By Tim Hames, Senior Adviser | 5th June 2020

Back to Brexit. A UK-EU FTA deal may go to the wire but can be done.

It is a strange world where writing about Brexit almost feels like light relief. After ten plus weeks focused on the coronavirus crisis, the opportunity for a change of subject is here. This week has witnessed another round of negotiations, apparently not conducted in the very best of spirits, between the EU-27 and the UK over the Free Trade Agreement that would be the basis for their future relationship. Before any more talking can occur after this session, the political leadership of the two sides are legally obliged to take stock on the progress that has been made and whether it is (a) worth continuing at all and (b) if the option of an extension to a transition period due to end on December 31 should be exercised, as by law it must be, before July 1. Expectations are hardly high at this hour.

EXECUTIVE SUMMARY

- It should be absolutely no surprise that the talks are where they are at present. It will require strong political direction for them to resume in a more positive light. This is likely to materialise.
- It is close to inconceivable that the UK will seek an extension of the transition period either before July 1 or at a later point if a legal device to do this emerged.
- There are, though, still strong incentives for a deal albeit a relatively thin one.
- Some additional complexities and costs for business are essentially unavoidable.

- The ratification process allows for the essence of an accord to be reached at a very late stage indeed (mid-December) in the right context and circumstances.
- Even in a more challenging situation, much of a deal that could not be ratified in its entirity before 2021 could be implemented anyway on a provisional basis.
- There is also the potential flexibility to allow for some sector-specific period for implentation during which the UK would shadow aspects of the single market.
- Business should be prepared for a deal that allows them little time to prepare.

Where we are is not remotely surprising.

It should be no surprise to anyone that the Brexit Stage II deliberations are nowhere near a breakthrough yet. Although the negotiations have been complicated by the COVID-19 crisis in that sessions have been lost, both lead negotiators fell ill to the virus in short order and they have had to be conducted remotely rather than face-to-face, it is far from clear that they would be much further advanced by this moment if none of the above had applied and everyone had been working in comparatively luxurious surroundings in London and Brussels, moving smoothly between those two cities via the Eurostar.

For, as set out in the FTI UK Political Analysis of March 6th (*Fireworks, financial services and fish. What to expect as the UK-EU "end state" talks continue*), the political incentives to compromise or even send out hints as to what might be true 'red lines' and what others may have a pinkish hue to them do not exist right now and will not for a while to come. A somewhat grumpy impasse is likely to be reached with muttered threats that it might not be worth even attempting to make any more progress and prepare instead for an 'Australian' or WTO-terms outcome, before Boris Johnson engages in high-level talks with the President of the European Commission and other key players in Brussels, Berlin and Paris. A process would then start of sending coded messages about whether there might be adjustments on issues such as financial services, and the form of 'equivalence' rules that the UK could expect, and the sort of access to UK waters that the EU-27 fishing fleets might be entitled to obtain. The exact definition of a 'level playing field' is also out there to be tested. In many ways, the most difficult issue is really a more technical one, namely what the governance structure will be in the event that there are disputes in the

future which need to be resolved. The EU wants a single, strong, quasi-judicial actor. The UK would much prefer multiple, weaker and more politically deferential adjudicators.

Until this is sorted, serious trade-offs cannot be firmly put on the table. It requires a strong steer from the respective leaderships of the two camps to make this happen. Unless (for some reason) the European Commission President, the German Chancellor and the French President have already decided that they do not want to conclude an FTA of any form with the UK, or the UK has made that decision itself (which would seem to be improbable this early on), then some new wording will be found and David Frost and Michel Barnier will be instructed to resume their dialogue with more urgency and vigour.

It is virtually inconceivable that the UK will seek an extension of the transition period.

This month is an important one for the overall debate because in legal terms the UK and EU have until July 1 to request an extension of the transition period for up to two years. There is very little chance indeed that London will take up that option. Nor will it do so at a later moment by a different legal ruse were such an opportunity offered to the UK.

This is often portrayed as a stance of dogmatism in sections of the UK media rendered even more dangerous by the unanticipated arrival of the coronavirus crisis this year. Actually, there is a pretty strong case that an extension would not assist either side.

From the UK's perspective these reasons are particularly robust, but the EU has its own motives for wanting to bring the Brexit saga to a final conclusion sooner and not later.

The arguments as far as the UK Prime Minister and Government are concerned are that:

- They have repeatedly asserted that they would not seek an extension of the transition. To reverse that position would undermine their credibility just as Theresa May's insistence that the UK would leave the EU on March 29th, 2019 ultimately destroyed her politically when she could not deliver on that pledge. She at least had the alibi that she did not have a stable majority in the House of Commons. Her successor cannot make that claim and would face a party revolt.

- The Conservative Party Manifesto on which the Government was returned to office on December 12th, 2019 was absolutely explicit on the transition period.
- It has subsequently become a matter of domestic law since the election result.
- It would require the UK to continue to be in the manifestly unappealling position of having to obey all EU legislation and regulation while having no voice in them.
- It would mean that the UK would continue to contribute into the EU budget, and do so at a time when the Coronavirus Recovery Fund was being established.
- The lessons of the crisis as far as London is concerned will include the need to have more, not less, autonomy over matters relating to State Aid in the future even if that comes at the cost of some tariffs and quotas in certain sectors. In this, it may have the private sympathy of a number of EU countries which also feel they would like more capacity to recast their manufacturing sectors as well.

