



Department for
International Trade

Continuing the United Kingdom's Trade Relationship with The Faroe Islands

Agreement establishing a Free Trade Agreement between the United Kingdom of Great Britain and Northern Ireland and the Kingdom of Denmark in respect of the Faroe Islands.

February 2019



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Introduction

1. In line with the Minister for Trade Policy's commitment to Parliament, this report explains the Government's approach to delivering continuity in the trade relationship of the United Kingdom (the "UK") with the Faroe Islands as the UK leaves the European Union (the "EU").
2. As the UK leaves the EU, the Government has sought to deliver the maximum possible certainty to businesses and consumers through ensuring continuity in the UK's existing trade relationships. It is in no-one's interests to disrupt existing trade flows.
3. To achieve this, we have developed new bilateral agreements that replicate, as far as possible, the effects of our existing trade agreements with existing partners. The agreements provide for entry into force when the existing agreements between the EU and a third country cease to apply to the UK, whether the UK leaves the EU with no agreement or at the end of the Implementation Period if the Withdrawal Agreement is ratified. In either event, the new bilateral agreements will form the starting points for our future trade agreements with partners.
4. Wherever possible, the Government has sought a technical replication of these agreements, but in some cases, it has applied bespoke solutions for individual agreements as necessary to ensure continuity of effect in a bilateral context.
5. In accordance with commitments provided for in the Trade Bill 2017-19, this report gives details of, and explains the reasons for, any significant differences between:
 - a. The Free Trade Agreement between the United Kingdom of Great Britain and Northern Ireland and the Kingdom of Denmark in respect of the Faroe Islands (the "UK-Faroe Islands Free Trade Agreement") and
 - b. The trade-related provisions of the existing free trade agreement between the European Union and the Government of Denmark and the Home Government of the Faroe Islands (the "EU-Faroe Islands Agreement").
6. The report first sets out the general drafting changes which are consistent across all the UK's short form continuity trade agreements and which have no significant impact on the UK's current trade relationships. It then considers articles of the UK-Faroe Islands Free Trade Agreement, in turn explaining any significant differences between the trade-related provisions of the Agreement and the corresponding articles of the EU-Faroe Islands Agreement. To assist the reader, this report includes some discussion of the economic impacts as appropriate. The report focuses solely on the changes made to the relationship between the UK and the Faroe Islands as a result of moving from the current arrangements to a new agreement. Any impacts resulting from the UK's exit from the EU or the nature of the Future Economic Partnership (the "FEP") have been excluded from this report.
7. The UK has agreed with many third countries that the most appropriate and proportionate form of legal instrument to ensure continuity in the current circumstances is a short form agreement which incorporates by reference the relevant provisions of the underlying EU-third country agreement with relatively few necessary modifications; the advantages of the short form are set out below. However, the UK has simply chosen the form that the States involved agree is the most pragmatic and sensible in the circumstances, taking into account the wishes of partner countries. Accordingly, some agreements have been drafted in long form to reflect these wishes.

Legal Approach

8. The UK has agreed with many third countries that the most appropriate and proportionate form of legal instrument to ensure continuity is a short form agreement which incorporates by reference the relevant provisions of the underlying EU-third country agreement with relatively few necessary modifications, and this is the approach taken in the UK-Faroe Islands Free Trade Agreement. The approach is like that used in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), where Article 1 of the CPTPP incorporates by reference the provisions of the Trans-Pacific Partnership Agreement, of 4 February 2016, into and makes them part of, *mutatis mutandis*, the CPTPP. The advantages of this approach include:
 - a. the short form agreement may more easily be adapted to accommodate different scenarios, such as the various possible outcomes of the UK's ongoing negotiations with the EU regarding the end state of the UK-EU relationship;
 - b. the format itself will send a clear message to businesses, consumers and investors in both the UK and third countries that the aim is simply to secure continuity in existing trading arrangements, with the only changes being the ones clearly specified on the face of the agreement; and
 - c. the approach will provide a clear legal text, making rights and obligations unambiguous where they had by necessity changed, yet reduce the burden on both countries of legal scrubbing, translation, domestic procedures and, potentially, ratification.
9. The UK-Faroe Islands Free Trade Agreement reproduces the effects of the existing EU-Faroe Islands Agreement as closely as possible, including the establishment of institutional arrangements between the UK and the Faroe Islands based on existing structures (such as joint committees) that allow for the ongoing management and updating of the agreement.
10. Many of the general changes to the EU-Faroe Islands Agreement (such as replacing "EU" with "UK") are applied *mutatis mutandis*, that is, with the technical changes necessary to apply the agreement as if it had been concluded between the UK and the Faroe Islands in the first instance. The interpretive *mutatis mutandis* principle applies to most references to EU law so that, where appropriate, such references are to be read as references to retained EU law or to EU law incorporated in the law of the territories for whose international relations the UK is responsible when relevant EU law ceases to apply to the UK, or legislation in the UK or the territories that replaces that legislation. This has avoided the need to reproduce every page and has significantly reduced the volume of text that needs to be agreed.
11. Where more substantive amendments have been required to ensure operability in a bilateral context, or where the UK and the Faroe Islands jointly agreed that *mutatis mutandis* would not deliver adequate certainty over rights and obligations, detailed amendments have been included in an Annex to the UK-Faroe Islands Free Trade Agreement.

