

BOLD ACTION IS NECESSARY TO REVERSE THE ADVERSE EFFECTS OF BREXIT, BUT THE SUNAK GOVERNMENT IS NOT POISED TO DELIVER IT

On Tuesday, Rishi Sunak became the third Tory prime minister in eight weeks and the fifth in six years. The Tory party managed to avoid a repeat of the divisive leadership contest held last summer that culminated in Liz Truss' ill-fated and short-lived premiership. Less than seven weeks after losing that summer contest, Rishi Sunak emerged as the sole candidate two minutes before Monday's 2:00 pm deadline set under the hastily re-arranged leadership contest rules drawn up by the 1922 Committee. The threat of a comeback by Boris Johnson failed to materialize as significant numbers of Tory MPs shunned his entreaties for support.

At 42, Rishi Sunak becomes the youngest PM in two centuries and its first British Asian PM. Britain narrowly missed having its first millennial prime minister. He enjoyed a lightening rise to power, reaching the pinnacle after only seven years as an MP. He served in the Johnson cabinet as chancellor, and his resignation last summer was among the key triggers of the downfall of Boris Johnson. He was an early supporter of Brexit, but has never been associated with the ideological hard-line Brexiteer wing. During the summer leadership contest that he lost to Liz Truss, he was viewed with suspicion by the Brexit hardliners (loosely grouped within the European Research Group ("ERG")).

The Headwinds

Economics

Rishi Sunak lands in No. 10 at a time when Britain faces a deep economic crisis. In his first [public statement](#) on Monday after clinching the premiership (slightly shorter than the 90-second resignation statement of his predecessor), he spoke of a "profound economic challenge" and called for stability and unity. There was nothing of substance.

Trussonomics may have been shelved, but do not expect panaceas to spring forth under new leadership. In short, Britain is by no means poised to rebound any time soon. The government has consequential decisions to make on taxes and public spending, at a time when the country faces a cost of living crisis and a looming energy crisis, when the confidence of business and the markets is dangerously low and where the effects of the pandemic, the climate crisis and the upending of the geopolitical order by Russia remain ever-present. The publication of the [medium-term fiscal plan](#) (otherwise known as the "Autumn Statement"), together with the forecast of the Office for Budget Responsibility, has been [pushed back](#) from October 31 to November 17. The plan will need to cover tax increases/reversals of tax cuts as well as cuts in spending in order to offset what is estimated to be a £30-40 billion deficit. (Media reports suggest the target will be £50 billion, as the efforts themselves will reduce short- to medium-term tax revenues, hence the need for more headroom.)

Political/Ideological

The new PM's challenges are by no means confined to economics. He (together with his chancellor) faces political headwinds as he tries to unite the disparate factions of the Tory party, whose views on management of the economy – taxes and spending, immigration and the entire Brexit project may well put his call for unity beyond his reach. The Tories are not only split between the supporters of a hard Brexit and the more moderate elements, but also

within each camp. The divisions are deep and fundamental – the infighting is likely to continue.

Rishi Sunak has kept Suella Braverman, who represents the anti-immigration hard-line wing (and champions the Rwanda deportation plan), as home secretary, this despite her forced resignation from the Truss government last week due to a security breach. (Doubts about her account of the breach surfaced earlier this week.) He brought Dominic Raab (another Brexit hardliner, whom Liz Truss declined to bring onboard) back into the cabinet as deputy prime minister and justice secretary. Jeremy Hunt, who stays on as chancellor, represents a more moderate wing. He may not have been Rishi Sunak's first choice, but he did stabilize the markets.

At the top of the in-box is the Northern Ireland Protocol Bill (the "Protocol Bill") and a host of issues left unresolved by the UK-EU Trade and Cooperation Agreement (see my previous briefing note, available [here](#)). The Protocol Bill, which, in effect, allows the government to override parts of the Northern Ireland Protocol (see my previous briefing note, available [here](#)), continues to wind its way through Parliament, and while talks between Brussels and London were restarted a few weeks ago under Liz Truss, it is unclear where the new PM, who supported Brexit but is no ideologue, sits on the Brexit continuum in reference to the Protocol as well as the range of other issues (including access to the EU Horizon research program) yet to be addressed.

Given the turmoil in Westminster over the past months, it is unclear how far EU negotiators are prepared to go in their negotiations with London. Is Britain prepared to be engaged seriously and can negotiators deliver the requisite Tory party support for any concessions made? The PM will also be looking to reset relations with Washington – Liz Truss did not endear herself with her comments on Speaker Pelosi in the context of "delivering on Northern Ireland" or her trickle-down economics orthodoxy, and reportedly was taken aback by the level of US concern over the Northern Ireland Protocol Bill. Recall that the new PM, unlike his two predecessors who both served as foreign secretary, has little foreign policy experience. Official Washington is likely looking to Treasury Secretary Yellen for insights on the new PM.

