BREXIT:
TAKING STOCK

BEERG

A BEERG Analysis – January, 2018

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Forward

Over the past year we in BEERG have been discussing and debating the implications of Brexit through meetings and workshops with employee and labour relations experts from the many multinational companies we deal with. The conclusion is clear: Brexit will negatively impact businesses in the UK, Ireland and elsewhere in Europe in the short term and will change the business, political and economic landscape for decades to come. As for the long term, whether or not Brexit turns out to be a smart move depends on a whole host of factors, some internal to the UK, some external.

Uniquely, we, in BEERG, have looked at Brexit-related issues in the light of our decades-long involvement in complex and detailed labour relations negotiations, rather than from the perspective of lawyers, politicians or economists.

Over the past six months, through our weekly BEERG Brexit Blog, we have examined different individual issues and questions thrown up by the Brexit process as they have presented themselves.

As we start a new year and as the Article 50 talks enter phase two we thought it would be a useful moment to stand back and attempt to pen a calm and dispassionate overview of what has happened so far in the negotiations; where we are now and what we anticipate could happen over the coming months. As regards the last point we are at all times mindful of the comments of an Irish politician: *"All predictions are hard, but predictions about the future are harder still"*.

This document is the combined result of the work of all of us in the BEERG team. We offer it as positive contribution to the process.

TOM HAYES
Executive Director, BEERG
January 2018

INTRODUCTION

Brexit, the decision by the UK to leave the European Union (EU) and especially its single market and customs union, is unprecedented in modern times. The single market and the customs union together create an integrated internal market within the EU, providing for tariff-free and frictionless trade between members. A decision to leave this market will inevitably result in trade barriers between the UK and the EU, involving both financial and procedural burdens where none previously existed. It will make all parties worse off than they are today.

As Philip Stephens comments in the *Financial Times (04/01/2018):*

> *The purpose of free trade deals is to increase the welfare of both, or all, sides. They generally work. Dismantling economic barriers increases competition, raises productivity and, ultimately, lifts living standards. In this respect, the proposed agreement between Britain and the EU27 will be uncomfortably unique. Whatever its precise terms, a Brexit deal will limit rather than liberalise trade. Win-win is to be replaced by lose-lose. Both sides end up poorer.*

This report looks at where we are in the Brexit process as we enter 2018. It is written primarily for the guidance of executives in the multinational companies that BEERG deals with as they contemplate the challenges which Brexit presents, however it plays out. It looks at where we are today, how we got here, and what happens next.

We remain unconvinced that Brexit is in the best economic interests of the UK, but recognise that economics and business imperatives are not the sole issues that people take into account when making democratic decisions. Economic rationalism is not the be-all and end-all of politics.

But if "politics is the language of priorities" then choosing priorities necessitates making hard choices. Trade-offs can involve losses. You can have more sovereignty, but you may have to pay an economic price for that. A constant refrain by critics of Brexit is that the realities of that choice were never spelt out to the electorate by those advocating Brexit.

As the French say: "*On ne peut pas avoir le beurre et l'argent du beurre*. " This translates in English as trying to "*have your cake and eat it*". A thread that runs through this report is the recurring argument from those who favour Brexit that you can have your cake and eat it. That you can have the economic and trade benefits of EU membership without actually being a member and shouldering the obligations of membership. A second thread is that as the EU simply does not accept this argument it is not going to offer the "cake and eat it" deal that the UK is looking for.

In attempting to understand the Brexit process a number of considerations need to be kept in mind:

1. Those who campaigned for Brexit argued that leaving the EU would allow the UK to "take back control" of its borders, finances and laws. While for some this meant a new, freer-trading, Global Britain, many who voted for Brexit believed that it would allow the UK to control immigration seen, whether rightly or wrongly, as having depressed living standards by allowing wages and working conditions to be undercut. Of course, there was an undercurrent of nationalism animating Brexit, of putting the "great" back into Great Britain, but many Brexit voters were protesting at having been economically "left behind", at being collateral damage of globalisation. They saw themselves as paying the social costs while others pocket the financial gains. These voters did not necessarily make any connection between damaged trade relations with the EU and the health of their own local economies. Most had probably never heard of the single market or the customs union. No matter how Brexit unfolds over the coming year, connecting with these voters and finding solutions to their problems

will be critical if sound and thriving communities are to be rebuilt.

2. The result of the Brexit vote continues to be a matter of continuing, political contestation in the UK. First of all, the narrow margin of victory for the Leave side: 52% to 48%, with the 52% representing 37% of the total electorate. Scotland, Northern Ireland and London all voted to remain in the EU. Such a narrow margin of victory for an issue of such profound economic and constitutional significance was always going to invite questions as to the legitimacy of the process. Second, the question posed in the referendum was somewhat unusual when compared to questions normally found in referenda. For example, the question put to the Irish electorate in 2015 on the issue of gay marriage read:

   Marriage may be contracted in accordance with law by two persons without distinction as to their sex.

   It is fairly clear what this means. So, also, was the question posed in the Swiss 2014 referendum:

   Do you accept the federal popular initiative "against mass immigration"?

   However, the question posed in the UK referendum was, and still is, open to many interpretations:

   Should the United Kingdom remain a member of the European Union or leave the European Union?

   What exactly does leaving the EU mean? Does it simply mean leaving the political structures of the EU, but not the market or customs union structures? Is there a choice to be made between increased sovereignty and looser economic ties? These questions were never fully explored or answered during the referendum campaign and continue to be the source of heated political controversy.

   All of which means that there is a lack of political consensus in the UK about Brexit, what it means and how, if at all, it should be implemented. 15 minutes spent looking at Brexit-related posts on Twitter will confirm the validity of this statement.

3. The UK freely decided to leave the EU. It was not expelled nor was it asked to leave. This means that the exit process is not so much a negotiation as a tidying up of matters outstanding. If you hand in your resignation to the company you work for you generally don't get to say to your employer: "I'm leaving. Here is my notice of resignation. Now, I'd like to negotiate with you the terms under which I am leaving. Oh, and I'd also like you to offer me a consultancy assignment so I can continue to work for you while I also work for other people. Actually, I'd like things to be much the same as they are now except I won't be your employee, bound by company rules and regulations". Your leverage to achieve this "cake and eat it" package? "If you don't offer me what I want I am leaving".

   Leavers can't dictate the terms of their leaving. This, unfortunately, is something many in the UK government do not seem to have grasped during the Brexit process to date.

4. The economic downside of Brexit is already beginning making itself apparent in depressed standards of living, as we note elsewhere in this report. We also know that whatever the final trade agreement between the EU and the UK turns out to be it will be less advantageous than it is today.

   How do we know this? Because the EU has said so. There are those in the British government who argue that the UK will get a trade deal with the EU that will be every bit as good as the arrangements they have today. This is not going to happen. Just as you can't make someone sell you their house if they do not want to sell, so the UK cannot force the EU to offer it the trade deal it wants. The EU will offer the UK a trade deal the EU believes to be in the best interests of the EU. As EU Commission president, Jean-Claude Juncker told Mrs. May at a Downing Street dinner: *The EU has no interest in making Brexit a success.*

Brexiters argue that any losses in UK-EU trade will be more than compensated by gains elsewhere. But this cannot be known with any certainty. How the UK fares post-Brexit depends on three sets of factors:

a. *The internal politics of the UK and the policy stances its government takes.*
b. *The nature of future trading relations between the UK and the EU, covering both goods and services.*
c. *The nature of future trading agreements, if any, between the UK and non-EU countries and how long it takes to put these agreements in place.*

At this time, it is impossible to forecast the future alignment between the three sets of factors. For example: the current UK government puts great store on a free trade deal, post-Brexit, with the US. Who can know what sort of deal the Trump administration might offer? But if there were to be a change of government in the UK, would a Corbyn-led Labour government want to negotiate a trade deal with Trump's US? For that matter, how would the declared "socialism in one country" policies of Corbyn impact UK-EU trade relations or how would businesses with investments in the UK react? ("Socialism in one country" refers to a set of policies involving: renationalising the railways and other utilities; new labour and collective bargaining laws heavily favouring the trade union; heavier rates of tax on higher earners; a significant increase in public spending on schools, hospitals, and social services; a much tougher regulatory regime for the financial sector; greater spending on infrastructure, financed by borrowing; state support for industry.)

As we point out in this report, the Brexit process still has some way to run before the UK actually leaves the EU. An awful lot could happen between now and March 2019 that could impact the process one way or the other.

One last point. Brexit may be all consuming for the British political class and media, but it comes low down on the scale of priorities of both the EU itself and most other EU member states. It was barely mentioned in the recent German general election. The Europeans have bigger concerns than Brexit: the drift towards authoritarianism in Poland and Hungary; the continuing need to strengthen the governance of the Eurozone; migrant flows from Africa and the Middle-East; Islamic terrorism; and the prowling Russian bear on the eastern border. The EU has come to the view that Brexit is a problem of the UK's own making and that it is up to the UK to sort it out itself, possibly with the exception of the border issue on the island of Ireland because it involves an EU member state, Ireland.

The EU will not invest a great deal of effort and resources into Brexit. The bottom line will be: You decided to leave; Your choice. The UK is coming late to "existentialism" – you make your choices and you live with the consequences.

Section 1: Brexit - Some Context

In the long run, Brexit may turn out to have been a smart idea. A very smart idea.