Resources

12. This report is intended to aid businesses, consumers and parliamentarians in understanding any significant differences made to the UK's trading relationship with the Faroe Islands by the UK-Faroe Islands Free Trade Agreement, the reasons for any changes, and their impact.

13. Should you wish to view the EU-Faroe Islands Agreement as originally published, it can be found in hard copy in the Houses of Parliament Libraries and online on the [EUR-Lex website](#). The supplementary Veterinary Protocol is also available on the [EUR-Lex website](#). More detail, including decisions of the Joint Committee set up pursuant to the EU-Faroe Islands Agreement for the purpose of administering the Agreement, can be found on the [EUR-Lex website](#). A consolidated version of the Agreement can also be found on the EUR-Lex site. The consolidated text is not an authoritative version of the Agreement but will assist readers to understand how the Agreement has been amended since its entry into force.
14. Should you wish to view the text of the new UK-Faroe Islands Free Trade Agreement, it will be laid in Parliament alongside an Explanatory Memorandum in accordance with the Constitutional Reform and Governance Act 2010 (“CRAG”). The text will be available online on GOV.UK.

Economic Background

Trade between the UK and the Faroe Islands

15. This section provides a country-specific background analysis of trade between the UK and the Faroe Islands.
16. The Faroe Islands is the UK's 114th largest trading partner,¹ accounting for <0.1% of total UK trade. Total trade in goods and services between the UK and the Faroe Islands was £236 million in 2017.²
17. In 2017, UK exports to the Faroe Islands were £6 million, making it the UK's joint 192nd largest export market (accounting for <0.1% of all UK exports). UK imports from the Faroe Islands were £230 million, making it the UK's 94th largest import source (accounting for <0.1% of all UK imports).

Table 1: Trade between the UK and the Faroe Islands, 2017 (£, Million)

	Trade in goods	Trade in services	Total trade
UK exports to the Faroe Islands	3	3	6
UK imports from the Faroe Islands	229	1	230
Total trade	232	4	236

Source: [ONS, \(2018\). UK trade: August 2018](#); [ONS, \(2018\). UK trade in services by partner country experimental data: April to June 2018](#).

18. The Faroe Islands is an important trading partner for the UK. Using data from HMRC for trade in goods only, Table 2 shows most of the UK's goods imports from the Faroe Islands were in fish and crustaceans (£201.7 million). The top goods exported to the Faroe Islands were in machinery and mechanical appliances (£2.5 million) and residue and waste (food industries) (£1.7 million), representing over a third of the total value of goods exported to the Faroe Islands.

Table 2: Top 5 UK goods exports to & imports from the Faroe Islands, 2017 (at HS2, £ million)

Top 5 UK goods exports to the Faroe Islands	Value	Top 5 UK goods imports from the Faroe Islands	Value
Machinery and mechanical appliances	2.5	Fish and crustaceans	201.7

¹ EU members are treated as individual trading partners with the UK.

² [ONS, \(2018\). UK trade: August 2018](#); [ONS, \(2018\). UK trade in services by partner country experimental data: April to June 2018](#).

Residues and waste (food industries)	1.7	Residues and waste (food industries)	10.8
Mineral fuels or oils, products of their distillation	1.1	Other products	0.1
Articles of iron or steel	0.9	Electrical machinery and equipment	0.1

Source: [HMRC trade statistics by commodity code](#) (accessed November 2018). Sectors classified according to Harmonised System Sections. Data presented is recorded on a 'physical basis where a good is recorded as an export (import) if it physically leaves (enters) the economic territory of a country.

19. The UK exported £3 million in services to the Faroe Islands, and imported £1 million. A detailed breakdown of types of services is not available, and the UK-Faroe Islands Free Trade Agreement does not cover trade in services.
20. The goods and services trade figures in the tables above are not directly comparable. The ONS data is recorded on a 'Balance of Payments' or 'change of ownership' basis where a good or service leaving (entering) the economic territory of a country is recorded as an export (import) only if it has changed ownership between the resident of the reporting country and non-residents. Goods exports (imports) are recorded by HMRC if a good physically leaves (enters) the economic territory of a country.

