Edited by:

Dáithí Ó’Ceallaigh with Andrew Gilmore

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The IIEA is grateful to the members of its UK Group, whose insights and expertise were vital to the writing of this report.
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Tony Brown is a joint Founder, former Board Member, and Senior Fellow of the IIEA. He served on the Board of the European Bank for Reconstruction and Development (1997-2000) and was an adviser to the Oireachtas Delegation to the European Convention in 2002-2003. Tony served as Special Advisor to the Tánaiste and Minister for Social Welfare (1973-1977) and Honorary International Secretary of the Labour Party (1978-1997).

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Dr. John Bradley was formerly a Research Professor at the Economic and Social Research Institute (ESRI) and is an international research consultant in economic development, with an emphasis on EU cohesion policy and industrial strategy in EU Member States. He regularly acts as a consultant to the European Commission, the European Parliament and government ministries in the EU and elsewhere.

Barry Andrews

Barry Andrews is Director General of the Institute of International and European Affairs, a role he has held since April 2017. Prior to the IIEA, Barry was CEO of international NGO GOAL from November 2012 to November 2016. He was appointed Minister for Children by An Taoiseach Brian Cowen in May 2008 serving in that position as a member of cabinet until March 2011.

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Andrew Gilmore is Senior Researcher at the Institute of International and European Affairs, and an Associate Researcher at the European Council on Foreign Relations (ECFR). In his role at the IIEA, he is responsible for coordinating the work of the UK project group, in particular the IIEA's Brexit events and publications programme.
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Glossary

**Article 50 TEU**

This is the article in the Treaty on European Union which provides the mechanism through which a Member State can leave the EU. Once triggered the article allows a negotiation period of two years. It is the process through which ‘Brexit’ will occur.

**Brexit**

Brexit is a colloquial term for the UK’s departure from the European Union, under Article 50 TEU. It consists of three possible elements: Withdrawal agreement, transition, and future relationship.

**Withdrawal agreement**

The withdrawal agreement is the terms on which the UK leaves the EU. This will include settlement of its outstanding liabilities, reciprocal rights for British and EU citizens, and issues relating to Ireland, including the Common Travel Area and the Good Friday Agreement.

**Future relationship**

The withdrawal agreement can take account of the framework for the future relationship, but it is likely to take much longer than the two-year withdrawal process to finalise the new trading relationship between the UK and EU.

**Transition**

This is the period between the UK’s departure in 2019 and the finalisation of a new relationship. The goal of the transitional phase would be to minimise disruption and provide certainty for citizens and business, until a future relationship between the EU and UK is agreed.

**Customs Union**

The EU Customs Union is an agreement that allows for tariff free trade between all Member States. It removes customs duties on goods at the borders between EU Member States, applies common customs duties on imports from outside the EU, common rules of origins procedures for products from outside the EU, and includes a common commercial policy. It is separate from the EU’s Single Market.

**Common Commercial Policy**

The Common Commercial Policy is an essential element of the EU Customs Union. It means that the EU Member States negotiate trade deals as a single bloc, with the European Commission having the exclusive right to negotiate on behalf of the members of the Customs Union.

**Common Agricultural Policy**

Agriculture is a key shared competence of the European Union. The Common Agricultural Policy (CAP) has its origin in the Treaty of Rome and the policy was established in 1962. The initial purpose was to increase food production across Europe by offering guaranteed prices. The aim of the policy is to support food production, the management of natural resources and the development of rural areas.

**Common Travel Area**

The Common Travel Area (CTA) is an agreement between Ireland and the United Kingdom allowing for free movement between the two states. It predates the free movement of persons provisions that are a part of the fundamental freedoms in the EU Treaties.

**European Economic Area**

The European Economic Area (EEA) is a trade zone comprised of all 28 EU Member States and three European Free Trade Association countries – Iceland, Liechtenstein and Norway. All the EEA states are participants in the EU’s Single Market, allowing for the free movement of persons, goods, services and capital across the entire EEA.

**European Free Trade Association**

The European Free Trade Association (EFTA) is a group of countries (Iceland, Liechtenstein, Norway and Switzerland) that promote free trade and economic integration amongst themselves. Iceland, Liechtenstein and Norway are also in the EEA, but Switzerland is not. Switzerland has a bilateral Free Movement of Persons Agreement with the EU which means EU citizens wishing to live or work in Switzerland can do so
Equivalence regime

Financial services in the EU are regulated activities. This means that firms have to be authorised and approved of by a regulator before they can operate in a market. Equivalence is a principle by which the European Commission can recognise that a country’s rules and oversight of specific business lines are in compliance with its own rules.

Free movement of people

Free movement of people is one of the four fundamental principles of the EU, allowing citizens of any EU and European Economic Area state to live and work in any other EU or EEA state.

Free Trade Agreement

A free trade agreement (FTA) is an agreement between countries to reduce barriers to trade between them. Broadly speaking, FTAs concentrate more on the liberalisation of trade in goods rather than in services. A free trade agreement differs from a Customs Union in not requiring its members to set the same tariffs on trade with countries outside the agreement.

Good Friday Agreement

Agreed in 1998, the Good Friday Agreement aimed to bring an end to the conflict in Northern Ireland. The Agreement established the Northern Ireland Assembly and power-sharing executive. The peace process has been supported both politically and financially by the European Union.

Liabilities

A liability is a legally binding obligation payable to another entity. Liabilities may include, for example, pensions and other employee benefits or invoices that haven’t yet been settled.

Passporting

Financial services in the EU are regulated activities. In the EU, authorisation in one EU Member State can mean that the firm can operate and sell in all EU countries if it has a passport for that activity. There are individual passports for separate activities.

Schengen agreement

This agreement enhances free movement of people by removing border controls between participating states, allowing for passport-free travel for people in most of Europe. The UK and Ireland have opted out of Schengen, in a protocol that recognises the special status of their shared Common Travel Area.

Single Market

The EU’s ‘Single Market’ is an enhanced free-trade area. It defines the EU as one territory without internal borders or any other obstacles to the free movement of (i) goods, (ii) capital, (iii) services and (iv) people. All the EU Member States are a part of the Single Market. Preferential access to the market is also provided to certain third party countries.

Tariff

This is essentially a tax on imports or exports into a country or Customs Union from another country or Customs Union. Tariffs will often be accompanied by non-tariff barriers to trade.

Non-tariff barriers to trade (NTBs)

These are barriers that restrict imports or exports of goods or services through mechanisms other than tariffs. They may take the form of import quotas, subsidies, customs delays, technical barriers, or other issues preventing or impeding trade. Removing barriers to trade requires a free trade agreement.

World Trade Organization (WTO)

The WTO is an international organisation with over 164 member countries, which provides a forum for negotiating multilateral trade agreements and monitors the application of rules and tariffs on international trade and settles disputes between its members. The European Commission represents EU Member States in the WTO.
Introduction

Dáithí O’Ceallaigh

The purpose of the IIEA’s Brexit Status Report series of publications is to provide the members of the IIEA and other interested parties with reliable information on the coming negotiations between the UK and the EU, and their implications for Ireland.

The status reports are intended to be a reference guide to what is known about the negotiations. They are not intended to be opinion pieces and hopefully this second edition, like its predecessor, is written in an accessible and reachable style.

Since our first Status Report was published earlier this year the EU has agreed its negotiating mandate and in the recently published Conservative election manifesto the British Government has stated clearly its objectives for the forthcoming Brexit negotiations. The two positions are quite far apart.

Three key commitments in the Conservative election campaign are to leave the Single Market and the Customs Union, and to dispense with the European Court of Justice which ensures that Member States comply with their obligations. There can be no room for doubt. If Mrs May wins the election, which seems very likely, the UK will leave the European Union even if agreement cannot be reached on a deal. The negotiations will be extremely difficult.

The May edition of the status report consists of 12 chapters divided into two sections: first, an update on the political context, and second, an update on the economic context.

The first section aims to provide a comprehensive state of play on the political situation in the UK, Ireland, EU and key Member States. It contains chapters setting out the overall state of play, written by Brendan Halligan, followed by assessments of developments in the EU, UK and on the island of Ireland. Tony Brown and Paul Gillespie separately examine the impact of Brexit on the other Member States, and on the internal dynamics of the UK, with particular regard to the cohesion of the United Kingdom.

John Temple Lang examines the options for the UK’s future relationship with the EU, noting the need for a solution to Northern Ireland’s unique concerns. This theme is picked up again by Blair Horan in Chapter 6, with an assessment of the potential for ‘flexible and creative’ solutions to the border and trade issues. Tom Arnold examines the Irish Government’s strategy and notes some issues for Ireland beyond the Brexit negotiations.

Section two examines the possible economic impact of Brexit, based on what is known about the negotiating stances, with particular emphasis on the impact on Ireland. John FitzGerald examines the possible channels through which the Irish economy is likely to be affected, while the subsequent chapters examine the possible risks and benefits of Brexit for individual sectors.

Con Lucey discusses the potentially serious impact on agriculture; John McGrane notes the risks for SMEs and discusses the need for small and medium enterprises to adapt to the challenging climate ahead; Padraic White stresses the FDI opportunities of Brexit, if the situation is duly managed; and John Cronin strikes a similar note in his contribution on financial services. John Bradley concludes the section, noting that Brexit is not the first external challenge that the island has faced, and that adapting to the challenges ahead will reveal opportunities for the Irish economy.

What emerges from this study is a consistent theme: Brexit presents Ireland with challenges, but also with opportunities – opportunities which must be leveraged and exploited in order to mitigate the damage of the UK’s withdrawal from the EU.
The challenges, of course, are significant. Brexit is one of the greatest risks the country has faced since the foundation of the state. Common membership of the EEC and later, the European Union, has underpinned the relationship between Ireland and the UK since 1973 and there are inevitable economic and political consequences of a breaking or weakening of these ties.

As detailed in this report, however, while the relationship with the UK remains vital to the Irish interest, it is only part of the story. Four decades of European summits, discussions, negotiations and agreements have contributed to a transformational shift in Ireland’s international relations. Through the EU, Ireland has cultivated strong relations with the other 26 Member States, which in political and economic terms are now at least as important as the relationship with our nearest neighbour. Securing and deepening these ties will be essential to leveraging the opportunities for Ireland in a post-Brexit EU.

In this context, the recognition of the Irish concerns by both the European Council and the European Parliament, as well as the supportive statements by the European Commission’s Chief Negotiator, Michel Barnier, are encouraging. But there remains a great distance to travel in the negotiations, and the European Union has made clear that nothing will be agreed until everything is agreed. Thus, the Irish concerns will only be addressed as part of a successful negotiation.

Precisely what will emerge at the end of the negotiations in March 2019 remains difficult to predict but we can say with some certainty that the future relationship will be very different from our current situation. Ireland must be prepared to adapt. As John Bradley notes, there is reason to be optimistic on this point - Ireland has shown that it can develop and change in response to external challenges, and as a vibrant and open economy, the country is better placed than at any time in the past to rise to this new challenge.

Because of the British decision to leave the European Union the challenges facing Ireland are stark and of great consequence for the future of the country. Ireland has overcome great challenges in the past. It can also do so on this occasion.

I would like to thank all the authors who contributed and helped with the production on this Report, as well as the members of the IIEA’s UK group, whose knowledge and expertise is an invaluable resource for the Institute.

I should also like to thank the staff and researchers in the IIEA, with a special thanks to the Senior Researcher, Andrew Gilmore, who oversaw this project, and Aisling Sinclair for her work on the design of the report.
The General Affairs Council of the EU authorises the opening of negotiations with the UK

Malta General Elections

UK General Election

UK-EU negotiations to begin once UK government is formed

European Council Summit

Estonian Presidency of the Council of the EU begins

German Parliamentary Elections

Austrian parliamentary elections

European Council Summit

European Council Summit

European Council Summit

European Council Summit

Austrian Presidency of the Council of the EU begins

European Council Summit

European Council Summit

Austrian Presidency of the Council of the EU begins

European Council Summit

European Parliament Elections

29th March 2019

Deadline for UK withdrawal

May 2019
Section 1
A Political Update

Chapter 1 The State Of Play
Brendan Halligan

The opening months of 2017 brought clarity to the Brexit process, cleared up ambiguities in the Treaties and provided some insights into the broad negotiating stances of the parties. This mid-summer audit of the state of play examines recent developments in the UK, EU and Ireland, sketches the shape of the negotiations ahead, and notes a number of potentially divisive issues for the negotiations.

Introduction

The verdict on the first trimester of 2017 is straightforward. The conclusion to be drawn is that things are beginning to take shape. The opening months of 2017 brought clarity to the Brexit process, cleared up ambiguities in the Treaties and filled in the lacunae. There has been a great sure-footedness about the way the Union has managed the task of translating untried legal texts into politics and processes. As a result, the European Union now has a clear road map on how to conduct and conclude the Brexit negotiations.

Pre-eminence of the Treaties

The Union approach to the negotiations has been formal and structured. This has been due to the pre-eminence accorded to the Treaties on which the Union is based. They, and they alone, have been used to determine the order and content of the negotiations, to lay down the limits within which they are to be conducted and to impart legal certainty and political legitimacy to its decisions. In short, the ultra vires rule has been invoked as the guiding principle governing the powers and the prerogatives of the Union's negotiators and explains what has been done by the Union since the European Council first set out its stall in the immediate aftermath of the referendum.

UK Approach

For its part, the United Kingdom has taken a more ad hoc approach and has elaborated its position in a series of speeches by the Prime Minister, a government White Paper on its exit strategy and, of course, in the formal letter of 29 March invoking Article 50 of the Treaty on European Union and thereby initiating the withdrawal process. As is made clear in subsequent chapters, we know more about what the UK does not want than about what it is hoping for. Unlike the Union, it does not have a road map and has little idea of how to reconcile the contradictions between its rejection of the Single Market, Customs Union, Court of Justice and budgetary solidarity with its determination to continue enjoying the advantages it is about to forego by leaving the EU.
Different Approaches

It is now clear, as it has been for months, that the first clash between the two sides will be about the sequence in which the negotiations will take place. The Union wants two distinct sets of negotiations, the first on British withdrawal, as prescribed by Article 50 TEU, and the second on the new UK relationship with the Union to be agreed after it has left the Union and become a “third country”.

Furthermore, the Union wants the withdrawal negotiations themselves to be conducted in three phases, the first of which would include Northern Ireland border issues and the highly controversial matter of the “single financial settlement”, or the “Brexit bill”, which will discharge the UK’s liabilities to the EU. Until that weighty matter is agreed the Union will not proceed with the second phase of discussions on the framework for its future relationship with the UK which, after-all, is the main preoccupation of the British negotiators. This would continue in parallel with a third phase which will define the terms of the transitional relationship.

Doing things in the right order is the motto governing the Union approach. The UK position is diametrically opposite. It wants all strands of the negotiations to proceed in parallel and for everything to be done within two years, including ratification of the eventual agreement(s) by the European Parliament, European Council and the British Parliament.

Non-negotiable Positions

Both sides remain adamant that their position is non-negotiable. But both recognise that if a composite Withdrawal Agreement is to be concluded and ratified within two years then there will have to be a breakthrough before Christmas 2017. The chances of failure are about 30%.

As said, the core issue is whether or not the UK has outstanding financial liabilities arising from membership of the Union. If it is conceded by the UK then the next step would be to agree the methodology for computing the amount to be paid into the EU coffers and then to agree on a repayment schedule. But, as is obvious, the biggest hurdle to be jumped is political rather than methodological and it is a moot point at this stage whether the Conservative Party would agree to pay what has come to be called the Brexit Bill.

The Timetable

Should it do so, and if, in the opinion of the European Council, sufficient progress is made on agreeing a methodology for computing the settlement then the withdrawal negotiations can move on to the second and third phases where the two main agenda items will be the future EU/UK relationship and transitional arrangements covering the interval between the UK ceasing to be a EU member (29 March 2019) and becoming an external partner (March 2022 at the latest).

Michel Barnier has outlined a provisional timetable as follows: an agreement on the first phase between October and December 2017, then a launch of the second phase between December 2017 and spring 2018, followed by agreement of transitional arrangements and finalisation of the Brexit deal towards October 2018. The timetable is laid out on the next page, alongside some key dates in the EU and UK.

