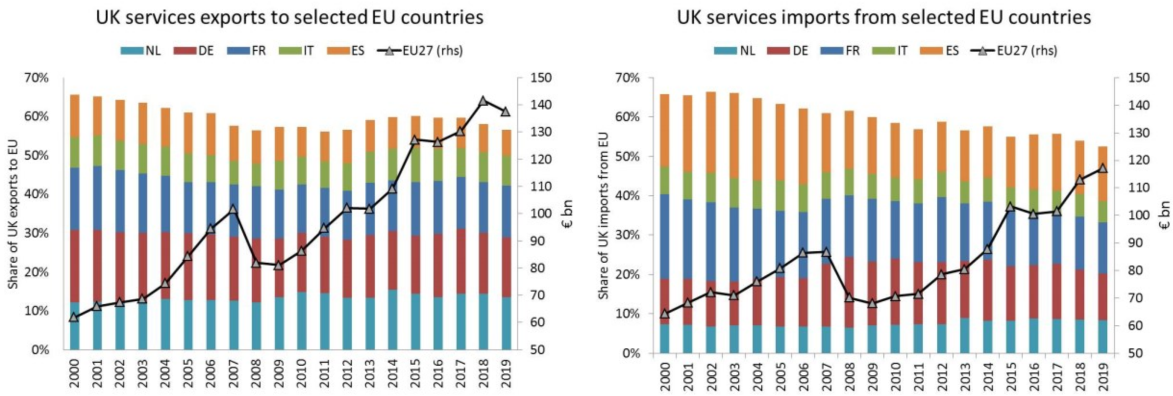


Author's calculations on ONS data

As for the EU, it is more controversial to understand and quantify the importance of the UK as a partner in trade in services, because Eurostat data are available only on an annual basis and only for the period 2010-2019 (and they significantly differ from those released by the ONS). Based on these data, the United Kingdom steadily absorbs over 20% of the all EU service exports to non-EU countries, while its share of total EU service imports is slightly lower (19%).

4.1. Within the EU, the UK's main partners in trade in services are Germany, the Netherlands, France, Italy and Spain. According to ONS data on international trade, these five countries absorb over 57% of the UK services exports to the EU and about 52% of its imports (Fig. 19). Germany and France play a significant role in both the purchase and sale of services to Britain, each of them with a contribution of more than 10% of the EU total. The position of the other countries considered is more heterogeneous: the Netherlands are an important outlet market for services provided by the United Kingdom, while Spain over time has retained a key position as an exporter of services to the other side of the Channel, surpassing even France and Germany in recent years. Finally, Italy from 2009-2010 has experienced a reduction in its share of the EU service exports to the UK, while maintaining stable (between 7% and 8%) its share of the EU service imports from Britain.

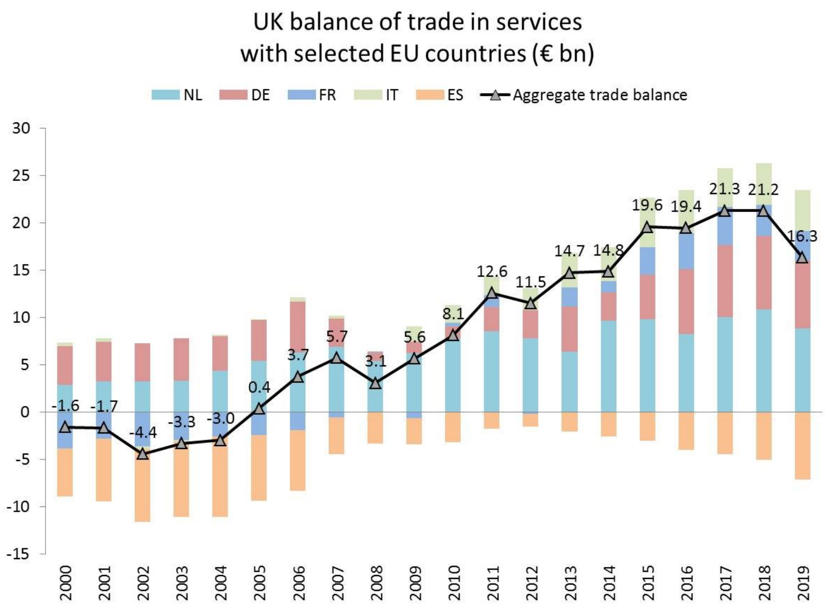
Figure 19



Author's calculations on ONS data

In net terms, over the last decade the United Kingdom has progressively increased its aggregate surplus towards the countries considered (Fig. 20), rising from 5.6 billion euros in 2009 to over 21 billion euros in the two-year period following the Brexit referendum. A decrease of 5 billion euros occurred in 2019 in line with what observed in § 4. The Netherlands are the EU partner to which Britain boasts the highest value of net service exports (€ 8.8 billion), followed by Germany (€ 7.2 billion) and Italy (€ 4.3 billion). Among the countries considered, only Spain has maintained a stable surplus towards the UK (€ 7.1 billion in 2019), which mainly stems from the fact that it attracts almost 33% of the entire UK imports of travel services from the EU.

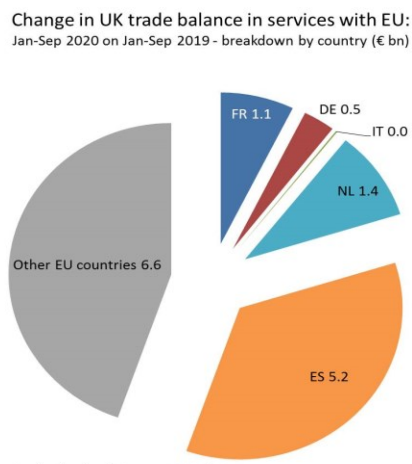
Figure 20



Source: ONS

With regard to the first three quarters of 2020, ONS data show that the UK's net exports to its main EU partners surged by € 8.2 billion (Fig. 21). The most affected country was Spain, which between January and September 2020 suffered a drop of over € 5 billion (-89%) in its services surplus to Britain.

