



VCI Position

Impact of Brexit on the chemical-pharmaceutical industry

Executive Summary

Cohesion in the EU while maintaining the fundamental freedoms has high priority for the chemical-pharmaceutical industry in the Brexit negotiations. At the same time, the economic damage to both sides should be kept as low as possible. Finally, the impact of Brexit on German chemical companies will depend on the concrete shape of future trade relations. Beside the possibility of tariff payments of 200 million euros annually, even higher burdens can be expected should regulation take different paths in the future in the EU-27 and the United Kingdom (UK), respectively – e.g. regarding the European chemicals regulation REACH or the authorisation of biocidal and plant protection products. The high standards in the protection of human health and environment, as achieved by EU legislation, should be kept up in harmonised form in the EU-27 and the UK also in the future. In order to ensure this, the EU should strive in the exit negotiations for a comprehensive partnership, investment and trade agreement with the UK.

Introduction

- In mid-2016 the voters in the UK decided by a small majority for leaving the EU. Consequently, on 29 March 2017 the British government formally notified the European Council of its intention to withdraw from the European Union, according to Article 50 of the EU Treaty. The UK and the EU have only two years to agree on the exit modalities and the form and content of their future relations. The Commission represents the EU in the negotiations which, as wanted by the Commission, are structured in two separate phases. The prerequisite for starting the second negotiating phase on the shaping of future trade relations is a unanimous European Council decision at the summit on 14/15 December 2017.
- Already before the official start of the exit negotiations the German chemical industry association VCI emphasised that the **achievements of European unification** must not be put at stake in the Brexit negotiations. **Cohesion in the EU** while maintaining the fundamental freedoms has high priority for the chemical-pharmaceutical industry. At the same time, the economic damage to both sides should be kept as low as possible. In order to ensure this, the EU should strive in the exit negotiations for a comprehensive partnership, investment and trade agreement with the UK.
- Finally, the impact of Brexit on German chemical companies will depend on the concrete shape of future trade relations. For example, should the British government introduce chemical and pharmaceutical tariffs equal to the existing external tariffs of the EU, **tariff payments of ca. 200 million euros annually** would

become due for Germany's third largest industry. Presumably even higher burdens could be expected should regulation take different paths in the future in the EU-27 and the UK, respectively – e.g. regarding **the European chemicals regulation REACH** or the authorisation of **biocidal and plant protection products**.

- The UK is an important trading partner and one of the largest markets in the EU for the German chemical-pharmaceutical industry. In 2016 the industry sold goods worth just under 12 billion euros to the UK (6.7 percent of German chemical exports). **Specialty chemicals** and **pharmaceuticals** accounted for the largest share. In the same year, German chemical companies imported products worth over 6.4 billion euros from the United Kingdom. This corresponds to 5.2 percent of German chemical imports and includes mainly **pharmaceutical inputs** and **petrochemicals**. The German-British foreign trade balance in chemical products is highly positive. Over the past five years, exports to the UK rose considerably while imports fell.
- The UK also has an important role as a **production and distribution location** for German chemical companies – even though this importance dropped somewhat in 2015 when the **UK ranked only 10th** among the major foreign locations. The stock of direct investments of German chemical companies in the UK amounted to roughly 1 billion euros. In 2015 there were 40 UK subsidiaries of German chemical companies, employing around 8,000 staff and achieving sales of 3.9 billion euros. The commitment of British investors to German chemistry was clearly higher, with direct investments exceeding 2.6 billion euros.
- In this position paper VCI gives a first **overview of the most important fields for the chemical-pharmaceutical industry** which are impacted by Brexit. Where this is already possible, **recommendations for positions** are derived for the second negotiating phase. Our goal is to actively accompany the negotiations in the coming years, update our positions according to the state of the negotiations, describe the impact on our industry to politicians, and contribute potential starting points for solutions to the debate.

1. Aspects of trade policy and customs legislation

Perspectives

- As an EU Member State the UK is a member of the World Trade Organization (WTO). It can be deemed certain that the UK will remain a WTO member after withdrawal from the European Union. But the exact modalities (e.g. tariff rates) are unclear. Should the negotiating parties fail to bring about a long-term agreement or appropriate transitional rules, there is the danger of the UK “dropping back” to **WTO status** vis-à-vis the European Union. In that case, the EU would need to treat the UK **purely as a third country** without any trade advantages.
- Should the UK introduce vis-à-vis the EU chemical and pharma tariffs equal to the existing EU external tariffs, we estimate that **tariff payments of ca. 200 million**

euros annually would become due. These costs would worsen the competitive situation of German chemical and pharma companies on the island, compared with their British competitors. Also, such higher costs would be to the detriment of the British customers of our industry.

