

Progress of the Brexit Negotiations

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On December 15 of last year, the European Council of the 27 remaining Member States (EU-27 hereinafter) concluded that sufficient progress had been made in the first phase of the Brexit negotiations that started in June 2017.¹ The first phase dealt with important matters regarding the United Kingdom's exit from the European Union per se, although the UK wanted to reduce the uncertainty stemming from the post-Brexit relationship by conducting parallel discussions on it. The European Council also decided to open the second phase of negotiations which deal with, among other subjects, the future relationship and a possible transition period between the termination of the UK's EU membership, scheduled for March 29 next year, and the beginning of a future relationship.

¹ In accordance with Article 50 of the Treaty on European Union, the UK does not participate in the European Council on Brexit.

I. First-Phase Results²

The main subjects of the first phase negotiations were: (1) the rights of citizens of the EU-27 residing in the UK and vice versa; (2) the border between Ireland, a remaining member state, and Northern Ireland, a part of the UK; and (3) the settlement of financial commitments made to each other.

1. Citizens' Rights

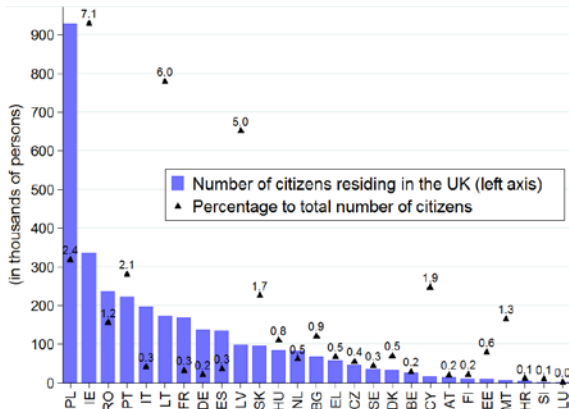
Citizens of EU member states enjoy the freedom to move and settle in another member state. As a result, about 3.2 million citizens from the EU-27 were living in the UK as of January 1, 2016 (see Figure 1). Poland had by far the largest number – almost a million – of its citizens living in the UK. Ireland, the UK's closest neighbor, and two Baltic states, Lithuania and Latvia, had more than 5% of their

² European Commission (2017), *Citizens' Rights*; Negotiators of the European Union and the United Kingdom Government (2017), *Joint report from the negotiators of the European Union and the United Kingdom Government on progress during phase 1 of negotiations under Article 50 TEU on the United Kingdom's orderly withdrawal from the European Union*.

citizens living in the UK.

Figure 1. EU-27 Citizens Residing in the UK

(as of January 1, 2016)

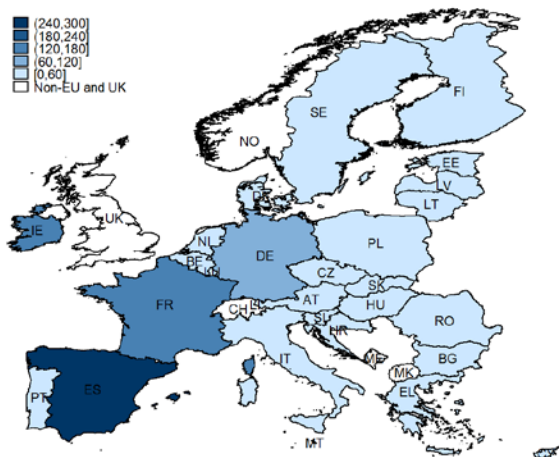


Source: Eurostat.

As for the UK, about 870 thousand, or 1.3%, of its citizens were residing in the EU-27 as of January 1, 2016. As Figure 2 shows, Spain hosted the largest number – about 300 thousand – followed by Ireland, France and Germany.

Figure 2. UK Citizens Residing in the EU-27

(as of January 1, 2016; in thousands of persons)



Source: Eurostat.

