

WHAT WOULD A “HARD” BREXIT
NEGOTIATION STRATEGY LOOK LIKE?

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EXECUTIVE SUMMARY

This report looks at what an ideal Brexit negotiating strategy for the UK might be and indeed, what a good outcome from the Article 50 negotiations might look like. Many of these thoughts may very well be already being discussed by the UK government – it is our sincere hope that this is the case.

We have identified three basic forms Brexit could take: soft, hard and ultra. Although the current UK government insists these are meaningless distinctions, they are not.

The soft option involves remaining in the single market and retaining freedom of movement as is (sometimes referred to as the “Norway option”); the ultra option is simply opting out of everything EU related and making up for it by transforming the UK into a low tax, low regulation, libertarian haven. We define hard Brexit as anything between these two extremes. It is also the most likely kind of Brexit the UK government will pursue.

The UK government’s negotiating position will unquestionably revolve around the following three main points of discussion:

1. limit immigration from the EU as much as possible while giving up as few desirable features of being an EU member (with access to the banking passport system likely top of the list) as possible.
2. pay as little into the EU budget as possible once Brexit occurs.
3. what cross border security arrangements will look like after the UK leaves the EU.

What some may hopefully note is that the UK is in essence trying to pull three levers during the Article 50 negotiations: limit immigration, keep as much access to the single market as possible, and pay as little into the EU budget as is feasible. Given the way negotiations are likely to go, limiting immigration and halting paying into EU budget are most likely not both achievable and one may have to be sacrificed for the other.

The UK government has to decide how much economic pain they are willing to suffer in order to limit immigration. Most of the meat of the negotiations between the UK and the EU will hinge on this all-important point. While

much of the final deal will depend on what the European Commission/Council is willing to give, the UK government has to have a united and agreed position on the following points:

1. what the minimum control on immigration coming back to the UK they are willing to accept would be.
2. what the minimum access to the single market and portions thereof the UK requires in a worst-case scenario.

This is the essence of a hard Brexit negotiating strategy, the interplay between these two factors.

It is the opinion of this paper that the UK government needs to retain the banking passport at the very least. Anything less than this would be too economically risky for the country in the short term. Given it seems that the crucial political element of any deal will be the ability to control immigration, it also seems likely that the UK will have to accept paying in large amounts to the EU budget – perhaps in extremis, even larger amounts than it did while it was a member of the European Union – in return for being able to have much more control over immigration from the EEA while retaining the banking passport.

How Brexit affects the business community is one of the vital questions of our time. This paper suggests that businesses:

1. Step up lobbying and no longer assume that the Tories pro-business reputation will be enough to protect business interests.
2. Watch the Great Repeal Act for its follow up exercise.
3. Think creatively about useful and often non-intuitive relationships in this new post-Brexit environment.

The recent discussions between Nissan and the government demonstrate an emerging “squeaky wheel” narrative. From a business perspective, if you want to have the needs of your sector prioritised, you will have to lobby the government hard over the next few years – but the “Sunderland deal” demonstrates that the business community can indeed achieve its goals in this manner.

There is no way a Conservative government will wish to keep everything inherited from the EU forever. There will be a process of elimination

regarding what inherited legislation needs to be kept and what needs to be discarded over a number of years.

The business community should look to form unintuitive alliances with portions of the traditional Left in order to ensure the legislative end point of the Great Repeal process is favourable. Since bodies like the TUC will be worried about workers' rights being excised eventually from the Great Repeal process, and the business community will be concerned with Britain continuing to be able to trade as easily as possible with the world, working together in concert could be advantageous. Businesses will have to accept that while certain elements of the social chapter legislation would ideally be jettisoned from their point of view, they will require the good will of the Left in order to ensure that the openness of Britain to world markets is retained. We really are in an age of a strange bedfellows.

1) THE THREE BROAD TYPES OF BREXIT AVAILABLE

Despite various government ministers trying to tell the public that terms like “soft” and “hard” Brexit have no meaning they are very straightforward to define. It is worth taking time to briefly review each of them – and add to it what could be termed “ultra” Brexit – as they are the best starting point if we are to understand what an ideal outcome from the UK leaving the European Union might look like.

