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UK-EU RELATIONS AFTER BREXIT

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Introduction

Britain has now settled into the hard graft of ensuring that its new Trade and Cooperation Agreement (TCA) with the EU will work in practice. As expected, the TCA has created some difficult problems, none greater than the post-Brexit trading relationship between Britain and Northern Ireland, given that the latter has remained inside the EU Single Market. Along with other disputes over Covid-19 vaccine exports and fisheries, the risk is that the UK-EU relationship will deteriorate before it is able to settle into a healthy, new ‘modus vivendi’.

I begin this paper by examining the current status of the UK-EU relationship.

I then take a look at how the UK-EU relationship might evolve over the forthcoming months and into next year. Next, I discuss whether the close alignment that exists between the UK and EU member states on most foreign policy challenges (Russia, China and combatting climate change, for example) might help stabilise the relationship. I also consider whether the Biden administration might offer some positive external discipline to the UK-EU relationship. I finish up with some conclusions on the future of the UK-EU relationship.

1. The status of the UK-EU relationship today

In simple terms – the relationship is bad. When the Boris Johnson government came into power in July 2019, it moved quickly to negotiate a basic Free Trade Agreement with the EU.

In essence, this is a zero-tariff, zero-quota agreement for trade in goods, but it does not provide for any mutual recognition of the product regulations or standards of each side, or any preferential treatment for trade in services.

This is a drastic change from the status quo ante. Gone are the plans of the Theresa May government for the UK to retain privileged access to the EU Single Market, which would have required agreement on some sort of ‘dynamic’ alignment between future UK regulations and those of the EU.

That said, a ‘soft Brexit’ was never on the cards. For example, the notion of the UK remaining the EU Customs Union after Brexit – as some British MPs continued to recommend during the negotiations – was always a pipe dream. It would be impossible for a UK government to hand over sovereign control of negotiating trade agreements with third countries to the EU.

But, even if a relatively ‘hard’ Brexit was inevitable, the deal negotiated by the Johnson government is particularly bad for the UK from an economic perspective.

First of all, the UK has run a trade deficit in goods with the EU for several decades. The TCA’s focus on sustaining bilateral flows of goods trade between the EU and the UK now risks entrenching the EU’s structural advantage. In contrast, the UK government has accepted a TCA that puts up new obstacles to exports of UK services to the EU, notwithstanding the fact that the UK runs a surplus in services trade with the EU.

For example, financial services were the UK’s most successful export to the EU. These services no longer benefit from the ‘passporting’ rights into the EU that had previously allowed UK-based

financial institutions to offer their services to EU customers under UK regulatory standards and supervision. Instead, UK-based banks must now wait for the European Commission to make a series of assessments on ‘equivalence’ to the way that specific UK financial services are regulated and offered in the EU, whether these be in insurance, asset management or investment banking. The Commission is then entitled to withdraw its equivalence assessment, and reimpose barriers on financial services trade into the EU, with minimal notice.

Apart from financial services, a host of other services that few people had given much thought to previously have also been negatively impacted; these include music groups, film-production teams, garden designers, ski instructors and IT specialists who now face new obstacles if they wish to ply their trades in the countries of the EU.

Moreover, the British government has not yet begun to impose customs or regulatory controls on goods coming into the UK from the EU because the UK’s new customs systems and staff are still not ready to deal with the huge, extra burden of post-Brexit border controls. However, the EU has already started implementing its full suite of regulatory controls and checks on UK goods being exported to the EU.

Secondly, the new arrangements are creating new frictions on trade between Great Britain and Northern Ireland. Northern Ireland was granted unique status under the UK’s Withdrawal Agreement from the EU (the agreement that preceded the TCA). In 2020, Johnson agreed to Northern Ireland remaining inside the EU Single Market and its Customs Union, although it will remain a sovereign part of the UK. This decision was taken to avoid the need to reimpose any sort of physical border, or any sort of behind-the-border

checks, between Northern Ireland and the Republic of Ireland. If these checks had been imposed, they would most likely have undermined the Good Friday Agreement of 1998, which has brought peace to the island of Ireland over the last two decades. This could result in the return of sectarian violence.

However, the outcome is what the Democratic Unionist Party (and the Theresa May government) warned would happen: the imposition of a border down the Irish Sea between Northern Ireland and Great Britain, and a consequent decline in GB-NI trade.

