

How bright are the prospects for UK trade and prosperity post-Brexit?

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Abstract

So long as the UK government liberates itself from the protectionist mindset of the EU and reduces trade barriers after Brexit, and UK businesses respond positively to the challenge of increased international competition (through increased productivity), the prospects for UK trade and prosperity post-Brexit are very bright indeed. The EU itself acknowledges that 90% of future growth in global GDP will be outside the EU. The costs of remaining in the EU are very high and not all purely economic: the EU is no longer a force for global liberalisation. On the basis of both international and EU law, the monetary costs to the UK of leaving the EU should be fairly low. Similarly, the frictional costs to both the UK and the EU of their post-Brexit trade relationship should also be low. However, as a consequence of both the concessions made to date by the UK in order to demonstrate its goodwill and the hard line taken by the EU in order to discourage other member states from leaving, these costs could well end up being much higher than they need be for both sides. Of particular concern is the EU's 'level playing field' demand, laid out in its negotiating Guidelines for a future trading relationship. This would effectively prevent the UK from achieving regulatory autonomy or from pursuing an independent trade policy. The Treasury predicts a 7.7% reduction in GDP in the event of 'no deal' in which the UK retained the existing Common External Tariffs with the rest of the world and also imposed the same tariffs on trade with the EU. However, EU barriers on trade in food and manufactures raise their prices by 20%. If the UK leaves the Customs Union and these barriers are reduced from 20% to 10%, UK GDP would rise by 4%. The cost of meeting the excessive regulatory standards of the Single Market is equivalent to 2% of GDP. If the UK also leaves the Single Market, UK GDP would rise by 6% in total.

Keywords: international trade, Brexit, protectionism, tariffs, Customs Union, Single Market
JEL classifications: F13, F40, F59

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How bright are the prospects for UK trade and prosperity post-Brexit? The short answer is that they will be inversely related to the size of the tariffs on international trade that the UK itself sets after Brexit. But both the question and answer can only be fully understood after considering two sets of costs: those of remaining in the European Union and those of leaving it. The EU has created the illusion that it is simultaneously both a worker's paradise – given the social protections it guarantees to workers – and capitalism's best friend – given how effectively businesses can lobby Brussels to raise barriers against imports from outside the EU.² It even claims that it has brought lasting peace to Europe after centuries of conflict, whereas it is NATO that has a much greater entitlement to this claim. So successful has the EU been in perpetrating this myth that it won the Nobel Peace Prize in 2012. The reality is rather different.

The costs of remaining in the EU

The costs of remaining in the EU are very high and they are not all purely economic.

First, the EU is a fundamentally protectionist trading bloc. Big business lobbies Brussels for more regulations to make it more difficult for small companies to enter the market and compete – whether these companies come from the EU or not.³

The Customs Union, to which all EU member states belong, imposes a set of Common External Tariffs covering more than 13,000 imported goods, while allowing tariff-free trade between member states. Table 1 provides some examples. As a result of these tariffs, EU consumers are paying an average of 17% above world prices on food.⁴ One example of this is tuna from the Maldives which attracts a 24% tariff, but is tariff free if it is destined for processing in the

² The most striking evidence for this claim is the support of the Confederation of British Industry and Institute of Directors for the Labour leader Jeremy Corbyn – someone who has devoted his entire political career to destroying capitalism – in his ambition to keeping the UK in the EU Customs Union after Brexit (Benjamin Kentish (2018) Business bodies throw support behind Corbyn's calls to keep customs union after Brexit, *Independent*, 27 February).

³ Simon Boyd, managing director of REIDSteel and a member of the CBI Manufacturing Council, argues that 'The Customs Union is no more than a protectionist racket. ...It is the opposite of fair trade. It damages many businesses throughout the UK and serves to control the market as the big players like. Membership has been harmful for us and other British businesses. It has excluded many of our traditional markets, particularly the Commonwealth; it prevents us from making our own trade agreements worldwide. ... I and many others have been working for decades to try and highlight just how damaging our membership of the EU has been to us. We have seen our international trade shrink and have watched over the demise of our manufacturing capabilities as businesses have been less able or willing to invest for the future. Our productivity has plunged because it is often easier to invest in cheap labour rather than train and invest at home. Multinationals have seen fit to export our jobs and expertise to other locations where labour is cheaper and incentives are greater, often with help from the EU: our money being spent to export our jobs and our industries. Our massive trade deficit in the Single Market and the Customs Union outweighs all of the other downsides and costs of belonging to the EU: nearly 5% of our GDP' (Simon Boyd (2018) SMEs have felt first-hand the negative effects of the EU and its Customs Union, *Brexit Central*, 2 May).

