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BREXIT UPDATE: UK government under pressure after “no deal” at October European Council

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KEY POINTS:

- While the October 17 European Council was intended to move negotiations forward on the Irish border issue, the result was a continuing deadlock between the UK and the EU27, casting doubt on whether a November European Council – intended to finalize the exit arrangements – would happen at all.
- The UK government’s internal divisions over the exit agreement burst into the open immediately before and after the European Council, with former ministers encouraging others to resign and reports of plots to remove Theresa May as prime minister. Despite a key Cabinet meeting after the European Council, the government’s internal differences remained unreconciled.

WHERE ARE WE TODAY?

On July 12th, the UK government presented its White Paper on Britain’s vision of the future UK-EU relationship, the so-called “Chequers plan.” London’s proposal was based on a double arrangement involving tariffs and customs; including participation in the single market for goods only – services were to be excluded, and without the free movement of people. That proposal was swiftly and squarely rejected by the other EU27 members at the European Council summit in Salzburg on September 20th, the elephant in the room remaining the so-called Irish backstop. **London and Brussels are still deadlocked over how to provide post-Brexit continuity for Northern Ireland and ensure no hard border emerges between Northern Ireland and the Republic of Ireland.**

The EU27 clearly underlined that they would not risk the integrity of the EU’s single market or the EU’s customs union, **asking the UK to either shift its red lines on free movement, or present new proposals that are “solid, operational and legally binding” and would address the Irish border question before the October 17th European Council.**

Theresa May returned to the UK visibly upset and displeased. While the British Prime Minister claimed her “white paper remained the only serious and credible proposal on the table,” she was left fighting to save both her Brexit plan and with it her authority as PM, a week ahead of the 2018 Conservative Party Conference (CPC). The Conference brought the profound divisions of the Conservatives to the fore, with foreign secretary Jeremy Hunt

comparing the European Union to the Soviet Union, and Boris Johnson calling in the same breath to support Theresa May while burying Chequers – a plan he presented as a concealed quasi ‘remain’ strategy that would make the UK a “vassal state” of the EU.

Theresa May came out of the CPC much better than many expected. She used the so-called Salzburg disaster to make herself look strong at the Tory conference, implicitly rebutting Boris Johnson by declaring that her position is to “back business,” while publicly chastising Jeremy Hunt over his EU-USSR comment. **In what appeared to be her first move towards a more conciliatory approach to EU demands ahead of the October 17 EU summit, during her conference speech, she insisted that “the idea of a perfect Brexit might be a chimera.”** Flipping on its head her own argument that no deal is better than a bad deal, she stated that “a good deal doesn’t necessarily mean total victory in the negotiations with the EU.”

Ahead of crucial last-minute negotiations with Dominic Raab, the Brexit Secretary, on Sunday 21st October, the EU’s chief negotiator Michel Barnier indicated that 90% of the Withdrawal Agreement had been agreed with the UK. He also reiterated that the contentious Irish border issue could still scupper a deal. **Hopes that an agreement could be reached between Brussels and London floundered that evening on just that issue, for internal UK political reasons:** following intense talks in London that weekend, it became clear to the British PM that she would struggle to sell a customs backstop with no end date to her Cabinet. May could clearly not rally support for her plan for an extended transition, a potential de facto customs union with the EU, and a future relationship based on a common rule book governing trade in goods. Furthermore, the EU demands for a default plan if the backstop ended – which would apply only to Northern Ireland, thus creating an actual border in the Irish Sea – was wholly unacceptable to the Tory majority in Parliament.

WHAT TO EXPECT?

While nobody wants a “no deal” situation, countries on the continent are preparing for it. Britain, which was hoping to find in Germany a last-minute white knight to help smooth over differences, has come to realize that the German government, across its different parts, is deeply united in its support for the Barnier line on Brexit, as is France. **Reaching a deal will require the UK to move, making “no-deal” a realistically possible outcome. Either the UK rows its position all the way back to a known landing zone, or there will be no deal.** However, this is neither new nor unexpected. For Germany, the EU and its single market are indispensable. Under no circumstances can the EU’s integrity be put at risk by offering too lenient conditions to the UK.

Despite this, with negotiation still going on furiously, the chances for an EU-UK deal to be reached are still high. Especially as the UK discovered on 25th October that post-Brexit WTO accession may not be that easy to obtain, after a number of countries expressed reservations over the draft text put forward by the UK, dashing London’s hope for a quick and easy membership to the global trade body.

