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The Brexit Detour:
Navigating Britain's Changing Role in the North Atlantic Space

Brexit: The Options

Any effort to improve transatlantic economic relations must accommodate a major new dynamic: the United Kingdom, the fifth largest economy in the world and the second largest economy in Europe in terms of GDP, the third largest destination of global foreign direct investment, and the leading European commercial partner for the United States and Canada, is leaving the European Union.

The previous TTIP framework, which began before the UK's Brexit referendum and focused exclusively on the U.S.-EU relationship, did not address this dynamic. A U.S.-EU economic deal is important, of course, also to the United Kingdom even when it leaves the EU, but it will be insufficient to accommodate such a dramatic change to the overall transatlantic partnership.

There are many unknowables and uncertainties regarding the Brexit process, particularly the nature of the UK-EU divorce deal, the nature of the future UK-EU economic relationship as well as future UK economic relations with non-EU countries, and the timetable that could govern this transition. But that also argues for a broad, flexible approach to transatlantic economic ties that can accommodate the UK's shifting relationships in ways that strengthen, rather than weaken, the overall North Atlantic alliance.

This is particularly important because under any of the possible Brexit scenarios, the UK, and to a lesser extent its key commercial partners, will take an initial economic hit that will cause considerable job dislocations, raise uncertainties for investors, and lower economic growth over a number of years. The size and duration of this economic dip will depend in large part on the arrangements that can be worked out.

The UK and the EU27 face three sets of negotiations. The first has involved settling the terms of Britain's departure from the EU, the most significant of which are the settlement of UK financial obligations once it leaves the EU; [111] the rights of UK citizens in the EU and EU citizens in the UK; questions related to Northern Ireland; and the jurisdiction of the European Court of Justice. While these issues have not been definitively settled,[112] in December 2017 the EU declared that the two sides had made "sufficient progress" so that they could unlock a second set of negotiations about Britain's future relationship with the EU in trade and other matters. A third set of discussions also loom about what type of transitional arrangements might be set in place to give both parties time to adjust and to complete negotiations on the future.

The timetable remains murky. The exit talks cannot go beyond March 29, 2019, without agreement of the UK and all 27 remaining EU member states, and the practical deadline for the talks may come as early as October 2018, given that the European Parliament must approve any final arrangement before the European Council could accept it. Beyond this, it seems increasingly likely that there will be a transition period between March 29, 2019 and December 31, 2020, when the current EU seven-year budget cycle runs its course. During this period Britain would stay temporarily in the Single Market and Customs Union and remain bound by the EU's international agreements. London would be unable to enter into any new agreements affecting fields of EU competence (including trade) without EU approval, even though on March 29, 2019 the UK could fall out of trade agreements with more than 50 countries that have struck accords with the EU.[113]

Beyond this, different models of UK-EU relations may be envisaged.

The UK has ruled out four "softer" variants by which it would retain access to the EU Single Market or the Customs Union.[114] These include the so-called "Norwegian Model," in which the UK would pay for access to the EU Single

Market but leave the Customs Union, be obliged to allow free movement of goods, services, capital, and people in and out of the EU, face non-tariff barriers and accept EU regulations. It has ruled out a related variant that would have it continue its membership in the European Economic Area (EEA), a market formed by the EU and Norway, Liechtenstein and Iceland, three member-states of the European Free Trade Association (EFTA), which operates under the same basic rules as the EU internal market, allowing freedom of movement of goods, services, capital, and people, but where the non-EU members do not have voting rights. It has also ruled out the so-called "Swiss Model," in which the UK would have partial access to the Single Market for goods based on sector-specific bilateral agreements with the EU, but would have to agree to free movement of people, and would have no voting rights on internal market rules.

Finally, the British government has also said it will not contemplate maintaining a Customs Union for goods with the EU while leaving the Single Market. Staying in the Customs Union without staying in the Single Market would deprive the UK of its ability to conclude its own trade deals in areas covered by the Customs Union.

Membership in the Single Market means allowing the free movement of goods, services, capital and people. The latter element has been a red line for those advocating for the UK's exit from the EU. They also object to paying the EU for access to the Single Market, and refuse to accept jurisdiction of the European Court of Justice, which are other traditional conditions of being in the Single Market.

