

BRIEFING

A SERIES OF POST-REFERENDUM BRIEFINGS

August 2017

THE NEGOTIATIONS WILL FAIL

Calling the result of the UK-EU negotiations now

I do not normally pose as a futurologist but, on 26 March 2016, you may have received the Futurus article '*Projection of the EU Referendum Vote*' with the summary, "for these reasons, I am calling the result of the referendum now – a win for Leave – by about ten points." (embedded in an article '*Nostradamus Lives*' published in July 2016 with a commentary on its accuracy)

In the same way it was possible to make a reasonably correct prediction of the EU referendum vote, is it possible to forecast the outcome of the current EU-UK negotiations? I believe it is and, therefore, I am calling the result – that the current talks will fail (failure defined as not concluding a jointly agreed leaving process and a future relationship so it can come into effect, possibly with a transition period, by March 2019).

We need to get some reality into the appreciation of the Brexit negotiations. Mishandling by the British government has allowed the EU to sequence the talks, putting a financial settlement up front, with negotiations on a future relationship relegated to a second, time-constrained phase.

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[published also by the Campaign for an Independent Britain and available on its website](#)

There is no motivation for the British government, or Parliament, to agree to a financial settlement unless a future relationship is simultaneously on the table.

I do not expect either side to walk out and I expect continuing expressions of goodwill. I do not expect rancour.

But, mistakes by the EU and the British government have made it impossible to conclude an agreement.

I therefore expect one of the following:

- a) A stopping of the clock and a reset of the negotiations on a different, achievable basis and possibly with different negotiators.
- b) If that cannot be agreed, the UK would have to move to a Plan B. Such a Plan B will have to be worked up if there is no agreement by Spring 2018 and is discussed below.

The view from Moscow

Flying back to London from Moscow recently by British Airways, I considered Michael O'Leary's thoughts that, after March 2019, British airliners would not be able to fly in EU airspace. The bizarreness of this has to be appreciated while observing European airliners landing every few minutes in Moscow, despite Russia being under trade sanctions by the EU (including the UK) and the US.

Now the US and the EU are in conflict with each other over the sanctions each is imposing on Russia.

One should also note that British forces are being deployed in Eastern European countries. Under O'Leary's scenario the only British air movements allowed in the EU will be military ones while EU and British airliners freely land in trade-sanctioned Moscow. Or is he wrong? While the British government must take some of the blame, the fact is that the EU appears to be quite unconcerned about such a scenario. This attitude has inevitable effects on the political situation in the UK.

Opening shots

On 29 March 2017 Theresa May wrote to Donald Tusk, President of the European Council, notifying him that the UK was withdrawing from the EU under Article 50 of the Treaty on European Union.

She also included two statements: *"the United Kingdom does not seek membership of the Single Market"* and three times in the letter in slightly different wording, *"... but we believe it is necessary to agree the terms of our future partnership alongside those of our withdrawal from the EU."*

Michel Barnier confirmed on 12 July 2017 in evidence to the House of Lords travelling committee in Brussels, *"I know that after the elections David Davis ... confirmed that the UK is to leave the Union, the single market and the Customs Union"*.

Accordingly the British government, the EU (and Jeremy Corbyn) are approaching the negotiations on the basis confirmed by Michel Barnier.

Change of tack

However, there has been two significant changes to the background scenery. Michel Barnier has confirmed his negotiating mandate from the EU Commission is to be sequenced. The first phase was to concern citizens' rights, a financial settlement and the Irish borders and there would be no discussions on the terms of a future partnership unless preliminary talks about the three issues were satisfactory.

This mandate was of course contrary to Article 50 of the Treaty, *"The Union shall negotiate and conclude an agreement with that state [withdrawing], setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union."*

However, for reasons not explained David Davis agreed with the negotiations taking place on this sequencing despite being contrary to the wording of Article 50 and, moreover, the government actually passing approval of the Article 50 notification through Parliament. He was warned by Varoufakis, the former Greek Finance Minister, *"They will get you on the sequencing."* He could have rejected the EU mandate as incompatible with the terms of Article 50 on which the referendum vote and Parliamentary approval was based.. He also could have had the Institute of Chartered Accountants examine the principles of a financial settlement (as they did in June) and had their report on the table while Barnier had no expert evidence. In fact, he let the EU take control of the negotiations. The EU detailed proposals were not for a financial settlement but for a division of liabilities while no division of assets was considered.

David Davis also said he did not want to extend the negotiations beyond March 2019. All this has now had serious consequences.