In short, there are many conditions to be met before progress can be made and they explain in part why Mrs May has insisted that from her perspective no deal is better than a bad deal. The ramifications of no deal, or a “cliff edge” as Mrs May calls it, are spelled out in the chapters that follow.
### The Negotiations – A Timeline

<table>
<thead>
<tr>
<th>Event Date</th>
<th>Event Description</th>
</tr>
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<tbody>
<tr>
<td>29 March 2017</td>
<td>UK invokes Article 50</td>
</tr>
<tr>
<td>5 April 2017</td>
<td>European Parliament adopts its position on the UK’s withdrawal</td>
</tr>
<tr>
<td>29 April 2017</td>
<td>European Council adopts its negotiating guidelines</td>
</tr>
<tr>
<td>22 May 2017</td>
<td>The General Affairs Council of the European Union authorises the opening of negotiations</td>
</tr>
<tr>
<td>8 June 2017</td>
<td>UK General Election</td>
</tr>
<tr>
<td>22-23 June 2017</td>
<td>European Council Summit</td>
</tr>
<tr>
<td>1 July 2017</td>
<td>Estonian Presidency of the Council of the EU begins</td>
</tr>
<tr>
<td>24 September 2017</td>
<td>European Council Summit</td>
</tr>
<tr>
<td>19-20 October 2017</td>
<td>European Council Summit</td>
</tr>
<tr>
<td>14-15 December 2017</td>
<td>European Council Summit</td>
</tr>
<tr>
<td>1 January 2018</td>
<td>Bulgarian Presidency of the Council of the EU begins</td>
</tr>
<tr>
<td>22-23 March 2018</td>
<td>European Council Summit</td>
</tr>
<tr>
<td>28-29 June 2018</td>
<td>European Council Summit</td>
</tr>
<tr>
<td>1 July 2018</td>
<td>Austrian Presidency of the Council of the EU begins</td>
</tr>
<tr>
<td>September 2018</td>
<td>European Council Summit</td>
</tr>
<tr>
<td>October 2018</td>
<td>European Council Summit</td>
</tr>
<tr>
<td>December 2018</td>
<td>European Council Summit</td>
</tr>
<tr>
<td>1 January 2019</td>
<td>Romanian Presidency of the Council of the EU begins</td>
</tr>
<tr>
<td>March 2019</td>
<td>European Council Summit</td>
</tr>
<tr>
<td>29 March 2019</td>
<td>The UK leaves the EU</td>
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### Article 50 notification and response

#### Preliminary phase

**Withdrawing**

Negotiations will begin after the UK Government is formed in June. Priority issues in this phase will include:

- Reciprocal rights for UK and EU citizens
- Agree on methodology for calculating the UK’s liabilities
- Northern Ireland and the Good Friday Agreement

**Future relations**

If sufficient progress is made in Phase 1, discussions would begin on a framework for the future relationship.

Withdrawal negotiations would continue in parallel with this phase.

The European Commission may seek updated negotiating guidelines for this phase.

**Transition**

Assuming progress on Phase 1 and Phase 2, the UK and European Commission will negotiate time-limited transitional arrangements.

These arrangements would cover the period between the UK’s exit and the beginning of the new relationship.

Negotiations on the future relationship may continue in parallel.

Assuming the other phases are completed in a timely fashion, the last months will be set aside for finalisation and approval of the deal by the European Council and the European Parliament.

**Approval phase**

29 March 2017
UK invokes Article 50

5 April 2017
European Parliament adopts its position on the UK’s withdrawal

29 April 2017
European Council adopts its negotiating guidelines

22 May 2017
The General Affairs Council of the European Union authorises the opening of negotiations

8 June 2017
UK General Election
The New EU-UK Relationship

Notwithstanding its fuss over the sequencing of the talks, the UK has tacitly accepted the logic of the EU negotiating mandate as adopted by the General Affairs Council on 22 May. Consequently, it is understood by both sides that the Withdrawal Agreement will contain no more than a political outline of the new relationship to be constructed. Article 50 TEU calls this a “framework”. It is equally understood that elaborating on the content of the framework can only begin when the UK has actually left the EU and has become a “third country”, as it is known.

Until the new relationship comes into force there will have to be what the Union calls “transitional arrangements” to bridge the gap. In its resolution on the Brexit process the European Parliament limited the transitional regime to three years and it can be assumed that this time limit will be respected. All that said, what remains obscure as of mid-Summer 2017 is the nature of the economic partnership being sought by the UK subsequent to its withdrawal. There are no real clues in the Prime Minister’s pronouncements or the government White Paper, or Mrs May’s letter to President Tusk, probably for the reason that the British government does not yet know what it wants.

Irish Government

In contrast, the Irish government has made its position crystal clear and has secured unanimous support from the other Member States on the primacy to be attached to the Northern Ireland peace process and to preventing the re-imposition of border controls within the island of Ireland. On the economic front there has been an emerging consensus that Brexit will lead to substantial job losses which according to a Central Bank estimate could be as high as 40,000 (equivalent to 2% of the labour force). Reference is made in the chapters to follow that there has been no corresponding estimates of job gains arising from relocations from the UK, the diversion of FDI originally intended for the UK or increased FDI intended to take advantage of Ireland’s continued membership of the Single Market and Customs Union. Nevertheless, a number of expert contributions on the macro-economic effects of Brexit suggest that the benefits could be substantial.

Prospects

A mid-summer audit of the state of play would be incomplete without reference to re-invigoration of the Franco-German alliance. The election of President Macron in France and Mrs. Merkel’s expected return as Chancellor presage a period of political stability, economic growth and unity of purpose for the EU as a whole. These developments enhance the prospects of resolute EU leadership in the forthcoming autumn negotiations by imparting a sense of unity to the EU side that might otherwise be absent, as well as reinforcing its determination to defend the common interests of the Member States. The same may be said for the UK. If Mrs. May is re-elected she will have a mandate to negotiate for the version of Brexit contained in the Conservative Party mandate. It is a repetition of that originally presented in her Lancaster House speech and the subsequent Government White Paper and shows little room for manoeuvre on the key issues of immigration, the EU Court of Justice and a mutually satisfactory financial settlement with the EU. It does, however, repeat the previous assurances on border with Northern Ireland. The potential for compromise will become evident when the talks open in mid-June. Meanwhile there will be much skirmishing and jockeying for advantage.

Conclusion

As both sides mark time until the new UK government is in place and as Ireland itself awaits a new government the focus has shifted to identifying national priorities. The following chapters confirm that a great deal of work is being done and that a new agenda for Ireland is being framed.
### Box 1. Negotiating positions side-by-side

<table>
<thead>
<tr>
<th>Negotiating Issue</th>
<th>UK negotiating position</th>
<th>EU negotiating position</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rights of citizens</strong></td>
<td>Wants rights of UK citizens in EU to be secured.</td>
<td>Wants rights for EU citizens in UK to be secured.</td>
</tr>
<tr>
<td></td>
<td>May be willing to reciprocate but may have concerns over issues such as acquired rights for EU citizens.</td>
<td>Willing to reciprocate.</td>
</tr>
<tr>
<td><strong>The UK’s liabilities</strong> (the ‘divorce bill’)</td>
<td>A substantial exit bill will prove politically difficult</td>
<td>Will seek financial settlement to cover all the UK’s legal and budgetary commitments and liabilities, including contingent liabilities.</td>
</tr>
<tr>
<td><strong>Preserving the Good Friday agreement</strong></td>
<td>Stated priority</td>
<td>Stated priority</td>
</tr>
<tr>
<td><strong>Minimising damage to Ireland-UK relations</strong></td>
<td>Stated priority</td>
<td>Stated priority</td>
</tr>
<tr>
<td></td>
<td>Common Travel Area and border issues are acknowledged</td>
<td>Suggests that existing ‘bilateral arrangements’ (eg the Common Travel Area) between the UK and Ireland can be maintained, if they are compatible with EU law</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Suggests that “flexible and creative solutions” will be required to address the Irish issues</td>
</tr>
<tr>
<td><strong>Negotiations on the Future relationship</strong></td>
<td>Wishes for this to begin as early as possible, perhaps in parallel with the withdrawal negotiations.</td>
<td>Talks on Future Relationship can only happen once sufficient progress has been made on the terms of withdrawal, including the question of the UK’s liabilities</td>
</tr>
<tr>
<td><strong>Transitional Arrangements</strong></td>
<td>Acknowledges the need for transitional arrangements between EU membership and the future relationship</td>
<td>Believes transitional arrangements will be necessary to avoid disruption</td>
</tr>
<tr>
<td></td>
<td>No stated preference as to the format of these arrangements</td>
<td>Must be time-limited and subject to appropriate enforcement rules</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Open to a time-limited prolongation of UK’s EU membership</td>
</tr>
<tr>
<td><strong>Future free trade agreement</strong></td>
<td>Wants an ambitious free trade deal</td>
<td>Broadly concurs that this is in EU interests. Notes that this cannot be agreed until the UK has left the EU</td>
</tr>
<tr>
<td></td>
<td>Accepts that it cannot cherry-pick EU membership benefits</td>
<td>Future relationship must be subject to appropriate enforcement rules.</td>
</tr>
<tr>
<td></td>
<td>Will not seek Single Market access</td>
<td>Insists on the need for a ‘level playing field, particularly with respect to competition and State-aid</td>
</tr>
<tr>
<td><strong>Security cooperation</strong></td>
<td>Stated position is a desire to continue security cooperation with the EU</td>
<td>Willing to consider establishing a partnership in the fight against terrorism, international crime, security and defence.</td>
</tr>
<tr>
<td><strong>Minimising disruption</strong></td>
<td>Hope to avoid ‘cliff-edge’ for business and citizens</td>
<td>Concurs and hopes to provide early clarity on terms of exit</td>
</tr>
<tr>
<td></td>
<td>Hopes for early resolution to the talks</td>
<td>Achieving this is contingent upon settlement of UK’s rights and obligations arising from its EU membership</td>
</tr>
<tr>
<td><strong>Gibraltar and Spain</strong></td>
<td>No stated position in the Article 50 letter</td>
<td>No future agreement between the EU and the United Kingdom, after the UK leaves the EU, may apply to the territory of Gibraltar without agreement between the Kingdom of Spain and the United Kingdom.</td>
</tr>
</tbody>
</table>
The European Union responded rapidly to the UK's Article 50 Notification in March 2017, and preparations are in place for the opening of negotiations after the new UK Government is formed in June. This chapter sets out the current state of play for the European Commission, Council and Parliament, and notes some potential issues for the Member States.

Box 2: The Roles of the European Commission, Council and Parliament

The European Commission will negotiate on behalf of the European Union, according to a mandate provided to it by the European Council. The Commission can request an updated mandate from the Council during the negotiations. Its negotiating team will be led by Michel Barnier, a former European Commissioner for Regional Policy and Development, and later for the Internal Market.

The European Council will provide the negotiating mandate, and is tasked with providing political oversight during the negotiations. The Council can modify the mandate during the negotiations, if it feels it appropriate. It will also vote by qualified majority to approve or reject the final deal. Didier Seeuws, a Belgian diplomat, will lead the Council’s Brexit taskforce.

The European Parliament adopts its own position on the negotiations. The Parliament will be kept informed of progress and closely monitor developments. Ultimately, it will vote by simple majority to accept or reject the deal. The Parliament’s point person for Brexit is MEP and Former Belgian Prime Minister, Guy Verhofstadt.

The European Commission

On 27 July 2016, President Juncker appointed Michel Barnier as Chief Negotiator leading the Commission Taskforce in the preparation and conduct of the Brexit negotiations with the UK (the ‘Article 50 Taskforce’). The Taskforce is headquartered in the Berlaymont under strict security conditions (in addition to the usual swipe cards, separate fingerprint-activated access to offices for example).

To date, two Irish persons have been appointed to the Taskforce: Tadhg O’Briain, who originally came from the Northern Ireland civil service as a national expert, joined DG ENER and was most recently with the Secretariat General; and Daniel Ferrie, who transferred from the Spokespersons’ Service.
When Article 50 was triggered on 29 March, the Commission and in particular chief negotiator Michel Barnier came out with a very strong line, both in public and behind the doors of the College meeting room. Ireland topped the agenda in terms of reassurances and the overall tone was measured. In addition to the Irish dimension, the Commission was emphatic about three things; transparency is essential, the 27 must remain united and the principles of an orderly withdrawal - including the financial settlement - must first be established before phase 2 of negotiations can begin.

In terms of impact no one knows what ‘no deal’ really means, but all Commission services are working on their assessments of the possible consequences. Timing is tight: if things go according to plan, principles should be agreed by the end of 2017, transitional arrangements can then be considered in Spring 2018 and these must be agreed by October 2018 in order to fit with the political cycle (European Parliament elections in May 2019). Agreement will require ratification by all 27 and, to be successful, regulatory dumping will have to be avoided. The Commission intends to be ambitious, citing tax, environmental and social standards in particular. Security is equally considered a priority.

The rhetoric in March was serious but positive, with Barnier stressing that the Commission will remain firm, friendly but never naïve – there should be no talk of punishment or revenge. While the basic messages remain the same, the tone has changed significantly in the intervening period. The Commission’s negotiating mandate will be agreed by the European Council on 22 May and all indications are that (Member State) positions have hardened in the course of preparations.

The Commission’s assessment is that Member States will tighten the mandate considerably, introducing details on citizens’ rights...
and the role of the ECJ, which set a very high bar for phase 1 agreement to be reached. There seems to be little if any appetite for flexibility around the financial settlement and the rules governing its calculation. Once phase 1 is deemed complete (Council will decide when a satisfactory agreement has been reached), a second negotiating mandate will have to be agreed before negotiators can move on to phase 2.

Discussion of transitional arrangements is still off the table and it is clear that whatever might be agreed next year must be clearly defined, time limited and subject to effective enforcement mechanisms. Existing Union regulatory, budgetary, supervisory, judiciary and enforcement structures will have to apply to any transition agreement.

Member States agree (though not unanimously) with the transparency approach so important to Barnier, who sees this as essential to avoid the 27 splitting and opening bilateral channels of discussion. It is understood that the UK attempted (but failed) to persuade the Maltese Presidency to soften language in the draft paper on transparency that will be agreed by Council.

It appears clear that the starting positions could hardly be further apart, making the transition from phase 1 to phase 2 of the negotiations very difficult. The Commission’s negotiating team seems grimly aware that the coming months are going to be tough and despite their commitment to reaching a deal, there is a real chance of failure. The Commission are concerned that in expecting soft transition arrangements to buffer the blows, many Member States have still not quite woken up to the consequences of the UK’s exit, and will get a very rude awakening if no agreement can be reached.

**European Parliament**

The consent - by simple majority - of the European Parliament is the penultimate step prior to a final decision by the European Council on the withdrawal of the UK. The Parliament has made it very clear that while in formal terms, its involvement comes close to the end of the exit procedure, it wishes to be involved and see its influence operating throughout all stages of the negotiations.

The EP representative for Brexit negotiations, Guy Verhofstadt MEP (former Belgian Prime Minister and current leader of the Liberal group in the Parliament), has taken an active and visible role in Brexit negotiations. He has frequently underlined that the Parliament could reject a deal if it feels that its views have not been adequately taken into account throughout the two-year negotiating period. Since April 2017, the Parliament has also established a Steering Committee on Brexit, composed of representatives of most of the largest groups in the Parliament.

Over the final quarter of 2016, the European Parliament committees engaged in a screening exercise in their respective policy areas of competence, focusing on the possible impact of Brexit on legislative files currently under discussion as well as sectoral impacts on the discussions which would take place on the EU-UK withdrawal agreement and on the future EU-UK relationship.

Drawing on the outcome of this work, and on the basis of a proposal tabled by four of the Parliament’s political groups in the Parliament (EPP, Socialists, Liberals, Greens) a resolution setting out the Parliament’s starting position in the negotiations was adopted by a large majority (516 votes in favour, 133 against and 60 abstentions) on 5 April 2017.

A number of key EP priorities were emphasised in the parliamentary debate and in the resolution:

- fair treatment of EU-27 citizens and the need for reciprocity and non-discrimination between UK citizens living in the EU and EU citizens living in the UK;

**Box 5. Profile: Guy Verhofstadt**

A deeply pro-European politician, and the current Leader of the centrist ALDE group of Liberal MEPs, Verhofstadt has been involved in politics since the early 70s. In 1978 he was elected to the Belgian Parliament and served three times as Belgian Prime Minister (1999-2008). He has been an MEP since 2009. Though he will not be directly involved in the negotiations with the UK, he will be key to securing the European Parliament’s approval for the final agreement.
a maximum of transparency in the negotiations, and a substantial role for the European Parliament in the implementation of Article 50; this will be essential in order to ensure a clear majority supporting the eventual decision on consent;

- the need to achieve an appropriate settlement of financial matters;

- recognition of the unique position and the special circumstances confronting the island of Ireland, including means and measures to mitigate effects on the border;

Further resolutions are expected to be adopted in autumn, on specific issues such as citizens’ rights, budgetary and financial affairs and the situation in Ireland. Once a withdrawal agreement is finalised, the lead committee preparing Parliament’s report and vote on the matter will be its Committee on Constitutional Affairs (chair Danuta Huebner, EPP, Poland).

**Council of the European Union/European Council**

In response to the UK’s Article 50 notification of 29 March 2017, a Special European Council (Article 50), in an EU 27 format, was held on 29 April 2017.

This first formal sitting of the European Council dedicated specifically to Brexit adopted the guidelines for the Brexit negotiations. The guidelines define the framework for negotiations and set out the overall EU positions and principles during the talks.

In the guidelines, the European Council states that the EU27 will keep its unity and act as one during the negotiations. The leaders:

- reiterate their wish to have the UK as a close partner;

- reiterate that any future deal will need to be based on a balance of rights and obligations and ensure a level playing field;

- stress that the integrity of the single market must be preserved, which means the four freedoms are indivisible and excludes any cherry-picking;

- state that a non-member cannot enjoy the same rights and benefits as a member.