"Harder" Brexit options are still in play. The "hardest" is a "cliff edge" scenario where the UK leaves the EU without any deal, in which case its trade with the EU and the rest of the world would be governed by WTO-bound tariff schedules.

UK Prime Minister Teresa May favors a 'Comprehensive Free Trade Agreement' (CFTA), under which the UK would have 'maximum access' to the EU Single Market without being a member of it. Such an approach could be characterized as a "Norway Minus" arrangement: the benefits of the Single Market without free movement, the European Court of Justice and financial contributions. While the relationship would be less close than that between the EU and Norway, it would be much closer than the EU-Canada CETA model, and could even extend to coordination over foreign and security policies, justice and home affairs, and possible UK participation in a wide range of EU agencies and programs.[115] Her government plans to introduce on Day 1 of withdrawal a 'Great Repeal Act' that would transfer onto the UK statute book all relevant EU *acquis*. There is little evidence, however, that the EU would agree to Norway Minus; EU leaders have been clear that the EU's four freedoms of capital, labor, goods and people are non-negotiable.

Another imaginable scenario is a "Canada Plus" relationship, which is favored by other members of the May Cabinet. Such an arrangement would be similar to the EU-Canada CETA deal, but with additional arrangements opening services markets. However, such an agreement would represent a retreat from the harmonization of standards and mutual recognition that the UK currently enjoys as a member of the EU. It would also be incompatible with the December 2017 UK-EU agreement that any outcome must avoid physical infrastructure on the land border in Ireland. Prime Minister May has dismissed Canada Plus because it would mean "restriction on our mutual market access."[116] In addition, there is little sign that the European Commission or EU member states are considering Canada Plus as a realistic option.[117]

Other possibilities include a UK-EU transitional zero-tariff arrangement, a UK-U.S. free trade agreement and some sort of trilateral U.S.-UK-EU arrangements.[118]

Each of these options would mitigate the harshest effects of the "cliff edge" scenario, but none would fully compensate for the overall GDP loss to the UK resulting from Brexit. There has been a considerable amount of quantitative modelling work done on various Brexit scenarios by both official institutions (UK Treasury, OECD) and independent economists. For the UK the losses average from 1.31%-4.9% of GDP over the course of a decade.[119]

Additional challenges loom. While the Great Repeal Act would align UK and EU rules on the first day of separation, divergences will soon begin to appear that could have significant effect on UK-EU economic ties. For example, if the UK becomes less than fully compliant with the EU's government procurement directive, it would lose market access in that sector.[120]

There is also the question of UK economic relations with non-EU countries around the world following Brexit. The UK, as an EU member, is currently party to 45 free trade agreements with over 60 non-EU countries and regional groupings around the world. Another five agreements, including with Canada, are awaiting final legislative ratification.[121] Close to 40% of UK exports to non-EU countries are governed by these EU agreements, thus making it critical for the UK to secure replacement deals post-Brexit. The current British approach is to ask every country with which it currently has a trade deal as a member of the EU to adopt the same terms with it as it leaves the EU, at least for an undefined transitional period. It is unclear whether so many countries will agree, and without favorable market access terms, UK trade, and the UK economy, are likely to suffer.[122]

The EU does not currently have free trade agreements with such countries as the United States, China, or India, but London will want to secure such deals. Trying to do so with China, without first having strong deals with the United States and the EU, however, would put the UK at a disadvantage. This is another reason why the full North Atlantic and global dimensions of Brexit, beyond the UK-EU dynamic itself, are so important.

The UK will also have to sort out its economic ties with 18 other non-EU European commercial partners. The UK has been vague on how it will do this, other than to state that it would be "seeking to achieve continuity."[123] Since the UK will not be part of the EU's Customs Union, it will have the opportunity to conclude its own trade arrangements with most non-EU European states. The exceptions are Turkey, Andorra, Monaco and San Marino, all of which are now part of the EU's Customs Union.[124] Negotiating and concluding such agreements with so many countries, at a time when the UK is likely to be seeking agreements with bigger non-European countries, will stretch UK time and resources. In this regard, a UK-Turkey JAGA may offer at least an interim solution.

