

From: Daniel Schwanen
To: Canadian businesses and diplomats in the EU
Date: October 30, 2018
Re: **CANADIAN INTEREST AND POSSIBILITIES IN AVOIDING A “HARD BREXIT”
(PART ONE)**

Governments and businesses in European Union nations are increasingly staring at a “hard” Brexit scenario, under which the United Kingdom leaves in March 2019 without a withdrawal agreement. Such an agreement is necessary to open the door to a transition period, lasting until the end of 2020, during which the UK would be outside the EU’s political institutions, but would remain part of the EU economic union while the two parties seek to agree on new rules of trade between them.

Why should Canadians care? There are more than \$100 billion of Canadian investments in the UK, which depend in no small part for their success on the ability to effectively access the broader EU market. Brexit will also affect the benefits Canada would have expected from its Comprehensive Economic and Trade Agreement (CETA) with the European Union, unless the latter can somehow be replicated with the EU and the UK as separate entities. Canada has an interest more generally in supporting economic growth and reducing uncertainty in the EU, our second-largest export market. And Canada’s interest, overwhelmingly, is to support rules-based trade in a world in which it is threatened.

The current major sticking point in the Brexit negotiation is finding an arrangement that would maintain the current fluidity of exchanges between the Republic of Ireland and Northern Ireland. This is essential to a withdrawal agreement and thus to avoiding a hard Brexit. The EU has proposed a temporary “backstop” solution of Northern Ireland remaining under EU rules, which is unacceptable to the UK. A type of solution there could see Northern Ireland operating as a Special Economic Zone, of which there are numerous models around the world. Imports and people could come in duty and inspection free from both the UK and the EU, but only leaving for the EU or the UK once cleared by EU or UK authorities operating in that zone.

Even if such an arrangement manages to prevent a hard Brexit, however, trade will become more difficult. This is because differences in duties potentially applied to third-party goods, regulatory divergence in a range of sectors, and new limits on the movement of skilled people will arise, a natural consequence of the UK taking back trade and regulatory powers that now rest with the EU.

These differences, in turn, threaten value chains and access for key British goods-producing and services industries – and for Canadian businesses located in the UK – to a market five times the size of the UK domestic market. Economies in the rest of the EU would be significantly hurt as well.

To minimize this negative trade impact, thoughts have naturally gravitated toward the UK potentially joining the European Economic Area – within which Norway and three other countries enjoy the free movement of most goods and services between them and the EU. But this means that Norway has been forced to adopt most EU rules without having a say in them, to accept free movement of people, and even to make certain budgetary contributions to the EU – three features that run opposite to the greater autonomy that was supposed to be the benefit of Brexit in the first place.

What, then, are the possible scenarios that could minimize post-Brexit trade impediments, including long lineups at ports of entry?

No doubt the UK and the EU have been looking at agreements and models around the world, from which different elements could be applied to their unique situation. All would have shortcomings relative to the currently integrated markets, but some have more realistic chances than others to maintain the ease of trade as much as possible, while also respecting the wish of the UK to operate outside of the EU economic union.

In this context, a “Canada-style” or a “Canada plus” solution, referring to the CETA as a model, has increasingly been discussed as a better template for future relations between the EU and the UK, than a “no-deal” Brexit that would see the two parties re-imposing WTO tariffs and rules between them.

Tomorrow, we will look at what such a deal might entail and Canada’s interests in seeing it come to fruition.

Read part two of the memo.

Daniel Schwanen is Vice-President Research at the C.D. Howe Institute.

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