

# BREXIT INSIGHTS - SEEING THINGS DIFFERENTLY

Till Brexit do us part



In our March 2017 report 'Till Brexit Do Us Part' we examined the findings of our Brexit survey of more than 400 leaders of mid-market businesses on the eve of Article 50 being triggered. It captured a mood of resilience and level-headedness in British business, tempered with uncertainty about the prospects of a trade deal and concern about a lack of guidance, leaving many businesses feeling unable to make contingency plans.

**Since the report, the formal Brexit process has started and negotiations have begun. Whilst the deadline for Brexit remains unchanged, complexities are growing and objectives are changing. The prospect of a completed trade deal now looks remote.**

Within days of invoking Article 50 the UK Government called a General Election. This unexpectedly led to a hung Parliament and a new wave of political uncertainty.

Meanwhile, the EU27 published a series of key documents which set out its approach to negotiations. In these documents, the EU27 legally bound its negotiators to a phased negotiating process. Having initially rejected the EU's negotiating structure, the UK conceded to the phased approach on the first day of discussions.

This is a significant U-turn. The UK's negotiating objectives are no longer clear. The June election has re-opened questions over whether the UK wishes to maintain an association with the free market or the customs union. It is unknown whether these options would be available even if there was sufficient time to explore them.

These complex and politically difficult points will obstruct progress towards a trade deal. If no deal is done by 29 March 2019 the UK will face a hard and chaotic Brexit.

This insights report provides businesses with information on the direction of the first phase of Brexit negotiations. A lot can happen between now and 30 March 2019. But planning takes time and businesses that plan the earliest will secure the biggest advantages.



# With the triggering of Article 50, the UK began the formal process of withdrawing from the European Union (EU). Conflicting negotiating objectives mean a deal is increasingly unlikely. As a key adviser to mid-market businesses, we provide an analysis of this to help businesses plan for an uncertain future.

The UK and EU are approaching Brexit negotiations from opposite perspectives. The EU is focusing on the exit arrangements while the UK needs to focus on the new trading relationship. It is hard to see how these positions can be reconciled within the two-year timeframe. The clock is already ticking.

The EU may be criticised for a number of faults but a failure to create and follow a process is rarely one of them. It has locked-down its Brexit negotiating position in three key documents, each of which builds on the last and creates a two-phase approach to negotiations – where there will be no talk about trade or the future relationship until “sufficient progress” on the separation is agreed.

The UK’s own negotiating objectives are now uncertain. The Article 50 letter said the UK would leave the single market and customs union. In its response, the EU welcomed the UK’s implicit recognition that the four freedoms of the single market are indivisible and that there can be no “cherry picking”. However, following June’s General Election, it is no longer clear that is still the UK’s position.

While it is a right of politicians to change their mind during a negotiation, the problem with Brexit is the very hard and real deadline approaching. Even if the political will changes, it will take time to agree the change with the EU Council and the EU Parliament; and time is in very short supply.

Businesses need to start planning for a difficult Brexit. This will involve a big investment of time and may lead to difficult decisions. On page 10 we suggest where that planning should start.



**Adam McGiveron** is our Brexit specialist.

# Timeline to Brexit

## In a nutshell - time constraints are tough

**Major treaties take around six months for translation and ratification. That leaves only 14 months to actually negotiate and agree all the details. This is not enough time.**

The UK is scheduled to leave the EU at midnight in Brussels on 29 March 2019. Few people expect a political appetite for an extension, and so a deal needs to be done.

In the words of Article 50, when Brexit happens “the Treaties shall cease to apply to the [UK]”. The UK will be out of the EU, the Customs Union and the Free Market. We will no longer be members of the various EU regulatory bodies that govern everything from airspace to nuclear fuels.

The UK will be a “third country” for the purposes of trade with the EU, and will no longer benefit from the 45 trade deals between the EU and other countries.

Some issues are of such fundamental importance that it is hard to envisage there will be no deal at all. Rights of residence for UK citizens already living in the EU and vice versa are likely to be agreed.