“Soft” Brexit would be one in which Britain leaves the EU but remains in the EEA. The country retains single market access and accepts freedom of movement from other EEA countries, as it does now, as part of this bargain. Essentially, it’s very much like being in the EU only the United Kingdom does not elect MEPs to sit in the European Parliament to vote on European legislation. This means that the UK does not have a say in said legislation and simply must accept any and all laws that apply to every EEA country as well as accepting free movement of people, the latter point being the toughest to swallow from a political standpoint.

It is worth noting that soft Brexit would also be by no means easy to arrange – there have been plenty of noises from the continent (Donald Tusk instantly springs to mind with his “hard Brexit or no Brexit” statement) around the inclination not to give the UK a soft Brexit even if it was desired by the departing country. It would have to be approved by the European Commission and the parliaments of all EEA states, which is a lot of gauntlets to run.

On the plus side, soft Brexit could almost certainly be negotiated in the two-year time period set by Article 50. There is far less to work out than would be involved if Britain were to choose not to ideally stay in the EEA as the treaty basis has already been established. This may make it appealing to the Commission in the end, whatever the rhetoric thus far out of Brussels.

Another sub-form of Brexit that could be looked upon as “Slightly Harder Soft Brexit” is the “Swiss option”. However, it should be stressed that this isn’t really an option per se, an off the shelf model to adopt, so much as an approach. It is much like soft Brexit in that the UK would retain freedom of movement and stay inside the single market, but then attempt to get what

would be seen by the British government as a “better deal” than the EEA countries are currently getting. This probably means in practice much the same thing as the UK remaining in the EEA from both a British and an EU perspective in that it would involve UK retaining freedom of movement in exchange for full access to the single market (or at least the crucial elements of it), all while probably paying generously into the EU budget year on year.

This brings us to the biggest element to be negotiated if any form of soft Brexit became desired within the walls of Whitehall, which would be for the UK to pay less into the EU than it does currently. This is probably very unlikely in the end, regardless of approach. The EU looks as if it will seek to “punish” the UK in some way, and it may judge that getting the UK to pay even more than it did when it was a full EU member in return for continued access to the single market or the customs union or even just the banking passport is necessary.

When one examines the immigration implications of any form of soft Brexit and then takes on board the fact that it would be likely the EU would look to extract a high price in terms of UK contributions to the EU budget going forward in return for any single market access, the British government pursuing any form of soft Brexit as a preferred outcome seems unlikely at this stage.

Before discussing what a “hard” Brexit might look like in terms of desired outcome, it is worth touching briefly on the “ultra” Brexit option. This is the most extreme version of Brexit, in theory at least. Yet unlike hard Brexit, ultra Brexit is much more clearly defined, at least in terms of starting points, next steps, and ideal conclusions.

An ultra Brexit would be the exact option in most respects to a soft Brexit. The idea would be that the UK leaves the EU and the single market altogether, and as quickly as possible. Outside of all single market and EU institutions, Britain would be free to trade as it chooses (only confined by the desires of their potential trading partners). Ultra Brexit recognises this is a perilous position in some respects and so goes in hard to correct for them. For instance, having to take up WTO rules – if the UK adopted a very low to no tariff approach to all exports, it would be advantageous to both the setting up of trade deals with third countries as well as ensuring that tariffs on British exports were kept as low as possible. Also, on regulation and taxation, an ultra Brexit approach would be to keep these to a

minimum. Overturning most of the social chapter legislation taken in via the EU so that employers could “hire and fire” with less risk and less obligation would be part of this, as well as lowering corporation tax further so as to incentivise foreign investment.

On immigration, freedom of movement would no longer be a feature of UK immigration policy, but some sort of fudge in this respect might be considered in order to keep the banking passporting in play (this is the only aspect of being inside the single market an ultra Brexit would consider worth negotiating for). The essence of the immigration policy under ultra Brexit would be to make it easier for companies to get workers in from anywhere in the world with little red tape. As a result, immigration from the EU would get technically more difficult (as visas would now be required whereas previously it was just like hiring British nationals), while hiring foreign workers from outside of the EU would become much more straightforward. Net immigration, as a result, may well increase, but only in skilled sectors.

