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# Starting to Build Britain's Post-Brexit Future

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Conservative Group for Europe

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Conservative  
Group for Europe

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# 1. INTRODUCTION

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Having secured a House of Commons majority of 80 seats over all other parties, the Government now has the necessary parliamentary votes to ensure passage of its Brexit legislation.

Now that it is clear that Brexit will happen on January 31 2020, attention must focus on the future relationship between the United Kingdom and the European Union that will follow a transition period in which the UK follows EU rules without any substantive role in shaping them.

This transition period is currently scheduled to end on December 31 2020, and the Government has indicated a desire to enshrine this in legislation. However, under the terms of the Withdrawal Agreement concluded between the UK and the EU, this exit phase can be extended, with the consent of both parties, up to the end of 2022. There are indications that the EU would consider extending the transition period and regards it as necessary and desirable if an ambitious new agreement is to be completed covering both trade and wider areas of cooperation.

No comprehensive free trade deal has ever been negotiated by the EU—or probably by any other major bloc—in a mere 11 months. Moreover, since such a treaty requires the approval not only of the Westminster and European Parliaments but also the 27 member states that will comprise the EU after January 31 2020, extending the transition stage may prove necessary—since these ratifications are likely to take at least four months. It is worth noting too that the transition period would have been almost twice as long had the May version of the WA been approved by Parliament and Brexit had occurred on March 29 2019.

But the Government's stated determination to end the transition at the close of this year makes exiting the EU with no deal a real possibility, despite the many government and independent assessments of the economic harm this would cause, as well as potentially adverse impacts in other areas, such as national security.

The purpose of this paper is to outline a way forward that avoids a highly damaging crash-out of the UK's existing legal rights and responsibilities vis-à-vis the EU and safeguards as many of the benefits as possible of our 47-year-old EU membership.

Accordingly, the Conservative Group for Europe, which advocates the closest practicable relationship between the UK and the EU going forward, publishes this analysis as a contribution to the debate about how to take such a vision forward after Brexit. By doing so, we can ensure that our prosperity, security and influence in the world, as well as the future of the UK, is best protected.

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## 2. EXECUTIVE SUMMARY

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- The UK-EU Withdrawal Agreement and Political Declaration represent a ‘hard’ Brexit for Great Britain—97 percent of the UK economy—and a ‘soft’ Brexit for Northern Ireland.
- A ‘no-deal’ Brexit is a real possibility should the UK and EU fail to agree a Free Trade Agreement in the less than one year between now and December 31, 2020.
- Independent forecasts and the Government’s own projections show that a ‘hard’ Brexit—leaving the EU single market and customs union—would have severe consequences. UK Government projections show that even a basic EU-UK FTA will result in a five percent reduction in economic growth over 15 years and an eight percent cut in a no-deal scenario.
- The UK’s most vulnerable regions and nations face the most severe economic impacts from the only Brexit outcomes the Government is prepared to consider—a ‘hard’ Brexit or no deal exit: only London, the South East and South West would suffer declines less than the UK average.
- Government policy risks damaging all aspects of the economy: services, goods and agriculture.
- A ‘bare bones’ FTA will require £57 billion in additional net government borrowing by 2033-34; a no-deal Brexit would incur £81 billion, according to the Government’s own estimates.
- Gains from potential FTAs between the UK and third party countries, at an estimated 0.1 percent to 0.4 percent in GDP annually, will not come close to compensating for the costs of losing access to the lucrative EU market to Great Britain, worth an estimated 12 percent of GDP each year.
- The divergence from EU rules required of the UK to conclude an FTA with the US would entail restrictions on UK access to the EU’s single market, which is responsible for half the UK’s trade.
- The priority for UK post-Brexit third country trade deals should be countries with similarly high environmental, consumer and employment standards. A UK-US trade deal is highly desirable but the UK should not undertake a ‘distress purchase’ from a weak negotiating position.
- A hard/no-deal Brexit has potential to break up the Union, leading to pressure for a united Ireland and independent Scotland—not only because Scotland and Northern Ireland voted to Remain but also because of the adverse and alienating consequences of these extreme forms of Brexit.

- Northern Ireland would be less damaged than the mainland by the 'soft' Brexit the Government proposes but this separate treatment from the rest of the UK threatens to undermine the union.
- Hardline iterations of Brexit also threaten the UK's shared security with EU allies, which require a continuing commitment to the European Court of Human Rights and its values to be effective.
- To ensure that the potential damage of Brexit is limited, the Government should pursue maximum access to the EU single market and 'third country' trade deals consistent with that goal, requiring a practical rather than theological approach to continuing alignment of key regulatory standards.
- As the crisis in Iran/Iraq shows, it is of critical importance for the UK to be able to work in close alignment with leading EU countries if we are to enjoy key leverage in world affairs. This will require a robust framework for cooperation and political dialogue.

# 3. THE WITHDRAWAL AGREEMENT

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The European Union (Withdrawal Agreement) Bill 2019-20 has now passed second reading. The WA is structured in five parts. These are (i) common provisions; (ii) citizens' rights; (iii) separation provisions; (iv) the transition; and (v) the financial settlement.

## 3.1 Common provisions

Part 1 of the WA contains 'common provisions.' These set out the agreement's territorial scope, key definitions and how it is to be given effect in the UK.

