

von Ondarza, Nicolai

Research Report

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The Trouble with Transition

No Off-the-Shelf Arrangement for the UK after Brexit

Nicolai von Ondarza

The transition will be the most important medium-term issue in the second phase of the Brexit negotiations. The United Kingdom is due to leave the European Union officially in March 2019, too soon to negotiate a detailed agreement on future relations. With neither side standing to gain from a cliff-edge, the British request for a transitional arrangement falls on open ears. But finding agreement will be no easy matter. From the EU's perspective the only acceptable option is full and complete replication of the status quo, with the UK accepting and implementing EU rules for two years without having any say over them. This will include Prime Minister Theresa May needing to secure a parliamentary majority accepting "rule-taker" status for the UK – and breaking all the promises of the advocates of Brexit for at least two years.

The clock is ticking for London. After triggering Article 50 of the Treaty on European Union on 29 March 2017, the UK is due to leave the EU exactly two years later. Before the UK becomes a third state on 29 March 2019, Prime Minister Theresa May hopes to negotiate a comprehensive "Deep and Special Partnership" with the EU, with the UK outside the single market and the customs union.

Currently, however, the two sides are miles apart: talks on such an agreement are only just about to begin. The EU-27 made negotiations on the shape of the future relationship conditional on "sufficient progress" first being achieved on the divorce settlement – on London's outstanding financial obligations to the EU, the rights of EU citizens and the Irish border question. This was

already a difficult process. May is politically weakened after losing her majority in early elections she called herself in June 2017; her cabinet is divided and she depends on Northern Ireland's Democratic Unionist Party for her parliamentary majority. This left her unable to conclude the first phase of negotiations with the EU-27 as hoped in October 2017.

After tough negotiations, especially on the Irish question, May made significant concessions in all three areas; in December 2017 the EU negotiators were finally satisfied that sufficient progress had been made. Now the truly difficult questions about the future relationship must be tackled (see SWP Comment 49/2016). The European Council is now preparing to define the EU-27's guidelines for future relations in trade

and other matters such as foreign policy, security, defence, and the fight against terrorism at its next meeting in March 2018. Experience to date – with wide-reaching free trade talks in general and with the Brexit negotiations specifically – suggest agreement on anything more than a general framework will be virtually impossible to achieve before “Brexit day” at the end of March 2019.

Three Concepts for the Transition

The rigidity of the timeframe magnifies the urgency of finding a transitional arrangement. May first explicitly floated the idea in her Florence speech in September 2017.

There are, however, three distinctly different concepts concerning how the transition should be defined and what goals it should pursue. British businesses want to be able to plan for the period after March 2019, without fear of a “disorderly Brexit” causing great economic disruption. Especially in the financial sector, they therefore want to see trade arrangements for the period after 30 March 2019 clarified by spring 2018 at the latest, with full participation in the single market and the customs union guaranteed for as long as possible after Brexit. Otherwise, they argue, businesses will have to prepare for a disorderly Brexit and activate contingency plans.

Prime Minister May, on the other hand, speaks of an “implementation phase”. She sees this being agreed at the same time as the future relationship – whereby the transition would ease the way into the new relationship. May’s implementation phase would thus gradually transition the UK into its new role as a third state with a “Deep and Special Partnership”. This also implies that parts of the EU’s acquis would successively cease to apply in the UK as the process rolled out. This would be comparable to reversing the transitional arrangements for new EU member states, for which some parts of the EU acquis (like full freedom of movement of persons) only came into force step by step after they joined the Union.

The Interests of the EU-27

The EU-27 has its own ideas. It is willing in principle to agree a transition phase. In its guidelines for the Brexit negotiations, the European Council stipulates that transitional arrangements may be made “to the extent necessary and legally possible”.

Crucially, however, the European Commission regards a transitional phase principally as a means to gain more time for the complex negotiations on the future relationship. In this view the withdrawal agreement will only define the general political principles for the future relationship. But full trade negotiations will only be concluded during the post-Brexit transition, after the UK has become a third country. The Union’s stance for this “standstill” transition is predicated on preserving the integrity of the single market, without exceptions, in pursuit of three objectives:

Firstly, a transition phase only makes sense for the EU-27 if the UK accepts the EU’s entire acquis for the whole period and participates fully in all the Union’s policies. Permitting London to cherry-pick the most advantageous aspects of the acquis would undermine the single market and weaken the EU’s position in negotiations over the future relationship. Secondly, the EU-27 has its own interest in seeing the UK leave the EU’s political institutions in March 2019: as a third state it will no longer participate in the Union’s decision-making processes, nor stage elections to the European Parliament in May 2019. Thirdly, a transitional arrangement would allow one of the most difficult Brexit issues – the problem of the border between Northern Ireland and the Republic of Ireland – to be deferred. Notwithstanding the UK’s commitment to “regulatory alignment” with the EU’s single market and customs union in the areas necessary to keep the border open as part of the political agreement on “sufficient progress”, the challenges involved in actually realising this are far from solved. From the EU’s perspective any transition arrangement must therefore guarantee that the status quo is preserved, by keeping the UK

fully in the single market and customs union.

