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Brexit: Beware the deals beyond 'no deal'

In the debate about whether a 'no deal' Brexit is a viable option for the UK, there is a gap in perceptions of what 'no deal' really means. Among those who argue that "no deal" is viable, many appear to mean no formal agreement on withdrawal terms is struck under Article 50, but that there would still be a set of deals struck in order to keep trade between the UK and the EU flowing, even if WTO-compliant tariffs were applied on that trade. Bernard Jenkin MP provides an example of a Eurosceptic who has recently argued that the UK should be prepared to bring an end to the negotiations under Article 50 if necessary, while expecting a set of arrangements to sustain trade alongside WTO rules would follow; a lengthy quote explaining his thinking is provided below. But even among MPs not known for their Euroscepticism, and more sensitive to the risks "no deal" would entail, there is a sense that "no deal" is not an absolute. Hence, Chancellor Phillip Hammond, while acknowledging the possibility that UK-EU flights would not operate after Brexit, stated that "no one seriously expects this to happen". We note the British Association of Airline Pilots appears to think it could – see [here](#).

A number of arguments are made to sustain the idea that "no deal" would not see trade flows seriously hindered. On this view, it is recognized the new processes for customs declarations, collection of tariffs, and VAT collection would need to be put in place. Arrangements on the origin of goods would also be needed as the UK's relationships with non-EU countries diverged from the EU's over time. But prominent is the idea that the EU's pursuit of its own commercial advantage would drive it to facilitate trade given the importance of the UK as a market for its exports. In addition, the starting point of the UK's regulatory convergence with the EU should accelerate the ability to make deals on mutual recognition of regulatory arrangements, product conformity and sectoral trade facilitation. Some also argue that UK and EU adherence to WTO agreements seeking to limit technical barriers to trade, and EU treaty articles stating an objective of good relations with its neighbours, would also pressure the EU into agreement. Of course, these arguments are familiar: they are essentially the same as those made in the context of the current Article 50 negotiations for the claim that it would be straightforward for the UK would be able to secure a medium-term trade arrangement which largely replicates the status quo.

In our view, this perspective seriously misreads the dynamics of how a "no deal" situation would be likely to play out. There are significant political, procedural and practical constraints on the ability of the EU to put in place arrangements that would smooth a path to trade on WTO terms. Moreover, the incentive for the EU to do so is not clear. The impact of a reversion to WTO rules as a framework for governing trade without accompanying facilitation measures would be negative for both sides, but it would be much worse for the UK. Some sense of the relative impact is given by the following: the share of UK exports to the EU in GDP is close to 12.5%, the equivalent figure for the EU is 3.5%. The EU would prioritize those areas of trade facilitation which would minimize the damage to itself, both in the run-up to the EU exit and afterward. And it would expect a medium-term offset to the short-term output losses from trade disruption via corporate relocation from the UK to the EU as firms sought to avoid any future supply chain disruption. The disruption to the UK would be a potent signal of the disadvantages of leaving the EU. And it would likely leave the UK in a weakened position as it sought a more durable medium-term trade settlement with the EU.

The Article 50 negotiations have seen the EU lay out the terms upon which it will move toward a negotiated exit. In a "no deal" scenario, the UK rejects those terms. As the UK seeks subsequent discussions of trade facilitation, the EU is under no compulsion to enter those talks. Rather, it would likely direct the UK back to the framework for a negotiated withdrawal. It would also likely argue that, under Article 218 of the Treaty, it is legally constrained on the extent to which it can instruct the Commission to engage in detailed discussion of

trade issues with an existing member state. The UK would likely argue that, with March 2019 approaching, it was imperative that both sides engage on trade facilitation. The EU would likely point to the ability to extend the Article 50 process via unanimous agreement in the Council, and suggest the UK should re-engage with the negotiations and seek to create time for them via that route.

