CENTRE FOR EUROPEAN REFORM

Insight

'Canada', 'Norway' or something in between?

by Charles Grant
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The UK and the EU will soon start talks on the outlines of their future economic partnership. Three questions matter. What will Britain ask for? How will the EU respond? And what will be the outcome?

Michel Barnier, the European Commission's chief negotiator, says that Britain must choose between 'Canada' (something like the EU-Canada free trade agreement, which provides for free trade in goods but covers only a few services), or 'Norway' (in the single market – but accepting EU rules, European Court of Justice jurisprudence, free movement and payments to the EU). He has also spoken of 'Canada Plus' as a possibility, without defining what that might mean.

The UK has already said that it wants neither Canada nor Norway. It is preparing to propose a relationship based on a unique, bespoke model of regulatory alignment with the EU. British officials suggest that one of the approaches explored in a recent report from the Institute for Government is a fair guide to their government's thinking. This approach divides economic activity into three baskets:

- Complete regulatory alignment. The UK would follow EU rules and accept that if it deviated it would face retaliation, in the form of restricted market access. In the areas covered by this basket, the UK would be almost in the single market.
- Rough regulatory alignment or 'managed mutual recognition'. The EU and the UK would agree on common objectives and outcomes but choose their own rules for achieving them. If the UK deviated substantially, the EU would retaliate.
- In areas that are irrelevant to the single market, the UK would adopt its own rules.

Officials in Brussels and national capitals are starting to react to these not-yet-proposed ideas. The Germans, the French and the Commission are hostile. Their objections include:

1. The UK is asking to 'cherry-pick'. It would be in the single market in areas that suited it (such as chemicals, financial services or aviation) and outside in the areas that did not. This would lead to an unbalanced deal that benefited the UK more than the EU. Cherry-picking grates against the EU

philosophy that the single market is an integrated whole that cannot be picked apart. If a country outside the EU wants to be in the single market it must meet the conditions that members of the European Economic Area (EEA) like Norway meet (see above). But the UK does not want to accept these conditions.

2. The Germans and others see the British proposals as leading towards a Swiss-style model – namely partial membership of the single market, with a horribly complex system of management through joint committees, and the EU unable to enforce its rules in Swiss courts. The EU strongly dislikes the Swiss model and is trying to cajole Switzerland into accepting new arrangements that involve the European Court of Justice (ECJ). Otherwise, says the EU, it will reject any more bilateral treaties with Switzerland.

3. How on earth could the 27 ever agree on which areas fell into which baskets, ask EU governments. The 27 have differing interests and economic strengths, so they would find it hard to forge a common view on the contents of each basket. And then the EU would have to reach an accord with the UK on what went where. At the very least, say EU governments, sorting out all this would require an enormous and complex negotiation lasting many years.

4. Dispute-settlement procedures worry the Germans. The IFG proposals include mechanisms for resolving differences, but the Germans and others worry that these would not be quick or effective enough to prevent the British from distorting the level playing field. There is a huge concern – stretching across all the member-states – that the UK will find clever ways of gaining a competitive advantage over its EU partners by undermining the single market's standards. Even countries sympathetic to the UK, like Ireland, worry that a deal with an imbalance of rights and obligations could enable British firms to undercut their own.

5. There is a bigger and more political problem. Angela Merkel is apparently concerned about the consequences of a deal that allowed the UK to retain partial membership of the single market. The UK could then thrive outside the EU, enabling eurosceptics in other countries to argue that a British-style deal could allow others to succeed on the same terms as the British. She has a particular concern about the Dutch wanting to follow the British out. She also worries that if Norway sees the UK profiting from half-in, half-out arrangements, it will demand a revision of the EEA's rules. The CER thinks her concerns about the Dutch are exaggerated, but that she has a point on Norway. In any case Merkel's worries are shared by some senior figures in Paris.

Given how strongly several member-states object to UK thinking on regulatory alignment, the chances of London's proposals being accepted are slim. However, some British officials remain somewhat optimistic. This is because they note that several member-states are uncomfortable with the hard line taken by France, Germany and the Commission. When Barnier says the UK's red lines mean that it can only have a deal similar to that of Canada, some governments wonder if makes sense to push the UK's future relations with the EU into such a narrow box. After all, the UK's trade with the EU is eight times that of Canada's; and the EU wants a much closer relationship in areas like security, foreign policy and research than it has with Canada. Several member-states want a trade agreement that retains as much of the status quo as possible.