## 3.2 Citizens' rights

The citizens' rights provisions of the Johnson WA are not significantly different from May's draft. There are no substantive changes or additions, except the addition of provisions on the rights of nationals from Iceland, Liechtenstein, Norway and Switzerland.

This section of the agreement provides for free movement of EU citizens to continue until the transition period ends. United Kingdom nationals will be free to move to EU Member states, as currently permitted by EU law. European Union citizens living in their host states before the end of transition will have permanent residence rights under the WA, subject to certain requirements. The UK and the EU27 have discretion under the agreement to require EU or UK nationals to apply for a new residency status.

The UK has chosen to implement a scheme that requires EU citizens to apply for a new residency status known as 'settled' or 'pre-

settled' status. It is still unclear whether each EU27 nation will exercise their discretion under the WA to require UK residents to apply for a new residency but some nations have understandably begun to make arrangements. In France, the hundreds of thousands of UK citizens exercising EU free movement rights to reside there must apply for their *carte de séjour permanent*, the qualifications for which include fluency in French—which is not required under free movement rules.

On 19 December 2018, the British Home Secretary set out the government's detailed proposals for 'The UK's future skills-based immigration system.' There will be a year-long consultation on these.

The government proposes to implement at the end of the transition a single, unified immigration system to apply to everyone who wants to come to the UK. This system will be based on the current immigration rules for non-EU nationals, with many changes. The government has said that it wants the focus of the immigration system to be on immigrants' skills and talent and has praised the Australian 'points-based' system, which aims to confer visas based on personal attributes and abilities to contribute to society and the economy.

## 3.3 Separation provisions

The third part of the WA intends to create an orderly exit from the EU. Ongoing processes and arrangements will be allowed to expire based on current EU rules after the transition ends. This section covers market access for goods, ongoing customs, VAT and excise matters, intellectual property, ongoing police and judicial cooperation in

both criminal and civil/commercial matters, the protection of data obtained before the end of transition, ongoing public procurement procedures, Euratom issues, ongoing EU judicial and administrative processes, and privileges and immunities, among other arrangements.

### **3.4 Goods placed on the market**

The WA allows most goods already in the EU-UK market when the transition period terminates to continue to move freely between the two territories, with limited additional requirements placed on them.

### **3.5 Ongoing customs and procurement procedures**

Similarly, goods moving between the EU and UK at the end of the transition will be allowed to complete their movement under the rules that were in place at the start of their journey, without being subject to additional customs procedures or having to restart their customs transit.

### **3.6 Continuing VAT and excise duty issues**

Existing EU Value Added Tax arrangements will apply to goods transported or dispatched between the EU and the UK, where the dispatch or transport began prior to the end of the transition period. Unless a future agreement provides otherwise, goods exported between the UK and EU after the end of transition will be subject to VAT and customs formalities.

There is equivalent provision for EU excise arrangements for fuel, alcohol and tobacco products. After the transition, exports of excisable products from the UK to the EU will be subject to customs formalities before they can be moved within the EU. To meet these requirements, the UK may have access to relevant network and information systems and databases.

### **3.7 Intellectual property**

Intellectual property law is harmonised to a large extent across Europe, and much of the UK legislative framework in this area is currently composed of directly applicable EU Regulations and transposed EU Directives. Under the WA, the existing body of directly applicable EU law will be converted into UK law.

### **3.8 Police and judicial cooperation in criminal matters going forward**

The UK participates in about 40 EU measures that aim to support and enhance internal security and policing and judicial cooperation in criminal matters. Measures identified as being of particular significance include the European Arrest Warrant; access to databases, including the Second Generation Schengen Information System; European Criminal Records Information Exchange System and Passenger Name Records; and participation in Europol and Eurojust. These are covered by the WA but not no deal.

### **3.9 Future judicial cooperation in civil and commercial matters**

The UK also takes part in measures designed to facilitate judicial cooperation in civil, family and commercial matters. These concern the choice of courts to be used to resolve disputes as well as the applicable laws and the automatic recognition and enforcement of legal decisions in member states.

### **3.10 Approval of plant varieties, medicinal and chemical products**

After Brexit, the UK will not act as a leading authority for EU-level or joint-Member state risk assessments, examinations, approvals or authorisations relating to plant variety rights and various medicinal and

chemical products, product labelling and placing certain substances on the market.

### **3.11 Agricultural support**

The Government's Agriculture Bill will take forward measures for new UK agricultural support schemes. The WA disapplies EU state aid rules that continue to apply to the UK more generally to enable the UK to operate agricultural support schemes during transition. Common Agricultural Policy rules will not apply directly, however, the UK's 2020 scheme must be equivalent to the CAP, and expenditures on UK schemes during the transition period are limited to CAP spending levels—again, not so under no deal.

Certain EU regulations on food and agriculture continue to apply to Northern Ireland during an initial four-year period. Existing checks on animals and animal products moving from GB into Northern Ireland I will be scaled up.

### **3.12 Data protection**

Under the EU's data protection framework, personal data can only be transferred to third (non-EU) countries when an 'adequate' level of protection is guaranteed. One option is for the European Commission to make an adequacy decision. The WA covers data processed or obtained before the end of the transition period or on the basis of the Agreement. EU data protection law will apply in the UK with respect to processing personal data of subjects outside the UK where it was processed under EU law before the end of the transition period or where the data was processed after the end of the transition period. These rules would not apply if the EU deems the processing 'adequate.' If an adequacy decision ceases to apply, the UK will have to ensure its data processing was 'essentially equivalent' to EU law.