Economic impact of the EU-Faroe Islands Agreement

21. The EU-Faroe Islands Agreement entered into force in 1997. Subsequent negotiations occurred with further liberalisation. The Agreement has reduced tariffs on many products, except on certain goods such as certain agriculture and fishery products. The Agreement also tackles some non-tariff barriers.
22. A 2017 study looking at European Economic Integration Agreements included analysis of the EU-Faroe Islands Agreement.³ Economic modelling of the arrangement with the Faroe Islands showed a statistically significant and positive impact on trade flows.
23. HMRC and ONS data shows that bilateral trade flows between the UK and the Faroe Islands are heavily driven by UK imports. Trade data is volatile, though for around the last decade, bilateral trade has been on an upward trend.

Potential loss to UK if the UK-Faroe Islands Free Trade Agreement is not ratified

24. Not being able to rely upon the UK-Faroe Islands Free Trade Agreement would risk UK businesses losing the preferences negotiated in the EU-Faroe Islands Agreement. This could include the re-imposition of tariffs, with the UK returning to MFN treatment with the

³ Soete S and Van Hove J. (2017). 'Dissecting the Trade Effects of Europe's Economic Integration Agreements'. *Journal of Economic Integration*, 32(1), pp. 193-243.

Faroe Islands. The benefits derived from trading under preferences within the FTA, such as increases in trade flows, may then be reversed.

25. However, it is unlikely that the entire effect of the agreement would disappear. While tariffs would automatically revert to MFN rates, discussed in further detail below, it could take longer for some of the other benefits to be lost. Some gains might endure even in the long-run and business connections formed because of the EU-Faroe Islands Agreement might be maintained.
26. The size of the impact of not being able to rely upon the UK-Faroe Islands Free Trade Agreement would depend on the responsiveness of trade flows to increased costs brought about by the loss of access to the Agreement.⁴

Immediate impact if not transitioned

Tariffs

27. Much international goods trade takes place in products for which MFN rates are already zero. However, free trade agreements (“FTAs”) provide additional opportunities by reducing tariffs in products where this is not the case. If the UK-Faroe Islands Free Trade Agreement could not be relied upon, tariffs between the two countries would risk reverting to MFN rates for all trade. This would lead to an increase in duties on some UK exports to and imports from the Faroe Islands.
28. To estimate the potential impact of losing tariff preferences, assumptions have to be made. If all current trade between the UK and the Faroe Islands occurred at the agreed preferential tariff rate, if current patterns of trade remained unchanged in future, and without taking into account the effect of any unilateral preferences, reverting to the UK and the Faroe Island’s current MFN tariff rates would result in an implied annual increase in total duties of up to around £11 million.⁵
29. However, these estimates assume that all tariff preferences offered under the EU-Faroe Islands Agreement are fully utilised by exporters. This is unlikely to be true. In 2016, DIT estimates suggest that 100% of the UK’s eligible goods imports from the Faroe Islands (being those exports which occurred under tariff lines where a preferential rate was provided for in the Agreement) actually utilised the tariff preferences.⁶

⁴ Head K and Mayer T. (2014). [‘Gravity Equations - Workhorse, toolkit and cookbook’](#). *Handbook of International Economics*, 4, pp. 131-195.

Dhingra S, et al. (2018). [‘Beyond Tariff Reductions: What Extra Boost From Trade Agreement Provisions?’](#). *CEP Discussion Paper No 1532*, LSE, pp. 1-38.

⁵ DIT’s own calculations using tariff data from ITC Market Access Map (MacMap) and HMRC trade statistics (accessed 24th October 2018). Implied additional duties are calculated using the difference in MFN and preferential tariff rates and the current value of trade for each product at HS2 level, 2017. MFN tariff rates for imports into the UK are trade-weighted average rates using a reference group of countries by ITC Market Access Map, rather than bilateral trade data. This is to overcome endogeneity bias which may show low average tariff rates where there are low bilateral trade values. These results assume all trade occurs under preferential FTA tariff rates. Different approaches to this analysis are likely to yield different results. (Sources: [ITC Market Access Map](#) and [HMRC Trade statistics](#)).

⁶ DIT’s own calculations using data from [Eurostat](#) (accessed 19th November 2018). Note that using a single year does not account for fluctuating trends in bilateral trade flows, which can be significant. In general, data on the preference utilisation of trade deals is not readily accessible and should be treated with caution. They

30. Similar data on UK eligible goods exports to the Faroe Islands is not publicly available. [The European Commission](#)⁷ has recently published available data on preference utilisation of exports to selected FTA partner countries.⁸ For these countries, 68% of UK eligible goods exports were traded under preferences.
31. The total duty which would in fact be charged on exports and imports would depend on how quantities and prices of traded products adjusted to the imposition of tariffs. If UK producers were not previously utilising the preferential rates or producers and consumers changed their behaviour in response to higher tariffs, this cost would be lower than estimated above. These are strong assumptions, so this figure should be treated as an indicative estimate of the magnitude of the trade barrier under this scenario.
32. The largest implied additional import duties would be for fish and crustaceans (HS03) of up to almost £11 million. All other products would have implied additional duties of under £4000.
33. Indicative estimates of implied additional tariff duties are provided to give a sense of scale of possible additional costs of trade. Tariff duties are transfers, where the cost to business is equal to the benefit felt by the UK Exchequer and the Faroe Islands which could collect more tariff revenue. However, depending on businesses' response to the change in duties, there could be wider effects of increased costs of trade, including negative impacts on consumer choice, prices, and ultimately economic growth and welfare. Estimates of implied additional duties therefore do not constitute an estimate of the impact.