Figure 21



Author's calculations on ONS data

The limitations on the free movement of people required by the pandemic have in fact precipitated UK imports of travel services of which – as mentioned –

Spain is the first source within the EU. In the period considered, net exports of UK services to the Netherlands and France also increased compared to the same period in 2019, while those to Germany and Italy were substantially unchanged.

4.2. The most important services traded between the UK and the EU are financial services, other business services, services related to telecommunications and information technology (hereinafter also ICT services) and travel services.

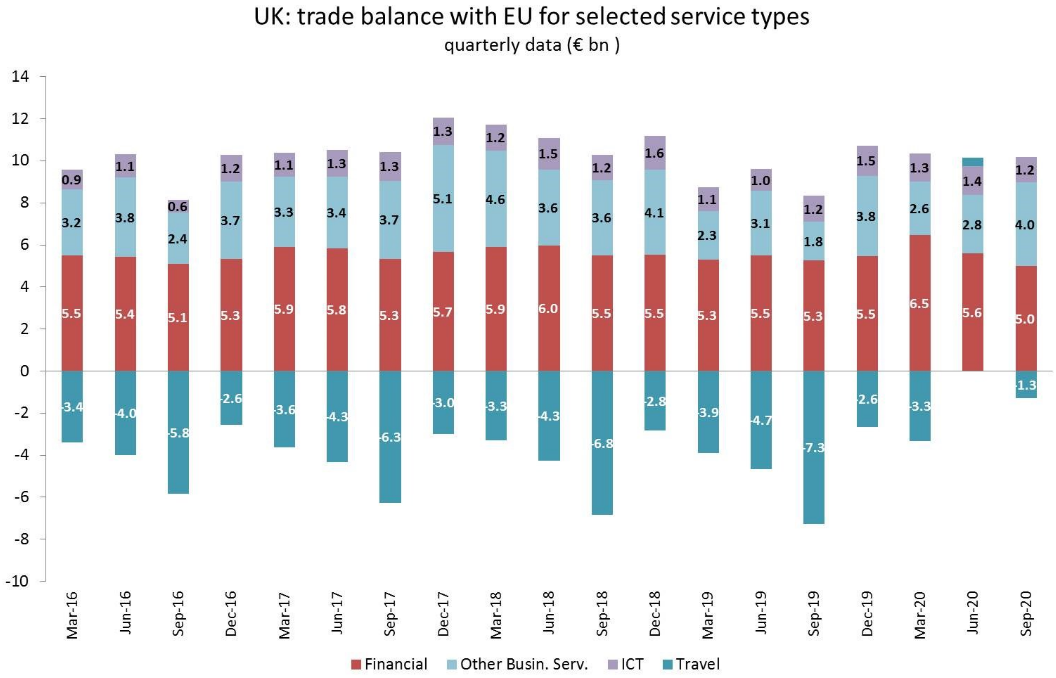
For both Parties, these types of services are of paramount importance in international trade, accounting for 70%-75% of the global import-export of British services and for 60%-65% of the EU trade in services with non-EU countries.

Fig. 22 illustrates UK quarterly net exports to the EU for the four types of services considered in the 2016-2020 period using ONS data.

Over the period considered, the EU posted a constant in surplus as regards travel services with net exports across the Channel averaging € 4 billion per quarter.

On the other hand, the United Kingdom recorded a systematic surplus towards the EU countries on the other types of services (financial, ICT and other business services), for an average total value of € 10 billion on a quarterly basis. All these three types of services fall into the macro-category of «*knowledge intensive business services*» (KIBS). In this category of services, the Kingdom holds a leading position on a global level, which was consolidated over time also thanks to the deregulation of financial and ICT services started under the premiership of Margaret Thatcher. The reforms introduced since the 1980s have in fact accompanied the transition of the British economy from an economy based on traditional industrial sectors to a service economy.

Figure 22

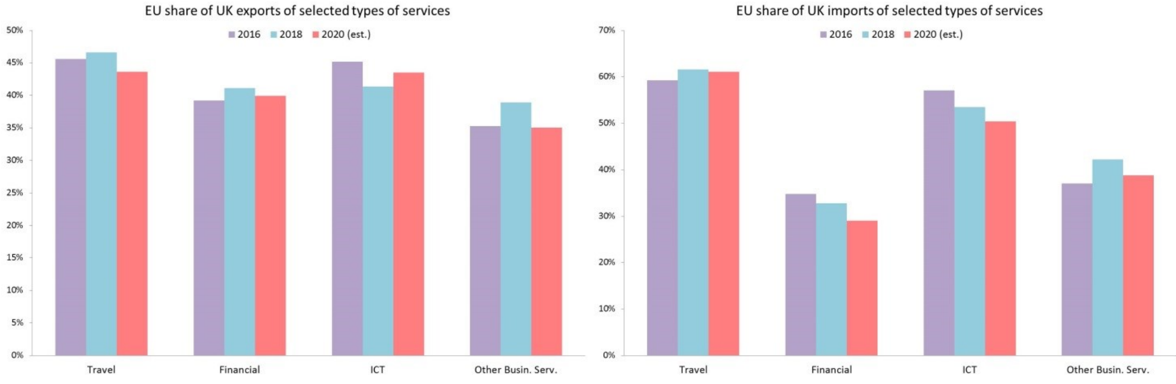


Source: ONS

Financial services are the most important component of the UK trade in services with the EU: on average, they earn the country an annual surplus of 22 billion euros, that is, between 40% and 45% of the entire British surplus in financial services. EU countries account for 40% of all UK exports of this type of services, a share that has remained pretty stable over the last years. On the other hand, since 2016 their share of UK imports of financial services has declined from 35% to 29%, hinting that the outcome of the Brexit referendum may have narrowed UK demand for EU services in this category.

