

Brexit Insight Issue 7:

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| BREXIT Insight

A Weekly Analysis for Senior Executives

Issue No.7 | 10 Apr 2017



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By Brendan Halligan



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The scene is set for British withdrawal from the European Union. The process is expected to last two years unless extended unanimously by the 28 countries involved. We now have the opening positions of both sides and they confirm what we already know: the UK is leaving the EU but there is no known way of reconciling its demands with EU rules and regulations. This issue of the Brexit Insight focuses on how the negotiating process is shaping up. Already there are sharp differences of opinion as to how the negotiations should proceed. A list of contentious issues is set out below along with the most likely timelines over the next two years. The biggest controversy so far is the size of the Brexit Bill to be paid by the UK. Unless handled properly it could be a show stopper. Here's what we know so far... with a brief look at what we still don't know.

Setting the Scene

The UK triggered Article 50 of the Treaty on European Union on 29 March thereby setting the withdrawal process in train. Britain is scheduled to leave the EU at midnight on 28 March 2019 as there is a two year deadline on the negotiations (though this can be extended by unanimous agreement of the European Council).

The UK's notification was contained in a letter from Prime Minister Theresa May to the President of the European Council, Donald Tusk. For its part, the EU response consists of draft guidelines to be given by the other 27 Heads of State or Government to their Chief Negotiator, Michel Barnier. The draft is

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tabled for discussion at a special meeting scheduled for 29 April, at which it will probably be adopted. Until then, there will be no formal negotiations even though the clock has begun to tick.

Differences

There are notable differences between the two documents, the principal one being on the structure of the negotiations. What should be relatively straightforward is complicated by the fact that there are two separate agreements to be concluded, the first on the UK's withdrawal and the second on the new EU/UK relationship. The EU attaches great importance to settling what it calls “the disentanglement” of the UK from the EU. The UK



for its part is prioritising what it calls a “new deep and special relationship” with the EU. Therein lies the problem.

The EU Approach

The EU wants the process to begin with designing an orderly UK withdrawal that will provide clarity and legal certainty to business and citizens. Above all, it wants the thorny question of the UK’s net liabilities to be agreed before proceeding to next business. The draft guidelines are quite explicit in calling this Phase One of the negotiations and in stating that movement to Phase Two dealing with the new relationship will only commence when “sufficient progress” has been made in Phase One. Simply put, the EU want sequential negotiations.

The UK Approach

The UK is pushing for a different approach and wants the negotiations to proceed in parallel. Prime Minister May believes it’s necessary to agree the terms of the future partnership “alongside” those of their withdrawal. This particular phrase was repeated three times in her letter so there can be no doubt about her insistence on conducting parallel negotiations. The UK negotiating strategy has been flagged for months and hasn’t wavered despite contrary messages from the EU.

Trouble Ahead

It is impossible to forecast how this difference is to be resolved. Fear, based on a lack of trust, is the nub of the problem; on the EU side, fear that the UK will not agree to honour its financial liabilities in full and, on the UK side, fear that the bill will be

so unacceptably large that it could bring down the government were it to be conceded. This has all the makings of a deadlock.

From a British perspective, the EU insistence on sequential negotiations sounds a bit ominous as there’s no way of judging at this remove what’s meant by “satisfactory progress” in Phase One as the precondition for moving to Phase Two. The longer it drags on the less time there will be for Phase Two, which for the UK is the heart of the matter.

Bridging the Gap

Phase Two will consist of negotiating a “framework” for the UK’s future relationship with the EU. It will be a political understanding that will have to translated into a treaty. But enshrining the partnership in a legal form can only be concluded after the UK actually leaves the EU (and has become a “third country” in legal jargon). It follows there will be a time-gap between the date of withdrawal and the commencement date for the new relationship.