A key element of the guidelines is the need to conduct the talks on the basis of a ‘phased approach’. This means simply that there will be no discussion of the framework for future relations with Britain, before sufficient progress is made on ensuring an orderly withdrawal.

Short-term issues such as citizen’s rights, the free movement of persons and the Irish border issue must be dealt with before moving on to longer-term issues.

The European Council will only take the decision to move to the next phase once they have reached ‘sufficient progress’ in the negotiations.

The European Council will update the guidelines in the course of the negotiations as necessary.

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**Box 6. Profile: Didier Seeuws**

A Belgian diplomat and former advisor and later Chief of Staff to previous Council President Herman Van Rompuy (2011-2014). Didier Seeuws has been a diplomat since 1989, having worked in Washington on economic and trade affairs, as well as in the Belgian Permanent Representation to the EU, where he was Deputy Permanent Representative. Prior to his current role, he served as Director of Transport, Telecommunications and Energy in the General Secretariat of the Council of the European Union.
The head of its Brexit taskforce is a Belgian diplomat, Didier Seeuws, who is supported by representatives of the remaining Member States.

Other Member States

As detailed in the next Chapter, by Tony Brown, the EU27 have thus far successfully maintained a clear unity of approach on Brexit, notably on issues such as the indivisibility of the four freedoms of the single market and the fact that ‘cherry-picking’ is not an option.

Once negotiations begin, Member States will of course bring a variety of different domestic priorities and concerns to the table, and informal groupings may emerge. A number of potential issues or fault lines can be identified, for example:

- Changes to the trading dynamic between the UK and EU may cause divisions between Member States with significant trading interests with the UK (eg Germany or Belgium) versus those (such as Austria, Croatia or Slovenia) who will be less directly impacted by any changes in the EU-UK trade dynamic the UK Between Member States.

- The withdrawal of the UK, a net contributor to the EU budget, may sharpen divisions between net EU contributors and beneficiaries. In principle, decisions on the EU’s multiannual budget for the post 2020 period should be decided in late 2018/early 2019, i.e. in parallel with Brexit negotiations.

- Freedom of movement and the rights of citizens currently working in the UK is particularly important for countries with significant numbers of citizens working in the UK such as the Visegrád Group (Poland, Hungary, Czech Republic and Slovakia) or Romania.

- Security and defence will be important, as maintaining the UK’s role in NATO is a major concern for Member States on the EU’s eastern frontiers such as Poland and the Baltic States.

Further issues of specific relevance to individual Member States (eg the status of Gibraltar) may also become more salient as negotiations progress.

As will be seen in the timeline at the start of this Status Report, a number of national elections are taking place across the EU in 2017 and beyond, including in the UK itself, France (legislative elections), Austria, Malta (currently holding the EU presidency) and Germany. Some commentators have suggested that newly-elected French President Emmanuel Macron could take a tough line towards the UK in the Brexit negotiations, though it remains to be seen whether this will be the case.

There is equally a recognition that the outcome of elections in Germany in the autumn, and the question of whether Chancellor Angela Merkel will be elected for a fourth term, will have an important impact on the negotiations.

The issue of transparency

Following the letter of the UK Government activating Article 50, European Ombudsman Emily O’Reilly wrote to Commission President Juncker regarding information for the public on the upcoming negotiations. The article 50 negotiations will, according to Commission President Juncker “be unique and will differ from any international negotiation conducted by the Union. There is no precedent for the process. Therefore, our transparency policy will also be unique and unprecedented”.

In her letter to the Commission, the Ombudsman emphasised the need to assist in protecting EU citizens’ rights. Citizens of other EU
Member States residing in the UK are likely to be particularly affected, as are UK citizens residing in other EU Member States. This relates to questions, complaints and concerns about citizens’ rights and obligations arising from the fact that they have exercised their right of free movement. She invited the Commission to set out the arrangements that it envisages putting in place in relation to the types of information and documents it intends to publish (and when); and secondly how the Commission plans to secure and structure the input it needs from stakeholders to inform its negotiating position throughout the process.

In response, the Commission noted its plans to secure and structure stakeholder input. It intends to assist stakeholders by explaining the timeline and the governance structure of the negotiations as soon as they start.

### The Article 50 negotiations – Roles of the EU Institutions

<table>
<thead>
<tr>
<th>European Council</th>
<th>European Commission</th>
<th>European Parliament</th>
</tr>
</thead>
<tbody>
<tr>
<td>Role: Provides negotiating mandate, oversight and votes to approve final agreement</td>
<td>Role: Provides technical input and leads negotiations</td>
<td>Role: Provides input and votes to approve agreement</td>
</tr>
<tr>
<td><strong>Head of Task Force:</strong> Didier Seeuws</td>
<td><strong>Head of Task Force:</strong> Michel Barnier</td>
<td><strong>Head of Task Force:</strong> Guy Verhofstadt MEP</td>
</tr>
<tr>
<td><strong>Process</strong></td>
<td><strong>Process</strong></td>
<td><strong>Process</strong></td>
</tr>
<tr>
<td>Member States transmit their positions to the Secretariat</td>
<td>Receives its negotiating mandate from the Council</td>
<td>Defines its position on Brexit via a resolution before the negotiations begin</td>
</tr>
<tr>
<td>The Council agrees on a negotiating mandate for the Commission</td>
<td>Negotiates with UK</td>
<td>Monitors progress of negotiations</td>
</tr>
<tr>
<td>The Council provides political oversight during the negotiations and can modify the mandate at any time</td>
<td>Regularly briefs the Council and the Parliament on the progress</td>
<td>Votes on final agreement by simple majority</td>
</tr>
<tr>
<td>The Council votes by qualified majority to approve the final deal</td>
<td>Submits final agreement for approval by Council and Parliament</td>
<td></td>
</tr>
</tbody>
</table>

**Negotiations**

- **Participants:** UK and European Commission
- **Goal:** Reach agreement on the terms of the UK’s departure, taking account of the future relationship
- **Timeframe:** Expected to last 15-18 months, with 3-6 months allowed for finalisation and approval

**Final agreement**

- The European Parliament votes by simple majority to approve or reject the agreement
- The European Council votes by qualified majority to approve or reject the agreement

**Deal**

- UK exits on the agreed terms

**No deal is agreed before the two year deadline**

- The European Council can vote unanimously to extend the negotiations
- The UK leaves without a withdrawal deal or a framework for future relations

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"The article 50 negotiations will be unique and will differ from any international negotiation conducted by the Union. There is no precedent for the process. Therefore, the transparency policy will also be unique and unprecedented."
There has been one dominant theme in the EU discourse following the Brexit decision in the UK – ‘Unity’. From the first, shocked, response at Bratislava to the Rome anniversary on 25 March there has been a determined effort to bind the leaders of the EU 27 together in facing up to the existential threat to the European project inherent in the first departure of a Member State. Both the Commission White Paper on Europe’s Future and the Brussels Guidelines paper have continued, and underlined, an idea which became a commitment, as President Donald Tusk insisted “We need to remain united as EU 27. It is only then that we will be able to conclude the negotiations.”

The EU 27 have many contentious issues on their agenda - migration, climate change, jobs and growth, the continuing fall-out from the financial crisis, the threat posed by crude nationalism – and they struggle to find common ground and reach agreed solutions. Yet, on Brexit, they have been able to demonstrate unity, not only on principles and aspirations, but on the substance and the method of the forthcoming exit talks process.

While the achievement of this unity is of critical importance it is clear, for example, from recent commentaries assembled by the European Council on Foreign Relations that there are differences of opinion and of priority within the 27.

The positions of the major players – France and Germany – are, as always, significant. In a Presidential election year, it has been pointed out that French position on Brexit is likely to be less a reflection of French national interests than a by-product of Emmanuel Macron’s European policy in the election campaign. Germany has been prepared to make concessions in the past “grounded in Britain’s membership in the EU and Germany’s strong interest in preserving the integrity of the EU. By leaving the Union, Britain has lost that leverage. Downing Street may not have noticed that, yet. But the Chancellery clearly has.”

Both countries want to see a positive outcome to negotiations but share the view that if the UK insists on leaving the Single Market and the Customs Union it will have to accept the consequences.

Citizens’ rights will be high on the agenda for many Member States during the talks. It is clear that Member States like Spain and Malta have a fundamental concern about the future of the many older British individuals who have moved there, and the related costs of health care and related services. On the other hand, countries such as Poland, Italy, Lithuania, Romania and Bulgaria, are urgently concerned about the status, and long term security of many thousands of their citizens living and working in the U.K.
Estonia is seen to have another perspective on Brexit. Without major issues in respect of trade and citizens’ rights, Estonia has deep concerns about the EU budget from which it benefits through its use of Cohesion Funds. And, its geography dictates that it places great emphasis on security – with 800 British troops on NATO duty on its territory – and will actively argue for continued close co-operation between the UK and EU on all aspects of regional security.

Speaking in Dáil Éireann on the adoption of the EU Guidelines, the Taoiseach referred to bilateral meetings with ten EU Heads of Government, including the Prime Ministers of Denmark and the Netherlands, countries which, like Ireland, have close trade relationships with the UK. These three countries are likely to be the most at risk of economic damage arising from the UK’s departure.

The UK is Denmark’s fourth largest export market and the Netherlands’ second-largest trading partner. A recent parliamentary report argued that “Any restriction on free trade with Britain would inevitably be at the cost of Dutch exports, prosperity and employment.” And, some 53,000 Danish jobs are dependent on exports to the UK. The three leaders agreed on the need to find early agreements on the key ‘exit’ issues to permit the opening of discussions on the crucial long term trade relations between the EU 27 and the UK.

Bringing the Member State positions together

The various political, economic and social perspectives of these Member States, no doubt replicated in the others, exist within the broad consensus which has permitted the Chief EU Negotiator, Michel Barnier, to launch on 3 May the draft negotiating directives for the initial phase of the talks with the UK authorities, telling a Brussels press conference that “Our hard work paid off: the 27 leaders and the Presidents of the three institutions showing their unity by agreeing on clear guidelines for the negotiation.”

However, it is necessary to take heed of the comments of Commission President, Jean-Claude Juncker, speaking after the European Council adoption of the Guidelines. He warned that the talks ahead are unlikely to be as quick as they were on that Saturday lunchtime. “We won’t always be as calm and measured as today, I foresee that.” And he knows only too well how hard, if not impossible, it will be to keep up the unified front as the UK and the EU get into the detailed negotiations.

A fragile unity?

The much-praised unity between EU countries must be recognised as fragile, and the Brexit negotiations, as they inevitably take time and demonstrate their inherent complexity, could produce disagreement and frustration among the leaders of the EU 27. For example, Juncker has said he is concerned the countries will face tough decisions over a shared budget once Britain leaves.

The UK, despite its famous rebates, is still one of the top contributors to the EU budget and its departure will leave an annual gap of as much as €18 billion per year. The other Member States will be called upon to increase their payments and, to quote President Juncker once more: “Clearly there are those who don’t want to pay a penny more and those who don’t want to give up a penny either.”
Brexit challenges the structure and even the unity of the United Kingdom as it decides on how to tackle key issues in the forthcoming negotiations. As previous IIEA analyses of Britain and Europe have argued, the UK faces a dual sovereignty crisis in which the external question of leaving the European Union is directly linked to the internal question of that state’s future integrity. As a result, the UK faces an internal choice between restructuring its constitutional order or breaking up. This chapter first assesses that internal issue, then examines the political and party dynamics affecting it in the general election campaign, the possibility of finding a differentiated outcome in the Brexit talks and how that might affect the UK’s future unity.

The Referendum Results

<table>
<thead>
<tr>
<th>Country</th>
<th>LEAVE</th>
<th>REMAIN</th>
</tr>
</thead>
<tbody>
<tr>
<td>England</td>
<td>Leave</td>
<td>53.4%</td>
</tr>
<tr>
<td></td>
<td>Remain</td>
<td>46.6%</td>
</tr>
<tr>
<td>Wales</td>
<td>Leave</td>
<td>52.5%</td>
</tr>
<tr>
<td></td>
<td>Remain</td>
<td>47.5%</td>
</tr>
<tr>
<td>Northern Ireland</td>
<td>Leave</td>
<td>44.2%</td>
</tr>
<tr>
<td></td>
<td>Remain</td>
<td>55.8%</td>
</tr>
<tr>
<td>Scotland</td>
<td>Leave</td>
<td>30%</td>
</tr>
<tr>
<td></td>
<td>Remain</td>
<td>62%</td>
</tr>
<tr>
<td>UK Total</td>
<td>Leave</td>
<td>52%</td>
</tr>
<tr>
<td></td>
<td>Remain</td>
<td>48%</td>
</tr>
</tbody>
</table>

The Dual Sovereignty Issue Today

The differential outcome of voting in the June 2016 referendum, whereby England and Wales voted to leave the EU and Scotland and Northern Ireland voted to remain, strongly reinforces the UK’s dual sovereignty crisis.

The Scottish National Party government says the Remain vote there, which carried in all areas, creates a mandate for another referendum on independence. It drew this conclusion after publishing a white paper putting the argument for allowing Scotland to stay in the EU’s Single Market, accepting its four freedoms of movement including migration. Along with repatriation to Edinburgh of sectors like agriculture returning from Brussels and a stronger Joint Ministerial Council (JMC) involving the devolved governments in co-decision of Brexit policy with Westminster this would provide a compromise solution.

Theresa May’s vigorous rejection of such a different and more equal path for Scotland sets the scene for another constitutional battle over independence. Her decision to call a general election, driven by political timing issues in Brexit, has overshadowed similar questions on when another independence vote might be held; she is likely to argue it should happen, if at all, after Brexit talks are concluded in the early 2020s, whereas the SNP demand a poll in 2019.

SNP spokesmen like Michael Russell, minister in charge of Scotland’s EU negotiations, say May’s failure to consult on her strategy and a quite ineffective
JMC reveal a centralising trend reinforcing sovereigntists in Westminster that cuts across devolution and disrespects the UK's constituent nations. His critique of the JMC process is echoed explicitly by Welsh political and officials and similarly but less vocally by Northern Irish ones. They say it is ill-prepared, not well attended by London ministers and is systematically consultative rather than co-deciding. Alongside this official process, an emergent English nationalism resents Scottish claims and resists ceding extra powers or funds, much less co-decision, to them after the 2014 referendum on independence.

These structural and constitutional dynamics and tensions mean there is little space to examine or debate a federal or quasi-federal alternative to the existing devolution settlements in the UK whose weakness Brexit exposes. Former prime minister Gordon Brown's proposals along these lines have attracted media attention but little detailed consideration. Nonetheless the Labour Party's election manifesto commits it to convene a constitutional convention on how Britain is governed and where power and sovereignty lies, including the "option of a more federalised country". The Welsh government has pushed a similar line, but from a weaker position because of the Brexit majority vote there. In their manifesto the Conservatives support more decentralisation of government in Britain as part of a strong commitment to maintaining the union. But Brexit's thrust is in practice towards more centralised control of policy.

Northern Ireland is marginalised in this internal UK debate by its continuing political/constitutional and religious/ethnic divisions, the breakdown of power-sharing and the failure to form another executive. Northern Ireland lacks a coherent voice to represent its interests on Brexit through London, even though its electorate also voted to remain in the EU.

Since Ireland is most exposed within the EU to the asymmetric shock of Brexit this is a huge weakness. So is the growing realisation that the estimated £10 billion plus annual subsidy to Northern Ireland from London, together with its relatively high public sector and agricultural sector, will become vulnerable to cuts as the economic costs of Brexit come through in the medium term. That these distinct and unique concerns have been nevertheless been explicitly recognised in Brussels and EU capitals, as well as in London testifies to the Irish Government's political and diplomatic success in pressing their case. The Scottish government recognises and supports that case but says its special problems should also be mentioned.

In parallel with the question of Scottish independence, Irish unification also arises from the UK's external crisis of sovereignty with the EU as well as from North-South dynamics on this island. That prospect is now linked explicitly to full EU membership in the assurances received from the EU by the Irish Government that Northern Ireland would join the EU as part of the territory of a united Ireland, as East Germany did in 1989-90.

### Political and Party Dynamics

Accelerated political changes accompany and drive these constitutional and structural shifts in the UK's internal and external sovereignty. Theresa May's decision to call a general election seeks to turn these changes to her Conservative Party's advantage. She expects to benefit from an exceptionally strong Conservative lead in opinion polls, whether in its overall lead, or more significantly its lead in the policy spheres thought most important by voters, such as capacity to handle Brexit, the economy and migration, notwithstanding Labour's better performance on fairness, equality and welfare issues, reflected in it closing the polling gap between the parties. The Labour Party's polling weakness is compounded by its historic loss of seats in Scotland to the SNP, its contested leadership by Jeremy Corbyn and its ambiguous stand on Brexit. As a result the party is losing pro-Brexit support to the Conservatives in England and Wales and anti-independence voters to the Conservatives in Scotland. UKIP's implosion since the 2016 Brexit referendum is benefitting the Conservatives.

