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# A Path to Brexit Agreement

Finding a landing zone  
for a compromise

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# A Path to Brexit Agreement: Finding a landing zone for a compromise

## Executive Summary

- 1. The UK and the EU are now at a critical juncture in Brexit negotiations.** With less than six months to go before the UK is due to leave the Brexit transition period, British and European negotiators are now trying to find an acceptable deal on their long-term relationship. The task before them is immense: By the end of this year, they have to find an agreement, ratify it in their respective parliaments and implement it on the ground. If they fail to do so, the UK would leave the transition period without any negotiated future agreement. Such an outcome, particularly when the UK and European economy are facing a deep recession, would be deeply damaging for both sides and must be avoided at all costs.
- 2. There is a serious risk now that, unless both sides shift from their absolutist positions, the negotiations will continue to be mired in a deep disagreement that ultimately leads to a breakdown.** So far, the negotiations have stalled on political disagreements over several sensitive issues, including on “level playing field”, governance, fisheries and security cooperation. These issues are more political than technical in nature and require further political intervention for their resolution. If the UK and the EU are serious about finding a deal by the end of this year, they must put aside grand principles and start looking for a compromise.
- 3. It is possible to envisage an eventual route out of disagreement, but the landing zone for a deal is narrow and requires compromises on both sides.** For a compromise, the EU would need to move away from its hard position on state aid, and on fisheries. The UK, on the other hand, would need to propose a more forward-leaning offer on level playing field, accepting that a deal requires more binding assurances to the EU that its future domestic actions will not open up wholesale deregulation of its economy. These should be based on treaty-based commitments on what the UK will do domestically on state aid and environmental and labour standards, and how those will be enforced in practice. The UK should also show the way on governance and structure of the relationship. More concrete solutions to these issues are set out in the table on page five.

4. **If there is a deal, it will be a thin and asymmetrical preferential trade agreement.**  
The type of trade agreement being negotiated would prevent any future tariffs and quotas on manufactured goods but offer precious little for avoiding regulatory differences and enabling services and digital trade. Economically, this deal will favour the EU, which has a large surplus in goods trade, more than Britain, whose ability to sell cross-border services will be severely hit by this deal. This asymmetry will be further reinforced due to commitments made under the Northern Ireland protocol, which will see EU exporters facing lower costs to trade between the EU and the UK, particularly if the Government wants to avoid any regulatory barriers in the Irish Sea. However thin and asymmetrical the future deal, it avoids the fracturing of long-term UK-EU relations and provides a platform to rebuild their relationship in future. It is still better than no deal.
5. **Time is extremely limited, and even with all the best efforts, it is unrealistic to expect that the future relationship can be agreed by the end of this year.** The UK and the EU have less than six months to find a political compromise, iron out all the technical detail, ratify the deal in their respective legislatures, and make sure that businesses are ready in time for the biggest change in trading arrangements in more than four decades. In rushing through a quick agreement, the two sides risk not just that many businesses would not be ready for the new trading arrangements, but also that their agreement would lead to legal and political difficulties that would have negative consequences further down the line.
6. **If UK and EU leaders are serious about finding a deal by the end of this year, there are three key steps they must consider now:**
  1. **Give flexibility to negotiators to explore technical compromises to key issues.**  
There are credible technical solutions that can help facilitate a deal, but negotiators need the political cover to explore them in the negotiating room. Both the UK and the EU should allow their negotiators to interpret the political mandates more flexibly.
  2. **Aim for an "in principle" political deal to be concluded by the autumn rather than a full-fledged treaty.** The agreement should articulate not only common objectives – as the joint political declaration did, to no avail – but also concrete solutions across all areas of the future relationship.
  3. **Agree to a time-limited standstill implementation period, for up to 12 months, conditional on reaching an in-principle agreement by the autumn.** This would not be a blanket extension to the transition period – which the UK government has already rejected – but a time-limited standstill period allowing both sides to complete ratification and domestic preparations, as well as to give businesses the time they need to get ready for the new trading arrangements. Failing to agree to such a time-limited standstill period when the UK and European economies are facing a deep recession following the Covid-19 pandemic would be a grave mistake.

Table 1 – Summary of possible solutions to key negotiating issues

Negotiating area	Problem	Possible solutions
<b>Level playing field</b>	<p>The EU insists that any trade deal must include robust level playing field (LPF) guarantees, especially on state aid and labour and environmental rules. According to the EU, the UK's geographical proximity and trade volumes require greater protection than other trading partners with a similar level of market access. In contrast, the UK argues that any LPF commitments should be strictly proportionate to the level of market access. The UK has proposed provisions on subsidies, competition, environment and labour standards, but it argues that those should mirror a more conventional FTA and, under no circumstances, bind the UK to ongoing alignment with EU rules.</p>	<p>There are two broad preconditions to finding a compromise on LPF.</p> <p>One is on the UK's side: The UK needs to be able to engage more constructively with the EU's concerns with a more forward-leaning offer, on both state aid and environmental and labour rules. It should also consider its own defensive interests in making LPF commitments more enforceable, particularly in light of recent developments that have seen the loosening of the EU's state-aid regime.</p> <p>The second is on the EU's side: It needs to shift from insisting on dynamic alignment on state aid and look for an arrangement that could provide a similar level of protection through other means – particularly through domestic law and appropriate enforcement – and which would be counterbalanced with robust enforcement and remedial measures.</p>
<b>State aid</b>	<p>The EU has asked the UK to continue dynamically following its state-aid rules in order to prevent risks of trade distortion in future. These rules would be enforced domestically in the UK, but they would be under the ultimate jurisdiction of the European Court of Justice (ECJ). The UK wants a much looser arrangement following the WTO anti-subsidy rules, with notifications between the UK and the EU on subsidies and potential risks.</p>	<p>Agree to a reciprocal commitment that would oblige both sides to maintain an effective domestic anti-subsidy regime after the end of the transition period. As a result, the UK would be under a treaty obligation to develop, and to maintain, its own state-aid regime. This would be underpinned by further obligations, including:</p> <ul style="list-style-type: none"> <li>(i) Agreement on “common objectives” which would be defined in the treaty and guide the operation of the domestic regime and its procedures;</li> <li>(ii) Obligation to ensure robust enforcement of the domestic anti-subsidy regime, including by an independent regulator in the UK (e.g. the CMA); and</li> <li>(iii) A system of remedial measures to ensure that any short-term risks of trade distortion could be compensated.</li> </ul>

Negotiating area	Problem	Possible solutions
<b>Environmental and labour standards</b>	<p>The EU wants the UK to maintain existing “common standards”, which would be set out by EU law at the end of the transition period. These standards should be enforced domestically. The UK seeks a softer “non-regression” clause, with a trade distortion test so that only measures that “encourage trade and investment” would be in scope. Its commitment, unlike the EU’s, wouldn’t be subject to dispute settlement.</p>	<p>Agree to a reciprocal commitment that would oblige both sides to maintain their existing level of protections on labour and environment, set by domestic laws of each party at the end of the transition period. The UK would likely need to commit to enforcement of the existing protections by independent domestic bodies, in both labour and environmental protection, with the powers to hold the UK government to account.</p>
<b>Fisheries</b>	<p>The EU has asked for reciprocal access to each other’s waters and stable fishing quota shares, similar to the status quo. The richer fishing grounds are in the UK’s waters, so this is a key interest for several EU member states. The UK, in contrast, seeks full control over its waters, with annual negotiations on access to UK and EU waters, but it also needs continued access to EU markets for its fish products.</p>	<p>Agree to an arrangement that balances the UK’s objective to secure a larger share of fishing opportunities and catch limits for its vessels with more preferential access for EU vessels to UK waters. This could be underpinned by a set of “common principles” governing access to the waters, joint management structures, and periodic renegotiations of quotas. Appropriate remedies for breaches of the fisheries agreement should be included, including by suspending market access arrangements for fish products.</p>
<b>Governance</b>	<p>The EU seeks a single all-encompassing treaty, with a common institutional framework providing the same governance structures for the whole relationship. The UK, however, wants separate agreements, covering trade, security and other bilateral issues – each with its own governance arrangements proportionate to the nature of cooperation.</p>	<p>Agree to an overarching institutional framework governing the whole relationship that would provide for a common way of managing the agreements and resolving disputes. Different parts of the agreement should be allowed more bespoke dispute settlement provisions. This framework could be part of a single overarching agreement or a freestanding institutional framework agreement. Final legal structure should be guided by ratification considerations.</p> <p>If the agreement contains provisions of EU law, a reference procedure from independent arbitration to the ECJ would be necessary for interpretation of questions of EU law within the agreement. The UK’s concerns can be minimised by restricting the scope of this procedure to those parts of the agreement where EU law is directly referenced.</p>

Negotiating area	Problem	Possible solutions
<b>Future security cooperation</b>	The UK and the EU agree on the need to continue close security cooperation, including on data exchange for criminal matters and extradition. They disagree on the conditions for this continued cooperation: The EU says that the UK should respect a role for the ECJ in the agreement and continue adhering to the European Convention for Human Rights within its domestic law.	Agree to a human-rights safeguard as one of the “essential elements” underpinning the future agreement, linked to appropriate sanctions for any potential breaches.

# Introduction

The UK and the EU find themselves at a critical juncture of the Brexit negotiations.

When the new phase of negotiations on the long-term EU-UK relationship began in March, the world looked different from today. The UK had just officially left the European Union on 31 January; its economy was predicted to grow by 1.4 per cent of GDP in 2020<sup>1</sup>; and the country was ready to move on from the divisive saga of the past four years. Today, and less than six months before the end of the Brexit transition period, the two sides are far apart on most sensitive issues in the negotiation; the British government doesn't want to prolong the transition period beyond the end of this year; and the country is facing the prospect of a disruptive no-deal in addition to the gravest post-war economic slump, which is estimated to shrink the UK economy by 11.5 per cent this year.<sup>2</sup>

While Covid-19 has profoundly changed the context within which the negotiations are taking place, both sides appear as if nothing has changed. The UK and the EU still have until the end of the year to finalise an agreement, ratify it in their respective parliaments, and make sure that businesses are ready for the biggest change in trading arrangements in nearly five decades. The British government is also facing an additional hurdle of preparing new arrangements for trade between Northern Ireland and the rest of the UK, which it agreed to as part of the withdrawal agreement package. If there is no negotiated agreement on 31 December 2020, the UK will leave the transition period with no deal on their future relationship.

