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BREXIT: TIME IS RUNNING OUT TO REACH AN AGREEMENT

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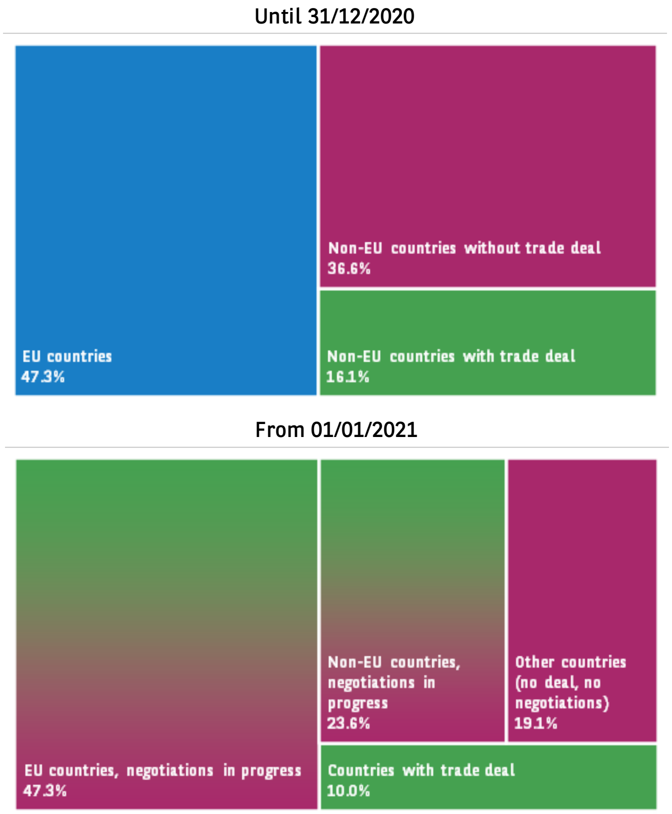
Although the United Kingdom officially left the European Union on 31 January 2020, trade relations between the two trading blocs remain intact during a transition period. Barring a spectacular turn of events, this period will end on 31 December.

Whatever happens, the UK is heading towards an exit from both the EU's single market and customs union. This means that it will be a "hard" Brexit. And it could be the hardest possible if the two parties failed to agree on a free trade agreement.

In fact, UK and EU negotiators have just completed their ninth round of talks – the last initially planned – but there are still major divergences. Should they fail to reach an agreement, the World Trade Organization's basic rules would start to apply, which would be even more damaging for trade between the two blocs.

Meanwhile, the UK has entered into negotiations with the rest of the world to replicate the EU's trade agreements with third countries, from which the country will stop benefitting next year...

COMMERCIAL PARTNERS OF THE UK (% OF TOTAL IMPORTS AND EXPORTS)



SOURCE: ONS

On 23 June 2016, the British electorate voted with a majority of nearly 52% to withdraw from the European Union (EU). After more than three and a half years of negotiations, the UK finally left the EU on 31 January 2020. "Brexit" was made possible after the two parties reached an agreement in October 2019 on the terms of their separation, in a document known as the EU-UK Withdrawal Agreement[1].

Nonetheless, this official act was not accompanied by any immediate changes, notably at the economic and trade levels. The UK has entered a transition period during which it continues to comply with all EU rules and regulations, and remains a member of both the EU's single market and customs union. The transition period will end on 31 December 2020, as the UK government refused to extend it.

1 See https://ec.europa.eu/info/european-union-and-united-kingdom-forging-new-partnership/eu-uk-withdrawal-agreement_en

ECONOMIC RESEARCH

THE NEGOTIATIONS WITH THE EU

Alongside the Withdrawal Agreement, the EU and the UK agreed on setting out the framework for their future relationship in a document called the "Political Declaration"[2]. Although not legally binding, the declaration defines the bases for negotiating a free trade agreement. At this point, reaching such a deal is the most ambitious outcome.