For example, British-based firms can no longer export ‘chilled meats’ (including their sacred sausages) to shops in Northern Ireland, as trade in these products is not permitted under the TCA for health reasons.

This has stoked fears among the Unionist community in Northern Ireland that the TCA is going to drive demands for the unification of Northern Ireland and the Republic of Ireland. And Boris Johnson has woken up to the real risk that he could be held responsible for the reunification of Ireland – a politically unacceptable outcome for the leader of the ‘Conservative and Unionist’ Party.

The third problem area of the TCA concerns migration. Immigration from the EU to the UK has fallen drastically since the 2016 referendum. In 2016, the year of the EU referendum, roughly 220,000 of the 330,000 net immigrants to the UK came from the EU. In 2020, these figures had been reversed completely, with EU immigration accounting for only 20% of the total.

So, might this count as a Brexit success for the Johnson government? If we consider this point in terms of the reduction in the number of people coming from the EU to look for work – which was

one of the demands of many Brexit supporters – the answer is yes. But the change in migration patterns has also brought some severely negative short-term effects for the UK economy. There is now a shortage of workers in the lower-paid sectors of the UK economy such as hospitality (restaurants and hotels), food processing and agriculture. As an iconic reflection of this problem, the UK will need to import an additional one million turkeys if British consumers are to enjoy their traditional Christmas dinner this December. And in the more immediate future, a shortfall in the number of qualified British lorry drivers has resulted in supply shortages at many British businesses, including supermarkets. This has contributed to the dramatic fuel shortages and panic-buying at petrol stations that the UK experienced in early October.

In addition to these three major post-Brexit disruptions to UK-EU relations, there are a number of other less publicised frictions. For example, there have been reports in official British circles that the French government has been delaying the inclusion of UK universities and other scientific groups in consortia that are competing for projects under the EU's Horizon R&D programme. This is despite the fact that the UK reached an agreement during the TCA negotiations to remain part of Horizon and notwithstanding the fact that it is paying its full share of the Horizon budget.

The lack of barriers to the sharing of consumer and other data between UK and the EU companies has been one of the few positive signs for UK-EU relations in the post-Brexit era. Here, the EU has accepted that the UK meets the necessary EU standards. This is of major importance for both sides given the large foreign investment stakes that EU and UK companies still have in each other's markets. But this is just one of the few bright spots in an otherwise bleak landscape.

2. How might the UK-EU relationship evolve over the next year or two?

Where are we headed right now? In the short term, we are heading to a worse place. Far from declining, obstacles to EU-UK goods trade are likely to increase in the months to come.

At the end of the year, the EU will start to require formal proof of the origin of all components contained in UK goods that are being exported to the EU. At least 55% of the content of these goods must come from the UK or the EU if they are to be traded into the EU without tariffs or quotas.

The aim of these 'rules of origin' is to ensure that the UK does not become a satellite for third countries exporting products into the EU under the zero tariff/zero quota arrangements that the UK enjoys under the TCA. These requirements will greatly increase the paperwork that British companies will have to fill out and they might even result in some smaller businesses deciding not to export to the EU or to move their operations to EU Member States.

The UK should finally get around to imposing its own checks on the customs paperwork and regulatory standards of EU imports into the UK market between January and July 2022.

The Irish problem might reach boiling point by then. If UK and EU negotiators fail to find a compromise in the coming weeks on reducing the number of checks being imposed on UK exports to Northern Ireland, the UK might end up using the 'nuclear option' of triggering Article 16 of the Northern Ireland Protocol and suspending all customs checks on trade across the Irish Sea. If the EU were to conclude that this safeguard mechanism had been implemented unfairly, the EU might then retaliate in other areas of the

trading relationship – as permitted under the TCA – and impose new restrictions on specific goods and services flowing into the overall EU market.

During recent negotiations, the EU offered some major concessions, including the removal of border checks on products imported into Northern Ireland from the UK and designed (and labelled) to be sold only in that market. The EU is also allowing UK-produced medicines to be sold in Northern Ireland without the need for approval by the European Medicines Agency. However, the UK is making what looks like a deal-breaking demand, which is that the European Court of Justice should no longer have an oversight role over market issues in Northern Ireland, even though the region operates within the EU Single Market and Customs Union. Compromise on this issue is highly unlikely.

Fishing quotas are another potential flashpoint. The UK has disappointed the French in particular with the number of boats that the UK has licensed to fish inside its coastal waters.

Another French blockade of the Channel Islands is not out of the question. The imminent French presidential election in spring 2022 has made this subject a highly charged political issue.