Following the June political summit between the UK and the EU, UK Prime Minister Boris Johnson and European Commission President Ursula von der Leyen agreed to inject “new momentum” into the stalled negotiations to accelerate the talks with face-to-face negotiations. Their objective now is to reach “an early understanding on the principles underlying future agreement” later in the summer.<sup>3</sup> This, they hope, will help them reconcile some of the key differences and guide them towards a zone of possible agreement.

Yet, for all the new momentum in the discussions, the last two rounds of face-to-face discussions between Michel Barnier, EU chief negotiator, and David Frost, his UK counterpart, delivered no progress.

Their disagreements remain serious and substantial.

As both sides try to navigate the narrow space for a deal in the coming months, this paper examines options for a landing zone for a possible compromise between the UK and the EU. It begins by explaining the key differences of view between the two sides. It then sets out possible solutions to each of the areas of disagreement, including on level playing field, governance, fisheries, and cooperation on law enforcement and security. Finally, it concludes with a proposal for an “in principle” political agreement, providing negotiators with a proposal to move the talks forward and unlock agreement.



# Where We Are Now (and How We Got Here)

The negotiations between the UK and the EU have reached a stalemate. Since the talks on the long-term trading and security relationship began in March, the two sides have held several negotiating rounds, published their respective drafts of the future treaty and began their work on implementing the withdrawal agreement. More recently, they have accelerated the talks with face-to-face discussions between chief negotiators Michel Barnier and David Frost and their closer teams. Yet, the negotiations remain mired in disagreement over several sensitive issues: level playing field, fisheries, governance and future security cooperation. This section sets out key differences between the UK and the EU and explains the sources of their disagreement.

## The UK and the EU have similar expectations for future market access

One of the defining features of the past three years has been a lack of clarity about the shape of the UK’s eventual relationship with the EU. Now, for the first time in the Brexit process, the UK and the EU have broadly similar expectations of what their future relationship should deliver in terms of access to each other’s markets.

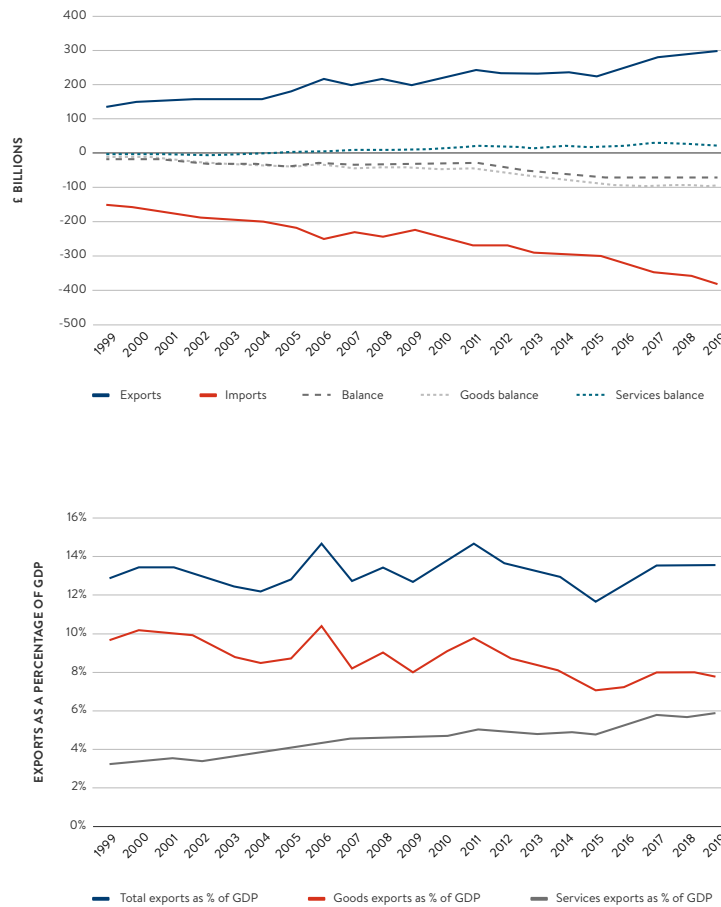
The UK has said that it wants a simple free trade agreement (FTA) that would allow businesses to trade goods without tariffs and quotas. Boris Johnson, unlike his predecessor, Theresa May, doesn’t want a “bespoke deal” allowing for mutual recognition of regulations or continued alignment to EU rules. The promise of a “deep and special partnership” by his predecessor has been replaced by a conventional free trade agreement that

offers a little more economic integration than the EU’s agreement with Canada or Japan. The EU’s proposals, too, reflect a very standard free trade agreement, with no tariffs and quotas on manufactured goods, but precious little on closer integration in areas such as services and regulations.

There are some differences in the market access offer of the two sides. The UK has become a demandeur on services, asking the EU for more ambitious commitments on the recognition of professional qualifications and cross-border movement of services professionals.

The EU, on the other hand, has narrowed its ambition across some areas, even below the standard agreed in its most recent FTAs. The quid pro quo for tariff-free market access, in the EU’s view, are obligations on level playing field.

Figures 1A and 1B: UK trade with the EU, and UK exports to the EU as a percentage of UK GDP



Source: TBI analysis of ONS Balance of payments data, 2020.

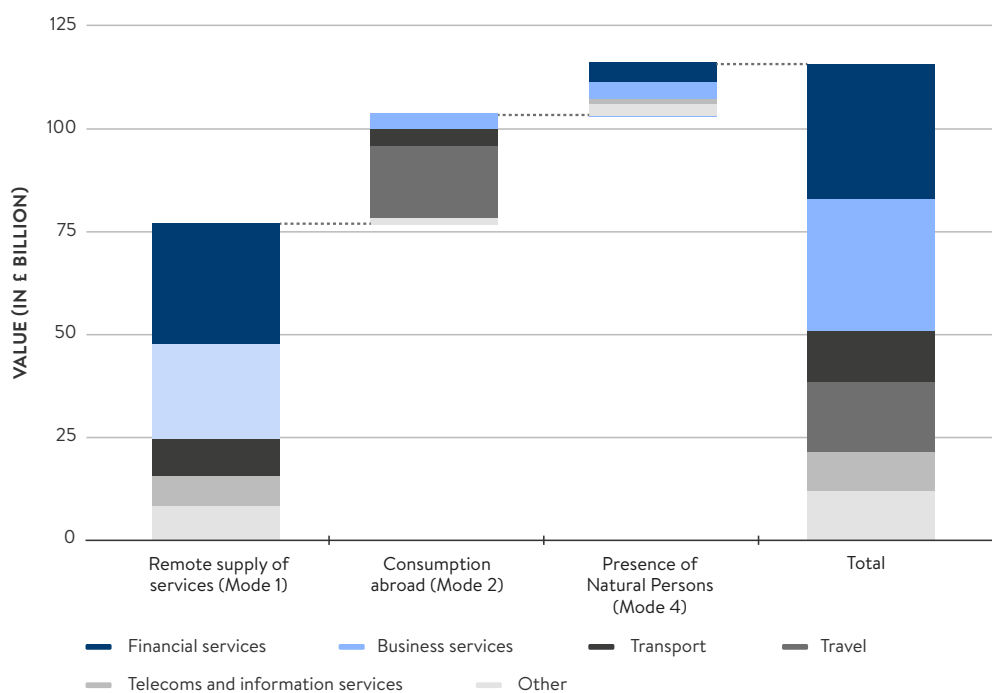
For a bilateral trading relationship that covers 45 per cent of all UK exports and 14 per cent of the EU's – and the one that has consistently grown in absolute terms for the UK as well as the EU – the ambition on both sides is minimal. It is true that this agreement, unlike most free trade agreements, seeks to eliminate all tariffs and quotas on goods. However, it is also true that it does little to prevent new non-tariff barriers for regulated goods, such as chemicals, advanced manufacturing and agriculture, and loss of market access rights into EU markets for many cross-border services, including licensed professionals, and financial services.

It is also an asymmetrical trade deal. By offering tariff-free access for goods, it favours the EU, which has had an annual surplus of £76 billion with the UK over the past 10-year period, as Figures 1A and 1B on the previous page show. However, this agreement does little to services, disadvantaging the UK in a key export sector, in which it sells to the EU over £20 billion more than it imports every year. The importance of UK services exports to the UK cannot be underestimated: Unlike goods, services exports to the EU grew by 25 per cent as a proportion of the UK's gross domestic

product over the past ten years. In 2019, they accounted for nearly 6 per cent of UK GDP. And, as previous research commissioned by TBI has estimated, cross-border services could fall by up to 35 to 40 per cent across the UK.<sup>4</sup>

Furthermore, the UK's structure of services exports makes it particularly vulnerable to this type of agreement. This is mainly because the UK is heavily reliant on remote supply of services (as the chart below shows), which has been enabled by a presumption of home-country regulation within the single market. This principle will fall away in a standard FTA, severely restricting the ability of UK firms to provide cross-border services. In a few areas where Britain could continue exporting cross-border services to the EU, such as parts of financial services, its ability to access EU markets will be governed by the EU's own system for third countries, meaning that the EU will be fully in control of granting and withdrawing market access rights to UK firms. It also means that UK regulators will continue having to closely look up to EU financial services regulations, continuously assessing any potential divergence and its impacts for the loss of market access to UK firms.

Figure 2 – Breakdown of UK services exports to the EU by mode of supply



Source: TBI analysis of ONS data, experimental estimates, 2018.