Other business services represent another key item in UK-EU trade in services. They rank first among UK service exports to EU countries, with an over 30% share that was not visibly affected by the 2016 referendum. This category gathers various types of services, including those relating to professional and management consultancy and those of technical and commercial nature. In the 2016-2020 period, their annual contribution to the UK services surplus with the EU averaged € 13.5 billion. EU countries absorb between 35% and 40% of the entire British import-export of this type of services (Fig. 23).

Figure 23



Author's calculations on ONS data

Also ICT services make an important contribution to the UK services surplus with EU countries, with annual net exports averaging € 5 billion. EU accounts for the 45% of all UK exports of this type of services (Fig. 23), and for an even larger share of UK imports (50%, albeit on a declining trend over the last few years, as shown in Fig. 23).

Travel services are UK's largest service import from the EU: in the period 2016-2019 they made up 33% of the full value of the services Britain bought from EU countries. The European Union is in fact the preferred destination of the British, stably absorbing 60% of their spending on travel abroad (Fig. 23). EU is also a large importer of UK travel services, covering the 45% of the Kingdom's exports of this service category to the rest of the world (Fig. 23). In net terms, the UK' trade deficit towards the EU on this type of services is around 17 billion euros per year (except for 2020). Within the EU, the preferred travel destination for UK citizens is Spain whose net exports of travel services to the UK averaged € 10 billion a year between 2016 and 2019, corresponding to 60% of the entire EU surplus towards the United Kingdom on this service category.

Travel services were the most affected by the restrictions imposed in 2020 by many governments on the movement of people to contain the pandemic. These restrictions included in fact prolonged periods of closure of the borders between the EU bloc and the United Kingdom, which caused a slump in UK imports of travel services from the EU, down 67% in the first three quarters of 2020 compared to the same period in 2019.

In monetary terms, this reduction exceeds 20 billion euros and represents the 75% of the entire downsizing in British imports from the EU between January and September 2020 compared to the same period one year earlier. Although in the same months of 2020 travels by European citizens to the UK also dropped dramatically, the net effect was a thinning in the British deficit with the EU in this service category.

The other most relevant types of services exchanged between the UK and the EU (financial, ICT and other business services) have been substantially spared from the negative consequences of the pandemic, probably because they can be easily provided also remotely. Consequently, the above described performance of travel services explains much of the improvement in the UK service surplus with the EU recorded in the first three quarters of 2020.

4.3. Following the definitive exit from the EU, UK service suppliers have lost the automatic right to offer services in EU countries. As a consequence, starting from 2021, their exports will need to comply with the regulations in force in the host-country which are subject to a certain variability among the different member States.

Despite the great importance of services for the British economy, TCA provisions on trade in services are extremely sparse and, broadly speaking, very far from the objectives that the United Kingdom has tried to achieve during the long negotiations with Europe.

In essence, the TCA re-proposes the basic structure envisaged by the WTO's

General Agreement on Trade in Services (GATS) introducing some new features. GATS framework relies on a few core principles aimed at guaranteeing the liberalization of the trade in services [Jozepa *et al.*, 2019], namely those of non-discrimination among one's trading partners and of transparency and reasonableness of all applicable rules and regulations. Non-discrimination, in particular, requires that foreign service providers cannot be treated worse than domestic ones (*national treatment*) and that all one's trading partners are treated equally (*Most-Favoured-Nation* or MFN).

A first failure for UK negotiators regards the missed achievement of the mutual recognition of professional qualifications. Accordingly, as of 1 January 2021, British professionals such as doctors, nurses, pharmacists, lawyers, architects or engineers will have to obtain the qualification from the competent institutions of the relevant EU member State before being able to exercise their profession in that country. The same obviously applies to professionals from EU countries wishing to offer their services in the UK. As a (minimal) mitigation of the new set-up, the TCA foresees that in the future the two Parties may agree, on a case-by-case basis and for specific professions, on additional arrangements for the mutual recognition of certain professional qualifications [EU Commission, 2020].

Another novelty that is likely to impact on the exchange of services between the UK and the EU is that people will no longer be able to move freely from one side of the Channel to the other. Indeed, whilst the Parties have agreed not to require visas for travel, yet their citizens will be subject to checks prior crossing the border and they will no longer be allowed to use biometric passports to pass checks more quickly. Albeit also in this case the Agreement provides for some (temporary) mitigation especially for short-term business travelers, the introduction of border screenings could lead to a decline in the import-export of travel services between the UK and the EU. This would reasonably hit EU countries more than the UK, resulting in a worsening of their surplus with Britain on this service category.

From the UK's standpoint the main criticality of the TCA concerns financial services. As seen in § 4.2., financial services are the most significant component of the UK services surplus with the EU. And this still gives only a limited idea of the deep degree of integration between UK and EU in the financial field: prior to Brexit 37% of assets under management in the EU were managed in the UK and 46% of equity funding raised in the EU was raised in the UK [Moloney, 2021].

These numbers explain why the UK had already set to work in the aftermath of the 2016 referendum to try to obtain a bespoke treatment that would continue to guarantee its financial services firms an easy and streamlined access to the EU market. For its part, the European Commission had instead clarified from the beginning of the negotiations its unwillingness to grant the United Kingdom easier access conditions to the single market than those existing with other third-countries.