Then there are the reasons to avoid an extended transition from the EU perspective.

- The EU has not had an impressive coronavirus crisis with member states charging to take back control of their borders (obstructing the single market as they did) and with Italy, especially, entitled to feel that it was abandoned. With wounds to heal, an unnecessary and elongated dispute with the UK looks like a distraction.
- The disruption to supply chains between the UK and the EU caused by the virus has been of a scale at least as large as and arguably greater than that which a limited FTA or even shifting to WTO-rules would have been expected to provoke. Nor is the fear of a Brexit Recession as substantial a sentiment in Whitehall as it was six months ago. Any adverse impact would be counterbalanced by the scale of the fiscal stimulus to the economy that can be expected as recovery occurs.
- The electoral cycles of the countries which have the closest economic ties to the UK will undoubtedly have significant if unacknowledged influence. Holland is due to vote in March 2021, Germany in September or October 2021, France in April or May 2022 (presidential, followed swiftly by the National Assembly contest). The present incumbents would be rational to conclude that a comparatively swift if limited deal with the UK suited them better than a longer deliberation. If there is to be any economic disruption or dislocation then best to take it earlier. For France, notably, a new 2022 deadline on the transition looks rather messy.

- Finally, although time is short, there is no compelling evidence that it is the schedule itself, rather than the need to sum up the political will required for a deal to be done, that is the primary hurdle here. The warp speed at which the Northern Ireland ‘backstop’ provisions of the old Withdrawal Agreement were changed last October when London and Dublin reached an accord illustrates this. More time would not produce more energy to reach an understanding quickly, rather it would probably defer the point at which the two parties were truly serious in their intent towards one another for several more months to come.

A deal, even of an initially limited character, thus still has enough attraction all round.

The political imperative here is clear. The UK will cease to be within and hence subject to the single market and customs union on January 1, 2021. Even a significant second spike in the coronavirus crisis is unlikely to prevent this from happening. The issue, therefore, is whether it then moves into a state which may be described as ‘Can-Pan’ (a deal that is a cross between the EU-Canada CETA and the EU-Japan EPA) or a WTO mode instead.

The former option is the least challenging to each side. Most of the questions which are currently proving very difficult and divisive are capable of being finessed. The UK has to have some sort of relationship with its largest trading partner. The EU appreciates that if there is no deal then it has no chance of avoiding a big regulatory competitor next door. If there is a deal, the consideration is timing. The UK would like it wrapped up by the end of September and endorsed and ratified in October. It could easily go closer to the wire.

Some additional complexity and cost for the business community is unavoidable.

Even a comparatively straightforward “zero tariffs, zero quotas, zero dumping” deal would involve some complexity and cost. There will be a raft of new customs procedures, potentially new security systems and the situation around the Irish border would mean that intra-UK trade involving Great Britain and Northern Ireland would change as well.

The UK will probably need 50,000 new customs agents (perhaps drawn from those it is now recruiting as contact tracers?). Around 200,000 businesses will have to complete customs forms for the first time. Added to which, firms will have to adapt to the end of free movement and a quite different and untested points-based immigration structure. In ideal circumstances, business would like months to prepare. It may find it has weeks.

The ratification process may end up having significant influence over the deal done.

Substance and process will be interconnected as the UK and EU look for a solution. It is important to appreciate how different sorts of treaties require different ratification.

The UK starts with the immense advantage of simplicity in ratification. The Constitutional Reform and Governance Act, 2010, (or CRAG) allows a government to ratify a treaty 21 days after it has been laid before Parliament provided that MPs do not vote against it. It can even expedite or disapply such a measure and move faster in “exceptional cases”. All this means is that a Minister sets out a statement before Parliament explaining why it is an exceptional case. If the Government has a reliable parliamentary majority behind it (which Mrs May did not have on EU policy at any time) then it holds all of the cards here.

The situation in the EU is different. The means of ratification is dependent on whether a treaty is considered to cover ‘EU-only’ matters (areas where the EU and EU law have exclusive control) or a ‘mixed agreement’ (containing both spheres that are entirely within the EU’s scope and others where member states also have legal power). If a treaty were one based on territory where the EU had no meaningful competence at all (e.g. health), then the ratification procedure would be the same as a mixed agreement.

The distinction is crucial. If an EU-UK FTA is deemed ‘EU-only’ then it only has to be agreed by the Council of Ministers and the European Parliament. So, for instance, if a deal were done as late as December 9th, it could be agreed at the Council of Ministers meeting on December 10-11 and the European Parliament’s pre-Christmas plenary session on December 14th or 15th and be pushed through the House of Commons in the UK with the Government contending that it was an “exceptional case” and authorising it.