In these circumstances the prospect of a strong Conservative majority in the next parliament should be factored in to any analysis of the internal challenges facing the UK from Brexit.

Seen from Scotland, that prospect will reinforce the SNP vision of a dominant English majority increasingly ruling with less sympathy...
and respect for Scottish concerns. Recentralisation of decision-making in a sovereign Westminster parliament reverses devolution and heads off a federalising agenda. If Brexit goes badly economically the associated risks of independence from reduced oil revenues might loom less large for Scottish voters. We should therefore expect more constitutional turbulence concerning the UK’s own future as the Brexit story unfolds.

Seen from Northern Ireland a similar dynamic may unfold. It will be difficult to secure political attention for its sectoral concerns and interests even if the Border issues are adequately addressed. The Democratic Unionist Party will lose whatever political leverage it possessed with Theresa May arising from her small majority in the outgoing parliament. As with Scotland, a weakening UK economy under Brexit will affect the readiness of the English majority to pay the political and financial price of union with smaller and more peripheral parts of the UK. That may shift key unionist groups who favoured remaining in the EU to consider looking towards Dublin and Brussels for a more favourable outcome than can be secured from London. Irish unity would then arise not only out of irredentist claims from Irish nationalism but from structural crisis in the UK itself. We cannot predict such outcomes but should anticipate them as possible scenarios, plan accordingly and prepare for a mature and sympathetic debate with unionists on how they understand these changes in the union they cherish.

A stronger Conservative majority is conventionally seen to favour a softer Brexit outcome by allowing Theresa May see off the fringe of hard Brexiteers in her party, creating space for compromises. That may well be true. But this should not obscure the other political reality that her majority may also intensify the UK’s disunity.

**Conclusion**

Ireland was described by the French writer Jean Blanchard in 1958 an “an island behind an island”. The phrase has regularly been used to describe Irish peripherality in European terms. In their determination to avoid being caught in a pincer of peripherality between Britain and Europe after Brexit Irish political leaders and voting publics want to remain in the European centre rather than becoming once again dependent on a sovereigntist England with no European counterweight.

“Maintaining Ireland’s role in Europe must take full account of how Brexit affects Northern Ireland and the future of the UK itself.”

Maintaining Ireland’s role in Europe must take full account of how Brexit affects Northern Ireland and the future of the UK itself. Whether it all foreshadows a united federal Ireland in a confederation with Scotland, each in the EU and enjoying strong bilateral relationships with an England and Wales outside it remains to be seen. But it is no longer fanciful to imagine such futures between these islands and their changing unions.
Chapter 5 Brexit: The Options for the UK’s Relationship with the EU

John Temple Lang

The final format of the UK’s withdrawal deal and future relationship with the EU is presently unknown. However, Theresa May’s Government has already apparently ruled out a number of options, including UK membership of the Single Market and the European Economic Area, and the EU Customs Union. The UK has also indicated that it will not accept a future relationship that allows for continued free movement of EU citizens or subjects the UK to the continued jurisdiction of the European Court of Justice. This chapter examines the implications of this position.

The UK government has decided that the UK should not remain in the EU Customs Union after Brexit, because that would prevent the UK from negotiating its own trade agreements with other States.

The UK has also decided not to remain in the Single Market, for several reasons. To stay in the Single Market, the UK would have to accept greater freedom of movement of persons than the UK apparently wants. The UK would also have to accept the jurisdiction of the Court of European Court of Justice (ECJ).

Box 7: The Customs Union and the Single Market:

The EU Customs Union is an agreement that removes customs duties on goods at the borders between EU Member States, applies common customs duties on imports from outside the EU and common rules of origins procedures for products from outside the EU. It ensures that common tariffs are applied in the same way across all the EU’s external borders. One of the consequences of this Customs Union is that the EU Member States negotiate trade deals as a single bloc (the Common Commercial Policy), with the European Commission having the exclusive right to negotiate on behalf of the European Union.

The EU Single Market is an enhanced free-trade area. The Customs Union established, in principle, the free movement of goods in the EU, but the Single Market goes much further. It defines the EU as one territory without internal borders or any other obstacles to the free movement of (i) goods, (ii) capital, (iii) services and (iv) people. These ‘Four Freedoms’ are the foundation-stones of the Single Market. All the EU Member States are a part of the Single Market. Preferential access to the market is also provided to certain third party countries, like Norway, Liechtenstein, Iceland and Switzerland, as part of trade agreements such as the European Economic Area and the European Free Trade Area. Third party countries must conform to Single Market rules and regulations in order to secure this access.
The UK government has also decided that the UK should not join the European Economic Area (EEA), composed of the 28 EU Member States plus Iceland, Norway and Liechtenstein, because that would also mean accepting an undesired degree of free movement of individuals. It is also not clear whether the UK would be more willing to accept the jurisdiction of the European Free Trade Association Court (the court of the EEA) than that of the ECJ.

Instead the UK government has said that it wishes to negotiate a free trade agreement. The terms desired are not yet clear, but it is possible to say several things about them with a reasonable degree of confidence:

1. The proposed agreement would have to be comprehensive, because that is required by World Trade Organisation rules on free trade areas.
2. It would need to deal with services, particularly financial services, because of the importance of services for the UK economy.
3. It would need to deal with non-tariff barriers, because they are much more important than tariffs in modern trade.
4. It would have to limit State aid, since the EU would not agree to the UK being free to subsidise its industries.
5. There would have to be some effective mechanism for dealing with disputes between the UK and the EU, and the mechanism would have to include a court, because the EU has already told Switzerland that its future agreements with the EU must involve a court, and with the UK the EU will certainly not accept less.

The arrangements for non-tariff barriers and technical obstacles to trade would necessitate a degree of harmonisation of the legislation in the UK and the EU. Since the UK cannot expect, after it has left the EU, to be able to influence the terms of future EU measures, harmonisation essentially means that in order to retain a degree of access to the Single Market, future UK legislation will need to copy future EU measures. The UK will not be able to retain access to the EU Single Market and simultaneously to be free to relax its legislation on industries that are regulated in the EU in order to give UK companies competitive advantages over EU companies.

A level playing field

The arrangements would need to provide for as much freedom of movement of services, freedom of establishment, and free movement of capital as would be compatible with the UK's wish to be able to regulate movement of persons from the EU into the UK. There would have to be provisions about public contracts, trademarks, patents and other industrial and commercial property rights.

In negotiating all these matters the EU negotiators will be aware that UK companies will always be free to set up subsidiaries in the EU which will have all the benefits and advantages of EU law. The EU will therefore want to make sure that the UK accepts obligations in all sectors that balance the advantages that EU law gives, and will continue to give, to companies set up within the Single Market. In other words, the EU negotiators will want to make certain that the UK does not obtain most of the advantages of access to the EU Single Market without accepting corresponding obligations. Since it seems that this is precisely what some UK politicians want, this will not be easy, either technically or politically. It will be particularly difficult because it seems unlikely that the UK will be willing to accept an overriding obligation or objective of “homogeneity” such as that accepted by the EEA States. The UK got off
to a bad start by apparently promising at least one car producer in the UK that it would get a subsidy to cover any additional cost of exporting to the EU as a result of Brexit. Any such subsidy for export would be clearly contrary to WTO rules (see Box 5), quite apart from any agreement between the UK and the EU.

Agriculture and other questions

It will also be necessary for any new trade agreement between the UK and the EU to deal with agricultural products. Brexit will deprive farmers in the UK (including of course Northern Ireland) of all the benefits of the EU common agricultural policy and the EU regional and social policies. It will not be clear for several years what agricultural policy the UK is likely to adopt. But it seems likely that it will be a cheap food policy based on imports of low cost agricultural products from e.g. Argentina, Brazil, Australia and New Zealand, since that would be one of the only advantages that could be obtained by the UK when negotiating its own trade agreements. A cheap food policy would benefit UK consumers, but would be contrary to the interests of UK farmers, who will have to be compensated and subsidised in some way. The new UK farm policy, whatever it may prove to be, will have to be dealt with somehow in any long-term trade agreement with the EU.

In addition, UK-EU arrangements will be needed to deal with a large number of other questions such as Euratom, security and defence, scientific research, fisheries and, last but not least, Northern Ireland.

The Available Options

Several things are clear from the above.

First, it will almost certainly be impossible to negotiate solutions to all of the issues referred to above in the two-year period provided by Article 50. It may take longer than that for UK politicians who advocated Brexit to understand that the UK cannot get all the advantages of the EU with none of the obligations and constraints, and to accept whatever compromises may be worked out.

Second, it will be seen from what is said above that the proposed free trade arrangements, whatever the details may be, will be very like the European Economic Area. That is helpful, because it gives negotiators a standard of comparison and a body of experience to draw on.

It would be particularly helpful if, as is proposed by a team of experts in Queen’s University Belfast (see Box 9 at the end of this Chapter), Northern Ireland were allowed to join the European Economic Area separately from the rest of the UK.

That solution would allow Northern Ireland to trade freely with both the EU (including of course the rest of Ireland) and with the rest of the UK. The UK government should be willing to accept arrangements for Northern Ireland that they are apparently not willing to accept for the UK as a whole. If this EEA option proves to be politically acceptable, it could be the most satisfactory solution economically for Northern Ireland.

Box 8. World Trade Organisation

The World Trade Organisation is the successor of the General Agreement on Tariffs and Trade (GATT) and is an intergovernmental organisation which regulates international trade.

All the EU Member States belong to the WTO and the European Commission is mandated by them to represent them collectively (as the EU) in international trade negotiations.

The WTO currently has 164 members. It serves as a negotiating forum for its members to create international trade rules, and as an organisation it oversees implementation of those rules.

If this EEA option proves to be politically acceptable, it could be the most satisfactory solution economically for Northern Ireland.
Third, it is clear that if the UK were to leave the EU without having made a new trade agreement, the result would be that both sides would be bound by World Trade Organisation rules. Exports from the UK to the EU would be liable to EU tariffs. There would be no effective provisions allowing UK companies to provide services in the EU: all UK service companies, including financial service companies, would need to set up subsidiaries in the EU. The UK could lower the tariffs on imports from the EU, but only by lowering its tariffs on imports from all other sources, thereby losing one of the few elements with which it could bargain in negotiating new trade agreements. UK exports to the EU would also be potentially liable to anti-dumping duties and countervailing duties.

Box 9. Northern Ireland and Brexit: the European Economic Area Option

The European Economic Area is a free trade area in which Norway, Iceland and Liechtenstein obtain the benefits of being in the EU Single Market, on certain conditions, but are not in the EU Customs Union. They are therefore free to make trade agreements with other States.

It is suggested in a paper circulated by professors in Queen’s University Belfast that Northern Ireland could be allowed to join the EEA even if the UK does not do so. This would maintain much of the economic status quo for Northern Ireland, and minimise the ill-effects of Brexit on Northern Ireland and on Ireland as a whole. If this proved to be politically feasible, in the EEA Northern Ireland would retain full access to the Single Market, with free movement of goods, services, capital and people. The EEA option would not solve the problem of trade in agricultural products (Northern Ireland would be outside the EU agricultural policy) but it would not make them harder to resolve. Northern Ireland would continue to trade with the rest of the UK substantially as at present. It would need to adopt legislation corresponding to EU measures, as is done by e.g. Norway. It would not be subject to the jurisdiction of the European Court of Justice: there is a separate dispute settlement mechanism in the EEA, with the EFTA Court.

In short, if Northern Ireland were to join the EEA it would continue to be able to trade freely with both the UK and the EU (including the rest of Ireland). Except for continued EU membership, the EEA is the only existing arrangement that can achieve this. There would be technical and legal problems concerning rules of origin, but problems of this kind are unavoidable whatever arrangements may be made.

The title of the paper is Northern Ireland and Brexit: the European Economic Area Option, and is available to download for the website of the European Policy Centre (www.epc.eu).
Ireland is arguably the Member State most affected by Brexit, and its concerns have been reflected in the negotiating stances issues by the UK, the European Council and the European Parliament. This chapter traces the Irish government’s political and policy response to Brexit and discusses how this response may evolve as the negotiation on the UK’s withdrawal and future relationship with the EU proceeds.

The story so far

The decision by the British electorate to vote for Brexit in June 2016 shifted a foundation stone of Irish external policy in place since the late 1950s. At that time, Irish policy moved from the protectionism adopted during the 1930s towards economic modernisation and openness to the outside world. The emergence of the European Economic Community (EEC) was a factor in influencing this policy shift. But the realities of Ireland’s trade dependence on the UK, as well as many other economic linkages, meant that Ireland could only contemplate EEC membership if Britain joined at the same time. The 1960s provided an opportunity for the Irish economy to prepare for more competitive trading relationships with the UK, and ultimately the EEC, which the UK and Ireland joined in 1973.

Common membership of the EEC and later, the European Union (EU), has underpinned the relationship between Ireland and the UK since 1973. Membership of the EU and, since 1993, the Single Market, has been central to Ireland’s economic transformation. Ireland has substantially diversified its trade and reduced its dependence on the UK since the 1970s.

Notwithstanding this, Irish/UK trade remains very important, there are considerable linkages between the Irish and British economies and there has been a growth in linkages within the all-Ireland economy. The improved political relationship between the two countries, along with political and

Box 10. Some key issues for the island of Ireland

- Protecting the gains of the Northern Ireland Peace Process
- The future of EU support for the peace process, and EU funding for border-regions
- Preserving the Common Travel Area between Ireland and the U.K.
- Avoiding a hard border on the island, including customs posts
- Protecting the rights of Irish citizens in Northern Ireland post-Brexit
- Continuation of the all-island energy market
- Minimising the impact of Brexit on the economies on both sides of the border
- Minimising disruption for cross-border business, particularly, but not limited to, the agri-food industry
financial support from the EU, was critical in reaching the Good Friday Agreement (GFA), leading to the winding down of the Northern Ireland conflict.

This was the background to the awareness within Irish politics, business and civil society of the risks of a Brexit to the Irish economy and other aspects of Irish society. Although making assumptions about the possible nature of a Brexit was problematic, a number of studies attempted to quantify the possible risks and costs. The IIEA examined different scenarios of changing relations between the UK and the EU and the implications for Ireland in its book *Britain and Europe: The Endgame. An Irish Perspective* (March, 2015). The ESRI quantified how a Brexit might impact on the key economic areas of trade, energy and foreign investment (November 2015).

During the referendum campaign in the first half of 2016 the Irish government expressed a clear view that it would be in the best interests of the UK, the EU and Ireland for the UK to remain as a member of the EU while acknowledging that the decision on whether or not to do so was for the British people through their referendum vote.

While it was hoped in political circles that the British electorate would not opt for Brexit, the Irish government conducted a contingency risk analysis of the likely impact of Brexit. This meant that, shortly after the referendum decision, the government was able to indicate the nature and scale of the main Brexit risks it anticipated.

**Irish priorities**

Drawing on this analysis, the government set out its political and policy priorities, as follows:

- Protecting the gains of the Northern Ireland Peace Process and avoiding a hard border on the island
- Preserving the Common Travel Area between Ireland and the U.K.
- Minimising the impact of Brexit on the Irish economy and trade
- Ensuring that Ireland remains at the heart of EU27 post-Brexit.

These priorities were at the centre of a major political and diplomatic initiative on behalf the Irish government from Autumn 2016. The initiative was led by Taoiseach Enda Kenny; Minister for Foreign Affairs and Trade, Charlie Flanagan, T.D.; and Minister of State for European Affairs, Dara Murphy, T.D.

In addition to the policy priorities outlined above, part of the core messaging was that Brexit risked having a greater proportionate negative impact on the Irish economy than on any other EU Member State. Ireland’s special situation in regard to Northern Ireland was also emphasised, given the key role the EU had played in bringing about the Good Friday Agreement.

The government also sought to stimulate a broader discussion on Brexit through the convening of the All-Island Civic Forum which brought together a range of economic, social and cultural interest groups, from the Republic and from Northern Ireland, to discuss its implications. The Forum has met twice in plenary session, on 2 November 2016 and on 17 February 2017, and has convened a number of sectoral forums.

By contrast to Ireland, British planning for a possible Brexit was minimal. For political reasons, no serious contingency planning had been done in advance of the referendum. The immediate consequence of the Brexit vote was a change of Prime Minister, with Theresa May replacing David Cameron. Prime Minister May appointed three Brexiteers, Boris Johnson, David Davis, and Liam Fox into the key ministries responsible for Brexit. But for a number of months following her election, the degree of policy clarity appeared to be that ‘Brexit means Brexit’.
**Recognition of the Irish concerns**

At the Conservative Party conference in October 2016, the Prime Minister clarified that the UK would submit, by end-March 2017, its Article 50 letter confirming its intention to leave the EU.

This set in train a number of important policy announcements during the first half of 2017, on behalf of the British government and the EU, which set the framework for the negotiation of UK departure from, and its future relationship with, the EU, and which respond to the Irish interests as represented in the political and diplomatic initiative undertaken by the government. These statements are reproduced in Box 11 below.