And so it was. As recognized by the European Commission, the TCA «*covers financial services in the same way as they are generally covered in EU's other FTAs with third countries*» [EU Commission, 2020].

Like for the other types of services, there is a reciprocal commitment to not discriminate operators from the other Party and to grant them continued market access. The Parties also committed to implement and apply internationally agreed standards in the financial services sector within their territories. However, all these commitments are subject to the *Prudential Carve-Out* (PCO), which gives each Party the right to maintain or adopt measures for prudential reasons, including the protection of domestic consumers of financial services and the preservation of financial stability and of the integrity of domestic financial markets. Officially the PCO is only intended to pursue prudential purposes, but in practice it could be used also as a protectionist weapon, because it can be very difficult to clearly distinguish whether a given measure is required to protect domestic investors rather than the domestic financial industry.

Financial services are also explicitly excluded by the MFN clause generally envisaged by the Agreement with regard to trade in services. Thus, neither Party will be entitled to claim any more favored treatment granted by the other Party in its future agreements on trade in financial services with other third countries.

Most importantly, the TCA does not address the new scenario for the exchange of financial services arising from the UK's departure from the EU. Until 2020 the UK was able to easily export its finance to the continent thanks to the passport system in force between EU member States. Indeed, under the passport system, once authorized by the competent authorities of a given Member State, a financial services firm can operate in all other Member States without the need for further authorizations. To get an idea of the relevance of the passport in the exchange of financial services between the EU and the UK, it is useful to consider that according to the Financial Conduct Authority (FCA) in 2016 the total number of passports inbound and outbound the UK was 359,000, of which 23,532 inbound and 336,421 outbound [EURO-CEFG, 2017][8].

Following the loss of the passport (from January 1, 2021), the access of British financial firms to the EU market becomes much more complex. Basically there are two alternatives available: the repatriation of operations to the EU or the achievement of an equivalence determination by the EU Commission. Both options, however, will entail significant additional costs for the UK financial sector with respect to the frictionless passport regime.

Option 1 (repatriation) is inherited from WTO standards, which recognize the supplier of a third country the opportunity to open a subsidiary in the host-country to be able to offer its financial services. Unlike branches (which are a mere

[8] More in detail, «*inbound passports*» are meant as passports into the UK from the European Economic Area, whereas «*outbound passports*» are meant as passports of UK firms into the European Economic Area. The European Economic Area, abbreviated as EEA, consists of the EU member States and three countries of the European Free Trade Association (Iceland, Norway and Liechtenstein, excluding Switzerland).

extension of the main office), subsidiaries are in fact legal entities distinct from the main office and subject to the regulation and supervision in force in the host-country in which they are established. Many financial services firms have opted for repatriation, as it is often perceived as less uncertain than the complex and still largely opaque framework surrounding the equivalence decision. According to the Ernst & Young (EY) Financial Services Brexit Tracker, 43% of Financial Services firms have moved or are planning to move some UK operation and/or staff to Europe, taking the total number of Brexit-related job moves to almost 7,600 as of early March 2021[9].

However, repatriation is not without costs for the UK financial industry and for the strength of the City of London as international financial centre. These Brexit-management moves, in fact, could lead to a greater fragmentation of the European financial markets, with consequences that could undermine the attractiveness of the Square Mile (the other name for the City of London).

As an example, consider that the establishment of a subsidiary implies that the new entity needs to fulfill specific capital requirements: therefore, a more or less large part of the capital envelope that prior to Brexit was concentrated in the London headquarters would have to be split across subsidiaries scattered among various EU countries. Part of this capital re-allocation is already in progress (if not actually happened). The above mentioned EY tracker reveals that since the 2016 referendum, 24 financial services firms have declared they will transfer almost £ 1.3 trillion of UK assets to the EU by the early months of 2021.

The ability to pool together a huge amount of capital is one of the strength points of a global financial hub. Should this comparative advantage fade, it would be a huge loss for the City. Not surprisingly many UK-based financial firms have thought of getting around the problem by resorting to back-to-back trading, that is

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[9]See:https://www.ey.com/en_uk/news/2021/03/ey-financial-services-brexit-tracker--uk-financial-services-firms-continue-to-incrementally-move-assets-and-relocate-jobs-to-the-eu-but-changes-since-the-brexit-deal-are-small.

by duplicating transactions in order to maintain money and risk management activities in London. Here is the description of such a practice in an article appeared on the Financial Times (Jenkins, 2017):

«*So-called "back-to-back" trading allows an entity in one jurisdiction to carry out a duplicate transaction in a larger location. So a deal done on the ground for a client in Lisbon can actually be booked in London. Banks, which already use the mechanism routinely to book business from Asia, Africa and Latin America through London, will be able to do the same for transactions originated in the EU27. This is a big deal for banks, because it suggests they will be able to continue centralizing their European capital needs and risk management in London*».

Yet, as observed in the same article, this strategy is hard to implement due to the warnings issued by the EU competent financial authorities; in particular, the European Banking Authority (EBA) has stated that EU subsidiaries must not be empty shells units and that it will not be accepted the resort to back-to-back trading on an excessive scale [EBA, 2017].

Option 2 conditions the cross-border supply of financial services in the EU territory by third countries' operators upon the release of an equivalence determination by the European Commission, which decides after having assessed whether the regulatory and supervisory regime of a non-EU country is sufficiently aligned with the corresponding EU regime or not.

The decision on equivalence comes as a result of a complex process: one or more of the European Surveillance Authorities[10] (ESAs) issue a technical advice to the European Commission, which is responsible for the final decision. Often the Commission decides according to the indications of the ESAs, but it can also independently carry out an additional investigation before ruling.

