Brexit: Why an extension to the transition period still seems likely

As UK-EU trade talks resume, the British government has insisted it won't ask to extend the 11-month transition period. But given the risks involved with a sharp change in trading conditions at the start of 2021, particularly if that were to coincide with another Covid-19 outbreak, we think an extension looks increasingly likely

British Prime Minister Boris Johnson welcomes European Commission President Ursula von der Leyen to 10 Downing Street

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Brexit talks are soldiering on, despite coronavirus

Brexit - remember that?

It's a little over two months since the UK formally left the EU, although it feels like much longer. But despite the global outbreak of the coronavirus pandemic, trade talks between the two sides are still continuing in the background, albeit via conference calls. Both sides will meet for further virtual talks this week.

As things stand, the UK's post-Brexit transition period - during which the UK's trade relationship with Europe remains virtually unchanged - is still due to end on 31 December 2020. The UK government said last week that it won't ask for an extension, nor will it accept one even if the EU offers it.

Is a deal still possible?

We think this position could change. After all, both sides have until late-June to agree to an extension. But first a quick recap.

Back in February, before coronavirus had really taken hold in Europe, the general consensus among trade experts was that a bare-bones trade deal covering goods was just about possible this year, assuming the UK agreed on some key issues.

Fishing is clearly one, while perhaps the biggest sticking point was the so-called 'level-field commitments'. We concluded back in February that the whole process may well boil down to whether the UK is prepared to stick to EU rules on state aid.

That's probably still the case, but the onset of coronavirus means more time will inevitably be needed, regardless of whether the UK government is open to compromise on a deal. Here are three key reasons why:

1 Time isn't on anyone's side

Firstly, the time and resources available to agree on a deal are clearly diminished.

Trade deals are typically multi-year exercises, but in this case, the UK and EU realistically have until October to agree on terms, allowing time for ratification. And while formal talks are continuing, many of the civil service resources previously assigned to support negotiations have been reallocated to deal with the coronavirus emergency response.

Admittedly many of the thornier issues were always likely to be left untouched until after the summer. But these are tough, political choices, and with the health crisis likely to persist for many more months to come, Brexit simply isn't going to be high up politicians' list of priorities - on either side of the channel.

2 Businesses won't be ready for a change in trading conditions

But the transition period wasn't just designed to facilitate negotiations, it was also there to give businesses time to prepare for the future relationship. This is where failing to extend the transition period looks risky.

Regardless of whether a free-trade agreement (FTA) is concluded this year, there will still be major changes to the UK's trading relationship at the start of 2021. New customs documentation will be required, and in the case of services, access to the European market will become significantly more restrictive.

Even before coronavirus, there were concerns that the 11-month transition wouldn't leave enough time for businesses to adapt. Before the original Brexit deal was agreed in 2019, there were concerns that many firms, particularly small-medium size enterprises were not fully prepared for a 'no deal' exit.

The same is still likely to be true now, and with coronavirus set to continue causing wide-scale disruptions for a range of UK businesses, it is unlikely that many firms will have the capacity to increase readiness for a sharp change in trading conditions in 2021.

3 Supply chain disruption pose risks to coronavirus response

However, the biggest risk with not extending the transition period is linked to Covid-19 itself.

While lockdowns are likely to be gradually unwound later this quarter, many scientists expect there to be future outbreaks. If that were to coincide with the end of the transition period over the winter, then it could be deeply disruptive.

Supply chains have proven fairly resilient over recent weeks, despite surging demand for certain consumer products. But that could change with the introduction of new customs processes at the borders. With or without a free-trade agreement, there would likely be some initial disruption at the ports.

In that case, it's not inconceivable that medical supply chains could be disrupted. It was for this very reason that the UK government asked all pharmaceutical companies to stockpile at least six-weeks worth of drugs ahead of the original Brexit deadlines.

The Centre for European Reform has roughly estimated that anywhere from a quarter to half of imported NHS protective equipment is sourced from the EU.

Possible extension agreement in June?

We (and a growing chorus of Brexit commentators) believe an extension to the transition period remains likely, and it's really a question of 'when'. Two-thirds of the public said they would approve of an extension, according to a recent *Focaldata* poll.

Officials have until late-June to agree on an extension, and it looks likely that both sides will use a planned June conference to take stock. If an extension is agreed, the default position would be for it to last for two years, in exchange for the UK making ongoing budget contributions during that time.

However, UK negotiators may well push for a clause that allows that time period to be shortened, if a deal can be agreed and ratified sooner than expected.

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