House of Commons
Treasury Committee

Transitional arrangements for exiting the European Union: Government Response to the Treasury Committee’s Fourth Report

First Special Report of Session 2017–19

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The Treasury Committee

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First Special Report


Appendix: Government Response

Introduction

The Treasury Select Committee published its report: “Transitional arrangements for exiting the European Union” on 14 December 2017. This document sets out the government response to the conclusions and recommendations in that report.

The government recognises the important work of the Treasury Select Committee in this area. The report is a helpful contribution to the current debate on the design and scope of the implementation period, and particularly the need for reaching agreement quickly. The government wishes to acknowledge those who have provided evidence and expertise to assist the committee’s preparation of the report. During the ongoing negotiations with the EU, and particularly as talks move towards the UK’s future partnership with the EU, it is important that the government continues to hear views from a range of stakeholders—including experts and businesses—to ensure a range of voices are listened to.

The government welcomes many of the recommendations made in this report and considers they fit within the framework for the UK’s approach, as set out by the Prime Minister in both the Lancaster House and Florence speeches.

In the next stage of the negotiations with the EU, the ambition of both the UK and EU, as endorsed by EU leaders in December, is to reach political agreement on the implementation period by March European Council, finalising the terms with as much certainty as possible. The government welcomed the General Affairs Council adoption on 29th January of the European Commission’s negotiating directives, which provided the formal mandate to progress implementation period negotiations, and we have welcomed the constructive talks since then.

This ambition is aimed at providing businesses, in all sectors of the economy, with the certainty they require to carry on investing, to carry on contracting across borders and to ensure the continued smooth flow of goods, services and people between the UK and EU.

The recommendations made by the Committee fall under four broad categories:

1. Providing certainty to businesses, citizens and government. The government agrees with the Committee’s view regarding the need to agree the implementation period quickly—that is why we are seeking an agreement by March European Council. Businesses in the UK and EU should have a period of time to adjust to the future EU partnership and should only have to prepare for a single set of changes.
2. The UK’s legal status or relationship with the EU during the implementation period. During the implementation period, the government has proposed that access to one another’s markets will continue in its current form, based on the EU’s existing rules, regulations and agencies. For the implementation period to work both sides must continue to follow the same stable set of laws and rules, maintaining the same regulations across all sectors of the economy.

3. Preventing cliff-edges and ensuring a smooth exit through preparations for all scenarios. The government has been clear that the future relationship it seeks with the European Union is a deep and special partnership, covering both economic and security cooperation. We are confident that this partnership will be in the mutual interests of both sides, but we continue to prepare for the unlikely scenario in which no agreement can be reached.

4. Relationship to the UK’s future EU partnership. The government agrees with the committee’s view that the terms of the UK’s future partnership should be agreed by the point of exit. This is the approach set out by the Prime Minister at Lancaster House and in Florence. Article 50 is clear that the withdrawal agreement should take account of the future EU partnership. The government welcomes the preparations the EU27 are making to agree a common position on that framework, ahead of March European Council.

The individual recommendations are addressed in turn, below.

1. Providing early certainty to businesses, citizens and government

Simplicity of agreement

Recommendation: This ‘standstill’ transitional arrangement must be sufficiently simple to negotiate within a matter of weeks, to provide early certainty about the legal framework for trade from 30 March 2019, and maximise the time available for subsequent discussions on the future framework for trade.

Response: The government agrees that the implementation period should provide early certainty to businesses, citizens and governments that there will be a smooth exit, and only one set of changes. That is why the government has proposed a simple arrangement, based on the existing structure of EU rules, regulations and agencies. The guidelines and negotiating directives, agreed by the EU27, point to the shared desire of the EU and the UK to make rapid progress on an implementation period. The government has emphasised the importance of concluding the talks on the implementation period as soon as possible—that is why the government is seeking agreement by March European Council.

Recommendation: The Committee supports the Government’s proposal for a time-limited arrangement after the Article 50 negotiations conclude, and welcomes the alignment between the UK and EU27 on the core objective of this arrangement; namely, that the same common rules of trade should continue to apply in the UK and the EU as existed at the point of the UK’s formal exit.

Response: As set out in response to the recommendation above, the government is seeking to negotiate a time-limited implementation period. In leaving the EU on 29 March 2019,
the United Kingdom will be outside the EU’s Customs Union and Single Market. However, during the implementation period, the government proposes to replicate the effects of both to ensure that access to one another’s markets will continue in its current form. This means businesses, in all sectors of the economy, will be able to continue operating with the EU on the same terms as today.