Equivalence may be granted in full or partially, for an indefinite period or with a time limit and may apply to the entire supervisory framework of a non-EU

[10]European Banking Authority (EBA), European Securities and Markets Authority (ESMA) and European Insurance and Occupational Pensions Authority (EIOPA).

country or only to some of its authorities.

EU law on financial services contains around 40 provisions allowing the Commission to rule on equivalence [Deslandes *et al.*, 2019]. These provisions cover *only a small portion* of the core banking and financial activities ruled by the EU legislation, whereas most of them are excluded from the equivalence regime as an access route to the single market, as in the case of deposit-taking and lending, payment services and investment services to retail clients[11] [*ibidem*].

Furthermore, it has also to be recalled that, after having recognized the equivalence with respect to the relevant European sectorial provisions, the Commission retains the prerogative to monitor the ongoing status of the equivalence decisions and, with it, the power to suspend or even withdraw such decisions at any time and at short notice, including those issued for an indefinite period.

The described regime is clearly intended at safeguarding the interests of EU customers of financial services by preserving the right of the Commission to decide unilaterally and independently not only on the adoption but also on the suspension or withdrawal of equivalence[12]. These decisions cannot be appealed by the third country at stake. Thereby the Commission can promptly take corrective interventions when it detects excessive deviations of the relevant legal or regulatory framework of a third country compared to that in force in the EU.

From the standpoint of third-countries financial services firms, this set-up creates an unpleasant climate of operational uncertainty. For this reason, for a large part of the trade talks the UK government sought to obtain a permanent equivalence determination on its financial regulation from the EU. These attempts, however, were in vain, as the European Union clarified its unwillingness

[11]Activities for which the possibility of an equivalence decision is not contemplated can be carried out by third-countries financial firms through the establishment of subsidiaries within the EU borders (and, therefore, subject to European regulation and supervision) or in the hypothesis of reverse solicitation.

[12]In mid-2019 the EU has decided to not renew the equivalence status it had previously recognized to Switzerland's financial market rules.

to make similar concessions from the early stages of the negotiations[13].

The seeming intransigence of the EU needs to be contextualized in the broader scenario disclosed by the Brexit. One of the main workhorses of the pro-Brexit campaign in the United Kingdom was precisely the desire to regain legislative and regulatory independence from Europe. It makes therefore understandable the EU decision to manage this crucial aspect of the negotiations with an iron fist approach. EU institutions aim to prevent member countries from becoming easy prey to financial colonization by UK firms, which – should the requests of the UK government had been accepted – could have benefited from systematic regulatory arbitrage opportunities (given the concrete risk of a turn in an ultra-liberal sense of the UK regulatory framework).

In 2020 the UK government has had to take note of the firmness of the EU position and has updated its requests with the proposal of a regulatory cooperation for the purpose of establishing and maintaining, among other things, «*transparency and appropriate consultation in the process of adoption, suspension and withdrawal of equivalence decisions*»[14].

And actually this is what the UK more or less achieved. Attached to the TCA is a non-binding Joint Declaration by which the Parties commit to make their best endeavors to pursue regulatory cooperation and to carry on the discussion on how to move forward on specific equivalence determinations. The new framework for regulatory cooperation should be codified in a Memorandum of Understanding (MoU) to be signed by the end of March 2021, but it seems unlikely that the MoU can go much further than the umpteenth declaration of making any effort to carry on the dialogue on the possibility of future positive equivalence decisions on a case-by-case basis.

As aforementioned, the main obstacle to an actual agreement on

[13]See: https://www.consilium.europa.eu/media/37059/20181121-cover-political-declaration.pdf.
[14]See:https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachmentdata/file/886010/DRAFT_UK-EU_Comprehensive_Free_Trade_Agreement.pdf

equivalence are the EU strong perplexities about the UK ill-concealed ambitions of a second wave of financial deregulation. These perplexities are part of the broader EU concerns about the actual compliance by the UK with the TCA provisions aimed at ensuring open and fair competition through a leveled playing field on key topics such as environment and climate, labor and social standards, State aids and taxation.

In 2020, following the UK application for the EU equivalence determination on 28 distinct areas, the Commission has involved it in multiple rounds of clarifications, with particular regard to *«how the UK will diverge from EU frameworks after 31 December* [2020 and] *how it will use its supervisory discretion regarding EU firms*»[15]. The Commission also announced that it has taken note of the equivalence decisions taken by the UK on 17 areas relating to banking and financial activities, underlining that these decisions were taken in the UK's interest and that *«similarly, the EU will consider equivalence when they are in the EU's interest*»[16].