Businesses

34. Additional duties could be absorbed by either UK or Faroe Islanders businesses, passed on to consumers, or existing trade patterns could be interrupted. This could impact UK competitiveness, leading to disruptions in supply chains and job losses in the short term.
35. Businesses that rely on imports as part of their supply chains may be affected if import prices rise, including UK exporters that rely on Faroe Island inputs to export goods to the rest of the world. In 2015 (latest data), around 15.1% of the value added in UK's gross exports reflected imports from abroad.⁹ Specific data for the Faroe Islands as a percentage of these imports is not available, but is likely to be very low given the low share in overall imports. UK companies which rely on Faroe Islands imports would become less competitive. Given the small share of UK trade under the EU-Faroe Islands Agreement, in this case one would expect these impacts to be relatively small, but they could be noticeable for some specific companies.

indicate whether businesses trading in goods are benefitting from negotiated preferences, but do not tell us which or how many businesses are using these preferences. Nor do they cover services trade.

⁷ Nilsson L and Preillon N. (2018). '[EU Exports, Preferences Utilisation and Duty Savings by Member State, Sector and Partner Country](#)'. European Commission, pp. 1-17. This report uses data collected by EU Delegations from relevant authorities in countries with which the EU has bilateral reciprocal trade agreements in place.

⁸ Albania, Chile, Colombia, Costa Rica, Dominican Rep., Egypt, FYR Macedonia, Israel, Kosovo, Lebanon, Mexico, Montenegro, Morocco, South Africa, Korea, Switzerland, Turkey. Data not available for all partner countries.

⁹ OECD, 2018. [Trade in Value Added \(TiVA\): Origin of value added in gross exports](#), December 2018. Experimental statistics.

Consumers

36. Imported products could be more expensive for consumers if retailers pass on additional duties to consumers through increases in domestic prices. This could disproportionately affect certain groups of consumers, for example those at the lower end of the income distribution. Consumers might also see a reduction in choice of products available. Given the small share of UK-Faroe Islands trade in total UK trade, this impact may be relatively small overall, but could be noticeable on specific product lines.

Longer-term impact

37. In the long run, if the UK-Faroe Islands Agreement is not able to be relied upon, the UK would forgo the longer-term benefits that the EU-Faroe Islands Agreement would have brought to UK. This could result in the long-term UK GDP marginally decreasing if a deal is not reached. Given that the Faroe Islands represents a very small share of UK trade, one would expect the impact on GDP to be very small. The Government expects this agreement to support the economy of the Faroe Islands by providing continuity in trading arrangements with the UK. This could be of particular benefit to partner firms producing fish products for which the UK is an important export market.

Explanation of this Agreement,

Including significant differences between the UK-Faroe Islands Free Trade Agreement and the EU-Faroe Islands Agreement

38. The UK-Faroe Islands Free Trade Agreement follows the short form approach explained above in paragraph 8. Beyond the general *mutatis mutandis* changes explained in paragraphs 10-11, this section describes global changes made to continuity free trade agreements following the short form approach and goes on to provide a detailed discussion of the UK-Faroe Islands Free Trade Agreement.
39. No significant changes have been made to the main text of the existing EU-Faroe Islands Agreement; excepting tariff rate quotas changes that are outlined below. However, the UK and the Faroe Islands agreed to modifications to one preambular paragraph as well as Protocols 1, 3, 4, 5 and the additional supplementary Veterinary Protocol to the EU-Faroe Islands Agreement. The modifications are included in the Annex of the UK-Faroe Islands Free Trade Agreement.

General Provisions

Territorial Application

40. Territorial application provisions in a treaty set out the territories to which the treaty applies and how it applies to them. In the existing EU-Faroe Islands Agreement, the Territorial Application article defines the territorial application of the Agreement by reference to the EU Treaties. In the UK-Faroe Islands Free Trade Agreement, this has been replaced by an article which ensures that the agreement applies to the UK and the territories for whose international relations it is responsible to the same extent and under the same conditions as the existing EU-Faroe Islands Agreement applies.

