

State of Play



10 December 2020

Our Investment Specialist, Simon Durling, shares his thoughts in our latest update.

Deal or no deal... with just days left before the end of the transition period and a brand new relationship with Europe beginning, that is the crucial question. In this Brexit special edition, I look at the history of our relationship with the European Union (EU), from the Treaty of Rome through to the last ditch attempt by Prime Minister Boris Johnson to strike a deal.

There are only three weeks to go and we are yet to see a final deal. With this in mind, I wanted to take a step back in time to chart the events that have brought us to this point and the key subjects that have dominated the negotiations since the British public voted to leave the EU in 2016.

The Treaty of Rome – the start of the European project

The EU as we know it started its journey over half a century ago when European leaders came together to create economic and political stability to ensure long-term peace in Europe. In 1951, the Treaty of Paris established the European Coal and Steel Community (ECSC), the first of a series of treaties with the aim of increasing cooperation in Europe. The founding countries of the ECSC were Belgium, France, West Germany, Italy, Luxembourg and the Netherlands. Following these simple origins, the same founding countries broadened their cooperation by signing the Treaty of Rome in March 1957, establishing the European Economic Community (EEC) and the European Atomic Energy Community (EURATOM). The aim of the EEC was to create a common market based on four key freedoms - movement of goods, services, capital and people.

The first referendum on EU membership

The UK first applied to join the EU in 1961. This application was vetoed by the French Government in 1963 and again in 1967. President de Gaulle of France had feared British membership would weaken the French voice within Europe, and that the US-UK relationship would strengthen America's influence. Britain found a route to join after President de Gaulle resigned in 1969, with talks starting in 1970. The UK joined the EEC (as it was then) on 1 January 1973, alongside Denmark and Ireland. In 1975, a referendum was held on whether the UK should stay in the EEC under different terms of entry. The public voted 'yes' by 67.2% to 32.8% to remain in Europe. In those days the entity was primarily an economic union. It wasn't until 1992 that the EU was officially formed, with Britain's and other countries membership coming into force in November 1993.

Euroscepticism

The downfall of several Prime Ministers can be linked directly to Euroscepticism, but this existed even before Britain joined. Margaret Thatcher's relationship with the EU can be described as somewhat changeable. She was a keen backer of the 'yes' campaign in the 1975 Referendum on whether to stay in the EEC even famously wearing a sweater with the flags of the member countries sewn in. However, her 11 years in Downing Street were marked by a growing opposition to European integration that eventually contributed heavily to her downfall.

It was in the 1980s that Euroscepticism really embedded itself within the Conservative Party. The EEC was increasingly seen as changing from an initial economic agreement into something far more political, raising questions about how Britain would be governed in the future and of the nature of democracy itself. An 'us and them' narrative developed and was gleefully picked up by the right-wing press, which endlessly lambasted the inequalities and waste of the Common Agricultural Policy. 'Wine lakes and butter mountains' were constant gripes through the 1980s.

Margaret Thatcher's first visible sign of frustration with the EEC related to Britain's budget contribution - because Britain was absent at the EEC's birth, it did not set up the financial rules of the game, which gave an inherent advantage to those countries with big agricultural sectors, such as France. At a summit of leaders in Fontainebleau, France, in 1984, Thatcher secured an agreement whereby Britain, which has a relatively small agricultural sector, gained a rebate. Though her government backed the creation of the single European market the following year, which removed all barriers to trade, Thatcher became increasingly hostile to further integration between the European countries. The appointment of French socialist Jacques Delors to head the Executive European Commission in 1985 arguably provided the Eurosceptic's their first real EU bogeyman. Thatcher was aghast at Delors' ambition for the creation of a single currency and a European central bank. The EEC, to her, was venturing into areas that would significantly dilute the sovereignty of individual nation states to set economic policy.

The 'Farage' factor

I am fairly certain if you were to randomly ask the public who has had the most impact on bringing about Brexit the vast majority of those you spoke to would cite Nigel Farage. Initially a Conservative, he resigned from the party in 1992 in protest at the 'Maastricht Treaty' which created the EU (as we know it today). He was a

founding member of the newly formed United Kingdom Independence Party (UKIP) and was elected as a Member of European Parliament (MEP) in 1999. UKIP's main policy and purpose was to bring about the UK withdrawal from the EU. He became the leader of UKIP in September 2006 before stepping down in 2009. He was re-elected as their leader in 2010 and famously led them through until 23 June 2016, the date of the UK Referendum.