In the long run that is, for in the short run the likeliest outcomes are economic pain, especially for wage and salary earners, and a harsh lesson for the UK that it is of less importance in the world than its politicians like to imagine.

Since the Brexit vote the UK economy has already taken some hits. Sterling is down around 14% against the euro since June 2016. A report, published by the Centre for Economic Performance in late 2017, 'The Brexit vote, inflation and UK living standards', finds Brexit is costing the average household £7.74 per week through higher prices – which is equivalent to £404 a year. Higher inflation has also reduced the growth of real wages. The impact of price increases due to the referendum is equivalent to a £448 cut in annual pay for the average worker. In other words, the Brexit vote has cost the average worker almost one week's wages. And, in a separate report, the Resolution Foundation predicts that pay growth will again remain flat in 2018, figures that chime with those from the Trade Union Congress (TUC): here. See also: here.

The Resolution Foundation's prediction dovetails with comments in the *Financial Times* (27/12/2017) that while the employment rate hit a new high of more than 75 per cent in the summer of 2017, with unemployment standing at a 43-year low of 4.3 per cent, the "combination of a slowing economy and strong employment implies that productivity growth — the efficiency of labour — has been exceptionally poor. Without faster productivity growth, there will not be the additional resources available to raise wages and living standards in the years to come."

Further, the UK is bound to lose markets in Europe as, inevitably, new barriers to trade and services come into force when it finally leaves, whatever the UK government may say about not wanting such barriers. Remember, for example, that, more or less, the entire auto industry in the UK is foreign-owned: Japanese, Indian, French and German companies run the car plants and if Brexit poses a threat to their Europe-wide supply chains they will move production elsewhere.

Can such difficulties be compensated for by growth opportunities elsewhere in the world, by markets opened by the "ambitious" trade deals that UK government ministers constantly affirm are there to be agreed once the UK is free to do so? As we write this it is being reported that the UK is examining the possibility of joining TPP, the Trans-Pacific Partnership. It would seem that for some the lure of faraway trade deals looks so much more attractive than the mundane one they already have on their own doorstep with the richest market in the world.

NOT JUST ABOUT ECONOMICS

But before considering the question of whether new opportunities elsewhere can compensate for the loss of business with the EU, one extremely important point needs to be made. While the potential economic cost of leaving was the key consideration for the 48% of those who voted in the referendum to remain in the EU, for the vast majority of the 52% who voted to leave, controlling immigration, especially from the EU, was the main motivator. (See Evans and Menon: *Brexit and British Politics,* page 77).

This has been taken as a mandate by the current UK government to leave not only the political structures of the EU, but also the integrated, internal market that results from a combination of the Single Market and the Customs Union, and which allows for tariff-free, frictionless trade between EU and EEA member states.

"Taking back control over borders, money and laws" is not just an economic statement. It is a call for a reassertion of national sovereignty, even if that sovereignty was never really lost in the first place, as the government's White Paper on exiting the EU admits. Which has led to arguments by those who support Brexit that, yes, there may be short term economic pain, but it will be all worth it in the long-term as a "Global Britain" recovers its place in the world. Difficult arguments to counter as, while you may doubt it, you can never definitively disprove the future.

NOTHING HAS CHANGED

For now, however, it has to be remembered that Brexit has not happened yet. To borrow a phrase from Mrs. May: nothing (visible) has changed. The UK remains a member of the EU and trade in goods and services continues much as if there never been a Brexit vote. What has changed is invisible.

Businesses holding off on investment plans or quietly making post-Brexit contingency arrangements: the financial services company building capacity in Spain; UK lawyers registering in Dublin; US banks leasing office space in Frankfort or Paris; manufacturing companies looking for new suppliers in EEA countries.

Even when the UK leaves the EU on March 29th, 2019, again nothing will appear to have changed as it now looks like the EU will agree to a UK request for a transition arrangement that will run until December 31, 2020 during which the UK will behave *as if* it were still a member of the EU. It will only be from January 1, 2021 when new arrangements, if any, between the EU and the UK come into force that change will become apparent.

The extent or otherwise of that change will depend on what is, or is not agreed, between the EU and the UK between now and then.

CAKE AND EAT IT

Since the Brexit vote, a continual refrain from UK government ministers is that, when it comes to trade with the EU, the UK can "have its cake and eat it". By this is meant that the UK can continue to have the same trading relationships with the EU as it has now, while "taking back control" over its "borders, money and laws". Translated, this means that the UK can put an end to the free movement of workers from the EU, stop paying into the EU budget and diverge from EU laws where it wants to, while suffering no loss of trading rights. The UK believes that the EU will buy into this because, as UK prime minister, Mrs. May, said in her Florence speech, anything else would represent a "restriction on our mutual market access that would benefit neither of our economies."

Mrs. May, has also said that she wants a "deep and special partnership" with the EU. The conundrum is that the UK already has such a "deep and special partnership". It is called membership of the EU and of single market and the customs union, while having a range of opt-outs, such as not being obliged to swap the UK pound for the euro. Inevitably, any other "deep and special partnership" cannot be as good as that which the UK now enjoys.

NOT ON THE MENU

To put it bluntly, as the *Financial Times's* Philip Stephens says, Brexit is the first known example of a situation in which a country has initiated negotiations for a trade agreement that will make it worse off in economic terms than it now is. The UK may not see it that way, but that is the way the EU sees it and has said as much. In a document published on December 20th last (COM92017) 830 final) the European Commission noted:

> A non-member of the Union, that does not live up to the same obligations as a member, cannot have the same rights and enjoy the same benefits as a member.

Michel Barnier, the EU's Brexit negotiator, put it in even more bluntly in an interview with *Prospect* magazine on December 17 last:

> *They (the UK) have to realise there won't be any cherry picking. We won't mix up the various scenarios to create a specific one and accommodate their wishes, mixing, for instance,*

the advantage of the Norwegian model, member of the single market, with the simple requirements of the Canadian one. No way. They have to face the consequences of their own decisions.

Barnier added that "no one should be surprised that the French, German, Dutch, Italian and other leaders are anxious the European project is not harmed by the UK departure. There is no reason for our values and principles to be damaged as a result", a reference, no doubt, to the fact that for most European countries the EU cannot be reduced to simple economics and business, as the UK has always wanted.

The EU will not be changing its "desert and cake" *carte* to suit British tastes anytime soon.

ISSUES IN PLAY

If there is already a negative "Brexit effect" on the UK economy, what other factors come into play in determining how Brexit will work out in the long-term and which will decide if it is a smart move? Consider the following:

- The narrowness of the Brexit vote, 52% to 48% on a 37% turnout, means that there continues to be deep divisions in the UK over the issue, potentially resulting in significant political realignments. (See the Evans and Menon book).

- Scotland, Northern Ireland and London did not vote for Brexit, further complicating the political map.

- Against the backdrop of UK/Ireland *Good Friday Agreement,* which helped end the violence on the island of Ireland, Brexit creates complex and deeply emotional issues around the possible return of borders between Northern Ireland and Ireland for all the parties involved.

- Over 40% per cent of the UK's goods exports go to the EU and about £90bn of services went from the UK to the EU, about 37 per cent of all services exports. How much of a hit will these exports of goods and services take, post-Brexit? (By way of comparison, only about 10% of EU exports go to the UK).

- What policy decisions will future UK governments take? Could a Conservative government opt for a "Singapore-upon-Thames" orientation, resulting in a low-tax, low-regulation economy? (To be accurate, an imagined version of the Singapore model).

- How would a "Singapore-upon-Thames" model play out with those who voted leave to control immigration? "Singapore" requires opening up the UK to the world. Many leave voters want a "drawbridge economy", one that keeps the jobs in and the people out, less, not more, globalisation.

- Could Labour come to power under Jeremy Corbyn and opt for a "socialism in one country" model? How would the business community react, both within the UK and globally?

- The UK will need to build a whole new customs infrastructure at its ports and airports to handle UK/EU trade. Outside the single market and customs union new checks are inevitable. The Port of Dover estimates that it currently takes less than two minutes to clear an intra-EU truck, heading to Calais. Were, on average, two minutes to be added to the time taken for each truck then this would create long tailbacks out of the port within hours, stretching 17 miles up the M20. On the French side, there would be kilometres long "bouchons" on the E40 out of Calais and Dunkerque, with all the problem that brings as regards non-European migrants trying to board trucks to illegally enter the UK.

- Brexit-related legislation will clog parliament for years, as the UK adjusts the body of EU laws that the *European Union (Withdrawal Bill)* incorporates, for now, into UK domestic law to be repealed or amended as future governments see fit

- As of today, we cannot know the nature of the agreement that the EU will come to with the UK. As we discuss elsewhere in this report, it could run all the way from BINO (Brexit in name only) to World Trade Organization (WTO) rules. Where the deal falls along this spectrum will be of huge significance for trading arrangements.

- What happens if the EU economy powers ahead, leaving the UK in its wake? Remember, after Brexit the Eurozone will constitute 85% of the EU's GDP. With the UK out of the EU a major block to more integration will have been removed, integration driven by the needs of the Eurozone. What pull will the Eurozone have on Sweden and Denmark, the two main Western EU members who are not Eurozone members?