Another way to reduce these challenges could be for the UK to associate itself with, but not fully join, EFTA, a grouping it helped to found in 1960. UK association with EFTA, at least for a transitional period, could prove to be a better option than membership, since the EU has told EFTA states that access to the Single Market is only possible if they accept a non-national surveillance and court mechanism. Since the EU has imposed this new condition, no new market access agreement has been concluded with Switzerland, for example. This is likely to also prove problematic for the UK. It would limit the UK's ability to conclude its own trade agreements, and movement of persons could be problematic. That is why association could be more attractive than membership. It would be similar to the association arrangements established between EFTA and Finland between 1964 and 1986. Association would mean the UK could join some, but need not join all, of the free trade arrangements EFTA has with other countries. The UK could subject the free movement of persons to special safeguard clauses. It would not have a veto, but it would also not have an obligation, regarding decisions of the EFTA Council.

In associating with EFTA, the UK would secure free trade with the EFTA-4, which together make up the UK's third most important export market. In 2015 UK-EFTA trade of 46 billion pounds exceeded UK trade with France. UK association with EFTA would also preserve trade in services, movement of capital, and a high degree of intellectual property protection between the UK and the EFTA-4. This is particularly important for the UK as EFTA countries are a major source of direct investment into the UK.[125]

Associating with EFTA and the free trade agreements it has with 38 countries would allow the UK to maintain its trade with important partners and limit the anticipated loss of preferential access to over 50 markets that Brexit would bring. It would reduce the number of bilateral negotiations the UK would need to conclude, and would limit the extent to which post-Brexit Britain would need to rely on unambitious WTO rules. The free trade deals EFTA has in place, together with trade to EFTA countries, cover exports worth more than what the UK sells to the United States. Following EFTA association, the UK would need just five more deals – with the EU, the United States, Japan, China and Australia — to cover almost 90% of current UK exports.[126] Associating with EFTA would not involve submitting to the jurisdiction of a supranational court or a supranational surveillance system, which EFTA does not have, which would fit well with the UK's insistence that it will no longer be subject to the jurisdiction of the supranational European Court of Justice.[127]

The possibility of UK association with EFTA underscores yet again why a broader approach to the North Atlantic economy, including but going beyond the narrow bilateral frame of the U.S.-EU relationship, may help North America and Europe adapt more easily to changes unfolding before them.

Implications for the United States and Transatlantic Economic Ties

The United States has significant interests at play with regard to the ultimate outcome of Brexit and Britain's changing role in Europe and in the North Atlantic space. The United Kingdom and the United States are critical economic partners for one another. Each has a vested interest in ensuring that bilateral ties are strengthened, rather than disrupted, by Brexit. In addition, according to the vast modeling work that has been done, of all the conceivable hard Brexit models, the one that includes the United States is best for all concerned. According to RAND, the best outcome would be a set of free trade agreements between the UK and the EU, the United States and the

EU, and the United States and the UK. Transatlantic triangulation, according to RAND, is even a better deal for the UK than the notion of Global Britain, which would prioritize trade deals with extra-European partners. New transatlantic arrangements may be able to mitigate some of Brexit's harsher economic effects, although none will fully compensate for the full damage, at least for a certain period of time. [128]

As London and Washington bargain over a new set of economic arrangements, each will have its own economic relationship with the EU in mind. America's significant commercial and financial presence in the UK has been premised in large part on UK membership in the European Union — the largest, wealthiest and most important foreign market in the world to U.S. companies. For decades, the UK has served as a strategic gateway to the European Union for U.S. firms and financial institutions. The primary motivation of many U.S. companies to invest in the UK has not been to serve only the UK market but to gain access to the much bigger EU Single Market. U.S. affiliates based in the UK export more to the rest of Europe, in fact, than U.S. affiliates based in China export to the rest of the world.[129]

Since many U.S. companies are based in the UK because of its role as a gateway to the Single Market, U.S. negotiators will want to know how open, wide and strong that gateway will be after Brexit. And while the UK will want to move quickly to clarify its economic bonds with the United States, it is also likely to condition its efforts on the nature of its negotiations with the EU. The UK's trade with the EU is double its trade with the United States.[130]

Since Washington and London each have more to gain from achieving some agreement with Brussels than simply an agreement with each other, each will want to ensure that whatever arrangements they reach with each other serve to strengthen, rather than disrupt, their more significant commercial connections with the EU. Similarly, the EU will want to ensure that a U.S.-UK agreement, as well as any separate arrangements it may advance with the United States and with the UK, will enhance its own economic ties with two of its most significant economic partners.