Nigel Farage is arguably the most successful Eurosceptic politician - growing UKIP's membership and popularity throughout his time as leader. He spotted a growing resentment towards the EU, especially in areas and regions that were left behind after the financial crash in 2008, and suffered the most from growing immigration brought about by the freedom of movement and countries joining from Eastern Europe in 2004 and then Romania and Bulgaria in 2007. Farage led UKIP to be the first party to win the popular share of the vote in a national election over the two main parties since 1906, when in the European Parliament elections in May 2014 they won 27% of the popular vote and 24 seats at the European Parliament. This rise in popularity, often eating into the Conservative's share of voters prompted then Prime Minister David Cameron to offer a referendum on membership of the EU in his party manifesto in the 2015 General Election. He promised to negotiate a better arrangement with the EU and then fight for the UK to remain in the EU. UKIP came third in terms of votes with 12.6%, but won only one seat, with Nigel Farage failing to win the seat of South Thanet. David Cameron won 331 seats and an unexpected majority triggering the promise of a national vote on our EU membership.

June 2016 Referendum

The campaign to remain or to leave the EU prior to the Referendum took some time to ignite but as voting day came closer tactics on both sides stepped up a notch, as the remain campaign warned that families would be significantly worse off if we left without providing too much detail on how they arrived at the figures. The leave campaign notoriously travelled around in their campaign bus with the words 'we send £350m a week to the EU, let's give it to the NHS instead'. At times the debate was angry and even friends, families and colleagues became divided on a subject that has created more angry exchanges than any other for a generation or more. The leave campaign employed the help of social media and Cambridge Analytica who used computer algorithms to run billions of posts and adverts on Facebook and other social media sites, shaped by data held on millions of individuals tapping into their fears over immigration and sovereignty. In addition, Nigel Farage (separate to the official leave campaign efforts) famously stood in front of a poster which showed a queue of mostly non-white migrants and refugees with the slogan 'Breaking point: the EU has failed us all'. On voting day there was a near record turn out with over 34 million votes cast, but at about 4.39am after the polls had closed and the vast majority of the votes had been counted, David Dimbleby said on the BBC 'the British people have spoken and the answer is we are out, we are leaving the EU'. Later that morning David Cameron walked outside 10 Downing Street to announce his resignation triggering a leadership election for the Conservative Party and a change in Prime Minister. Nigel Farage on the other hand joyously declared it 'UK Independence Day'.

Article 50, the Withdrawal Agreement and extensions galore!

Theresa May was elected by the Conservative Party as their next leader on 27 September 2016 and she immediately set about implementing the Referendum result, working hard to try and build a consensus and promising 'Brexit means Brexit'. Invocation of Article 50 occurred on 29 March 2017, when Sir Tim Barrow, the Permanent Representative of the United Kingdom to the European Union, formally delivered by hand a letter signed by Prime Minister Theresa May to Donald Tusk, the President of the European Council in Brussels. This started the countdown to the intended date of departure for 29 March 2019.

However progress was very slow with fierce debate between Members of Parliament (MPs) who had wanted the UK to remain constantly fighting with Eurosceptic MPs who wanted a complete clean break and quickly, deal or no deal. In a political gamble that didn't pay off the Prime Minister decided to trigger a snap general election on 8 June 2017 in the hope of increasing her small majority of 16 in Parliament but lost. With no majority she had to form a minority government based on 'confidence and supply' deal with the Democratic Unionist Party (DUP) in Northern Ireland. The Prime Minister continued to negotiate with the EU and eventually agreed a withdrawal deal which provided for a form of customs union and alignment of Northern Ireland with the EU single market, thereby preserving the Good Friday Agreement (an agreement which established power sharing and eliminated borders between the Republic of Ireland and Northern Ireland otherwise known as 'the Irish backstop'). Theresa May's withdrawal deal was rejected in Parliament three times.

On 20 March 2019 the Prime Minister wrote to European Council President Donald Tusk asking to extend Article 50 until 30 June 2019. Following a European Council meeting the next day, EU27 leaders agreed to grant an extension comprising two possible dates: 22 May 2019, should the Withdrawal Agreement gain approval from MPs; or 12 April 2019, should the Withdrawal Agreement not be approved by the House of Commons. On 2 April 2019, the Prime Minister announced she will seek a further extension to the Article 50 process and offered to meet the Leader of the Opposition to agree a deal that can win the support of MPs. At a meeting of the European Council on 10 April 2019, the UK and EU27 agreed to extend Article 50 until 31 October 2019.