The unfortunate fact of this negotiation is that the political reality has reduced the ambition of their future relationship to the bare minimum. The UK, under the premiership of Theresa May, put forward ambitious proposals for a close partnership with the EU but failed to acknowledge, both internally and externally, that such a close partnership wouldn't come cost-free and would entail certain obligations. The closer the integration into the single market, the greater the obligation for the UK to accept alignment to the EU rulebook and the jurisdiction of the European Court of Justice (ECJ). The UK government's inability to acknowledge this central trade-off in the past three years – and to have an honest public debate about it – handed the EU an opportunity to accuse the UK of “cherry-picking” the best parts of the single market without accepting the corresponding obligations.

Boris Johnson, unlike his predecessor, made a choice to prioritise sovereignty over market access, putting a premium on a clean break from the EU's regulatory sphere and a thin trade agreement to be agreed as quickly as possible. He modelled his envisaged deal on the EU's past FTAs with Canada and Japan – arguing passionately that all he wants is a simple free trade agreement just like the ones that EU has agreed in the past. This has been the crux of the UK's position particularly on level playing field, where the UK argues that any future commitments shouldn't go beyond conventional trade deals that the EU has done in the past.

In other areas of the negotiations, however, the government has asked for more preferential terms than have been granted to most third countries. This is particularly the case for the UK's ask for services.<sup>5</sup> It is entirely legitimate for the UK to seek to protect its key interests in the negotiation. However, the problem with the UK's position is all about its coherence: The government cannot, on the one hand, credibly argue that all it wants is a very normal free trade agreement in some areas, like level playing field, and argue for much more in others, like services. It has to choose: It either makes a compelling case for asking more than a standard third-country relationship (a perfectly legitimate position if it is willing to consider trade-offs across different areas of the future

relationship) – or it sticks to the alleged purity of a standard free trade deal. That the UK has done both appears to have undermined its negotiating position.

For its part, the EU has sought to safeguard its key economic interests. In some areas the EU has offered the UK less than other third countries, even those in which it is currently negotiating FTAs, such as Australia and New Zealand. EU draft proposals lack, for example, provisions allowing for recognition of conformity assessment for manufactured goods; mechanisms allowing voluntary recognition of animal welfare standards; or provisions allowing for ongoing regulatory cooperation in financial services. That the EU has done so is unsurprising: Its lack of ambition reflects, on the one hand, the fact that it has already secured a deeply economically favourable agreement through the Northern Ireland protocol and, on the other, a tactical negotiating choice – it lets the UK be a demandeur on a wider range of issues in the negotiation.

The consequence of all this is that, even though the UK and the EU have a broadly similar ambition for their future market access, their ambition is relatively low – even in comparison with other standard trade agreements. As a result, if a deal emerges from the negotiations, it will most likely be a thin preferential trade deal – representing an enormous step back from the status quo – and simultaneously asymmetrical, favouring the EU economically more than the UK.

## Four key issues stand in the way of a deal between the UK and the EU

Despite their broadly similar ambition for market access, the two sides are far apart on four sensitive issues. This includes whether the future relationship should include a level playing field aimed at preventing trade distortion and unfair competition; whether EU fishing vessels should be able to access UK waters on the same terms as now; how the two sides can maintain effective cooperation on cross-border criminal matters and law enforcement; and how their future relationship should be governed and structured. The UK's and the EU's respective positions are explained further in [Box 1](#).

**Box 1 – UK and EU positions on key issues**

1. **Level playing field:** The EU has said that it would only agree to a zero-tariff, zero-quota deal if the UK accepts “level playing field” commitments in the areas of subsidy control (state aid), competition, tax, labour and environmental standards. It is seeking legally binding commitments, with EU standards as a reference point, subject to robust enforcement domestically and through bilateral dispute settlement. The UK doesn’t deny the need for a level playing field in principle, but it doesn’t want to agree to any commitments that could constrain its ability to regulate in the future.
2. **Fisheries:** The UK and the EU need to decide how they will govern future access to each other’s waters – a politically charged issue for both sides. After the UK leaves the EU’s Common Fisheries Policy, the two sides need to decide how sharing rights should be agreed going forward. Right now, the UK wants full control over access to its waters, with annual negotiations on the quotas, while the EU has asked for the de facto status quo: continued reciprocal access and stable quota shares.
3. **Cooperation on law enforcement and judicial cooperation:** The UK and the EU also disagree over the extent to which the two sides can maintain effective cooperation on law enforcement and criminal issues when the UK becomes a third country. The UK has asked for continued access to some of the EU’s security systems and databases. The EU insists that the UK can’t deviate from existing standards and protections on data and that any agreement must accommodate a role for the European Convention on Human Rights (ECHR) and for the European Court of Justice (ECJ) – two key sticking points in the security negotiations.
4. **Governance and legal form:** The final area of disagreement relates to how the overall relationship should be governed and structured. The EU favours a single all-encompassing treaty, with an overarching institutional framework to govern how the relationship evolves over time. The UK wants a suite of standalone treaties for different issues, each with their own governance and dispute-settlement arrangements. It is not just a disagreement about form, however. It goes to the heart of how embedded the UK will remain in the EU’s institutional structures, how disputes will be resolved, whether the ECJ will be involved at all, and whether there can be retaliation across different parts of the future relationship.

**Disagreements reflect a fundamental difference of view between the UK and the EU**

It is not unusual for the negotiating parties to be far apart in the first few months of negotiation. In most negotiations, both sides start off from maximalist positions before weighing concessions to their negotiating partner. However, disagreements over these four substantive issues reflect a more fundamental difference of view between the UK and the EU – an issue about how closely the UK should stay within the EU’s regulatory and institutional orbit, which has tainted the Brexit negotiations for a number of years

This question wasn’t settled through the political declaration (PD) on the future relationship, agreed as part of the withdrawal package. The PD was intended as a joint statement of objectives for the future negotiations.

Yet, for all its promise of clarity, the document became a fudge. Many issues, too contentious to be discussed in detail, were put aside for later negotiations. In some areas, disagreements were too deep for the two sides to even find common language to describe their objectives. In one instance, Brussels insisted on using the now-infamous “level playing field” within the document, while the UK argued that the term was specific to the EU’s single market and instead argued that “open and fair competition” should be used. The PD, a fudge, includes a single paragraph on “level playing field for open and fair competition”. In other words, the document, which reflected the lowest common denominator between the two sides, accommodated a range of potential outcomes that could be represented differently to domestic audiences on both sides. However, on the main contentious issues, it offered little clarity for the current negotiation.

The difference of view about how closely the UK should stay within the EU's regulatory and institutional sphere has deepened after Boris Johnson became the prime minister in 2019. Following his election, the UK government has made clear that it favours a clean break from EU rules and common institutional structures. It has put a premium on the notion of "sovereignty" – defined, in the words of the UK's chief negotiator, David Frost, as "the ability to get your own rules right in a way that suits our own conditions".<sup>6</sup> The prize of Brexit, in the view of the Johnson government, is the ability to choose its own laws – including deciding how far it wants to diverge from EU rules in future. Any form of ongoing alignment to EU laws and regulations, and their enforcement and supervision by common European institutions, has been rejected by the UK government on this basis. So have any forms of ongoing institutional cooperation with the EU – even in areas such as foreign policy and external security – which would maintain treating the UK as yet another member of the club.

The EU, on the other hand, wants to keep the UK as close as possible to its regulatory and institutional sphere. It has proposed a wide-ranging "association agreement" with the UK that seeks to maintain close ties in several areas. It sees the UK not just as a partner, but also as a potential strategic competitor – a key factor driving its insistence on including robust rules of the game within the future agreement. As Michel Barnier, the EU's chief negotiator, said in his remarks on 10 May, the EU will "not allow post-Brexit Britain to act as an international entry point into the EU market. We need to look beyond the short-term adaptation costs to our long-term economic interests."

While it has manifested itself most clearly in level playing field, governance, and fisheries, the essence of disagreement between the UK and the EU has revolved around a more fundamental, and deeply political, issue.

The UK has been on the offensive for sovereignty, unwilling to compromise beyond anything more than a conventional trade deal, while the EU insists that the UK should be kept close to its regulatory sphere in order to prevent the UK from becoming a deregulated strategic competitor on its doorstep. That both sides put forward their principled positions is not just a tactical posturing; it is an exercise in self-justification

and an attempt to convince the other side of the validity of their underlying position.

Whether this fundamental disagreement can be bridged depends on whether the two sides are prepared to compromise on some of their principles in the interest of finding an agreement. If they are, there are credible technical solutions that UK and EU negotiators can find to most substantive issues in the negotiation (set out in the next section of this paper). If not, there is a serious risk that the negotiation will continue to be mired in the irreconcilable efforts of both sides to prove the superiority of their underlying positions. This would be a sure path to no-deal.

### Covid-19 has increased the costs of no-deal and made finding an agreement more necessary

If there is one reason which should keep both sides negotiating despite their significant disagreements, it is the new reality in which the world has found itself due to Covid-19. The economic consequences of the pandemic should force both sides to prevent any unnecessary economic disruption that would hit their economies. Moreover, the pandemic has shown how important it is to maintain close cooperation in an interconnected, yet increasingly fractured world, with key players, such as the US and China, narrowly pursuing their self-interest in an international sphere.