This gap will have to be filled with an interim deal to provide legal certainty for business and citizens, otherwise there will be a legal limbo. For the moment, negotiating the interim deal can be regarded as Phase Three. The penny is beginning to drop in the British media that this is the logic of the process Mrs May has initiated.

Transitional Arrangements

The draft guidelines leave no room for doubt that transitional arrangements are needed and indicate that they will have to be clearly defined, limited in time and subject to effective enforcement



mechanisms, with a role for EU institutions (including the Court of Justice of the European Union). The European Parliament says they should not last beyond three years, a stipulation that has to be taken seriously as under the terms of Article 50 its assent is required before the European Council signs off on the withdrawal Agreement.

Implementation Periods

Mrs. May has a different focus. Rather than looking at mechanisms for bridging the gap she refers to what she calls implementation periods during which the New Relationship will be phased in. Clearly, she is correct in pointing to the need for an orderly introduction of the new regime. Interestingly, her letter highlights the need to manage the evolution of the respective regulatory frameworks and she also introduces the question of dispute resolution mechanisms, although without specifying what they would entail. But it can be taken that she wants to omit any role for the EU Court of Justice whereas the guidelines state that it must be involved in dispute resolution throughout the transitional period. That's going to a big bone of contention.

No Cherry Picking

On the other hand, Mrs May's opening position on UK access to the Single Market turned out to be highly pragmatic. Mrs May said that she accepts the indivisibility of the four freedoms on which it is based and acknowledges that there can be no "cherry picking" when it comes to the UK's relationship with the Single Market. For their part, the guidelines simply state that preserving the integrity of the Single Market excludes UK participation based on

a sector-by-sector approach. Early in her letter Mrs. May says that she understands that but later on talks about a "bold and ambitious Free Trade Agreement" between the UK and the EU that would cover sectors such as "financial services and network industries". That sounds like cherry picking. We'll have to wait to see what the UK really intends. Detailed proposals are promised in due course.

Level Playing Field

Referring to the future trade agreement, the guidelines, having disposed of the cherry-picking threat, issue a clear warning about unfair competition. There must be a level playing field in terms of competition and state aid and safeguards against unfair competitive advantages through fiscal, social and environmental dumping. This part of the guidelines would seem to rule out any potential for the UK to pursue a Singaporean economic model if it wants a comprehensive Free Trade Area with the EU. Having one's cake while eating it seems to be an ever more elusive mirage.

The Brexit Bill

The first negotiating hurdle to be overcome is settling the Brexit Bill. Maybe it'll prove to be the biggest one. The details have not yet been revealed by the EU but President Juncker hinted that the total could be the €60bn estimated by some think-tanks and as reported in the financial media. The reaction among the Brexiteers has been predictable and does not bode well for a smooth passage through the House of Commons. An IIEA research paper on this topic, written by Michael Tutty, formerly of the Department of Finance and the EIB, and currently



the chair of the IIEA Economic Governance Group, will be available from IIEA.com soon.

Gibraltar

The other sour note so far is Gibraltar. The guidelines state that no agreement between the EU and the UK may apply to Gibraltar without agreement between Spain and the UK. This statement of the obvious gave rise to over-excited reaction within some elements of London's political establishment and is cause for concern because, ultimately, the deal will have to be accepted as a whole, or not at all.

Nothing is Agreed Until Everything is Agreed

This is normal practice. The guidelines stipulate that the negotiations are to be conducted as a single package and that individual items cannot be settled separately. The principle that nothing is agreed until everything is agreed will be applied. On the face of it that would rule out "early wins" to be applied in the first few months, such as on the position of UK citizens living in the EU, and vice versa of course. But it will put pressure on the negotiators as the clock runs down, and that carries its own dangers.

The Good News – Northern Ireland

From an Irish perspective, the good news is that the special difficulties relating to the border with Northern Ireland got specific mention in both the negotiating guide lines and in Mrs May's letter. Both sides are determined to work out solutions to what on the face of it look like intractable problems. Undoubtedly, this represents a significant achievement for the government and bodes well for

its capacity to deal with other problems arising from Brexit, such as on the broad economic front.