The chances of such a deal getting through Parliament are however already considerably lower. To secure its passing, the British PM may have no other option than to play for time

to ensure the UK Parliament approves the deal. In that case, she would need Brexit talks to go right up against the deadline. **A Parliamentary vote in December may be too soon, as the consequences of saying “no” to Europe will still be too remote.** As the March deadline moves closer, with no deal on the table, markets will adjust, and business contingency plans will be triggered. The PM will then be able to portray the choice as a “this deal or no deal,” with the considerable perils of a “no deal” staring Parliament in the face. **While the hardline Brexiteers in Parliament may not like the deal on the table, it is still unlikely that they will want to be responsible for the chaos of a no deal.**

FOUR SCENARIOS

To better assess the possible outcomes and their risks for business, we present four potential scenarios. Brexit is inherently unpredictable, and the safest bet is that none of these scenarios will become reality as written. But **with only five months to go, the options are narrowing.**

Scenario 1: Over the Cliff Edge

In this scenario, the parties cannot reach agreement and there is “no deal.” The key to this is the exit agreement. Two elements of that accord are now finalized: the financial settlement and the arrangements on citizens’ rights (ie the rights of EU citizens in Britain and those of British citizens in the EU). But as described above, **there has been little progress on deciding the arrangements for the border between Northern Ireland (NI) and the Republic of Ireland.**

Ireland, with the support of its EU27 partners, has rejected the notion that a visible border should be re-established, claiming that it is contrary to the spirit of the Good Friday accord. But if Britain is to leave the customs union, there must be a border of some kind between the Republic and NI. The EU “backstop,” which would keep Northern Ireland in the customs union and establish a border in the Irish Sea, has been declared unacceptable by many Conservatives and by the Democratic Unionist Party (DUP), whose ten seats give Theresa May her parliamentary majority. Thus, **even if May were to agree to the “backstop” or something similar, it is unlikely that it would be accepted by the Westminster Parliament, as required of the final deal.**

In this most pessimistic scenario, the Labour Party can be counted on to vote against any deal struck by the government, in hopes of triggering a general election, so the entire Conservative parliamentary party and the DUP must support the deal. Any wavering, and “no deal” becomes reality. **For business, this scenario, which is likely to play out only at the last minute, could have a significant and disruptive impact.**

Scenario 2: Exiting and Then Into the Transition Phase

The UK government and the EU could find common ground by agreeing to resolve some of the difficult questions during a transition phase while proceeding with the Withdrawal Agreement. In this scenario, the EU26 and Ireland at the last minute accept a less than clear statement on the Irish border, delaying any definitive resolution until the terms of the future relationship have been negotiated. This would require replacing the EU’s “backstop” provision with ambiguous language. In this form, the exit agreement could possibly be approved at Westminster on a party-line vote, with the support of the Conservatives and

DUP. **This exit agreement would then be accompanied by a vague statement on the ambitions for the future relationship.** There would be some comments about both the customs union and the single market, but nothing that would commit either the EU or the UK to final arrangements. There might be more specific wording about other elements of the relationship, such as a security/anti-terrorism partnership. Overall, the paper on the future relationship would be more of an indication of where future negotiations might go, rather than a mandate that provides guidance for the negotiators.

A key element of this scenario is that **agreement on the exit accord then starts a transition period that lasts at least until December 2020.** This will allow time for further negotiations on issues such as the final shape of a customs agreement or an FTA. During this time, arrangements for business will remain as though the UK was still in the EU, except that the UK will no longer have a seat in EU meetings. But with negotiations ongoing throughout that time, **there will be little clarity regarding conditions for business until late 2020, or possibly even later.**

Scenario 3: The Customs Union

As discussed above, one possibility recently mooted is that the **entire UK would stay in the customs union as a way of resolving the stalemate over the Irish border** and avoiding the extensive congestion at ports that a “no deal” scenario would bring. But this option faces an enormous political hurdle within the Conservative party: **staying in the customs union would require Britain to forfeit negotiating its own trade deals with non-EU parties, including the United States.** The vision of a “Global Britain” would have to be abandoned.

If May was to agree to such a plan, she would face a revolution within her own party. To get such an arrangement through Parliament, she would be at the mercy of the Labour Party, which has at times supported this option. Would Labour support her, or would it stand aside and let the Brexiteers defeat her, in hopes of triggering a general election? **While staying in the customs union might be a desirable option for many businesses, the attempt to reach that agreement could trigger a UK government crisis. If the measure is defeated, especially at the last minute, the “no deal” scenario could easily re-emerge.**

Scenario 4: A General Election

The UK is not required to hold a general election until May 2022. However, a general election can be called if the government loses a vote of no confidence, unless reversed by a vote of confidence within fourteen days. In one potential scenario, **the Commons could reject the Brexit deal agreed with the EU, and this could result in a vote of no confidence against the government, throwing Britain into the turmoil of a six-week general election campaign just as it needs to renegotiate with the EU or face a “no deal” scenario.**

There have also been reports that some Conservatives hope to trigger a leadership challenge to Prime Minister May. If that happens, and she is replaced by a staunch Brexiteer, then Labour, the Scottish Nationalists, and the Liberal Democrats may be able to pass a vote of no confidence. Depending on the timing, an election campaign could significantly delay negotiations with the EU27. At the moment, this scenario seems unlikely,

since no senior Tory seems to want the premiership right now. However, **the possibility of a vote of no confidence linked to a rejection of the Brexit deal should not be discounted.** If an election is called, current polls indicate that the Conservatives lead Labour 41 to 36 percent, but Britain's "first-past-the-post" electoral system makes the outcome uncertain. **For business, a general election before Brexit is finalized will greatly exacerbate the unpredictability associated with Brexit,** and also brings the risk of a Labour government led by Jeremy Corbyn.

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