**Recommendation**: The Government has taken a pragmatic approach so far. It has accepted that the ECJ’s jurisdiction may continue; that the ambit of the arrangements may extend beyond EU law relating to the Single Market and Customs Union; and that the UK may follow new EU law implemented during transition.

**Response**: The government has proposed to negotiate a simple implementation period during which the UK’s terms of trade with the EU will remain unchanged. For the implementation period to work both sides must continue to follow the same stable set of laws and rules, maintaining the same regulations across all sectors of the economy.

**Unilateral termination**

**Recommendation**: To prevent the arrangements becoming a ‘transition to nowhere’, and to address legitimate concerns over sovereignty, the Committee recommends that any transition should be capable of being unilaterally terminated by either side. Termination on the UK’s part should be subject to the approval of Parliament.

**Response**: It is not in the interests of the UK or the EU to terminate the implementation period, as this would undermine the certainty it will provide to businesses, citizens and governments in the UK and the EU. The government’s engagement with businesses, across a variety of sectors, has been clear that providing this certainty—through agreeing an implementation period—is vital to maintain confidence. We are therefore seeking to agree the terms of that implementation period by March European Council.

**Early agreement**

**Recommendation**: In her Florence Speech on 22 September 2017, the Prime Minister outlined the Government’s objectives for a transitional deal, namely that: “people, businesses and public services should only have to plan for one set of changes in the relationship between the UK and the EU”; that “during the implementation period access to one another’s markets should continue on current terms”; that there should be a “strictly time-limited period” under “the existing structure of EU rules and regulations”; and that “how long the period is should be determined simply by how long it will take to prepare and implement the new processes and new systems that will underpin that future partnership”. If an agreement on these terms can be reached quickly, the Committee believes that such an arrangement will give people, businesses and public services the certainty they need to plan for the future and will also mitigate against the risk of a regulatory ‘cliff edge’ occurring during talks on the UK’s future relationship with the EU.

**Response**: The government recognises the importance of reaching early agreement on the implementation period. The guidelines published by the European Council point to the shared desire of the EU and the UK to make rapid progress on an implementation
period. The government recognises that it is important to conclude the talks on the implementation period as soon as possible—that is why is why the government is seeking agreement on the implementation period by March European Council.

**Diminishing value**

**Recommendation:** It is not only the materialisation of a ‘no-deal’ scenario that has damaging economic consequences, but the anticipation of such a scenario. It is for this reason that the Committee agrees with the Chancellor that transitional arrangements are a “wasting asset”, the value of which will diminish the longer they take to negotiate.

**Response:** As in previous responses, the government recognises the importance of reaching early agreement on the implementation period. Though there would still be value in agreeing an implementation period later on in the Article 50 period, it is in the interests of businesses both in the UK and the EU to reach agreement quickly.

2. The UK’s legal status or relationship with the EU during the implementation period

**Legal form of the transition**

**Recommendation:** The two options presented by legal experts from whom the Committee heard—either to append relevant Treaty provisions to the Withdrawal Agreement, or for the Agreement to specify which provisions will continue to apply—are both reasonable ways of giving effect to ‘standstill’ transition. The other options available for the preservation of the ‘status quo’—the extension of the Article 50 period or the delaying of the entry into force of the Withdrawal Agreement—are not compatible with the Government’s objective of leaving the EU on 30 March 2019.

**Response:** The government agrees, and has set out that the implementation period can be agreed under Article 50, as part of the Withdrawal Treaty. The government’s ambition is to reach agreement on the implementation period by March European Council.

**The UK’s formal exit from the EU**

**Recommendation:** The ‘standstill’ transition period...must be consistent with the referendum result, in the sense that the UK should no longer be a Member State of the EU. It must also address concerns among the EU27 about preserving a balance of rights and obligations.

**Response:** The United Kingdom will cease to be a member of the European Union on 29 March 2019. As the Prime Minister set out in Florence, the UK will—from that point—no longer sit at the European Council table or in the Council of Ministers, and the UK will no longer have Members of the European Parliament. However, during the time-limited implementation period which follows, access to one another’s markets should continue in its current form, ensuring businesses only have to make one set of changes, to adapt to the future EU partnership at the end of the implementation period.
The applicability of EU law during the implementation period

Recommendation: The precise scope of transition, and whether the principles of direct effect and supremacy will continue to apply to the EU, are questions the Government has yet fully to address. The best outcome would be for transition to apply only to EU law pertaining to the Single Market and Customs Union, and for the transitional arrangements, along with the rest of the Withdrawal Agreement, to be implemented using domestic legal concepts, rather than in a way that retains the principles of direct effect and supremacy in the UK’s legal order. But the best must not be the enemy of the good. The costs arising from the deferment, on a strictly temporary basis, of the repatriation of domestic powers to alter EU law, are outweighed by the economic benefits of avoiding a sudden reversion to WTO rules. The Government should not rule out a transition arrangement that encompasses EU rules beyond those pertaining to the Single Market and Customs Union, and retains, on a temporary basis, the principles of direct effect and supremacy, if that expedites the negotiations. Visible disagreement between the parties on points of principle would lead to a loss of confidence among businesses, and diminish the value of whatever is eventually negotiated.

