

## Brexit negotiations

### The bumpy road to a withdrawal agreement

Petropoulou Paraskevi  
 Senior Economist

[ppetropoulou@eurobank.gr](mailto:ppetropoulou@eurobank.gr)

#### Brexit negotiations- Where we currently stand

With just five and a half months before the planned Brexit date of 30 March 2019 and an agreement providing for the UK's orderly exit from the European Union (EU) yet to be reached, EU/UK official talks on a withdrawal agreement in accordance with Article 50 of the EU Treaty, have gained pace. Not long ago, EU Brexit Commissioner Michel Barnier stated that it is "realistic" to expect a withdrawal agreement (i.e. a deal on the first phase of Brexit negotiations) by mid-November. Admittedly, out of the five priority issues necessary for a withdrawal agreement, three have already been settled: EU citizens' rights, UK financial commitments and the 21-month status quo transition period after the UK's exit to allow time for consumers, businesses and public bodies to adjust to changes in the rules governing their operation as a result of leaving the EU.<sup>1</sup> However, the remaining two issues are, undoubtedly, the most controversial ones: (i) avoiding a hard border between Northern Ireland (part of the UK) and the Republic of Ireland (member of the EU) so as to abide by the 1999 Good Friday peace agreement; and (ii) the framework of the future (i.e. post-Brexit) EU/UK relationship. In line with Article 50 of the EU Treaty which sets in motion the process for a country's exit from the EU,<sup>2</sup> a withdrawal agreement should be concluded "setting out the arrangements for its (the member state's) withdrawal, taking account of the framework for its future relationship with the Union".<sup>3</sup>

A deal that will cover both the UK's separation issues from the EU and the framework of the long-term EU/UK relationship —according to the decision reached at the 22/23 March EU Summit — would pave the way for the UK to enter the transition period giving the government time to come in full agreement with the EU on the principles governing the future EU/UK relationship. This is in line with Article 50 of the EU Treaty, which sets out explicitly that such an agreement is a prerequisite for Brexit talks to proceed to the second (and final) phase related to the terms of the future EU/UK relationship. It is worth noting that an agreement on the *framework* for the future EU/UK relationship is not equivalent to an actual trade deal, i.e. a deal on the *principles* governing the future EU/UK relationship.

#### Irish border backstop; likely agreement in principle at the October EU Council meeting

At the 22-23 March European Council meeting, the two sides agreed in principal to insert a clause to the withdrawal agreement, the so-called "Irish backstop option", stating that, in the absence of any agreed solution and in order to avoid the establishment of a hard border, Northern Ireland will effectively remain aligned to EU regulation after Brexit. However, UK

#### DISCLAIMER

This document has been issued by Eurobank Ergasias S.A. (Eurobank) and may not be reproduced in any manner. The information provided has been obtained from sources believed to be reliable but has not been verified by Eurobank and the opinions expressed are exclusively of their author. This information does not constitute an investment advice or any other advice or an offer to buy or sell or a solicitation of an offer to buy or sell or an offer or a solicitation to execute transactions on the financial instruments mentioned. The investments discussed may be unsuitable for investors, depending on their specific investment objectives, their needs, their investment experience and financial position. No representation or warranty (express or implied) is made as to the accuracy, completeness, correctness, timeliness or fairness of the information or opinions, all of which are subject to change without notice. No responsibility or liability, whatsoever or howsoever arising, is accepted in relation to the contents thereof by Eurobank or any of its directors, officers and employees.

<sup>1</sup> As agreed at the 23/24 March European Council meeting, the transition period will be running for 21 months from 30 March 2019 until 31 December 2020, provided that an agreement covering both the UK's separation issues from the EU and the framework of the long-term EU/UK relationship has been reached by 30 March 2019. The transition has been defined as a status quo period with the UK retaining single market and customs union membership but without participation in the EU institutions and decision making EU bodies.

<sup>2</sup> Article 50 has never been tested before as no country has ever withdrawn from the EU after the Lisbon Treaty entered into force in 1 December 2009.

<sup>3</sup> According to the 22-23 March EU Council meeting, the EU/UK agreement on the framework for the future relationship will be annexed as a political declaration to the withdrawal agreement and referenced within.

Prime Minister Theresa May rejected the EU's backstop proposal in public speeches afterwards, on the grounds that such a solution would result in border checks between Northern Ireland and the rest of the UK (at the Irish Sea), threatening the constitutional integrity of the UK. The Irish backstop is vehemently opposed by Conservative Eurosceptic MPs who consider it as inconsistent with their pledge for "taking back control" of British borders, as well as the Democratic Unionist Party (DUP) from Northern Ireland. The latter is the junior partner in the UK coalition government controlling 10 MPs that, along with the 316 Conservative MPs, provide Theresa May a 6 seat majority in the 650-seat parliament.<sup>4</sup> Undoubtedly, the Irish backstop issue is very challenging. Yet, as discussed at the 30 September- 3 October Conservative Party conference, if no solution is found, a hard border would be inevitable between the Northern Ireland and the mainland.