### **3.13 Privileges and immunities**

The WA generally provides for a continuation of existing privileges and immunities for activities that took place before the end of the transition period.

### **3.14 Euratom**

The UK will be responsible for its own nuclear safeguards. There are provisions on ownership of materials and equipment in relation to third countries and Euratom Member states. The UK will keep assets in the UK but will purchase from Euratom any equipment and other property related to the provision of safeguards in the UK as it implements its own regime. The UK will continue to fulfill obligations with third countries and to be responsible for its nuclear waste on UK and EU territory.

### **3.15 The transition**

The European Union (Withdrawal Agreement) Bill 2019-20 has now passed second reading. As with Theresa May's draft WA legislation, the new Government's legislation is often misunderstood. The bill merely addresses the terms of the UK's withdrawal from the EU—the future relationship is the subject of the legally non-binding PD – the provisions of which can be changed during the forthcoming negotiations.

### **3.16 The Financial settlement**

The WA details how the UK and EU will settle outstanding financial commitments to each other. The UK's liability is currently estimated at around £33 billion, although this may change based on the length of transition and other future decisions.

During the transition period, until the end of 2020, the UK will pay into the EU budget almost as if it were a Member state. It also



will receive funding from EU programmes, such as structural funding.

EU annual budgets commit to some future spending without making payments to recipients at the time. These commitments will become payments in the future. The UK will contribute to the EU's outstanding commitments as of 31 December, 2020. Recipients in the UK will also receive funding for outstanding commitments made to them.

The UK will share the cost of EU liabilities that exist at the end of 2020 as well as any materialising contingent liabilities—potential liabilities that may occur depending on the outcome of an uncertain event in the future—entered into before withdrawal, and will receive back a share of some assets. Thereafter, the pensions of EU staff are likely to be the most significant liabilities for the UK. The most significant item being returned to the UK is capital paid into the European Investment Bank.

Until 31 March, 2021, financial settlement payments will be made from the Government's current account—the Consolidated Fund—without need for Parliament's annual approval. This direct payment method is known as a standing service provision. This is the way that the UK currently makes payments, as a Member state, to the EU, under the European Communities Act 1972.

The Government could also make payments out of the account it usually uses for its borrowing and lending: the National Loans Fund.

This will change after 31 March, 2021, when most financial settlement payments will become part of Parliament's annual process for approving Government spending—each year, Parliament's

authorisation is required for most government spending. Exceptions are financial settlement payments that arise from customs duties and sugar levies collected by the UK on the EU's behalf. The date when the standing service ends can be changed by ministers through regulations with Commons approval.

The Government has not yet explained why it would like the standing service provision to end after 31 March 2021. Around two-thirds of the UK's net payments could still be due on 31 March, 2021. When Theresa May's Government set out how it would legislate for the financial settlement, it said that it would use a standing service provision, and no time limit was mentioned. As the size of payments will vary, May's Government reasoned that making financial settlement payments would require flexibility, which is better provided through a standing service provision.

Seeking annual approval from Parliament potentially opens payments up to more scrutiny but introduces the possibility that spending might be voted down or amended by the House of Commons. However, the UK would still be required to meet its legal obligations under the financial settlement. Votes in Parliament would not extinguish or affect UK legal Treaty-based obligations.

The Bill also states that EU payments to the UK will be paid into the Consolidated Fund or, if the Government wishes, the National Loans Fund. This includes the repayment of the UK's subscription to the funding of the European Investment Bank.

Only payments arising directly from the financial settlement are authorised by the WA. It does not cover payments relating to any future agreements, for example those arising from future UK participation

in EU programs, nor does it require the Government to update Parliament regarding future payments.

### **3.17 The Northern Ireland ‘backstop’**

The most substantial difference between Johnson’s WA and that negotiated by Theresa May is that it removes the so-called Northern Ireland backstop, which required the entire UK to remain in a customs union with the EU following the transition period unless or until the UK and EU agreed on a solution avoiding a hard Irish border. Instead, the new protocol on Northern Ireland will be permanent, unless the democratic consent of the Northern Ireland Assembly is withdrawn at a later stage.

Northern Ireland will now be part of UK customs territory upon cessation of transition—and therefore included in any future trade agreements with third-party countries, including preferential market access to those trading partners on the same terms as for goods produced elsewhere in the UK.

There remains uncertainty about future customs provisions for Northern Ireland businesses. On the one hand, the prime minister has denied that there will be customs checks and declarations on goods flowing between Northern Ireland and Great Britain while other ministers have said the contrary—as does the WA text agreed between the UK and EU.

More controversially in the UK and Northern Ireland, EU customs duties will apply to all goods entering Northern Ireland if those goods are at risk of entering the EU single market. This effectively creates a customs border in the Irish Sea—something that May said no UK prime minister could support.

Exempt from customs duty are the personal property of UK residents who moved to Northern Ireland from other parts of the UK, goods on low value consignment and goods sent from one individual to another.

EU law on VAT will apply in Northern Ireland. The EU was concerned that VAT differences between Northern Ireland and the Republic of Ireland could create trade distortions and damage the credibility of the internal market, and it won the argument.

