



## Theresa May and her six-pack of difficult deals

by Charles Grant

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**Britain's exit from the EU will require not just a single deal, but at least six interlocking sets of negotiations. If the British government wants the talks to run smoothly, it will need to earn the goodwill not only of the countries in the EU, but also of those in the World Trade Organisation (WTO).**

The Brexit negotiations will take much longer and be far more complicated than many British politicians realise. One set of talks will cover Britain's legal separation from the EU, the second a free trade agreement (FTA) with the EU, the third interim cover for the UK between its departure from the EU and the entry into force of the FTA, the fourth accession to full membership of the WTO, the fifth new FTAs to replace those that currently link the EU and 53 other countries, and the sixth co-operation on foreign, defence and security policies.

The first deal, the divorce settlement prescribed by Article 50 of the Treaty on European Union, will divide up the properties, institutions and pension rights, and deal with budget payments. It will also cover the rights of UK citizens in the EU and vice versa. The treaty sets out a two-year period for this negotiation, extendable by unanimity. The 27 want Britain out before the June 2019 European elections, and before talks on the EU's next seven-year budget cycle get underway (the current cycle ends in 2020), so will not extend the two years. Article 50 was designed to put the departing country at a disadvantage: once the two-year clock starts ticking it is under pressure to strike a bargain, lest it leave the EU without the protection of any new legal framework.

The second deal will be some sort of FTA, probably similar in scope to that recently negotiated by Canada and the EU. The much-discussed 'Norwegian model' is not viable: Norway, as part of the European Economic Area (EEA), participates in the single market, but pays into the EU budget and has to accept free movement. The latter condition, and perhaps the former, would be unacceptable to the British Parliament. Although most MPs supported Remain, many of them now believe that the referendum result means that free movement must be restricted.

But even a Canadian-style FTA will require the British government to make painful trade-offs. The FTA may well eliminate tariffs on manufactured goods – but only if the UK agrees to comply with

EU environmental, social and health and safety rules; otherwise the 27 would worry about unfair competition or 'dumping' by British firms. The UK's FTA, like that of Canada, will probably provide only limited access to the single market for services. In return for deeper access, the 27 would ask the UK to accept free movement, budget contributions and the relevant EU rules. Therefore UK-based financial firms will almost certainly lose the 'passporting' that currently enables them to do business across the EU whilst being UK-regulated. Other industries would suffer, too, such as tourism, accountancy, law, air transport, freight and shipping. Like Canadian firms, British ones would probably have limited access to European public procurement markets, and vice versa, to the detriment of taxpayers on both sides. As a general principle, the UK will gain fuller access to European markets to the extent that it retains existing EU regulations and directives.

Both the European Commission and Donald Tusk, the president of the European Council, have said that work on the FTA should not start until the UK has left the EU. Perhaps they worry that if the UK negotiates on trade while still an EU member, it will be a more awkward customer. But their hard line would extend the period of uncertainty afflicting the UK economy. Many member-states, including Germany, suggest that the UK be allowed to work on the FTA at the same time as the divorce settlement. That softer line will probably prevail, but in any case the FTA will take many more years to negotiate and ratify than the Article 50 deal (which does not require ratification by the member-states); the EU-Canada FTA took seven years to negotiate and may take many more years to ratify in national parliaments. So there will be a period of several years between Britain leaving the EU and the FTA coming into effect.

That gap requires a third negotiation, for an interim deal. Without such a deal, British companies would face great uncertainty and depend on WTO rules – which set maximum levels for tariffs – to prevent unfair decisions or practices by EU countries. One possible interim solution, floated by the eurosceptic MEP Daniel Hannan, would be for the UK to become an EEA country for a limited period, while it works on the FTA (technically, the UK would have to join EFTA, the European Free Trade Association, in order to make EEA membership work). But ardent British eurosceptics might jib at the price of EEA membership – substantial budget payments, free movement of labour, most of the EU's single market rules and judgements by the EFTA court. Furthermore, the existing EEA countries (Iceland and Liechtenstein, in addition to Norway) show little desire to reconstruct their own treaties and institutions to accommodate temporary British visitors.

So there will probably be a bespoke interim deal to provide temporary cover to the British economy. Anand Menon and Damian Chalmers have suggested one possible model in a paper for Open Europe. Britain would be able to repeal EU laws and shun European Court of Justice rulings, but face the prospect of countermeasures from the EU. Menon and Chalmers would limit free movement to those with job offers, and exclude families of EU migrants unless the wage-earner's income passed a certain level. Britain would stop paying into the EU budget but make direct payments to poorer member-states. Some of the 27 would consider this scheme too soft on the British: they do not want the process of exit to be seen to be pain-free, lest others try it. There will certainly be much haggling over the terms of the interim deal, which will, among other things, phase out Britain's participation in EU policies and programmes.