There have been a number of press reports over the last few days suggesting that the two sides are "very close" to a deal according to which, the transition period will be extended for as long as needed for a mutually accepted solution to be found and the UK will remain in a customs union with the EU, not just the Northern Ireland (so as to avoid rules of origin and customs checks for goods traded between Northern Ireland and the rest of the UK) while accepting some limited regulatory controls in the Irish Sea, subject to approval of the Northern Ireland Assembly. As per the same sources, an agreement in principle on the issue is likely to be struck in time for the next EU Summit scheduled for 17-18 October.

#### **Economic elements of the future EU/UK relationship; probably deferred to the transition period**

UK Prime Minister Theresa May's Chequers proposal<sup>5</sup> on the preferred long-term UK/EU relationship published in early July, envisioned a new "Facilitated Customs Arrangement" that would effectively allow the country to apply either the EU or the UK tariff, where appropriate, i.e. goods entering the UK and destined for the UK would be levied with a new UK tariff regime while goods entering the UK but destined for the EU would be subject to the EU's common external tariff. Moreover, under the proposed plan, the UK would remain in the single market for goods ("common rulebook for all goods") but the UK's service sector would be left without preferential access to have the flexibility to diverge on rules and regulations. Unsurprisingly, the plan was rejected by EU officials at the Salzburg informal Council meeting on 20 September mainly on the grounds that, signing up to the single market for goods but not for services, could be seen as "cherry picking", denting the integrity of the EU's single market.

As things stand, and assuming that an agreement on the Irish backstop is reached soon, there seems to be two potential options on the framework for the future relationship. First, the UK could accept further compromises potentially involving, inter alia, commitment to the whole single market rulebook along with continuing fiscal contributions to the EU budget for as long as the country continues to benefit from the single market and customs union membership. Should such an agreement prove unpalatable (which is highly likely) and taking into account that not enough time is left to agree on the details of the future relationship, the two sides could instead come to an accord on a quite vague "political declaration" stating that they should stay closely connected (the two sides have already agreed the framework of the future relationship to take the form of a "political declaration"). In this case, real negotiations for a legally-binding agreement on the principles governing their future relationship will be deferred to the transition period. They will commence once the UK leaves the EU and will last until the end of the transition period, or longer if required, probably with an aim to signing an ambitious Free Trade Agreement (FTA) and a new customs arrangement.

---

<sup>4</sup>Out of the 650 MPs in the UK parliament, 640 lawmakers have the right to vote (less the seven Sinn Féin MPs who do not take up their seats, one non-voting deputy speaker from the Conservative Party and two non-voting deputy speakers from the Labour Party).

<sup>5</sup>Chequers is UK PM Theresa May's official country residence where the key points of the proposed plan for the future UK/EU relationship were agreed by the cabinet.

The ultimate target is for the negotiations on the divorce issues and the general non-binding framework of future relationship to conclude by the end of the year to allow time for the completion of approval procedures in the EU and the UK by 30 March 2019, the planned Brexit date.<sup>6</sup> If no agreement is reached by the end of this year, we should expect the two sides to discuss an extension of Brexit negotiations beyond March 2019 (i.e. beyond the 2-year negotiation period after withdrawal notification Article 50 of the EU Treaty provides). Under Article 50, extension would require approval by the UK parliament and unanimous agreement by the EU27 Member States.

### **UK Parliamentary approval, the main challenge for PM Theresa May towards a withdrawal agreement**

Although an EU/UK agreement on the divorce issues and the framework of the future relationship seems feasible in the coming weeks, the biggest obstacle is whether the UK Prime Minister can get it through the UK parliament, both the House of Commons and the House of Lords. That is because, all things considered, there is currently no parliamentary majority for a possible deal. The main opposition Labour Party has said publicly that it will vote against while, within her own party, the Prime Minister faces the difficult task of trying to balance the opposing demands of the soft Brexiteers and the hard Brexiteers.<sup>7</sup> The latter group has been rumored to contain around 70 MPs, enough to vote down any agreement that allows the UK to remain closely tied to the EU. Alternatively, the UK Premier would have to rely on abstentions or/and likely support from some MPs from the Labour Party who would be faced with the alternative of a “crash-out” Brexit. That is because an overwhelming majority of Labour MPs wants to avoid such a scenario. At the Labour Party conference in late September, although party delegates decided to vote against Theresa May’s proposal in the hope that this would lead to a snap election, they opposed leaving the EU without a deal (the Labour Party’s Brexit stance reportedly favors a soft Brexit securing single market and customs union membership).<sup>8</sup>