Ireland is considering a single market for electricity enabling homes in Northern Ireland to get their energy from a supplier in Northern Ireland or the Republic. There were fears this could be disrupted by Brexit. Under the Johnson deal, this will still be able to go ahead.

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## 4. THE POLITICAL DECLARATION

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On 22 November, 2018, the negotiators agreed to a 'Political Declaration Setting out the Framework for the Future Relationship between the European Union and the United Kingdom,' which expanded on and replaced the earlier 'outline' political declaration of 14 November, 2019. The PD was endorsed by EU leaders at a special meeting of the European Council on 25 November, 2019.

### 4.1 Legal status

The PD is not a binding legal document, and it is unlikely that it will bind the parties to anything beyond a commitment to negotiate for a future relationship in good faith, as per Article 184 of the WA.

### 4.2 Structure

The PD is structured in five parts:

- i) Basis for Cooperation;
- ii) Economic Partnership;
- iii) Security Partnership;
- iv) Institutional and Other Horizontal Arrangements;
- v) Forward Process.

### 4.3 The basis for cooperation

This section establishes that the future relationship should be based on the shared EU and UK values and principles such as respect for human rights, democracy, the rule of law, working together globally, and the non-proliferation of nuclear weapons. It includes the UK's commitment to respect the framework of the European Convention

on Human Rights rather than the ECHR itself and the EU's and EU27's commitment to the EU's Charter of Fundamental Rights.

It includes a mutual commitment to "ensuring a high level of personal data protection" to facilitate data flows and an EU intention to start work on adequacy decisions on the UK's data framework "as soon as possible" after Brexit, "endeavouring" to adopt decisions by the end of 2020. There also is an intention that the UK will seek, and the EU will grant, where legally possible and with a UK financial contribution, UK participation in EU programmes in areas such as science and innovation, youth, culture and education, overseas development, external action, defence capabilities, civil protection and space.

### 4.4 Economic partnership

The PD calls on the UK and EU to agree on "an ambitious, wide-ranging future economic partnership." It leaves open many details to be decided during future negotiations and keeps open a range of options.

The future relationship is envisaged to encompass a free trade area and cooperation in particular sectors where it is in the parties' mutual interest. It is intended that the economic partnership will cover trade in goods, trade in services and investment, and a number of market sectors, including financial services, digital, transport, energy and fishing. There are also sections on movement of people and on procurement. Some of these are described below.

#### **4.5 Trade in goods**

The economic partnership should maintain the current situation of no tariffs or quotas on trade in goods between the UK and EU. Customs arrangements should “build and improve on” the single customs territory set out in the WA. The PD also refers to the UK having an “independent” trade policy.

The Johnson version of the PD refers to a trading relationship which is “as close as possible.” There are no references to frictionless trade or a common rulebook for trade in goods, which were prominent features of May’s iteration. A range of outcomes for checks and controls are possible, depending on the final design of the customs and regulatory arrangements.

Avoiding a hard Irish border is reiterated, with a commitment to considering technological solutions to the Irish border issue—although no specific solutions are proposed.

#### **4.6 Trade in services**

Johnson’s PD leaves the settlement of trade in services and investment open for future EU-UK negotiations. It builds on the premise that the UK leaves the single market for services and pursues regulatory autonomy. On services and investment, the UK and the EU have states an ambition to go well beyond the current commitments under the World Trade Organization and existing FTAs. The Government has noted that the principles agreed to for services offer the UK the flexibility and regulatory autonomy needed.

The PD also sets out principles of market access and non-discrimination, as well as broad terms of regulatory autonomy and cooperation.

#### **4.7 Public procurement**

The PD suggests that the UK and EU will open additional public procurement markets beyond those they are committing to open via the WTO Government Procurement Agreement. The UK and EU may agree on other measures that would encourage the two markets to be mutually open. There will be mechanisms for reviewing and remedying breaches of procurement rules.

#### **4.8 Financial services**

The PD recognises the interdependence of financial services across boundaries and the common interest in honest and sound markets and fair competition within them. To that end, it highlights the need for continuing close cooperation between different regulators and regimes. The future basis of cooperation will be “equivalence,” which is different, and less extensive, than the current system of passported services.

#### **4.9 Law enforcement and judicial cooperation in criminal matters**

The future relationship will cover arrangements across three areas: data exchange; operational cooperation between law enforcement authorities and judicial cooperation in criminal matters; and anti-money laundering and counter-terrorism financing.

There will be arrangements for exchanges of Passenger Name Record data, DNA, fingerprints and vehicle registration data and extradition arrangements; data-sharing arrangements for wanted and missing persons; and exchange of criminal records and cooperation between the UK and Europol and Eurojust.

#### **4.10 Foreign policy and defence**

The PD reiterates many of the principles of future cooperation in foreign policy and defence already agreed to in negotiations,

such as the need for “close, flexible and scalable cooperation” that respects the autonomy of both Parties; structured consultation between the UK and EU at different levels; the “exchange of information” and need for “close cooperation in Union-led crisis management missions and operations, both civilian and military.” But there is limited detail on how such principles will be delivered. The PD’s language suggests a degree of compromise in certain areas, such as operational planning and defence industrial cooperation but it is unclear what either side has ceded or achieved in that regard and what is left to be resolved once formal negotiations on the future security partnership begin.