That is because of the red lines the UK imposed for these negotiations. Since the referendum did not stipulate the type of relationship that the British wanted to maintain with the EU, these red lines were determined by the government. In her Lancaster House speech on 17 January 2017, the then Prime Minister Theresa May presented her government's negotiating objectives for exiting the EU[3]. She expressed willingness to withdraw from both the EU's single market and customs union – her successor, Boris Johnson, has not deviated from this position. The reason is that the UK refuses to comply with the free movement of persons, to be under the jurisdiction of the European Court of Justice or to make significant contributions to the EU budget. Moreover, the country wants to restore its regulatory autonomy and to define its own trade policy. Faced with these red lines, the EU would in any case not have let the UK remain within the European Economic Area (EEA) or its customs union, as it does not want to compromise on the conditions to access its economic space.

Looking at the various scenarios that were possible after the referendum, the UK is clearly heading towards a "hard" Brexit. The two possible outcomes of the trade talks are a free-trade agreement or an exit without a deal. If no deal is reached, the World Trade Organisation's basic rules would apply, which would be the hardest Brexit possible (see table 1).

Although the two parties say that they want to reach a free trade agreement, the negotiations have been tough. Since March, the EU and UK negotiating teams, led by Michel Barnier and David Frost, respectively, have completed the nine rounds of official talks that were initially planned. At the end of the final round on 2 October, Michel Barnier issued a statement reviewing the progress of the negotiations[4].

DIFFERENT TYPES OF BREXIT AND UK RED LINES

Type of Brexit	Type of trade relationship	Example	UK red lines: No free movement	No ECJ jurisdiction	No financial contributi	Regulatory autonomy	Independent trade policy
SOFT	European Economic Area membership		✗	✗	✗	✗	✓
	Bilateral agreement		✗	✓	✗	✗	✓
	Customs union agreement		✓	✓	✓	✓	✗
HARD	Free-trade agreement		✓	✓	✓	✓	✓
	WTO membership		✓	✓	✓	✓	✓

TABLE 1 SOURCE: EUROPEAN COMMISSION

Although he noted some "points of convergence" and "positive new developments", he emphasised the "lack of progress" on key topics and "persistent serious divergences" on subjects of "major importance" for the EU. Meanwhile, in a separate statement David Frost called on the EU to show greater "realism and flexibility", and shared his concern that there was very little time left to reach an agreement[5]. There are three fundamental points of divergence.

THREE POINTS OF DIVERGENCE

The first concerns the two parties' commitment to respecting a "level playing field", which means a framework that aims to maintain "open and fair" competition in the long term. Given their geographic proximity and interdependence, the EU and the UK have agreed, in paragraph 77 of the Political Declaration, to maintain the high standards applicable in the EU and the UK in the areas of state aid, competition, social, employment and environmental standards, climate change and tax matters. In particular, the agreement underscores their determination to maintain a "robust and comprehensive framework" for competition and state aid control, in order to prevent "undue distortion of trade and competition". Toward this end, the two parties have agreed to establish appropriate mechanisms both to ensure effective enforcement of these standards and to settle disputes.

However, the UK's proposal[6] for a free-trade agreement only refers to "consultations" between the parties in case of disagreement on government subsidies and excludes these consultations from the proposed dispute resolution mechanism – which itself rejects any implication of the European Court of Justice. In addition, EU negotiators have asked the UK government for more details on the state aid scheme that it will establish, but so far the British have only made vague commitments[7]. They seem to be refusing to commit not only to maintaining high standards, but also to establishing mechanisms to prevent anticompetitive practices.

Although the Political Declaration is not legally binding, progress in the negotiations has been hindered by the UK backtracking on some of its commitments. That is because the EU fears that the UK will refuse to respect economic and commercial fair play once it has left the EU's economic area, and that the country will lower its standards in order to gain competitive advantages.

The second major point of divergence concerns fishery. EU negotiators want an agreement that guarantees long-term access to UK waters for EU fishermen. That would be the counterpart to access for the UK fishing industry to the EU market. However, the UK wants to recover full sovereignty over its waters, and therefore exclude EU vessels.