The fourth deal that May needs to strike is attaining full WTO membership. Britain is currently a member via the EU. Full members must deposit 'schedules' of tariffs, quotas, subsidies and other concessions on market access with the WTO. The UK will have to negotiate its own schedules, initially with the other 27. The tariff negotiation could be simple, if the British followed what the EU currently does. But dividing up quotas, on say New Zealand lamb imports, would be more complicated. And then the new British

schedules would need the approval of all 163 WTO members, since the organisation's decisions require consensus. So if one member (for example, Argentina or Russia) wanted to create difficulties, it could block the British schedules. British officials hope that such difficulties do not arise, but reckon that it will be hard work to sort out WTO membership within the two years of the Article 50 negotiation.

The fifth negotiation concerns the series of deals that must be struck with the countries that have FTAs with the EU. By some counts there are 53 such countries, including Algeria, Singapore, Israel, Vietnam, South Korea and Mexico. During the referendum campaign, some Leavers claimed that the 1969 Vienna Convention on the Law of Treaties means that, post-Brexit, the UK will still benefit from these FTAs. But that does not work legally: the day that Britain leaves the EU, the FTAs cease to apply to it. The UK will have to scramble to cut its own bilateral deals with these countries, before it exits the EU. Most of the 53 will probably do their best to be helpful. But some may be difficult, perhaps because they have particular industries that face competition from the UK.

This work on bilateral FTAs will keep Britain's embryonic Ministry of International Trade busy. At the time of the referendum, the British government employed no more than (by its own count) 12 to 20 trade negotiators. It is now hurrying to recruit many hundreds more, from friendly countries and the private sector. If one listens to the rhetoric of some Conservative ministers, Britain will soon be striking bilateral trade deals with dozens of states with which the EU has not yet completed FTAs – such as the US, China, India, Australia and New Zealand.

But this is highly unlikely, for legal and practical reasons. So long as the UK is part of the EU, it cannot legally complete an FTA with another country. It can talk about talks. But given that its current capacity for trade negotiations is limited, its priority will have to be salvaging the bilateral deals with the 53 countries that it risks losing, as well as forging the big FTA that it needs with the EU.

In any case, countries like the US, New Zealand or China will simply not want to negotiate an FTA with the UK until they know what Britain's relationship with the EU is likely to be. Which bits of the single market, if any, will the UK be in? Which parts of EU competition law will apply to the UK? Once Britain has left the EU's customs union, what 'rules of origin' will Brussels apply, so that other countries cannot use the UK as a way of circumventing EU restrictions on their exports? Would regulatory harmonisation between the EU and the UK make convergence between the UK and other countries impossible?

On July 25th Michael Froman, the US Trade Representative, said that "as a practical matter, it is not possible to meaningfully advance separate trade and investment negotiations with the UK until some of the basic issues around the future EU-UK relationship have been worked out." But as Jack Schickler has written for InFacts, "the terms of our EU deal may not be certain till the end of the process". In any case, Britain's partners will not want to deal with it until it is a full member of the WTO. The New Zealand government is one that has said it does not want to broach an FTA until the UK has sorted out its relationship with the WTO.

The sixth negotiation will cover UK-EU ties in areas like foreign and defence policy, police and judicial co-operation and counter-terrorism. As I have written elsewhere, on these dossiers the UK is in a relatively strong position. It has important diplomatic, intelligence and military assets that can be useful to its partners. The British are likely to ask for mechanisms that allow them to feed their knowledge and expertise into EU deliberations – similar to those which the US already has with the European External Action Service, or Norway with Europol. At the moment several of the 27 oppose giving the UK formal

links to EU foreign policy-making machinery, as opposed to informal channels, though that may change when emotions subside. There would be a mutual self-interest in creating consultation mechanisms – though the UK must accept that it will have much less influence on EU policy-making than it has today.

At least one senior figure in May's government has floated the idea of linking the security dossiers with the EU-UK trade agreement. The suggestion is that, because Britain has just strengthened its commitment to the defence of the Baltic states and Poland (supplying a battalion of troops), these countries should work hard to secure a good trade deal for the UK. It is perfectly legitimate for the British to hope that their security policies generate goodwill. But if they imply that they are defending Eastern Europe in order to engineer a better FTA, rather than because they care about democracy and deterring bullying by Russia, they will rapidly lose credibility in the region.

In order to reach outcomes that are half-decent from a British point of view, Theresa May's government needs to earn the goodwill of her 27 EU partners, and the EU institutions – including the European Parliament, which must vote on both the Article 50 divorce settlement and the FTA. But her ministers will also need to charm many other governments across the world, if they want the WTO talks and the FTA negotiations with non-EU countries to run smoothly. Hopefully, the three leading Brexiteer ministers – David Davis, Liam Fox and Boris Johnson – will understand the point. If they resort to thumping the table and threatening other governments, they will delay the deals they need. The longer the British government takes to complete these many negotiations, the worse the uncertainty for the British economy. So May's government will have incentives to compromise.

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