⁴ The Institute for Economic Affairs estimates that the Common Agricultural Policy raises food prices by 17%; <https://iea.org.uk/blog/abolish-the-cap-let-food-prices-tumble>

EU, thereby allowing European manufacturers to capture the bulk of the value added of this import from a developing country.⁵ Another is cocoa: ‘While the import duties for unprocessed cocoa beans is rather small, the EU charges 30% for processed cocoa products like chocolate bars or cocoa powder, and 60% for some other refined products containing cocoa’.^{6, 7}

Dairy products	35.4
Sugars and confectionery	23.6
Beverages and tobacco	19.6
Cars, trucks and lorries	16.0
Animal products	15.7
Cereals and preparations	12.8
Fish and fish products	12.0
Clothing	11.5
Fruit, vegetables and plants	10.5
Textiles	6.5
Coffee, tea	6.1
Oilseeds, fats and oils	5.6
Chemicals	4.5
Transport equipment	4.3
Leather, footwear etc	4.1
Other agricultural products	3.6
Electrical machinery	2.8
Other manufactures	2.6
Petroleum	2.5
Minerals and metals	2.0
Non-electrical machinery	1.9
Wood, paper etc	0.9
Cotton	0.0
Sources: WTO World Tariff Profiles 2017, p.82; https://publications.parliament.uk/pa/ld201617/ldselect/ldcom/169/16906.htm	

There are also significant non-tariff barriers (NTBs).⁸ These are often justified on environmental or health and safety grounds in line with the EU’s ‘precautionary principle’,

⁵ Ahmed Shiaan (2017) On behalf of the Maldives, I don’t just respect the Brexit vote – I welcome it, *Brexit Central*, 11 December.

⁶ <http://www.dw.com/en/high-duties-keep-food-imports-from-poor-countries-out-of-europe/a-5127705>

⁷ There are many more examples: see, e.g., Kevin Dowd (2018) Remainer Lord Hannay is wrong about EU tariffs on African imports, *Brexit Central*, 24 April.

⁸ These include quotas, prohibitions, import licences, product standards (such as regulatory standards on labelling and testing), dual certification, customs documentation requirements and border delays, and rules of

but are in reality mostly just forms of protectionism and market distortions. One example of this is the ban on Basmati rice from India due to concerns about pesticides and residues that can be barely measured scientifically. Another is the General Data Protection Regulation which prevented services involving data flow being included in the trade deal with Canada. Shanker Singham argues that 'more and more EU regulation is prescriptive and anti-competitive in nature. The EU will not grow vibrantly but will continue to destroy wealth for its own citizens and also for the rest of the world. The EU is therefore no longer a force for global liberalisation'.^{9, 10}

It is also very important to note that NTBs are illegal under WTO rules which forbid any form of discrimination on standards between home and foreign products or between the foreign products of different countries.¹¹ The same applies to services.¹² Dyson – which manufactures its products in Asia – has won a court case against the EU Commission by successfully arguing that EU energy labelling regulations were based on tests which favoured German manufacturers.¹³

Then there is the Single Market¹⁴ which is claimed to be the jewel in the crown of the EU with its four freedoms of movement – of goods, services, capital and people. But the Single Market is not a free trade area, rather it is a single protectionist zone where regulations are standardised and all goods and services produced must satisfy these regulations whether or not they are sold in other member states. Only 6% of UK companies trade with the EU – accounting for around 12% of GDP¹⁵ – yet 100% of UK regulations are determined in Brussels, including for the 94% of UK companies that do not trade with the EU.^{16, 17}

origin requirements. Rules of origin are the criteria used to determine the national source of a product: they are used to set duties and restrictions on imported products;

https://www.wto.org/english/tratop_e/roi_e/roi_info_e.htm

⁹ Shanker Singham (2018) EU's regulation obsession is protectionist in nature, *Daily Telegraph*, 22 February.