#### **4.11 Institutional and other horizontal arrangements**

An overarching institutional structure will be underpinned by mechanisms for dialogue and arrangements for setting the direction and implementing the future relationship. Dispute resolution will be based on the dispute resolution mechanism in the WA.

#### **4.12 Forward process**

Once the WA is concluded, and before the UK leaves the EU, preparatory work will begin for the formal negotiations on the

future relationship. The priority will be to find alternative, permanent arrangements for ensuring there is no hard border on the island of Ireland.

Negotiations to ratify the legal agreements will begin as soon as the UK is a third country and both parties have committed to “best endeavours” to ensure the future relationship is implemented by the end of the transition period.

#### **4.13 Pre-withdrawal**

Between the approval of the PD and the UK’s exit from the EU, both parties will engage in preparatory organisational work in order to enable formal negotiations on the future partnership to commence rapidly.

#### **4.14 Post-withdrawal**

A procedure for EU negotiation of agreements with third countries is set out. After formal negotiations are launched, the UK and EU will negotiate parallel agreements on the future relationship.

#### **4.15 Review**

The UK and EU will convene a high-level conference every six months after the UK’s departure “to take stock of progress and agree, as far as is possible between them, actions to move forward.”

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## 5. HOW JOHNSON'S AGREEMENT DIFFERS FROM MAY'S

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### 5.1 Prior commitments on employment, environment and consumer law moved from the legally-binding WA to the non-binding PD

Boris Johnson's renegotiated deal opens the way to a much looser relationship with the EU than envisaged by his predecessor, Theresa May, including allowing for more divergence from EU regulations. As such, instead of writing into the legally binding WA the requirement that the UK will abide by EU standards on workers' rights and the environment, these 'level-playing field' commitments have been shifted to the forward-looking—non-legally binding—PD.

The Government has promised to write a series of commitments into the legislation implementing Brexit but has yet to publish these.

### 5.2 Employment, environmental and consumer law

Ministers would be obliged to make a statement each time any new law could affect employment rights and say whether they would comply with EU standards.

The Government would also report regularly on changes to EU standards and whether the UK planned to mirror them. Members of Parliament would then be given a vote on these reports, to approve or reject the Government's plan.

Ministers point out that the Government announced an employment reform bill in The Queen's Speech that would increase standards and insisted they had no intention of reducing standards. But this assurance has been moved from the legally binding WA to the PD.

As per employment and environmental law, the Government has stated its intention to enshrine current consumer protections in legislation but has yet to publish this.

### 5.3 No Common Rule Book

At the heart of May's attempt to ensure the seamless flow of goods between the EU and UK was a commitment to a 'common rule book' to standardise product regulations. This is no longer included in Government proposals, fueling concern that it intends to diverge from EU rules in this area, threatening the discontinuation of tariff-free trade in goods guaranteed by EU membership and the transition.

### 5.4 Government procurement

Prime Minister Boris Johnson has repeatedly insisted National Health Service contracts will not be part of any future trade deal with the US and put hospital funding at the heart of his bid for re-election. However, critics have accused him of being willing to put it up for sale.

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## 6. SAFEGUARDING THE ECONOMY

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### 6.1 Johnson's Brexit 'harder' than May's

One frequently overlooked aspect of Johnson's revised WA and PD is that the Government's new position represents an even 'harder' Brexit than that proposed by his predecessor. While Theresa May's rejection of the EU's internal market and customs union proposed excluding the UK from these lucrative sources of UK jobs and investment and the EU's half-billion-person consumer market, it did attempt to ensure a continuing seamless trade in goods by committing to a common 'rule book'. Boris Johnson's rejection of this compromise makes for even more of a hard Brexit than May's plans, which sought to protect some EU market access by agreeing to common product standards.

The Government's current commitment to keep open the option of divergence in product standards places UK goods at risk of EU tariffs and restricted single market access.

### 6.2 Divergence versus market access

The Government's proposed FTA would give it the right to diverge from EU rules, a facility that many government sources have emphasised. No less importantly, the EU's chief Brexit negotiator, Michel Barnier, has made the bloc's position crystal clear: "Access to our markets will be proportional to the commitments taken to the common rules." This reality has huge implications for the UK economy.

### 6.3 The cost of a 'hard' Brexit

There are many estimates of the harm that a 'hard' Brexit—leaving the EU's internal

market and customs union—will cause the UK economy, from the impact assessments undertaken, but not published, by the May Government to research from independent analysts such as the National Institute for Economic and Social Research and The UK in a Changing Europe.

Impact estimates are complex attempts to predict an unknowable and variable future. They also are easily abused for partisan purposes. But while forecasters differ on the extent of the long-term economic damage of a hard Brexit, they are united on the direction of travel. The UK in a Changing Europe places the long-term hit from a 'bare-bones' UK-EU free trade agreement at 2.3 to 7.0 percent; the Treasury calculates 5 percent and NIESR 3.5 percent, over 15 years.

The Centre for European Reform divides the differences among economists between those who think the economic growth hit will be a one-off before the UK economy ultimately adjusts and their peers who are convinced the damage will be ongoing and possibly permanent.

