BREXIT WAS NEVER ABOUT ECONOMICS – BRITAIN IS NOW PAYING THE PRICE

Brexit was in the news this past week. I was tempted to say it was "back" in the news, but in reality it never left, with examples of this regularly emanating from multiple corners of British society – farmers, small business owners, entertainers, scientific and other researchers, the health service and the care home sector. From many, but not the denizens of Westminster. The trigger was a news report in The Sunday Times that "senior [UK] government figures" were considering a "Swiss-style" relationship with the European Union over the next decade to achieve frictionless trade. The leak caused an immediate and furious backlash from the Eurosceptic hardliners represented by the European Research Group ("ERG").

This latest flashpoint comes in the context of tough questions being asked about immigration, the Northern Ireland Protocol, the government's plan to scrap EU retained laws (what some have termed a "regulatory bonfire") and the worsening state of the economy.

As I have observed in a prior briefing note (available here) neither Labour nor the Conservatives have been keen to revisit Brexit, both seeing the topic as toxic from political perspective. The implosion of the Truss government seems to have diluted somewhat the taboo on speaking out on the issue, particularly for business leaders.

Economic Headwinds

Britain is now in recession that will last just over a year, with an expected rise in unemployment of 505,000, according to the Office for Budget Responsibility's November 2022 Economic and fiscal outlook (the "OBR November Outlook"). The Office for National Statistics ("ONS") reported earlier this month that the British economy had contracted 0.2% over July, August and September, compared to the prevision three months. While both Britain and the European Union face rising inflation and slowing growth driven by the war in Ukraine and sanctions, which have caused surges in the prices of fuel, food and fertilizer, as well as by supply chain disruptions and severe weather events, the impact is expected to be more severe for Britain. Undoubtedly, the Truss-Kwarteng economic plan and the market reactions exacerbated the situation, but most independent analysts and economists ultimately attribute the dire economic outlook for Britain to Brexit.

According to the OBR, inflation is set to peak at a 40-year high of 11% this quarter; the peak would have been 2.5 percentage points higher without the energy price guarantee. Rising prices are expected to erode real wages and reduce living standards by 7% over 2023/2024, effectively wiping out growth over the prior eight years.

In a report issued earlier this week, the OECD warned that Britain would be the second weakest performer among the global economies (-0.4% in 2023 and would increase only 0.2% in 2024), with only Russia among the G20 members suffering a worse contraction in GDP in 2023 (-5.6%) and 2024 (-0.2%).

An analysis of ONS trade data from the UK in a Changing Europe think tank earlier this month concludes that Britain has not seen "a promised boom in non-EU trade, especially exports but instead stagnation across the board." Moreover, Britain continues to lag behind the rest of the G7 on trade performance since Brexit, and since the end of the transition period has performed the worst.

Chancellor Hunt on Trade Removing Barriers

Recall that last Friday Chancellor Hunt, while rejecting the idea of rejoining the single market, had suggested in an interview with BBC Radio 4 that removing the "vast majority" of trade barriers between Britain and the European Union over time, leading to unfettered trade with neighbors, could lead to a much needed boost in growth.

This came on the heels of the publication of the OBR November Outlook (issued alongside the government's Autumn Statement delivered by the Chancellor). The OBR reported that the latest evidence showed that Brexit had had "a significant adverse trade effect on UK trade via reducing both overall trade volumes and the number of trading relationships between UK and EU firms." The OBR forecasts that Brexit will result in the UK's trade intensity (the measure of an economy's integration with the world economy) being 15% lower in the long run than had the UK remined in the EU. OBR had earlier forecast that the a "Brexit effect" would lead to a long-term hit to UK productivity of 4%.

Swiss-Style Solution?

Two days later, on Sunday (the most eventful day of the week in the British political calendar because of the importance of the Sunday newspapers), the Swiss-style deal burst into the headlines and the PM, at a conference of the Confederation of Business Industry (CBI) in Birmingham on Monday, was forced to row back on any such deal. The backpedalling was needed notwithstanding that the Sunday Times article spoke of a plan with a ten-year time horizon, which incidentally (though unrealistically) was not expected to trip up the emotive red line of free movement.

The PM specifically ruled out "[pursuing] any relationship with Europe that relies on alignment with EU laws." Among other things, he cited the opportunities presented by having the "regulatory freedom" to diverge from EU regulatory standards.

A bit of history: the EU Brexit negotiator Maroš Šefčovič had offered a Swiss-style deal in June 2021 on food and veterinary standards to ease the friction on Great Britain to Northern Ireland (GB-NI) trade, but the proposed agri-food alignment was rejected by the then Brexit minister, David Frost. The EU is not a particular fan of its EU-Swiss arrangements, the foundations for which are over 100 bilateral agreements.[1] The Swiss have selective access to the EU single market, contribute to the EU budget, participate in Schengen and participate in various EU education and research programs. Documentary and identify checks and many physical checks have been removed. Switzerland is a rule-taker.

The problem from the Brexiteers' perspective is that such a deal would require Britain to align food and agriculture standards and accept free movement of people and ECJ jurisdiction. It would also restrict the ability of the UK to strike trade deals outside the European Union.

[1] Switzerland is neither a member of the European Union or the European Economic Area ("EEA"), although together with the three members of the EEA (Iceland, Liechtenstein and Norway) it forms the European Free Trade Association.

Commentators have questioned whether the leak of the Swiss-style deal, which follows a familiar pattern of leak-forceful denial, was intended as a trial balloon (the leak) or as a message to keep the ERG happy (the forceful denial).