Boris Johnson and yet another General Election

In July 2019 Theresa May resigned and the Conservative Party elected Boris Johnson as its leader and consequently he became Prime Minister. Boris Johnson was in favour of a hard Brexit strategy and threatened the EU with no deal unless they renegotiated Theresa May's withdrawal bill by removing the Irish backstop and making Northern Ireland part of the UK customs area. Boris was determined to force the EU to renegotiate and threatened to leave the EU by 31 October 2019 with no deal. He suspended Parliament for 5 weeks from 9 September 2019, known as 'Prorogation', to add pressure on the EU to agree a deal. This was deemed by the Supreme Court of the United Kingdom to be illegal because the purpose was to deprive Parliament of the ability to debate Brexit. Parliament reassembled and passed a law known as the 'Benn Act' after its proposer, Hilary Benn a Labour MP, to require the Prime Minister to ask for an extension to 31 January 2020 if there was no withdrawal agreement with the EU by 19 October 2019. The Prime Minister failed to

negotiate a deal by 19 October and applied for an extension for an EU deal to the 31 January 2020, which was granted.

The Prime Minister then renegotiated the withdrawal bill and agreed with the EU a new deal in which the whole of the UK will leave the EU Customs Union but Northern Ireland remains in alignment with the EU Customs Union. Legally there will be a customs border between Northern Ireland (which stays in the UK) and the Republic of Ireland (which stays in the EU), but in practice goods are unlikely to be checked on that border as this would likely place the Good Friday Agreement in jeopardy. The UK will be free to negotiate its own free trade agreements in the future. Although Prime Minister Boris Johnson's deal was passed at the first reading in Parliament, it would have been subject to amendment in later stages of the Parliamentary process and the Government had no majority to stop any amendments. Therefore, Boris Johnson decided to pull the EU deal from Parliament and press for a General Election. Parliament agreed that a General Election was the best solution to the impasse and the election was held on 12 December 2019. Boris Johnson won a majority of 80 seats in the General Election and reaffirmed his commitment to 'get Brexit done'. On 23 January 2020, the EU (Withdrawal Agreement) Act received Royal Assent - this is the legislation that will implement the withdrawal agreement negotiated by the UK and the EU. At 11pm on 31 January 2020, the UK left the EU and entered a transition period that is due to end on 31 December 2020.

Brexit negotiations 2020

The crucial sticking points

As with all of the negotiations between Britain and the EU, even after the UK left on 31 January, the talks to agree a more permanent relationship at the end of the transition period have been painful. Compromise has been in short supply with threats from both sides even though it is in the best interests of both sides to agree a deal.

Level playing field

This relates to the rules on fair competition for business, both now and in the future. The idea of level playing field rules within any agreement is to ensure businesses on one side don't have an unfair advantage over their competitors on the other. If the UK reduced regulations in the future it makes it cheaper to make and distribute goods providing a competitive advantage which worries the EU. It wants the UK to commit to sticking closely to current EU rules on environmental regulations, worker's rights, and state aid (financial subsidies given by government to businesses). The UK Government has been very explicit that voting to leave the EU was in large part to break free of exactly these constraints. Both sides have been working hard to agree a minimum requirement on some issues where neither side would go below. The EU has also tried but failed to persuade the UK to mirror its rules on subsidies. The UK says it is determined to assert its sovereignty.

Resolving potential future disputes

The focus on future potential disputes relates to the mechanism for enforcing the rules in case one side were to break them. This is also about who might adjudicate disputes, and whether the European Court of Justice will play a lead role.

The EU has been asking for powers to retaliate against the UK breaking the rules in

one area by hitting back in another, for example, imposing tariffs or taxes where it thinks they might hurt the UK most. Such powers would of course be available to the UK as well. All of this matters a great deal as it sets the future framework for any ongoing relationship and the foundation of any initial trust earned - allowing for a successful ongoing trading and working partnership.

