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DEVELOPMENTS IN THE BREXIT NEGOTIATIONS

On 29 March 2017 the United Kingdom formally initiated the process of withdrawal from the EU; negotiations began in June of that year. In line with the European Council's guidelines of 29 April 2017, the first round of negotiations dealt with the withdrawal issues, notably the rights of European citizens living in the UK and of British citizens living in the EU, the settlement of the UK's financial obligations deriving from its membership of the EU, and the avoiding of a hard border between Ireland and Northern Ireland. On 15 December, the European Council decided that the first phase of the negotiations had achieved sufficient progress and therefore agreed to move on to the negotiations on future bilateral relations and, as requested by the UK government, on a possible transition period following the withdrawal.

In March 2018, European and British negotiators reached an understanding on some parts of the draft withdrawal agreement, relating among other things to citizens' rights, the financial settlement and a transition period; there is as yet no consensus on the issue of the Irish border. During the transition period, which should run from 30 March 2019 until the end of 2020, the United Kingdom will not take part in any EU decision-making since it will no longer be a member state, though it will continue to benefit from being part of the single market and will be required to comply with European law. However, there will be no certainty about the transition period until the entire withdrawal agreement has been ratified by both parties, according to the principle that, as the EU has reiterated on several occasions, 'nothing is agreed until everything is agreed'.

On 23 March 2018, the European Council issued further guidelines for the negotiations on future relations between the EU and the UK, and established that any agreement must ensure financial stability in the EU, as well as compliance with its laws and its supervisory system. Explicit UK opposition to accession to the European Economic Area, which would allow it to continue to be part of the single market, together with the fact that, from the EU's point of view, the four freedoms (free movement of people, goods, services and capital) are inseparable, mean that no trade agreement can give the UK prerogatives similar to those enjoyed under EU membership, including those deriving from the single passport in the financial sector.

Should there be a free trade agreement, as set out in the European Council's guidelines, trade in goods would not be completely free since, even without tariffs being applied, a series of non-tariff barriers could be introduced. Moreover, trade in services would be subject to the rules of the host country and the current situation of free movement would no longer apply. The guidelines make no reference to financial services which, like other services, would be subject to the general principles of the host country's regulations and to the guarantee of a level playing field. Yet uncertainty over future relations remains high, given that the second phase of the negotiations has only just begun.

If no free trade agreement is reached, trade relations will be governed by the World Trade Organization (WTO) regulations and Most Favoured Nation (MFN) tariffs will be applied to bilateral imports. This would cause more damage to the UK economy than to that of the euro area, especially if less openness to trade were to have repercussions on productivity in the UK.[1]

The impact of any tariffs would be amplified by the fact that, given the highly integrated cross-border production between the two areas, intermediate goods often cross the Channel more than once. Should the UK adopt the same MFN tariffs that the EU applies to third countries, it is estimated that total production costs for UK firms would increase by around 1 percentage point, taking account of national and international value chains.[2] In contrast, the increase in costs for European firms would be marginal, at around 0.1 percentage points, with country-to-country differences depending on the extent to which they rely on manufactured products imported from the UK; in any case the impact on Italy would be even lower than the European average. This can all be attributed to the marked asymmetry in bilateral relations in the supply of intermediate goods: a fifth of the products used in the UK comes from the EU, while only 1.5 per cent of the products used in the EU comes from the UK (0.7 per cent for Italy).

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1 M. Pisani and F. Vergara Caffarelli, 'What will Brexit mean for the British and euro-area economies? A model-based assessment of trade regimes', Banca d'Italia, Temi di Discussione (Working Papers), 1163, 2018.

2 R. Cappariello, M. Damianovic, M. Mancini and F. Vergara Caffarelli, 'EU-UK Global Value Chain trade and the indirect costs of Brexit', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), forthcoming.