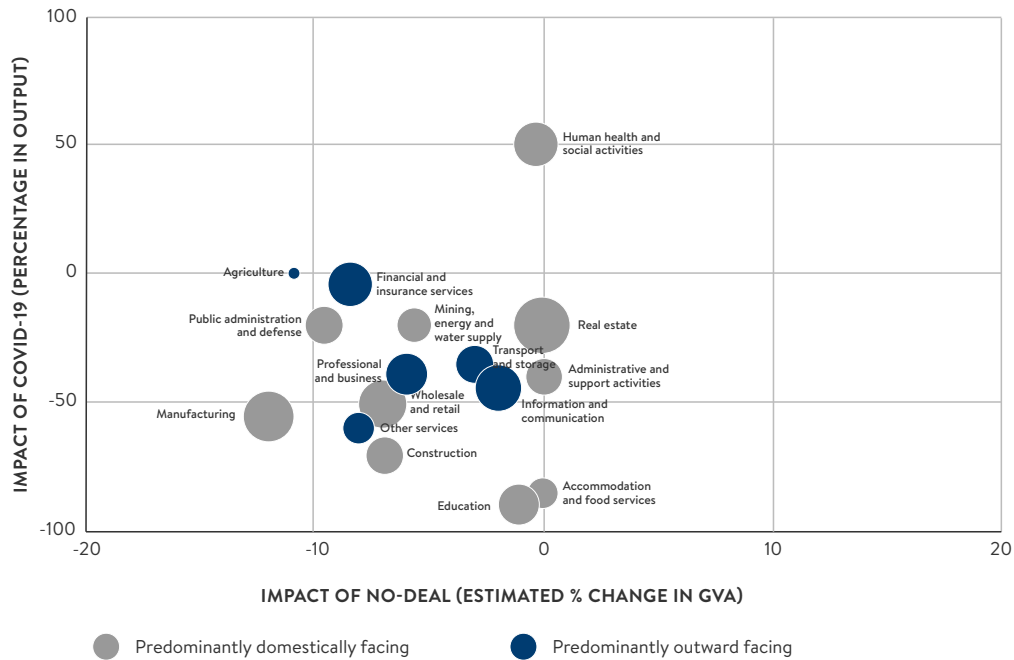
It is, therefore, particularly alarming that there is a view in some UK government circles that Covid-19 has made the deal with the EU less costly. There is an argument that trade barriers from a no-deal Brexit would be less significant in the context of a deep economic recession. Some even take this further by claiming that a no-deal would be desirable, since it would allegedly give the UK extra flexibility to diverge from EU rules in order to manage the post-Covid recovery more smoothly.

The reality, however, is that no-deal would deepen the current recession in the UK, particularly affecting the sectors of the economy that have suffered most in recent months, as the chart below shows. It would cause a further hit to the manufacturing sectors, which are already expected to have their output shrunk by more than a half this year.<sup>7</sup>

No-deal would also hit the outward-facing services sectors, such as financial and professional services, that have performed comparatively better throughout the pandemic but would be disproportionately affected under no-deal. Moreover, the impacts of no-deal would compound the economic shock from

the pandemic: While the shock from the pandemic would be temporary, no-deal would lead to a more permanent change in the way that supply chains and business models are structured, creating a drag on the speed of any post-Covid recovery.

Figure 3 – No-deal Brexit would reinforce the negative impacts of Covid-19



Source: TBI analysis, using OBR data on the sectoral impacts of Covid-19 and HMG estimates of the impact on no-deal. Size of the bubbles represents the gross value added for individual sectors.

Nor is it correct to claim that the post-Covid recovery would be constrained by the UK's future relationship with the EU. The ability of the UK economy to recover from the recession depends, first and foremost, on the choices that the government makes domestically. It cannot be credibly argued that EU state-aid rules would prevent

the UK from investing heavily into its recovery, since the EU's rules have been loosened to accommodate higher government support following the pandemic. Rather than seeking to find ways to disguise the impacts of its potential failure to strike a deal with the EU, the absolute priority of the UK government should be to find an agreement as soon as possible.

# A Landing Zone for Compromise

This section sets out what a landing zone of potential compromise could be in each area of disagreement, namely level playing field, fisheries, governance and cooperation on law enforcement.



## Level playing field

One of the key disagreements between the UK and the EU is over the issue of level playing field – a term describing a set of rules which are designed to prevent businesses in one jurisdiction getting unfair competitive advantage through differences in their regulatory environment and government support. It includes wide-ranging rules, covering state aid, competition laws, and labour, environment and climate standards.

The EU has consistently argued that it would only agree to a future trade agreement if it includes “strong level playing field guarantees”.<sup>8</sup> The concern in Brussels is that after the UK leaves the single market, it will use its domestic policies to try to strengthen its international competitiveness through deregulation. Unlike other trading partners, the EU argues that Britain’s close geographical proximity and interconnectedness with European markets make the need for binding rules against unfair competition more necessary.

The UK doesn’t deny the need for a level playing field. In its legal text, published in May 2020, the UK has proposed chapters on subsidy control, competition, and environmental and labour standards. But its ambition is much lower than the EU’s. It argues that any level-playing-field commitments should be “commensurate to the level of market access” and, since its texts resemble previous EU agreements with Canada and Japan, its commitments on LPF are based on the EU’s standard FTAs.

This difference of view is most clearly seen over two level-playing-field issues – state aid and standards on environmental and labour protection. In other areas, such as competition laws or taxation, the UK and the EU are in broad agreement.

In looking for a compromise in each area of level playing field, there are four substantive questions for negotiators as they seek to find a compromise solution:

1. What are the commitments in a given LPF area based on? (e.g. are the rules defined by reference to EU law; international law/standards; or domestic law of the parties?)
2. How reciprocal are the baseline commitments? (e.g. do they impose reciprocal obligations to both sides or not?)
3. How enforceable are the commitments? (e.g. are they a “soft law” commitment unenforceable under dispute settlement? Or are they enforceable under bilateral dispute settlement through independent arbitration? Is there any domestic enforcement?)
4. What happens if either side is found in breach of these commitments? (e.g. what fines or remedies can be applied by the parties? Are there any rebalancing measures? How are those sanctions determined, for example by arbitration/unilaterally by the parties?)

### *State aid*

On state aid, the EU has suggested that the UK continues to follow EU state-aid legislation in perpetuity. These rules would be domestically enforced by the UK’s Competition and Markets Authority (CMA), but the EU’s demands include a role for the ECJ to continue its binding jurisdiction in the area of state aid. Brussels has also proposed a system of unilateral remedial measures that could be taken at the EU’s discretion if it thinks that the UK is failing to comply with EU rules.

The UK, in contrast, has based its proposals on much looser commitments, from the WTO Subsidies and Countervailing Measures Agreement (ASCM), which sets out a broad framework for governing subsidies. There would be no obligation for the UK to align to EU state-aid rules, nor an obligation to maintain an effective domestic anti-subsidy regime in future. The UK has proposed that both sides will have the right to subsidise their domestic industries within the WTO rules, but there would be a consultation mechanism allowing a party concerned about unfair subsidies to raise its concerns.

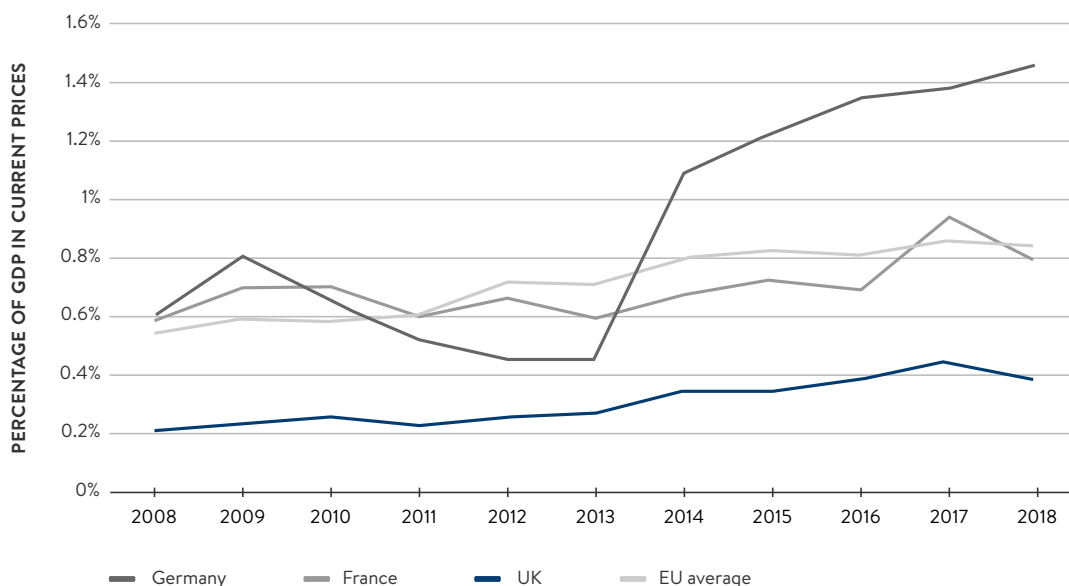
It is important to note at the outset that, under the withdrawal agreement, the UK has already committed to applying EU state-aid rules with respect to “measures affecting trade” between the EU and Northern Ireland.<sup>9</sup> This is a very expansive provision that could catch not only subsidies given to Northern Irish firms, but also to other UK businesses. On its basis, it could be argued, for example, that a UK government subsidy given to a UK-based car manufacturer, like Nissan, might distort trade with the EU, since it would limit the imports of cars from the EU to Northern Ireland.

In other words, if the EU thought that the UK offered an unfair subsidy to a UK business, through direct or indirect means, and that this subsidy has an “effect on trade” between the EU and Northern Ireland, the Commission could challenge this UK decision and, ultimately, it could be considered by the European Court of Justice.<sup>10</sup> Irrespective of what is agreed in the future relationship for the UK as a whole, the EU already has some leverage over the UK on subsidies.

This is also a reason why it is wholly unrealistic to expect that the UK could do without any domestic anti-subsidy regime after the end of the transition period. If the government did so, future government support could easily have a trade-distorting effect in Northern Ireland. This, in turn, could mean the UK was in breach of its international obligations under the Withdrawal Agreement, as well as the corresponding domestic legislation, with its actions being subject to judicial review in UK courts.