- It is also worth keeping in mind that in leaving the EU the UK is also leaving some 40 plus EU agencies that play a vital role in regulating business activities. Examples include: European Medicines Agency; European Banking Authority; European Food Safety Agency; and the European Aviation Safety Agency, to name but a few. The UK will need to put in place its own regulatory framework to replicate the rules and enforcement procedures of these agencies if it wants to trade with the EU, and the rest of the world. How long will it take to create and staff these agencies to the required level of professionalism?

- Will the UK be able to strike trade deals with major, non-EU countries, such as the US, India and China? On what terms? How long will it take to do such deals? Will they be politically sellable in the UK? For example, look at the political consternation among Conservative MPs in late 2017 when an ill-founded rumour hit social media that the House of Commons had voted that animals were not sentient beings and animal-loving, Conservative supporters became apoplectic with rage. What chance chlorinated chickens and GM beef as part of a trade deal with the US?

- Even if the UK does strike favourable trade deals, how long will such deals take to negotiate? Keep in mind that the UK has not negotiated its own trade deals since it joined the EU back in 1973 and so does not have a cadre of experienced trade negotiators to handle such deals. Even if it did, just how many deals could it handle at the same time? Where will its trade negotiations priorities lie?

- But trade agreements on their own do not generate trade. It is individual businesses that do deals, find market opportunities, build relationships with new customers. There is a great deal of economic literature that suggests that deals are best done with near neighbours. Distance results in increased costs and difficulties. You can fly to Milan and back in a day to sign a contract, or sort a problem if there is a glitch. How long to fly to Mumbai or Mombasa and back?

- The EU has around 750 agreements with non-EU countries, some 300 or so of which concern trade matters. The UK will need to replicate or better all of these agreements and that may be a very challenging target. It will certainly not be as simple as "find European Union" and "replace with United Kingdom" in the documents. Some countries will, in their own interests, ask the UK: "What's in it for us?" Others may find that the terms of the agreement include elements that the UK cannot match, or which preclude them from agreeing similar terms with a non-EU state. The UK is not the only country that can "take back control" or pursue its own interests as it sees those interests.

- Finally, to ensure continued data flows between the EU and the UK, the UK will need to secure a data adequacy decision from the EU as EU laws prevent the flow of personal data to countries outside the EU law framework without such a decision. In the absence of such an adequacy decision individual companies will need to put internal mechanisms based on either binding corporate rules or model clauses in place. However, existing UK security law, *Investigatory Powers Act 2016,* generally known as the snoopers' charter and drafted by Mrs. May when she was Home Secretary, could make securing an adequacy decision very difficult.

The UK government will have to grapple with all of the above, while at the same time dealing with issues of domestic political concern, such as funding the

National Health Service, housing, education the safety of the realm in an era of international terrorism and the myriad of other problems that citizens elect governments to take care of.

With the best will in the world, there is only so much any government can do, or at least do well, at any one time.

CLIFF EDGE

Given all of the above considerations it will be many years before we know if Brexit is a smart move. As of today, we cannot know. Brexit is not just a leap in the dark. It is a leap in the dark off a cliff without knowing how long the drop is, what lies at the bottom of the drop, if indeed there is a bottom.

Section 2: How to Leave the EU

On June 23rd, 2016, the UK voted to leave the EU by 52% to 48% on a turnout of 72%. The 52% represented 37% of the total electorate. On June 24th, Prime Minister, David Cameron who had led the campaign for the UK to remain in the EU, resigned. Shortly, thereafter, he was replaced by Mrs. Theresa May, until then the Home Secretary, as leader of the Conservative Party and prime minister.

ARTICLE 50

The process whereby a country can leave the EU is set out in Article 50 (A50) of the Treaties of the European Union. It reads:

1. *Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.*
2. *A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.*
3. *The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.*
4. *For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it. A qualified majority shall be defined in accordance with Article 238(3)(b) of the Treaty on the Functioning of the European Union.*
5. *If a State which has withdrawn from the Union asks to re-join, its request shall be subject to the procedure referred to in Article 49.*

While it would not be until April, 2017, a month after the UK officially informed the EU that it was to quit, that the EU spelt out in writing what the A50 agreement would cover, it was clear from the start that the EU would demand that the UK settle financial obligations it had committed to as an EU member, that the rights of EU citizens who had settled in the UK be safeguarded, and that the issue of a possible return of a border in Ireland be dealt with. Unofficial estimates that the UK was on the hook to the EU for about €50bn plus, began to circulate.

Key points to note in A50 when it comes to the timing, structure and content of exit negotiations are:

1. Having taken a decision to leave the EU, the member state has to notify the European Council of its intention. There is nothing in A50 which specifies how soon after taking a decision to leave a member state must notify the EU. That is entirely a matter for the member state to decide. It can't be pressurised by the rest of the EU into doing so. It is unclear what would or could happen if a member state, having decided to leave, then didn't serve the A50 withdrawal notice and continued to take an active part in the EU's governance structures. Could it become a disruptive influence within the governance structures, refusing to serve the notice until such time as the rest of the EU told it what deal would be on offer when it did? As the UK served the notice some nine months after it took the decision it didn't make use of this possible option. What would have

happened if it did is a question we can just leave hanging there.

2. However, once a departing state does notify the EU of its decision to leave a two-year period begins in which the departing state and the EU negotiate a Withdrawal Agreement. The departing state is then negotiating against a deadline. Once the deadline is activated the negotiating leverage is with the EU as the departing state has put itself in a position where the only real alternative to an agreement on the terms offered by the EU is no agreement at all.

3. The two-year period can be extended by agreement between the member state and the European Council, if the European Council, acting unanimously, so decides. One dissenting member on the EU Council can veto an extension.

4. The key language in A50 is: *"In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union."* To be noted here is that:

    a. The Union drafts "guidelines", instructions to its negotiator as to what should be contained in the Withdrawal Agreement;

    b. The agreement is to cover the "arrangements" for the withdrawal of the departing state, which, in practice, means how the "guidelines" are to be implemented;

    c. It is also to cover the "framework for its future relationship with the Union". Not the details of the actual relationship, just the "framework" or nature of the relationship. (See below on this).

5. The Withdrawal Agreement is to be approved by the European Council by qualified majority vote, after obtaining the "consent" of the European Parliament. So, even though an individual member state does not have a veto on the Withdrawal Agreement, the European Parliament does. This means that the departing state needs to be sensitive to the position of the European Parliament. Any belief that members of the European Parliament will do as directed by their national governments is very wide of the mark. Increasingly, the European Parliament is very much a political actor in its own right.

While the EU can negotiate the "framework" of a future relationship, it cannot negotiate the details of that relationship with a departing member state until after the member state has actually left and become, in EU terms, a "third country". By "future relationship" we are, in reality, talking about a trade agreement. (*See the next section of this paper for a fuller discussion on this).*

"MINGLE EVERYTHING"

Now it can be argued, as the UK did, that the details of the exit agreement and the future trade deal should be negotiated in parallel, during the A50 process while the UK was still a member of the EU. The EU rejected this approach and insisted on the sequencing of talks: exit terms to be agreed first; then the "framework" of the future relationship and, finally, after the UK had left, the substance of a future trade agreement.

The UK had wanted to be able to use discussions on the money it owed the EU on departure as leverage in talks for a trade agreement. Using yesterday's money to buy tomorrow's benefits. As the EU's negotiator, Michael Barnier put it in the *Prospect* interview from which we quoted earlier:

> *"The British had the idea that they could mingle everything; the price for past commitments, the financial issue and the future. We said: first we settle the past, like in any separation, then we start talking about the future. So parallel talks will probably start next March. The actual negotiations on the future relationship will only begin once the UK leaves the EU."*

The EU was never going to put itself in a position where a departing member state was going to be able to demand future benefits in return for discharging financial obligations it had committed to as a member. After all, as we have already noted, it was the UK that decided to leave and trigger the A50 notice, so starting the clock running on a two-year notice period. This allows EU to say to the UK: “You want to leave on agreed terms? Ok, here are our terms.” What negotiating leverage did the UK have? “If you don’t give us what we want we are leaving?” The old joke of the mugger who tells their intended victim that if they don’t hand over their money and other valuables the mugger is going to shoot himself comes to mind.

But apart from not allowing outstanding financial commitments to be played off against future benefits there is another reason why the EU will not negotiate a trade agreement with a departing member state while that state is still a member. As a member the departing state continues to be involved in all EU governance processes, meaning meetings of ministers and heads of government, elected representatives in the European Parliament and having a member of the European Commission and a judge on the European Court.

A departing members state which was trying to negotiate an advantageous future trade arrangement with the EU would be able to use its involvement in the governing processes as leverage in the trade discussions. It could use every trick in the book to block and delay legislation and other initiatives, such as budget discussions, to exert pressure in the trade talks. It would be a disruptive influence, to say the least.

This may not have been in the minds of those who drafted Article 50, who, apparently, never anticipated that a country such as the UK would leave the EU, but any human resource manager will tell you that “long goodbyes” are never in anyone’s interests. Which is why companies so often pay off employees who are being let go or who have given in their notice. It never pays to have a wounded tiger stalking your organisation.

“NO RUNNING COMMENTARY”

As home secretary, Theresa May had adopted a “command and control” management approach, saying little and relying on a close-knit group of advisors and officials. It appears that she thought she could adopt the same approach to Brexit. In the months following her appointment as prime minister she said little about Brexit, other than to give the impression that there would be limited public debate on the matter and that key decisions would be taken by ministers, with parliament largely side-lined.