The essence of the ultra Brexit standpoint is to turn Britain into a low tax, low regulation, hyper capitalist state. To make up for the expected shortfall in tax revenues from the lowering of corporation tax, public services would be cut – in some cases, quite drastically.

From what we have heard from Theresa May’s government thus far, ultra Brexit seems unlikely. It would require doing many politically unpalatable things and, at least in the short term, the poorest in society would likely bear the brunt of the change.

This brings us finally onto “hard” Brexit. Theresa May and the relevant ministers have grown to despise this term, and understandably so, as it has already gathered negative connotations. For the purposes of the paper, a hard Brexit would be described as anything between the soft and ultra options. In other words, pretty much any negotiating position the British government will likely take as a starting position. We are almost certainly headed towards a hard Brexit whether government ministers wish to avoid the term or not. The following chapter looks at what that means.

2) WHAT A HARD BREXIT NEGOTIATING STANCE WILL PROBABLY LOOK LIKE

The UK government's negotiating position will unquestionably revolve around the following three main points of discussion:

1. limit immigration from the EU as much as possible while giving up as few desirable features of being an EU member (with access to the banking passport system likely top of the list) as possible.
2. pay as little into the EU budget as possible once Brexit occurs.
3. work out what cross border security arrangements will look like after the UK leaves the EU.

While there are any number of complexities about how things will play out in negotiations between the EU and the UK, these are the only real, major concerns of the British government when entering Article 50 negotiations. The rights of UK citizens living in the EU will be covered in the immigration negotiations; the closing of EU agencies in the UK is a minor point and arguably would be covered in point 3; one can safely assume that things like agriculture policy come fully back to the purview of the United Kingdom anyhow since that would be done in the softest Brexit scenario available. Even point three isn't even all that major since the EU would most likely want to retain as many cross-border security measures as possible with the UK – and it is unlikely the UK would use this as a bargaining tool.

The reason these three points would be described specifically as components of a hard Brexit negotiating stance as opposed to something intrinsic to the soft or ultra positions as well is that issue one is resolved from the start if a soft Brexit approach is taken; freedom of movement and full access to the single market are built into the equation. Thus, it would simply be a matter of negotiating the lowest possible amount for the UK to pay into the EU budget (which would be the EU's big negotiating strength if soft Brexit were pursued by the UK - essentially trying to get the UK to pay a premium for single market access). In an ultra Brexit scenario, you start with the idea that your ability to limit immigration and the ceiling of how much the UK is willing to pay into the EU coffers is what it is from the start; if the EU doesn't like it, the UK is prepared to walk away from it all with only a WTO deal in place with the European Union. Only in hard Brexit is there all

to play for.

Who will be involved in the negotiations themselves is an important consideration when thinking about tactics. They will presumably at this stage be led by the European Commission – although it could be taken over by the European Council or even some sort of combination of the two organisations. It is impossible to say before Article 50 is triggered and the negotiations begin (unless the EU makes an announcement defining this concretely before Article 50 is triggered, which is unlikely). Part of what the government has been looking for clarity on has been this precise point – who exactly the government will be negotiating with – and it has not been forthcoming.

Whomever is in the room, immigration will be the key plank of the discussions between the British government and the EU after Article 50 has been triggered. It is important to bear in mind how central an issue this is to the European Union officials who will be leading the negotiations from the other side, regardless of whether it is the Commission or Council involved. Many pro-Brexit MPs have remarked upon what a huge economic gamble it would be for the EU to deny the UK a favourable deal in regards to single market or at least customs union access (or at the very least, banking passporting) – without considering that they themselves were willing to take an economic gamble based on a perceived greater principle. A huge clash in negotiations could be the EU's quasi-religious attachment to freedom of movement versus the UK's pursuit of sovereignty.

The UK government has to decide how much economic pain they are willing to suffer in order to limit immigration. Most of the meat of the negotiations between the UK and the EU will hinge on this all-important point. While much of the final deal will depend on what the European Commission/ Council is willing to give, the UK government has to have a united and agreed position on the following points:

1. what the minimum control on immigration coming back to the UK they are willing to accept would be.
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A realistic ambition on immigration control for the UK would be to require EEA citizens visa free access to the UK but for the relevant individuals to require a work visa to be legally employed. In practice, these work visas would have to be relatively easy to obtain and – crucially for the EU Commission/Council to have any hope of agreeing to this – set a demonstrably lower bar for EEA nationals wishing to work in Britain as compared to non-EEA citizens.