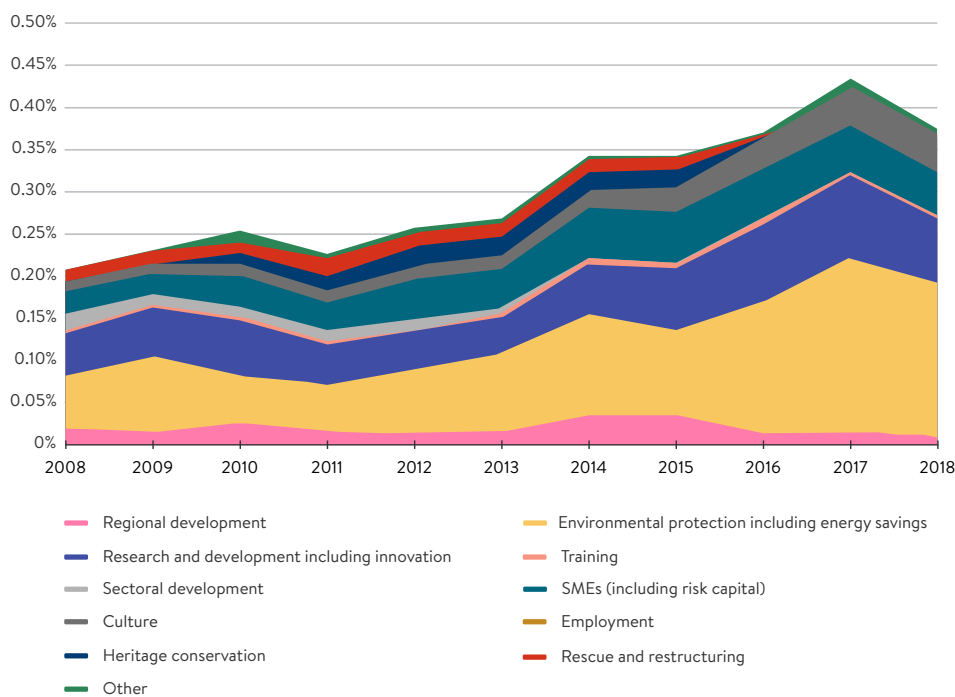
However, asking the whole of the UK to continue dynamically harmonising with the EU’s state-aid rules represents an unprecedented and asymmetrical proposal in the context of a thin preferential trade agreement that falls well short of the level of access provided by the single market. No other third countries are required to do this, except for the EEA states, like Norway, which are full members of the single market; Ukraine, which is hoping to join the EU one day; and Turkey, which is in the customs union with the EU.

Figure 4 – The UK spend on state aid is below the EU27 average (as a percentage of GDP in current prices)



Source: TBI analysis based on the Eurostat data

Figure 5 – Most of the UK’s state aid goes to environmental subsidies, R&D and support for SMEs



Source: TBI analysis based on the Eurostat data

Nor is it clear that the UK has the tendency to overly subsidise domestic businesses. The UK has had a considerably lower state-aid spend than most EU member states, averaging 0.4 per cent of GDP over the past ten years, less than the average of the EU of 0.7 per cent and that of key member states such as Germany and France (see chart below). Where the UK has used subsidies, most of them have been applied to environmental protection and support for R&D – areas which are usually exempted from the lengthy process of approving state-aid decisions by the Commission.

This track record supports the UK’s position, but it offers little comfort to Brussels without understanding if future UK governments might want to change domestic state-aid rules. The EU makes a valid point in arguing that the UK is very different from countries such as Japan or Canada – both in its close proximity to the EU market and its composition and volume of trade – and a looser regime with more generous rules could have a greater and more direct effect on bilateral trade with the EU.

So, given how far apart the two sides are, what are the options for a compromise? It is clear that the EU’s high ask for dynamic alignment is unacceptable to the UK government, not only because it is not proportionate to the level of market access offered to the UK, but also because, as a matter of principle, it would constrain the UK’s right to regulate. A compromise will, therefore, require the EU to shift from its position on dynamic alignment to a more symmetrical offer.

However, it is not just the EU that needs to move from its hard stance on state aid. If UK negotiators want Brussels to move its position, they need to do more than point to the unreasonableness of its ask.

They need to develop a forward-leaning proposition to demonstrate to the EU that (i) the UK is committed to maintaining a domestic anti-subsidy regime in future, and (ii) that the future regime will provide a similar level of protection to the EU’s regime, even if it may not be based on the identical set of rules and procedures.

The UK shouldn't view this as a "concession". This is for two main reasons. First, as the EU's own state-aid rules have considerably loosened due to the coronavirus crisis, with calls by several EU member states for an overhaul of the whole regime, it is reasonable for the UK to seek to lock in some security for UK firms against the erosion of state-aid rules on the continent. Second, if the UK doesn't commit to any clear state-aid rules for the UK as a whole within the future relationship, it is extremely likely that the EU would use its leverage under the Northern Ireland protocol to argue that aid granted to UK businesses has spillover effects on trade between Northern Ireland and the EU, which would in turn bring in direct enforcement by the Commission and the ECJ. It is clearly in the UK's interest to avoid this, but the UK's current negotiating position risks putting the UK as a whole at a strategic disadvantage.

A sensible compromise on state aid would include five core elements:

1. **A reciprocal commitment by both sides to maintain a robust and effective domestic anti-subsidy regime.** This would ensure that the UK establishes, and maintains, a domestic state-aid regime even if it decides to change its substantive rules and procedures.
2. **Agreement on "common objectives" governing domestic regimes within the agreement.** Additional clarity on the operation of the domestic regime in the UK could be provided by treaty-based commitments on "common objectives" – effectively mirroring the state-aid principles within EU law – and thus guiding domestic procedures for state-aid decisions.
3. **Commitment to domestic enforcement of the state-aid regimes.** It would be essential to ensure that domestic anti-subsidy rules are adequately enforced. Enforcement can take different forms, but at the minimum the UK government would have to notify its domestic enforcement body if it intends to put a new subsidy in effect and ask the enforcement body to authorise it in line with UK state-aid legislation. In the EU, enforcement is already done by the European Commission. For the UK, it means that it would have to establish a new independent regulator (e.g. the Competition and Markets Authority). Furthermore, the "effectiveness" of the regulator in enforcing domestic rules could be made subject to dispute settlement, meaning that if the EU were concerned about the functioning of the UK's domestic regime, it could launch a dispute against the UK through the future treaty. A similar solution for enforcement was provided for state aid within the Northern Ireland protocol of 2018.<sup>11</sup>
4. **Commitment to bilateral cooperation between regulators.** It is in both sides' interest to avoid formal disputes in the international arena, so the Commission and the CMA should be able to continue their bilateral cooperation on an ongoing basis and exchange real-time information on relevant cases. Additional reassurance could be provided by:
  5. **A system of retaliatory measures.** If the UK government, for example, failed to notify the independent authority of new subsidies, with a consequential impact on trade between the UK and the EU, or if the UK diverged from "common objectives" for its domestic state-aid regime, the EU could be empowered to take remedial measures. These could take different forms, for example through temporary unilateral suspension of concessions (such as tariffs), or "rebalancing measures" that would seek to correct any trading imbalance caused by an unfair subsidy.

Taken together, this proposal would allow the UK government to be able to design its own anti-subsidy regime and to amend substantive rules and procedures, if it so wishes. But it wouldn't allow the UK to abandon the principle of maintaining a domestic anti-subsidy regime going forward. Indeed, there are few, if any, reasons why a Conservative government, if it is serious about being in favour of a pro-competitive environment, would want to go down such a radical path.

From the EU's perspective, this offer should reassure them that, although the UK wouldn't dynamically follow EU state-aid rules line-by-line, it would maintain an effective domestic state-aid regime going forward, and this system would be guided by the same substantive objectives as their own regime.

The lack of ongoing alignment with EU legislation could be counterbalanced by having the UK commit to domestic enforcement of its state-aid regime by an independent regulator and, furthermore, by including a system of unilateral remedial measures that could be taken if there were a risk of trade distortion.

### *Labour and environmental standards*

Another area of contention relates to labour and environmental standards. Provisions on labour and environment are usually contained in their respective chapters and differ, but the problem concerning the UK is similar in both areas.

Unlike in the area of state aid, the EU hasn't asked the UK to continue harmonising with its social, employment and environmental regulations, but it has asked the UK to maintain "common standards" with the EU going forward. These "common standards" would be defined by the minimum baseline set by EU law at the end of the transition period. The EU also has proposed a "ratchet clause", which means that if either the EU or the UK raised their domestic protections in future, they couldn't go back on these commitments.

So far, the UK's principal argument has been based on mutual trust. The government has said that it would not deregulate and didn't see the need for binding obligations in either area. Instead, the UK has proposed a soft "non-derogation" clause on environment and labour, modelled on a similar provision in the EU's agreement with Canada (CETA). This prohibits both sides from "encouraging trade and investment" by "weakening or reducing the levels of protection" afforded by their environmental and labour laws.<sup>12</sup> The government also doesn't want to make those protections enforceable under the agreement. In practice, this means that for environmental policy protections that are not related to trade and investment, there would be scope for UK divergence from EU standards over time.

For the EU, the problems with the UK's proposal are threefold. First, the UK's proposed "non-regression" clause includes a trade-distortion test; this means that only those protections that are related to "encouraging trade and investment" would be caught

by the clause. Second, the UK's baseline rules are based on the environmental and labour laws of each party rather than a set of commonly defined standards contained within a UK-EU FTA. Finally, the UK's commitments are non-enforceable, meaning they are not subject to dispute settlement and couldn't be challenged by arbitration.

If the UK wants to find a compromise, it needs to move beyond arguments of mutual trust and put forward a more credible proposition in order to convince the EU that it won't deregulate. This has to be balanced against ensuring that it won't be strictly tied into future EU standards.

One option for the UK is to maintain its position on reciprocal non-regression but seek to move closer to the EU's position by offering to make the non-regression clause more enforceable and binding.

This could be done in three different ways:

- **Enforcing "non-regression" domestically.** The non-regression clause would be monitored and enforced in the UK by a domestic body independent from the government. For environmental standards, for instance, this job could be done by the recently established Office for Environmental Protection. As for the proposals for state aid, the "effectiveness" of domestic bodies in enforcing domestic standards could be subject to dispute settlement.<sup>13</sup>
- **Making "non-regression" enforceable under dispute settlement.** Alternatively, both sides could agree to make their non-regression commitment subject to state-to-state dispute settlement. If either side was in breach of the agreed baseline commitments, the other could launch a dispute, which would be adjudicated by independent arbitration.
- **Using trade sanctions.** If the provisions were not subject to state-to-state dispute settlement, they could still be subject to sanctions contained within the agreement. In the event of a breach of relevant commitments, the injured party would be compensated for such a breach if it was quantified.