One of her first acts as prime minister was to restructure the government to focus on Brexit. A key architect of the Brexit vote, Boris Johnson, was appointed as Foreign Secretary, while two other “Brexiteers”, David Davis was appointed Secretary of State for Exiting the European Union and Liam Fox was made Secretary of State for International Trade. Davis was, in effect, made the UK’s Brexit negotiator, while Fox was mandated to negotiate trade agreements on behalf of the UK, something he soon found he couldn’t actually do while the UK remained a member of the EU. The media quickly dubbed Johnson, Davis and Fox as the “three Brexiteers”.

May soon came under pressure from Brexiteers and the Brexit-supporting media to serve the A50 notice to the EU, telling it that the UK was leaving. However, she refused to do so on the grounds that preparatory work was needed in the first place. While no one can be certain, it does appear that the UK was very far from ready to begin the exit process. The previous prime minister, David Cameron, had prevented the civil service from doing any forward planning on what the UK leaving the EU might mean, lest word of such planning leaked and gave the impression that he was actually contemplating such a result.

This was an early example of something that has bedevilled the Brexit process on the UK side ever since: if you don’t think about it then it won’t happen, or, more positively, if you close your eyes really tight and truly, truly believe, then it will come true. Unfortunately, as the UK soon discovered, the EU did not believe in fairy tales.

So, as the UK political "establishment" never believed that Brexit would happen no thought had been given to what leaving the EU would actually mean, how it should be done, or what the UK should seek to replace EU membership with. A little like deciding to sell your house without having decided where you were going to live afterwards and making sure, in advance, that alternative accommodation was available.

However, the fact that the UK was not ready to begin the negotiation process did not prevent UK diplomats from making contact with their colleagues in other EU countries to explore their thinking, "test the waters", and see if side-deals could be negotiated with individual countries in advance of the main negotiations with the EU.

To counter this, the EU27 took a decision that there could be "no negotiations before notification", meaning that there could be no talks until the UK had officially sent the A50 notice and then discussions would be centralised, with the EU negotiating as a bloc. Much to the annoyance of the British, this policy held and all attempts at outreach by the UK were rebuffed by individual member states.

The first public indication of Mrs. May's thinking came at prime minister's question time on September 7, 2016. She told the House of Commons that she would not give a "running commentary" on Brexit negotiations, and she refused to say whether she wanted the UK to stay in the European single market. While the PM said she wanted control over the movement of people from the EU to the UK and the "right deal" for trade, she told MPs the government would not "reveal our hand prematurely" or comment on "every twist and turn". She said:

> *"What I want for the UK is that we put into practice the vote that was taken by the people of the UK to leave the EU, that we get the right deal for the trade in goods and services with the EU in a new relationship that we will be building with them and that we also introduce control of the movement of people from the European Union into the UK."*

She went further at a speech to the Conservative annual conference on Sunday, October 2nd, where she told delegates:

> *"Brexit means Brexit…We are going to become a fully independent, sovereign country – a country that is no longer part of a political union with supranational institutions that can override national parliaments and courts. And that means we are going, once more, to have the freedom to make our own decisions on a whole host of different matters, from how we label our food to the way in which we choose to control immigration".*

While not saying so explicitly, it was clear that if she was to achieve what she wanted to achieve it would mean the UK leaving not just the EU, but also the single market, the customs union and the jurisdiction of the Court of Justice of the European Union (CJEU). Mrs. May also told the delegates that she planned to send the A50 notice by the end of March 2017, which would mean the UK leaving the EU in March 2019, two years later.

The UK continued to claim that all matters should be on the table at the one time - the issues to be covered in the Withdrawal Agreement as well as the substance of future trade arrangements. The UK also made it clear that it believed that that the entire Brexit process could be completed by March 2019.

May further clarified her position in a speech at Lancaster House in January 2017. She clearly stated that Britain would leave the single market and would instead seek to negotiate a free trade agreement with the EU. She also said that the UK would be leaving the customs union. "Full membership of the customs union prevents us from negotiating our own trade deals" so she did not want Britain to be bound by the common commercial policy and the common external tariff.

But she also said she wanted tariff-free trade with Europe and for such trade to be "as frictionless as possible". She wanted Britain to have "a" customs union agreement with the EU, just not "the" existing customs union. That could come in the form of a completely new customs agreement, or Britain could become an associate member of the customs union in some way, or retain some parts of it.

NOTICE SERVED

The A50 exit notice was eventually sent to the EU at the end of March 2017, thereby setting the exit date of the UK from the EU as the 29th March 2019. For its part, the EU said it would take time to consider the situation and prepare for negotiations.

On April 18th Mrs. May called an unexpected general election for June 8th, hoping to improve her slim Commons majority of 17, so as to enable her to push through Brexit-related legislation. Such was her commanding poll lead at the time that early predictions suggested that the Conservatives would come back with 395 seats to the Labour Party's 164, a potentially crushing majority. Such a majority would give Mrs. May a free hand and, as she saw it, strengthen her negotiating position in dealing with the EU.

With the election under way, in late April Mrs. May, along with Brexit Secretary, David Davis, met with EU Commission President, Jean-Claude Juncker and the EU's Brexit negotiator, Michael Barnier, for dinner at the prime minister's residence, 10 Downing Street.

According to a subsequent report of the dinner in the German newspaper *FAZ,* Mrs. May told Mr. Juncker that she believed that issues relating to the rights of EU citizens in the UK, and UK citizens in the EU, could be wrapped up in a couple of hours at a meeting in Brussels in June. She further told him that the UK had no legal obligation to pay the EU anything on leaving and that the exit talks should be conducted in complete confidence until such time as a final agreement was concluded. Mrs. May also added that she wanted the EU to work with the UK to "make Brexit a success".

An apparently astonished Juncker first of all told Mrs. May that the EU had no interest in "making Brexit a success". He went on to say, according to *FAZ,* that if the UK refused to honour its financial commitments to the EU then that would put negotiations of any future trade deal at risk, that issues relating to the rights of citizens were a lot more complex than she imagined, and that there could be no question of the talks being conducted in secret. All papers and reports of meetings would be published. If Mrs. May was not prepared to give a running commentary on the negotiations, then the EU certainly was.

Several days after the dinner, on April 29th, the EU published *Guidelines* to inform the A50 negotiations on the UK's exit from the EU. The paper set out a sequential approach to the negotiations:

- *Phase 1 to deal with the three key issues of the UK's financial obligations to the EU; citizen's rights and issues relating to the island of Ireland, as well as with some lesser order withdrawal matters.*
- *Only when sufficient progress was made on these three issues could phase 2 of the talks move onto the "framework" of the UK's future relationship with the EU after it had left and any possible "transition".*
- *Finally, only when the UK had left the EU and become a "third country" could any future trade deal be finalised.*

The publication of the *Guidelines* put an end to any suggestion that exit talks and trade talks would run in parallel and that the UK would have a future trade deal with the EU completed by the time if left in March 2019. Little more was heard from government ministers or MPs, as had previously been the case, that "Brexit would be easy"; "over in a matter of minutes"; "the EU will be paying us, not we them".

If Mrs. May hoped that the election she had called for June 8th would strengthen her hand in dealing with Brussels by given her a greatly increased Conservative majority that hope quickly disappeared as the results began to come in on election night. Far from the crushing majority she had hoped for, she lost the slim majority she had. The Conservatives saw their numbers in the Commons fall from 331 to 318, 8 short of an overall majority. The Labour Party picked up 30 seats. May quickly put together a deal with the Ulster-based Democratic Unionist Party to support her government, a decision which was to cause difficulties later and which could still pose major obstacles to finalising negotiations with the EU over Irish issues.

Hopes of an all-powerful prime minister negotiating with Brussels with the backing of an overwhelming majority in the Commons had disappeared. Press reports suggest that the only reason she was not dumped by the Conservatives as leader and prime minister is that the party could not agree on who should replace her.

The new mathematics of the House of Commons puts a question mark over the government's ability to get any agreement it reaches with the EU accepted by parliament. We will come back to this critical issue later in this paper.

The Brexit talks between the EU and the UK eventually got underway in Brussels on Monday, June 19th. Prior suggestions by David Davis that the talks would open with the "row of the summer" over the EU's insistence on a sequential structure came to naught when the UK accepted the EU's position during the opening morning. Davis, has just learned the truth of the dictum that the best laid plans of any army disintegrate on the first contact with the enemy.

By late August the UK government was becoming frustrated with the pace of the discussions and had come to the conclusion that Barnier and his team were being unhelpful and had to be circumvented. May announced that she would make a major speech to help "unlock" the negotiations. It was finally decided that she would make the speech in Florence in Italy. It is still unclear as to why she decided to pick Florence.

The audience for her speech turned out to be one Italian politician, and members of the British cabinet and journalists flown in from the UK specially for the event. A colleague commented to us at the time: "if she wanted an Italian ambience it would have been a lot cheaper for the taxpayer for her to have hired one of Carluccio's London restaurants".

The key points of May's Florence speech were that the UK would now seek a transition arrangement after March 2019, or implementation phase as she insisted on calling it, and would pay enough into the EU to ensure no member state will have to contribute more (or receive less) during the current budget round ending in 2020. She did not mention a sum, but press reports suggested she believed that it should be around about €20bn (£18bn). "The UK will honour commitments it has made during the period of our membership," she said.