Despite Barnier's negotiating mandate, he himself confirmed to the House of Lords Committee on 12 July 2017 when discussing the Irish situation, *"Afterwards, I know that part of the technical solutions will depend on the nature of our relationship in future. For a free trade area, that is not the same thing as if we have something else."* This is plainly reverting to the original terms embodied in Article 50 of the Treaty which emphasised the importance of the future framework.

The Single Market

During the run up to the referendum and afterwards the Leave Alliance has continuously put forward the theme that the UK withdrawal from the EU was a long and complicated process, that there were many areas to negotiate and that it would suit both parties if the UK remained in the Single Market via continuing its membership of the European Economic Area [EEA] and, if possible, rejoining the European Trade Association [EFTA].

The EEA itself would be a ready-made trading and regulatory interface with other countries outside the EU and with the UN economic and governance bodies.

The advantages and disadvantages of Single Market membership have been widely discussed elsewhere.

However, two background facts should be borne in mind. A large proportion of British goods exports has always gone to 'Europe'. According to Professor Ashworth in his *'Economic History of England'*, about 40% of UK gross goods exports went to Europe even in the nineteenth century. The UK does not face a clean sheet. The UK has been in the EEA for 26 years (40 years in the EU) and its trade is contoured around these arrangements, including the very important multinational supply chains.

The principal theorist behind these carefully worked out Leave Alliance's proposals was Dr. Richard North and his widely read blog, eureferendum.com and its numerous high quality commentators.

It is fair to say that the Leave Alliance theme of step-by-step action and the continuing membership of the EEA, at least for a transition period, is now being supported by numerous media and internet commentators, industry bodies, politicians, etc. However, it should be noted that this is a debate among the British and that Michel Barnier can only negotiate with one party – the British government and its approved position.

While it is just about conceivable, even at this late stage, that the British government could decide to remain in the EEA as a transitional arrangement at least, there is no sign of any preparation for this and, indeed, there have been many emphatic statements that the UK would leave the Single Market (not quite the same as the EEA but pretty close) another unnecessary and imprecise statement. Barnier has noted this and his negotiating approach is based on this outcome.

The current position of the EU, and also of the British government, is that leaving the EU automatically means leaving the EEA.

One should note that as regards European trade agreements this would take the UK not only back to 1972 but, actually, to 1959 before EFTA was created.

However, the British government would have to pass a law through Parliament to reverse its accession through the EEA Act 1993 and to terminate its membership. Also, because relationships and obligations with the non-EU EEA members are involved in the EEA agreement, and are not covered by the EU-UK negotiations, there would have to be negotiations with the non-EU EEA member states on the effects of the UK exiting the EEA and their future relationships with the UK. In view of the evolution of opinion none of this would be an easy task. The EEA relationships and obligations to the non-EU EEA members would not be changed in the slightest by any UK-EU agreement under Article 50.

It looks like leaving the EEA would have major diplomatic, parliamentary and trade obstacles.

A decision to remain in the EEA would, therefore, remove the need for yet another set of negotiations and it is far more likely to pass through Parliament. Such a change of

direction would also create a more attractive political setting for a stopping of the clock and re-setting the UK-EU negotiations to conform with the Treaty.

EFTA

However, there is no indication that the British government has considered taking any preliminary steps to open talks with the EFTA countries in rejoining that organisation. There is no particular reason that the EFTA countries would oppose this but, equally, there must be some concern that the EFTA countries might not be interested in the UK using EFTA as a possibly temporary stopping off point. EFTA/EEA membership would certainly give the UK a ready made, off-the-shelf, worked-out relationship with the EU.

Contrary to many assertions, such membership would not include EU budget payments or jurisdiction by the European Courts of Justice. It would also allow more flexible control of inward immigration. It is fair to say that the ECJ would still have a major influence over the EEA and changes to immigration would require careful handling. However, there would be far greater national control than exists under EU membership. The EFTA states are not affected by EU laws outside the Single Market (20% of EU laws) and they are also outside the Common Agricultural Policy and Common Fisheries Policy, Common Foreign Policy, Justice and Home Affairs, and other areas.

Negotiating British politicians

After the referendum vote to leave the EU, it was always obvious, as stated in the Campaign for an Independent Britain Briefing in March 2016, that the British government would need about a year to clarify its desired aim, its plan and its timetable for its future relationship with the EU, and how to negotiate it.

But a year has gone by and there is no evidence that the aim, plan and timetable has been settled. Indeed, much of the time there has not been talks with the EU but talks within the government without any effective result. Indeed, Michel Barnier has frequently stated that he cannot negotiate without input from the UK negotiators.