One hard Brexit option is to remain inside the customs union but to leave the single market. This has sometimes been referred to as the “Turkish option” (although less and less these days, given the Leave campaign’s emphasis on the negative aspects of Turkey joining the EU). It would allow goods to move freely and without tariffs throughout the European customs union area while not having to subscribe to the perceived real negatives of having to be part of the single market, in particular having to accept freedom of movement of people. Yet it would still come with downsides from a hard Brexit perspective, namely that being inside the customs unions means that striking deals with third countries would not be possible.

It becomes obvious when you discuss the realities of Brexit that any final deal will be far removed from the more fanciful dreams of hardened pro-Brexit figures. But unless Theresa May’s government is prepared to go the ultra Brexit route, these are the unavoidable parameters.

3) WHAT DOES ALL THIS MEAN FOR UK BUSINESS?

Now is a worrying time for the UK business community, but particularly FTSE 100 countries. What access there will be to the single market beyond WTO rules – thus being subjected to the EU’s standard tariff for third countries – is a key concern. Businesses want as little red tape as possible in regards to immigration and full access to the single market if possible. But given immigration and market access will be the opposite sides in a see-saw debate, as already covered, it could possibly end up being a lose-lose scenario.

What the business community should do from here breaks down three ways:

1. Step up lobbying and no longer assume that the Tories pro-business reputation will be enough to protect business interests.
2. Watch the Great Repeal Act for its follow up exercise.
3. Think creatively about useful and often non-intuitive relationships in this new post-Brexit environment.

The recent discussions between Nissan and the government demonstrate an emerging “squeaky wheel” narrative. From a business perspective, if you want to have the needs of your sector prioritised, you will have to lobby the government hard over the next few years – but the “Sunderland deal” demonstrates that the business community can indeed achieve its goals in this manner.

In terms of the Great Repeal Act, Theresa May announced in her Conservative Party conference 2016 speech that a bill would be created that will essentially take all existing European legislation currently applied in the UK via EU membership that has built up over the forty-plus years since the UK joined the EEC, put it into UK law and then repeal the 1972 European Communities Act. Such a move will make UK parliament supreme once more and will be the real legislative move from parliament in terms of leaving the EU (Article 50 is simply a notification to the EU and the trigger of post-EU negotiations).

What will be interesting about the Great Repeal Act will be the follow up to it. There is no way a Conservative government will wish to keep everything

inherited from the EU forever. There will be a process of elimination regarding what inherited legislation needs to be kept and what needs to be discarded over a number of years. Further to the first point in this regard: the business community should not assume that this process of elimination will be slanted in their favour. It is also worth noting that the government could possibly use statutory instruments to pare down the old EU legislation as opposed to having to go through parliament to do so (this depends partly on the way the Great Repeal Act itself is constructed).

The business community should look to form unintuitive alliances with portions of the traditional Left in order to ensure the legislative end point of the Great Repeal process is favourable. Since bodies like the TUC will be worried about workers' rights being excised eventually from the Great Repeal process, and the business community will be concerned with Britain continuing to be able to trade as easily as possible with the world, working together in concert could be advantageous. Businesses will have to accept that while certain elements of the social chapter legislation would ideally be jettisoned from their point of view, they will require the good will of the Left in order to ensure that the openness of Britain to world markets is retained. We really are in an age of a strange bedfellows.

Some kind of NGO that deals explicitly with this problem would be ideal, but failing that, the government needs to open more consultation with the relevant stakeholders. Going back to point one, business needs to lobby for this more vociferously.

Brexit can be done in a way that causes no major shocks to the economic system (other than the ones triggered already by the vote, of course). Yet there are many, many ways that it could be done where this is certainly not the case. As Theresa May said in the House of Commons recently: "There are those who talk about means and there are those who talk about ends." For the business community in the Britain, the ends are all that matter now.

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