The Devil in the Details

In principle the UK government, British businesses and the EU-27 would all like to see a transitional phase. Where they differ is in what shape and for how long the arrangement should apply. The EU in particular will insist on a comprehensive agreement with a “status quo transition”, and refuse gradual implementation.

But there are also legal and political obstacles to a “status quo” arrangement. Legally speaking, the UK cannot maintain its status quo, given that the very essence of Brexit is that the UK’s status changes from EU member state to third state. So the two sides will need to agree the conditions and timeframe for maintaining the substance of the UK’s EU membership, in particular participation in the single market and the customs union.

So a mere political agreement to preserve the status quo will not be enough, especially given the recent discussions in the UK questioning the seriousness of the political commitments that ended phase one of the Brexit negotiations. Instead a format will need to be found for a transition regime that keeps the UK within the EU’s legal order. Legally speaking, transition rules can be adopted as part of the withdrawal agreement under Article 50 as long as they are clearly limited in time. But politically this would require London to submit to European law – over which it no longer has any say – for the duration of the transition period. The more closely the requirements are examined, the more serious the doubts about the political feasibility of transition.

Preserving the EU’s Legal Order

If the UK is to preserve the status quo during the transition it will need above all to promise to remain within the EU’s legal framework. The Union and its single mar-

ket represent in the first place a shared legal order. On the other hand, under Article 50 (3) the EU treaties cease to apply in the departing state on the day the withdrawal agreement comes into effect. For that very reason, London is transposing the entire EU acquis into British law with effect from Brexit day, through the so-called Withdrawal Bill. At first glance that would appear to ensure ongoing convergence between EU law and British law. At the same time, however, the Withdrawal Bill revokes the European Communities Act of 1972, which is the central legal foundation of the UK’s membership and the conduit connecting British and European law.

Even if the Withdrawal Bill passes both houses of the British parliament and the country adopts European law in full, four legal – and thus political – challenges remain:

Firstly, the vision of the UK as a fully sovereign country whose laws are – as demanded by Theresa May – made only in Westminster and the UK’s devolved parliaments and overseen only by British courts is fundamentally incompatible with remaining within the EU’s legal order. One of the Brexiteers’ central arguments has been to restore national parliamentary sovereignty (“take back control”). This is incompatible with one of the fundamental principles of European law as established by rulings of the European Court of Justice (ECJ): in any conflict between national and European law, European law takes precedence. The Withdrawal Bill annuls that principle with effect from the date of departure, permitting the British parliament and government to deviate from EU law. In legal terms, this is the very essence of Brexit. Yet a status quo transition would require London to guarantee ongoing primacy of EU law equivalent to the existing European Communities Act, by accepting the rulings of the ECJ as binding. Otherwise, for example, London would be able to undermine the single market by adopting lower standards than the EU’s.

Secondly the UK would have to promise to transpose all new EU legislation. Most EU

legislation is based on directives, which member states are required to transpose in their national legislation within a defined period. As long as the UK retains full access to the single market during the transition it will have to promise to transpose all new directives in British law – without having any say in their drafting. To date this has been guaranteed by the UK's European Communities Act, which also obliges the Scottish, Welsh and Northern Irish regional governments to transpose EU directives in matters falling within their powers. In public statements London has shown itself open to a solution, arguing that legal acts requiring transposition during a two-year transition would largely be those in whose creation the UK government had already participated. Political conflicts are, however, easily imaginable over EU directives in areas where the UK often disagrees with the rest of the EU, such as financial regulation.

Thirdly, EU law also has direct effect in the member states. In the UK to date this has also been guaranteed by the European Communities Act. But if the UK wishes to continue participating in the single market it will have to guarantee at least to enact EU regulations in such a way as to give them immediate force in British law (as the EEA states already do). That would also apply to EU regulations adopted largely or entirely without British participation during the transition phase.