Much to the dismay of London, the Florence speech did not move the process in the direction it had hoped. What the Florence speech showed was the lack of understanding on the part of London of the process in which they were engaged.

First, there was a belief on the part of May and her team that the Barnier discussions were just "front of house" and that the "real negotiations" would take place between "real politicians" such as May and Angela Merkel, the German chancellor and Emmanuel Macron, the French President. While that may well have been the case in normal EU negotiations it was never going to be the case in negotiations involving a country wanting to leave the EU. The EU was not prepared to break its legal order or bend procedures to suit the departing British. Barnier was the only game in town whether the UK liked it or not. There was no way around him.

Secondly, the use of the word "negotiations" is a misnomer to describe what was happening. The British may have regarded it as a negotiation, whereas the EU regarded it as a settling of accounts. As the EU saw it, the UK was leaving the EU and was thereby bound to honour commitments it had made as a member covering financial undertakings, citizens' rights and the island of Ireland. These were not matters to be haggled over, but duties to be discharged.

As we have already said, it was well known that the EU believed that the UK owed in the region of €50bn plus, to be calculated over time according to an agreed methodology. In response, the UK put €20bn on the table and was then taken aback when the EU did not respond with a counteroffer of, say, €40bn. The EU position continued to be that the UK needed to meet all its obligations, not engage in haggling.

It is not the intention of this paper to detail all the twists and turns between the time the talks began on June 19th and the time the European Council agreed in December that sufficient progress had been made in phase 1 to allow the talks to move on to phase 2. Suffice it to say that at no time did the EU move from the position set out in the April 29th *Guidelines* that the talks would be conducted in sequence, not in parallel, and that the settlement of outstanding financial obligations could not be used to "buy" a future trade agreement.

Before looking at what has been agreed so far between the EU and the UK, one other event is worth noting. On December 13th (check date) the House of Commons voted by 309 to 304 that parliament should have a vote on whatever final A50 agreement is reached between the UK and the EU. As the EU has said that the discussions need to be concluded by early October 2018 to allow time for ratification, this leaves a six-month period between the time the negotiations are concluded and March 29th, the date the UK is due to leave the EU. What happens if parliament rejects the deal the government comes back with? We will return to this in the next section of this report.

THE OUTCOME

In early December 2017, agreement was reached between the EU and the UK on the three main items under discussion in phase 1 of the A50 discussions: the financial settlement; the rights of citizens; and issues relating to the island of Ireland. It should be noted that what was agreed still remains to be captured in a legal text and, as many readers of this report will know only too well, agreeing what has been agreed and getting it down in writing can be as much a negotiation as the negotiation itself. It is only agreed when it is on paper and what is on paper is agreed.

Full details of what was agreed can be found in the *Joint Report from the negotiators of the European Union and the United Kingdom Government (TF50 (2017) 19* and the *Communication from the Commission to the European Council (Article 50) COM (2017) 784 final.*

As regards the **financial settlement** the UK accepted to honour its share of the financing of all the obligations undertaken while it was a member of the EU, in respect to the EU budget and related EU agencies. The parties agreed a methodology to calculate the extent of these obligations:

- *No member states should pay more or receive less because of UK's departure from the EU;*
- *The UK should pay its share of commitments taken during its membership; and*
- *The UK should neither pay more nor earlier than if it had remained a member states. This means that the UK will pay based on the actual outcome of the budget, i.e., adjusted to implementation.*

No figure as to what these obligations will amount to is contained in the joint report from the parties, but it is believed to be somewhere in the region of €50bn, if not even greater. As the payments will stretch out over future years it will be some time before the true figure is known, if ever. In any event, the number is a long way from Mrs. May's assertion at the Downing Street dinner that the UK had no legal obligation to pay anything and from an infamous remark by Foreign Secretary, Boris Johnson, in the House of Commons that the "EU could go whistle" if it thought the UK was going to pay what the EU believed it owed.

On **citizens' rights** the agreement attempts to ensure that the rights that EU citizens currently resident in the UK and UK subjects resident in the EU continue in the future as they are today. The agreement refers to citizens in the respective jurisdictions on the "specified date", which may refer either to the date on which the UK leaves the EU, or if there is a transition, the date on which the transition ends. It has been further agreed that the Withdrawal Agreement will protect the current rights of spouses, registered partners, parents, grandparents, children, grandchildren, and a person in a durable relationship, who do not yet live in the same state as the Union citizen or the UK national, to join them in the future.

The agreement on citizens' rights is to be incorporated into primary legislation in the UK and UK courts and tribunals will give due regards to relevant decisions of the CJEU (European Court) for up to eight years after the withdrawal date. Again, a long way from earlier assertions that the European Court would play no role in the UK after the date of departure.

It should be kept in mind that these provisions relating to citizens' rights refer to the rights of citizens currently resident in the two jurisdictions. What happens after the withdrawal as regards the future movement of people between the two jurisdictions, and whether such movement will require visas and/or work permits, remains to be decided by the two jurisdictions separately. Mutually acceptable arrangements between the two sides may subsequently be negotiated. It could be possible that individual members of the EU27 will have different requirements, so that if a UK national wished to live or work in any of the 27 they could be faced with different legal requirements and the fact that they could move to one country may be no guarantee that they can subsequently move to another.

As it turned out, the discussions around the **island of Ireland** proved to be the most contentious and the difficulties involved appear to have blindsided the UK government. While it is not our intention in this paper to go into the details, the UK government found itself caught between its own stated commitment to leave the single market and the customs union, and the very different positions of the Irish government, back by the other 26 remaining member states of the EU, determined to preserve the processes of the Good Friday Agreement, and the Northern Ireland-based Democratic Unionist Party (DUP) which exists, above all, to preserve the union between Northern Ireland and the rest of the United Kingdom.

Anything that is seen as weakening that link is regarded with the utmost suspicion by the DUP. That May's government in London is dependent on the 10 votes of the DUP is a hugely complicating factor.

There are two jurisdictions on the island: Ireland and Northern Ireland. Ireland, along with the UK and Denmark joined the forerunner of EU on January 1, 1973. Ireland remains, and will continue to remain, a member of the EU after Brexit. Northern Ireland is part of the United Kingdom and will leave the EU along with the rest of the United Kingdom.

The border between Ireland and Northern Ireland will become the only land border between the EU and the UK after Brexit. After Brexit, all the other UK borders will be "sea borders" such as the stretch of water between Dover and Calais, the English Channel.

Now the EU has plenty of land borders with non-EU countries, around 40 in fact. Poland/Russia is an example. The EU is more than familiar with the challenges of managing such borders. But a border on the island of Ireland would be *sui generis* for two reasons. First, the island of Ireland is pretty much a single, integrated economy, as Tony Connolly's book *Brexit and Ireland* makes plain. Introducing a border, with customs and related checks, would be disastrous in any circumstances.

But the circumstances are not just "any circumstances". The division of the island of Ireland into two jurisdictions is politically highly contested and emotionally fraught. There are two communities in Northern Ireland, unionist and nationalist, which, to a great extent also overlap with Protestants and Catholics, who look to Great Britain and Ireland, respectively, as the national, political communities to which they properly belong.

As is well known, the depths of divisions were the cause of a long and bloody campaign of murderous violence over a thirty-year period. The beginnings of the creation of a climate of peace on the island began with what is known as the Good Friday Agreement on 1998, a treaty between Ireland the and UK, brokered with American assistance, which put in place multi-dimensional political and economic structures involving the Irish and UK governments, as well as the representatives of the two communities in Northern Ireland.

The fact that Northern Ireland and Ireland were both members of the European Union and its single market and customs union, which facilitated frictionless trade between both parts of the island and dispensed with the need for economic borders, went a long way to making it possible to end security borders as well. (While neither Ireland nor the UK are members of Schengen there has long been a passport-free Common Travel Area between Ireland and the UK, which does away with the need to check the papers of people passing between the two parts of the island, and between Ireland and mainland Britain).

Just how important EU membership is to the Good Friday Agreements was highlighted in the *Joint Report* and the *Communication from the Commission to the European Council.* The second document states:

> *The negotiators carried out an extensive mapping exercise of North-South cooperation, as a central part of the Good Friday (Belfast) Agreement. The exercise showed that this cooperation relies, to a significant extent, on the common EU legal and policy framework. It also identified regulatory divergence between Northern Ireland and Ireland as the biggest single risk to its continuation and future development.*

In the light of these consideration, they key clauses in the *Joint Report* as regards the island of Ireland read:

49. *The United Kingdom remains committed to protecting North-South cooperation and to its guarantee of avoiding a hard border. Any future arrangements must be compatible with these overarching requirements. The United Kingdom's intention is to achieve these objectives through the overall EU-UK relationship. Should this not be possible, the United Kingdom will propose specific solutions to address the unique circumstances of the island of Ireland. In the absence of agreed solutions, the United Kingdom will maintain full alignment with those rules of the Internal Market and the Customs Union which, now or in the future, support North-South cooperation, the all island economy and the protection of the 1998 Agreement.*

50. *In the absence of agreed solutions, as set out in the previous paragraph, the United Kingdom will ensure that no new regulatory barriers develop between Northern Ireland and the rest of the United Kingdom, unless, consistent with the 1998 Agreement, the Northern Ireland Executive and Assembly agree that distinct arrangements are appropriate for Northern Ireland. In all circumstances, the United Kingdom will continue to ensure the same unfettered access for Northern Ireland's businesses to the whole of the United Kingdom internal market.*

In a letter to the people of Northern Ireland, as reported in the *Belfast Telegraph* on December 8th last, Mrs. May said:

> ***Third***, *there will be no new borders within the United Kingdom of Great Britain and Northern Ireland. In addition to no hard border between Northern Ireland and Ireland, we will maintain the Common Travel Area throughout these islands.*
>
> ***Fourth***, *the whole of the United Kingdom, including Northern Ireland, will leave the EU customs union and the EU single market. Nothing in the agreement I have reached alters that fundamental fact.*

To say that it is difficult to reconcile the commitments by the UK as set out in the *Joint Report* with a decision to leave the single market and the customs unions is to understate matters. A decision to leave both implies a hard border between the two parts of Ireland, with checks and controls. International trade rules do not provide for two jurisdictions with divergent customs regimes and potentially different tariff structures not to have a border between them. Otherwise, shoddy goods knocked up in sub-standard conditions could freely flow from one jurisdiction to the other.