In the field of financial services, the City of London has continued to perform quite well globally, despite having lost some important EU-related business to other European financial centres. And it is likely that the EU will grant the UK equivalence in a few specific financial sectors. However, the Bank of England will inevitably approve some regulatory divergence from the EU standards as it seeks to protect and enhance the City of London's position as one of the world's leading international financial centres.

We should also expect new divergences between the UK and EU in the area of data governance. British citizens take a more relaxed approach to the regulation of personal data than the German-led EU approach. This is partly due to the long-standing terrorist threats the UK has experienced and partly because of greater confidence in the judiciary to protect individual interests from the excesses of government agencies.

Nevertheless, data, along with financial services, is also one of the two areas where the Johnson government believes Brexit can deliver clear long-term benefits for the British economy. The levels of foreign direct investment (FDI) in the British tech sector appear to bear this out. The UK recorded the highest ever levels of FDI in tech start-ups in the first six months of 2021 (\$18 billion), which is larger than the funds invested in France, Germany and Israel combined; and three times higher than the same period in 2020.

When all is said and done, British domestic politics is one of the main reasons why UK-EU relations will not improve in the short term. The next UK general election is due to be held by July 2024 at the latest. But Boris Johnson might decide to bring the election forward to 2023, as the economy emerges from the Covid crisis, and before the Labour Party can get better organised. For the purpose of the next election, Johnson may once again need to fire up his base of Brexit supporters, putting UK-EU relations under continued stress.

3. Can foreign policy bridge the UK-EU divide?

Sadly, cooperation on foreign policy is also unlikely to bridge these divides in the near term. When it was negotiating the TCA, the Johnson government chose not to negotiate a separate treaty or agreement with the EU on setting out the objectives and structures for UK-EU cooperation on foreign and security policy. This was a break with the plan of his predecessor Theresa May and came as a surprise to the EU members. A formal arrangement for regular consultations with the EU on foreign and security policy would have provided both sides with greater predictability and transparency.

However, the decision reflects the Johnson government's view that it should start out on its solo journey as 'Global Britain' with as much flexibility as possible in terms of its foreign and security policy choices. It also avoids the appearance and reality of the UK being an observer rather than a decision-maker on European foreign policy. Instead, the UK can hold out for the prospect of a more structured relationship in the future, once the broader relationship has settled down into a more positive rhythm.

In the meantime, the UK has focused on building its bilateral relationships and strengthening its diplomatic presence in a number of EU capitals. In addition to its pre-existing 2010 Lancaster House defence treaty with France, the UK is developing bilateral coordination structures on foreign and security issues with Germany and Poland.

Furthermore, the UK still benefits from the intergovernmental coordination of the 'E3' grouping alongside France and Germany, which currently focuses on the nuclear negotiations with Iran. This may provide the basis for further flexible foreign policy coordination with a small group of EU members, even though the arrangement

has caused resentment among other EU states that are excluded from the process.

The UK is also looking around and beyond the EU. It is investing time and resources in the Northern Group of countries, which meets regularly to discuss defence and security issues with Denmark, Estonia, Finland, Germany, Iceland, Latvia, Lithuania, the Netherlands, Norway, Poland and Sweden. It has also initiated and it leads the Joint Expeditionary Force, which is made up of many of the same northern group of countries.

Above all, it is investing its main diplomatic efforts as well as its defence focus and resources in NATO. Indeed, in terms of military spending and troop commitments, the UK is the second most important member of NATO after the US. It is one of the lead contributors to NATO's policy of Enhanced Forward Presence, and it heads a multinational NATO battalion in Estonia. As one of NATO's Framework Nations, the UK initiated and leads the Joint Expeditionary Force, which is mostly made up of NATO's northern members plus a couple of non-NATO members.

In the UK's Integrated Review on Security, Defence, Diplomacy and Foreign Policy of March 2021, the Johnson government emphasised that the UK would be Europe's main Security Ally. And it stressed that Russia remains the main physical threat to the UK and its interests. However, the EU barely features in the Review. Instead, the focus is on NATO and other more flexible forms of cooperation.

The other main feature of the Integrated Review is its reference to the much-hyped "tilt" in British foreign and defence policy towards the Indo-Pacific. This reflects the rising importance of this region to British and global economic health, as well as the fact that the

region contains several longstanding, important bilateral relationships, such as those with India, Singapore, Japan and Australia.