The intertwined nature of UK-EU, U.S.-UK, and U.S.-EU negotiations can be best understood by looking at financial services. When the UK leaves the EU, financial services institutions based in the UK will lose their "passport" to provide services across the Single Market. This will not only disrupt the UK financial services industry. Many U.S. banks and other financial services companies established a presence in the UK to take advantage of passporting via the City of London to access the Single Market. Unless similar provisions are incorporated in any new UK-EU arrangements, many of these U.S. firms will probably choose another entry point to access the Single Market in the future. This will make a huge difference with regards to London's role as a financial hub, may accelerate the rise of other European financial centers, for instance Frankfurt, and will reinforce U.S. interest in strong and predictable financial services procedures with the EU. It will also affect the U.S. approach to financial services in any U.S.-UK arrangement. The EU has established an "equivalence" regime that extends limited access rights to non-EU countries, such as the U.S., that have rules that have been deemed "equivalent," but this is a relatively new and somewhat inconsistent approach with rights that are weaker than those granted under full "passporting."

Brexit has huge implications for each point on the transatlantic triangle — relations between the UK and the EU, links between the UK and the U.S., and ties between the U.S. and the EU. Given their deep mutual economic interlinkages, each of the three major actors has a vital interest in ensuring that each leg of this transatlantic stool remains strong and sturdy, particularly as the winds of global competition intensify. It is important that each track move ahead in synergistic, rather than competitive, ways. That is another reason why the concept of a North Atlantic Marketplace for Jobs and Growth could do even more to advance the interests of both parties.

How would it work?

EU rules mean that London cannot legally begin negotiating a trade deal with Washington before the UK leaves the EU, which at the earliest will be March 2019. An ensuing transition period, in which the UK is likely to remain part of both the Customs Union and the Single Market, is likely to last until December 31, 2020. As long as the UK remains a member of the Customs Union, it can't negotiate tariffs. And as long as the UK is a member of the Single Market, it can't negotiate on regulatory matters. Therefore, even if Brexit formally happens on March 29, 2019, formal U.S-UK negotiations could not begin until January 2021 at the earliest.[131]

Before Washington begins to negotiate a formal bilateral deal with the UK, it will want to understand the UK's new WTO commitments and the nature of UK-EU transitional arrangements following Brexit, as well as London's end goals with regard to a deal with the EU.[132]

That does not prevent the two sides, however, from initiating two types of exploratory discussions: one to engage on ways to draw closer now, without impinging on EU issues; and the second to set up a framework for future negotiations. In fact, that is what they are already doing.

Both parties are already engaged in bilateral discussions under what they are calling a Trade and Investment Partnership Forum. Those discussions seek to identify quick-win actions that could be taken in the short term to boost bilateral economic ties outside EU competence. Such areas might include support for SMEs and financial services, or a deal in aviation. They could consider whether a CFIUS-type process for screening foreign investments might be applicable to the UK, and how those processes might be aligned.[133] Updates to double taxation and social security treaties, or changes to customs procedures, could help thousands of firms more quickly. Both governments could boost practical support to help their firms explore each other's markets and alleviate the small, everyday barriers to doing business that suppliers and customers on both sides of the Atlantic often experience.[134]

Washington and London are also identifying where they are likely to want to establish arrangements in a host of areas that had previously been governed by EU-U.S. arrangements. Those areas would include wine and spirit names, organics, aviation arrangements, civilian nuclear cooperation, and managing different data protection requirements, and other issues.

Finally, the two sides are discussing ways they might coordinate positions more effectively within international organizations.

