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## The Brexit Negotiations: What's Important, What Matters, What's Next?



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At the end of January, the UK formally left the European Union. Prime Minister Johnson accepted withdrawal terms rejected by his predecessor Mrs May as unacceptable to any British government, because they involve checks on goods moving from other parts of the UK to Northern Ireland. The Withdrawal Agreement, however objectionable to Unionists in principle, leaves Northern Ireland in a curiously privileged position, with in effect continuing membership of the European single market.

The Government is now seeking to agree with the EU a Comprehensive Free Trade Agreement (CFTA) providing for maximum access to the European single market for goods produced elsewhere in the UK (though such access will almost certainly be less favourable than for goods from Northern Ireland). The Government hopes to conclude negotiations before 31 December this year, when the present transition period is due to end. What's important in this negotiation? And what really matters?

The Government published its objectives in February, in a document entitled 'The Future Relationship With The EU: The UK's Approach to Negotiations'. It makes clear what is important to the UK: 'sovereign equality', control of laws, 'equal right to regulate', no role for the ECJ, and recognition of the UK as 'an independent coastal state'. But it is not clear that ministers have taken full account of what really matters in this negotiation.

**Size matters.** When trade negotiations are asymmetric, the bigger party has much more influence on the outcome. The EU is an international trade titan - its single market is the largest in the world. The UK is also a significant trade power, but the contrast in scale is stark: the EU market is more than six times as big. Its size and international weight make the EU what has been described as a regulatory superpower. Irrespective of trade agreements, international business in many areas finds it convenient to adopt EU standards.

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**Proximity matters.** It is a continuing characteristic of international trade, notwithstanding the globalisation of recent decades, that exporting countries tend to send a large proportion of their goods to neighbours. This is as true for the UK as it is, for example, for Japan and South Korea. While the proportion of UK exports that go to the EU has been falling in recent years - from 55% in 2006 to 45% in 2018 – the European single market will remain the UK's largest international market for the foreseeable future.

**Relative trade flows matter.** While the EU is overwhelmingly the UK's largest international market, trade flows the other way are as a percentage much smaller: only 6.6% of EU 27 exports come to the UK. In terms of proportional economic damage, the UK would lose far more than the EU from failure to agree a trade agreement (a November 2018 Government estimate calculated up to 10.7% of GDP after 15 years).

**Options (or lack of them) matter.** The UK Government has sought to balance these realities by positioning its trade negotiations with other countries as possible alternative options. In particular, Ministers have suggested that the opening of trade negotiations with the US, and the possibility of rapid progress, exercise pressure on the EU. This is unrealistic: no trade deal with the US, which takes less than 15% of UK exported goods, could compensate for failure to agree a CFTA with the EU. Indeed, the government's own figures estimate that an agreement with the US would boost UK GDP by only 0.18% after 10 years.

**History matters.** The UK's economic integration with Europe over the past five decades (as well as its proximity) leads the EU to demand 'level playing-field' guarantees and supervisory arrangements beyond those in trade agreements with more distant countries. More generally, though less explicitly, the EU will wish to ensure that the outcome of these trade negotiations is less advantageous to the UK than continuing membership would have been. However unreasonable these aspects of the EU's approach may seem to the Government (eloquently expressed in the 19 May letter from the UK's Chief Negotiator to his European opposite number) they limit what it will be possible for the UK to achieve.

**The timetable matters.** There is much that is unprecedented in the present negotiation, not least that it will inevitably result in more rather than fewer trade barriers. Implementation of a CFTA between two major players less than a year after the launch of negotiations would certainly be unprecedented. If it had ever been possible, it now looks extremely unlikely. Time was lost when the chief negotiators on both sides fell victim to Covid-19, and the international health crisis may further disrupt progress. Yet the Government continues to rule out any extension of the transition period beyond the end of this year. Practical considerations nevertheless suggest such an extension would make sense, either in June, when formally the parties must agree it, or later if that is politically easier for the UK - assuming both sides still agree at that point that progress remains possible.

**What's next?** The Chief Negotiator's 19 May letter, though addressed to M Barnier, seems designed to encourage some member states to persuade the EU collectively to take a more accommodating approach. But EU solidarity has held remarkably well over the past three years. Unless there is a change of heart, the negotiating realities outlined above suggest that ultimately the UK may be faced with an uncomfortable choice: either to accept a CFTA on, essentially, EU terms; or to conclude the negotiations without an agreement and risk the considerable trade disruption and long-term damage that most economists judge would result.

The latter course might be welcomed by some in the Conservative Party, and there is speculation the Government might consider burying the economic hit of a no-deal outcome in the deep recession that will be generated by our present health crisis. But that choice would seem reckless in the extreme, particularly when economic prospects are already dark and, in response to the insecurities exposed by the pandemic, industrial supply lines are likely to become shorter and trade even more regional.

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