

# A Year of Tough Talks Awaits the EU and U.K.

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## Highlights

- *The United Kingdom and the European Union probably will reach an agreement on a post-Brexit transition period in 2018.*
- *A free trade agreement will be more difficult to negotiate, considering the conflicting strategic interests of Britain and the European Union.*
- *A trade agreement between London and Brussels would have to be ratified by the European Union and the United Kingdom, which could create further complications and delay its enforcement.*

The new year will be one of intense negotiations between the United Kingdom and the European Union. On Dec. 15, the European Council decided that the first phase of Brexit talks, which focused on the terms of the United Kingdom's departure from the European Union, had progressed enough to move to the next phase, which will focus on Britain's future relationship with the bloc. The EU-U.K. divorce talks were complex; the negotiations about their future ties will be even more difficult. Britain's desire to regain sovereignty in areas such as trade and immigration will clash with the European Union's goal of protecting the unity of the single market, the area where goods, people, services and capital move freely.

In the coming months, the negotiations between them will focus on two main topics: a transition period and a trade agreement. During the transition period, which would last about two years beyond Britain's departure from the European Union in March 2019, the United Kingdom would no longer be a member of the European Union but probably would still be a part of the single market. It would not have a say on EU policies but would still contribute to the EU budget and be under the jurisdiction of the European Court of Justice.

Some hard-line members of the British government oppose a transition period, because to some extent it would continue the status quo for two more years. However, the European Union and the United Kingdom will likely reach an

agreement on a transition period in 2018, because it would give companies and households in both Britain and the European Union time to adapt to the post-Brexit economic environment. Moreover, it would buy the governments in London and Brussels extra time to discuss the truly difficult problem: their future trade agreement. Trade is where the two parties have conflicting priorities and where negotiations will have to deal with several complex issues.

# THE BREXIT NEGOTIATION

■ **The single market** is the area where goods, people, services and capital move freely (the “four freedoms”).

■ **The customs union** is the area where countries share a common external tariff for imports (individual countries cannot sign trade agreements).

## The U.K.:

■ **Wants to leave** the EU single market and the customs union, to have independent trade and immigration policies.

■ **Offers to sign an FTA** (free trade agreement) that includes most goods and services; and to maintain a “regulatory alignment” with the European Union.

## The EU:

■ **Wants to protect** the unity of the single market, and to prevent other EU members from imitating the United Kingdom.

■ **Offers U.K. an option to stay** in the single market (and accept all four freedoms); or to negotiate a free trade agreement that covers most goods but not all services.

## How other countries trade with the EU

### Britain's Proposal

- U.K.-EU FTA covering most goods and services
- No contributions to the EU budget, no ECJ (European Court of Justice) or EU workers
- Can sign free trade agreements

### Norway

- Member of the single market, but not of the customs union
- Accepts EU workers; European Free Trade Association court follows ECJ rulings; contributes to the EU budget
- Can sign free trade agreements

### Switzerland

- Accepts EU workers, EU regulations, small contributions to EU budget
- Limited access to EU services sector
- Can sign free trade agreements

### Turkey

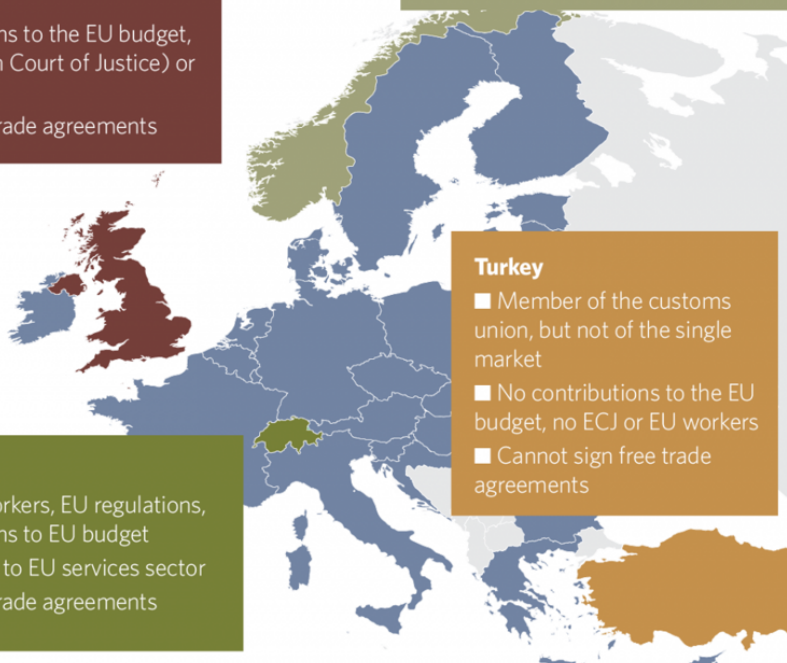
- Member of the customs union, but not of the single market
- No contributions to the EU budget, no ECJ or EU workers
- Cannot sign free trade agreements

### Canada

- FTA covering most goods but only some services
- No contributions to the EU budget, no ECJ or EU workers
- Can sign free trade agreements

### World Trade Organization

- Trade using WTO tariffs.



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## **Conflicting Views on a Trade Agreement**

The European Union wants the future trade agreement with the United Kingdom to respect the unity of the single market. The European Union opposes a deal that would allow goods, capital and services to move freely between Britain and the bloc but deny the free movement of people. This opposition is connected to a basic EU concern: Brussels wants to make sure the EU-U.K. agreement is less comprehensive than EU membership, out of fear that other countries will try to imitate Britain in the future and leave the bloc.

From the European Union's perspective, Britain could remain a member of the single market, and accept its four freedoms regarding goods, capital, services and people, or it could leave the single market and sign a trade agreement that covers most goods but not many services. The first option is known as the "Norway model," as the Scandinavian country is a member of the single market without being a member of the European Union. The latter option is the "Canada model": Canada and the European Union recently signed an agreement that covers 98 percent of the goods they trade but only a short list of services.

But the United Kingdom wants a comprehensive trade agreement that allows the free movement of goods, services and capital but leaves London free to have an independent immigration policy and sign trade agreements with non-EU countries. During the Brexit campaign, the "leave" camp promised that Britain would no longer accept EU workers, and that the country would sign trade agreements with allies such as the United States. The United Kingdom also wants a deal that allows its massive financial sector to continue trading freely with Europe. As a result, London has proposed a "creative" agreement that goes beyond the Norway and Canada models.

Switzerland offers another model the parties could try to emulate. The Alpine nation uses a hundred or so ad hoc bilateral agreements to manage its

relationship with the European Union. Through these deals, Switzerland follows EU norms and regulations on issues ranging from agricultural standards to public procurement in exchange for access to EU markets. But that model presents a problem for the United Kingdom in that Switzerland is required to accept EU workers, and Swiss financial institutions face restrictions to access the EU market (which forces Swiss firms to have offices in the European Union). This likely would make a similar arrangement not an acceptable solution for the British economy, which is heavily dependent on financial services.

## **Beyond the Existing Models**

Because of the conflicting strategic goals between the United Kingdom and the European Union, the negotiations probably will be long and complex. The United Kingdom will push to include services in the free trade agreement, but the European Union will refuse to agree unless the United Kingdom accepts EU workers. Should the negotiations linger, the United Kingdom could soften its position and offer to pay the European Union to access its services sector, to mention one possibility, or accept an annual quota of EU workers. Brussels, however, would still be skeptical of signing an agreement that could inspire other countries to leave the bloc. Moreover, some member states like France and Germany hope to attract companies in Britain's financial sector to relocate parts of their operations to the Continent because of Brexit.

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