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Understanding Brexit: Charting the Challenges

This is an updated version of an article first published by Anne McNaughton, Annmarie Elijah and James Cameron in the August 2016 edition of the *NSW Law Society Journal*.

Introduction

Despite the respective promises of the Remain and Leave campaigns, the UK economy has not collapsed and the NHS is yet to receive £300 million more a week. Instead, months on from the British people's decision to leave the European Union, the outlines of a genuine post-Brexit world are beginning to emerge. This policy note seeks to summarise the key issues that Theresa May's government and the European Union will face in the coming years as they seek to negotiate a settlement amenable to both sides.

Article 50

The provision dealing with the withdrawal of a State from the EU is article 50 of the *Treaty on European Union* ('TEU'). Much has been said and written about this provision, particularly concerning the two year time frame for negotiating the withdrawal arrangements between the EU and the UK.

Time starts to run from the date that the Member State in question notifies the European Council of its intention to withdraw. Unless and until the Member State notifies the European Council formally of this intention, time does not run under article 50 and the Member State (the UK in this instance) remains a full member of the EU. Given the complexity of the internal and external issues related to withdrawal, it is clear why the UK government is taking its time to issue a formal notification to the European Council.

What has not been reported is the fact that article 50 also allows for an extension of time for negotiations to continue beyond the two year period, provided both the Member State in question and the European Council unanimously agree to such an extension. In the interests of certainty, the possibility of such an extension has understandably been downplayed. Depending on how the negotiations play out, it may be that such an extension is necessary. At this early

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stage however, it is impossible to predict whether or not whether or not such an extension would be sought or agreed upon by the UK and the EU27.

Lastly, notwithstanding the hopes of some repentant Brexiteers, it is almost certain that the UK will eventually trigger article 50, with Prime Minister May repeatedly and publicly asserting that 'Brexit means Brexit.' Likewise, her appointments of Boris Johnson as Foreign Secretary and David Davis as Secretary of State for Exiting the European Union, both leading Brexit campaigners, suggest she will follow the result of the referendum and ultimately negotiate an exit.

Post-Article 50

On close inspection there are two separate tasks involved following the triggering of article 50: working out the precise terms of the UK exit, and sorting out the arrangements for UK-EU relations after that time. The nature of the post-Brexit relationship between the UK and the EU27 depends entirely on the terms that the UK is able to obtain from the EU27. The UK is heavily integrated into the single market and dependent upon trade with the EU. It will find itself (once again) on the receiving end of EU terms and conditions.

Before negotiations with the UK even commence, the position could be hard fought among the EU27. Assorted models have been put forward for the UK-EU relationship post-Brexit: the Norwegian, Swiss and Turkish models, or a standard bilateral trade agreement. These models may have some relevance. It is also possible that none of these will neatly fit the bill: there is no precedent for a 'post-regional' arrangement among states following a sustained period of economic and political integration over four decades. Whatever the model, there are a number of key areas that will have to be settled before the UK can complete an exit from the EU.

Free movement of goods

The free movement of goods represents arguably the most integrated part of the EU, and it will thus be a key area of negotiation with the UK. Ensuring the access of British goods to the EU is a central concern for May's Government, but it is also an issue for many other EU-member states for whom the UK is an important export market. The consequences for both sides will be significantly different depending on the model that the UK and the EU choose to pursue.

A possible consequence of the UK leaving the EU could be the reinstatement of tariff barriers between the two. This would raise a number of potential problems for both parties. In particular, determining the rate of tariff for each traded good, to be put in the schedules with the WTO, would be difficult. The Single Market's value and the composition of its internal trade and production would be substantially altered by the exit of the UK, meaning it may need to revisit the current tariffs it sets with the world, including with Britain. In contrast, the UK has not had its own tariffs in several decades, and would need to set about the complex task of erecting them. Aside from these costly and difficult administrative issues, the reimposition of tariffs would considerably increase transaction costs for companies trading between the UK and the EU. However, it is notable that EU tariffs on manufactured goods are generally low, though car manufacturing, an important sector in the British economy, would face a tariff of 10%. In contrast, agricultural products are covered by substantially higher tariffs, such as lamb at 40%.¹ Lastly, the UK's task of disentangling itself from the most integrated area of EU law would be immense. This would include replacing the multitude of EU directives and regulations that govern the movement of goods in and out of an EU member state. Likewise, as a member of the EU, the UK is party to more than 50 trade deals, which would need to be individually renegotiated. Thus, leaving the Single Market in favour of trading under WTO rules would potentially be a costly decision, although it would allow May's Government to say it is taking back control over law-making, a key demand of Brexit campaigners.

The simplest option would be for the UK to seek to remain in the European Economic Area (EEA), which is the basis of the Single Market, without being a member of the EU. This would leave the UK in a similar position to what it is in today, governed by a large number of EU regulations and directives and bound to accept the four freedoms of the Market. This latter issue may make the EEA model unpalatable to the UK, as it requires accepting the free movement of people. In addition, there is some debate over whether the UK is a member of the EEA already in its own right (and hence could 'remain') or whether its membership is a result of being in the EU. If the latter situation were held to be the case, it would mean that the UK would also need to negotiate re-admission to the EEA in its own right, rather than as a member of the EU.