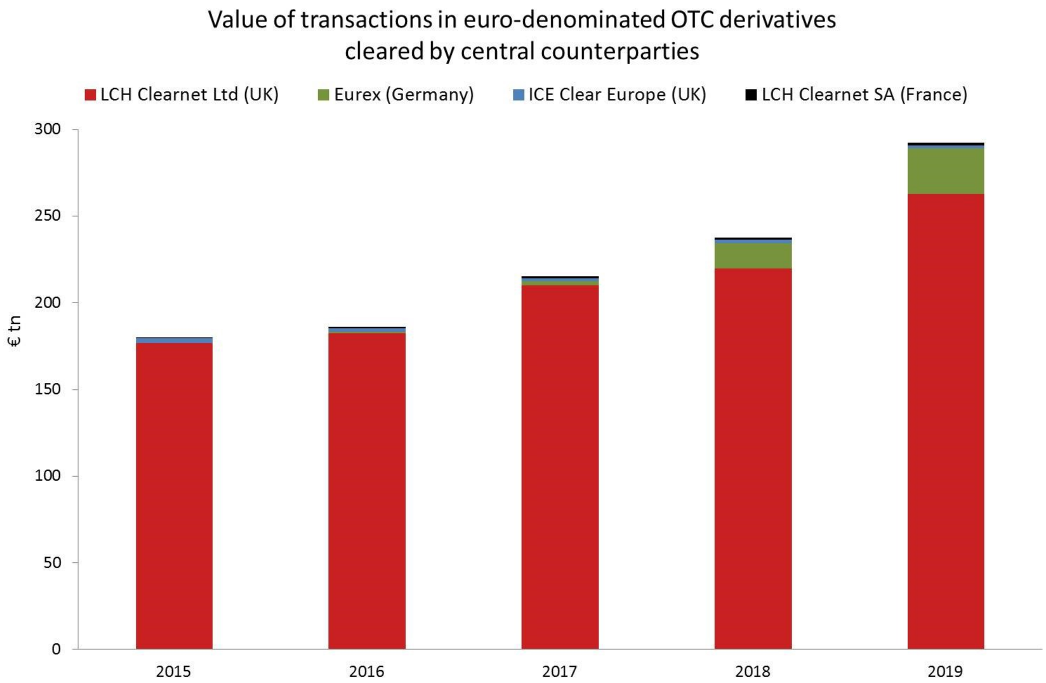
So far the EU Commission has taken a temporary equivalence determination on only two areas of the UK regulation: central securities depositories and central clearing counterparties (CCPs). Central securities depositories will be considered EU-equivalent until June 30, 2021, and CCPs until June 30, 2022. The Commission's favorable ruling on these two areas stems essentially from an assessment of convenience for the EU, whose financial industry is deeply reliant on the relevant UK market infrastructures.

This is especially true for London's clearinghouses such as LCH Clearnet Ltd and ICE Clear, which are among the major players worldwide and in practice monopolize the clearing of euro-denominated derivatives (Fig. 24) with market shares over 90% and annual revenues of around $ 400 billion. In 2019 they cleared euro-denominated derivatives for a value exceeding € 260 trillion, more than 10

[15]See: https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_2532
[16]*Ibidem*.

times that of the main EU competitor, the Eurex (Minenna, 2021).

Figure 24



Source: European Central Bank

This explains why the Commission considered unaffordable the risk to the EU financial stability resulting from the sudden loss of access to the clearing services provided by UK-based counterparties. Probably its intention was to give the European financial sector the time necessary to prepare adequate market infrastructures on the continent and thus allow a smooth transition of market operators from London to financial centres established in the EU. For this reason, many observers are convinced that the equivalence determination on CCPs (and, actually, also that on central securities depositories) will not be renewed upon expiry, leading to the end of the monopoly of London's clearinghouses.

Something similar is already occurring for the trading of euro-denominated shares. Article 23 of EU Regulation on Markets in Financial Instruments (MiFIR) states the so-called share trading obligation (STO), which requires that the trading of shares that are admitted to trading on an EU regulated market or trading venue must take place on a regulated market, multilateral trading facility or systematic internalizer or on a third-country trading venue assessed as equivalent by the EU Commission[17]. With regard to the relevant UK regulation the Commission has decided not to grant – even temporarily – equivalence, with the only exception of stocks traded in pound sterling that, however, account for less than 1% of EU total trading activity. As a consequence, in January 2021, Amsterdam overtook London for the first time in history as the largest shares trading venue in Europe, posting an average daily share value of 9.2 billion euros versus 8.6 billion euros made by the City [Vaghela, 2021]. In the same month also other EU financial centres (Dublin, Frankfurt, Paris and Milan) recorded an increase in their average daily share values.

One could argue that the European Union is using equivalence as a political weapon to relegate Britain to the role of rule-taker. Yet, in this regard, it should be noticed that the issue of equivalence – however complex and controversial – embodies the irrepressible protection needs of European savers and investors who cannot be subordinated to the profit targets of UK finance. The whole thing must also be contextualized in light of the UK's questionable track record during the negotiations. On the British side, the negotiations were in fact repeatedly marked by unexpected moves such as the publication of the Internal Market Bill, which – as said in § 3.1. – included provisions in contrast with the commitments made by the UK in the 2019 Protocol on Ireland and Northern Ireland.

Of course, the Square Mile already initiated several counter-moves to minimize the impact of Brexit on its prestigious position among world's top financial centres. In February 2021 it resumed trading on Swiss shares, which the UK had lost in mid-2019 together with the rest of the EU[18]. Furthermore, the FCA is moving to a softer approach on dark trading for stocks than the one enshrined under the provisions of the relevant EU Directive (MiFID-II). Dark trading is the

[17]There are some exceptions: trading on venues other than those provided by MiFIR is allowed when it is non-systematic, ad-hoc, irregular and infrequent, or when it is carried out between eligible and/or professional counterparties and does not contribute to the price discovery process.
[18]See footnote 12.

expression commonly used when financial instruments are traded on platforms that allow to execute transactions with a low pre-trade transparency. To safeguard market integrity and the effectiveness of the price discovery process, MiFID-II introduced a limit (so-called double volume cap or DVC), which basically limits the amount of dark trading in any share to a given percentage of total trading in that share. In December 2020 the UK regulator announced that it would no longer automatically apply the DVC to UK stocks, and in March 2021 the measure was extended to all other stocks. The move aims at recovering part of the business lost after the departure from the EU by attracting large international investors who are often interested in maintaining anonymity at least on part of their operations.

Recently the UK has also launched a review of the listing rules that is going to relax provisions on free float requirements and dual class shares structures. The review is mainly intended to promote the imagine of the City as the best place where to make the IPOs of tech companies that, as well known, often resort to dual class structures to preserve the powers of the founding shareholders. A particularly favorable regime will apply to the IPOs realized through Special Purpose Acquisition Companies (SPACs), the new US-born trend of shell companies established with the only purpose of raising public capitals to invest in the purchase of one or more operating businesses [Keown and Saigol, 2021].