These talks can usefully identify potential stumbling blocks before formal bilateral negotiations would begin. Based on this dialogue, a second set of discussions — essentially U.S.-UK "shadow" negotiations — could create a basic framework for a trade agreement once it can be negotiated officially. That would mean getting a jump start on the negotiations while respecting EU and WTO processes. Formal offers could not yet be exchanged, but officials could have a good idea of what could be done as soon as formal negotiations could begin. To paraphrase one official, negotiators could not yet order the food, but they could use the time to study the menu.[135]

A bilateral U.S.-UK JAGA could help address these challenges. Many issues currently being discussed between the two parties would fit a JAGA model. A bilateral JAGA could offer a vehicle enabling London and Washington to move ahead in four of the five notional baskets: workforce development, innovation and digital economy; affirming the primacy of domestic law with regard to investor rights; identifying more effective ways for regulators to do their job; and aligning economic policies with regard to third countries. In each basket they could identify, but leave for later, issues of clear EU competence, and they could declare that the trade basket would be taken up once the UK leaves the EU.

A JAGA could offer a stepping stone to an eventual U.S.-UK trade deal, without rushing the process. This is of some importance, because a deal could be harder, and take longer, than some anticipate.[136]

Many positive benefits could flow from a bilateral U.S.-UK arrangement. Agreeing on reductions in traditional trade tariffs is not likely to be very troublesome, since most tariffs are already quite small, with a few notable exceptions, such as agriculture. The biggest gains from a bilateral deal would come from reducing barriers to services, since almost 80% of economic activity in each country is services-based, and that is where most job gains are likely to occur. The United States is the UK's top services market, accounting for over 50% of UK services exports. is by far the top export destination for UK services, accounting for over 50%.[137]

Other areas of interest could include cooperation on intellectual property issues, more aligned approaches to state-owned enterprises, and reducing barriers to digital trade, easing cross-border data flows for business transactions and exports by small and medium-sized companies, and facilitating licensing and qualification requirements for professional service providers. Some issues may be less difficult in U.S.-UK negotiations than they were in TTIP, for instance, the EU's insistence on "cultural exceptions" or geographic indications.[138]

Other issues may be tougher. The Trump Administration is likely to press the UK to abandon some of its current food and environmental protection standards, to remove public authorities' responsibility for type approval of motor vehicles before sale in favor of a U.S. version of approval that involves self-certification to meet safety standards combined with post-sale verification by regulators, to rein in ambitions to regulate the 'digital space,' and to provide opportunities for U.S. influence on its standards-setting and regulation. The U.S. move in September 2017 to propose tariffs of more than 200% on the C series passenger jet made by Canada's bombardier, whose wings are made in Belfast, was a sign of the Trump Administration's tough trade strategy.[139]

Agriculture is likely to be particularly nettlesome. Expanding agricultural market access could be a key area of focus for the United States, given high EU average tariffs or tariff-rate quotas on products such as meat, fish, sugar, dairy products, soft drinks, and wine. It is unclear, for instance, whether UK farmers will be keen on a trade deal that would open them up to U.S. competition at the very time they are losing generous EU subsidies, or whether they will be willing to accommodate U.S. interests in changing their rules related to hygiene or genetically-modified organisms if that makes it harder for them to sell to the EU, which is their largest market. The United States may view a U.S.-UK trade agreement as an opportunity to open the UK market to U.S. exports currently constrained by EU restrictions, such as sanitary and phytosanitary barriers and technical barriers to trade.[140]

Other market access issues could arise in terms of public procurement. The UK shares EU concerns about U.S. restrictions to certain sensitive sectors, "Buy American" legislation, and access to U.S. state-level government procurement markets. Meanwhile, the UK has released a post-Brexit industrial strategy that includes a goal of using "strategic government procurement to drive innovation and enable the development of UK supply chains," which potentially could be discriminatory against U.S. and other firms.[141]

There is also widespread apprehension in Britain about possible U.S. intrusions into such sensitive domestic areas as healthcare. A bilateral JAGA "stepping stone" agreement could assuage such concerns by deferring or eliminating such issues from bilateral consideration.