Fourthly it would be necessary to define effective legal enforcement mechanisms for the transition. This raises questions concerning the jurisdiction of the European Court of Justice: To what extent do its rulings remain binding on British courts? Can the UK be brought before the ECJ if it fails to fulfil its legal obligations? Can British courts refer legal questions to the ECJ during the transition, and if so under what circumstances? Although Prime Minister May has not entirely ruled out a role for the ECJ during the transition, the details of any arrangement for jurisprudence, dispute settlement and enforcement of EU rules are likely to turn out to be extraordinarily complex.

In order to satisfy all these requirements, the UK would have to at least partially suspend the Withdrawal Bill for the transition period and enact instead a "Transition Act" equivalent to the European Communities Act. In other words, the prime minister needs a political majority in both houses of parliament for effectively making the UK a rule-taker during the transition. In view of her dependence on the pro-Brexit DUP for her slim majority, and more than forty hard Brexiteers in her own parliamentary party, it is by no means certain that she could win such a vote without the support of the opposition. If this involves binding the devolved administrations of Scotland, Wales and Northern Ireland to the EU's legal order – as currently provided by the ECA – the matter could become even more politically challenging.

The UK and the EU Institutions

Any transitional arrangement will also have to clarify the UK's institutional position. Prime Minister May has already announced that the British will leave the EU's "political" institutions during the transition. What exactly that is supposed to mean remains to be determined. The European Council, on the other hand, clarified that the UK will no longer "participate in, nominate or elect members of the EU institutions, nor participate in the decision-making of the Union bodies, offices or agencies".

While that is simply a natural consequence of leaving the EU, it becomes politically sensitive in any transitional arrangement, especially in relation to policy areas where the EU makes distributive decisions. In the Common Fisheries Policy for example, the EU-27 could adopt quotas disadvantaging the UK. For that reason Michael Gove, current British secretary of state for environment, food and rural affairs and a leading figure in the leave campaign, is demanding that the UK leave the Fisheries Policy during the transition phase. Other North Sea fishing nations like Denmark, the Netherlands and Ireland are likely to

be keen to preserve the EU quotas, assert their own fishery interests and insist that the UK remains bound by quotas the EU will decide without its participation.

Nor should sight be lost of the difficulties arising in the EU's second-tier bodies, including the comitology committees where implementing decisions for EU legal acts are agreed. The significance of the committees, in particular for the functioning of the single market, was highlighted by the recent controversial glyphosate decision. European Economic Area members are admitted to the committees under Article 100/101 of the EEA Agreement, while other third states are not. While the UK would be bound by their decisions, the current Council guidelines rule out participation by British representatives. Drawing comparisons to the EEA, the UK will have grounds to object to that principle.

There are also doubts concerning the UK's role vis-à-vis the currently thirty-eight EU agencies, some of which play crucial roles in regulating the single market. Third states like Norway are represented in the agencies alongside EU member states on a case-by-case basis. But they generally have no voting rights, even though they are bound by the agencies' decisions, associated EU legislation and ECJ judgements. Both for the transition and for the future relationship, the UK and the EU-27 will therefore have to negotiate UK participation for each of the thirty-eight agencies separately.

Finally, on a general level, the UK's role during the transition period as a taker of EU rules it cannot influence raises the question of an institutional forum. The UK will have legitimate grounds to claim that even as a third country, if it is fully bound by EU rules, there need to be some institutional forum for information exchange, dispute settlement and coordination.

EU Citizens and Freedom of Movement

Another of the EU-27's conditions for a transition phase is the preservation of all four freedoms of the single market. In the UK

the question of freedom of movement is highly charged: as far as the British government is concerned, reducing (labour) migration from other EU states was a (if not the) central motive behind the British leave vote. That is why Theresa May initially announced in 2016 that freedom of movement would end as soon as the UK left the Union.

In the meantime London has conceded that freedom of movement will continue to apply in the transition period. EU citizens who settle in the UK during this period will be required to register, and the system's compatibility with EU law will need to be carefully scrutinised.

The rights of EU citizens within the UK are also affected. In the first phase of Brexit talks London and Brussels agreed to safeguard the rights of all EU citizens living in the UK on the date of withdrawal. If freedom of movement is retained, however, the same question arises for EU citizens entering the UK during the transition phase. Most jobs appointments and university courses operate on timeframes longer than the planned two-year transition. The EU needs to insist that the UK supply legal clarification on this point and ensure that these citizens are not forced to leave again at the end of the transition. The same should naturally also apply to British citizens in the EU.