- Brexit also means much more administration, higher bureaucracy costs and risks for companies, both in the EU and the UK. In the WTO scenario there would be **barriers under customs law**.
 - In practice, **time-consuming customs controls** between the EU and the UK – and thus also delivery delays – will become inevitable in many cases. In the import, export and transit of goods the customs authorities will more intensively monitor compliance with those customs formalities, standards and legal provisions that either restrict or ban the movement of goods. However, this requires an expansion of the customs authorities' capacities, especially for the British partner.
 - Companies and particularly the customs authorities will need efficient IT systems and **qualified staff in sufficient numbers** to function in the changed conditions of Brexit.
 - The UK as a major logistics hub in the supply chain could be adversely affected by double customs duties on third country goods.
 - Moreover, **trade political protection measures** (anti-dumping, anti-subsidy measures) could become effective in the future and render market access more difficult or make it impossible.
- The UK will need to fully rearrange its trade relations and, at least initially, lose preferential access in over 50 countries.
 - As an EU Member State, the UK is party to many free trade agreements (FTAs) of the European Union. Here, too, it remains to be clarified definitely
 - to what extent the UK can transfer the EU FTAs into own British FTAs, and
 - how Brexit will influence the EU's **rules of origin** (British suppliers could become a burden for the export-oriented chemical industry in Germany: German companies using UK inputs in their productions might lose the preferential origin status and could no longer benefit from the customs advantages under EU free trade agreements).
- The UK is planning to conclude own FTAs (e.g. with the USA) after Brexit, but this will take much time too.
- The UK is also a party to the Chemical Weapons Convention (CWC) and the Biological Weapons Convention (BWC) and a member of the international control regime. This membership is not affected by Brexit.

Position

- The goal of the Brexit negotiations and the **negotiations about the future relations** should be very close ties between the UK and the EU-27. Tariffs – in particular, chemical tariffs – should not be introduced. Ultimately, it will be the decision of the negotiating parties whether this is realised in the form of a free trade area, a customs union or a special relationship still to be defined.
- Should it not be possible to adhere to the ambitious timetable for the Brexit negotiations, sound **transitional rules** are essential during these predictably difficult negotiations – up until the new relations with the UK are concretely defined. Also important is an appropriate timespan for the implementation of such rules by the economic players, in order to reduce costs and safeguard legal certainty.
- Wherever possible, the **transitional rules** should anticipate the future long-term provisions as to avoid several changes in system. Within the new bilateral framework
 - zero tariffs should be maintained,
 - customs controls and the resulting delays and costs should be reduced to a minimum through appropriate TBT rules (TBT = Technical Barriers to Trade), particularly by way of
 - mutual recognition of AEO programmes (AEO = Authorised Economic Operator),
 - the UK taking over the Unified Customs Code (UCC),
 - efficient IT systems,
 - expansion of capacities (including staff) at the customs authorities, particularly by the British partner but also by the EU.
- Alongside new TBT rules (see customs procedure), a transitional and “free trade” agreement should include provisions on sanitary and phytosanitary measures (SPS Agreement), non-tariff trade barriers (NTBs), regulatory cooperation, export barriers, IP protection (IP = Intellectual Property), sustainable development and dispute settlement. Reliable market access for investors needs to be safeguarded too.
- The EU and the UK should conclude a bilateral investment agreement, separately from the trade agreement.
- Also in case the UK “drops back” to WTO status, controls of goods between the EU and the UK should be as little time-consuming as possible, in order to keep delivery delays to a minimum. Here, too, contributions could come from the aspects highlighted above.

2. Chemical safety and environmental legislation

Perspectives

- Over the past 15 years the **legislation on chemical substances and products** (REACH, CLP, regulations governing e.g. biocides, plant protectants or cosmetics) has developed enormously in the EU and its Member States. This also holds true for numerous provisions on **occupational health and safety and environmental protection**. The outcome is a complex set of rules which practically covers all parts of manifold value chains – ranging from production to disposal or recovery/recycling.
- In these fields, the EU and its Member States have the **most exacting legislation worldwide**. Therefore, major burdens for the chemical-pharmaceutical industry could be expected if regulation was to take different paths in the EU-27 and the UK, respectively. Thus, **different legal requirements** (e.g. for the registration, authorisation, classification, labelling and packaging of chemical products or the authorisation of biocides and plant protectants) would mean **major bureaucratic obstacles and costs** for trade. Moreover, they would severely impact other sectors where chemical products are used as raw materials for processing.

Position

- The agreement between the EU-27 and the UK should include the widest possible mutual recognition as well as identical standards regarding the safety of products and chemicals and in occupational health and safety and environmental protection. The **high standards in the protection of human health and environment**, as achieved by EU legislation, should be kept up in harmonised form in the EU-27 and the UK also in the future.
- In respect of such legislation, the UK should be largely integrated in the single market – with all rights and obligations.
- Depending on the scope of a future agreement, at the very least long transitional periods should be laid down. During these transitional periods, all rights and obligations under existing EU law should continue to apply for the EU-27 and the UK alike and, obviously, need to be complied with.