Whichever prognosis proves most accurate, almost all analysts agree that higher tariffs and non-tariff trade barriers with the EU will make the UK economy less efficient as imported goods and services from the EU become more costly or scarce due to increased barriers. This adverse impact would be intensified if the UK diverges from EU rules.

Simultaneously, as a result of this protectionism, UK exports will cost more in the EU, meaning demand for these would fall while that for home-produced products

would rise, despite domestic producers becoming less efficient due to higher tariffs and non-tariff barriers.

More pessimistic forecasters expect that weaker competition will reduce incentives for UK firms to invest in plant and training that would increase workforce productivity – already a key UK weakness. Additionally, according to this view, with diminished single market access, the capacity of UK firms to specialise will be diminished.

#### **6.4 Foreign Direct Investment**

Other long-term impacts will likely follow from new barriers between the UK and the EU market, which is responsible for half of UK trade—45 percent of imports and 53 percent of exports, according to a House of Commons Library study. This volume of trade is thanks to the giant half-billion-person EU internal free market and the dozens of third countries with which the EU has concluded FTAs. At risk is the significant FDI into the UK—worth approximately \$300 billion annually and responsible for 18 percent of jobs and 33 percent of wages, the Office for National Statistics finds. The UK receives more FDI than any member state and is placed second globally for FDI (after the United States) ahead of the Netherlands (fourth); Ireland (fifth); Germany (eighth); and France (10<sup>th</sup>), World Bank figures record.

#### **6.5 Productivity**

Four in 10 EU nationals living in the UK are graduates compared to the quarter of UK citizens who hold a university degree—implying a higher average level of skills compared with the indigenous population. The productivity loss from ending free movement also will have a negative impact—even if the Government tries to compensate for this with a points-based system; this seems unlikely to reverse

relocations already executed, underway or planned.

One example of how close economic ties with the Continent has boosted UK productivity is how European Economic Community accession in 1973 led to sizeable gains in productivity and growth—nine percent according to analysis by Professors Nauro Campus and Fabrizio Coricelli of University College London and the Paris School of Economics respectively.

Yet more data from the National Institute for Economic and Social Research indicate that the UK economy since 2016's referendum is around 2.5 percent smaller than it would otherwise have been without the threat of a damaging Brexit.

#### **6.6 Services**

With the UK economy comprised 80 percent of service industries—92 percent in London—Government plans to withdraw from the EU single market and retain no-deal as an option seriously threatens a huge area of competitive advantage for the UK, especially in relation to financial services.

Removal of the passporting rights that the single market affords the UK's world-class financial services industry has the potential to severely damage this sector—and the more the Government pursues a policy of divergence from the EU, the more limited its access to the Single Market it will become.

The alternative to passporting—mutual recognition via 'equivalence'—is not as comprehensive or secure, endangering the UK financial services industry, which accounts for 12% of UK GDP.

#### **6.7 Manufacturing**



The Johnson Government's preference for divergence from the EU on product standards would substantially raise barriers on top of May's deal. As such Brexit proponent and Cardiff University Professor Patrick Minford has said: "Over time, if we left the EU, it seems likely that we would mostly eliminate manufacturing."

## 6.8 Agriculture

In May 2019, the presidents of the four UK farming unions issued a joint statement regarding the impact on the Government's two approved Brexit policy options—a EU-UK FTA and no deal—on UK agriculture. In it, they stated:

"Farmers want clarity on what the future trading relationship with Europe will be. We have argued for free and frictionless trade with the EU to continue, with no tariffs or non-tariff barriers. The default of trading with the EU under WTO rules alone is unacceptable and would decimate our industry.

"British farmers produce food to some of the highest production and animal welfare standards in the world. The food and farming industry continue to urge government to protect these standards and maintain the high levels of trade in agricultural goods between the UK and the EU, our largest export market."

While the UK is an EU member, UK farmers can export to EU countries tariff-free and without non-tariff barriers. Additionally, UK farmers benefit from FTAs that the EU has agreed with third countries such as Canada, Japan and South Korea and over two-thirds of UK agri-food products go to the EU. UK farmers also receive CAP subsidies, which the Government has only guaranteed until 2022.

In 2018 farmers received £3.5 billion in financial support through the CAP. The National Audit Office estimates that 42 percent of UK farmers would have made a loss between 2014 and 2017 without direct payments from the EU.

A Canada-style FTA would create sizeable non-tariff barriers. All agri-food exports to the EU would need customs declarations, transport permits and insurance certificates, and possible testing at border inspection posts.

Under a no-deal Brexit, the EU and all third countries with EU FTAs would immediately apply tariffs and non-tariff barriers to UK exports. At the same time, the Government's no-deal tariff schedule would allow many agricultural products to be imported to the UK tariff-free.

Specifically, tariffs could be imposed on the 60 percent of UK food, feed and drink that go to the EU, including export tariffs to an average of 27 percent on chicken, 46 percent on lamb, 65 percent on beef and to a range from €172 to €1,494 per tonne of pork.

World Trade Organisation Most Favoured Nation rules, the UK would be required to offer the same tariff rates to third countries as offered to the EU, significantly increasing imports to the detriment of UK farmers.

Additionally, the introduction of non-tariff barriers on exports will raise administrative costs and border checks to ensure compliance with EU food safety and animal health regulations.

Border delays will cause supply chain disruptions, with perishable goods such as dairy, meat produce and live animal exports particularly sensitive to delays.