Trade and the Customs Union

In order to temporarily maintain the status quo, special provisions will also be needed in relation to external trade policy. After leaving the EU the UK will legally become a third state like any other, and will no longer be covered by trade agreements between the EU and other third states such as Canada, South Korea or the EEA.

This is principally the UK's problem. Most such agreements contain clauses restricting their validity to the territory of the EU or of its member states. So in the transition period the UK will already be seeking to adopt the EU's agreements with third states – as quickly as possible and largely

unaltered. But to judge by initial discussions, such an outcome is neither guaranteed nor without consequences for the EU partners. For example, the EU-27 and the UK have proposed to the WTO that the EU's existing import quotas be shared between the EU-27 and the UK. But partners like the United States, Australia and Canada object on the grounds that the proposal restricts their freedom to redirect exports in line with economic developments. Furthermore, remaining within the EU's customs union during the transition will limit the UK's ability to strike trade deals with other third countries, as it will still be bound by the EU's customs regime at least until transition ends.

The economies of the EU-27, however, must also reckon with indirect effects. Firstly, the UK's status as a third state also changes rules of origin calculations. For example, under its free trade agreement with the EU, South Korea charges no tariffs on imported cars if at least 55 percent of their content is produced within the EU. After Brexit, car parts produced in the UK will no longer count towards the EU share, which could then in some cases fall below the exemption threshold.

Secondly, therefore, even if the UK remains in the single market during the transition customs controls will still be required between the UK and the EU-27/EEA to enforce rules of origin. This will also affect border arrangements between Ireland and the UK.

Thirdly, many important free trade agreements contain most-favoured-nation clauses. Under CETA for example the EU must offer Canada any tariff concessions it grants to other states in a comparable framework. So the EU and the UK cannot agree reciprocal exemption from duties without granting the same to other third states, and thus accruing additional obligations.

If the EU wishes to preserve the complete integrity of the single market, the EU-27 will have to seek the agreement of the EEA and all other affected third states that the

UK is covered by the respective agreements during the transition. That would demand considerable political and legal effort, even if most third states are likely to be fundamentally cooperative.

New Budget Obligations – Even after the “Brexit Bill”

Furthermore, the status quo can only be preserved if financial arrangements are kept in place. In the agreement that brought the first phase of the negotiations to its conclusion, the UK committed to fulfilling all the financial obligations it took on as EU member state, in particular during the current multi-annual financial framework (MFF).

It should be noted that the current MFF expires at the end of 2020. If the transition phase extends beyond that, further British contributions to the EU budget will be required. That would complicate the negotiations for the next MFF, in which the UK would figure simultaneously as member state and future third state. At least for the duration of any transition, the EU will insist on further financial contributions. In comparison, Switzerland and Norway also contribute to certain EU funds in proportion to their GDP – without having a vote on the EU's budget planning. Furthermore, when the UK leaves it will also lose the famous budget rebate that has capped its net contribution since 1985.

The political sensitivity of further financial demands should not be underestimated. May promised that the days of large financial contributions would be over after Brexit, and struggled to secure backing within her party and cabinet for the commitments already made by the UK. The British would feel that the EU was coming straight back for more, when they had just agreed to pay the EU a figure in the high tens of billions.

Duration and Extension

Finally, the duration of the transition regime will need to be agreed. British business representatives have called for a period of up

to five years, as has the Irish foreign minister; Prime Minister May and Brexit Secretary David Davis speak of about two years.

The EU-27 have yet to agree on this point. The “natural” deadline would be the end of the current MFF in December 2020, but that leaves a transition of just twenty-one months. In view of the experience of the Brexit talks thus far, even two years will not be enough to conclude a comprehensive agreement on future relations between the EU and the UK. In addition, a future trade deal will most likely be a mixed agreement, which requires lengthy ratification across all the EU’s national parliaments.

This immediately poses the question of whether the transition period can be extended. If trade talks run into obstacles the EU-27 and/or the British government might be interested in acquiring more time, but the mere suggestion would provoke howls of protest in the UK. But the two-year limit on Article 50 has already proved to be a significant complicating factor for the Brexit negotiations. Any transitional arrangement should therefore contain an extension option from the outset.

Alternatives

Despite fundamental willingness on both sides, (rapid) agreement on a transitional arrangement is therefore anything but certain. The question of alternatives to the “status quo” transition outlined above is pertinent for both the EU’s negotiators and the British government.

