

Brexit storm clouds

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Following the triggering of Article 50 of the Treaty of Lisbon in March, the United Kingdom's exit process has formally begun. However, there is still significant uncertainty. It is not clear, for example, whether or not the UK can reach a new trade agreement in the coming years, or if there will be a period of transition which will prevent discontinuity in the market.

The UK's position is beginning to become clearer. Theresa May's aim is to limit immigration from the European Union and retake control over the law-making, which will cease to be under the jurisdiction of the General Court of the European Union. This is the so-called "Hard Brexit", in which the United Kingdom will also leave the Single Market. Under these restrictions, she will seek to negotiate an integrated trade agreement, which ensures the greatest possible access to the Single Market. This will represent a major challenge for her government, given the complexity of the negotiations and a certain reticence within the ranks of the Conservative Party. The problem could be mitigated if, in the coming elections, May's position is strengthened, reducing her dependence on the right wing of her party.

From the European side, on 29 April, leaders of the EU 27 will meet to decide on the details of their final negotiating strategy. It is expected that this will formalise the premise so frequently reiterated by European authorities: firstly, the exit will be negotiated (including the bill for Brexit and the rights of citizens), as well as establishing the basis for the new trade relationship between the two blocks. As far as this point is concerned, the 27 will attempt to prevent the UK from choosing the facets of the Single Market that most interest them, without assuming their corresponding responsibilities.

There are many factors that will affect the course of negotiations. One possibility is that the European Union and the United Kingdom will reach an agreement, both in terms of exit terms and the new trade relationship. This scenario seems very improbable. In the other extreme scenario, there may be no consensus, meaning that the new relationship between the two would be based on WTO rules. Between the two extremes there are a large number of alternatives, such as an exit agreement that does not include a trade deal, implementing a period of transition for a limited number of years or even ensuring an agreement.

The new trade relationship will be of vital importance to the UK. This is especially true in the financial sector, given that leaving the Single Market would see financial institutions losing their "passport". This is the mechanism that allows an organisation based in a member state to undertake financial transactions with a client in another EU country without needing further authorisation from the host country. Among other things, it allows banks to set up foreign branches with relative ease.

The United Kingdom has benefited considerably from the passport, which has contributed to consolidating its position as Europe's financial hub. The mechanism is very important for the UK economy, which has a sizeable trade deficit although a large surplus when it comes to financial services. Losing its status would represent a considerable risk which may result in firms moving to the continent, as has been warned of on numerous occasions.

In the short-term, a system based on equivalence may temper the loss of the passport. This is very much an

imperfect substitute however, as it is only a partial solution. Equivalence varies, depending on the activity and the directive that governs it. There are directives that do not permit such equivalence, or which only allow it in very limited cases.

At the end of the day, there needs to be a solution that minimises the negative consequences of Brexit. The market might not move en bloc to a new location outside the UK, but rather do so in small activity niches, with a certain tendency toward fragmentation. Negotiations should avoid risking the stability of the system. One way to ensure this would be to implement a long enough period of transition, which would allow the sector to adapt to the new panorama without major disruptions.

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