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<th>Box 11. References to Ireland by the UK, European Council and European Parliament</th>
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<td><strong>UK’s Article 50 Letter, 29 March 2017</strong></td>
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“In particular, we must pay attention to the UK’s unique relationship with the Republic of Ireland and the importance of the peace process in Northern Ireland. The Republic of Ireland is the only EU member state with a land border with the United Kingdom. We want to avoid a return to a hard border between our two countries, to be able to maintain the Common Travel Area between us, and to make sure that the UK’s withdrawal from the EU does not harm the Republic of Ireland. We also have an important responsibility to make sure that nothing is done to jeopardise the peace process in Northern Ireland, and to continue to uphold the Belfast Agreement.”

| **European Parliament Resolution on Brexit, 5 April 2017** |

“… recognises that the unique position of and the special circumstances confronting the island of Ireland must be addressed in the withdrawal agreement; urges that all means and measures consistent with European Union law and the 1998 Good Friday Agreement be used to mitigate the effects of the United Kingdom’s withdrawal on the border between Ireland and Northern Ireland; insists in that context on the absolute need to ensure continuity and stability of the Northern Ireland peace process and to do everything possible to avoid a hardening of the border.”

| **European Council Negotiating Guidelines, 29 April 2017** |

“The Union has consistently supported the goal of peace and reconciliation enshrined in the Good Friday Agreement, and continuing to support and protect the achievements, benefits and commitments of the Peace Process will remain of paramount importance. In view of the unique circumstances on the island of Ireland, flexible and imaginative solutions will be required, including with the aim of avoiding a hard border, while respecting the integrity of the Union legal order. In this context, the Union should also recognise existing bilateral agreements and arrangements between the United Kingdom and Ireland which are compatible with EU law.”

On 17 January, 2017, in a speech in Lancaster House, Prime Minister May outlined twelve priorities which would inform the British government’s approach to the Article 50 letter. Priority 4 dealt with ‘Maintaining the Common Travel Area with Ireland’, commenting that ‘nobody wants a return to the borders of the past’. This priority was reflected in the Article 50 letter of 31 March, which stated ‘We must pay particular attention to the UK’s unique relationship with the Republic of Ireland and the importance of the peace process in
Northern Ireland […] important responsibility to make sure nothing is done to jeopardise the peace process in Northern Ireland and to contribute to upholding the Belfast Agreement.

The formal response to the Article 50 letter was the adoption by the European Council of the Guidelines for Negotiation (29 April, 2017). Paragraph 11 of the Council Guidelines noted that ‘In view of the unique circumstances of the island of Ireland, flexible and imaginative solutions will be required, including the aim of avoiding a hard border, while representing the integrity of the legal order’. The EU Council also agreed on a text stipulating that, in the event of a united Ireland, brought about in accordance with the Good Friday Agreement, the entire territory of such a United Ireland would legally be part of the EU.

Although by no means a consensus view, many commentators believe that the formal statements of the British government and the EU, as referenced above, reflect an appropriate weight given to the concerns and priorities advocated by the Irish government. The real challenge will be how to translate high level political statements, such as - ‘no return to a hard border’ - into practical outcomes.

**Brexit and beyond**

In parallel to the negotiations, and taking a medium-term perspective, the Irish government will need to keep a particular focus on Northern Ireland and on improving the competitiveness of the Irish economy.

In relation to Northern Ireland, the government has a short-term responsibility as a co-guarantor of the Good Friday Agreement, along with the British government, to work towards the re-establishment of the Northern Ireland Executive. The British government has established the Joint Ministerial Council (JMC) as the means to engage the UK devolved administrations in the Brexit negotiations and a functioning Executive would need to be in place to represent the interests of the Northern Ireland during a period of great vulnerability for the economy.

In the medium term, the framework of the Good Friday Agreement is just one of the mechanisms through which the Irish Government can engage with the British Government to seek solutions to shared concerns as the wider UK-EU negotiations proceed.

Whether the outcome of the negotiations will be a hard or a soft Brexit, the trading relationship between Ireland and the UK will be more difficult than it is now with the UK a full member of the EU. There is thus an obvious and urgent need for a programme to increase the competitiveness of the Irish economy.

In a best case scenario, there will be a transition period after the two year negotiation period to 2019 for a number of years, and then a relatively soft Brexit. But it would be foolish to work on that basis.

For reasons of history, geography, economics and trade, the relationship between Ireland and Britain will continue, and the hope is that it should be as harmonious and mutually beneficial as possible: but from an Irish perspective, it will be part of a further development in which our trade, economic linkages and connections with the wider world become more diversified - and we must plan accordingly.
Northern Ireland voted by 55.8% to 44.2% in favour of remaining in the EU but with seven of the 18 constituencies, which have unionist majorities, opting for the UK to leave. The DUP was the only major political party to support the Leave campaign, and since the referendum, the two nationalist parties along with Alliance have called for Northern Ireland to have a special status with the EU.

In a letter to the UK Prime Minister last August, the First Minister and Deputy First Minister raised their concerns about the potential impact of a ‘hard border’ for the free movement of people, goods and services, and also the possibility of it becoming a catalyst for illegal activity, along with the special requirements of the agri-food sector. Both the Taoiseach and Prime Minister have stated their firm intention to avoid a ‘hard border’ and in the guidelines now agreed for the Article 50 negotiations both the EU Council and Parliament have committed to that objective.

Both the Taoiseach and Prime Minister have stated their firm intention to avoid a 'hard border'“}

### Options

While there are precedents for territories of Member States and European micro-states to have arrangements particular to their geographic or political circumstances, such as being in the Customs Union while being outside the EU, there are political, technical
and legal challenges involved in allowing this for regions of non-Member States.

However, the EU’s recognition of the unique economic circumstances on the island of Ireland built up over four decades of membership; the Peace Process and the terms of the Belfast/Good Friday Agreement could allow for specific arrangements unique to Northern Ireland being agreed. Among the options which have been raised are for Northern Ireland to remain in the Single Market, or in the Customs Union even though it appears likely that the UK will leave both structures.

1. Northern Ireland in the Single Market

As noted in John Temple Lang’s chapter, Northern Ireland could potentially remain in the Single Market, if the UK sponsored its membership of EFTA, and there was then an agreement for it to become a part of the European Economic Area. This would involve full acceptance of the EU acquis and the four freedoms for goods, services, capital and labour. It would also require substantial further devolution of power to Northern Ireland to ensure the on-going implementation of EU legislation.

Because the EEA does not cover free trade for all agriculture produce, and given the importance of agriculture to the Northern Ireland economy, it would also be necessary to seek a special arrangement in the area of agriculture. A further advantage of the EEA option is that it would allow the continuation of existing arrangements such as the single electricity market.

However, since the EEA arrangement does not involve membership of the Customs Union, it would not fully address the issue of a ‘hard border’, and some manner of customs controls would be required. The EEA option does, however, allow for a simplified customs procedure based on random and mobile checks, which could be supplemented with number plate recognition technology.

Under the EEA model, UK free trade agreements with low-cost food-producing countries, along with possible tariffs on UK-EU trade, would increase the need for customs procedures. The potential for revenue loss and economic risk to the agri-food sector would be significant. Audit at the point of destination of goods would be more costly and less effective than mobile customs patrols and checks nearer the border.

The impact of any customs checks would be disruptive for agri-food sector supply chains. These are highly integrated on a North/South basis with over 800 million litres of liquid milk along with 400,000 lambs going south of the border annually for processing, while 400,000 pigs travel in the opposite direction (IFA, 2017). A ‘soft Brexit’ would reduce the revenue and economic risks but would still have an impact on supply chains.

Finally, it is likely that the EEA solution would also require the implementation of the single rule book in financial services, which potentially would require the UK to operate two separate regulatory regimes. As there is no significant financial services industry in Northern Ireland, this would not currently be too onerous.

2. Northern Ireland in the Customs Union

The other option would be for Northern Ireland to remain in the EU Customs Union, but outside the EU, which has been the case for the Crown Dependencies of the Isle of Man and Channel Islands since accession in 1973.

However, a disadvantage of this option would be that it would necessitate customs controls at ports and airports between Northern Ireland and Great Britain to avoid revenue and economic risks for both the EU and UK. Note that Northern Ireland carries out over
60% of its trade with Great Britain and only 23% with the EU. Therefore, the Customs Union option, unlike that for the EEA, would require a separate EU–UK free trade agreement - which would also have to include agriculture produce - if it were to be a viable option.

Nonetheless, the Customs Union option would definitely resolve the ‘hard border’ and supply chain issues, and is effectively a Single Market for goods, which covers 82% of Northern Ireland’s exports. Both the EEA and Customs Union options would require the relevant EU legislative and regulatory compliance. It might also be potentially possible for Northern Ireland to be in both the EEA and Customs Union, but this might be considered to be too close to EU membership.

3. The Common Travel Area

The EU guidelines for the Article 50 negotiations also contain a commitment to maintain the Common Travel Area (CTA), provided that it is consistent with EU law.

Technically, the CTA does not include a right to work because Protocol 3 of the Accession Treaty of 1972, covering the Crown Dependencies, did not include free movement for work for EU nationals (including British and Irish) to the islands, nor EU free movement rights for Islanders, other than to the UK, unless they held British citizenship through a connection with the UK. An important objective will be to ensure that if the UK were to decide that passport controls were necessary, that they would be at ports and airports of mainland UK, and not on the land border.

The right of most Northern Ireland residents to have an Irish passport predates EEC entry, and has been copper-fastened by the Good Friday Agreement. Under the Maastricht Treaty each Member State has the sole right to decide who is entitled to citizenship. Most grant citizenship to non-EU nationals based on "jus sanguinis", which along with "jus soli" is universally recognised. Northern Ireland is somewhat different in being based on historical factors, though Germany has some similarities because it is based on pre-war territory rather than a personal or territorial link with the existing state.

...given the strong commitment to the Peace Process it is likely that every effort will be made to resolve these issues satisfactorily

The lack of reciprocity and equal treatment, which were central to Protocol 3, where residents of Northern Ireland would have full EU free movement rights while other EU citizens, other than Irish, would have no free movement rights to Northern Ireland could raise legal questions. Already an Advocate General of the Court of Justice in a case involving Protocol 3 and the Crown Dependencies has observed that the "scope and context of the nationality of a Member State may well differ for the purposes of national and Community law" (Court of Justice of the European Union, 1996). However, given the strong commitment to the Peace Process it is likely that every effort will be made to resolve these issues satisfactorily.

Box 13. The Common Travel Area (CTA)

The Common Travel Area is an agreement between Ireland and the United Kingdom allowing for free movement between the two states. It predates the EU’s rules on free movement of persons.

Agreed in 1923 between the United Kingdom and the Irish Free State, the CTA was fully implemented by 1925. It was suspended after the outbreak of the Second World War in 1939, but reinstated in 1952.

It has continued without interruption to the present day, although the heightened security during the Northern Irish conflict created difficulties, in particular for Irish citizens crossing into the United Kingdom.

The CTA Covers the whole of the United Kingdom and the Republic of Ireland, including the Channel Islands and the Isle of Man.

The CTA is not specifically provided for in legislation in either country, but is referenced in many pieces of domestic legislation and bilateral agreements between the UK and Ireland.

In the EU context, the CTA is protected by Protocol 20 of the Treaty on the Functioning on the European Union, which exempts the UK and Ireland from the Schengen agreement (the EU’s passport-free travel area).
Section 2
An Economic Update

Chapter 7 Untangling Ireland’s Economic Ties

John FitzGerald

Until the shape of the UK’s future relationship with the EU is determined, it is very difficult to quantify the precise economic impact of this major change in relationships. As such, this chapter aims to identify the main economic channels through which Brexit will impact on the Irish economy, highlighting: Northern Ireland, Trade, Foreign Direct Investment (FDI), Distribution and logistics, the Labour Market, the Financial channel, and other sectors including Energy, the Environment, Health, Welfare, and Education.

Having begun the 20th century as a region of the wider UK economy, over the subsequent century there was a gradual reduction in ties between Ireland and the UK since independence. The pace of change has been particularly rapid since Ireland and the UK joined the EU in 1973. The completion of the EU internal market in 1993 produced a further diversification of Ireland’s economic links.

While the ties between the two economies have been greatly reduced, they have not been sundered. EU membership has seen the development of the two economies in parallel, both benefitting from the access to the wider EU market. Brexit, however, will see a further major reduction in the links between the two economies, with probable significant adverse effects for both countries.

Instead of attempting a quantification of the possible effects of Brexit on Ireland, this note identifies the main economic channels through which Brexit will impact on the economy: Northern Ireland, Trade, Foreign Direct Investment (FDI), Distribution and logistics, the Labour Market, the Financial channel, and other sectors including Energy, the Environment, Health, Welfare, and Education.

Northern Ireland

A key concern about the current constitutional changes taking place in the UK is that it could leave an orphan Northern Ireland. Since the Good Friday Agreement, the Northern Ireland economy has failed to develop, so that today output per head is lower relative to the rest of the UK than it was 20 years ago. This makes the Northern economy even more dependent on fiscal transfers from London.

The fracturing of regional solidarity within the UK, which is taking place as part of the Brexit process, leaves open the possibility that UK transfers to the North could be cut or even eliminated. This would provoke an economic crisis in Northern Ireland which could have serious negative effects on economic well-being. In turn, the development of an economic collapse in the North could have serious knock-on economic effects in Ireland.

“A key concern about the current constitutional changes taking place in the UK is that it could leave an orphan Northern Ireland.”
Box 14. A Fractured United Kingdom

One of the effects of Brexit is that the regional cohesion of the United Kingdom is being undermined. With the political parties representing the North and Scotland already completely different from those in England, the divergence of political interests within the UK has never been greater.

Today within the UK there are significant internal transfers from England, especially the London region, to the North and Scotland. In the case of the North the budgetary transfers represent over 30% of regional output. In 2014, public expenditure per head in the North was £11,000 and around £10,500 in Scotland; by contrast, in England it was around £8,500 per head. Even within England, the poorer regions did not receive the same favourable treatment as the North and, this may further stoke internal tensions after Brexit.

With the growing fragmentation of political solidarity within the UK, after Brexit there is a major danger that the English dominated government will look much less favourably on the regional economies of Northern Ireland and Scotland. As the negative impact of Brexit on the North may be greater than the average for the UK, any major cut-back in transfers could compound the local economic problems and increase the prospect of local instability. For Ireland, this prospect is of major potential concern.

Trade Channel

The most obvious channel through which Brexit will affect Ireland is through trade.

The UK economy will be adversely affected by leaving the EU and this will significantly reduce growth over the coming decade. The long-run impact could range up to 8% of UK GDP with an average estimate of 4%. Even with no barriers to trade this would result in a fall in Irish exports to that market. However, the potential barriers to trade arising from the post-Brexit deal with the EU could prove far more damaging.

Where firms exporting from Ireland to the UK have significant market power, the effects of trade barriers may not be that great. For example, MNEs that manufacture pharmaceuticals in Ireland have very significant market power. If the UK wants the drugs they produce the UK will have to pay whatever it takes to get them. Such trade is likely to suffer limited disruption. (Often the trade is denominated in dollars).

However, Irish-owned firms that are producing commodity products such as butter have little or no market power and they will be very significantly affected by any new barriers to trade or enhanced competition on the UK market. In addition, where the Irish producers use substantial Irish inputs, as in food processing, the tight margins of the food producers may see a significant part of the cost of Brexit being passed back to farmers as lower prices. The position of such firms supplying commodity products to the UK would be much worse if WTO tariffs were applied; the WTO tariff regime would be especially draconian for meat products – an Important Irish export.

It is estimated that if there were significant tariff barriers between the UK and the EU, Irish output could be down substantially in the long-term – with a central estimate of around -4%, albeit with wide margins of error. The negative effects will begin to hit the economy whenever the Brexit process is completed and will take some time to fully play out.

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1 For example, the UK could open access to food products from third countries.
An important benefit to Ireland of the EU Single Market was the opening up of EU public procurement. Any move by the UK to move away from this regime could also adversely affect Irish firms.

**Foreign Investment**

Many foreign firms today have located in the UK to serve the wider EU market. As a result of Brexit, they will find themselves in a very difficult position. Over a long period, it is likely that many of them will relocate to other countries within the EU. As detailed in Chapter 10 of this report, by Pádraic White, Brexit does present Ireland with opportunities on this front, and the country could expect to pick up a share of these firms relocating. This relocation of activity could, in the long run, add around 3% to Irish output, partly offsetting the trade losses.

Furthermore, as noted by John Cronin in Chapter 11 of this report, there is clear evidence that a significant number of financial services firms will relocate to Ireland to preserve their access to the EU market. This could result in some additional benefits for Ireland. As against that, some Irish companies may need to relocate some of their production to the UK to preserve market access. However, this movement of investment in both directions will be dominated by the much larger flow from the UK to Ireland and the rest of the EU.

The relocation of firms from the UK will, most likely, be a gradual process. It is only when firms have to choose to invest that the relocation decision will take place. The financial sector is likely to be the exception as relocation may be urgent to preserve market access, taking place before Brexit is fully complete.