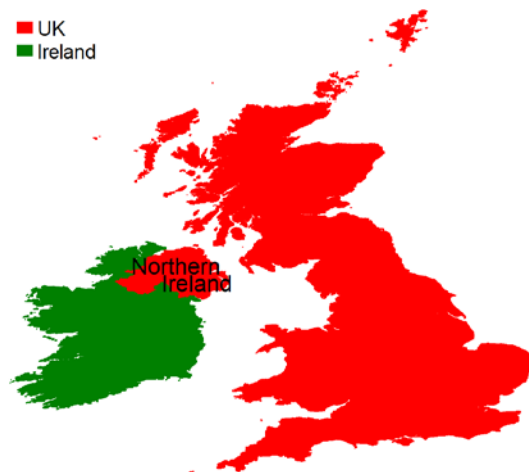
During the first phase, the two sides agreed in principle to grant similar rights to those citizens lawfully residing on each other’s side as of the day of the UK’s withdrawal. They agreed to grant a temporary residence permit

to those with less than 5 years’ continued residence, who will also have the right to apply for permanent residence status upon completion of this requirement. Citizens with a permanent residence as of the day of withdrawal will be able to acquire permanent residence status. The same rules will apply to members of family that exists on the day of withdrawal and to children born or adopted afterwards.

2. Irish Border

The northeastern part of the island of Ireland is the territory of Northern Ireland, which belongs to the UK, while (the Republic of) Ireland that occupies the rest of the island is a remaining member state (see Figure 3).

Figure 3. Map of Ireland and the UK



Source: Eurostat.

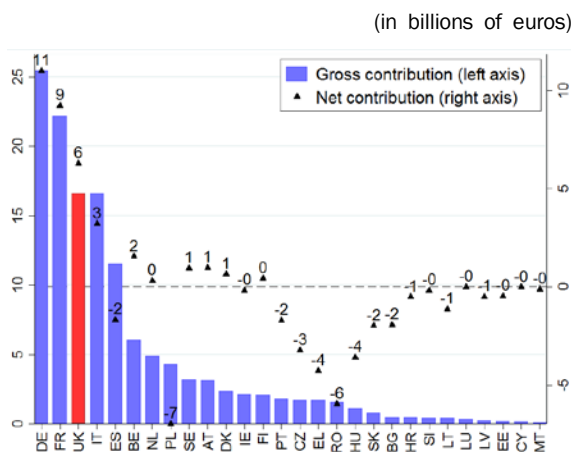
The UK and Ireland keep the land border between their territories at a low level within the framework of the Common Travel Area (CTA), which dates back to 1922 when the Irish Free State was established. People move freely within the CTA, normally without border controls. As a result, estimated annual person crossings of the border amount to 110 mil-

lion.³ The EU and the UK agreed in principle to maintain the CTA. Further discussions will be carried out during the second-phase negotiations to prevent conflicts between the CTA and the EU citizens' freedom of movement.

3. Financial Settlement

The EU operates an annual budget of around 150 billion euros, or 1% of the Union's GDP, according to the Multi-annual Financial Framework for 2014–2020.⁴ Member states contribute to its budget, and the UK is one of the largest contributors (see Figure 4): for 2016, for instance, its contribution is about 17 billion euros in gross and about 6 billion euros in net. It is also one of the largest shareholders of important financial institutions of the Union, such as the European Investment Bank and the European Central Bank (EIB and ECB, respectively, hereinafter).

Figure 4. Member States' Contributions to the 2016 EU Budget



Source: <http://ec.europa.eu/budget/library/figures/internet-tables-all.xls> (last accessed on February 28, 2018).

³ HM Government (2017), *Additional Data Paper: Common Travel Area Data and Statistics*, p. 2.

⁴ European Commission (2013), *Multiannual financial framework 2014–2020 and EU budget 2014 — The figures*, p. 7.