Scrapping EU Retained Law

With the economic figures highlighting a depressing outlook, and the Swiss-deal grabbing Westminster's attention, other Brexit-related themes were percolating to a boil, though admittedly this has been an ongoing boil for a while.

As I summarized in a previous briefing note (available here), in a move intended to mollify the Eurosceptic hardliners and in another example of the so-called "party of business" putting ideology before business and market imperatives, the government has been moving forward with legislation (the Retained EU Law (Revocation and Reform) Bill) that could sweep away EU retained law that evolved over 47 years of the UK's EU membership. The initial dashboard of 2,400 pieces of legislation reportedly has grown by a further recently disclosed 1,400 laws. In a letter released yesterday, the Trades Union Congress, Institute of Directors and Chartered Institute of Personnel and Development warned that the Bill would "cause significant confusion and disruption for businesses, working people and those seeking to protect the environment." The Bill also risks breaching the UK-EU Trade and Cooperation Agreement ("TCA"). The government's Regulatory Policy Committee has opined that the impact assessment prepared in support of the Bill is "not fit for purpose."

As the think tank UK in a Changing Europe noted in its October 2022 divergence tracker, echoing criticism from a number of legal experts,

> "[T]the job of reviewing thousands of pieces of law in just over a year is a mammoth undertaking for civil servants, significantly restricting their capacity to focus on other government priorities. Moreover, this leaves very little time to design new legislation to replace EU laws which expire, or to draft and implement restatements of existing EU law. The risk is poorly designed new legislation and gaps on the UK statute book where laws expire before they are replaced (especially in areas like environment and transport which have high levels of retained EU law). The risk of poor legislation is exacerbated by new government powers to amend retained EU law via statutory instrument, giving parliament much less scrutiny over legislative reform."

If nothing else, this effort is destined to create significant uncertainty for business, already suffering from inflation and high energy bills. It is misplaced, as CBI Director-General Tony Danker called out at the Birmingham conference, when he stated that regulation is not "the fault of Europe," but rather "the biggest regulatory barriers facing businesses today are based on British laws, created by a British parliament, and administered by British regulators."

The so-called "sunset effort" highlights yet again how the party of business has shown little willingness to understand what business needs and what it does not need. Ideology trumps business and market imperatives. What businesses selling goods into the European Union can ill-afford is regulatory divergence.

Northern Ireland Protocol

The Guardian reported yesterday that the Northern Ireland minister, Steve Baker, is proposing to reopen the TCA as a way to fix the Northern Ireland Protocol (see my previous briefing note, available here), including removing ECJ jurisdiction over trade disputes. This would be a reprise of a concept that was rejected by EU negotiators in 2017, which rejection led to the Protocol being embedded in the Withdrawal Agreement rather than left for the subsequent TCA. Experts are sceptical that the EU would accept this as retaining ECJ jurisdiction over trade disputes remains a clear EU red line. After all, Northern Ireland remains in the EU customs union and so GB-NI goods must comply with EU regulations on customs and standards.

The connection with the Swiss story is that, since July 2022, the UK has been calling for a so-called "green lane/red lane" approach, with the former for goods destined for Northern Ireland and the latter for goods heading to the Republic of Ireland (and potentially throughout the rest of the European Union). When the EU proposed a Swiss-style arrangement in June 2021 to reduce up to 80% of the checks – on the ground that food and agricultural standards in the UK would be aligned with the EU, as noted above, it was rejected as it was premised on regulatory alignment. The PM's continued embrace of regulatory freedom calls into question whether progress can be made.

Prospects of addressing legitimate issues of friction, as Jill Rutter in a post on the Institute for Government website noted, have been complicated by the fact that the Tories and the PM's two predecessors have let differences over the Protocol escalate well beyond technicalities about customs arrangements and regulatory checks. The UK government's position essentially has been to scrap and rewrite the entire arrangement. That puts the PM between a rock and a hard place.

Concluding Thoughts

As many predicted (*see* my previous briefing note, available here), while "Get Brexit Done" delivered a stunning victory for Boris Johnson in 2019, Brexit today is no more done than it was when the UK left the single market and the customs union.

The benefits of Brexit heralded by the Brexiteers have not materialized. Instead, there is the Brexit effect, and that effect is substantially a negative one. The cornerstone free trade agreement with Australia announced in 2021 (one of three new deals, the others with New Zealand and Japan – the benchmark being deals that are not roll-over EU deals) was panned two weeks ago by the former Environment Secretary George Eustice, who told the House of Commons that the "UK gave away far too much for far too little in return" in negotiating the agreement. (*See also*, *Curb your Enthusiasm* from the UK Trade Policy Observatory.)

The EU does not seem to be in a mood to revisit the Brexit arrangements, with the energy crisis and the war in Ukraine consuming much of the bandwidth of European leaders. In the meantime, there is a looming deadline – April 10, 2023, the 25th anniversary of the Good Friday (Belfast) Agreement, by which the PM promised a deal would be reached on the Protocol. That promise reportedly was made to President Biden last week on the sidelines of the G20 Bali summit.

The Protocol needs to be addressed – this incidentally is a phrase heard repeatedly from experts since the UK left the customs union and the single market – before progress can be made on any of the other trade issues. As CBI Director-General Tony Danker asserted at the Birmingham conference, Britain's growth potential is with the European Union but is "locked up … [b]ecause still, we argue over the Northern Ireland Protocol. Still, we argue over sovereignty. Get round the table, do the deal. Unlock the TCA." In a warning to Brexiteers, he concludes on this point, "the best guarantor of Brexit is an economy that grows. And the biggest risk is one that doesn't."

As for those other trade issues, there is no obvious panacea. Brexit was the ultimate in national self-harm, and the economic cost now is palpable. We stay tuned.

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