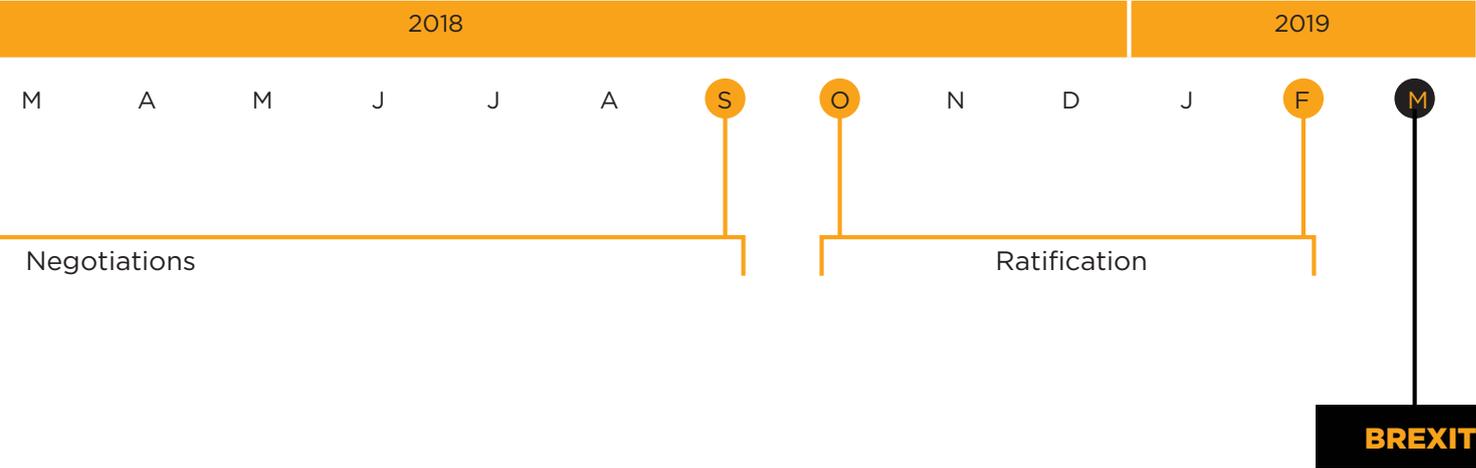
Other issues, which would have catastrophic consequences if there were no deal at all, need resolving. These include regulation of the UK’s airspace, regulation of nuclear fuel, medicines, and maritime safety. There is also the highly complex and sensitive topic of the Irish border.

The EU’s trade deal with Canada took seven years to negotiate and did not comprehensively cover services, which represent around 80% of the UK economy.

On top of this, a large amount of politically difficult legislation to implement Brexit needs to be passed through Parliament before the two years are up.

Against this backdrop, it is highly unlikely that there will be time to negotiate a trade deal as well as everything else that needs to be done before Brexit takes place.









# A fundamentally different approach

## In a nutshell – “sufficient progress”

**Theresa May’s Article 50 letter made several references to negotiating a free trade agreement alongside the withdrawal terms. However, the EU27 crystallised its position as being quite different: giving its negotiator no capacity to deal with trade matters until “sufficient progress” is made on the separation.**

These two approaches were incompatible. David Davis noted in May 2017 that the UK would be disadvantaged by having to agree the financial settlement before addressing trade and said that the debate over sequencing would be “the row of the summer”.

However, when negotiations started on 19 June Mr Davis immediately acquiesced to the EU’s position and both sides have now agreed to deal with separation before turning to the future relationship in a phased approach to negotiations. This is a significant and surprising U-turn and may be reflective of the post-election politics and changing UK negotiating objectives.

This phased approach means that sufficient progress has to be made in relation to citizen’s rights, the highly complex question of the Irish border and the politically toxic issue of the separation bill before talks can begin on the future trading relationship.

On the face of it, the question of citizens’ rights was expected to be the least controversial aspect of the negotiations. It is widely thought that both sides want a reciprocal arrangement where the rights of UK citizens in the EU are equivalent to the rights of EU citizens in the UK. The fact that even this issue is proving difficult to unlock does not bode well for the more complex discussions to come.

## In a nutshell – “deep and special partnership”

**The UK government wants to negotiate a “deep and special partnership” and believes both a withdrawal agreement and a new trade agreement can be concluded at the same time within the two-year timeframe. The EU is saying that a new trade agreement can’t be discussed until sufficient progress is made on the withdrawal agreement. Even if we get to this second phase of negotiations, the EU is taking a restricted view on what it wants to achieve.**

The current UK government has indicated that it will not seek to remain in the Single Market but would like to pursue an ambitious free trade agreement with the EU.

The European Council’s Negotiating Guidelines require that any free trade agreement should be balanced, ambitious and wide-ranging, but that it cannot mean participation in the Single Market or parts of the Single Market.