The initiatives described above could hint that Britain is betting on a competition to the bottom with the EU, that is, on a softening of its financial regulation compared to that of the EU bloc. At the moment, however, it is too early to understand whether the UK will decide to press to the bottom of the accelerator of financial deregulation. A possible alternative could be, for example, that of a «*selective deregulation*», that is carving out the role of rule-maker in the new frontiers of banking and finance while adopting a more accommodating attitude with the EU on traditional finance.

Many of the regulatory novelties adopted or planned by the United Kingdom have to do with the latest developments in the financial sector. This is the case, for example, of the fintech sector in which Britain is one of the main players worldwide. In 2019 fintech generated revenues of 9.9 billion pounds, an increase of 7.5% compared to the previous year: a performance that attracts massive investments (38.3 billion pounds in 2019) both from "classic" finance and from players looking for profit opportunities such as venture capital and private equity. The particularly friendly regulatory framework represents one of the most important success factors of this thriving industry. Six years ago, the FCA was the first regulator in the world to launch a regulatory sandbox, that is, a space that allows digital finance start-ups to test innovative products and services according to an agreed and supervised plan by the competent authority (Minenna, 2020). The UK is also at the forefront of digital banking (home to prominent names such as Monzo, Revolut and Starling), open banking and use of artificial intelligence to process the data made available by banks through the opening of the application program interfaces. And the Kingdom has also signed numerous bilateral cooperation agreements (fintech bridges) with non-EU countries (especially in the promising Asean-Pacific region), which will ensure London a key influence in defining the international regulation of this sector.

Diversified know-how, top-level market infrastructures, regulatory flexibility and openness to innovation are all strategic assets for British finance. Nevertheless, a mismanagement of relations with the EU risks turning into a downgrade for the UK financial industry. An excessively confrontational attitude could push the EU to aggressive retaliatory measures, resulting in a large hemorrhage of human and capital resources for the City and the rest of Britain.

As a first approximation, there is the danger of a substantial downsizing of the trade in financial services with the EU bloc which, as seen in § 4.2., alone contributes 40%-45% to the overall UK surplus in this service category. In addition, there could also be consequences on the global competitiveness of the British financial sector as finance benefits from the so-called «*eco-system effect*», i.e. the added value arising from the specialization of activities and the geographical concentration of certain resources and operations. Financial intermediation in a broad sense is fueled by experience, expertise, concentration of monetary resources (think of the importance of liquidity for the proper functioning of markets) and human resources and the ability to do and offer networking, that is to exchange contacts, views, ideas and to share projects. For this reason, the loss of influence and acquaintance with the EU market could prove costly for the City in terms of its ability to attract investments, transactions and projects even from non-EU countries[19].

Other financial centres located within the EU (such as Dublin, Amsterdam and Frankfurt), but also non-European hubs (such as Wall Street, Hong Kong and Singapore) could benefit from this. In the first months of 2021 some of these hubs have experienced a surge in their activities, including shares trading, trading and clearing of euro-denominated swaps and trading of carbon allowances.

From the EU's standpoint, Brexit – especially if the United Kingdom will make excessive use of regulatory independence – represents an opportunity to bring onshore a large chunk of the banking and financial activities that so far have taken place mainly beyond the Channel. This opportunity is, however, also a challenge for the European financial industry that in some areas – such as the central clearing of derivatives – is strongly reliant on the UK market infrastructure and is not equipped with equally developed in-house infrastructure.

Furthermore, Brexit could strengthen the multi-centricity of the EU financial system. Even before the UK's departure from the EU, the ECB had found some degree of activity concentration among a small number of hubs in banks'

[19] According to estimates released on January 2021 by the Centre for Economic and Business Research, London's financial services and associated professional services firms will lose over 2 billion pounds of GDP per year [CEBR, 2021].

relocation plans [ECB, 2020]. The possible consolidation of these dynamics in the coming years would make it appropriate to improve the interaction between the various financial centres of the Union. To this end, efforts would be needed to remove the barriers to the cross-border provisions of financial services which – despite the good results achieved by the harmonization of the European regulatory framework – still present strong differences between national regulations on several issues, such as tax and insolvency regimes.

All-in-all, it seems that future developments in the EU and UK financial systems will be necessarily affected by the way in which the two blocs will manage their future interactions both on a strictly financial and on a political-economic level. On the one hand, Britain looks the Party that has the most to lose in the financial services business and, therefore, should carefully assess how much regulatory divergence the EU will be able to tolerate. On the other hand, it has to be recalled that EU's interests in the UK market are not limited to trade in services, and rather a huge part of these interests is in the form of trade in goods with Britain. Even if the EU bloc can count on a privileged position as a negotiating Party due to the higher-level size of its economy compared to the British one, a too rigid attitude on delicate issues such as that of equivalence could push the United Kingdom to hasten the search for new partners, such as China, willing to satisfy its excess domestic demand for goods.

5. After a negotiation that lasted almost 4 years, on the eve of Christmas 2020 the European Union and the United Kingdom finally reached an agreement – the Trade and Cooperation Agreement (or TCA) – which governs their bilateral relations since 1 January 2021, the date of the UK's definitive departure from the EU.

At the heart of the TCA are the provisions governing the trade in goods and services between the two Parties, historically linked by deep and important commercial relations.

In the post-Brexit context, these trade relations will inevitably encounter frictions due to the fact that the UK is no longer part of the customs union and the single market. Not surprisingly, already in the aftermath of the 2016 referendum, economic and financial operators on both sides of the Channel have embarked on a difficult path to adapt to the new scenario.