If it turns out that the UK cannot reconcile the commitments set out in Articles 49 and 50 of the *Joint Report* with a decision to leave the customs union and the single market, then finalising the A50 discussions could become well-nigh impossible. It is possible that the UK will argue that the words found in Article 49 have a limited meaning:

> *…will maintain full alignment with those rules of the Internal Market and the Customs Union which, now or in the future, support North-South cooperation, the all island economy and the protection of the 1998 Agreement.*

Others will argue that you cannot have "half a border", no border for some goods and services because of "full alignment" which are seen as supporting the GFA, while having a border for goods and services which do not. "Full alignment" means full alignment not just between Northern Ireland and Ireland on all EU rules, but full alignment between the UK and the rest of the EU as well. We will come back to this in the final section of this paper.

SECTION 3: BREXIT: WHAT HAPPENS NEXT?

As we saw in the previous section, at its meeting in December 2017, the European Council agreed that sufficient progress had been made in phase 1 of the A50 talks to justify moving on to phase 2. The decision of the European Council set was set out in *European Council (Art. 50), meeting (15 December 2017) – Guidelines.*

These *Guidelines* were quickly supplemented by a document from the Commission, *Recommendation for a Council Decision (COM[2017] 830 final)* which sets out in considerable more detail negotiating parameters for the transition arrangement requested by the UK, to take effect after March 29, 2019. This *Recommendation* is expected to be endorsed at a meeting of member states in January 2018.

When the *Recommendation* is looked at closely it is clear that the phrase "transition arrangements" may be the wrong choice of words. "Continuity membership" may be more accurate as that, in effect, is what the Commission is offering, as we shall see below. However, for the purposes of this paper we will stick with "transition arrangement".

Phase 2 of the discussions will focus on four aspects:

1. *Transition arrangements to apply after March 2019*
2. *The "framework for the future relationship"*
3. *Governance of the Withdrawal Agreement*
4. *Issues relating to the island of Ireland*

The European Council has made it clear that these discussions can only progress as long as all the commitments undertaking during the first phase are "… respected in full and translated faithfully in legal terms as quickly as possible." The necessity for such stark language resulted from remarks made by David Davis the weekend after the phase 1 agreements had been reached that what had been agreed was not legally binding but only a political "statement of intent". The European Council wanted to make it clear that what had been agreed had been agreed and could not be unpicked by the UK in phase 2. As we have already said, writing an agreement down in such a way that it can be implemented properly can be as fraught as negotiating the agreement in the first place.

The point has been made that the A50 talks will result in a withdrawal agreement and, as with any agreement, nothing is agreed until everything is agreed. The UK has attempted to suggest that the phrase "nothing is agreed until everything is agreed" encompasses a comprehensive trade agreement between the UK and the EU. The EU has rejected this interpretation on the part of the UK and has made it clear that the phrase refers solely to the issues identified in A50 of the Treaties, which limit talks on future trade arrangements to a "framework" for such arrangements, to be filled out after the UK has left the EU. As the Council notes in its December *Guidelines:*

> *While an agreement on a future relationship can only be finalised and concluded once the United Kingdom has become a third country, the Union will be ready to engage in preliminary and preparatory discussions with the aim of identifying an overall understanding of the framework for the future relationship, once additional guidelines have been adopted to this effect. Such an understanding should be elaborated in a political declaration accompanying and referred to in the Withdrawal Agreement.*

Of course, if an A50 agreement cannot be reached then, obviously, all the commitments made by the UK fall away and it will leave the UK without either a transition arrangement or a roadmap towards a future trade agreement. In the jargon, the UK will "crash out" of the EU in March 2019 with no follow-on arrangements in place.

Even if a transition arrangement is agreed there is no guarantee that a comprehensive trade agreement will be finalised before it ends. More than likely it will not, given the complexities involved, particularly as regards services, which account for 80% of the UK's economy. All a transition period means is Brexit postponed, with a "no agreement Brexit" a real possibility when the transition ends, in December 2020. If that is the case then New Year's Day, 2021, may not ring in a Happy New Year.

TRANSITION

As noted in Section 2 of this report, the UK government's decision to interpret the vote for Brexit as mandating that the UK also leave the single market and the customs union means that the UK will fall out of a whole panoply of regulatory agencies and multiple agreements between the EU and a host of third countries. To be "Brexit ready" the UK will need to expand its customs authority both in terms of personal and infrastructure, as well as establishing its own regulatory agencies to replace the EU agencies from which it will have withdrawn. It will also need to find a way of replacing the agreements the EU has with third countries.

One simple example of the difficulties that UK companies will potentially face is the upgrade of the Customs Declaration Service (CDS) computer system, originally planned to come onstream in January 2020, but now pulled forward to January, 2019, three months before "Brexit day". CDS is designed to replace the existing system, Chief, which is close on 20 years old. CDS was designed to handle 100 million customs declaration each year.

With Brexit it will have to handle, at a minimum, 250 million. A quantum leap in capacity utilisation at any time. But factor in 130,000 additional traders who will have to make customs declarations for the first time and will have little initial idea as to what they are doing and you are getting close to "if it can go wrong it will go wrong". (As an aside, where are companies going to get all the trained and qualified personnel necessary for this work, and at what cost?)

All of this will take time, and given that little work has been done to date, it will certainly not be done by the end of March 2019. In other words, no matter what agreements are reached between the UK and the EU, the UK will be in no position to implement them by March 2019. Which is why the UK has asked the EU for a transition arrangement of "around two years", though many experts believe that two years is still not long enough. But that is all the EU will offer at most and all the UK will ask for, for internal political reasons on the part of both parties as we will discuss below.

It is important to keep in mind that it is the UK has asked for the transition period. As such, it will have little or no say in the terms the EU offers for such an arrangement. Generally, in life you cannot ask for something and then try to negotiate the terms under which it will be offered to you. As we said in the Introduction: Leavers can't dictate the terms of their leaving.

In the *Guidelines/Recommendation* the EU says it is prepared to negotiate a transition arrangement on the understanding that during the transition the UK, while no longer a member of the EU, will continue to act *as if it was.* This means that the UK will abide by the totality of the EU acquis, but as a third country will "no longer participate in the decision-making of the Union bodies, offices and agencies."

During the transition the UK will have to be "all in" or "all out". There cannot be any sector-by-sector approach. There can be no "cherry picking". The UK will have to implement any new EU laws that come into force during the transition and will remain subject to the jurisdiction of the European Court. The UK become a "rule taker" with no say in rule making during the transition.

The transition is not to last beyond the 31 December 2020, somewhat less than the two years the UK is looking for. As the end of 2020 is when the current EU budget cycle ends, the EU sees it as a natural cut-off date.

"VASSALDOM"

UK Eurosceptics have been quick to say that what is being offered by the EU would turn the UK into a "vassal state" for the duration of the transition, subject to rules over which it will have no say in shaping and to the jurisdiction of a court on which it is not represented. Whether their distaste for what is being proposed will harden into parliamentary opposition remains to be seen.

It has been suggested that one way around the "vassaldom" of a transition period would be for the UK to ask for an extension of the A50 notice period from two years, to say 4-5 years. During such a prolonged notice period the UK would continue to be a full member of the EU, participating in all decision making processes, save for decisions involving the EU/UK negotiations themselves.

This is unlikely to be acceptable to the EU for a number of reasons. First, the other EU member states are would not want a country that has given notice to leave the EU to continue to participate in EU decision making for roughly another four to five years from the start of 2018. As we said earlier, no one wants a wounded tiger stalking their organisation.

Secondly, the EU would not want the UK to be involved in the 2019 election to the European Parliament, nor to have a voice in the selection of the next European Commission, including the selection of the Commission president.

But it is unlikely that the current UK government would request an extension of the A50 timeline in any event. While a transition might turn the UK into a "vassal state" it would be for a strict, time limited period, which would have ended before the next UK general election, due in 2022. Whatever the economic damage, the government could go to the electorate saying it had delivered fully on Brexit and that the UK was out of the EU.

Further, during an extended transition the UK would still be excluded from negotiating a future trade deal, for reasons we outlined both in Section 2 of this paper and also above.

An extension of the A50 timeline would see the UK participate in the 2019 European Parliament elections. Such elections could throw a lifeline to UKIP, which, given that the UK would still be a member of the EU, would campaign on a platform of "Brexit betrayal". No Conservative government would want that and so is unlikely to ask for an A50 extension.