Continuation of Time Periods

41. Certain provisions of the EU-Faroe Islands Agreement that provide for a transitional period, requiring a party to complete an action within a certain timeframe, but which may not yet have been fulfilled under the conditions of the Agreement. These periods have been amended in the UK-Faroe Islands Free Trade Agreement so that the Agreement reflects the remaining time in which the obligation must be fulfilled. Where a time bound commitment has been completed, reference to the time period has been left in and is covered by the interpretative *mutatis mutandis* principle to reflect any continuing obligations of either party. The general commitment to continue time periods in the EU-Faroe Islands Agreement can be found in Article 7 of the UK-Faroe Islands Free Trade Agreement.
42. Article 7 also provides an exception for time periods which relate to a procedure or other administrative matter, such as a review, committee procedure or notification. These periods are not affected and therefore 'start again' when the UK-Faroe Islands Free Trade Agreement enters into force.

Institutions and Committees

43. Institutions provided for in the EU-Faroe Islands Agreement have been adopted *mutatis mutandis* and have been amended to remain operable in a bilateral UK-Faroe Islands context.
44. Article 8 of the main text of the UK-Faroe Islands Free Trade Agreement tasks the newly established Joint Committee with ensuring that the Agreement operates properly from entry into force. It further stipulates that the Joint Committee established under the UK-Faroe Islands Free Trade Agreement is deemed to have adopted the decisions of the Joint Committee established under the EU-Faroe Islands Agreement, to the extent those decisions relate to the UK and the Faroes Islands, *mutatis mutandis*.

Amendment Clause

45. Amendment clauses set out the process that must be followed if the parties agree to amend the provisions of the agreement after it enters into force. Though parties to an agreement are generally free to amend it as they deem necessary, amendment clauses serve to make the process clearer and more transparent.
46. In the UK-Faroe Islands Free Trade Agreement, any amendment of the Agreement must be set out in writing between the Parties and any relevant legal requirements and procedures of each Party must be successfully completed for the change to take effect. The Agreement also enables the Joint Committee to make a decision to amend an Annex, Protocol or Appendix to the Agreement.
47. The insertion of an amendment article into the UK-Faroe Islands Free Trade Agreement does not commit the UK to making any changes to the Agreement once it enters into force. It simply sets out a process which may be used if needed. Therefore, the insertion of an amendment clause is not expected to have an impact on the operability of the Agreement in a bilateral context.

Entry into Force and Provisional Application

48. Entry into force provisions specify the date from which the terms of the agreement will bind the parties. Existing entry into force provisions have been replaced with new provisions in the UK-Faroe Islands Free Trade Agreement to reflect that, whatever the scenario in which the EU-Faroe Islands Agreement ceases to apply to the UK, the UK-Faroe Islands Free Trade Agreement enters into force as swiftly as possible. For the UK-Faroe Islands Free Trade Agreement to enter into force, it must first be ratified by both the UK and the Faroe Islands. In UK domestic law, before an agreement subject to ratification may be formally ratified, it must be laid before Parliament for scrutiny under CRAG.
49. Provisional application is a mechanism which allows an agreement to be applied prior to its entry into force. This means that the agreement can be provisionally applied prior to completion of the procedures required by the domestic law of the respective negotiating states, provided any necessary domestic implementing measures are in place. Where the negotiating states have agreed that a continuity FTA may be provisionally applied from the date the underlying agreement ceases to apply to the UK, the agreement may be operated provisionally from that date while, in the case of the UK, the agreement completes the procedures set out in CRAG. A number of the existing EU FTAs provide for provisional application and were provisionally applied by the UK as an EU Member State.

50. The UK and the Faroe Islands have agreed to allow provisional application of the UK-Faroe Islands Free Trade Agreement in the event that this is necessary.¹⁰ Given that the Government is seeking to maintain the effects of the EU-Faroe Islands Agreement as the UK leaves the EU, this is a proportionate approach to manage the timing constraints during this unique period, and reduces the risk of business and consumers experiencing disruption as the UK leaves the EU.

Trade Remedies and Dispute Settlement

51. Trade remedies provide a safety net for domestic industry against unfair or injurious trading practices caused by dumped, subsidised or unexpected surges of imports of goods. Most WTO members have a trade remedies regime.

52. The economic benefits of an FTA can only be realised if they are faithfully implemented and complied with. A dispute settlement mechanism in an agreement signals the parties' intention to abide by the agreement, thereby increasing business and stakeholder confidence that commitments set out in the agreement can, and will, be upheld. The dispute settlement mechanism therefore provides an important deterrent function. It also provides an effective mechanism for enforcing those commitments, and for resolving any disputes arising.

53. The UK-Faroe Islands Free Trade Agreement replicates the effects of the trade remedies and dispute settlement provisions in the EU-Faroe Islands Agreement *mutatis mutandis*.

54. One of the impacts of transitioning the dispute settlement chapters in the existing EU trade agreements is that, in the event that a dispute arises, the UK will be directly responsible for any relevant costs associated with the dispute settlement process.

Preamble

55. References to the EU-Faroe Islands Agreement on Fisheries within the preamble of the EU-Faroe Islands Agreement were removed as the UK will no longer be party to the Fisheries Agreement between the EU and the Faroe Islands after the UK leaves the EU.