With regard to trade in goods, EU suppliers have tried to reduce the dependence of their exports on UK demand; and, in turn, Britain has initiated a re-orientation of its imports towards non-EU source markets. These dynamics have contributed to the UK's shift to second place (after the US) as a partner towards which the EU records the largest surplus in global goods trading and have also made easier the boom in British imports from China.

However, these developments cannot be attributed exclusively to the outcome of the 2016 referendum as they were also affected by the tensions that have characterized international trade in recent years, including the tariff war between the United States and China and, more in general, the protectionist attitude of the US foreign economic policy during the Trump presidency.

Furthermore, the data for the period 2016-2019 indicate that following the Brexit referendum there was a braking in the growth path that had characterized the EU goods surplus with the Britain from 2012 onwards, but the trade volumes reached until 2016 held up.

The UK's decision to leave the EU also had a modest impact on bilateral trade in services, in which even after the referendum Britain maintained its surplus towards the EU, thanks to the strength of its financial sector and, more in general, of its knowledge-intensive business services industry.

In 2020, the outbreak of the Covid-19 pandemic, adding to the impending exit of the UK from the EU in an extremely difficult negotiating climate, instead led to a significant reduction in trade between the two blocs. To be most affected was the EU, which recorded a decline in its goods surplus and a widening of its deficit in services trade with Britain. The joint effect was a worsening of the EU's overall trade balance towards the UK of about 30 billion euros compared to 2019.

These numbers probably had a key role in the EU's decision to reach a last-minute agreement with the UK government, despite the unconvincing attitude shown by the latter on several occasions, including the publication of the Internal Market Bill with some provisions in contrast with the commitments undertaken in the 2019 Protocol on Ireland and Northern Ireland.

This interpretation would help to understand why TCA provisions are carefully detailed in dealing with trade in goods (at the core of the EU' interests) and instead address in a vague and incomplete way trade in services on which is the UK to have the major interests at stake.

As for trade in goods, the TCA has made it possible to avoid the application of quotas and tariffs at the EU-UK border for products that meet specific requirements in terms of rules of origin. Nevertheless, the introduction of customs controls, bureaucratic formalities and detailed rules of origin engenders frictions on bilateral trade relations, as evidenced by the huge reduction in trading volumes occurred in the first months of 2021. In order to minimize friction costs borne by domestic traders, both the EU and the UK will have to adopt timely and efficient border control procedures. Important initiatives in this sense have already been taken, for example, in France and Italy.

On the exports side, UK looks more disadvantaged than the EU, as it still lacks strong and efficient customs infrastructures and British producers may need a deep rethinking of their supply chains to be compliant with the preferential rules of origin introduced by the Agreement. Yet, this disadvantage is somehow offset (at least partially) on the imports side, where the UK could be tempted to exploit its structural deficit position towards the EU by further accelerating the re-orientation of its imports to non-EU partners, starting from China. Such a move would create serious difficulties to the many EU countries (Germany in the lead), given that the UK has so far represented one of the most important outlet markets for European goods at the global level.

In the field of trade in services, the greatest risks are looming for the British economy, which owes the EU a substantial share of its services surplus with the rest of the world. In spite of this, the uncompromising stance held by the EU throughout the entire negotiation prevented the UK from reaping significant benefits from the agreement reached at the end of 2020.

The main concerns relate to the resilience of the British financial sector (the most important in trading services with the EU bloc) in the face of the loss of a streamlined access to the European market. As recognized by the European Commission, the TCA covers financial services in the same way as they are covered in EU's other free trade agreements with thirds countries. Mutual commitments to grant continued market access to operators from the other Party will be subject to the PCO, which gives each Party the right to maintain or adopt measures for prudential reasons.

The TCA also explicitly rules out financial services from the MFN treatment and – what matters most – does not address the issue of equivalence determinations due to the express decision of the EU to carry out further assessments on how the UK will diverge from EU frameworks after the definitive withdrawal from the Union. Consequently, the main alternative for UK financial firms that want to offer their services in the EU is the repatriation of operations to the European Union through the establishment of subsidiaries. However, this is not a cost-free alternative since it requires moving human and financial resources across the EU, thus fragmenting their business across multiple locations and losing the benefits associated with the so-called «*eco-system effect*».

A few months after the agreement was reached (the TCA has not yet been ratified by the national Parliaments of EU countries), it is not possible to understand whether or not Brexit has the potential to undermine London's strong position as an international financial centre. A reduction in business with the EU is obvious, but it is too early to estimate its extent and, even more so, to understand whether and to what extent it will also impact on relations between UK finance and non-EU countries.

In its favor, the British financial sector can count on numerous strengths: diversified know-how, top-level market infrastructures, regulatory flexibility and openness to financial innovation. On the other hand, a too bold approach in the review of post-Brexit financial regulation could fuel new tensions with the EU and a tightening of the European Commission on key dossiers such as that of equivalence determinations.

All in all, the TCA represents an important milestone in redesigning trade relationship between the two blocs, and a major achievement for the EU, which was able to chisel the text of the agreement in order to protect its interests and avoid excessive concessions to Britain.

Future developments will depend on the commitment that the Parties will make to base their bilateral relations on solid cooperation. In an economic setting weakened by the heavy consequences of the pandemic, a cooperative conduct looks the best strategy to safeguard the respective trade interests and avoid harmful retaliation. Tensions emerged in the first part of 2021 on the issue of the Irish sea border and on the exchange of anti-Covid vaccines unfortunately do not seem to go in the right direction. Time will tell if the EU and the UK will be able to reverse course and establish a climate of greater serenity and mutual confidence.

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