## 6.9 Public services and public debt

A hard/no deal Brexit would starve UK public services of funds following a long squeeze under ‘austerity’ and dramatically increase net public borrowing—already at a post-war high following the financial crash.

Brexit would have cost UK public services £40bn a year under May’s preferred deal, rising to £81bn in a no deal scenario. Estimates suggest the costs will be higher under Boris Johnson's deal.

|   | <b>Norway deal</b><br>EEA rules | <b>Canada deal</b><br>FTA Rules | <b>No deal</b><br>WTO rules | <b>May deal</b> |
|---|---------------------------------|---------------------------------|-----------------------------|-----------------|
| Additional net borrowing each year by 2033-24 | £17bn                           | £57bn                           | £81bn                       | £40bn           |
| Cost per week in 2033-34 at 2018 prices       | £262m                           | £877m                           | £1.25m                      | £615m           |

## 6.10 Impact on the UK’s Nations and Regions

The Government estimates of the regional impact of Brexit outcomes contemplated to date—issued initially on a confidential basis to MPs—reveal that the UK’s least diversified, most vulnerable regions and nations would be hardest hit:

Government assessment of Brexit scenario impacts on economic growth over 15 years:

| <b>Region/Nation</b> | <b>EEA</b> | <b>FTA</b> | <b>No Deal</b> |
|----------------------|------------|------------|----------------|
| East Midlands        | -1.8%      | -5%        | -8.5%          |
| Eastern              | -1.8%      | -5%        | -8%            |
| London               | -1%        | -2%        | -3.5%          |
| North-East           | -3%        | -11%       | -16%           |
| North-West           | -2.5%      | -8%        | -12%           |
| South-East           | -1.5%      | -4.5%      | -7.5%          |
| South-West           | -1%        | -2%        | -5%            |
| West Midlands        | -2.5%      | -8%        | -13%           |
| Yorkshire and Humber | -1.5%      | -5%        | -7%            |
| Northern Ireland     | -2.5%      | -8%        | -12%           |
| Scotland             | -2.5%      | -6%        | -9%            |
| Wales                | -1.5%      | -5.5%      | -9.5%          |
| UK                   | -2.0%      | -5.0%      | -8.0%          |

In addition to the overall negative impact of a hard Brexit FTA and still worse no deal exit, with the steepest GDP declines in the UK’s most vulnerable regions and nations.

## 7. MAXIMISING TRADE OPPORTUNITIES

The half of the UK's trade that is conducted with the EU in the single market is not easily replicated by undertaking negotiations with new trade partners. This is not merely due to the volume of tariff-free trade involved but also the removal of non-tariff barriers in the EU's internal market, and the fact that with nearly eight-times the population of UK, the EU has so much more leverage than the UK alone.

The Government's own estimates reveal the very limited gains available to the UK from third party details are 0.1-0.4 percent of GDP annually, according to analysis published by the House of Commons Exiting the European Committee, compared to the 12 percent of GDP research out of Aston Business School found accrues from full access to the EU market.

Of no potential post-Brexit agreement is the point about leverage more acute than the administration's eagerness to conclude an early trade deal with the United States, which has over four times the UK's population. And while the UK is the world's fifth largest economy, the EU is the second largest and the US the first.

This power imbalance manifests itself in multiple ways:

- The Trump administration wants to prise the UK away from the EU's regulatory approaches, thereby reducing the EU's de facto dominance in global standard setting;
- Attitudes to animal welfare, food production methods and safety standards and consumer labeling vastly differ, making a deal in which the US view is inevitably reflected politically unsaleable in the UK;
- Such attempts at convergence with the US market standards also will result in divergences from the much more important EU market.
- In addition to powerful US agri-business interests, the no less influential US pharmaceutical industry wants higher drug prices and more patent protection in the UK;
- If the UK managed to overcome its inferior negotiating position, such an agreement may not pass, or become bogged down in Congress;
- A US-UK deal, in which the US effectively imposes its standards runs the risk of toxifying the potential for those with others smaller nations with higher standards;
- Precedents set in any US-UK trade agreement by a UK government would also encourage powerful potential trade partners such as China and India to press their policy agendas.
- The UK would do better in terms of maximising trade opportunities by attempting to keep trading ties with the EU as close as possible post-Brexit and seek trade deals with nations such as Japan, Canada, Australia and New Zealand, whose high standards are comparable to the UK and EU.

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## 8. PROTECTING THE UNION

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Perhaps the greatest long-term threat of a hard Brexit or no deal is the impact that severing the UK's ties with the EU could have on the Union between England, Scotland, Wales and Northern Ireland. The reasons for this include but go beyond the fact that Scotland and Northern Ireland voted to Remain while England and Wales elected to Leave.

fueling support for Scottish independence, risking a currently fragile 300-year-plus union in order to force the hardest of breaks with the UK's European allies.

| <b>Nation</b>    | <b>Leave</b> | <b>Remain</b> |
|------------------|--------------|---------------|
| England          | 53.4%        | 46.6%         |
| Scotland         | 38.0%        | 62.0%         |
| Wales            | 52.5%        | 47.5%         |
| Northern Ireland | 44.2%        | 55.8%         |

The divisions were similarly reflected in the UK General Election results with pro-Remain parties being dominant in Scotland.