3. Intellectual Property Rights

Perspectives

- Through Brexit, all existing Community-wide property rights (Union trademarks, designs) could **become invalid in the UK**. In that case, companies would be left without protection in the United Kingdom or they would need to apply for new trademarks. This involves the danger of **losing priorities in protection rights**.

- EU Unitary Patent System:** By way of enhanced cooperation the Member States (excluding Spain and Croatia) agreed on introducing a unitary patent and on setting up a **unified patent court**. The underlying international agreement needs to be ratified by France, Germany and the UK to enter into force. After the Brexit vote, the UK signalled readiness to ratify the agreement nonetheless. Should Germany, too, issue the ratification act and deposit the ratification instrument, the agreement becomes effective. Then the question arises about the consequences of **Brexit implementation**. It would need to be clarified whether the UK can continue to participate in the unified patent court system.
- By contrast, Brexit has no consequences for patents granted by the national patent offices and “bundle patents” granted by the European Patent Office (EPO).

Position

- It would be desirable for the UK to enact rules for **transferring EU protection rights into national law**.
- Furthermore, a binding clarification would be desirable of whether the UK can continue to participate in the unified patent court system also after Brexit implementation.

4. Competition law

Perspectives

With the withdrawal from the EU, the competition rules under the Treaty on the Functioning of the European Union (TFEU) would no longer apply in the UK. On the one hand, this would mean that the EU Commission could no longer prosecute **competition violations** committed by companies in the UK. This would also impact the claims for damages by companies injured by cartels.

The fact that future **merger control proceedings** could be no longer notified centrally to the EU Commission but would (additionally) require notification in the UK – should mergers have an effect in that country – would be even more relevant in practise. This can mean **considerable extra costs and more time input**. Evidently, there is also the danger of divergent decisions.

5. Energy and climate policy

Perspectives

- Regarding the climate policy, Brexit comes with questions about the further participation of UK industry in European emission trading. In principle, British industry remaining tied to **EU emission trading** would be desirable also for reasons

of equality in competition. If this is not possible, no extra burdens should arise for European industry so that adaptations would become necessary in EU ETS.

- It is difficult to make general forecasts for the impacts on the **energy sector**; these depend on the concrete shape of the exit conditions. The UK being possibly no longer bound to European state aid law might cause further inequalities (e.g. in the strain from electricity prices) between industry in the UK and the remaining EU Member States.
- At present, it cannot be stated whether or to what extent Brexit will necessitate an **adaptation of the EU's targets** for reducing greenhouse gas emissions, expanding renewables and energy efficiency. This too will depend on the concrete conditions of the withdrawal from the European Union.
- **The UK has no strategically important role for energy security** in Europe, as oil and gas are mostly supplied by Russia and Norway. Only the costs of electricity and steam generation in industrial parks might increase due to higher prices for substitute fuels; these are currently imported in considerable quantities from the UK.

Further topics

Perspectives

- Moreover, Brexit could impact the businesses of the chemical-pharmaceutical industry through **changes in company and capital market law**.¹
- Regarding company tax law, it is important to safeguard the international competitiveness of German businesses and of Germany as an industry location. Triggered by the Brexit vote, the British government has announced a reduction in corporate taxation from 10 to 15 percent. The thus created **advantage in international tax competition** is additionally propped up by comparable plans of US President Donald Trump who brought a tax rate between 20 and 25 percent in the debate. Such a tax advantage is to the detriment of German businesses which keep their head offices in this country: because in Germany the municipalities with their high trade tax rates have increased the burden on companies by up to 34 percent. In order to prevent competitive disadvantages for German businesses, cuts in company taxation are necessary; these require a **trade tax reform** too. Also needed are binding and effective intergovernmental dispute settlement mechanisms in double taxation agreements.

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¹ The VCI has an active role in the „Brexit“ steering circle of Deutsches Aktieninstitut where, inter alia, relevant company law issues are discussed and cross-sector positions are developed: <http://brexit-kompodium.de/de/>

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- Identification no. in the EU Transparency Register: 15423437054-40
- The VCI is registered in the “public list on the registration of associations and their representatives” of German Parliament (Deutscher Bundestag).

The VCI represents the politico-economic interests of around 1,700 German chemical companies and German subsidiaries of foreign businesses. For this purpose, the VCI is in contact with politicians, public authorities, other industries, science and media. The VCI stands for over 90 percent of the chemical industry in Germany. In 2016 the German chemical industry realized sales of around 185 billion euros and employed over 447,000 staff.