These options have their pros and cons. The first would limit the scope for disputes between the two sides, since the UK government would be held to account for maintaining its environmental and labour standards under domestic law. The second option would put the onus on state-to-state dispute settlement, marking a departure from the EU's usual approach in its FTAs which leaves environment and labour chapters outside of dispute settlement. The third, sanctions-based option could be viable, but it is unlikely to be sufficient on its own. For the EU, the considerations will be part of a larger internal debate about enforcement of sustainable development chapters within its FTAs for several years.

The EU will be reluctant to set a precedent that could have an impact on its future approach with other countries.<sup>14</sup> Arguably, the most feasible option is to make non-regression enforceable domestically. This has a precedent in the Northern Ireland protocol of November 2018 and would provide a sufficient level of protection to both sides.

This solution would preserve the UK's domestic policy space to regulate on environment and labour as long as the government doesn't lower its domestic standards below the agreed baseline. In this respect, it won't be different from other FTAs that the UK will strike, for example, with the US. In its mandate for the UK-US FTA, the government has already made clear that it will not "waive or lower domestic environmental or labour protections in ways that create an artificial competitive advantage".<sup>15</sup>

It is in the UK's defensive interest to put those commitments on a more stable footing by making them enforceable. Failing to do so would risk that, in the event of a potential breach of environmental or labour rules, the EU would retaliate in those areas that might hurt the UK most, such as the UK's access to European markets for financial firms or data adequacy. Although this possibility cannot be fully prevented, its likelihood can be minimised by making any breaches of LPF commitments subject to a clear process for resolving disputes and ensuring that the proportionality of any retaliatory actions can be challenged before independent arbitration.

## Fisheries

Another area of contention is fisheries. The disagreement here is about the access to each other's waters after the UK leaves the EU's Common Fisheries Policy and becomes a fully independent coastal state. While trade in fisheries accounts for the economically negligible 0.7 per cent of the UK's share of all its exports to the EU<sup>16</sup>, access to each other's waters is a politically sensitive issue for both sides. The UK made the issue of fisheries emblematic of the desire to "take back control"; for the EU, several EU member states have a key interest in maintaining as much of the status quo as possible.

The dilemma is about reconciling the two sides' different needs: On the one hand, the UK wants to regain control over its waters but its exporters need access to the EU market for selling fish. On the other, the EU is asking for preferential access to the richer fishing grounds in the British waters in return for allowing UK fishers to sell into its market.

This unavoidable disconnect between the two sides has been the basis for the past mutually beneficial arrangements. It is perhaps unsurprising that the EU would like the status quo to continue. Its position would preserve current reciprocal access to each other's waters and use stable quota shares. Reaching a deal on fishing rights is essential to the EU; it insists that it will not agree to an FTA, which grants market access rights, without a deal on the access to waters.

In contrast, the UK wants a separate fisheries agreement from the wider trade deal with access to waters to be negotiated annually, similar to the EU's present fishing arrangement with Norway. In the UK's view, fishing opportunities should be based on the principle of "zonal attachment" – a method for allocating fishing opportunities using information on the spatial distribution of fish stock over time and lifecycle.

The UK doesn't want to close off the access of EU vessels to its waters entirely, but it insists on having full control over their management. It knows well that closing access to the UK waters for EU fishers would mean the EU reciprocating by constraining access to its markets for fish exports.

Although fisheries account for a small share of the UK's total exports to the EU, access to the EU market is important for UK fishers: In 2018, the UK exported £1.3 billion of fish products to the EU, accounting for more than 70 per cent of all UK fish exports and an annual surplus of £300 million.<sup>17</sup>

This is an issue on which the two sides have diametrically opposed views. If there is room for compromise, it will likely involve the UK being able to secure a larger share of fishing opportunities and catch limits for its vessels than under the current arrangements. And, if the EU wants to maintain preferential fishing rights in UK waters, it should move away from the position that everything should stay as it is now.

Any compromise will involve balancing the UK's desire for increased fishing quotas with allowing EU vessels to have preferential access to its waters. The eventual agreement will revolve around the extent to which fishing rights are jointly managed, how frequently the two sides will negotiate their quota shares, and how any disputes are resolved.

Ultimately, however, the eventual compromise in this area will be weighed against other interests in the negotiation and will likely be part of a grand bargain at the end of the process.

## Governance

The third area of contention is how the overall relationship is governed and structured. The EU has proposed a comprehensive treaty with an “overarching institutional framework”, providing a single system of resolving disputes across all parts of the future relationship. In contrast, the UK favours a suite of separate agreements: a free trade agreement and several standalone treaties covering areas of bilateral cooperation, from fisheries and air transport to social security coordination and cooperation on law enforcement and criminal matters.

The EU's proposals are clearly driven by a desire to avoid the “Swiss trap”, whereby the relationship between the EU and its partner fragments into a hundred smaller agreements and becomes unmanageable over time, as has happened with Switzerland over the past two decades.

The UK's interests, on the other hand, are driven by a desire to resemble a more conventional third-country relationship – like the relationship the EU has with countries such as Canada and Japan, which separate out a trade and economic agreement with other bilateral issues. The UK insists that each of the agreements should have its own governance and dispute-settlement arrangements proportionate to the nature of each agreement.

### *Legal structure and governance*

There are two substantive issues on governance. First, there is a clear disagreement over a legal structure of the future relationship. Second, the two sides disagree on whether the relationship should contain a single system for its ongoing management and dispute resolution. Although these two issues are linked, it is perfectly possible to have multiple agreements that provide for common governance, just as it is to have different ways of governing parts of the relationship within a single treaty. The EU has in the past used both models: The recently agreed Institutional Framework Agreement with Switzerland provides a way for common governance of multiple treaties, while the EU's agreement in Ukraine provides three systems of dispute settlement that vary according to parts of the agreement, all contained in the same treaty.<sup>18</sup>

Differences on governance are not irreconcilable. One possible compromise is for the two sides to agree to the principle of an overarching institutional framework but leave its scope and precise legal form until the final stages of negotiations. The advantage of this approach is that it would ensure the EU's interest that there is a single framework for governing the relationship, while also accommodating the UK's objective to make governance arrangements proportionate to the type of cooperation in specific parts of the relationship.

Another advantage is that such an institutional framework could ultimately be either part of a single treaty, as the EU has proposed in its draft text, or form a standalone institutional framework agreement, which would be more consistent with the UK's approach. This would allow the parties to return to the question of legal structure at the end of negotiations, when it can be guided by other considerations, particularly the speed of ratification.



In its substance, this framework could provide an overarching joint committee governing the whole relationship and a set of fundamental principles governing their long-term cooperation, including so-called “essential elements”. This framework could also contain a state-to-state dispute-settlement mechanism, with the arbitration procedure. If the UK were concerned about the possibility that arbitration applies to all parts of the future relationship – including those where it is unnecessary – it could seek to limit the scope of arbitration with a “positive list” approach, by listing areas of the agreement where it should explicitly apply.

Another problem is the possibility of cross-retaliation. The EU’s text suggests that, in the event of a breach of commitments and a subsequent dispute, the EU could retaliate against the UK across any parts of the future relationship. The UK is justifiably concerned about this risk, since the Commission has previously used a similar strategy with Switzerland, for example when it linked the Swiss failure to ratify an institutional framework agreement with its access to EU markets for stock exchanges.<sup>19</sup> This risk could be minimised by ensuring that any remedial actions are as localised to the area of a breach as possible, asking both sides to consider retaliatory measures that would not disproportionately affect areas of the agreement where a breach did not occur. However, the problem for the UK is that, as it stands, the EU does already have the option to retaliate in those areas that will hurt the UK most – the UK’s access to EU financial markets and recognition of data standards – since those areas sit outside any formal bilateral agreement.

### *Role for the European Court of Justice*

Another issue which would need to be resolved in this context is whether the institutional framework implies a role for the European Court of Justice.

Both the UK and the EU proposals suggest that any disputes between them should be resolved by an ad-hoc arbitration panel, composed of representatives nominated by both parties. However, the EU also includes a role for the ECJ if there is a question of EU law arising in the future agreement. If this were the case, the panel of independent arbitrators would have to ask the ECJ for an interpretation of relevant

provisions of EU law, and the court’s opinion would be binding on the arbitration panel. This isn’t a new proposal; it is based on an identical system agreed in the withdrawal treaty, as well as the recently concluded EU-Switzerland institutional framework agreement.

Ultimately, resolution to this issue depends on whether there is EU law included within the future agreements or not. If there is no EU law or concepts of EU law within the future treaty, there is no inherent reason why the future relationship should contain any role for the ECJ. However, if there are provisions for EU law that appear in some areas of the agreement, such as law enforcement or level playing field, the UK will need to accept the role for the ECJ if those commitments were to be enforceable. The existing ECJ case law limits what can be done here without the Commission acting unlawfully within its own legal order: The ECJ has to be the ultimate arbiter of EU law if aspects of EU law are contained within an international treaty.<sup>20</sup> There is no shortcut to this issue.

The UK’s key interest, rather than categorically opposing the inclusion of any role for the ECJ, should be to limit possible instances where EU law might arise within the agreement and to seek to limit the scope of the ECJ provision so that it applies only to those parts of the agreement where aspects of EU law might arise. This is entirely consistent with the political declaration, which clearly states that “there should be no reference to the CJEU where a dispute does not raise such a question”.<sup>21</sup> It would restrict any involvement of the ECJ to a set of narrow issues, with its role constrained purely to interpretation of those issues, while also preserving the EU’s red line.

### **Cooperation on law enforcement and security**

The last area of disagreement relates to continued cooperation on law enforcement and judicial cooperation. The UK has proposed a separate law enforcement treaty, covering arrangements supporting data exchange for law enforcement purposes, operational cooperation between agencies and judicial cooperation in criminal matters. It is also seeking access to the EU’s systems and databases equivalent to those currently provided by the Schengen Information System II database.



The EU seeks close cooperation on law enforcement as part of the comprehensive treaty. It includes arrangements for continued cooperation for data exchange, cooperation through Eurojust and Europol, and streamlined extradition arrangements.