The new proposed arrangements for a customs border down the Irish Sea with Northern Ireland essentially remaining in the EU's single market, subject to the consent of the Northern Ireland Assembly, create separate rules for the province, moving it closer to the status of a fully-fledged EU member, the Republic of Ireland. This has increased support for Irish reunification, according to Lord Ashcroft polls, which recently recorded a majority for this option.

The Government's proposals for Northern Ireland have also has boosted backing for Scottish independence in the latest polling. Scotland, which voted to remain in the EU by nearly two-to-one will be denied access to the EU single market – an option sought by the Scottish Government -, unlike Northern Ireland.

The deleterious consequences of a hard Brexit or a no-deal exit create a danger of

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## 9. PREVENTING NO DEAL

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Given the severe consequences of no deal—for the UK economy; the union of its four nations; public services, government debt and security cooperation between the UK and the EU, preventing a deeply damaging crash-out from the intricate layers of legislation that codify what will be by December 2020 a near half-century increasingly close and complex relationship with the EU, should be our first priority.

Given the Government’s enthusiasm for regulatory divergence from the EU and the time it takes the EU to conclude FTAs, a no deal outcome remains a strong possibility, with all the alarming consequences set out in the Government’s leaked ‘Operation Yellowhammer’ contingency planning.

Operation Yellowhammer identifies 12 areas of risk. These include the food and medicine supply chains and the status of UK citizens residing in the EU.[2] There are also three risks common to all areas. The twelve areas of risk identified are: transport systems, people crossing borders, key goods crossing borders, healthcare services, UK energy and other critical systems, UK food and water supplies, UK nationals in the EU, law enforcement implications, banking and finance industry services, Brexit and the Irish border, specific risks to overseas territories and Crown dependencies—including the effect on Gibraltar and national security. Risks common to all areas identified are: legal, communications and data.

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## 10. SHARING SECURITY

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The revised Political Declaration proposes a “broad, comprehensive and balanced security partnership,” which is currently underpinned by adherence to the European Court of Human Rights. Contrary to much misunderstanding ECHR is not part of the EU and UK support for it does not require Member state status.

If post-Brexit security cooperation is to even approach current levels, the UK will almost certainly have to meet ECHR standards—a shared commitment to these values underpins ‘mutual recognition’ between Member states. A no-deal Brexit is incompatible with cooperation at that level but even the Government’s preferred FTA

Brexit requires a UK commitment to ECHR to fully protect and enhance the security UK citizens enjoy based on the joint EU efforts that exist today.

Areas of co-operation include the European Arrest Warrant; access to databases, including the Second Generation Schengen Information System; European Criminal Records Information Exchange System and Passenger Name Records; and participation in Europol and Eurojust. These need to be sustained and developed between the EU and the UK. A no-deal exit would terminate UK participation.

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## 11. NEXT STEPS

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There was widespread relief in both the UK and the EU, and especially among UK businesses, when Prime Minister Johnson was able to conclude his deal—ostensibly taking the impending disaster of a no-deal Brexit off the table. That relief largely obscured the extent to which the new terms further ratcheted the UK-EU relationship into a more distant and negative direction. The implications of this are still little discussed or potentially understood. They will play out most prominently in 2020 during the negotiations on the future relationship.

As this paper shows, however, major and politically and economically important issues remain outstanding. These raise significant questions about the future unity of the United Kingdom, our security, as well as our reputation and influence in the wider world.

Whilst the future trading relationship is of real importance to the prosperity of our country, it is also important for the Government to display some vision and generosity of spirit towards our European friends and allies so that uniquely close co-operative arrangements can be put in place. These need to cover areas such as security, crime, foreign policy, science and universities, climate change and consumer rights. Too often the Government conveys an impression of wishing to minimise links with our own continent and of treating our relationships as an encumbrance rather than being a fundamental dimension of the UK's future success and unity.

The Prime Minister has urged national unity but at the same time conveyed the impression that this merely involves everyone 'buying-in' to the hardline version

of Brexit being pursued. Once 'Brexit' has occurred on January 31 2020, it will be important for a new and less confrontational approach to be adopted and for the emphasis to be on building new frameworks and ways of working together. To this end, it would be sensible and pragmatic for the Government to remain open, *inter alia*, to an extension of the transition arrangements rather than creating new crises around the cliff-edge that awaits on 31st December 2020. The important objectives should be to heal rifts within our country and with our neighbours and to find arrangements that are in our shared interests—whether they take 11, 18 or even 23 months to negotiate.



# Conservative Group for Europe

Founded almost 50 years ago, the Conservative Group for Europe is an organisation committed to a positive and constructive approach to the UK's relationship with the European Union.

The Group maintains that it is in the interests of the United Kingdom, the European Union and the wider world that the UK maintains the closest, practicable political, economic, social and security relationship with its friends, partners and allies in the European Union.

Our activities include hosting discussions and debates on topical European issues, publishing policy research, fostering close co-operation with centre-right parties within the EU, as well as sharing articles and speeches, and promoting a pro-European stance within the Conservative Party.

## January 2020

[www.conservativegroupforeurope.org.uk](http://www.conservativegroupforeurope.org.uk)

*\*The views and ideas expressed in this paper are not necessarily the views and ideas of the Conservative Group for Europe nor should they be considered to represent Conservative Group for Europe policy*