In Berlin, some officials worry that in contrast to phase one of the Brexit talks, when the 27 followed the firm line set by Berlin and Paris, in phase two – on the future relationship – it may be harder for France and Germany to get their way. The interests of the 27 in phase two evidently differ, which will make unity hard to achieve. One German official noted that the British proposals would require a massive intellectual effort from EU governments, since they posited a completely new kind relationship between the EU and a third country.

The official is right that some governments will be less critical of the UK ideas than others. For example, one Swedish official says Germany is being over-legalistic and insufficiently pragmatic. A Dutch official says that his government will consider British proposals on regulatory alignment very seriously, and give a considered response, rather than condemn them out of hand. In The Hague, lobbying by Dutch industrial interests seems to influence government thinking on Brexit. (That contrasts with the situation in Berlin, where officials claim they do not listen to industrial lobbying, and where industrialists generally support a hard line with the UK, believing that the integrity of the single market matters more than a bit of lost trade.)

Other countries which might take a softer line than France or Germany include Denmark, Ireland, Portugal, Italy, Croatia, Hungary, Poland and – depending on whom one talks to – perhaps Spain. Luxembourg wants to retain as much of its current business with the City of London as possible. It shares the view of several countries (including Ireland) that the insistence of France and Barnier that the FTA should exclude financial services is unreasonable. Creating obstacles to relations between the City and the 27 could make it harder for Luxembourg to trade with other global financial centres, say its officials.

But the British should not get too excited about member-states differing with Paris or Berlin. Most of them will reject UK plans for regulatory alignment, because they worry about potential damage to the level playing field. Furthermore, those countries favouring a softer deal want it to be softer in different ways and for different reasons; they have neither common positions nor a natural leader. And they all understand that they will need to adopt a united position for the talks on the future relationship; they know that if France and Germany want something – and have the Brussels institutions behind them – they usually get a large part of what they want.

Another factor is that the EU's talks on the next 'multi-annual financial framework' (MFF) are just getting underway. Some of the countries that need Germany's goodwill in these budget negotiations may be unwilling to annoy it over Brexit. And then there are technical obstacles to any deal that includes significant provisions on services: the EU's existing trade agreements often include 'most favoured nation' (MFN) clauses, obliging the EU to grant the country concerned as good a deal on services as it grants to any future partner in an FTA (such as Britain). Commission officials say this makes it hard to give the British much on services. And Luxembourg officials think the MFN problem could prevent the EU and the UK from striking a deal on financial services.

Despite these difficulties, a number of member-states will argue for a broader deal than Paris, Berlin and Brussels seem to want. If the British wish for a deal providing significant access to EU services markets, they need to listen very carefully to the EU's concerns. They will have to find a legally coherent answer to the MFN problem. And the particular system that the UK chooses to limit EU migration will affect EU attitudes to its proposals: if the UK proposes minimal controls and significantly easier procedures for EU than for non-EU nationals, it will generate much goodwill.

And they must bend over backwards to reassure the 27 in what they propose on the level playing field and dispute settlement. A softer approach to the involvement of the European Court of Justice would help (there are some hints that the British government's hostility to the court has diminished in the last six months).

Could cash buy a better deal? Last year senior Germans dismissed any idea that the EU would sell access to the single market as undignified and against their principles. But recently there have been reports of German officials suggesting that the City of London could get a deal if the UK paid for it. This is not the EU's current position. But that could change as the EU's talks on the next MFF get underway this spring. Brexit is leaving a big hole in the EU's budget, and some governments might welcome UK contributions.

The EU is adamant that the UK cannot cherry-pick. And it will certainly not allow the British into parts of the single market, unless their red lines change. But the British could negotiate a deal that includes more services than the EU-Canada FTA. In certain sectors the EU could conceivably grant the UK favourable access that is close to but less than single market membership. Emmanuel Macron seemed to imply as much in a BBC interview broadcast on January 21st: "The UK will perhaps get something between full access [to the single market] and a free trade agreement." Subsequently, however, his officials 'clarified' those remarks by saying that, given Britain's red lines, the trade agreement would have to be much closer to Canada than Norway.

The depth and breadth of the UK's deal will depend on British attitudes to the ECJ and EU immigration, and the degree to which it is prepared to accept EU rules and payments to the club. Theresa May's government will soon have to make painful choices on the inevitable trade-offs between sovereignty and market access.

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