Response: The government wants swift agreement on an implementation period, based on the existing structure of EU rules, regulations and agencies, so that there’s just one set of changes for businesses and citizens. For the implementation period to work both sides must continue to follow the same stable set of laws and rules, maintaining the same regulations across all sectors of the economy.

The UK’s independent trade relationships during the implementation period

Recommendation: A core purpose of transitional arrangements is to allow planning for the UK’s future outside the EU to take place in an environment of stability and certainty. Given that the EU has exercised exclusive competence over trade policy for over 40 years, a key aspect of that planning is for the UK to establish independent trade relationships, both with countries which have an existing trade agreement with the EU and with those which do not. Notwithstanding that no trade agreements can enter force until the transition period has come to an end, nothing in the Withdrawal Agreement should prevent the UK from undertaking this work.

Response: The government agrees with the recommendation that the UK should be able to undertake work regarding trade agreements during the implementation period. In relation to existing trade agreements with the EU, the government is committed to seeking continuity in its current trade and investment relationships, including those covered by EU FTAs or other EU preferential arrangements. This ensures that the UK maintains the greatest amount of certainty, continuity and stability for businesses, consumers and trading partners. The government is discussing with trading partners how continuity is best achieved and has received positive reactions from engagement with partner countries to the government’s approach so far.

Furthermore, during the implementation period, the government is preparing for the UK’s future independent trade policy by negotiating—and where possible signing—trade deals with third countries, which could come into force after the conclusion of the implementation period.
3. Preventing cliff-edges and delivering a smooth exit

**Government readiness to deliver a smooth exit**

**Recommendation**: A ‘standstill’ transitional arrangement would also mitigate the major risk that HMRC’s Customs Declarations Service (CDS) is not ready in time for 30 March 2019. The Committee remains to be convinced that robust contingency plans exist to avoid the severe disruption to goods trade that would occur in an unplanned ‘no-deal’ scenario were this project to fail, or even be modestly delayed.

**Response**: CDS (Customs Declaration Service) is a top priority government programme that will provide a more flexible customs declaration system to meet future needs. HMRC have a robust plan to deliver CDS by January 2019, and this was recently independently reviewed by the Infrastructure and Projects Authority (IPA). Given the critical nature of the system, as a contingency HMRC will continue to operate the current Customs Handling of Import and Export Freight (CHIEF) service in tandem with CDS during the transition from one system to the other. This will mitigate any risk of disruption to trade.

**Recommendation**: The Government and regulators can take other steps to mitigate some of the consequences of an unplanned ‘no-deal’ scenario. For instance, HMRC and other agencies operating at the border could radically scale back their inspection regime, and the financial regulators could allow firms currently passporting into the UK to carry on doing so, while they process applications for domestic authorisation. These actions have attendant risks—to revenue, to consumer safety, and to financial stability—that would grow over time. And they do not mitigate the risk of disruption on the other side of the border, which will remain subject to EU rules.

**Response**: The government is confident that a future EU partnership will in the mutual interests of both sides. However, the government continues to prepare for the unlikely scenario in which no agreement can be reached.

**Inspection Regimes**

The government is committed to maintaining trade fluidity through UK ports. In the unlikely scenario where no agreement can be reached, the government would continue to take a risk-based approach to customs interventions and is actively considering how customs controls could be applied away from the border in appropriate cases, or in a way that does not impede the flow of trade.

**“Temporary Permissions” Regime**

On 20 December 2017, the Chancellor announced that the government will, if necessary, bring forward legislation to give the regulators the ability to operate a “Temporary Permissions” regime. This would allow inward passporting EEA firms and funds to continue regulated activities in the UK for a limited period after exit day, giving themselves and the UK regulators more time to complete the authorisation process.

While the government has made clear through this announcement that it is prepared to take responsible unilateral action to protect UK customers and help mitigate consequences
of not reaching agreement, the government have emphasised that a joint approach which mitigates potential disruption in both the UK and the rest of the EU would be preferred and in the interests of both the UK and the EU.

