

Brexit begins now

Blog post by Chief Economist Gregor Irwin, 19 January 2017

Theresa May's Lancaster House speech has provided much needed clarity about the British approach to Brexit. It has reset the baseline for the negotiation by taking the UK out of the single market. This is a hard concession for Europhiles in Britain to swallow, but one that was inevitable. By conceding the point early, the UK will avoid being put on the defensive immediately and will therefore find itself in a better negotiating position.

But the speech also exposed a fault line in the UK's strategy that will mean problems ahead for May's negotiating team. In short, she is beholden to a timetable being set for her by Eurosceptic Conservatives in parliament. They want the UK to be out of the single market and a new relationship with the EU that satisfies their political demands to be locked in before 2020, when the next general election is due.

This domestic political imperative has two implications for the approach set out by May and two further consequences that will become apparent soon enough. First, and most obviously, it means the UK must race towards a very tight deadline. May has now committed to agree a new partnership with the EU by the time the UK leaves the EU, most likely in 2019. This means concluding a deal of unprecedented complexity in record-breaking time.

Second, it means the UK must seek an "implementation phase" to avoid a cliff edge at the point of Brexit, rather than a "transitional phase". The difference is not just semantic. The latter would preserve *existing* rights and obligations while it applied, whereas the former establishes a path to the *new* arrangements. Conservative Eurosceptics won't buy a transitional phase, as they fear it could become never-ending, forcing May's hand.

The consequences are significant. The tight deadline weakens the UK's bargaining position. The European Commission's lead negotiator Michel Barnier has repeatedly said the EU will insist on a sequential negotiation with the divorce terms agreed first, before the new economic relationship. The divorce bill could be expensive, as high as €50-€60 billion by some estimates. This is the zero-sum bit of the negotiation. May's deadline will make it harder to resist the EU's demands. It will be politically costly for the UK; but equally important politically for the EU.

The trade negotiation that would follow is not zero-sum, but the interests of the two sides are far from being fully aligned. The EU will want to calibrate where and how the UK has access to the single market. May's deadline gives the EU the upper hand in that negotiation. Despite what May has said about "no deal being better than a bad deal", the consequences of failure will still be greater for the UK. She has now denied herself the option of playing for time.

The other consequence is for businesses that have been in wait-and-see mode. May's strategy means change will come quickly during the implementation phase, but businesses won't know what that change will look like until towards the end of the tight two-year negotiating period. For many, waiting until the outcome is known may no longer be a viable option, as the lead time required to restructure operations is often a long one. It's not what May intended, but her Lancaster House

speech could be the moment when many businesses decide to start implementing their Brexit contingency plans.