Fishing rights and quotas

Fishing contributes less than 1% to the UK and EU economy but was central to the 'Leave' campaign that won the 2016 Brexit Referendum in the UK. It is symbolically important to several EU countries but especially France. Currently the vast majority of the fishing quotas are allocated to European States and the EU is pushing for maximum access for its boats to continue operating in UK waters, where they currently catch about £600m worth of fish every year. The UK wants most of that business back, and says it will prioritise its own boats after 1 January when it will become an independent coastal state, outside the EU's Common Fisheries Policy. The dispute is not just about access, but also about a bigger share of the fishing quota for the UK fleet. There's also been disagreement about the length of a potential status quo period before new measures come into full force. The EU wants it to last for up to 10 years, the UK says it should be considerably shorter.

Northern Ireland border

Throughout the negotiations, for both the withdrawal agreement and the subsequent trade discussions, Northern Ireland has been an enormous hurdle. The Good Friday Agreement was struck on 10 April 1998 between the British and Irish governments, and most of the political parties in Northern Ireland, on how Northern Ireland should be governed. It broadly brought an end to many decades of trouble and violence and has been applauded internationally as an example of what can be achieved in spite of the strong feelings on all sides. Crucial to this peace accord is the border between North and South remaining open without border check or controls. In the withdrawal agreement the UK made a commitment on keeping this border as open as it is now even though this border will be the only land border with the EU after the transition period ends. The detail of the agreement on Northern Ireland is subject to separate negotiations in an EU/UK joint committee, but it can't reach conclusions on many important issues until it knows whether a trade deal is going to be agreed or not. In addition, the EU is concerned about an internal markets bill that threatens to override this commitment made in the withdrawal agreement breaking international law and destroying any trust that remains between the two sides.

Other important side issues

It's worth remembering that the negotiations are not just about trade with the EU. Other important areas for discussion and agreement are about security and co-operation. The UK wants to maintain access to shared databases that it has now, but the EU says that it doesn't offer access to non-members. Other agency memberships and agreements may have to be addressed after the main deal is reached.

Last ditch attempt to strike a deal

Prime Minister Boris Johnson flew to Brussels this week for an eleventh hour summit with the European Commission President in a final effort to unlock the stalemate

in Brexit negotiations. The Prime Minister met Ursula von der Leyen yesterday (9 December) after they spoke on the telephone and failed to resolve any of the key differences between Britain and the EU. Downing Street confirmed after the meeting that 'very large gaps remain between the two sides and it is still unclear whether these can be bridged'. However, discussions will continue over the coming days, with both parties agreeing that 'by Sunday a firm decision should be taken about the future of the talks'. Any deal would still need to be ratified by parliaments on both sides, which will want time to scrutinise it properly. It's an important agreement that will form the basis of EU/UK relations for years, if not decades, to come. It's certainly possible that a basic trade deal can be done in the short time that remains but both sides are going to have to compromise, and quickly.

Market update

Ever since the UK voted to leave the EU in the 2016 Referendum the investment returns on the UK Market have been affected by the outcome of the vote, albeit the type of sectors that make up the FTSE 100 will also have had a big part to play. Initially the fall in the value of the pound (GBP) brought about better returns for larger companies within the FTSE 100 in the first six months, but since then the returns have been underwhelming. To provide context, the total investment return including dividends over the last five years for the FTSE 100 is 30%. By comparison the MSCI World Index has delivered 95% and the S&P 500 in the US has a total return of 114% over the same five year period. The FTSE 100 is a more traditional index dominated by cyclical and value stocks and has a much smaller technology sector which have performed particularly well. However this does demonstrate to a certain extent how out of favour the UK stock market has been globally since the Referendum result (also represented by large initial outflows into other international markets).

If a compromise is unable to be reached the risks remain that GBP could fall further in value and the additional tariffs, checks and processes forced on UK businesses will be very detrimental to profit margins. Prices in the UK may rise and stock market values may fall along with increased borrowing costs for government and corporate debt. However it can also be argued that if a deal (even if basic) is agreed, with further detail and changes to be made after the deadline has passed, given how discounted the UK market is against most historical value measures, it could benefit from a strong resurgence especially after the vaccination programme accelerates, and economies and life starts to return to normal. Virtually every deadline that has been set during the last four and half years has been passed before a last minute deal is agreed. Will this be one deadline too many, or with intervention at the highest level expected this week, will common sense override political pride?

**Find out
more**

Listen here to our **2021 Outlook: Beyond a year of uncertainty** from our Portfolio Manager, John Mullins, as he shares his thoughts on the key themes to watch out for next year [here](#).

Note: Data as at 9 December 2020.



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