**Distribution and Logistics**

While most attention has focused on Irish exports to the UK, imports from the UK are much larger in value. This reflects the fact that much of the distribution sector is organised on a British-Irish basis. If the UK as a whole leaves the Customs Union, this integrated distribution sector will be sundered.

Some UK firms may withdraw from the market. Others will have to raise their Irish prices to reflect the higher costs of supplying shops in Ireland arising from customs barriers, as well as possible tariffs. In turn, this will make the Irish retail sector less competitive. This will be particularly bad for consumers, though possibly benefitting some Irish-based retailers.

Less competition will likely see a significant permanent increase in the Irish cost base. In turn, this will adversely affect all firms operating in the tradable sector of the economy, causing a further reduction in potential output.

A possible solution for Ireland would be to promote major new entry by distribution sector firms located in the EU. Such an inflow of new investment could bring enhanced competition to replace UK firms. A major effort needs to be devoted to attracting such firms to Ireland, along with other types of FDI oriented more to the export market.

A further crucial issue for Ireland will arise from the fact that a significant amount of Irish imports from non-UK countries passes through the UK in lorries. This reflects the importance of the European distribution hub centred around Rotterdam and Antwerp. Unless provision is made for this transit trade to pass through the UK without customs checks and without customs duties, the cost base of the Irish economy could suffer a major setback. Special provision needs to be made to allow this passing trade to continue without a significant increase in its costs.

Unless provision is made for transit trade to pass through the UK without customs checks and without customs duties, the cost base of the Irish economy could suffer a major set-back.
A further concern about the transit trade is whether the UK would adopt the practise in Austria before they joined the EU in 1995. Austria imposed major tolls on transit traffic from Germany to Italy, greatly adding to the costs of trade within the EU. If the UK were to adopt an Austrian-type regime this could also greatly add to Ireland’s cost base.

The Labour Market

If the UK were to impose serious restrictions on Irish immigrants this could have a major impact on the Irish labour market: if labour could not move in a time of domestic economic crisis the result would be much lower wage rates in Ireland. However, it seems very unlikely that the UK will restrict movement and the right to work by Irish citizens. In addition, with a successful Irish economy there is a two-way flow of labour between the UK and Ireland. Whatever the UK does Ireland will not prevent UK citizens coming and working in Ireland.

Nonetheless the restriction by the UK on other immigrants may have other knock-on effects for Ireland. For example, there may be some diversion of immigration from the UK to Ireland.

The Irish labour market has operated as part of a wider British Isles Labour market. Between the late 1920s and 1960 Irish wage rates were around 60% of those in the UK. Changes in expectations in Ireland in the 1960s saw a rapid convergence of wage rates to UK levels by the early 1970s. Since then, give or take the exchange rate, Irish wage rates have been similar to those in the UK. It remains to be seen whether this relationship persists post-Brexit with changes in access for EU migrants to the UK.

The Financial Channel

Since Irish independence there has always been free movement of capital between the UK and Ireland. This has also meant that there was rapid transmission of monetary shocks from the UK to Ireland. Neither of these things is likely to change, post-Brexit.

In the first half century of independence Irish monetary policy was determined by the Bank of England. However, today Ireland is a member of the Euro area and monetary policy is determined by the ECB. These arrangements too will not change as a result of Brexit.

Brexit has seen a serious weakening in Sterling. However, so far, the value of sterling in Euro terms is still above its previous minimum. Even if Brexit sees a further weakening of sterling this will have essentially temporary effects. In the long run a weaker sterling will see more rapid inflation in the UK, gradually eliminating any competitiveness gain.

Focusing on quoted shares, 51 per cent of the €6,700 billion held by Irish household in 2016, was denominated in euro. This share is rather low and there may be a need for the private sector to reduce its sterling exposure, moving investment into Euro assets.

Other Channels

There are a range of other channels of a more micro character through which changes in the UK’s status could affect the Irish economy.

The integrated nature of the energy market on the island of Ireland, especially the electricity market, means that changes in UK energy or environmental policy can impact on Ireland. It remains to be seen whether the UK will change these policies after Brexit and what would be the implications for Ireland of such changes.

Finally, a very wide range of other policy areas, such as health, education and welfare, will be affected by Brexit. Changes in UK policy in these areas may have implications, inter alia, for the public finances.
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Chapter 8 – Implications for Irish SMEs

John McGrane

*With Prime Minister May’s triggering of Article 50 and the subsequent snap General Election extending the political timeframe to work out a deal, all businesses now have confirmation that a relatively hard Brexit needs to be prepared for - but also that a relatively softer Brexit could ultimately be the case. Amid growing realisation of the real consequences of Brexit, SMEs are most at risk but least well-placed to protect themselves.*

The impact on Ireland’s SME sector will be a key factor in the overall consequences for Ireland of the final terms of the UK’s departure from the European Union.

The greatest threat to business investment and employment is uncertainty.

Should Mrs May win an extended term for her government, this at least affords some increased assurance that adequate time might now be available for both the political and commercial work needed to manage an orderly Brexit in any form. While not assured, this augurs better for agreement of a viable (and necessary) transitional agreement for the UK.

Nonetheless, it seems clear that the calling of a premature General Election confirms that the UK economy has been known by HM Treasury to be poised to go into potentially sharp decline. Insulated from Sterling’s post-referendum slump by extensive currency hedging, UK manufacturing input prices in Q1 2017 have been rising at up to an alarming 20% per annum. In an economy less productive and more indebted than its main competitors, the UK is poised to suffer a rapid increase in both business costs and consumer prices. After an illusory boost to exports, now unsurprisingly we can foresee a slump in domestic UK market demand. Retail sales in the UK saw their largest decline in seven years in Q1 2017. Whereas many (though not all) larger firms may have international diversity to offset their exposure to the UK’s economy, SMEs (in both the UK and Ireland) do not.

*Why SMEs matter...*

The greater number of all businesses are SMEs and most SMEs don’t trade internationally. Accordingly, SMEs’ direct exposure is typically to fluctuations in national demand within their home country. However, in Ireland’s relatively small open economy, the trading environment for our SMEs often depends on some other firm which does trade internationally.

Box 15. What is an SME?

Small and medium-sized enterprises (SMEs) are defined in the EU recommendation 2003/361.

There are three classifications that comprise the SME sector

- A Micro Enterprise is an enterprise that has fewer than 10 employees and has either an annual turnover and/or annual balance sheet not exceeding €2 million.

- A Small Enterprise is an enterprise that has fewer than 50 employees and has either an annual turnover and/or an annual balance sheet total not exceeding €10 million.

- A Medium Enterprise has fewer than 250 employees and annual turnover below €50 million or balance sheet below €43 million.
SMEs are also major employers in Ireland, and the jobs which SMEs create are geographically spread throughout the countryside of Ireland. This includes valuable employment in farming, fishing and food processing, in tourism and in local retailing and services. While many have not yet had to directly confront either the challenges or opportunities of Brexit, how SMEs are impacted and respond to Brexit has significant national consequences.

How does the UK Referendum affect Irish SMEs?

For SME firms directly trading with the UK, the most immediate issue in the aftermath of the UK Referendum was a decline in the value of the Sterling Pound by up to 17%. In an immediate double blow for the Irish SME economy, this severely eroded un-hedged Irish exporters’ margins and made it easier for importers to substitute UK product for indigenous supplies. UK currency weakness following the Referendum also impacted tourism volumes from Northern Ireland and Britain and led to a short-term increase in the UK’s export competitiveness (ahead of underlying input price increases).

As the UK’s weakened currency and debt-strapped public and consumer finances have persisted, the new worry for Irish SMEs is of a real decline in market demand firstly in the UK and by consequence more widely in Ireland. Additionally, weaker Sterling has teed up a dangerous consideration in the UK of replacing more expensive Irish food and other imports with alternatives from cheaper countries, regardless of consumer preference and quality or safety concerns.

It is important to note also that second-order effects are as important as direct threats to the most vulnerable sectors because in provincial Ireland, when farming or tourism incomes decline, every SME in every locality is affected, from the local insurance broker to motor dealers to doctors and retailers.

Irish SMEs are significantly connected (directly or indirectly) to the two-way supply chains of UK/Ireland trade in industries such as Life Sciences, Financial Services, Education, Technology, Food, Energy, Infrastructure, Bloodstock and Sport. Thus, Irish SMEs face a derived loss of business upon any decline in the fortunes of key UK sectors like food and tourism, motor manufacture, education and research, all of which are facing material threat from Brexit.

Other derived effects may arise for Irish SMEs exposed to potential future Brexit-related problems for UK airlines, for financial service providers and for any other adversely affected UK sectors as well as challenges in deploying key staff under restricted movement rules.

Among the more obvious difficulties will be logistics delays and costs. Over 60,000 Irish trading firms have never previously had to deal with customs nor faced impediments to using Britain as their land bridge for goods trade to or from Europe. Restrictions on freedom
of movement between Ireland, Northern Ireland and Britain, not only for employees but for EU-national truck drivers, would cause compounding delays and costs at ports, warehouses and retailers.

For SMEs as well as for larger firms, the post-Brexit treatment of trade in services is not at all certain. By their nature, services depend on free movement of the people delivering them, on the freedom to transfer data across borders and on the freedom to pay internationally for services without exchange controls.

Box 16. How can the State respond to SME hazard?

The initial structural response in Ireland has been to encourage Irish exporters to reduce reliance on the UK market and to find new customers in other international markets.

However, this requires time and money. Enterprise Ireland and other agencies have been given some additional resources to assist within State-aid rules. In the context of Brexit, EI have also devised a strategy to boost exports to the Eurozone by €2 billion per annum by 2020, focusing in particular on construction, engineering, medtech and food. More substantial support will likely be needed under either EU-approved derogations or special-impact assistance to enable structural reshaping of certain sectors or locations of the economy.

Irish SMEs are typically undercapitalised, even if no longer over-borrowed, but risk-averse and unwilling or unable to borrow. While larger firms can access more supports, most SMEs do not qualify for material State supports as they fall below the thresholds of eligibility for Enterprise Ireland assistance and the cost for many small firms of accessing other supports is often not worthwhile.

Thus, though the initiatives mentioned above are positive, the State is somewhat limited in what it can do at the level of the individual firm and must instead focus on the macro environment. This includes minimising costs of creating and sustaining jobs by SMEs and boosting our national competitiveness infrastructure including air, sea, road and rail access, broadband, energy and, critically, education.

How might Irish SMEs benefit from Brexit?

While the risks to Irish SMEs from Brexit are clear, there will also be opportunities and indeed these must be harvested if Ireland is to offset wider negative impacts in the most vulnerable parts of the economy. Because of the challenges (of time and resources) to a national diversification strategy away from the UK market, the earliest opportunities will be derived from the UK itself.

- **Establishing a UK base.** In many sectors, the easiest mitigant for Irish SMEs reliant on the 60 million consumer market of the UK will be to establish a base inside the UK, whether by setting up a direct presence or joint ventures. They may also consider increasing their business activity in that market as other opportunities emerge. Such new opportunities will include the inversion of licences currently held by UK firms to distribute products throughout the UK and Ireland such that Irish firms may acquire such licences to distribute into the EU and the UK.

- **Supporting FDI firms in Ireland.** There will also be opportunities for SMEs to support FDI firms newly establishing in Ireland to service the EU market from here rather than from the UK. Irish businesses can also enable UK SMEs to ensure their continued ability to service EU markets by adding a further base in Ireland to their existing UK operations.
• Replacing the UK as a source for EU importers. UK firms currently send half their exports to EU countries. This presents definite opportunities for Irish SMEs to replace some of those exports so that EU buyers can receive them free of tariff and non-tariff barriers.

• Replacing EU countries as a source for UK imports. Similarly, UK imports from other EU countries present opportunities for replacement by sourcing from Irish SMEs including those who may establish a UK presence. There is also scope to strategically negotiate redenomination of certain international financial contracts under Irish Law which would create new opportunities for SMEs engaged in professional services here.

• Attracting new labour. Brexit could make it easier for Irish SMEs to attract specialist technicians and researchers from the EU, benefiting SMEs engaged in such growth sectors as CyberTech, CleanTech and an emergent new BrexitTech sector (delivering Customs solutions, Proof-of-Origin and Anti-Abuse systems).

Future EU developments impacting on SMEs

The acknowledgment by both the UK and the EU of Ireland’s unique circumstances offers some hope of pragmatic enablement of free movement across Britain and Ireland and potential freedoms in trade of goods and services.

Border areas feature numerous SME businesses on either side whose operations are border-agnostic, ranging from agri-business to tourism to financial services to retail. EU Vice President Timmermans, while acknowledging Ireland’s unique case for recognition of our interconnectedness with the UK, has also highlighted that it will require much work to deliver viable solutions to Brexit within the context of EU law. Taken alongside wider challenges of Brexit for Irish SMEs, a potential contesting of Ireland’s corporation tax rate from other EU countries and the slowness of the EU to respond to challenges by both UK and Irish SMEs on the costs of bureaucracy, Ireland will clearly need to be adept in managing multiple forthcoming issues that impact all its stakeholders, not least our SME sector.

"Ireland will clearly need to be adept in managing multiple forthcoming issues that impact all its stakeholders, not least our SME sector"
Brexit carries with it deep uncertainties for the Irish agri-food industry - a sector which is highly dependent on the UK market and uniquely vulnerable to the negative effects of the UK’s withdrawal. While the terms of the UK’s departure are not yet known, this chapter identifies some potential issues, highlighting the implications of a UK departure from the Customs Union, the possible impact of WTO rules and changes to the EU budget post-Brexit.

Ireland’s agri-food sector is particularly vulnerable to the UK decision to leave the EU for three main reasons:

- The agri-food sector has a high dependence on the UK market.
- The highest level of EU import tariff protection applies to the products of major importance to Irish agriculture, beef and dairy products, and thus are vulnerable to a future liberal trade policy by the UK.
- The land border between Ireland and Northern Ireland.

Following the UK referendum last June, the first round of negative implications resulted from the depreciation of sterling. The exit agreement, and particularly the new trading arrangement, will have enormous implications for the sector.

### The UK Food Market

The UK is a substantial net importer of food, with imports of about £38b in 2015, and exports of about £18b. Overall, about 48% of total food requirements are imported, with the major component coming from the EU, and the remainder from a range of countries. Over 50% of UK food and drink exports go to EU countries.

### Irish Agri-food Exports to the UK

The UK is Ireland’s largest market for food and drink, valued at €4.1b in 2016 and accounting for 37% of total agri-food exports. In value terms, beef, certain dairy products and prepared foods are the most important. The

### Table 1: Origin of Food consumed in the UK

<table>
<thead>
<tr>
<th>Country</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>52</td>
</tr>
<tr>
<td>EU</td>
<td>29</td>
</tr>
<tr>
<td>Africa</td>
<td>4</td>
</tr>
<tr>
<td>North America</td>
<td>4</td>
</tr>
<tr>
<td>Asia</td>
<td>4</td>
</tr>
<tr>
<td>South America</td>
<td>4</td>
</tr>
<tr>
<td>Rest of Europe</td>
<td>2</td>
</tr>
<tr>
<td>Australia / NZ</td>
<td>1</td>
</tr>
</tbody>
</table>

Table 2: Value of UK market for Irish agri-food exports 2016

<table>
<thead>
<tr>
<th>Destination</th>
<th>UK (€m)</th>
<th>EU (€m)</th>
<th>Rest of World (€m)</th>
<th>Total (€m)</th>
<th>UK as a % of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dairy products and ingredients</td>
<td>825</td>
<td>890</td>
<td>1,665</td>
<td>3,380</td>
<td>25%</td>
</tr>
<tr>
<td>Beef</td>
<td>1,180</td>
<td>1,180</td>
<td>120</td>
<td>2,380</td>
<td>50%</td>
</tr>
<tr>
<td>Pigmeat</td>
<td>345</td>
<td>100</td>
<td>170</td>
<td>615</td>
<td>56%</td>
</tr>
<tr>
<td>Sheep</td>
<td>55</td>
<td>175</td>
<td>10</td>
<td>240</td>
<td>23%</td>
</tr>
<tr>
<td>Poultry</td>
<td>235</td>
<td>20</td>
<td>20</td>
<td>275</td>
<td>85%</td>
</tr>
<tr>
<td>Live exports</td>
<td>110</td>
<td>25</td>
<td>15</td>
<td>150</td>
<td>73%</td>
</tr>
<tr>
<td>Edible Horticulture and Cereals</td>
<td>195</td>
<td>35</td>
<td>-</td>
<td>230</td>
<td>85%</td>
</tr>
<tr>
<td>Seafood</td>
<td>70</td>
<td>340</td>
<td>145</td>
<td>555</td>
<td>13%</td>
</tr>
<tr>
<td>Prepared foods</td>
<td>740</td>
<td>565</td>
<td>620</td>
<td>1,925</td>
<td>38%</td>
</tr>
<tr>
<td>Beverages</td>
<td>380</td>
<td>300</td>
<td>720</td>
<td>1,400</td>
<td>27%</td>
</tr>
</tbody>
</table>

3 IFA estimate, derived from Bord Bia Export Performance and Prospects 2016-2017

UK market is particularly important for our two main sectors, beef and dairy products. For the smaller sectors, pig meat, poultry meat and horticulture, particularly mushrooms, it is also very important.