Should the UK parliament fail to ratify a withdrawal deal, a number of scenarios could materialize (in the following first six scenarios below, we assume that the UK and the EU will agree on an extension of Brexit talks). These scenarios are as follows:

- (i) *The UK government sets out how it proposes to proceed.* According to UK legislation, should the parliament reject the deal, the government will then have to issue a statement within 28 days setting out how it proposes to proceed. Parliament would then vote “in neutral terms” meaning that it would simply take note of the government’s plan but not have any right to propose amendments. It could however try to overturn the government via a confidence motion.
- (ii) *The UK Premier returns to Brussels.* Theresa May resumes discussions with EU officials with an aim to securing certain alterations for an agreement, probably similar to the Norway-style EEA/EFTA arrangement<sup>9</sup> plus securing customs union membership, which could likely receive parliamentary support but split the Conservative Party.

---

<sup>6</sup>For EU approval of the withdrawal deal, Article 50 of the EU Lisbon Treaty states that the European Council should first obtain the consent of the European Parliament, which is defined as a simple majority (including UK MEPs). The European Council will then vote and the agreement will need to be approved by enhanced qualified majority that requires the support of at least 72% of the EU27 Member States, representing at least 65% of the EU27 population. However, the agreement on the future relationship which will be discussed and is expected to conclude in the transition period, will also require the consent of the individual EU27 Member States, in accordance with their national procedure. In the UK, the agreement needs to pass both the House of Commons and the House of Lords with simple majority.

<sup>7</sup>A soft Brexit is usually taken to refer to an agreement that keeps the UK closely aligned with the EU. The objective is to minimize the disruption to trade, supply chains and to business in general that could be created by diverging from the EU’s regulations and standards. In practice, it means staying within both the EU’s single market (Norway or Swiss model) and its customs union (likely Turkey). On the flipside, a hard Brexit envisages the UK to leave not only the EU but also the single market and the customs union aiming to secure a free trade deal with the EU, ideally covering both goods and services. The UK would not have to abide by the four freedoms of the EU or be subject to the European Court of Justice. It would probably not have to contribute to the EU budget and would be able to sign free trade deals with other countries upon its exit from the EU but it would trade with the EU and other countries under World Trade Organization (WTO) rules.

<sup>8</sup>According to recent UK press reports, around 30-40 Labour Party MPs would be willing to defy Labour leader Jeremy Corbyn and back Theresa May’s possible Brexit deal to prevent a crash-out Brexit.

<sup>9</sup>By agreeing to an EFTA Norwegian style deal, the UK could remain in the single market, therefore accepting the four freedoms of the EU; the freedom of the movement of goods, people, services and capital within the EU. It would be subject to European Court of Justice and custom checks.

- (iii) *Early elections* (i.e. before May 2022). This can only be called if: (i) the government loses a no confidence vote (via a simple majority). A new government would then have 14 days to win a confidence vote otherwise a general election could be called automatically. For general elections to be avoided, either a new leader is appointed by the Conservative Party who manages to win a confidence vote or the Labour Party forms a government and wins a confidence vote, coming to power without a general election; (ii) the House of Commons votes to dissolve parliament. Under the Fixed-Term Parliaments Act, early elections could be held should 2/3 of MPs vote in favor (this was the case in April 2017 when Theresa May called an early election).
- (iv) *UK Premier faces a leadership challenge*. The threshold for holding a vote of no confidence in the party leader, requires 48 Conservative MPs (15% of the parliamentary group). Given that the hard Brexit group within the Conservative Party contains around 70 MPs, it is reasonable to assume that there are enough Tories to trigger a vote of no confidence. However, it is far from clear that Theresa May could lose such a vote (simple majority of Conservative MPs is required). But if she does, the election for the new party leader will take place in two stages: 1) Conservative MPs will go through a series of voting rounds with candidates receiving the fewest votes getting eliminated in each round. 2) When the number of candidates comes down to two, the new leader will be chosen by party members (as opposed to MPs) in a postal ballot.
- (v) *UK Premier resigns*. An interim leader is appointed until a Conservative Party leadership is held.
- (vi) *A new referendum* (proposed via a cross party channel). For a second Brexit referendum to be held, the UK parliament should first approve the relevant legislation determining, among others, the referendum question, the date, the spending limits, the timeframe and the rules of the poll. Furthermore, the Electoral Commission needs around 12 weeks to assess the intelligibility of the referendum question while by law there should be a minimum of 10 weeks campaign period (the Referendum Act 2015 took seven months to go through parliament).
- (vii) *Crash-Out Brexit*. The UK exits the EU abruptly, without agreement on the terms of the Brexit divorce, without a legal basis for trade with the EU and other countries and without transition period (disorderly hard Brexit). Such a development could inflict serious economic damage to the UK, which would have to trade under World Trade Organization (WTO) rules with exports subject to the EU's common external tariffs and associated customs checks as of 30 March 2019. Crash-Out Brexit could be the result of various scenarios including: (i) the EU/UK fail to agree on the terms of the withdrawal agreement and the framework for future relations; (ii) there is an agreement in principle but more time is needed and the EU27 Member States refuse to extend negotiations or, alternatively, the EU27 are willing to extend but the UK refuses to ask for an extension; (iii) the deal is agreed but rejected afterwards by the UK parliament or the European Parliament.
- (viii) *Revoking Article 50?* Article 50 says nothing about revocation. This is a legal question that only the European Court of Justice (ECJ) can answer. According to a statement by Scotland's Court of Session in early October, the ECJ has been asked for a preliminary ruling on whether Britain can reverse its decision to leave the EU. Reportedly, a decision on this case is expected by Christmas.