Finally, the EU would like to reach a comprehensive agreement – based on robust dispute settlement mechanisms – whereas the UK would prefer several independent agreements. This explains why the EU is insisting that the negotiations on different topics progress in parallel. According to the UK negotiators, their EU counterparts are deliberately holding up discussions on the matter of trade in goods and services until an agreement is reached on state aid rules and fishery.

2 See https://ec.europa.eu/commission/publications/revised-political-declaration_en
3 See https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech
4 See https://ec.europa.eu/commission/presscorner/detail/en/statement_20_1817
5 See https://no10media.blog.gov.uk/2020/10/02/lord-frost-statement-after-round-9-of-the-negotiations/
6 See https://www.gov.uk/government/publications/our-approach-to-the-future-relationship-with-the-eu
7 See https://www.gov.uk/government/news/government-sets-out-plans-for-new-approach-to-subsidy-control

As a result, the chances of reaching an agreement on time are diminishing. According to the EU, for a free-trade agreement to take effect at the end of the transition period, a complete document must be ready by the end of October at the latest to leave enough time for ratification by both the European Council and the European Parliament. For the UK, the deadline is even tighter. Prime Minister Boris Johnson recently announced that his country would "move on" if an agreement was not in sight before the EU Summit on 15-16 October.

Meanwhile, the UK government has presented draft legislation – the Internal Market Bill – that would allow it to break with some aspects of the Withdrawal Agreement, even though it is legally binding. The hardening of the UK's negotiating stance might aim to push the EU to end the negotiations and in turn take the blame for failure to reach a free-trade agreement. Otherwise, the objective might be to win more concessions from the EU. In any case, a no-deal Brexit is still a clear possibility.

Nevertheless, while the EU has launched an infringement procedure against the UK over the Internal Market Bill[8], the negotiations continue. At the end of the final round of talks, European Commission President Ursula von der Leyen and UK Prime Minister Boris Johnson agreed on the "importance of finding an agreement" in a joint statement[9]. They instructed their chief negotiators to "work intensively" to bridge the gaps between the two parties' positions. As a result, Michel Barnier and David Frost have engaged in intensified negotiations since.

THE NEGOTIATIONS WITH THE REST OF THE WORLD

Meanwhile, the UK is also negotiating with the rest of the world. While the UK continues to benefit from the EU's trade agreements with third countries during the transition period, that period will end on 31 December 2020. To avoid reverting to basic WTO rules[10] for its exchanges with these countries, the UK is seeking to replicate the EU's various trade agreements. The EU currently has trade agreements with more than 75 countries[11]. Agreements with 24 more countries are in the process of being ratified, and negotiations are underway with six others counties (see table 2, next page).

So far, the UK has concluded 21 trade agreements with a total of about 50 countries[12] – some of these trade agreements have been signed with several countries at the same time. The most important is the one reached with Japan in September[13]. That said, this trade agreement does not go much further than the one between Japan and the EU. According to the UK government's own estimates, it will increase UK GDP by only GBP 1.5 bn over the long term, which is equivalent to about 0.07% of 2018 GDP[14].

At this stage, the countries that have concluded trade agreements with the UK account for barely 10% of the UK's exports and imports. (That does not mean that 10% of its exchanges will be covered, since trade agreements generally only cover trade in goods but not in services). In comparison, the countries that have concluded trade agreements with the EU account for about 16% of UK trade. Admittedly, negotiations are still pending with more than 20 other countries, including the United States, Canada, Australia and New Zealand. But, once again, little progress has been made.

Given the state of the negotiations, it is unlikely that an agreement will be reached with the United States or New Zealand before the end of the transition period. A new round of talks with the US began on 8 September, but there is still a long road ahead, and the US presidential election in November could delay the negotiations. Meanwhile, New Zealand's Deputy Prime Minister Winston Peters has said being "very frustrated" with the pace of negotiations. According to him, UK negotiators are "not match-fit" for such talks. After all, since it joined the EU in 1973 the UK has not negotiated a single trade agreement.

In total, these twenty or so countries account for less than a quarter of UK trade. By comparison, half of the UK's exchanges are made with EU countries (see chart 1).