Annexes and Protocols

Goods

56. Goods chapters in trade agreements set out the treatment and the level of access to the domestic market granted to partner goods. This includes setting tariff levels and quotas on various products, establishing safeguards and determining the rules of origin. Commitments on tariffs for both the UK and Faroe Islands have in most cases been transitioned without changes. This means that tariff preferences applied by the UK to the Faroe Islands will remain the same as those applied by the EU on the date the UK ceases to be bound by the EU-Faroes Islands Agreement, and, likewise, the Faroe Islands will continue to apply the same preferences to the UK that it is applying to products from the EU.

¹⁰ To note that the Faroe Islands cannot provisionally apply the UK-Faroe Islands Free Trade Agreement until the Agreement has been ratified through their Parliament.

57. The only exception to tariff commitments being transitioned without modifications occurred in instances where changes were made to the size of tariff-rate quotas, which can be found in Protocols 1 and 4 of the Annex in the UK-Faroe Islands Free Trade Agreement, where these have to be resized to deal with the fact that the UK will no longer be a member of the EU. These changes are detailed further below.

Tariff Rate Quotas (TRQs)

Justification for policy change

58. Tariff-rate quotas (TRQs) allow a certain quota of a product to enter the market at a zero or reduced tariff rate. Imports above the quota are subject to a higher tariff rate – usually the MFN rate. The EU has agreed TRQs, both for imports to the EU and to partner countries, in some of its trade agreements. In order for products to be able to continue to benefit from the use of TRQs in trade between the UK and its FTA partners, these quotas need to be present in the new UK agreements with those partners.
59. TRQs administered by the UK and by FTA partners have been re-sized to reflect the fact that the UK is a smaller importer and exporter than the EU28. Solutions were agreed with the Faroe Islands to set quotas to a sufficient level that will allow for continuity of historical trade flows for importers and exporters from both sides.
60. Where possible, TRQs have been re-sized based on three 3-years of customs usage data, which detail actual usage of the TRQs by importers. It includes information on the quantity and date of individual shipments of goods. This is customs data held by HMRC which records the volume and date of entry of shipments that come into the UK claiming TRQ preferences. Where there is not three years' worth of usage customs data, trade flow data have been used as a proxy instead. In order to address future market access opportunities for UK and partner country businesses, it was also agreed that a minimum level of access should be provided for all quotas, based on a proxy measure relevant to UK trade. Doing so allows future market access opportunities for UK and Faroese businesses using a fair and evidence-based methodology.
61. The quotas given in this agreement were calculated based on a mixture of customs and trade flow data.

Impacts

62. Without transitioning these TRQs, and without any other mitigating actions, goods imported from the Faroe Islands that are currently covered by TRQs in the EU-Faroe Islands Agreement could face MFN tariffs. This could make these imports more expensive. The nature of this impact will depend on a number of factors, including existing trading patterns and the behaviour and responsiveness of domestic consumers and businesses to the change in tariff. In the case of the Faroe Islands, all quotas were inward TRQs from the Faroe Islands with no outward TRQs from the UK. Historically, and according to trade data, Faroese usage of TRQs to export to the UK was low to zero. As such, one would expect the impact on UK producers and consumers resulting from this approach to resizing TRQs to be limited.
63. In the UK-Faroe Islands Free Trade Agreement, conditions attached to quotas have been retained, for instance for gluten content in fish feed, or a fixed increase in quota

size if the quota is filled the preceding year for prepared or preserved crustaceans, molluscs and other aquatic invertebrates.

64. The overall, immediate, impact on UK producers and consumers resulting from this approach to resizing TRQs is expected to be limited.

Inward TRQs

Table 3: List of TRQs from the Faroe Islands to the EU and new UK quota volumes

Quota No.	Product description	New UK quota volume
<p>TRQ No 1</p> <p>Order number¹¹ 09.0671</p>	<p>Live fish:</p> <p>-- Trout of the species <i>Oncorhynchus mykiss</i></p> <p>Fish, fresh or chilled, excluding fish fillets and other fish meat of heading No 0304:</p> <p>--- Trout of the species <i>Oncorhynchus mykiss</i></p> <p>Fish, frozen excluding fish fillets and other fish meat of heading No 0304:</p> <p>--- Trout of the species <i>Oncorhynchus mykiss</i></p> <p>Fish fillets and other fish meat (whether or not minced), fresh, chilled or frozen</p> <p>---- Of trout of the species <i>Oncorhynchus mykiss</i></p>	<p>95 Tonnes</p>
<p>TRQ No 2</p> <p>Order number 09.0675</p>	<p>Prepared or preserved fish; caviar and caviar substitutes prepared from fish eggs:</p> <p>Fish, whole or in pieces, but not minced:</p> <p>-- Atlantic salmon (<i>Salmo salar</i>)</p> <p>-- Other</p> <p>--- Trout of the species <i>Oncorhynchus mykiss</i></p> <p>- Other prepared or preserved fish:</p> <p>--- Of Atlantic salmon (<i>Salmon salar</i>)</p> <p>--- Of Trout of the species <i>Oncorhynchus mykiss</i></p>	<p>54 Tonnes</p>

¹¹ "Inward quotas, which are administered by the European Union, each have a unique order number. Further information about existing EU quotas can be found on the EU Customs and Taxation [website](#)."