**Beef**

The UK is only about 65% self-sufficient in beef. Ireland is the dominant import supplier, accounting almost 70% of total beef imports (270,000 tonnes). The market price in the UK in recent years has been consistently higher than the EU average price. The EU beef market is more than self-sufficient; thus, if Ireland had to divert this volume to the EU 26 market in the future it would destabilise the market.

At producer level, incomes on beef farms are relatively low and are highly dependent on the EU “decoupled” direct payments. About 45% of Ireland’s beef breeding herd consists of specialist suckler cows (the remainder are dairy cows); a significant beef price cut would undermine the viability of this production.

**Dairy Products**

Last year 53% of Irish cheese exports and 29% of butter exports went to the UK. Ireland exported 126,000 tonnes of cheese to the UK,
and cheddar accounted for 78,000 tonnes of this. This represented 82% of all cheddar imported by the UK. The alternative markets for cheddar are very limited. The UK market is also important for butter, with 63% of UK imports, or 41,000 tonnes, coming from Ireland.

**The Brexit Process: Major Issues for the Irish Agri-food Sector**

The following briefly outlines three major issues for Ireland’s agri-food sector: the Customs Union post Brexit, WTO particularly in the context of no trade agreement, and the EU Budget. (The NI border is also a major issue, and is discussed in another contribution).

**The Customs Union**

The EU Customs Union including the Common External Tariff is a cornerstone on which the Common Agricultural Policy (CAP) is built. The level of farm product prices in the EU is dependent on the protection provided by the import tariff, particularly for beef and the main dairy products, where tariff levels of about 60% and 50% respectively apply.

The UK wishes to negotiate new trade agreements with non-EU countries, and thus wants to leave the Customs Union, which mandates that Member States must negotiate trade deals as a single bloc. Prior to EU membership the UK operated a “cheap food” policy based on liberal imports, and this seems to be their objective for the future. The European Council has indicated that it is prepared to negotiate a free trade agreement with the UK under certain conditions including that “a level playing field” is ensured. The implication for Ireland of a liberal import policy by the UK would be that the value of the UK food market would be undermined. Furthermore, if this applies in parallel with a UK-EU free trade agreement, there are major implications for border controls to ensure the implementation of EU “rules of origin” and health and other regulatory matters.

**Box 17. Rules of Origin**

The EU’s Rules of Origin procedures are a means of determining the “economic nationality” of a product for the purposes of international trade. This nationality then determines what tariff, if any, is applied to the product.

The Rules ensure that goods from third counties cannot bypass the EU’s common external tariff, nor any customs restrictions or special requirements that might apply.

The implication for Ireland of a liberal food import policy by the UK would be that the value of the UK food market would be undermined.

**The World Trade Organisation**

Trade between EU countries and the rest of the world is governed by the rules of WTO. As regards trade in agricultural products, WTO agreements put limits on import tariffs and domestic support, and also establish sanitary standards for trade in livestock products and crop products.

The UK’s membership terms of WTO are bundled with the EU’s. As part of the exit process the UK will have to negotiate with the EU and other WTO members its future status. On agriculture, the EU has WTO commitments on preferential imports of high quality beef from eight countries, and on substantial sheep meat imports from New Zealand. Renegotiating these commitments may not be simple, as all parties seek to protect their interests.

In the longer-term, unless a mutually acceptable trade agreement is negotiated between the EU and the UK, WTO rules would apply on trade between them. Exports from the UK to the EU would be subject to EU import tariffs. The UK would initially inherit the EU import tariffs. However, the UK would be expected to act in two ways in the interest of achieving lower food prices; it would switch its food import supplies to non-EU countries, and it would seek to apply lower import tariffs. Over time, food imports from Ireland would not be competitive with imports from third countries.
The EU Budget and the Common Agricultural Policy

As the annual net contribution by the UK to the EU budget is about €10.5 billion, the UK exit will be very negative for the EU budget, even if the UK contributes to particular programmes in future. Currently the CAP accounts for almost 40% of the EU budget. About 90% of Ireland’s receipts from the EU budget come through the CAP with annual transfers of about €1.5b through CAP direct payments and Rural Development Programme.

Currently CAP direct payments account for 65% of income on Irish farms; this ranges from effectively the total income on the cattle and sheep farms (product prices just about cover production costs), to about one-third of income on dairy farms. Furthermore, if the EU market balance were to deteriorate arising from new trading arrangements, the EU budget would not have the resources to support the market.

Conclusion

The major issues of concern to the Irish agri-food sector come under Phase II of the negotiations, i.e. a framework for the EU/UK future relationship. We are far from having clarity on the three issues outlined here, the implications of the UK leaving the Customs Union, WTO rules in the context of a “hard Brexit”, and the EU budget, as well as the Northern Ireland border issue. Furthermore, a “hard Brexit” may have further negative consequences for the sterling exchange rate.

Transition arrangements can be anticipated after March 2019, but as the future EU-UK trade agreement is unlikely to be known at that time, the transition arrangements may be limited and possibly mainly involve the continuation of some existing policies. While transition arrangements offer time for adjustment, they do not change the final result.

Box 18. The EU Budget and the Common Agricultural Policy

Agriculture is a key shared competence of the European Union. It has its origin in the Treaty of Rome and the policy was established in 1962. The initial purpose was to increase food production across Europe by offering guaranteed prices. The policy has evolved, where production levels are now separated from subsidy payments. The aim of the policy is to support food production, the management of natural resources and the development of rural areas.

The policy applies across the EU but individual Member States have some scope over how they implement the policy. In the UK agriculture is a devolved matter so there are variations in how the CAP is implemented in each country of the UK. The CAP is subject to review and reform on the same timescale as the budget, with the current scheme running until 2020.

“While transition arrangements offer time for adjustment, they do not change the final result.”
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Chapter 10 Foreign Direct Investment
Padraic White

The implications of Brexit are interlinked with two other policy challenges: the tax reform proposals of the Trump administration and the attitude of the EU Commission to corporate tax reform and Ireland’s tax regime. Brexit in its own right is identified as providing definite FDI opportunities for Ireland but it is essential for Ireland to re-enforce internationally that it is and will continue to be a core member of the European Union. The EU negotiating guidelines are positive for FDI in stating some broad conditions for a UK-EU free trade agreement.

The Foreign Direct Investment (FDI) policy of Ireland stretches back to the pioneering Industrial Development Authority Act of 1950 and the FDI experience in Ireland has shown remarkable resilience over the intervening decades.

Today, direct employment in IDA client companies, at nearly 200,000, is at a record high. When indirect spin-off jobs of 140,000 in sub-suppliers & services are added, the total FDI dependent jobs comes to 340,000, equivalent to one in every six persons employed. The FDI companies account for about two-thirds of the exports of goods and services from Ireland (€149 billion of the total of €234 billion exports in 2015).

Investors from the differing global regions have differing rationales for establishing a strategic investment base in Ireland and the impact of Brexit on their future investment intentions and on their existing operations and employees in Ireland needs to be viewed through their particular perspectives.

In 2016, the USA was the source of 72% of IDA client investments, 20% came from Europe and 8% originated from Growth Markets, notably from Asia and these shares are typical of recent years.

The FDI environment in Ireland now faces three separate yet interlinked policy changes which will intensely challenge its resilience for investors from these areas. These challenges include:

- Brexit
- The tax reform proposals of the US Trump administration which were outlined on April 26, 2017
- The impact on Ireland’s corporate tax regime from the EU Commission game-plan as demonstrated by the EU Commission ruling on Apple’s tax treatment in Ireland and its drive towards a common consolidated corporate tax base (CCCTB).

<table>
<thead>
<tr>
<th>FDI by numbers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Over</strong></td>
</tr>
<tr>
<td>1,100 overseas companies</td>
</tr>
<tr>
<td>199,877 people were employed by overseas companies in 2016</td>
</tr>
<tr>
<td>1 in 6 jobs are FDI dependent</td>
</tr>
<tr>
<td>11,842 jobs net added in 2016</td>
</tr>
</tbody>
</table>

Overseas companies accounted for **€149 billion** in exports in 2015
So, a potential investor, from any of the regions mentioned above, looking at Ireland as a base for serving the EU market, could reasonably have many questions and concerns arising from these current policy challenges, including:

- Will a UK exit be followed by other countries leading to break-up of the EU? The recent election of Emmanuel Macron as President of France on a strong pro Europe platform should reduce anxiety on this front.
- What access will I have to the UK market which is important for me?
- Will the Irish 12.5% tax regime survive the hostility of the EU as shown in the Apple ruling?
- What are the implications for my tax liabilities of EU moves to a consolidated tax base?
- Would it make more sense to await the outcome of the UK deal with the EU as they might achieve free access to EU markets, lower their taxes even more and be free of the EU State aid and other bureaucratic requirements?

For the potential US investor, there are additional queries

- If I invest significantly in Ireland/EU, will my company be perceived as acting contrary to the President’s “America First” policy?
- Should I re-examine the logistics and feasibility of serving European and neighboring markets from a US base, given the promised dramatic reduction in US corporate tax from 35% to 15% - a drop of 20 percentage points?

While this article will focus primarily on the implications of Brexit for FDI in Ireland, the potential concerns listed indicate that investment decisions will not just be influenced by Brexit but in varying degrees by these other factors, namely, EU Commission policies on corporate tax and the Trump administration “America First” policies.

Opportunities for Ireland

Brexit does provide definite FDI opportunities for Ireland

The key to securing continuing investment is to consolidate - and repeat and refresh - the message to international investors that Ireland will continue to be a core member of the EU Single Market of over 500 million people and of the Eurozone.

This is all the more essential as we can underestimate the danger of Ireland’s EU attitude and membership being confused in the minds of investors across the world with that of Britain and Northern Ireland.

Ireland can convincingly make the case that its commitment to the EU is solid. This is evidenced by surveys which show Irish people are more optimistic about the future of the EU than any other country (77% in Ireland, compared to the EU average of 50%) and that over three quarters of Irish people feel like a citizen of the EU (78% in Ireland, compared to the EU average of 67%)⁴. In addition, the departure of the UK means that Ireland will then be the only English speaking country in the EU area.

IDA Ireland is a party to key Brexit preparation groups across Government and is actively promoting Ireland’s advantages to investors. The Agency launched an advertising campaign at the end of 2016 in the UK and US on the theme that “Ireland is and will remain a committed member of the European Union”. The Agency is actively engaged with clients in the UK, and in key investment decision making centers in the US and mainland Europe. IDA has received over 100 Brexit related queries so far with several of those queries

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⁴ Data from Eurobarometer, November 2016
resulting in itineraries to Ireland.

The possible re-location of services and jobs from the UK or planned expansions by companies based in the UK to a location within the EU offers specific and immediate opportunities. Ireland and many other European countries are actively targeting such opportunities. The Financial services sector, considered in the next chapter, offers opportunities due to the “passport” rights under the Single Market whereby a financial institution approved to offer bank services or products in one country can then offer the service in the other EU countries without obtaining separate approvals in each Member State.

Now that Article 50 has been triggered by the UK and the EU Council has set out its negotiating guidelines, companies will increasingly crystallise their decisions on relocations and expansions. Ireland is in stiff competition with other financial centers in the EU such as Paris, Luxembourg and Frankfurt but many location/expansion decisions will nonetheless come Ireland’s way - with the proviso that the Central Bank of Ireland is supportive.

Another implication of Brexit for existing FDI companies is the future regime which will govern their exports to the UK from Ireland. Of the €149 billion exports of goods and services by FDI companies here, 13% or €19 billion go the UK. IDA-Ireland is directly engaging with these companies to mitigate the effects of possible trade barriers post-Brexit as well as reviewing the potential for replacement or additional business within the EU.

A core issue for FDI companies with a significant interest in the UK market will be the nature of the trading relationship between the UK and the 27 members of the EU, when the nature of that relationship becomes apparent, and when it comes into effect.

The nature of the UK’s future deal with the EU matters greatly

Indigenous Irish industry and especially the food industry has an acute interest in the future UK/EU trade deal with even greater implications for jobs in Ireland.

The UK has sought an ambitious trade agreement with the EU and the assumption of Brexiteers had been that they could then offer more attractions to FDI by lowering taxes and easing social, environment and other regulations which had emanated from the EU. In short, the plan was to be able to still offer free access to the EU market without the State aid and regulatory restrictions of the EU - to become the offshore “Singapore” of Europe.

The EU Council negotiating guidelines are blunt in effectively ruling this out when they state that any free trade agreement “must ensure a level playing field, notably in terms of competition and state aid […] and encompass safeguards against unfair competitive advantages through, inter alia, tax, social, environmental and regulatory measures and practices”.

This is hugely supportive of Ireland being able to have a competitive FDI regime in comparison with the UK post Brexit. However, if the UK does not accept these restrictions as the price of “free trade”, it may settle for a negotiated tariff regime between it and the EU or end up with a World Trade Organisation tariff regime if there is “no deal”. Neither of these outcomes would be supportive of indigenous Irish industry and could result in losses of exports and jobs.

-These differing outcomes will have differing impacts respectively on FDI in Ireland and the fate of indigenous industry and deserve the closest attention during the negotiations.
Chapter 11 Financial Services

John Cronin

The impact of Brexit on the Irish financial services sector is still unknown at this time. However, the opportunities that it offers and the risks that it poses mean that the industry, the political and the policy responses in the forthcoming 12/24 months are likely to have long term consequences for both the industry itself and the overall Irish economy.

Ireland is likely to become a host to new categories to financial services. Accordingly, we [the Central Bank of Ireland (CBI)] stand ready to expand our range of supervisory activity as required, in close collaboration with our international regulatory colleagues within the European System of Financial Supervision.

Philip Lane, Governor of the Central Bank of Ireland, 28 March 2017.

This statement by Governor Philip Lane is key to what Ireland can actually achieve in financial services in the context of Brexit. It is, rightly, both ambitious and realistic about what we might reasonably seek to achieve.

The advantages of Ireland for financial services activities are well known at this stage. The one advantage about which we have been somewhat coy is that, in the CBI, we have a tried and tested regulator which is deeply embedded in the EU’s supervisory and regulatory system. Given the level of cross-border activity originating from Ireland, it also has considerable experience in cross-border regulation and supervision – indeed, it is among the most experienced regulators in Europe in this regard. That experience is likely to be of vital significance for any firm looking for a home from which to exercise passporting rights post-Brexit.

So, how are we doing so far?

State of play

Eleven months after the Brexit referendum, there has been considerable activity across the EU in endeavours to anticipate the likely new business landscape for financial services – whether seeking to attract new or revised trading arrangements and/or certain activities currently carried out in the UK. Ireland and the different Irish industry players have been energetic in their endeavours in this regard.

In the banking sector, and as anticipated from the very beginning, the “first tier” international banks and financial institutions have not committed themselves to any significant switch to another EU location. They have indicated a preference to keep as much of their activities in the UK (the City of London) as possible and to continue to service clients with as little disruption as possible.

However, following the UK Government’s White Paper in January 2017 and the clear statement from UK Prime Minister, Theresa May, that the UK would not remain in the single market after Brexit, some of these banks have given indications of the likely establishment of
some presence or an expansion of an existing operation in Germany (Frankfurt). Ireland’s hopes of attracting a new international bank or financial institution to Dublin was always likely to be in the next tier of banks, and this remains the case. Institutions from Asia, Australia, Canada and the Middle East being the most attractive candidates. However, those international banks already in Dublin are expanding, and are likely to continue to expand, their licenced activities to be carried out from here.

In the insurance sector there have been some small disappointments and, in part, this can be put down to some regulatory arbitrage – see further below. However, it can be said that firms with appropriate business models – those with convincing risk identification and management - can expect to be approved by the CBI whether or not such models already exist in Ireland. Also, and importantly, there should be no difficulty per se with outsourcing – the focus is on ensuring the activity is done well and in line with sound practices. The CBI has invoked the Solvency II principle that ‘an activity may be outsourced, but responsibility for it may not’.

In our view, UK groups are likely to set-up EU based insurance companies in Ireland to carry on pan-EU business which will then be reinsured back to the head office in the UK. This is an efficient approach and one which Ireland has and can continue to facilitate.

On the funds and asset management side, UK firms who need to access EU capital are likely to have to restructure part of their business in order to have continued access post-Brexit and many firms are looking at Ireland as their preferred domicile in this regard. In addition, those UK and US firms that require MiFID authorisation to do business in EU - especially in the newer areas of authorisation introduced by MiFID II – are looking to Ireland.

In Fintech, Brexit will be a boost to the development of the industry in Ireland. At present, 75% approximately of all European payment institutions and e-money institutions are authorised in the UK. Facebook’s authorisation in Ireland as an e-money institution last year has reinforced Ireland’s credibility as a good destination for Fintech and, in our view, other companies likely to follow suit. The CBI has set a positive tone, with an emphasis on a commitment to new streamlined authorisation procedure for payment & e-money institutions.