It could be said that the only real negotiations are those going on inside the British government as to what its aim, plan and timetable actually are and how to negotiate them. *“It has been a completely wasted year while the Tories negotiated with themselves”*, said Lord Kerr, the veteran diplomat. This is somewhat exaggerated but is accurate in describing the activities inside the Tory Party.

One of the most prominent themes to come out of the government talks is that there should be a transitional arrangement. That in itself is sensible but, as pointed out by Richard North, you cannot have a transitional arrangement unless you first agree what you are transiting towards.

So, accepting the need for a transitional arrangement still does not clear up the need for an aim, plan and timetable. Quite often, the UK media has represented some Tory politicians agreeing with other Tory politicians as a step forward in the negotiations but the real negotiations have hardly begun.

David Davis' mistake

Accepting the EU's sequencing of negotiations was a major mistake by the British government and the sequencing was in fact a mistake also by the EU Commission. It is true that even if the UK withdraws from the EU and rejoins EFTA and stays in the EEA there has to be a financial settlement at some point because the EFTA/EEA states do not pay into the EU budget and have little other financial relationships with the EU in relation to the ECB, European Investment Bank, the Juncker investment programme and to the EU as a whole. However, there would be a better atmosphere for these talks to take place with mutual interest in a realistic financial settlement as the parties would have a close ongoing relationship and UK membership of the EEA would ease time constraints.

The EU sequencing negotiating position is that the financial settlement must come first in at least agreeing the principles of settlement before there can be any discussions about the future relationship of the UK and the EU.

This was emphasised by Michel Barnier to the House of Lords' Committee travelling to Brussels in July, *"We have to understand how sensitive this is because it is the big risk of failure that I fear in the short term in these negotiations."* He stressed, *"Once again, this is an explosive point"*.

Barnier is correct. It is the explosive point also on the UK side because of past UK contributions to the EU and the question of how EU assets are to be divided or compensated for, considering that the UK was a major payer for those assets.

The financial settlement

It is worth restating that the EU negotiating position is contrary to Article 50 of the Treaty. It is also contrary to Mrs. May's wishes as expressed in the Article 50 notification letter.

And it certainly creates problems that there need not have existed.

One must ask what possible motivation there could be for the UK to agree the principles of a financial settlement without even the beginnings of discussion on a future relationship.

In these circumstances it would be impossible for the government to get a financial settlement in principle without any figures through Parliament and to get the approval of the electorate. It would be equally difficult to get a settlement with substantive payments approved. Also, the question arises as to how any financial settlement is to be paid – in euros. You can only get euros by profitable trade but the EU does not want to discuss future trading relationships yet, so it is left in the air how the EU expects the UK to generate extra trade so as to pay a financial settlement.

David Davis should never have accepted the sequencing because, as Barnier has suggested, the matter is *"explosive"*.

After all, Barnier is facing a big hole in EU finances and has to come up with big figures. Otherwise he would not be prioritising the finances.

Gladstone

Some have suggested that almost any proposed financial settlement should be accepted so that negotiations can move forward to the 'framework' for the future relationship. But how would this look if there is no satisfactory 'framework' agreed after this concession?

To look at the principles in negotiating international obligations we must go back to history and the locus classicus is Gladstone's speech about the State's obligations and guarantees of 10 August 1870 (in relation to Belgium in the Franco-Prussian war), also referred to by Sir Edward Grey in his historic speech to parliament before war was declared on 3 August 1914 and by Asquith the day before war was declared in 1914. Gladstone's essential statement of principle was as follows, "*I am not able to subscribe to what plainly amounts to an assertion, that the simple fact of the existence of a guarantee is binding on every party to it, irrespectively altogether of the particular position in which it may find itself at the time when the occasion for acting on the guarantee arises.*"

Following the logic of the commonsense principles laid down by Gladstone, in the last few years the German government breached the Stability and Growth Pact and the European Central Bank breached the Maastricht Treaty and bailed out indebted countries. In each case, they considered the interests of the German people and the defence of the euro justified such breaches despite their treaty obligations.

So, in the view of Gladstone, Grey and Asquith, as well as the German government and the ECB, international obligations and guarantees are not binding irrespectively but depend on the position at the time action is required.

One should also note that the UK Supreme Court has also rejected the notion that a legal obligation (in British law) is binding irrespectively, for example, in a case concerning party political funding (*Electoral Commission v United Kingdom Independence Party*, 2010).

To agree a financial settlement alongside negotiations over a future 'deep' relationship would be difficult enough. For the EU to think that the UK would agree a financial settlement without any guarantee of such a future relationship framework is not only contrary to the EU Treaty but purblind.

David Davis should never have accepted this sequencing.