The Indo-Pacific tilt could have been a point of convergence between the UK and the EU, given that the EU itself has just issued its own Indo-Pacific strategy, alongside the strategies presented by other EU Member States with an interest in the region, especially France, Germany and the Netherlands. But the surprise announcement on 15 September 2021 of the new defence partnership between Australia, the UK and the US has undercut this potential avenue for UK-EU cooperation for now.

The way in which ‘Aukus’ was secretly negotiated behind France’s back, scrapping its own nuclear submarine deal with Australia, has encouraged several EU governments, especially the French, to strengthen calls for the EU to build up its own ‘strategic autonomy’ from the US, an impulse that will initially exclude, rather than include the UK. Even if this means that the autonomy is more rhetorical than real, Aukus is a timely reminder that the UK’s main strategic ally remains the US, and not the EU.

If the UK is to build a long-term strategic partnership with the EU, it will need to start by taking a more indirect route. The G7 grouping, which the UK has been chairing in 2021, includes France, Germany, Italy and the EU as an institution. With the arrival of the Biden administration and its desire to strengthen the liberal democratic group of countries in the world, the G7 could provide a good framework through which the UK can work with its EU partners, alongside the US and Japan, on their many areas of common interest, such as confronting the rise of China, promoting the modernisation of the WTO, and combatting the spread of state surveillance technologies.

The G7 can also serve as a base from which to engage other key democratic partners, several of which were invited by the UK to the G7 summit that it hosted in Cornwall in June this year: including India, Australia, and South Korea.

Conclusion

My forecast for the UK-EU relationship is gloomy for the short term. Domestic politics in the UK, the structural realities of the UK-EU Trade and Cooperation Agreement, the Irish question, and the paucity of opportunities for foreign policy cooperation have led the UK and EU into a painful period in their relationship and one that they are stuck in.

However, my outlook for the medium term is more positive, and this is down to three reasons. First, the UK and the EU cannot ignore each other. The EU could be described as the earth to the UK’s moon. The UK cannot escape the gravitational pull of the EU but the EU cannot stop the UK from moving the tides within the EU. This means that the two sides will have to compromise with each other in the future, whether it be on Northern Ireland, new forms of regulatory coordination and informal alignment, or structures to coordinate foreign policy.

Second, Brexit Britain will eventually settle into a more stable relationship with itself and with the world. The UK has signed trade agreements with all the states it previously engaged with through the EU. It will soon complete bilateral deals with Australia and New Zealand, and it is now moving into new territory with its recent bid to join the CP-TPP (the Comprehensive and Progressive Trans-Pacific Partnership). The British government might also strike some sectoral deals with the US – possibly on

data and financial services – even if a UK-US FTA is not on the cards any time soon.

Completing these deals will give the UK government greater confidence to strike compromises with the EU.

Third, British politicians now have no excuse for their past failures to improve the domestic economic and social conditions of the many Britons who voted for Brexit. They can no longer indulge in the fiction that Brussels was holding Britain back.

Consequently, we are seeing a conservative Johnson government undertake an expansive ‘levelling up’ programme of investments in infrastructure and key social services that are designed to break down the divides between the richer South and the poorer North, and to include impoverished coastal towns.

If these are successful, the UK might be able to unlock a new dynamism in its economy that would compensate for the increased costs of being less integrated within the EU. A Britain that could regain its economic foothold outside the EU, and one less divided internally and economically at the same time, would also feel more confident to negotiate and compromise with the EU.

However, there is one big unknown factor that could prove to be a major disruptive risk to this benign medium-term scenario, and this is Scotland. The governing Scottish National Party is determined to call another referendum on independence, although the timing is difficult to predict. I would not expect another referendum until after the next UK election in 2023/24. Nevertheless, Brexit, which nearly two thirds of Scottish voters voted against in 2016, and antipathy to the ‘English’ Johnson government are two powerful new forces that are driving previously sceptical voters towards considering independence next time around.

If Scotland should ever vote for independence and then apply for EU membership, a wounded English nation might once again turn its anger on its European neighbours and push UK-EU relations to a new low.

The case of Scotland serves as a reminder that Britain’s relationship with the EU remains hostage to deeply held sentiments of history and identity. General Charles de Gaulle warned his European counterparts that the UK was not a natural or reliable member of the EU. The 2016 referendum proved him correct. However, the UK and EU are destined to remain intertwined whatever the shape of their institutional relationships.

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