<p>TRQ No 3</p> <p>Order number 09.0681</p>	<p>Prepared or preserved fish; caviar and caviar substitutes prepared from fish eggs:-</p> <p>— Fish, whole or in pieces, but not minced:</p> <p>----- Cod (<i>Gadus morhua</i>, <i>Gadus ogac</i>, <i>Gadus macrocephalus</i>)</p> <p>----- Coalfish (<i>Pollachius virens</i>)</p> <p>----- Hake (<i>Merluccius</i> spp., <i>Urophycis</i> spp.)</p> <p>----- Alaska pollack (<i>Theragra chalcogramma</i>) and pollack (<i>Pollachius pollachius</i>)</p> <p>----- Other</p> <p>— Other prepared or preserved fish:</p> <p>-- Preparations of surimi</p> <p>--- Of other fish:</p> <p>----- Other than of herring</p>	<p>163 Tonnes</p>
<p>TRQ No 4</p> <p>Order number 09.0679</p>	<p><u>Crustaceans, molluscs and other aquatic invertebrates, prepared or preserved:</u>b c</p> <p>- Shrimps and prawns:</p> <p>-- In airtight containers</p> <p>-- Other:</p> <p>--- In immediate packings of a net content not exceeding 2 kg</p> <p>--- Other</p> <p>- Norway lobsters (<i>Nephrops norvegicus</i>)</p>	<p>545 Tonnes</p>
<p>TRQ No 5</p> <p>Order number 09.0672,</p>	<p>Fish, dried, salted or in brine; smoked fish, whether or not cooked before or during the smoking process; flours, meals and pellets of fish, fit for human consumption:</p> <p>--- Coalfish (<i>Pollachius</i>) d</p>	<p>102 Tonnes</p>
<p>TRQ No 6</p> <p>Order number 09.0676</p>	<p>Crustaceans, whether in shell or not, live, fresh, chilled, frozen, dried, salted or in brine; crustaceans, in shell, cooked by steaming or by boiling in water, whether or not chilled, frozen, dried, salted or in brine; flours, meals and pellets or crustaceans, fit for human consumption:</p> <p>----- Crabs of the species <i>Geryon affinis</i> d</p>	<p>102 Tonnes</p>

<p>TRQ No 7</p> <p>Order number 09.0674</p>	<p>Molluscs, whether in shell or not, live, fresh, chilled, frozen, dried, salted or in brine; aquatic invertebrates other than crustaceans and molluscs, live, fresh, chilled, frozen, dried, salted or in brine; flours, meals and pellets of aquatic invertebrates other than crustaceans, fit for human consumption:</p> <p>-- <u>Live, fresh or chilled: d</u></p> <p>--- <u>Common whelk (<i>Buccinum undatum</i>) d</u></p> <p>--- <u>Frozen: d</u></p> <p>---- <u>Other: d</u></p> <p>---- <u>Common whelk (<i>Buccinum undatum</i>) d</u></p> <p>Crustaceans, molluscs and other aquatic invertebrates, prepared or preserved:</p> <p>--- <u>Common whelk (<i>Buccinum undatum</i>)d</u></p>	<p>163 tonnes</p>
<p>Order numbers</p> <p>090690</p> <p>092129</p> <p>092130</p>	<p>Meat of sheep or goats, fresh, chilled or frozen</p> <p>Edible offal of sheep and goats, fresh or chilled</p> <p>Edible offal of sheep and goats, frozen</p> <p>Meat of sheep or goats, salted, in brine, dried or smoked, with bone in</p> <p>Meat of sheep or goats, salted, in brine, dried or smoked, boneless</p> <p>Edible meat offal of sheep or goats, salted, in brine, dried or smoked</p> <p>Sausages and similar products, of meat, meat offal or blood; food preparations based on these products:</p> <p>- Of sheep and goats</p> <p>Other prepared or preserved meat, meat offal or blood:</p> <p>- Of sheep and goats</p>	<p>3 Tonnes</p>
<p>Order number</p> <p>090689</p>	<p><u>Fish feed</u></p>	<p>2724 Tonnes</p>