FRAMEWORK FOR FUTURE EU-UK RELATIONSHIP

All that talks in the A50 phase 2 discussions will focus on is the "framework" for the future EU-UK relationship. The EU has repeatedly made it clear that it cannot legally negotiate a trade deal with one of its own members, even if that member has given notice to leave. Such negotiations can only take place after the member has left and become a "third country". What can be done before the leaving date is to identify the type of agreement that will be negotiated in the future. The upcoming March 2018 guidelines should make this clear.

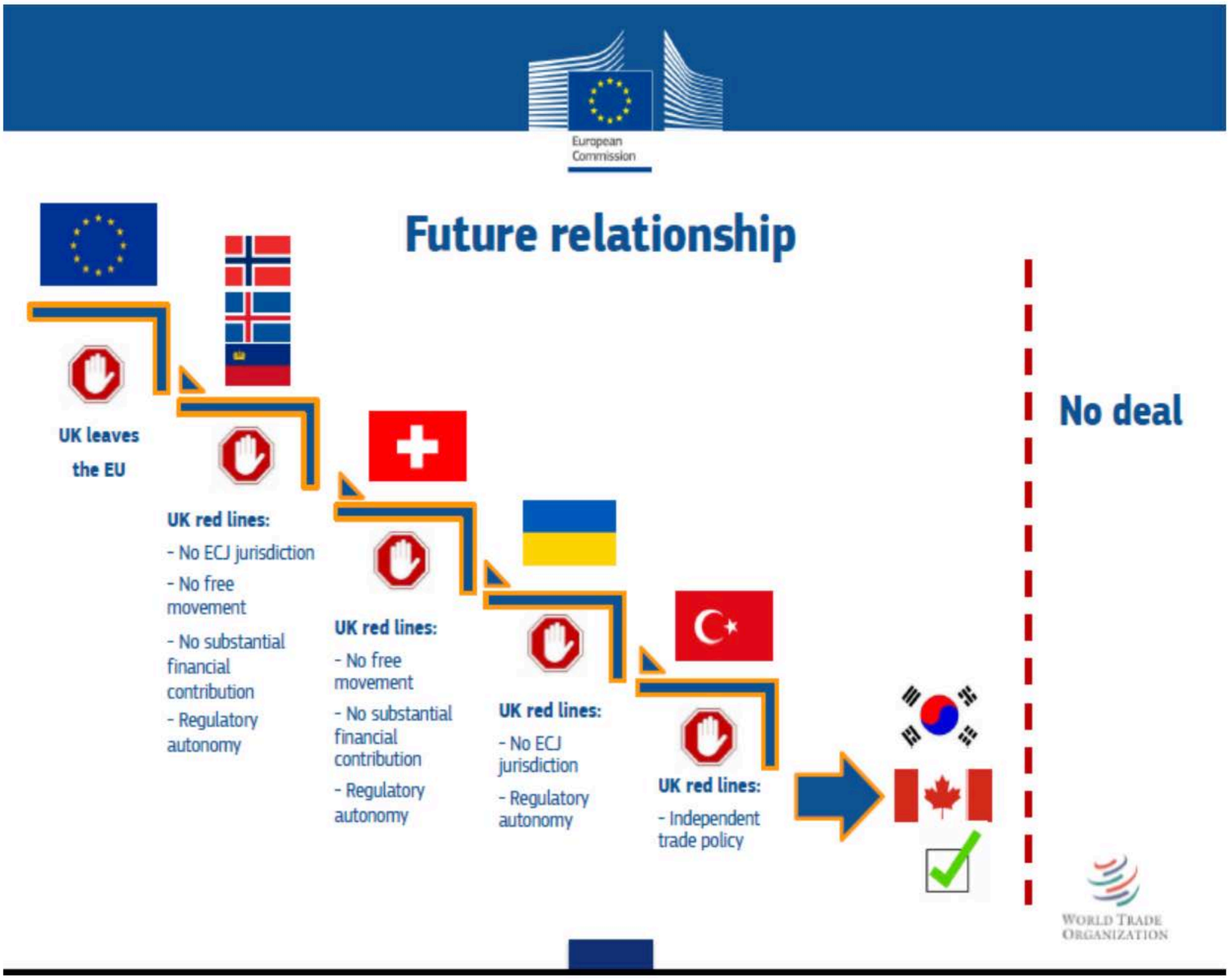
As of the time of writing, late 2017, beyond saying that it wants a "deep and special partnership" with the EU, the UK has not said what it would be seeking by way of a trade deal. Incredibly, the UK cabinet only had its first discussion on the issue in December 2017, a year and nine months after the Brexit vote and some nine months after the notice to leave was actually given.

In its *Guidelines* of December 15, 2017, the EU calls on the UK to "provide further clarity on its position on the framework for the future relationship". It is difficult to have discussions with someone who will not, or cannot, tell you what it is they want. As things stand today, the UK's position can probably best be summed up as: "We don't know what we want but we'll know it when we see it."

However, given that the UK has said that it wants to leave the single market and the customs union, the options are limited. All that the EU will make available to the UK is a trade agreement. The Commission *Recommendations* make it clear that:

- A non-member of the Union, that does not live up to the same obligations as a member, cannot have the same rights and enjoy the same benefits as a member;
- The four freedoms of the Single Market are indivisible and there can be no "cherry picking".

Michael Barnier, the EU's chief Brexit negotiator, has laid out the options in a chart presented to EU leaders.



Given the UK's "red lines" the only option on the table will be a trade deal along the lines of CETA, the recently signed deal between the EU and Canada. The primary focus of CETA is on goods, with very little to say on services. Given that services constitute some 80% of the its economy, the UK would want any trade deal to include services as well, particularly financial services.

To keep matters in perspective, it is worth revisiting some of the figures we noted in Section 2. Services are critical to the UK economy. The UK is the world's second-largest exporter of services after the US and services today account for 45% of the UK's total exports.

According to a *Financial Times* article of December 18, 2017, while the City of London "accounts for the biggest single slice, the majority of service exports are non-financial and are drawn from industries as diverse as information technology, telecoms, broadcasting, fashion design, tourism and education, as well as professional services such as accountancy and law".

The *Financial Times* article also says:

- 48 per cent of the UK's goods exports went to the EU.
- In 2016, about £90bn of services went from the UK to the EU, about 37 per cent of all services exports.

- The EU is the main market for UK services with a value of more than 70 per cent larger than the UK's services exports to its second-largest destination, the US.
- Financial services make up the UK's largest services surplus, and the EU is the destination for 44 per cent of financial services exports.
- In 2016, the UK financial services surplus with the EU was more than £20bn.

Much to the chagrin of other member states of the EU, the UK, even though it is not a member of the Eurozone, has effectively been the EU's chief financial centre until now.

In 2015, the UK won a battle at the European Court over an attempt by the European Central Bank (ECB) to force big clearing houses to move euro clearing to locations within the Eurozone. As the *Financial Times* said at the time:

> *The suit over the ECB's so-called "location policy" was a test of whether Britain could remain Europe's top financial centre and enjoy the full benefits of the EU's common market while remaining outside the euro.*

Having euro clearance in an EU country that is not a member of the Eurozone is one thing. Having the bulk of Eurozone clearance in a country that is not even an EU member is another, especially a country where a significant portion of its political elite see it as a potential competitor to the EU's social market model by turning it into the low tax, low regulation "Singapore-upon-Thames" of their imaginations.

No rational economic and political grouping, such as the EU and Eurozone, is going to allow such a vital function to be located outside its borders. Would the UK allow the bulk of sterling clearance to be located in Paris or Frankfort?

A further point needs to be made. After Brexit, 19 out of the 27-member states will also be members of the Eurozone, that is, countries that use the euro. That amounts to 70% of all member states, but 85% of the EU's GDP. In economic terms, the Eurozone is becoming the EU. The countries not using the euro are: Bulgaria, Croatia, Czech Republic, Denmark, Hungary, Poland, Romania, and Sweden.

The EU will see arguments about the unique skill set and expertise of the City of London as little more than special pleading. After all, financial services is a business like any other and a business that the EU will want inside the Eurozone.

If the status and business of the City of London is at risk, then that results from the decision of the UK to leave the EU. A diminished City of London may be a consequence of Brexit.

The EU plans to publish a further set of guidelines for the negotiation of the "framework for the future relationship" in March 2018. At that time, it will be clear what trade arrangement the EU is prepared to offer the UK, but what will be on offer should come as no surprise in light of all that has been said to date by various EU actors.

GOVERNANCE

The issue of the governance of the A50 agreements will come into focus as the discussions unfold. The UK will need to make payments into the EU long after Brexit day as commitments made as a member fall due. The involvement of the European Court in protection the rights of citizens will also last for some eight years after the UK leaves the EU. For issues relating to Ireland, see below.

As no details proposals have yet been published on this issue we do not intend to say anything on it at this time. However, "governance" is not a dry issue. It has the potential to limit UK decision making in the years ahead. As such, it could easily offend the "sovereignty" sensibilities of many ardent Brexiteers.

THE ISLAND OF IRELAND

In the previous section of this paper we touched on the historical and political complexities of issues relating to Ireland. Put simply, the stated objective of all parties is to avoid the rebuilding of a border between Ireland and the Republic of Ireland. The return of a border would undermine much of the progress that has been achieved in creating conditions for peace and stability on the island since the Good Friday Agreement was signed in 1998.