Free movement of people

A key issue during the Brexit campaign was immigration and its frequent conflation with the free movement of people within the EU. For many voters, immigration was an important concern in their vote to leave. In light of this, Prime Minister May has promised that she will deliver 'some controls' for Britain over free movement within the Single Market.

Such compromise is unlikely, as the free movement of member state citizens within the EU is one of the four fundamental freedoms. Indeed, French President Francois Hollande has said that the UK's access to the Single Market is dependent on accepting the four freedoms, including movement of people.² Likewise, the President of the EU Commission, Jean-Claude Juncker, emphasised that free movement is integral to the Single Market, and that the UK had to accept the aspects of the Market 'without exception or nuance.'³ Aside from these many public assertions from EU leaders, it would be damaging for the EU's legitimacy and unity if it were to compromise on the free movement of peoples. In particular, it would allow other Eurosceptic parties to demand similar concessions, likely strengthening the position of Marine Le Pen in France and Geert Wilders in the Netherlands. Both countries have elections next year. Thus, should the UK maintain its current position on freedom of movement, the possibility of the UK successfully being able to pursue the EEA option is limited.

Aside from resolving the position of new EU migrants to the UK, it is necessary to address the place of more than three million non-British EU citizens currently residing in Britain. Despite the promises of Vote Leave campaigners that 'there will be no change for EU citizens already lawfully resident in the UK,'⁴ it is evident that something will need to be negotiated that guarantees their position in law. There are also 1.3 million British citizens in other EU states, whose interests will also need to be reflected in negotiations.

¹ <http://www.theguardian.com/politics/2016/sep/13/david-davis-admits-possibility-of-uk-exiting-eu-without-trade-deal>

² <http://www.belfasttelegraph.co.uk/news/eu-referendum/brexit-uk-cant-be-in-single-market-without-freedom-of-movement-says-francois-hollande-34902753.html>

³ <http://www.express.co.uk/news/uk/692868/Britain-Brexit-Jean-Claude-Juncker-EU-referendum-leave-European-Union>

⁴ <http://www.theguardian.com/politics/2016/jun/24/what-does-brexit-mean-for-eu-citizens-in-britain-and-brits-in-europe>

Free movement of capital and services

The free movement of services and capital are the final two fundamental freedoms, often overlooked and certainly less integrated than goods and people. Nonetheless, for a services-based economy like the UK, Brexit presents a range of complications. This discussion is premised on the UK being unable or unwilling to access the EEA.

The financial services industry is particularly vulnerable to any change in the UK-EU relationship. Britain has over 2.2 million people employed in the financial services sector, and the sector is worth \$260 billion dollars to the British economy annually. Over the past two decades, the EU has been central in taking over the regulation of cross-border financial transactions, utilising a large number of directives and regulations to reduce transaction costs for the provision of cross-border financial services.⁵ Since 1999, the EU has created 'a single market by enabling financial services firms authorised in one Member State (their home state) to carry on business in any other Member State (a host state) without the need for a separate host state authorisation either by establishing a local branch or on a cross-border basis.'⁶ This system is known as 'passporting', and its end would have considerable effects on firms in the UK. In particular, banks have expressed concern that they would be adversely affected, meaning many would look to move their headquarters out of London so as to be within the EU's unified regulatory system and to avoid the need for multiple branches.⁷ Dublin, Frankfurt and Paris have been suggested as potential beneficiaries of British firms losing the right to passporting.

The Unexpected

Aside from the issues discussed above, there is also the possibility of external or internal pressures affecting the UK's negotiating position. For example, there have been calls for a general election in the aftermath of David Cameron's resignation and his replacement with Theresa May.⁸ Though it is unlikely that May is supportive of that proposition, and is restricted by the *Fixed-term Parliaments Act 2011*, it is possible that pressure from the media or a potential split in the British Labour Party may alter her calculation. Contending with an election would sap resources from negotiating efforts and would likely effect any timetable for triggering Article 50 or finalising an exit from the EU. Another potential internal issue would be the election, albeit unlikely, of Labour candidate Owen Smith to the Labour leadership. Smith has promised a second referendum on any proposed EU-UK settlement. Negotiations and a UK exit could be transformed if Smith were able to generate enough pressure on the Government by arguing that it needed to put the EU-UK settlement to a vote. Unlikely though this result is, it was a similar argument from UKIP and Tory backbenchers that contributed to Cameron's decision to call the Brexit referendum in the first place.

Conclusion

This policy note outlines a difficult situation consisting of a multitude of complex and interconnected issues. Without careful collaborative management, the British exit from the EU could leave a lasting negative legacy for the European Union and the United Kingdom, threatening the unity of both and prosperity of their citizens.

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