Importantly, the Guidelines also state that an agreement on a future trading relationship between the UK and EU can only be finalised once the UK has left the EU and is officially a “third country”. The EU sets out very vague ambitions for “an overall understanding on the framework for the future relationship”. This is short of being a concluded deal for a “deep and special partnership”.

If the trade deal has to be completed after the UK has left the EU, it pre-supposes there will be a period of no trade deal. The EU also may want to treat a future agreement with the UK like a trade deal with any other “third country”.

The rules of negotiating trade deals with the EU are complex. Theresa May’s desire for a “comprehensive, bold and ambitious free trade agreement” may well need a unanimous vote of the EU27. Any modern, wide-reaching trade deal will inevitably encompass more than just trade issues. It would become what is known as a “mixed” agreement, which was the case with the recent EU trade deal with Canada, and has to be approved and ratified by all member states.

In May 2017 the European Court of Justice gave a wider than expected decision on the scope of the EU Commission’s power to negotiate trade deals. Even in the light of this decision, any deal of the type contemplated by the UK Government will almost certainly need to be ratified by each of the EU states.

Failure to ratify will block the agreement, as was nearly the case when the Walloonian Parliament in Belgium nearly blocked the deal with Canada. At the very least, being a “third country” will make the negotiating process longer.



## In a nutshell – “must honour all obligations”

**The EU Parliament also has a view and its position matters because it has a veto on any final deal. It has published its own resolution on what it expects from the negotiations – and that resolution also requires a divorce settlement before trade talks can start.**

Article 50 requires the EU Parliament to consent to any withdrawal agreement and so its opinion on the process counts. It passed a resolution on Brexit in April 2017 setting out the terms it requires in the agreement in order to give its consent.

The resolution covers the same ground as the EU Council's position, requiring a phased approach to negotiations and with no talks on future trade until “substantial progress” is made on the withdrawal agreement. The EU Parliament also stresses that: “the United Kingdom must honour all its legal, financial and budgetary obligations.”

In many ways, the EU Parliament has taken a harder line than the EU Council, saying: “a state withdrawing from the Union cannot enjoy similar benefits enjoyed by a member state, and [the EU Parliament] therefore announces that it will not consent to any agreement that would contradict this.”

This is a hard-line stance which makes a “deep and special partnership” unlikely. The resolution was passed by a substantial majority of 516 votes in favour and 133 against, with all countries other than the UK voting in favour.

Interestingly, 80 of the 96 German MEPs voted in favour of the resolution. This perhaps raises questions over an assessment made by David Davis MP before the referendum that German car manufacturers would: “within minutes of a Brexit vote... be knocking down Chancellor Merkel's door demanding that there be no barriers to German access to the British market.”

# Action points



## **On the current trajectory of negotiations, we conclude that a trade deal within the required timeframe is highly unlikely.**

The UK has now agreed to phased negotiations despite previously stating that this approach would be a serious impediment to securing a trade deal within the required timeframe.

Early negotiations are likely to get bogged down on the exit bill. The later stages of negotiations are likely to be dominated by matters of life and death, such as nuclear safety regimes and medicine regulation. Compared to these issues, trade will be pushed down the line.

Businesses need to start planning for a difficult Brexit. Those businesses that plan earliest will secure the biggest advantages. Here are four key areas to examine and put plans in place to minimise the risks.

### **Supply chain**

If no trade deal is concluded then customs barriers and tariffs will come into force. Businesses should assess their supply chain's direct and indirect exposure to import and export problems. Businesses with particularly high volumes of imports and exports should prepare for the administrative burden of customs checks.

### **Human resources**

Brexit is likely to be a deeply unsettling time for employees who are EU nationals. Employers may want to assist their overseas employees with applications for rights to remain in the UK. A core rationale for Brexit is to limit immigration, which will exacerbate the skills gap. Employers should monitor developments and take advice on how to maximise their opportunities in the immigration system.

### **Financial resilience**

A hard Brexit is likely to have unpredictable economic consequences. Businesses should prepare themselves for disrupted supply chains as well as an economic shock.

### **Regulatory controls**

The Reform Bill is expected to transfer all of European Law at the date of Brexit into English law. Some businesses will be reliant on one of the specific European regulatory agencies and the post-Brexit status of these agencies is unclear. We will monitor developments on this and report again in the future.





Contact us

[brexit@shma.co.uk](mailto:brexit@shma.co.uk)

03300 240 333

[www.shma.co.uk](http://www.shma.co.uk)