**Regulatory arbitrage**

Regulatory arbitrage in respect of regulation, supervision and capital requirements has played a part in the decisions made to date by some banks and financial institutions regarding the location of new operations in EU countries in anticipation of and post Brexit. To Ireland’s detriment, the matter was largely ignored at EU political and policy levels for the final six months of 2016 but it is now firmly in focus.

> We will resist any supervisory or regulatory race to the bottom. Any bank that moves to euro area will have to meet our standards – regardless of whether it comes from UK or any other place. Most importantly, we will not accept empty shell companies. All entities in euro area must have adequate local risk management, sufficient local staff and operational independence.

_Sabine Lautenschläger, Vice-Chair of the Supervisory Board of the ECB – 22 March 2017._

It is worth bearing in mind that there will be no new regulatory or supervisory regime post-Brexit in Ireland and that the same consistency, predictability and transparency should and can be expected by regulators throughout the EU. In addition, the ECB will take the final decision on authorisation or licensing of any ‘Significant Institution’ in any member state in the Euro area.

There are two remaining difficulties for Ireland in this regard: first, decisions made to date to establish or locate elsewhere are unlikely to be reversed, and, secondly, notwithstanding the statements of the ECB, financial institutions and firms are continuing to seek divergences in approaches by different EU regulators. Professional advisors in London tell us regularly that many of these institutions or firms are actively examining differences in, and nuances of, approach by regulators.
What of IFS 2020 Strategy?

The 2015 comprehensive review of the then-existing strengths of Ireland’s international financial services industry recognised that the sector was one of the pillars of the Irish economy and was a significant symbol of Ireland’s open and competitive economy. Published in March 2015, the Government’s Strategy could not have contemplated Brexit when anticipating future sectoral developments. Its aims, however, which included the promotion of Ireland as a location for international financial services and world class innovative products and services and developing employment opportunities from emerging new sectors and new markets, surely remain the same.

However, the Brexit referendum result brought an immediate urgency to the necessity of actual implementation of much of the Strategy’s aims.

The IFS 2020 Strategy can be advanced. It is our view that Brexit, and the current review by international financial services firms of their strategic objectives and where to locate their future operations, gives Ireland a unique opportunity to build-on our current offerings including capital markets, trading platforms, clearing houses, central securities depositories, brokerage operations, credit rating agencies and benchmark administrators, as well as insurance and banks.

Box 19. The EU’s financial services agenda?

Since 2008, the European Commission has proposed more than forty legislative measures to create new rules for the EU’s financial system, establish a safe, responsible and growth-enhancing EU financial sector and create a banking union to strengthen the euro.

Brexit will change things - but we do not know in what way or to what effect. It could provide a positive stimulus to certain elements of the EU’s financial services agenda or it could lead to some disruption and regulatory splintering. Looking at certain elements:

Capital markets union

The CMU is one of the best initiatives of the EU. Europe needs deeper capital markets to increase financing in the wider economy. EU businesses need a broader range of funding options to grow and create jobs; and deeper capital markets are crucial for long term investment. Brexit makes the case for CMU stronger and more urgent.

Third country access

Brexit is likely to lead to changes in the EU’s access regime for non-EU financial service providers. Currently that regime is a patchwork of different measures. Brexit should incentivise the EU to reach an agreement on a more streamlined “single point of access” arrangement.

The Single Rulebook

The Single Rulebook is the backbone of the EU’s Banking Union and the financial sector regulation in general. It consists of legal acts that all financial institutions in the EU must comply with. Among other things, it lays down capital requirements for banks; it ensures better protection for depositors; and it regulates the prevention and management of bank failures.

Brexit may impact the Single Rulebook. The Rulebook contains a number of national discretions and these create the potential for regulatory or supervisory arbitrage. As discussed above, this is becoming a
concern as Member States compete for post-Brexit business: delegation and outsourcing are two specific instances.

Financial supervision

Brexit will impact the European Supervisory Authorities (the ESAs) in diverse ways. Most obviously, it will provide momentum to the proposals to fund the ESAs from industry levies, as Brexit will cut the EU’s budget. Brexit may also lead to an increase in the ESAs’ roles and powers, leading to stronger supervisory convergence. The UK has traditionally argued against conferring the ESAs with direct supervisory authority but Brexit will deplete the ranks of the Member States seeking to limit the ESAs’ powers in this respect.

Maintenance of EU ambition

It is hoped that the EU’s ambitious plans will not be set aside by Brexit. Recently, Valdis Dombrovskis, Vice-President for the Euro and Social Dialogue, and Commissioner for Financial Stability, Financial Services and Capital Markets Union, has re-affirmed the focus to continue building the CMU, to complete a reliable framework for Europe’s banking sector, and to stick to evidence based rule making. While Brexit will be a real challenge, the hope is that it will provide a stimulus to realise such plans and such focus. However, it will require considerable endeavour and goodwill to succeed.

Conclusion

There is still much to play for in our aim to expand the range of international financial services activities carried on in and from Ireland. The urgency to achieve this aim is evident now in the endeavours of the Government (both Ministers and the various Departments), the IDA, the CBI and the professional services firms both here and overseas. It is important that we are ambitious and realistic about what we can expect and what we want to achieve.

The IDA has said that, independent of Brexit, the financial services industry is focused on reducing operating costs while capturing efficiencies, fresh capabilities and other advantages in alternative locations. It believes that many of Ireland’s advantages are now strongly aligned with the needs of the industry.

It is interesting to contrast the current outlook at home with that in the City of London where there is some unease and concern regarding the reduction and closure of certain business and businesses based in the UK. The sense there, certainly at present, is that the loss of business activities will be to a small number of European cities (including Dublin – there is even some preference in London for relocations to Dublin) and some flowback to New York. There is also a sense that the politics are such that in the medium to long term – perhaps, even an inevitability that – European financial services will be pulled or drawn towards Frankfurt and Paris.

In our view, Ireland can and should seek to expand the range of international activities carried on here; be an active proponent for and participator in the future development of the EU financial sector; and involve itself actively in the reconnection of the EU and UK in coherent equivalent financial services regimes.
Section 2
An Economic Update

Chapter 12 Opportunities for Ireland

John Bradley

Two previous experiences of major changes to Ireland’s strategic trading environment in the 1960s and the late 1980s triggered major structural changes which transformed our economic performance and prospects. Brexit is best regarded as another such strategic change and presents the opportunity to address remaining structural weaknesses in the indigenous SME sector that has partially internationalised but remains excessively focused on the UK market.

Irish discussions of the implications of Brexit have tended to focus on the likely negative consequences for the Irish economy, for Irish businesses and for Irish society, both North and South. Of course, the wider implications for the EU of 27 are also of concern in Ireland since the beneficial role played by our membership is widely seen to derive from a strong EU and the evolution of deeper European integration.

However, in the domestic debate, the feared threats to Irish economic and political wellbeing tend to dominate our thinking rather than the wider international threats to the EU as a whole.

There is nothing inherently wrong with such an approach. Dealing with the fallout from Brexit for Ireland will present policy, business and societal challenges that have to be addressed. It is essential that these potentially negative consequences be identified and evaluated. But there is a risk that the high visibility given to negative consequences may send wrong signals to policy makers who may then focus attention on trying to secure a post-Brexit negotiated outcome with respect to Irish-UK relations that is close to the pre-Brexit situation in the belief that the pre-Brexit context of Irish-UK interactions was the best of all possible worlds.

Nobel laureate Daniel Kahneman described this kind of situation as: “Familiarity breeds liking.” In other words, since we are familiar with the pre-Brexit world, we wish to retain it.

It is important to understand that an inherent characteristic of economic analysis makes it easier to analyse the downside of Brexit than it is to explore possible upsides. Quantitative economic analysis starts with a fixed model (or representation) of the economy as it is today and was in the past. It feeds in anticipated changes to the domestic and international policy environments and examines the impacts of such changes where the structure of the economy is frozen in time.

Changes in the external context for Ireland

But as Irish policy makers prepare for the consequences of Brexit, it may be helpful to regard this imminent change, not as a unique and existential threat, but rather as simply the third time in the last seventy years that the strategic external context for Irish policy-making has fundamentally changed.

The first such strategic change took place in the early 1960s when the long-standing policy of protectionism and import substitution...
Box 20. Earlier challenges for Ireland

The challenges of the 1950s and the 1990s lay in the changing external environment and focused on how domestic policy mediated between these changes and the transformation of the local economy.

The 1950s and 60s

The economic challenges of the mid-1950s forced a re-think of policy fundamentals and eventually produced an alternative: trade liberalisation and access to foreign capital. The strong web of dependency between Ireland and the Britain that had endured from independence until the late 1950s began to weaken after the gradual shift to FDI and export-led growth during the 1960s. The main losers were most of the weak "protected" manufacturing firms that were unable to make the transition to exporting.

The 1990s

Meanwhile, the challenges faced as Ireland participated in the Single European Market from 1992 were an acceleration of this process of adaptation to new external conditions, requiring massive public investment in infrastructure and human resources to meet the demands of competition in the emerging marketplace of 28 EU Member States.

Within both the foreign-owned multinational sector and the indigenous Irish sector there were massive changes. There was a switch from manufacturing to internationally traded services in the foreign sector as Ireland evolved into a high wage, high productivity economy. The indigenous sector also evolved, adopted modern production techniques, and began to extend its markets beyond Ireland and Britain.

Brexit could be seen as a question of facing a degree of closing with respect to an important trading partner.

In the absence of Brexit, it is unlikely that the Irish SME sector would embark on any risky strategic reorientation towards the continental EU markets and further afield.

Adapting to the challenges

In the absence of Brexit, it is unlikely that the Irish SME sector would embark on any risky strategic reorientation towards the continental EU markets and further afield, as suggested in John McGrane’s chapter. But Brexit has created massive uncertainty in a bedrock trading relationship that has its origins in geography and history, but which has not always been beneficial to Irish economic development and transformation.

Both the UK and Ireland restructured in recent decades, but in radically different ways. Ireland developed a modern manufacturing base effectively from scratch, and more recently a base of export-oriented services in software and finance-related areas. The UK,
previously a global industrial powerhouse, de-industrialised, shed much of its traditional manufacturing specialities, shrank the share of manufacturing to one of the smallest in the EU, and massively expanded its service sector in the financial and retail areas.

These developments have profound implications for the future of the Irish-UK economic relationship in the context of Brexit. Ireland has an economic strategy, albeit one involving a high degree of international dependency, that is heavily based on the efficient hosting of inward investment, which requires maintaining close links with the EU and with the US.

The UK, on the other hand, has struggled to find a robust post-industrial strategy and its actions were heavily influenced by the perceived need to protect its massive financial services sector from unwelcome EU regulation pre-Brexit and a desire to have unfettered access to the EU Single Market post-Brexit. In addition, as its traditional manufacturing sector contracted, it has not been able to put in place development strategies to revive its lagging regions in Scotland, Wales and Northern England.

The dominance of FDI in Irish manufacturing and in some sub-sectors of market services has created an industrial strategy “divide” that is unhealthy and not often found to the same extent in other small, developed economies. Flattering measures of Irish competitiveness can be heavily distorted by the dominance of the foreign, high technology sector.

A more appropriate conceptual framework for indigenous competitiveness benchmarking for the SME sector is needed, structured in terms of three dimensions.

- An activity dimension would examine competitiveness at all levels of production, from the most aggregated to the most disaggregated.
- A spatial dimension would recognise that competitiveness is also a concept that applies to the environment within which the enterprise sector operates. Unlike for the foreign sector, regions play a much bigger role in the indigenous sector and the Irish regions retain very distinctive characteristics.
- An innovation dimension would arise from the life-cycle of product birth, growth, maturity and decline, which imposes a dynamic behaviour that originates from within firms themselves and drives the evolution of the firms’ products.

**Conclusion**

Past industrial strategy success stories should not blind us to challenges and dangers that lie ahead. The recent global financial crisis and recession and the rise of Asian economies have changed the previous comfortable world of US industrial hegemony and EU consolidation, within which Ireland prospered from the 1960s. Brexit is simply an additional aspect of the changing face of globalisation. Knowledge of these changes and clear thinking about their longer-term implications must be essential elements of Irish enterprise strategy reformulation. Dealing with Brexit is a challenge, but it should provide an opportunity for completing the modernisation of our indigenous SME sector.
Conclusion
Barry Andrews

The IIEA’s first Brexit status report, published in January 2017, is a widely quoted ‘must-read’ document that provided timely insights into the Brexit process. This second status report contains an updated analysis to assist in deepening public understanding of what lies ahead.

The IIEA’s reputation for independence is built on years of credible and robust analysis of Ireland’s place in the world. At this critical time, the need for this type of independent analysis is greater than ever. The Institute’s unrivalled speaker programme and convening power brings thought leaders to Dublin to ensure Ireland is well equipped to meet that need.

Beyond Brexit, the Institute is already engaged in an analysis of future potential alliances for Ireland within the EU27. Who are the like-minded states with which we can create alliances with in the years ahead? And what are the political and economic themes that will deepen those alliances?

Who are the like-minded states with which we can create alliances with in the years ahead? And what are the political and economic themes that will deepen those alliances?

As my predecessor, Tom Arnold, noted in the last Status Report, there is a “consensus that Ireland’s engagement with the developing European Union over the past four decades has brought major benefits in terms of national self-confidence, greater political influence at European and international level, economic progress, and social and economic diversity.” If anything, that consensus has deepened in the intervening period with the latest RedC/Eurostat report showing 88% popular support for EU membership.

The chapters of this report provide the most comprehensive overview of critical issues to date.

Brendan Halligan’s lucid overview of the negotiation process thus far sets the scene; the unity of the EU27, early successes for the Irish government and the apparently irreconcilable positions of the UK government. Tony Brown’s and Paul Gillespie’s separate analysis of the difficult issues on both the EU and UK sides of the negotiating table underline the great range of potential trip hazards that lie ahead; more pronounced still by John Temple Lang’s assessment of the narrowing ground for UK options given the rejection of long-term membership of Single Market, Customs Union, and the EEA.

Blair Horan’s look at the unique position of Northern Ireland (which voted ‘Remain’) within these islands and the EU, and the implications for Northern Ireland of potential membership of the EEA, and/or the Customs Union further underlines the need for a swift restoration of the Northern Ireland Executive. While John McGrane’s analysis of the disproportionate impact of Brexit on SME’s (in contrast to MNE’s) is timely, his identification of opportunities complements John Bradley’s analysis of potential benefits for the wider economy. Indeed, though the serious risks for Ireland are acknowledged, the word ‘opportunity’ appears nearly thirty times across the various chapters. A rapid assessment of UK exports to the rest of the EU and the sensitivity of those exports to tariff and non-tariff barriers will result in the identification of opportunities for Irish exporters willing to fill the gap. John Bradley challenges the view that Brexit is an historically unique challenge for Ireland, placing it on a continuum with other challenges in the 1960s and 1980s.
Padraic White identifies risks to the FDI environment for Ireland, a key aspect of the Irish economy. The fear that these risks might not only come to pass but that they might happen concurrently and be mutually reinforcing will be eerily familiar to readers of the Regling Watson report into the banking crisis. However, it is commonly acknowledged that the centrality of Ireland in the declared EU opening negotiating position is a very solid start.

John Cronin in turn provides an excellent overview of threats and opportunities in Banking, insurance and Fintech.

What runs through each of the chapters is that the period of speculation is coming to an end; however, as John Fitzgerald notes in chapter 7, “until the shape of the UK’s future relationship with the EU is determined, it is very difficult to quantify the economic impact of this major change in relationships”. The French legislative elections as well as the UK, Italian and German elections will put in place the dramatis personae for the next few years and allow the more granular work of negotiation to begin. It is probably fair to say that Ireland’s next Taoiseach will have a shorter than usual ‘honeymoon’ period.

The next six months are critical for Ireland and no effort will be spared in the Institute in helping to shape the debate and develop policy options. Already, debating points are emerging regarding the nature of Ireland’s security policy, and in particular our policy of neutrality and regarding the sustainability of Ireland’s corporate tax policy in the new international context and banking union.

Our work in the Institute for the rest of 2017 will consist of the following main themes.

- Providing a highly responsive discussion forum for thought leaders, business and Government with a view to the development of policy papers for the negotiation process;
- Intensifying the work of our ‘Future of Europe’ group with a view to developing insights into key priorities for like-minded Member States and common policy areas such as energy policy and the Digital Single Market; and
- Continuing with our exceptional speaker programme but with an additional orientation towards Brexit-related themes.

Already, there have been business casualties of Brexit, particularly in the agri-food sector and mostly related to the weakness of Sterling. The urgency of the situation hardly requires emphasis and we hope that this report will further deepen understanding of the critical issues that lie ahead.

My sincere thanks to the authors and the editor, Dáithí O’Ceallaigh, who volunteer their time and effort to advance the mission of the Institute, and to McCann Fitzgerald for hosting the launch of this report.