Overall, the UK is heading towards an exit from both the EU's single market and customs union, and therefore towards a "hard" Brexit that will raise numerous trade barriers between the two trading blocks. Nonetheless, a free trade agreement would help to cushion the shock, notably by avoiding the application of tariffs and quotas. Meanwhile, although free-trade agreements with the UK's other major trading partners are welcome, they will certainly not be enough to offset the country's economic and commercial separation from the EU.

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8 See https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1798
9 See https://ec.europa.eu/commission/presscorner/detail/en/statement_20_1821
10 See https://www.wto.org/french/thewto_f/whatis_f/tif_f/fact2_f.htm
11 See https://ec.europa.eu/trade/policy/countries-and-regions/negotiations-and-agreements/
12 See https://www.gov.uk/guidance/uk-trade-agreements-with-non-eu-countries
13 See https://www.gov.uk/government/news/uk-and-japan-agree-historic-free-trade-agreement
14 See https://www.gov.uk/government/publications/uks-approach-to-negotiating-a-free-trade-agreement-with-japan/uk-japan-free-trade-agreement-the-uks-strategic-approach

TRADE AGREEMENTS WITH THE EUROPEAN UNION AND THE UNITED KINGDOM		
	European Union	**United Kingdom**
Trade deal signed	Albania, Algeria, Andorra, Antigua and Barbuda, Armenia, Azerbaijan, Bahamas, Barbados, Belize, Bosnia and Herzegovina, Botswana, Cameroon, Canada, Chile, Colombia, Comoros, Costa Rica, Côte d'Ivoire, Dominica, Dominican Republic, Ecuador, Egypt, El Salvador, Eswatini, Faroe Islands, Fiji, Georgia, Ghana, Grenada, Guatemala, Guyana, Honduras, Iceland, Israel, Iraq, Jamaica, Japan, Jordan, Kazakhstan, Kosovo, Lebanon, Lesotho, Liechtenstein, Madagascar, Mauritius, Mexico, Moldova, Montenegro, Morocco, Mozambique, Namibia, Nicaragua, North Macedonia, Norway, Palestinian Authority, Papua New Guinea, Madagascar, Peru, Samoa, San Marino, Serbia, Seychelles, Singapore, Solomon Islands, South Africa, South Korea, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Switzerland, Trinidad and Tobago, Tunisia, Turkey, Ukraine	Antigua and Barbuda, Bahamas, Barbados, Belize, Botswana, Chile, Colombia, Costa Rica, Dominica, Dominican Republic, Ecuador, El Salvador, Eswatini, Faroe Islands, Fiji, Georgia, Grenada, Guatemala, Guyana, Honduras, Iceland, Israel, Jamaica, Jordan, Kosovo, Lebanon, Lesotho, Liechtenstein, Madagascar, Mauritius, Morocco, Mozambique, Namibia, Nicaragua, Norway, Palestinian authority, Panama, Papua New Guinea, Peru, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Seychelles, South Africa, South Korea, Switzerland, Trinidad and Tobago, Tunisia, Zimbabwe
Trade deal being signed	Argentina, Benin, Brazil, Burkina Faso, Burundi, Cabo Verde, Gambia, Guinea, Guinea-Bissau, Haiti, Kenya, Liberia, Mali, Mauritania, Niger, Nigeria, Paraguay, Rwanda, Senegal, Sierra Leone, Tanzania, Togo, Uganda, Uruguay	Japan
Trade deal being discussed	Australia, China, Indonesia, Myanmar, New Zealand, Philippines	Albania, Algeria, Australia, Bosnia and Herzegovina, Burundi, Cameroon, Canada, Côte d'Ivoire, Egypt, Ghana, Kenya, Mexico, Moldova, Montenegro, New Zealand, North Macedonia, Rwanda, Serbia, Singapore, South Sudan, Tanzania, Turkey, Uganda, United States, Ukraine, Vietnam

TABLE 2

SOURCE: EUROPEAN COMMISSION, DEPARTMENT FOR INTERNATIONAL TRADE

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