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Brexit: a challenge and an opportunity

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So much has been said on Brexit and, still, the most common buzzword is uncertainty. It is not at all clear where the ongoing negotiations will take us and at what point in time. Time factor grows in importance. The clock is ticking. A year from now negotiations on the withdrawal and transition should be concluded. The British ideas on the landing zone seem confused. The risk of cliff edge exists and seems more pronounced on the UK side. Uncertainty is particularly damaging for industry which, whatever the sector, needs to prepare. Even the level of awareness of what Brexit really means is hugely diversified across the whole spectrum of those affected. Global US firms seem to be best prepared. Small and medium size European companies are on the other extreme.

Today businesses have no other choice but to identify the risks that might come with the hardest possible Brexit and adapt to them. Later on, once the plans for future will be more clearly defined by the British side, a new wave of adaptation can be designed. Adapting to the hardest solution, being prepared to mitigate the risks of hard disruptive Brexit is the only way to start.

There is no time for any bespoke transition agreement. Transitional arrangements will most likely mean a prolongation of the current legal reality. It will have to be subject to strong monitoring and enforcement mechanisms, high level of regulatory cooperation will have to be ensured without any role left to the Brits when it comes to the decision making. During the transition, UK will not be anymore the EU member state. This image of transition does not fit well with the “take back control” logic. Short transition period means that practically the transition is now.

All sectors of European economy will be affected. Financial services, for obvious reasons, attract today more attention. In the years to come EU will continue developing a strong, resilient, effective capital market on its own. It will spare no efforts to make itself an attractive financial centre. It needs today to reflect on what made CITY but most likely avoid following the same approach. In the case of UK a combination of factors contributed, certainly trading tradition, but also English language, I would also mention contract law. Without any doubt, however, investors were going to London not only for the British market but also because of the EU single market. Somebody has pointed to the role played by the connectivity provided by the Eurostar. The twenty-seven have as well assets, I would mention innovative capacities, talents or in more general terms skilled people. However, there are also risks. Europe will not develop a CITY like one financial centre. It would rather move in the direction of several regional hubs. Here however, comes the risk of going back toward the national way of thinking and making choices. If there are financial hubs in Paris, Frankfurt, Amsterdam or any other place on the continent, we must make sure that the global mind set stays, that global approach to hiring people stays, that national institutional traditions do not undermine what should be European in nature. This is the moment when Europe has a chance to ensure its seat at the global table for decades if it avoids national temptations.

I have said that not much is known about the British vision of the future relationship with the EU. All we know is that they do not want to be anymore part of the single market or the EU customs union. They reject the ECJ jurisdiction. Whatever the future arrangement, some loss of integration is obvious. With regard to financial sector, minimizing its fragmentation will be a challenge. Since the 2008 crisis we have been investing heavily in reducing fragmentation, not only within the EU but also across the Atlantic and globally. In the years to come the EU will continue to invest in financial markets integrity, in harmonization of rules, consistency, enforcement, strengthening of ESAs, probably in more empowerment of ESMA, third country regime enhancement etc. Today, London provides services for twenty-seven. One cannot exclude strengthening of the already visible tendency to shifting businesses not only to the EU but also to the US. Wholesale banking seems to be the crucial segment where abrupt UK departure can be particularly damaging. Fragmentation will have costs and will generate the challenge of access to capital. It can also create risk of regulatory race to the bottom. What EU must do is identifying all potential risks that Brexit could generate and continue the process of adapting through changes in the regulatory framework. Strengthening equivalence regime is necessary. Ensuring effective enforcement mechanism will be fundamental. Nevertheless, we must also today spare no efforts to avoid a situation where introduction of a transition period is seen as postponing solutions to problems for tomorrow, as extra two years allowing for the postponement of adjustment.

In the financial services, there will be differentiated impacts of Brexit depending on the sector, on the type of activities. CCPs are seen as services potentially most affected. They are concentrated in UK, they are systemically significant, and they depend on netting

Financial sector will be an important part of the future agreement between UK and EU, but the challenge is that there is not any FTA template for such agreements. CETA has a very modest component on financial services. TTIP negotiations showed how difficult it could be to address in a comprehensive trade agreement the issue of financial services, both in terms of market access and regulatory cooperation. As I mentioned before the question of equivalence will be crucial, but of course equivalence is unilateral and on the EU side will have to be tightened. We hear more and more often on back-to-back arrangements applied by banks. For the EU there might be a risk of losing control that will be left to London and empty shell subsidiaries established in the EU. This is of course unlikely as an acceptable solution, there would be strong conditions regarding subsidiaries.