A ‘mixed agreement’ is a much more extacting instrument. It needs the backing not only of the EU’s key institutions but, according to their own laws, the parliaments of the member states and in some circumstances certain regional parliaments as well. To be precise, in 14 of the 15 members with unicameral national parliaments, their active assent is demanded (in Malta, treaties can be backed without the Chamber of Deputies voting on them in a wide range of circumstances). Meanwhile, in 10 of the 12 members that are bicameral, both chambers must approve such a treaty (the Irish Seanad and the Slovenian National Council do not have to be approached, although to make all of this more mind-numbing still a majority in the Seanad plus a third of TDs in the Dail can petition the Irish President for a referendum on a treaty, which he/she would probably concede). In Belgium, not only do both houses of parliament need to embrace a treaty, but seven different regional assemblies do as well (hence the infamous incident when it appeared as if the Parliament of Wallonia was about to derail the EU-Canada FTA).

If matters become really farcical, there could be a repeat of a 2009 incident during the passage of the Treaty of Lisbon in Finland when the regional parliament of the Aland Islands (a set of native Swedish speakers in the far south-west of the country, estimated population in 2019 of 29,884) insisted that they had the right to vote on it even though neither Brussels or Helsinki agreed. For the record, and fortunately, they did approve it in a 24-6 vote as it is not obvious what the legal picture would have been if they had not.

It will not stun readers that the UK strongly prefers a core treaty that is ‘EU-only’ but could live with some side treaties (such as on aviation and road haulage) where it is very hard not to identify them as a mixed agreement. It probably also will not come as a massive shock that the decision as to whether a treaty is ‘EU-only’ or ‘mixed’ is mostly in the hands of EU institutions and that politics plays a part in this assessment. The EU-Japan EPA, which faced little opposition inside the EU in any member state, was deemed to be ‘EU-only’ and hence fast-tracked to ratification in a few months. The EU-Canada CFTA, which did have some vocal enemies from the outset, was taken to be a ‘mixed agreement’ and open to pot-shots from Wallonia (and its ratification is still not over). The thinner the UK-EU FTA, the easier it is to argue that it has satisfied the EU-only tests. Hence if there is a very late deal it should be viable to force most of it through this way. Ensuring that this is, in fact, the case will be an unspoken factor in the final negotiations.

Even if aspects of the UK-EU FTA are considered to be 'mixed' this may not matter.

This division between 'EU-only' and 'mixed agreement' is not quite as binary as it may appear. Suppose that there was one single final EU-UK FTA deal that while largely related to EU-only competencies, included enough that obviously touched on national authority and it was impossible simply to split the document in two and send one treaty down the 'EU-only' ratification chute and the other down the more cumbersome mixed route. In such an instance, a mechanism exists that allows any such agreement to be provisionally applied in all of the areas which are taken to be 'EU-only' spheres more or less straight away, while matters move more slowly along the mixed agreement track. The majority of a "zero tariffs, zero quotas, zero dumping" understanding would clearly fall into the EU-only category (it could be a substantial majority) and thus could come into force in 2021. Large tracts of the EU-Canada CETA have been provisionally operated since September 2017. It is not an ideal outcome but it is an entirely practical one if the UK and EU need it.

There is some flexibility that would allow for a sector-specific implementation time.

As a very thoughtful paper from the Institute for Government published last week points out (*Implementing Brexit: Securing More Time: Georgina Wright, James Kayne and Haydon Etherington*) it is not the case that the only device by which the EU and UK can acquire more time to complete the details of the FTA is by extending the transition. There are at least four other means to meet that end (although some would be toxic politically in the UK). One entirely respectable route would be to phase in some of the new arrangements. This is perfectly normal in FTAs in sensitive spheres. The EU-Canada FTA has some tariff cuts that will not be implemented fully for seven years after it has been ratified. The EU-Japan EPA provides for an extraordinary 20-year implementation period in a few areas which would otherwise have been matters of severe contention.

This method would mean that (if considered desirable) while the UK as a whole would in legal terms be completely extracted from the single market and customs area in 2021, there could be sectors in which the UK volunteers that it will "shadow" or choose not to

exercise its right to diverge until a date other than January 1, 2021. This would plainly have an impact on and be of importance to those elements of the economy so affected.

Conclusion.

It remains entirely possible that either by accident or design the FTA negotiations fail and are abandoned. Equally, the political will may emerge to seal an FTA by September or October. The first scenario would afford business six months to prepare for WTO-rules. The second would allow business two to three months to evaluate how they need to respond to the version of 'Can-Pan' that ultimately comes out in an agreed EU-UK FTA.

There is also, however, the distinct chance that matters will be more complicated than that. There might be a single deal that does not arrive until December, or more than one deal which will go down different ratification routes. It may or may not be practical for provisional implementation to occur depending on the sector of economic activity. It could be that, in some instances, the provisions of any agreement are deferred in terms of their implementation - and that period could be years, not months. In all of these situations (which are far from fanciful), different sorts of companies and markets will find themselves with different sorts of "end state" relationships with the EU over different lengths of time. It is completely understandable that, with the coronavirus crisis far from settled, businesses, sizeable as well as small, have not focused on this. They should do.

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