According to UK legislation, the vote on the withdrawal agreement and the framework of the future EU/UK relationship must be held by 21 January 2019. However, it may come earlier. Theresa May reportedly prefers the UK parliament to vote before the deal goes to the European Parliament. That is because, should UK MPs demand certain alterations to the final deal, there should be some time for her government to make these changes before it is formally ratified by the European Parliament. In terms of the timeline, negotiations are geared towards the 17/18 October EU Summit as the deadline for finalizing the deal so that a formal agreement be signed-off by the EU Council at the extraordinary summit of 17-18 November. If this date is missed, a deal could then be sealed at the last EU Council meeting of the year scheduled at 13-14 December. The ball then shifts to the UK parliament's court.

**Brexit timeline**



Source: EU Commission, European Parliament, House of Commons

## Eurobank Economic Analysis and Financial Markets Research

**Dr. Tasos Anastasatos: Group Chief Economist**  
*tanastasatos@eurobank.gr, +30 210 33 71 178*

### Research Team

**Anna Dimitriadou: Economic Analyst**  
*andimitriadou@eurobank.gr, +30 210 33718 793*

**Marisa Yiannisis: Administrator**  
*magiannisi@eurobank.gr, +210 3371242*

**Ioannis Gkionis: Senior Economist**  
*igkionis@eurobank.gr, +30 210 33 71 225*

**Dr. Stylianos Gogos: Economic Analyst**  
*sgogos@eurobank.gr, +30 210 33 71 226*

**Maria Kasola: Economic Analyst**  
*mkasola@eurobank.gr, +30 210 3371224*

**Olga Kosma: Research Economist**  
*okosma@eurobank.gr, +30 210 33 71 227*

**Paraskevi Petropoulou: Senior Economist**  
*ppetropoulou@eurobank.gr, +30 210 37 18 991*

**Dr. Theodoros Stamatiou: Senior Economist**  
*tstamatiou@eurobank.gr, +30 210 3371228*

**Elia Tsiampaou: Economic Analyst**  
*etsiampaou@eurobank.gr, +30 210 3371207*

Eurobank Ergasias S.A, 8 Othonos Str, 105 57 Athens, tel: +30 210 33 37 000, fax: +30 210 33 37 190, email: [Research@eurobank.gr](mailto:Research@eurobank.gr)

## Eurobank Economic Analysis and Financial Markets Research

More research available at <https://www.eurobank.gr/en/group/economic-research>

- **7 Ημέρες Οικονομία:** Weekly review of the Greek economy
- **Greece Macro Monitor - Focus Notes:** Periodic publication on the latest economic & market developments in Greece
- **Economy & Markets:** Analysis & research on the Greek and international economy
- **Regional Economics & Market Strategy Monthly:** Monthly edition on economic & market developments in the region
- **Emerging Markets Special Focus Reports:** Periodic publication on specific EM economy and markets developments
- **Daily Overview of Global markets & the SEE Region:** Daily overview of key macro & market developments in Greece, regional economies & global markets
- **Global Macro Themes & Market Implications for the EA Periphery and the CESEE:** Monthly review of the international economy and financial markets
- **Global Markets Special Focus Reports:** Periodic publication on specific global economy and markets developments

Subscribe electronically at <https://www.eurobank.gr/el/omilos/oikonomikes-analuseis>

Follow us on twitter: [https://twitter.com/Eurobank\\_Group](https://twitter.com/Eurobank_Group)