Breakdown

There will inevitably be a confrontation over the financial settlement and possibly other issues and, therefore, a breakdown in negotiations.

At this stage I see only two outcomes. First is an agreement on stopping the clock, a stand-still agreement in one form or another so the negotiations can be approached more sensibly and the EU negotiators can have a mandate conforming to the Treaty from the EU institutions. This is not simply a matter of extending the Article 50 time limit, which would be unproductive except for removing the time constraint. The real problems are the EU sequencing mandate and the British government's failure to have an aim and a plan for its negotiations.

The British government must, once and for all, establish its aim, plan and timetable. If that fails the second outcome is that, not only would the UK revert to WTO rules, but there would be an ongoing conflict over the financial settlement and other issues so there would be no clean break.

In any case, assuming the UK sets up mirror images of the EU customs regulation and tariffs (and no announcement has been made yet to this effect), future trade especially in the roll on, roll off, ferry routes will be very difficult and would lead to a reduction in UK exports to the EU as well as a reduction in EU exports to the UK. To avoid a financial crisis, the UK would have to invoke the get-out security clauses in the WTO agreement by specifically reducing imports from the EU in line with the fall in UK exports to the EU.

Russia did precisely this in 2014 when it imposed an embargo on food and other supplies from various EU countries entitled "*on applying individual special economic measures aimed at ensuring the security of the Russian Federation*". This was a counter to EU sanctions. The wording was very careful. In the sanctions' war, the EU and Russia maintain (barely, in the case of the EU) they operate within WTO rules using the appropriate opt out security clauses (originally GATT) and despite some rather half hearted threats, no action has been taken at the WTO by any of the parties.

The US does not seem to have bothered with asserting the security clauses.

Of course, the UK, along with the EU and the US, has already gone outside WTO rules by imposing sanctions on Russia (and other countries) without a UN mandate so there is precedent for this action. Russia seems to have been more careful to make a case that it is within WTO rules than the EU and US have cared to do.

Even today (3rd August) it is reported that the United Arab Emirates stated their trade sanctions on Qatar were taken under the security clauses of the WTO.

It needs to be plainly put to the EU that, if there is no trade agreement, and in good time, the UK will have to take steps to ensure its financial stability. That means reducing EU trade to a fair balance to what can be financed by British trade with the EU in the post-Brexit scenario.

As Mervyn King, former Governor of the Bank of England, has stated, the British government needs to have some clarity about what would happen if negotiations fail.

"If you are going to have any successful negotiation, you have got to have a fallback position which the other side understands and believes is credible. So we

need to be able to say if we can't reach an agreement we will nevertheless leave and we can make it work."

However, at present, there is no apparent willingness in the British government to plan a 'fallback position', let alone to confront what is necessary to make the 'fallback position work.

Plan B

Barnier is an intelligent man and must realise that if the UK cannot be put in a position where it can maintain its exports to the EU, it will take action. Trading under WTO rules is not a remedy because much of the problem is due to regulatory complexities in the EU, in effect the UK becoming a 'third country' to the EU overnight. As Richard North once again points out, no country trades with the EU exclusively under WTO rules. Other countries have numerous trade co-operation, inspection and other facilities in agreements with the EU drawn up over many years. The UK's problem is that it will go overnight from being an EU member to a 'third country' without any of these co-operation and facilitation agreements.

That is why transitional arrangements are necessary for the UK (and for the EU).

Meanwhile we have Angela Merkel insisting on free movement of workers but, at the same time, alluding to restrictions on British trade. Surely it should be obvious that restrictions on trade must mean less jobs for EU citizens in the UK?

Personally, I do not think that the EU is in the punishment game but they have not thought matters through.

- They cannot continue the same level of trade with the UK if the UK suffers a fall in exports due to EU regulatory complexity or trade problems following Brexit.
- Trade problems for the UK will result in a flood of EU workers returning home.
- Trade problems will mean there will be no will and no ability for the UK to make any financial settlement.

The EU has misidentified itself as a legal entity instead of as a political one. It is said that in the end the EU prizes its regulatory market and 'European unity' over any other goal. Yet the EU is now seriously at odds with all its major neighbours, Russia, Turkey, the United States and, possibly, the UK.

Unfortunately the EU made up its own negotiating mandate without any consultations with the UK. The Heads of State meeting to endorse the negotiating guidelines only lasted a few minutes. The British government originally said that it would not agree to this for the reasons outlined above but, on the first day of talks in Brussels, it caved in. This sequence of events has created a lot of problems.

Accepting the disregard for the Treaty and initiating discussions based on the EU sequencing mandate means the negotiations will inevitably fail.