The UK agreed to contribute to the 2019–2020 Union budget as if it had remained in the Union, and to honor its outstanding commitments at the end of 2020. It also agreed to provide the EIB with a guarantee of an amount equivalent to its callable capital at the time of withdrawal from the EU. Its paid-in capital in the EIB and the ECB will be reimbursed after its withdrawal. The UK government estimates the net payment it will have to make to be around 35–39 billion pounds.⁵

II. Second Phase: Transition Period and Post-Brexit Relationship

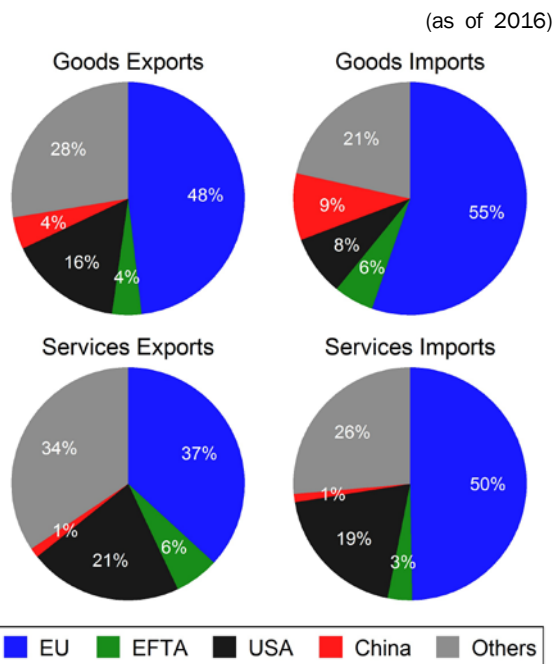
Given the short time left until the expected date of withdrawal, it was unlikely from the beginning that a final agreement on the future relationship would be made prior to withdrawal. To avoid an abrupt change, and to reduce the uncertainty stemming from this possibility, transition period is among the top agenda items of the second phase that started in February this year. A transition period means a fixed time period during which the UK remains in the Union's single market and customs union, but without rights to participate in the Union's decision-making. If agreed, it is likely to be until the end of 2020, despite the UK's desire for a longer period. This is because the UK's commitments to the Union budget, as agreed in the first phase, will end with the current Multi-annual Financial Framework for 2014–2020.

The most important topic of the second phase is the framework for the post-Brexit EU-UK economic relationship. The UK clearly ex-

⁵ HC Deb 11 December 2017, col 30, <https://goo.gl/jzGybt> (last accessed on February 28, 2018).

pressed from the beginning of the negotiations its intention for a “hard Brexit,” that is, it does not seek to stay in the single market. Because the EU is by far the largest trade partner of the UK (see Figure 5), such a disintegration will weigh heavily on its economy. Estimates range from a 1% to 10% reduction of the UK’s GDP.⁶

Figure 5. UK’s Major Trade Partners



Source: Office for National Statistics.

Despite this negative outlook, the UK government decided not to seek to stay in the single market because it interprets the Brexit referendum result as a rejection of the “four freedoms,” and most importantly the free movement of people, that each member of the single market is required to maintain. The EU has insisted repeatedly that the four freedoms are inseparable.

Given the conflicting positions on the four

freedoms maintained by the EU and the UK, their future relationship is expected to adopt a framework close to the EU-Canada Comprehensive Economic and Trade Agreement (CETA), among the existing agreements of the Union, with enhanced market access for services. CETA is the most comprehensive bilateral trade agreement the EU has made, but still provides for a significantly lower degree of market access in services than within the single market. In particular, it does not grant the passporting rights for financial services that the UK is much concerned about. Thus, a CETA-like agreement with enhanced access in the services market is currently seen as the most likely scenario. **KIEP**

⁶ Sampson (2017), "Brexit: The Economics of International Disintegration," *Journal of Economic Perspectives*, Vol. 31, No. 4, p. 164.