**Recommendation:** The Chancellor has allocated £3bn in the Autumn Budget for Brexit preparation measures. The Committee, like the Comptroller and Auditor General, is in favour of insurance. But there is not yet any clarity as to what those measures entail, nor how the money will be allocated between Departments. If it is to bolster the UK’s negotiating position as the Government intends—by demonstrating to the EU27 that the UK is prepared for any eventuality—more detail will be required.

**Response:** This funding represents a clear commitment by the government. HM Treasury will ensure departments and the Devolved Administrations continue to have the necessary money to prepare effectively for a range of exit scenarios, including the unlikely scenario in which no agreement can be reached.

HM Treasury is working with departments and the Department for Exiting the European Union to refine estimates of departmental requirements for 2018/19, and will allocate funding accordingly in early 2018. Departmental allocations for 2019/20 will be agreed at a later date, as requirements will be affected by progress in negotiations with the EU. HM Treasury will set more detail on the 2018/19 allocations before the start of the financial year.

**Recommendation:** CDS (Customs Declaration Service) is just one example of the swift administrative preparation needed for an unplanned ‘no-deal’ scenario. To take another, functions currently performed by a number of EU regulatory agencies, including the European Supervisory Agencies, the European Aviation Safety Agency, the European Chemicals Agency, and the European Medicines Agency, will have to be repatriated and allocated to domestic regulators. Their resources would have to be expanded, and the legal framework amended, to reflect these new functions. It is a vast undertaking for Government and Parliament to complete in less than sixteen months.

**Response:** The government agrees with the Committee that certain regulatory functions, currently performed at EU level, may ultimately need to be repatriated to domestic regulators, subject to the outcome of negotiations on the implementation period and the terms of the UK’s future partnership. The Chancellor has emphasised that the UK and the EU will need to maintain our common principles—including our shared belief in high standards—and continue the intelligent cooperation of regulators.

**Recommendation:** Mitigation of an unplanned ‘no-deal’ scenario may also be provided through agreements between the UK and the EU in specific sectors, such as aviation, where the potential for disruption is most severe. The Government appears to consider it inevitable that such arrangements would be reached in the dying days of the Article 50 process. But the history of international trade diplomacy is replete with examples of short-sighted political considerations prevailing over economic self-interest. And the conclusion of such agreements may come too late for firms that are intending to activate their contingency plans in the first quarter of 2018.
Response: The government’s priority is to ensure continuity in the effects of the UK’s international agreements across a range of policy areas, including as the UK move into the implementation period. The government is working with our international partners to seek to do this as seamlessly as possible.

**Business changes and readiness for exit**

**Recommendation:** Some firms may be able to take action to adapt to the changes to the legal and operational environment arising from a sudden reversion to WTO rules. However, doing so will be costly. It may involve a relocation of jobs and economic activity from the UK to the remaining EU. And it may in the end be unnecessary if a trade agreement is eventually concluded that restores some of the rights and market access that existed while the UK was an EU Member State.

**Response:** As Article 50 sets out, the withdrawal agreement needs to take account of the future relationship. The government, therefore, plans to negotiate the terms of the UK’s future partnership by the point at which we exit the EU on 29 March 2019. Alongside an agreement on an implementation period, this will allow people and businesses time to prepare for the UK’s future partnership and avoid unnecessary costs.

**Recommendation:** Irrespective of the delivery of CDS, the abruptness of the change to arrangements for cross-border trade in an unplanned ‘no-deal’ scenario will also have major consequences for the operation of borders and ports. The principal routes for UK-EU trade are not currently designed to cope with such arrangements. The decision to leave the EU Customs Union and the regulatory union of the Single Market will inevitably require large-scale investment in these ports. But the Committee remains to be convinced that the people, infrastructure and space required on both sides of the Channel to avoid major delays and disruption will be available by 30 March 2019.

**Response:** The government is committed to maintaining trade fluidity through UK ports. Under a Highly Streamlined Customs Arrangement, a bilateral technology-based solution would be implemented at roll-on, roll-off (ro-ro) ports. This solution would link consignments on a port IT system, to customs declarations and vehicle registration numbers, so that goods can be quickly identified and cleared to proceed, minimising the amount of space needed to hold goods. Under this model, it will be possible for goods to be diverted inland to businesses’ temporary storage locations so that any required inspections can take place away from the port.

However, such a solution would take time to implement and would require bilateral cooperation with other countries, ports and the haulage industry to preserve the level of fluidity traders depend on today. That is why the government has been clear that, in order to avoid any cliff-edges, it is seeking a time-limited implementation period during which the UK’s terms of trade with the EU will remain unchanged.

The government has also been engaging with businesses, ports, airports and other organisations involved in international trade throughout the UK. This engagement will help to inform effective policy development and delivery.

