The big Brexit rethink

On Friday UK Prime Minister Theresa May will attempt to persuade her ministers to rally around a new direction for Brexit. But will they, or indeed the EU, accept these proposals? And even if the answer is 'yes', is the plan good enough for the UK economy?

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As time runs out, the Prime Minister seeks a new Brexit direction

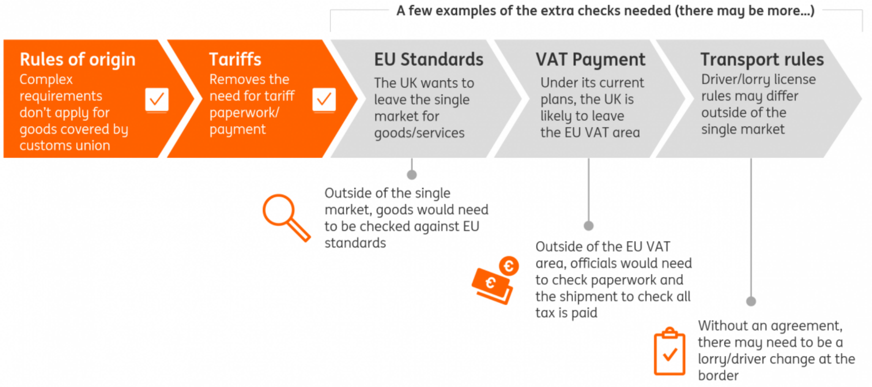
With the Brexit clock ticking, and concerns mounting about future frictions at UK borders, PM May will on Friday convene her Cabinet ministers for an 'away-day' in a bid to forge a unified stance on the future trading relationship.

Of course, this isn't the first time ministers have met like this. Cast your mind back to February, when the Cabinet gathered at Chequers (the PM's rural retreat) and agreed to pursue the so-called "three-baskets approach" – a policy that would see the UK remain aligned to EU rules in some economic areas, whilst diverging in others.

This approach was quickly met with a cold reception in Brussels. EU officials were primarily concerned about cherry-picking, but the bigger short-term issue was that it would likely result in friction on the Irish border. Two subsequent customs proposals made by the UK – so-called "max-fac" and "customs partnership" models – have been widely rendered as either politically or practically implausible.

So at Friday's meeting, May will reportedly propose a "third way". This is likely to amount to the UK joining a customs union with the EU, as well as remaining in the single market for goods (including agriculture) – albeit probably under different names.

A customs union doesn't mean frictionless borders...



Source: ING

In principle, this resolves a number of issues – not least the fact that it would remove the need for customs infrastructure on the Irish border. Remaining in the customs union would mean firms don't have to embroil themselves in complex rules of origin checks, or pay tariffs on the goods being transported. Staying within the single markets for goods would remove the need for checks to ensure compliance with EU standards. Assuming the UK also decides to remain in the VAT area, this should result in a much smoother customs process. Of course, this is relevant not just for Northern Ireland, but all of the UK's ports, which would go some way to preventing friction at the biggest one of all – Dover.

The EU is unlikely to sign-up to this new proposal

So will the EU accept this new vision? Well, the most obvious (and probably most likely) reaction is "absolutely not". In Brussels' eyes, this still fundamentally amounts to cherry-picking as long as services are omitted – the major concern being that a deal that sees the UK flourish outside of the EU could encourage others to seek similar terms.

> *The most obvious (and probably most likely) EU reaction is "absolutely not*

But some on the UK side have been keen to point out that the EU has accepted this exact arrangement before. Switzerland is in the single market for goods only, while smaller territories such as Jersey also trade with the EU under similar terms. Brussels has also already proposed the customs union + single markets for goods option as a backstop for the Irish border.

On the Swiss model though, with hindsight, the EU reportedly views this deal as a mistake. In reference to this, Stefaan De Rynck, a key advisor to Michel Barnier, tweeted recently that "the integrity of the single market is more important today than ever before". And on Jersey/Northern

Ireland, the EU would likely contest that it's one thing offering a bespoke agreement in these smaller, politically special cases, and quite another to offer it to a major trading partner.

This means the EU is likely to reject the UK's proposal, although whether this rejection is unanimous is less clear. After all, it is arguably the first serious and potentially viable proposal for the future partnership that the UK has put on the table. According to some reports, this is already proving to be a tempting offer outside of Germany and France.

Friday's meeting is likely to be contentious

But even if a more flexible EU approach were to prevail, this assumes the UK government can get behind the proposal in the first place – and there's no guarantee that will be the case.

For the likes of Foreign Secretary Boris Johnson and International Trade Secretary Liam Fox, May's proposal could be unacceptable. The idea of becoming a rule-taker would be incompatible with the Leave campaign mantra of "taking back control". Brexiteers also argue this would tie the government's hands when it comes to negotiating access for services.

Then there are the obligations that single market membership – even if only partial – would involve. Budget contributions, European Courts of Justice oversight, as well as some form of free movement of people, to name just three. While the EU might ultimately agree to a fudge for some of these issues – payments could be made under the guise of aid payments for instance, while the EFTA court model has been suggested as a possible ECJ middle ground – Brexit-supporting ministers are unlikely to accept this. Some high-profile ministerial resignations, therefore, shouldn't be ruled out over the next few weeks, although whether this would be enough to topple the Prime Minister is not so clear.

The latest proposal does little for trade in services

But even if hypothetically the EU and UK government can be persuaded by the proposal, is it good enough for the UK economy? Whilst it would remove costly and time-consuming processes for goods producers, it would do little to help the much larger service sector. For instance, banks would still likely lose the right to 'passport' from the UK to the EU27. And as many commentators have pointed out, trade in goods and services are increasingly intertwined. Products often rely on foreign design, finance and transport services as part of the purchase.

47% Growth in UK services exports

(Between 2008-16, based on ONS figures)

With this in mind, the UK government is also reportedly still pushing for mutual recognition when it comes to services. But even if it says yes to the single market for goods, the EU is likely to remain heavily resistant.

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