

BREXIT UNIT

After Florence, what next?

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In narrow terms, the Prime Minister's Brexit speech in Florence can be judged against two tests. First, will the offers on the financial settlement and citizens' rights represent 'sufficient progress' to allow talks on the future relationship to begin at last? And second, will the plan for a two-year transition period be enough to ease the widespread fears about a cliff-edge departure?

In both cases, the speech is a helpful step forward, even if more will be needed. Criticisms that the speech lacked substance, merely 'kicks the can down the road', or is a 'betrayal of Brexit', all seem unfair.

But it is also important not to lose sight of the bigger picture. Above all, any transition period must only be a stepping stone. The final destination should be a new and comprehensive free trade deal with the EU that also permits the UK to have a more open relationship with the rest of the world and smarter regulation at home. This surely means leaving both the Customs Union and the Single Market well behind.

Still all to play for

Mrs. May's latest speech on Brexit, given in Florence on 22nd September, provides some welcome clarity on the UK's preferred transitional arrangements and puts the ball back firmly in the EU's court. The speech was also refreshingly upbeat about the future relationship. However, the result of the match remains in doubt.

Forgetting the politics and personalities for a moment, the Brexit talks have actually been making some important headway (particularly on the status of Northern Ireland and citizens' rights). But the EU has created a stumbling block by refusing to discuss the future economic relationship with the UK until there has also been 'sufficient progress' on the financial settlement. This has made it impossible to begin negotiations over a new and comprehensive free trade agreement, or the transitional arrangements that will apply in the interim. The first test of the speech is therefore whether the opening offer on the 'divorce bill' helps to break this deadlock.

The financial settlement

Here, the Prime Minister has effectively offered to continue the UK's annual payments until the end of the current EU budget period in 2020. This is consistent with what the IEA Brexit Unit proposed back in June and implies a final bill of around €30bn (£26bn) once a few extras such as pension contributions are included. Note that the UK would have to pay this amount anyway if it remained an EU member. The 'divorce bill' is therefore not an additional cost of leaving.

- The Prime Minister's speech in Florence was primarily, of course, a piece of political theatre. But it would be wrong to say it contained nothing new, or of substance.
- For a start, Mrs. May signalled for the first time that the UK would be willing to continue to pay financial contributions until the end of the current EU budget period (in 2020).
- What's more, in addition to guarantees already offered on citizens' rights, she said she wants "UK courts to be able to take into account the judgments of the ECJ".
- Finally, she confirmed that the UK would be seeking a transitional period of 'around two years'. But she rejected continued membership of the European Economic Area (effectively 'the Norway option'), in favour of a bespoke deal tailored to the UK's interests.

Nonetheless, the EU must offer something in return. After all, the UK would be on strong legal ground if it decided to walk away without paying a penny. 'No deal' is still preferable to any arrangement that burdens the UK with the costs and constraints of EU membership for the foreseeable future.

The transition

The Prime Minister has linked this financial offer to a transition period of 'around two years'. This would retain some – but not all – of the elements of both the Single Market and the Customs Union. Some have concluded that Brexit is being delayed until 2021, or even that those who voted for Brexit are being 'betrayed'. The latter is surely too strong.

A clean break in March 2019 would enable the UK to start exploiting the benefits of Brexit straightaway. But it could also be the riskiest option, especially given the potential disruption to trade from non-tariff barriers. There are valid concerns, for example, about the readiness of the customs technology that needs to be in place. It will also take time to implement new immigration systems. What's more, whether justified or not, fears about a cliff-edge Brexit are already holding back investment in the UK and prompting some firms to relocate.

The second test of the Florence speech is therefore whether it helps reassure businesses. The initial responses have mostly been positive, but the long lead times in corporate decision-making mean that some more tangible progress is probably required by the end of this year.

Equally, though, it would be premature to conclude that a transition period simply 'kicks the can down the road'. An additional two years after March 2019 (making three and a half in total from now) should be long enough to agree a new and comprehensive free trade deal. The aim would be to negotiate a bespoke deal for the UK, rather than settle for an off-the-peg arrangement that simply replicates the position of Norway or Switzerland.

Many devils in the detail

Admittedly, the details of the transition still need to be worked out. The entire world already has 'access to the Single Market', so for this to be worth paying for the UK's access must at least be tariff-free. This begs the question of the obligations that would come with this – including the acceptance of 'free movement' and the application of EU regulations to the whole economy, not just that part which exports to the continent.

Similarly, continued membership of some form of Customs Union would help to minimise non-tariff barriers. But it would also delay the point at which the UK can implement its own free trade deals with the rest of the world, or be able to lower prices for UK consumers by cutting tariffs on imports unilaterally.

A two-year wait here is not a game-changer, especially if the UK is freed from the obligation to adopt any new EU regulations and is able at least to *negotiate* trade deals straightaway. These should be 'red lines'. Brexit is also a once-in-a-generation opportunity to reshape the economy, so it is surely worth spending another two years to get it right.

Nonetheless, it is hard to see how the UK can make the most of the opportunities of Brexit without leaving both the Single Market and the Customs Union well behind. It is therefore essential that any transitional arrangements are indeed time-limited and not a backdoor to continued EU membership. Compared to this, the precise amount of the financial settlement or the length of the transition period are a sideshow.

Over to EU

Finally, all this depends on the EU showing some flexibility too. The EU will still have to decide whether the Prime Minister's offer on the financial settlement and further commitments on citizens' rights represent the 'sufficient progress' necessary to begin to discuss the future economic relationship. We should learn more as the talks resume this week. But the Florence speech is at least an important step forward.

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- Many would argue that the UK should just make a clean break in March 2019 and cease payments to the EU budget then too.
- Indeed, the option of simply walking away with 'no deal' is still preferable to any arrangement that burdens the UK with the costs and constraints of EU membership for the foreseeable future.
- Nonetheless, a short transitional period would not be a 'betrayal of Brexit', nor would it simply be 'kicking the can down the road'.
- It could bridge the gap before a comprehensive free trade deal can be agreed between the UK and the EU, minimising both tariff and non-tariff barriers in the interim.
- However, the size of the financial settlements and the details of any transition are sideshows compared to the much bigger issue of the long-term relationship. It is hard to see how the UK can make the most of Brexit without leaving both the Single Market and the Customs Union well behind.