A Formidable List

So, a formidable list of contentious items is beginning to emerge. It can only get bigger. Here's a sample of the big-ticket items:

- The sequencing of the two sets of negotiations;
- The size of the Brexit Bill and the payment schedule;
- Bridging the gap between the two agreements;
- The future role of the Court of Justice;
- Phasing in the new relationship;
- Preventing the UK from cherry picking;
- Gibraltar; and
- Maintaining regulatory convergence between the EU and UK.

The Cliff Edge

The list can only grow as the negotiations proceed and that led Mrs May to repeat her fears of the clock running down without a deal being concluded and thereby pushing the UK over the cliff edge into a legal vacuum. But, as in her Lancaster House speech, she said failure to conclude a deal would lead to a weakening in defence and security cooperation. That sounds like a threat and has not gone down too well as it jars with her assertions that she wants a deep and special partnership with the EU. To emphasise his displeasure at this arm-twisting Monsieur Barnier



has spelled out some examples of what the cliff edge would entail. The simple conclusion is that it is to be avoided.

A Hard Brexit

A hard Brexit is inevitable unless the negotiators can reconcile Mrs May's interpretation of last June's referendum result with the realities of the Customs Union and Single Market. Leaving the Customs Union will reintroduce customs posts and procedures. Exiting the Single Market will restore technical and fiscal barriers to trade and will change the rules on mobility of labour between the UK and EU. That's the logic of leaving the EU and is the polar opposite of the regimes put in place since 1973. For the moment, that's where things stand and everyone is living in hope that somehow the circle can be squared, but without knowing how.

What We Still Don't Know

It's clear from the above that there are a number of other major imponderables. We don't know how the structuring of the negotiations will work out. This is more than an administrative issue. It's a matter of high politics and whatever is decided will decisively influence the contents of the overall outcome, particularly the sort of special relationship the UK will have with the EU. Neither do we know if the negotiating guidelines will be amended during the month ahead. Probably not, but one can never be sure. And finally, we don't know the size of the Brexit Bill. Clearly, this will have a decisive influence on the atmosphere in which the negotiations are conducted and on the prospects of coming up with win-win solutions.

Final Thoughts

The accompanying box sets out the timetable for the next two years but there is one major caveat. If the French Presidential election on May 7th were to deliver a victory for Madame Le Pen then all bets are off. If Monsieur Macron wins then everything will remain on track and the biggest hurdle to be overcome will then be the first one - the Brexit Bill.

Brexit Brief

The IIEA's "Brexit Brief" will now appear fortnightly in view of the gathering pace of the negotiations. The most recent issue can be read [here](#).

Brexit Insight

Brexit Insight will now appear fortnightly, alternating with the Brexit Brief. That means we'll be issuing updates and analysis on a weekly basis. The previous issue can be read [here](#).





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Timetable

April 29 2017	:	European Council to adopt the Negotiating Guidelines
May 7 2017	:	Second Round of French Presidential elections
June 2017	:	The negotiations begin Phase One commences
September 2017	:	German Federal Elections
December 2017	:	Phase Two opens <i>(If substantial progress on withdrawal recorded)</i>
June 2018	:	Framework for future relationship agreed
July 2018	:	Transitional Arrangements discussed
October 2018	:	The package is agreed
November 2018	:	European Parliament debates
March 2019	:	European Council concludes Withdrawal Agreement with UK UK Parliament approves the deal
March 28 2019	:	UK leaves the EU

The Brexit Insight is produced by the IIEA Brexit Project Group chaired by Dáithí O’Ceallaigh, former Ambassador to the UK. This issue is written by Brendan Halligan, President of the Institute.

As an independent forum, the Institute does not express any opinions of its own. The views expressed in the article are the sole responsibility of the author.



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