Rules of Origin

Justification for policy change

65. In free trade agreements, Rules of Origin are used to determine the economic nationality of a good. In order to qualify for preferential tariff rates, a good must “originate” in one of the parties to the agreement. Trade agreements may also allow materials originating and/or processing in a country other than the exporting Party to count towards meeting the specific origin requirements for preferential treatment, a process known as “cumulation”.
66. There are two categories relevant to determining whether goods “originate” in the exporting country for the purposes of a free trade agreement:
- a. Wholly obtained – These are goods that are wholly obtained or produced entirely in a single country. Examples include mineral products extracted from the soil and live animals born and raised there.
 - b. Substantial transformation – These are goods that are made from materials which come from more than one country, and the origin is therefore defined as that of the country where the goods were last substantially transformed. This can be determined in three ways:
 - i. Value added – This type of rule requires that a particular proportion of the final value of the product be added in the exporting country.
 - ii. Change in Tariff Classification (“CTC”) – This type of rule requires that the final product be sufficiently different from the imported materials so that it moves to a different tariff classification altogether.
 - iii. Specific processing or manufacturing – These rules typically apply where value added or CTC rules may not adequately determine originating status, and where specific processes are required to meet originating criteria.
67. As a member of the EU, all UK content is currently considered as “originating” in the EU and UK exports are designated as “EU origin”. This means that originating materials from, and processing in, the UK and the rest of the EU can be used interchangeably in bilateral trade with existing EU FTA partners. This will no longer be the case when existing EU FTAs cease to apply to the UK. At this point, the designation of UK exports will shift from “EU” originating, to “UK” originating and EU content will (unless specific provision is made in new agreements) no longer count towards meeting the origin requirements for preferential treatment for either party. This would have implications for goods traded between the UK, EU and the Faroe Islands.
68. To address these implications and to provide maximum continuity for business, it has been agreed in the UK-Faroe Islands Free Trade Agreement that EU materials can be recognised (i.e. cumulated) in UK and Faroe Islands’ exports to one another. Furthermore, EU processing can be recognised (i.e. cumulated) in UK exports to the Faroe Islands. The cumulation arrangements are set out in detail in Title II (Definition of the concept of ‘originating products’) of the Rules of Origin Protocol and are subject to satisfying certain conditions specified in the agreement.

69. The EU and the Kingdom of Denmark in respect of the Faroe Islands are currently contracting parties to the Regional Convention on pan-Euro-Mediterranean preferential rules of origin (PEM Convention) and apply the PEM Convention between them. The PEM Convention is a multilateral agreement that harmonises preferential rules of origin across the Euro-Med area and provides for cumulation between contracting parties to that Convention. The UK's future relationship with the PEM Convention will, in part, depend on UK-EU arrangements, so the UK-Faroe Islands Free Trade Agreement reflects the provisions of the PEM Convention in a bilateral context with modifications.
70. The text of the Rules of Origin Protocol can be found in the Appendix to the Annex of the UK-Faroe Islands Free Trade Agreement.

Impact

71. If cumulation of EU content for the UK and the Faroe Islands was not permitted under the UK-Faroe Islands Free Trade Agreement, some UK and Faroe Islands based exporters might find themselves unable to access preferences as they are currently able to under the EU-Faroe Islands Agreement. UK exporters to the Faroe Islands who rely on EU content might have to revert to paying Most Favoured Nation (MFN)¹² tariff rates, if they continued using EU content, or they might have to review and reassess their existing supply and value chains as a result of this change to existing terms. The impact would, of course, vary across sectors.
72. The UK-Faroe Islands Free Trade Agreement provides only for trade between the UK and the Faroes Islands, and does not provide for either party's direct trade with the EU.
73. We expect this agreement to support the economy of the Faroe Islands by providing continuity in trading arrangements with the UK. This could be of particular benefit to partner firms producing fish products for which the UK is an important export market.

Customs

74. The negotiating States have replicated the EU-Faroe Islands Agreement customs provisions *mutatis mutandis*. However, minor changes were made to Article 10 of Protocol 5, by removing the reference to the provisions on confidentiality applying to the EU institutions. Article 14 of Protocol 5, which relates to the relationship between the EU-Faroe Islands Agreement and any bilateral agreements between the Faroe Islands and an EU member state, was not incorporated into the Agreement as this provision is no longer relevant in the bilateral context.

The Veterinary Protocol

75. The Veterinary Protocol supplementing the EU-Faroe Islands Agreement contains provisions that harmonise Faroese veterinary standards closely with EU standards, effectively extending the EU *acquis* on these matters to the Faroe Islands. The UK cannot at this time commit to retaining these terms, until the nature of the UK's future relationship with the EU has been determined. The Government understands that the Faroe Islands,

¹² 'Most Favoured Nation' treatment is applied to all World Trade Organisation (WTO) members, which states that members should accord similar treatment for all other members. Preferential Trade Agreements are allowed as an exception to this provision, under Article VI of WTO law, if they cover 'substantially all trade'.

under its obligations within the EU-Faroe Islands Agreement, also cannot agree to recognise UK standards as equivalent to EU standards.

76. The negotiating States have incorporated the Veterinary Protocol provisions but excluded any references to EU harmonised standards. The incorporation includes the governance structures, including the Veterinary Sub-Group set up under the Joint Committee.

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