Meanwhile, the Council's decision-making process through the UK's withdrawal is working via unanimity in the Council. Hence even if those countries most exposed to a "no deal" outcome (Ireland and the Netherlands, for example) were to push for talks on trade facilitation, they may be frustrated by other countries less prepared to engage in such discussions. Simultaneously, there are significant questions about the UK's ability to sustain political support for a "no deal" approach should it pursue it. Hence, even if the UK takes an assertive stance in the discussions from this point onward and is able to sustain that position, a significant amount of time is likely to elapse between now and the point where any discussion of trade facilitation under a WTO regime would begin. Constraints of time would hence be pressing as March 2019 looms, and the option of a return to a 'more orderly' process of withdrawal would linger in the background.

For the EU to engage in talks on trade facilitation with the UK under these conditions would be unprecedented and its mechanics would be unclear. The EU is not set up as an institution to deal with the technicalities of trade arrangements as expeditiously as the ticking clock would require: documents need to be translated into 23 languages, trade negotiators with detailed sectoral knowledge are in short supply, and while Brexit may create urgent pressures, it is not alone among the issues trade negotiators need to deal with. The EU will likely be aware that any arrangement initially entered into on a time-limited basis designed to smooth conditions around withdrawal creates precedent which makes it difficult to remove when the time-limit expires. Moreover, in the absence of a recognized regional trade agreement with the UK recognized by the WTO, the EU faces constraints that come from principles of non-discrimination at the WTO: whatever terms it is prepared to offer the UK on trade facilitation have to be available to other WTO members.

Given the above, it is likely that any trade facilitation arrangements the EU would be prepared to discuss in advance of the UK leaving the EU would be limited to a restricted number of sectors where the EU felt the most pressing need to generate continuity in the short run. In other areas, the UK will likely argue that the precedents created by the EU's facilitation agreements with others mean similar arrangements should be extended to the UK. But the UK's ability to force such agreements to be in place as it leaves the EU is weak: there will be relevant differences or absences in those arrangements compared to the UK in how they maintain regulatory convergence through time, and dispute resolution through the WTO is a notoriously slow-moving process. Hence, one can imagine time-consuming dispute between the UK and EU on the basis of where such a discussion should focus. For example, the EU would prioritize segments of financial services where it sees specific financial stability risks, the UK would want a more wide-ranging discussion for the sector. And the EU would decide exactly what resources it would put into areas such as customs processing with the same selectivity and its own interests in mind. Among the limited set of sectors, the EU would be able to address ahead of March 2019, perhaps air travel would be selected and agreement reached in time. Perhaps not.

If the basic view that the EU's commercial interests will compel it to offer the UK a "good" deal is correct, then this would express itself by concessions within the Article 50 process which accommodate the UK's objectives. Even given a transition period, the timelines in securing a successor FTA and putting the relevant systems and infrastructure in place likely extend well beyond those the May administration has in mind. But, in our view, it is an illusion to suggest the UK will find an accommodative solution from the EU outside the Article 50 process.

From Bernard Jenkin MP, 26th June 2017

"There is so much tosh being talked about the difficulty and perils of leaving the EU. There is no "cliff edge" if the UK and the EU are able to conclude a half decent agreement about arrangements for our departure – and it is inevitable that we will. There is too much at stake of mutual interest to fail in this. Some people think that "no deal" means no customs facilitation agreements, no mutual recognition of product standards, no transition to separation of institutions like the Medicines agency, no new aviation services agreements. These need prompt no great difficulty, certainly nothing more than reaching the kind of arrangements that the EU has with a

hundred or more third countries, with whom they do not have a formal trade agreement. Otherwise, the EU's largest export market, the UK, would be at risk. "No deal is better than a bad deal" means the UK should be ready to trade on the same terms as the US does with the EU on WTO Most Favoured Nation terms, and when it comes to a long term comprehensive trade agreement, but you have to believe the EU is completely insane if you think that they will cut the telephone lines, ground all UK flights in and out of the EU, and insist on checking every mini exported to the EU at the border, to see if it does in fact meet the EU's definition of "a car"." (<http://www.politeia.co.uk/we-are-on-the-brink-of-corbyn-what-does-it-mean-for-brex-it-by/>)

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