Also then on the agenda are:

- the potential withdrawal of Britain from the European Court of Human Rights;
- the plan to deport asylum seekers to Rwanda (Suella Braverman [spoke](#) earlier this month of her dream of seeing migrants deported to Rwanda before Christmas); and
- the proposed [Retained EU Law \(Revocation and Reform\) Bill](#) (the "EU Retained Law Bill") that, in effect, would empower government ministers to amend, replace or repeal, by the end of 2023, potentially over 2,400 pieces of "retained EU legislation," affecting a range of protections developed over 40 years, including in respect of the environment and workers' rights (encompassing over 300 policy areas across 21 sectors of the British economy). The default would be repeal ("sunset"), unless any particular piece of legislation is amended or replaced. (See the UK government's retained EU law [dashboard](#).) Some believe the new PM would extend the sunset date to the tenth anniversary of the Brexit referendum (2026), provision for which is made in the Bill. Parliament [issued](#) a call for evidence earlier this week on the Bill.

The Elephant in the Room

The irony is that while Brexit has had, and is continuing to have, significant adverse impacts on Britain’s economy and British business (as well as a host of other areas), there is no formal move to address the underlying source of the problem, namely the withdrawal of Britain from the single market and customs union. While the Tories have a massive rebranding effort ahead of them to improve the reputation of the party tarnished first by a crisis of integrity under Boris Johnson and then a crisis of economic incompetence under Liz Truss, it is hard to see a Sunak-led government breaking with the hard-Brexit orthodoxy. Similarly, although for different reasons, Labour, whose leader this past summer set out a [five-point plan](#) to “make Brexit work,” has made no effort to re-imagine a return to the single market or customs union. The New Statement last summer characterized this as a “conspiracy of silence [that] pervades British politics.”

Ultimately though, there would be significant benefits to rejoining the single market and/or the customs union¹. This is not about seeking to rejoin the European Union, but rather to find a way to fix the strained relationship with the European Union and address the myriad causes of friction between the European Union and Britain.² The reality is that a purported benefit of Brexit -- a series of independent trade deals – is no substitute for the benefits of being part of the customs union and single market. And this is not hypothetical. While all of the advanced economies have faced pressures starting with the pandemic, and more recently from the war in Ukraine and rising energy prices, no country has fared as poorly as Britain, and the reason is Brexit. While the pandemic and the war have served to obscure some of the Brexit effects, those effects nonetheless are palpable and measurable.

¹ Prior to Brexit, as a member of the European Union, Britain was part of the EU single market and the EU customs union. Incidentally, one can be a member of a single market and not a customs union, and vice versa.

- A customs union is a free-trade area with a common external tariff regime, with all members of the customs union applying the same duties to imports from third countries. Goods move freely within the customs union. No single member of a customs union can enter into its own free trade agreement with a third country. The European Union and Turkey form part of a customs union.
- In the EU single market, goods, services, people and capital move freely among the members – these are the founding principles, the four freedoms. The predicate for the single market is harmonized rules and regulations. The three members of the European Economic Area (EEA) form part of the EU single market, but are not members of the EU customs union, as a result of which they are free to enter into their own trade deals with third countries.

One of the options considered following the Brexit referendum was a “Common Market 2.0” or “Norway plus” arrangement in which Britain would join the EEA (and thereby have full access to the EU single market) together with a customs union. This would have been a “soft Brexit.”

² According to a [report](#) issued by the Tony Blair Institute for Global Change (October 2022), based on polling of Britons conducted by JL Partners,

- 60% believe Brexit has had an adverse effect on the UK economy, including 34% who voted Leave.
- Regarding the effects of Brexit on their lives, 63% view the trade impact negatively and 54% view the cost/ease of doing business with the European Union negatively.
- 58% would favor the UK government forging a workable relationship with the European Union.
- 70% think that, over the medium-term, Britain should have a closer relationship with the European Union, although only a third think Britain should rejoin the single market.

As a result of the non-tariff barriers that the UK-EU Trade and Cooperation Agreement failed to address, small and medium-sized British businesses face delays, increased costs and significant administrative burdens, including having to comply with trade rules across 27 different jurisdictions. The workaround of setting up a physical operation in an EU member state – to access the other 26 without trade friction – has had a direct negative effect on economic activity and jobs in Britain.

Concluding Thoughts

While bold action to address the continuing burdens of Brexit could steer the economy in a better direction, Britain has neither the political leadership that can propose it nor the parliamentary configuration that can deliver it. Rishi Sunak has to deal with the fiscal items in his in-box as a matter of urgency, and in doing so will also have to contend with the competing interests of his fractious party. On the fiscal side, he has little choice but to increase taxes and cut spending. The former certainly will be deeply unpopular across the Tory party. On the political side, the two pieces of legislation that pose the greatest threat to perceptions on the part of the bond and f/x markets, business and international allies that he can deliver stability and unity are bills championed by the Brexit hardliners – the Protocol Bill and the sunset provisions in the Retained EU Law Bill. The markets may have calmed down, but with less room to manoeuvre as a matter of fiscal policy given the bleak fiscal outlook, Rishi Sunak may conclude he has little choice but to push the hard-line political agenda to appease the ERG.

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