**Recommendation:** More generally, goods and services trade would be affected by changes to data sharing arrangements and customs procedures. Many of these changes would occur
anyway as a result of leaving the Single Market and Customs Union. But an unplanned ‘no-deal’ scenario leaves firms with insufficient time to adapt. This is particularly the case for the 130,000 firms—mostly SMEs—that trade only with the EU, and have no prior experience of dealing with customs formalities.

Response: As set out in the response above, the government is seeking a time-limited implementation period during which the UK’s terms of trade with the EU will remain unchanged. This would ensure businesses and people in the UK and the EU only have to adjust once to a new customs relationship.

While the UK is seeking a negotiated settlement in the interests of all parties, it is only prudent that the government prepares for every eventuality. In addition to providing for most negotiated outcomes, the Taxation (Cross-border Trade) Bill will give the government the ability to operate a standalone customs regime and ensure that VAT and excise legislation operates effectively, if the UK were to leave the EU without a negotiated settlement.

The government will ensure the appropriate support, education and guidance is in place to ensure businesses are ready for future trade with the EU. As with any regulatory change businesses are advised to understand how these may affect their business and explore potential impacts. The government will also continue its already-extensive engagement with businesses across the UK.

4. Relationship to the UK’s future economic partnership

Recommendation: There remain differences between the two sides as to the purpose of transitional arrangements. The EU27 use the term “transition” and envisage negotiations on a long-term trade deal continuing during the interim period, while the UK is a ‘third country’. The Government uses the term “implementation”, and maintains that the purpose of this period is to provide time to adapt to a trade relationship that will be known and agreed by the end of 2018, when the Article 50 talks are expected to conclude.

The Committee strongly supports the Government’s objective of maintaining, “the freest and most frictionless trade possible” through a “bold and ambitious” trade deal with the EU. However, it considers it very challenging for the completed details of the ‘bespoke’ free trade agreement envisaged by the Government to be fully agreed within the Article 50 process, particularly when negotiations on the future framework for trade are not yet underway. More importantly, businesses do not have confidence that the future relationship will be known and agreed by March 2019. The Government should seek, by the end of the Article 50 process, an agreed framework for the future trade agreement and a clear direction of travel.

Response: As Article 50 sets out, the withdrawal agreement needs to take account of the future relationship. This means that by the point of exit, the terms of the UK’s future partnership with the EU should be known. Unlike other countries negotiating FTAs, this is not about bringing together two different systems; both sides start from exactly the same position.

However, as the Prime Minister set out in Florence, the EU is not legally able to conclude an agreement on the future partnership while the UK is still part of the EU. This agreement
will also require the appropriate legal ratification which will take time. That is part of the reason why the government has proposed an implementation period, the length of which will be determined by how long it will take to prepare and implement this future EU partnership.

**Recommendation:** The commitment to preserve, through the EU (Withdrawal) Bill, the substance of EU law in the domestic legal system provides a sensible basis for the negotiation of a future UK-EU trade relationship that provides comprehensive market access. But it does not obviate the need for such access to be negotiated and agreed by both sides. In the absence of any agreement on these issues, the mere fact of regulatory alignment on the day after the UK leaves the EU will provide no mitigation to the consequences described above: the UK will have the status of a third country, and WTO commitments will form the basis for cross-border trade.

**Response:** The purpose of the European Union ( Withdrawal) Bill is to provide a functioning statute book on the day we leave the EU, and ensure that it is for Parliament (and in some cases for the devolved legislatures) to make any future changes. The powers in the Bill will ensure that, whatever the outcome of the negotiations, the statute book can continue to function. New primary legislation beyond the European Union (Withdrawal) Bill will be required to implement new policies or institutional arrangements that go beyond replicating current EU arrangements in UK law.

**Recommendation:** Taking into account the challenges of concluding a trade agreement during the Article 50 process, and the alignment between the two sides on the objectives for the interim period, there are in practice two broad categories of outcome for the UK’s economic relationship with the EU on 30 March 2019: a reversion to a trade relationship based on WTO commitments (sometimes called a ‘no-deal’ scenario), or the preservation, on a temporary basis, of the status quo. In terms of their economic impact on both the UK and the EU27, the difference between these two outcomes is dramatic.

**Response:** The government is proposing a strictly time-limited implementation period, following the UK’s exit from the EU on 29 March 2019. This will allow businesses to continue trading with the EU on current terms, under the existing structure of rules and regulations, from that point until the future EU partnership has been agreed and implemented. As highlighted in previous responses, the government is confident that this implementation period is in the mutual interests of both sides and can be agreed quickly, providing certainty to businesses, citizens and governments.