

Intelligence MEMOS



From: Daniel Schwanen
To: The Honourable Chrystia Freeland
Date: August 15, 2019
Re: **THE BREXIT ENDGAME IS IN SIGHT: HOW SHOULD CANADA PLAY IT?**

Canada's trade and investment relationship with the United Kingdom and with the rest of the European Union has evolved under a major cloud of uncertainty in the three years since UK voters decided to leave the European Union.

Newly installed Prime Minister Boris Johnson is vowing to take the UK out of the EU on October 31 with or without a formal withdrawal agreement.

Former Prime Minister Theresa May negotiated an exit deal that provided for a finite transition period during which the UK would leave the EU political institutions, but still follow its trade rules as the two parties negotiated a fresh trade agreement.

Yet, Parliament repeatedly rejected May's agreement, leaving the country in limbo.

An essential point of friction was that the accord would have seen the UK keep trade rules for Northern Ireland aligned with those of the EU for an indefinite period in the event that a post-Brexit deal to preserve seamless passage at the border with Ireland could not be agreed on. This so-called "Irish Backstop" is unacceptable to Mr. Johnson.

A "no deal" option would mean that the UK-EU trade relationship (which accounts for half of all UK exports) risks being downgraded to that between the EU and any other WTO member, giving firms and people on both sides much reduced access to each other's markets. This would mean a costly disruption of supply chains across the continent.

Canada has much at stake here. Yes, Canada and the UK are good and supportive friends, as last week's visit by Foreign Secretary Dominic Raab to Ottawa made abundantly clear.

But since the referendum, exports to the United Kingdom have been a weak spot in Canada's trade with Europe, despite the Comprehensive Economic and Trade Agreement (CETA) between Canada and the EU entering into provisional application in September 2017. While Canada's exports to the UK are notoriously dependent on volatile precious metals trade, they also include well over a billion dollars annually of machinery and parts, much of which, like Canada's \$109 billion in direct investments in the UK are predicated on UK firms being able to easily access the EU.

Once it has left, of course, the UK will be able to negotiate free trade agreements with other trading partners. Indeed, the UK, with EU blessing, has already agreed with a number of countries to "roll over" existing EU trade agreements, such that they could continue to apply to the UK once it has left the EU.

Using that model, Canada could continue trading freely but separately with the UK and with the rest of the EU, based on the CETA model.

However, Canada's deeper interests lie in arrangements that preserve as much as possible the movement of goods, services and capital, and the temporary movement of skilled and business personnel, between the UK and the EU, with Canadian inputs continuing to qualify as "originating" and hence qualifying for tariff-free treatment between the UK and the EU.

Indeed, both the European Union and the UK would be better off remaining part of a tripartite CETA, than with each reverting to WTO rules. Apart from zero tariffs on goods originating in any of the three partners, the CETA would provide the UK and the EU with a starting "negative list" of exceptions to free trade in services – a unique feature of CETA among EU trade agreements. The CETA would provide a good trade "backstop", compared to the less comprehensive WTO rules, while the EU and the UK negotiate a deeper arrangement.

That is why the comment in *The Globe and Mail* by an official in your office, that Canada would allow the UK to remain part of CETA, or rules based on CETA, during any transition period, is encouraging.

To be clear, even with a trilateral CETA, the question of how to maintain a seamless border between Northern Ireland and the Republic of Ireland will remain exceedingly difficult to solve. But not impossible, as I [wrote](#) last year.

It would also be as difficult to preserve the delicate balance of agricultural concessions achieved in the CETA negotiations, when reapportioning quotas between the UK and the rest of the EU, in a trilateral CETA than under two separate deals scenario.

But it would be worth trying, and it would certainly be better for all of us than the UK reverting to WTO rules.

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

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