In short, one can assume that the future relationship agreement will be a mix of trade agreement with some services, with strong component of regulatory cooperation and equivalence, with a strong control and enforcement mechanism. If UK would want to negotiate some sort of custom union with the EU, it would have to include agriculture. But it must be clear from the beginning that custom union does not work without elements that belong to single market. I think here of all norms and standards, product safety, conformity assessment. So checks on the border will exist. Seamless border does not seem a possibly reality.

Data protection will be very important and will have to be adequate. It is actually amazing that UK has not yet applied EU regulation on data protection. We do not know what regulatory regime UK will have in this respect. I hear that they do not know themselves. We do not know yet enough about the consequences of the great repeal bill which is more often called now a withdrawal bill. It is still in legislative process.

For Polish businesses, uncertainty about the future relationship between the Union and UK comes on the top of political uncertainty. Traditionally and, I would say, despite sufficient evidence, Poland has been looking at the UK as a likeminded member state. It is actually surprising that in such situation the EU unity is not a priority for Polish government. One would expect that Poland would now support European security and defense initiatives. Non-euro group of EU member states will be weaker both politically and economically. Multi speed options based on limited interest of Poland in participating in some areas of integration combined with euro skepticism of Polish political elites will further marginalize Poland. This means that Polish domestic debate about joining euro would make now a lot of sense. In general, a constructive engagement of Poland in deepening the unity would make sense now. But this is rather unlikely.

Poland should also look at the consequences of Brexit for the British economy, it will have impact across economy, from agriculture through manufacturing through services to education and research. There will be consequences for markets, subsidies, supply chains, labour market, one can even expect its impact on economic model, taxation etc. UK in mid and long term will be a different economic partner for Polish businesses. We have to take into account that the British side sticks to the three Noes meaning no single market, no customs union, and no ECJ jurisdiction as a plan for the future.

Polish businesses must be aware of the fact that the Brits were not any more a part of EU customs union, even if they signed some sort of a customs union with EU, there would be border barriers. NTBs will stay. Of course, FTA would mean no common external tariff, but still the need of respecting the principle of rules of origin regarding components produced and imported from outside the FTA. In a true customs union goods circulate freely once they pass the external border. EU has a formal custom union with Turkey, Andorra, San Marino. In case of Turkey agriculture is excluded. There are anti-dumping duties possibilities. There are NTBs. It is important to understand the difference between being part of the EU customs union and having a custom union with the EU. If U.K. negotiates a custom union with EU it will not mean frictionless trade. For any exceptions, there will be customs checks. I mentioned that there are traded goods where some issues are covered by single market rules, for example all technical requirements, standards related for instance to food safety, certification of conformity assessment, TIR certificates and many others. Therefore, a custom union with EU will not solve problems if UK leaves single market. There will be border checks. Custom union deal would have to be very broad to avoid or at least to reduce customs checks. UK would have to follow EU bilateral trade policies in WTO, include agriculture in the deal which will be crucial for Northern Ireland. Nevertheless, to avoid checks at border there will be the need to harmonize standards and technical requirement mentioned above. Any deal with exceptions requires border control. Then, for obvious reasons, mechanism of recognition and conformity assessments, and then of monitoring, control, enforcement will have to be established and function well.

EU customs union technically covers only goods; union with Turkey covers only manufacturing. Services are addressed by single market rules. Of course, if U.K. negotiates a custom union with EU then it can sign trade agreements with third countries on services. However, it would be rare to separate them from goods.

Sometimes, when listening to the expectations of the British businesses one has the impression that they expect a soft Brexit that would mean EEA, and a broad custom union with EU. Then of course, it is impossible to understand what is the purpose of leaving the EU, and losing the place at the table where decisions are made. Staying in single market equals EEA. We have also to take into account the fact that within WTO there are limits to cherry picking for a custom union, it is rather not possible for few sectors, practically any custom union or FTA covers all sectors. Most likely, what we will see as the British request for the future relationship will lead through negotiations to a FTA including services, custom union covering also agriculture, regulatory cooperation, equivalence and strong enforcement mechanism.