The simplest route in legal terms would be to extend the two-year deadline for the withdrawal talks. Under Article 50 (3) TEU this can be decided at any time without legal constraint, by agreement of all member states including the UK. The latter would remain a normal member of the EU until agreement was reached or the agreed extension expired. But politically neither side is currently speaking about such a solution. For the EU-27 it would mean the departing UK participating in the next European Parliament elections in May 2019, keeping its

seat at the table and right of veto for the duration. And the already fragile British government would have to abandon its central symbolic objective of accomplishing its departure by March 2019. But if the UK finds itself facing growing economic pressure and/or political turbulence, a request to extend the deadline would be conceivable.

Another option, in the event of failure to reach agreement, would be for the UK to leave without a transition. Given that the transition is being negotiated as part of the Article 50 process, this would call into question the entire withdrawal agreement. There are presently two “no deal” scenarios. One would follow the overall collapse of talks (“hostile no deal”) without agreement on withdrawal, transition or the future relationship. At the end of the two-year period all the EU treaties would cease to apply to the UK, without any alternative legal arrangements. The currently politically agreed divorce settlement would not come into force either, negating the UK’s commitment to securing the rights of EU citizens and meeting its financial obligations. As well as reverting to WTO trade rules, the UK would fall out of all the Union’s other regulatory arrangements with dramatic consequences for the British economy. The first-phase agreement, where London made significant concessions, has made this scenario considerably less likely.

The second “no deal” scenario would be a pure withdrawal agreement between the EU and the UK, including the components agreed in the first phase but without London agreeing to conditions for the transition. In this scenario of orderly withdrawal trade would also revert to WTO rules, but the two sides would at least agree flanking measures to avert the worst (for example permitting British airlines to continue flying to the EU). This is technically possible, but politically problematic, as the Conservative Party in particular would have to accept the budget liabilities with no transition in return. It is also questionable how the British-Irish border could be kept fully open under this scenario.

At least in theory the UK could revoke its notification of intention to leave under Article 50 and remain a member of the EU. Although this option is not explicitly mentioned in the treaty, EU leaders like European Council President Donald Tusk have always insisted that the door remains open. In view of the current state of British politics, however, the likelihood of such a turn of events must be small. Barring a major shift in British public opinion, a Brexit U-turn would tear even further into the Conservative Party and the divided nation.

Outlook

A transitional arrangement thus remains the best of a range of problematic options for both the UK and for the EU-27, despite the complexities involved in implementation. On the basis of the above overview of the components required for a transitional arrangement that maintains the status quo, three central conclusions can be drawn.

Firstly, the British government will have to deny all the main objectives of the Brexit supporters, at least until 2021, if it wishes to fulfil the EU-27's conditions for maintaining the status quo during a transition phase. A status quo transition regime will only be viable if the UK anchors the EU's legal framework in UK law for the duration of the transition by means of a "Transition Act", including the primacy of EU law, its direct effect and jurisdiction of the ECJ. This is made more difficult by the May government's domestic weakness, where she will need the support of hard Brexiteers in her parliamentary party and in cabinet to turn the UK into an (albeit at least time-limited) rule-taker. Instead of taking back control, the UK would in effect cede sovereignty to the EU on an unprecedented scale. Instead of enjoying voting or even veto rights, it will be reduced to accepting and implementing EU decisions. This makes agreement on such transitional arrangements far from politically certain.

Secondly, the complexity of the highly controversial political negotiations clashes

with business's demands for rapid clarification. The red lines on both sides and the experience to date with the Brexit talks suggest that more hard talk is still to come – not just between Brussels and London, but between different sides in London. But it is not just the UK that will have to make tough choices over the shape of the transition. The EU-27 will also face difficult questions, for example concerning the UK's role in the EU institutions, further post-2020 financial obligations, and the role of the ECJ. The extent to which the EU's free trade agreements apply to the post-Brexit UK will also have to be clarified with third states.

Thirdly, the transition phase will not form a bridge to a predefined future relationship between the EU and the UK. It will merely be a means to keep the UK within the EU's legal framework for a little longer in order to negotiate the future relationship. March 2019 is an unrealistic deadline for a comprehensive agreement, even a two-year transition phase is ambitious. The transition is not a side-show; it will shape the relationship between the United Kingdom and Europe for years to come.

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SWP
Stiftung Wissenschaft und Politik
German Institute for International and Security Affairs

Ludwigkirchplatz 3–4
10719 Berlin
Telephone +49 30 880 07-0
Fax +49 30 880 07-100
www.swp-berlin.org
swp@swp-berlin.org

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