The disagreement here is less about the substance of respective proposals and more about the obligations that the UK is being asked to follow in order to continue close security cooperation with the EU. Indeed, there have already been reports that progress has been made on a number of substantive issues, including extradition arrangements.<sup>22</sup>

The EU argues that any future security cooperation is conditional on the UK adhering to the European Convention on Human Rights (ECHR) and on UK courts allowing citizens to invoke their rights under the ECHR in UK courts through the domestic Human Rights Act.

Furthermore, given that the UK would continue participating in EU security databases, it is also likely that this would trigger involvement of the European Court of Justice in dispute settlement.

It is extremely unlikely that there can be an agreement on security cooperation in the absence of a commitment by both sides on human rights. The UK would, at the minimum, have to consider including human rights as one of the “essential elements” of the future agreement and include sanctions if this commitment was ever breached. This could form the basis of the UK’s counteroffer to the EU’s demand to include robust provisions on ongoing compliance with the ECHR and its enforcement through domestic law.

On the question of the European Court of Justice, if the UK wants continued close cooperation, particularly access to EU databases, it has to accept that this might require some role for the ECJ through dispute settlement.

# Conclusion: A Way Forward for the Negotiations

The UK's decision not to seek an extension to the Brexit transition period means that if the UK and the EU want to avoid a no-deal, they have less than six months to find an acceptable deal, ratify it in their respective parliaments and be ready for the biggest change in their trading arrangements in almost five decades. By the end of this year, the British government must also ensure that the arrangements agreed for Northern Ireland will have been implemented and made operationally ready. The scale of this task would be overwhelming for any government, at any time, let alone a government fighting the pandemic and a deep economic recession. Finding an agreement is more important now than it ever was. However, it can only be achieved with a clear focus, willingness to compromise and realism about what can be achieved by the end of this year.

**There is a thin and asymmetrical agreement on the table. It is still better than no-deal.**

The negotiations are about a thin preferential trade agreement, which offers no tariffs or quotas on manufactured goods. However, this type of agreement does little in the way of lowering regulatory costs. For many UK exporters, particularly in the regulated manufacturing sectors, such as chemicals, selling to the EU markets will still mean producing to an EU standard but, unlike today, they will be unable to place their products on the EU market without getting new regulatory approvals and certifications. For other businesses, particularly those selling cross-border services, this deal will mean losing their market access rights altogether. In other words, it is a trade deal that imposes considerable new costs and represents a significant step back from the close economic integration that the EU single market currently provides.

It is also an asymmetrical deal. The agreement enhances the EU's trade surplus in goods – which currently stands at more than £95 billion a year – but it offers precious little for services, in which the UK exports to the EU amount to £20 billion more than its imports. This, in combination with the arrangements agreed for Northern Ireland that ease the barriers to goods trade for EU exporters, builds a degree of asymmetry into the future trading relationship between the UK and the EU.

This deal might have a political appeal to the UK prime minister, since it can be concluded relatively quickly, but it is a deal that, at least in economic terms, favours the EU more than the UK.

Yet, however minimal and asymmetrical this deal might be, it would prevent a fractious no-deal that would not just poison UK-EU relations for years to come, but amid the recession caused by Covid-19, would also exacerbate the economic pain from the pandemic. A deal would also provide a platform on which future governments can build to recreate closer economic relations with the EU. In those respects, an economically bad deal now is better than no deal at all.

Key disagreements are more political than technical. Without a further political intervention, there is a serious risk of the negotiations breaking down by the autumn.

The main disagreements between the UK and the EU are not just technical, but political in nature. What disagreements over level playing field, fisheries and governance have in common is that they all reflect a more fundamental difference of view about how closely the UK should stay within the EU's regulatory and institutional sphere. So far, both sides have tried to avoid compromising on any of their principles; instead, it appears that both sides have recently just doubled down.

Whether this fundamental difference of view can be bridged depends on whether the two sides are prepared to compromise on some of their principles in the interest of finding a political agreement. If they are, there are credible technical solutions that British and European negotiators can find to most substantive issues in the negotiation. If not, however, there is a serious risk that the negotiations will continue to be mired in the irreconcilable efforts of both sides to prove the intellectual superiority of their underlying positions. This would be a sure path to no-deal.

**It is possible to find a compromise. But the landing zone is narrow and requires compromises on both sides.**

It is possible to envisage a landing zone for agreement, but the space for a compromise is narrow. The EU would likely need to move away from its position on state aid, and on fisheries. The UK, on the other hand, would need to put forward a more forward-leaning offer on level playing field and show more flexibility on governance and structure of the relationship.

- On the **level playing field**, if the UK wants the EU to move past its insistence on using EU standards as a reference point, then the UK needs to be able to do more than simply point to the unreasonableness of the EU's proposals. The government needs to put forward a proposal that would engage with the EU's concerns, allowing the Commission to soften its position and manage the expectations of member states. A sensible general approach would be to demonstrate to the EU that the UK can use domestic law rather than an international treaty to meet the required level of protection.

- On **state aid**, both sides should make a binding commitment to maintain an effective domestic anti-subsidy regime, which would be based on a set of “common objectives” contained within the agreement. This would mean the UK would have to continue operating a domestic state-aid regime and commit to its enforcement by an independent regulator, like the CMA.
- On **environment and labour standards**, both sides should agree to uphold their existing protections at the level provided by EU law at the end of the transition period. This should be underpinned by a binding obligation to enforce standards domestically through independent bodies. Additionally, the agreement should include appropriate remedies and sanctions to ensure that unfair competition could be remedied following a dispute-settlement process.
- On **governance**, the UK and the EU should agree on an overarching institutional framework that would provide for a common way of managing the relationship and resolving disputes. The UK could ensure its interests by limiting the scope of dispute settlement only to specific areas of the agreement rather than by opposing the idea of an overarching framework. This would help the UK preserve its core governance interests, while giving the EU the reassurance that the future relationship will not turn into a fragmented and unmanageable relationship like it did with Switzerland over the past two decades.
- On **involvement of the European Court of Justice**, there will need to be a reference procedure from independent arbitration if the agreement contains aspects of EU law. The parties might limit the scope of the role of the ECJ only to those parts of the agreement that explicitly reference EU law or use EU law concepts.

**To unlock agreement, both sides need to think beyond their tactical interests and acknowledge the realities of their positions.**

Currently, there are two major stumbling blocks standing in the way of a compromise.

One is on the EU’s side: its insistence that the UK should continue to mirror future EU legislation, particularly on state aid, in perpetuity. Here, the European Commission has an uneasy task of managing a set of difficult interests of key member states. Some EU states, such as France, have urged the Commission to insist on dynamic alignment; others believe that this is too much to ask the UK. In developing its mandate, Brussels’s calculation may have been that the UK prime minister will ultimately cave in to this demand, as he did in the negotiations over the Northern Ireland protocol. But in doing so, Brussels, as well as key member states, underestimate a strong political drive of the UK’s governing political class to regain the country’s ability to determine its own laws, even if it inflicts an economic cost of no-deal. Thinking that the UK government will concede on this point and accept being a rule-taker risks pushing the UK to the point of walking away from the negotiations.

Moreover, in demanding that the UK follows EU rules without any say over them, Brussels also risks creating a new source of lasting tension in UK-EU relations. Forcing the UK to mirror future changes to swathes of EU rules would alienate a considerable section of the UK public even further and allow it to blame Brussels for its domestic failures even after its departure from the bloc. This would be a miscalculation by the EU. Therefore, rather than insisting that the UK should follow EU rules line-by-line, the EU should acknowledge that an adequate degree of protection against dumping and unfair competition can be achieved through other means provided that they are appropriately enforced.

The second key obstacle is on the UK’s side. The government is keen to emphasise the value of sovereignty after leaving the EU, but the notion that a country can have complete regulatory freedom while engaging in comprehensive free trade is based on a misunderstanding of the reality of modern trade. Regulatory sovereignty is worthwhile, according to the government, because it opens the possibility to choose – whether the UK chooses to be aligned with some EU rules or not should be its own decision in future. This is a legitimate position in its own right, but it dismisses the fact that trade agreements, particularly for a services-oriented economy like the UK’s, are defined by a trade-off between economic integration and regulatory autonomy.

If the UK wants to be an important player in global trade and reap the benefits of free trade, it needs to acknowledge this trade-off and have a more mature public debate about the extent to which it is willing to give up some of its regulatory autonomy in return for economic benefits. In other words, to govern is to choose, and to choose is to disappoint.

In the context of the current negotiations with the EU, this trade-off is most clearly seen in the discussion about level playing field with the EU. If the UK government is serious about finding a compromise, it needs to be able to consider a more forward-leaning position on baseline commitments on subsidies and environmental and labour regulations. This need not be an offer on dynamic alignment to EU legislation, but the UK needs to develop a more credible position that would maintain an anti-subsidy regime and environmental and labour protections within domestic law, and enforce them adequately.

Both sides should be realistic about what can be achieved by the end of the year. They should aim for an in-principle agreement rather than a full treaty.

Given how far apart the two sides are on the main negotiating issues, it will take time to find not just an acceptable deal, but also a legally operable text. The further the UK leaves the EU structures, the lengthier and more legally complex the future agreement will need to be. It is unrealistic to expect that a full-fledged thousand-page treaty, with a dozen standalone agreements and annexes, will be agreed by the autumn and be ready for ratification on both sides.

However, what can be achieved is an in-principle political agreement on the shape of a future deal, along with an agreement on a time-limited standstill "implementation period" to give negotiators the time to iron out the technical detail, lawyers time to scrub the treaty text, and legislatures – in the UK, the EU and its 27 member states – time to ratify the agreement.

The two sides should work towards an in-principle agreement by the autumn, to be agreed in time for approval by the EU27 at the European Council meeting in mid-October. Concluding an in-principle agreement rather than a full treaty is not unusual in international negotiations, especially in circumstances when the time doesn't allow for a full conclusion.

