

Uncertainty about an UK-EU trade deal rises as the deadline for negotiations draws nearer

RYO YAMADA
ECONOMIC RESEARCH OFFICE

MUFG Bank, Ltd.
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After the UK left the EU at the end of January this year, both parties entered into negotiations for a trade agreement on the premise that the transition period which is scheduled to come to a close at the end of the year will not be extended. However, the situation is highly unpredictable as there is still a large gap between the UK and EU's positions on a number of issues including conditions for fair competition, fishing and governance (Table 1). While the UK showed a willingness to compromise during a round of official negotiations ending on 2nd October, the European Council is still unwavering in its hard-line stance and is requesting further concessions from the UK, although it did decide upon a plan to extend the deadline for negotiations at a meeting on 15th and 16th October. In response to this, the UK has expressed its discontent and is once again strengthening its own position.

The direction negotiations will take in the future is extremely important, especially for the UK government. Regardless of whether or not there is a trade deal, there are unavoidable negative effects of Brexit which will appear from the start of next year, such as the need for goods to pass through customs clearance, a divergence in regulations and disruption to logistics after the end of the transition period. Furthermore, if there is a disorderly end to the transition period without a completed trade agreement, it is likely the measures put in place to mitigate disruption, such as simplified customs clearance, will be insufficient and the short-term chaos will be even greater. Under the uncertain economic conditions brought about by the COVID-19 pandemic, there is a possibility that intermittent changes to requirements for businesses will put downward pressure on business sentiment.

Given the mutual distrust between the UK and EU, it will be very difficult to start afresh with negotiations for a new trade agreement under a Johnson government, and the absence of a trade deal between the two parties for an extended period of time will probably deal an irreversible blow to EU trade with the UK. The UK's dependency on EU in terms of trade is higher than the EU's dependency on the UK (Chart 1). The cabinet of former British Prime Minister Theresa May also calculated that a trade deal with the EU would be important for the growth of the UK in the long term.

Northern Ireland and Scotland, who are opposed to leaving the EU, are deeply dissatisfied with the absence of a trade deal. If negotiations break down, there are concerns that the devolved governments will move further away from Westminster and that the divisions within the country

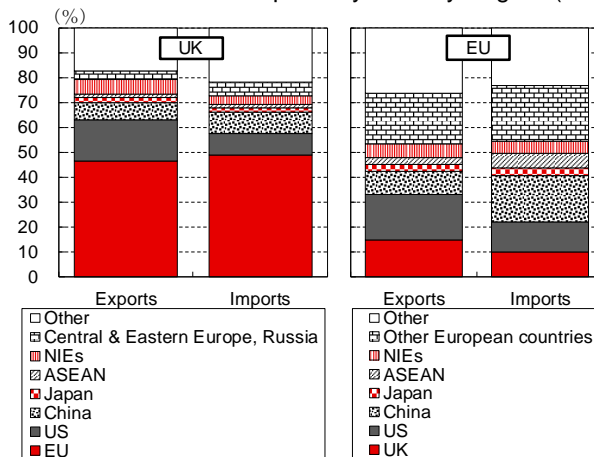
will deepen. When the transition period comes to a close at the end of this year, it will be a watershed moment for the UK, not just in terms of the short-term impacts on the country, but also its growth potential over the long term and whether or not the unity of the four countries under one kingdom can be maintained.

Table 1: Major Points of Contention between EU and UK

	EU	UK
Border controls	Withdrawal Agreement The UK will collect EU customs duties on goods that pass between Northern Ireland and the rest of the UK to avoid any customs border on the island of Ireland	Internal Market Bill Tariff-free trade between Northern Ireland and the rest of the UK with free access to the UK market for Northern Ireland
State subsidies	Withdrawal Agreement UK and EU commit to level playing field	Internal Market Bill EU regulations on state subsidies will apply to Northern Ireland, but the UK will be able to set up its own framework for subsidies
Fishing	Maintain current fishing quotas for EU members	Reduce in stages the quota of fish caught by EU members over several years
Governance	Introduce a comprehensive framework for settling disputes, such as economic disputes or cooperation over security	Introduce frameworks for settling disputes in each sector

Source: European Union, UK Parliament, news reports, MUFG Bank Economic Research Office

Chart 1: UK and EU Exports by Country/Region (2019)



Source: Office for National Statistics, Eurostat, MUFG Bank Economic Research Office

Translation by Elizabeth Foster

For further details, please contact the Economic Research Office, MUFG Bank

Managing Director, Rei Tsuruta Tel: +81-(0)3-3240-3204

Written by Ryo Yamada

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