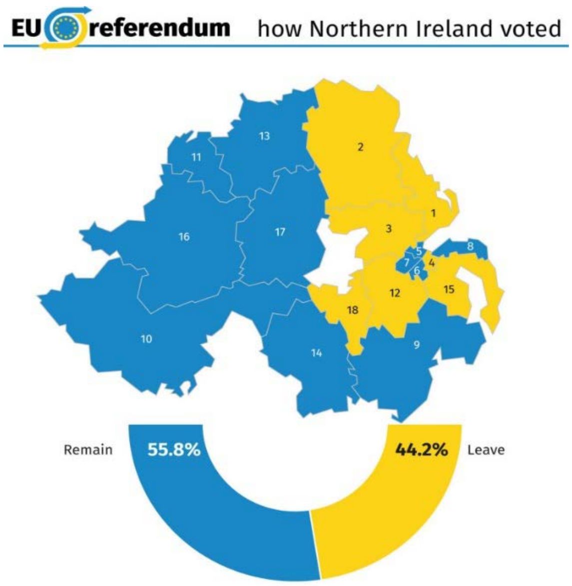
But the unwavering, to date, decision of the UK to leave the single market and the customs union will inevitably lead to the building of a border as there is no known example of two divergent custom regimes, cheek by jowl, without such a border.

The language in the A50 *Joint Report,* at 49 and 50, while tiptoeing around the incompatibility of the position of the parties, suggests that the solution lies, all else failing, in the UK maintaining "full alignment with those rules of the Internal Market and the Customs Union which, now or in the future, support North-South cooperation, the all island economy and the protection of the 1998 Agreement."

Conscious of the difficulties, the Commission *Recommendation* proposes, at Article 6:

> *During the second phase of the negotiations, in view of the specific nature of issues related to the island of Ireland, the work on detailed arrangements required to give effect to the principles and commitments set out in the Joint Report should continue in a distinct strand, some of which would be translated in the Withdrawal Agreements, others in the framework for the future relationship.*

We understand this to mean that in phase 2, the language in Articles 49 and 50 of the *Joint Report* have to be turned into operational practices, i.e., what is actually going to happen on the ground in Ireland? Given the



positions of the EU27, including Ireland, the UK government and the DUP, squaring a circle would be child's play by comparison.

Wrenching Northern Ireland out of the single market and the customs unions will hit the economy of Northern Ireland hard, perhaps even harder than the rest of the UK will be hit.

It is worth keeping in mind that Northern Ireland voted 56/44 to stay in the EU. Polls suggest that a majority favour staying in the single market and the customs union. What political dynamics will be let loose if the people of Northern Ireland are taken out of EU, the single market and the customs union against their will?

BEST GUESS ON WHAT HAPPENS NEXT

When we pull it all together, the A50 agreement, if one is finally reached, will:

- Detail the ongoing financial commitments of the UK to the EU, which could well be in excess of €50bn over future years.
- Set out the rights of EU citizens living in the UK and UK citizens living in the EU on an agreed date.
- Deal with issues in the island of Ireland
- Contain a "governance" mechanism to oversee the implementation of the A50 agreement
- Provide for a transition arrangement after March 2019 to end no later than December 2020 in which the UK continues to act as if it were still a member of the EU
- Identify the framework of a trade agreement to be negotiated in detail only after the UK has left the EU.

Michael Barnier, on behalf of the EU, has said that all of this must be in place by October 2018, to allow time for ratification by the EU Council and by the European Parliament. It means that the details of what is on offer to the UK will be on the table six months before the Article 50 notice expires in March 2019.

All things considered, it would appear that there are three possible outcomes to the Brexit negotiations:

1. The UK negotiates an A50 deal with the EU which locks down what has been agreed on the

UK's financial obligation, citizens' rights and Ireland, as well as covering a transition arrangement and the framework for a future trade deal that is acceptable to the House of Commons.

2. The UK negotiates an A50 deal that is **not** acceptable to the House of Commons.
3. The UK fails to negotiate an Article 50 agreement with the EU and risks crashing out of the EU on March 29, 2019.

Will what is on offer be enough to satisfy any of the various groupings in the House of Commons? While Eurosceptics will bridle at the extent of future payments to the EU, the "vassaldom" of the transition arrangement and the limitations on the negotiation of trade agreement during the transition, they will probably take the view that it is all a price worth paying to be out of the EU after March 2019. Transition and the costs of leaving are temporary; exit will be permanent, they will argue. In their view being "out" is all that counts.

But, as we have pointed out elsewhere in this paper, given the extent of the UK's economic relationship with the EU, both as regards goods and services, any deal outside the single market and the customs unions is going to be on lesser terms than the UK currently enjoys. New barriers to trade, of whatever sort, will result in a reduction of trade. Yet to be negotiated trade deals with countries far away will only mitigate the damage to a minor extent, if indeed they are negotiated at all.

So, how will the majority in the House of Commons react to a deal that will inevitably leave the UK with lesser economic and trading arrangements with the EU than it now has? Or to no deal at all, if the negotiations fail, which could happen at any time over the coming months?

David Davis has told the Commons that if it votes down the deal (or no deal) the government negotiates with the EU then UK will leave without a deal, save for the floor provided by World Trade Organization terms.

However, Davis appeared to be talking as if the deal would only come before the Commons days, if not hours before the March 29 deadline, leaving no time to do anything else if the deal was voted down. But what happens if the deal is on the table six months before the March 29 deadline and the House votes it down? This is the timetable that Barnier has set out.

Not much point instructing the government to go back to Brussels and negotiate a "better deal" because there will be no better deal on offer if the UK is still intent on Brexit, as defined by the May government. The only circumstance in which the EU would offer the UK a different deal would be if the UK changed its mind and asked to stay in the single market and the customs union.

Without rescinding the Article 50 notice could the House of Commons vote to instruct the government to inform the EU that the UK now wished to remain in both the single market and the customs union? While membership of the single market would mean the continued free movement of people, as former MP and Europe minister, Denis McShane has consistently pointed out, there is ample scope within existing EU legislation for a country to be able to control free movement rather than stopping free movement. In any event, as the EU economy picks up, and the pound continues to drop against the euro, the UK may not be as attractive a place to work in the future for Europeans as it has in the recent past. Could Brexit become a solution to a problem that no longer exists?

Bear in mind that the transition the government has asked for effectively sees it stay in the single market and customs union during that time. If the UK indicated that it wished to now stay in the single market and customs union permanently then that would mean negotiating a transition from EU to EFTA/EEA membership. Could that be done during the transition as what would be involved would be political disentanglement rather than economic disentanglement?

The plus side of any such arrangement would be continued frictionless trade in both goods and services between the EU and the UK, resolution of the issues around citizens' rights and an end to the problems that a rebuilding of a border on the island of Ireland would create.

The downside would be the inability of the UK to negotiate trade deals of its own with other countries, but most realists know that the benefits that such deals would bring pale into insignificance compared to the potential losses that new barriers to trade with the EU would create.

Freedom of movement could be controlled, rather than ended.

However, the biggest downside would be the exclusion of the UK from decision making over the rules governing the single market and the customs union. For the UK to be a rule-taker would be distasteful at the best of times. To be a rule-taker when decision making is driven by Eurozone imperatives would be wholly intolerable. But could new decision-making procedures as regards the single market and the customs union be negotiated after Brexit to give the UK, along with other EEA members such as Norway, a voice? This is a possibility that could be worth exploring.

Or could the House of Commons decide that, rather than go back to Brussels to negotiate single market/customs union membership, the terms on offer should be put to the British people by way of another referendum? The *motif* of such a referendum could be: "*You voted to leave the EU. Now that you know the price of leaving do you still want to leave?"* This would not be a re-run of the June 2016 referendum but a fresh referendum on a new, more explicit question.

While it has been suggested that there could be legal and technical difficulties in organising a referendum before the March 29 A50 deadline, if the decision of the House of Commons was for a second referendum, then a political way forward could be found.

How would a May-led Conservative government react to decision by the House to either negotiate single market/custom union membership with the EU or hold a second referendum? Could it actually do either? Could it run a referendum it which it was obliged to say to the people: *The House of Commons believes that this is a worse deal than we actually have today with the EU, that it will make you economically worse off, but we want you to vote for it anyway?*

Could the May government decide it can't do either and resign? Would that open the door to a new Conservative government under a new leader? Or a general election?

What impact might developments elsewhere in the world in 2018 have on the final Brexit decision?

When it comes to Brexit, 2018 is going to be a very long year[1].

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[1] An Irish footnote. When you consider the 307-304 vote in the House of Commons in early December on the issue of the House having a vote on the final A50 deal in good time, there is every possibility that a vote on the final A50 agreement could be as finely balanced. Depending on how discussions between the UK and the EU go, there is every possibility that Brexit could see the return of a hard border in Ireland. If that possibility loomed, could the seven Sinn Féin MPs turn up in the House of Commons to help vote down a deal that would see a rebuilding of a hard border in Ireland? if not, would it not be one of the great ironies of history that their policy of "abstention" (being elected to the House of Commons but refusing to actually take their seats) from the House of Commons resulted in a new border in Ireland, which their entire political *raison d'etre* is to prevent?

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