The EU itself signed an in-principle agreement with Japan in July 2017, before formally concluding the negotiations in December 2017, and, more recently, with Mercosur in July 2019.<sup>23</sup>

### **Ratifying the agreement and getting business ready in time will be challenging without a short standstill implementation period.**

Finding an acceptable deal will not end the Brexit process. An agreement will require approval from UK Parliament, the European Parliament, and potentially EU national parliaments, creating its own challenges. If the future treaty is a "mixed agreement" under EU law – that is, if it touches on competencies that are exclusive not only to the EU, but also to its member states – then it will require approval of all national parliaments of member states, according to their own domestic parliamentary procedures. As a result, up to 38 national and regional parliaments could be involved in its ratification. Whether this is the case depends on the scope of the final agreement (the type of issues it covers). An FTA could, in theory, be separated from wider bilateral issues, such as energy, transport or fisheries, where an issue of mixed competence is likely to arise. Ultimately, however, whether an agreement will be "mixed" or not is a decision of the European Commission.

To meet the December deadline, the draft agreement could be "provisionally" signed off by EU leaders at the European Council, before it is approved by national parliaments. Nevertheless, full ratification would be required further down the line, giving de facto veto power over the deal to every single EU member state. In recent years, there have been several cases of EU national parliaments delaying ratification and complicating negotiations, from the Wallonian parliament voting down CETA in 2016, to the Dutch parliament voting down the EU's deal with Mercosur as recently as at the beginning of 2020. It is not unlikely that some national political actors will want to use their involvement in ratifying the UK agreement for political gain.

Additionally, there is a risk that the agreement could be challenged under EU law, requiring the ECJ to adjudicate whether it is in line with the EU's constitutional rules.

This process can be triggered by member states or a group of MEPs, and it is possible that a challenge to this agreement could be brought, particularly if it offered inadequate protections on level playing field.

This could delay the ratification of the agreement and keep the negotiations on the cards for years to come.

Given all this, the responsible thing for both sides would be to agree to a standstill implementation period for up to 12 months. Such a standstill period wouldn't be an automatic extension of the transition period, which the UK government has already rejected under Article 132 of the withdrawal agreement. Rather, it would be an actual implementation period – legally contained within the future treaty – allowing both sides to complete the technical negotiations, ratify the deal, and implement it, without rushing through a quick and poor agreement and risking far bigger ratification and legal problems down the line. Failure to do so would be not just irresponsible to businesses, but also a strategic error.

### **Whatever the outcome of this negotiation, Brexit is here for the long run.**

Brexit is now branded by Downing Street as a “historic event”, and the term “Brexit” itself has been banned from the vocabulary of civil servants and government advisers.<sup>24</sup> Although the UK's departure from the EU can be labelled as an event of the past, this negotiation is far from resolving all the difficult questions that Brexit has opened up for the UK.

The greatest problem of all is that Northern Ireland prevents a clear-cut departure from the bloc, as the arrangements agreed in the protocol are poised to create a new source of lasting tension in UK-EU relations.

Under the protocol, Northern Ireland will be treated as a de facto member of the single market for trade in goods, even though it will formally be part of the UK customs territory. In return, Northern Ireland will have to continue adopting a significant body of EU law related to the single market, without democratic representation in Brussels over the shape of those rules, or even consultation when new EU legislation is prepared. This, it might be argued, was the cost of finding an acceptable compromise to prevent the return of a hard border on the island of Ireland. Yet the body of EU law relating to the single market for goods is not insignificant and can amount to up to 300 new EU legal acts every year.<sup>25</sup>

Under the protocol, the UK's adoption of those rules with regard to Northern Ireland will continue as it is today, and so will the possibility of infractions by the European Commission and ultimate enforcement by the European Court of Justice.

This might not pose an immediate challenge, but as the regulatory systems between the UK and the EU diverge over time, it will deepen regulatory differences between Northern Ireland and the rest of the UK and create a new source of tension between the UK and the EU.

The arrangements for Northern Ireland are dependent on the Northern Ireland Assembly expressing democratic consent to the protocol every four years, with the first vote due to take place in 2024. This ensures that the Assembly has the ability to veto this arrangement if it so wishes. While this grants Northern Ireland representatives the right to choose whether this arrangement is to continue, this process is likely to exacerbate political tension in the lead up to the vote, with the potential for disruption and economic instability every four years. Even with the best intentions of the UK government, the EU, and the Irish government, this will be a difficult arrangement to sustain over time. The UK prime minister signed off on this arrangement under the pressure to finalise the withdrawal agreement, in the hope to end a problem which had bedeviled negotiations for two years. Yet, for all the promise of the protocol resolving the issue, it has created a new one – every four years.

For all the present efforts of British and European negotiators to “get Brexit done” – and to settle the long-term relationship between the UK and the EU – their endeavors, even if successful, will not mark the end of the Brexit process. If the two sides find an acceptable deal by the end of this year, they will deliver an end to the divisive saga of the past four years. But the consequences of Brexit, with all its trade-offs, are here for the long term. The solution for Northern Ireland, in particular, means that future UK governments will likely be forced to rethink the long-term relationship between the UK and the EU from the ground up.

Whether the UK and the EU find a deal this year or not, Brexit, for all its promise to end the UK's uneasy relationship with the EU, has created new difficult choices for the UK – not just for the months ahead, but for the decades to come.

- 1** Bank of England, Monetary Policy Report 2019: <https://www.bankofengland.co.uk/monetary-policy-report/2019/november-2019>
- 2** OECD, 2020, Economic Outlook: <https://www.oecd-ilibrary.org/sites/Od1d1e2e-en/index.html?itemId=/content/publication/Od1d1e2e-en>
- 3** HM Government, EU-UK Statement following the High Level Meeting on 15 June 2020: <https://www.gov.uk/government/news/eu-uk-statement-following-the-high-level-meeting-on-15-june>
- 4** Tarrant and Tilford (2018), “Brexit and the UK’s Services Trade”, Tony Blair Institute for Global Change: <https://institute.global/sites/default/files/articles/Brexit-and-the-UK-s-Services-Trade.pdf>
- 5** Various aspects of the UK’s position on services resemble CETA. However, the UK has asked for more preferential commitments on the entry and stay of business professionals and investors; on the mutual recognition of qualifications; and further provisions on delivery services, audio-visual services and telecommunications, including cooperation on mobile roaming.
- 6** The Spectator, 2020, Full text of David Frost speech: <https://www.spectator.co.uk/article/full-text-top-uk-brexit-negotiator-david-frost-on-his-plans-for-an-eu-trade-deal>
- 7** OBR, 2020
- 8** This can be seen, for example, in the European Council negotiating guidelines (2017; <https://www.consilium.europa.eu/en/press/press-releases/2017/04/29/euco-brexit-guidelines/>) and, more recently, in the European Council negotiating mandate (2020; <https://ec.europa.eu/info/sites/info/files/communication-annex-negotiating-directives.pdf>)
- 9** This was agreed as the quid pro quo for Northern Ireland’s full access to the EU single market in goods. See Article 10, NI Protocol.
- 10** This follows from Art. 12, NI Protocol. The ECJ retains full jurisdiction.
- 11** This would be similar to enforcement of certain LPF provisions agreed in the Northern Ireland Protocol of November 2018, in Annex IV, Part IV, Art. 9.
- 12** See Art. 27(4) and 28(5) in the UK draft CFTA.
- 13** This solution also has a precedent in the Northern Ireland protocol of November 2018. Annex IV, Part II, Art. 3.
- 14** See, for example, this non-paper on enforcement of Sustainable Development chapters by DG Trade (2018): [http://trade.ec.europa.eu/doclib/docs/2018/february/tradoc\\_156618.pdf](http://trade.ec.europa.eu/doclib/docs/2018/february/tradoc_156618.pdf)
- 15** HMG, 2020, UK-US FTA negotiations mandate: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/869592/UK\\_US\\_FTA\\_negotiations.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/869592/UK_US_FTA_negotiations.pdf)
- 16** ONS, Balance of payments data, 2020.
- 17** ONS, Balance of payments data, 2020.
- 18** EU-Switzerland IFA provides a single dispute settlement mechanism contained within a separate treaty ([https://www.fdfa.admin.ch/dam/dea/fr/documents/abkommen/Accord-inst-Projet-de-texte\\_fr.pdf](https://www.fdfa.admin.ch/dam/dea/fr/documents/abkommen/Accord-inst-Projet-de-texte_fr.pdf)) covering a number of key market access agreements between the EU and Switzerland. EU-Ukraine provides a dispute settlement for the trade title of the agreement (Chapter 13, Art.303-321, EU-Ukraine AA); for specific provisions concerning provisions of EU law (Art. 322); and for all other parts of the agreement (Art. 477), which provides for political consultations.

- 19** The Financial Times, 2019, “Trading Costs Rise After Switzerland’s Loss of Market Access Rights”: <https://www.ft.com/content/1aa1561a-dea5-11e9-9743-db5a370481bc>
- 20** There is extensive CJEU case-law on this issue. See, for example, CJEU Opinion 1/17: <http://curia.europa.eu/juris/document/document>
- 21** UK-EU Political Declaration on the Future Relationship
- 22** The Telegraph, 2020, “Brexit Breakthrough Ahead as Negotiators Edge Toward Deal on Easier Extradition”: <https://www.telegraph.co.uk/politics/2020/06/20/brexit-breakthrough-ahead-negotiators-edge-toward-deal-easier/>
- 23** European Commission, DG Trade, 2017, EU-Japan Agreement in Principle: [https://trade.ec.europa.eu/doclib/docs/2017/july/tradoc\\_155693.doc.pdf](https://trade.ec.europa.eu/doclib/docs/2017/july/tradoc_155693.doc.pdf); DG Trade, 2019, EU-Mercosur Agreement in Principle: [https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc\\_157964.pdf](https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157964.pdf)
- 24** The Guardian, 2020, “No More Deal or No Deal”: <https://www.theguardian.com/politics/2020/feb/04/no-more-deal-or-no-deal-no-10s-brexit-diktat-to-foreign-office>
- 25** Based on the data on the size of the acquis applicable to the single market from the EEA-Efta countries. This includes new and updated directives and regulations



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