¹⁰ This is particularly true of financial services regulation as Ashley Fox MEP points out: 'Many of my colleagues in Europe get very worried about entrepreneurs and banks solving problems. They sometimes see innovation as something that should be controlled and managed. As a result, the EU often ends up writing blunt regulations that stunt progress and hurt European competitiveness, despite the best intentions. We have got into the habit of writing regulations that are not flexible or adaptive but blanket restrictions applied across countries and sectors; reworkings of current law rather than thinking differently' (Ashley Fox (2018) Time the EU updated its way of regulating financial services, *Financial News*, 14 May).

¹¹ WTO (2018a), WTO Technical Barriers to Trade Agreement (TBT);

https://www.wto.org/english/tratop_e/tbt_e/tbt_e.htm

¹² WTO (2018b), The GATS (General Agreement on Trade in Services);

https://www.wto.org/english/tratop_e/serv_e/gatsqa_e.htm

¹³ See Patrick Minford (2018, p.6) How the Civil Service has misled us on the Costs of Brexit and the Customs Union, Economists for Free Trade, May; <https://www.economistsforfreetrade.com/wp-content/uploads/2018/05/EFT-How-the-Civil-Service-has-misled-us-on-costs-of-Brexit-and-the-customs-union-May-2018.pdf>

¹⁴ Also known as the Internal Market.

¹⁵ Gross domestic product.

¹⁶ <http://www.bbc.co.uk/news/uk-politics-eu-referendum-36029211>

¹⁷ Richard Tice argues that 'Being encased by the protectionist wall of the EU's Customs Union has kept prices of food, clothing and footwear artificially high, while uncontrolled unskilled EU immigration thanks to our

The UK, in particular, has seen little economic benefit from the Single Market.¹⁸ UK goods exports to the 11 fellow founding members of the Single Market have grown over the years 1993-2015 at just 1% pa. Over the same period, UK goods exports to the 111 countries with which it trades under World Trade Organisation (WTO) rules have grown at 2.88% pa, nearly three times faster.¹⁹ This helps to explain why UK trade with the EU has fallen from 60% to 43% since the Single Market was introduced. Services account for 80% of the UK economy but only 38% of the UK's service exports go to the EU, amounting to just 5% of GDP. The result is a £14bn services surplus but a £96bn goods deficit with the EU, leaving an overall £82bn trade deficit in 2016.²⁰

Even strong supporters of the EU concede that the Single Market is 'not visible in the macro statistics.... the data are telling us a different story – that the Single Market is a giant economic non-event, for both the EU and the UK'.²¹ Federik Erixon and Rosita Georgieva go further:

New initiatives to reform the Single Market are often presented as initiatives to “complete the Single Market”. However, they have all fallen substantially short on that ambition, and Europe is far away from having a Single Market. In fact, it is further away from it now than ten years ago. The European economy has undergone profound structural changes, and as the economy has shifted profile, it has moved further into sectors and areas where there is very little of the Single Market. The more Europe's economy grows dependent on services and the digital sector, the less Single Market there will be in Europe.

Arguably, the piecemeal approach has prevented Europe from reaping the gains of structural change, and the relative policy conditions between sectors have damaged Europe's desire to grow faster on the back of new sectors and services. The failings of Europe's Single Market are becoming ever more evident and, left unaddressed, will

membership of the Single Market has depressed the wages of working people. These two factors have conspired to hit the pockets of the poorest in society' (Richard Tice (2018) Start measuring the countdown to freedom and opportunity in days, not years, *Brexit Central*, 27 March).

¹⁸ In 2005, an internal Treasury report, which later emerged because of a Freedom of Information request, found that the Single Market had only a marginal impact on UK trade. Furthermore, the UK has actually seen little benefit from its membership of the EU.

¹⁹Michael Burrage (2017) The Single Market promised much, but delivered little, *CAPX*, 27 April; Michael Burrage (2017) The disadvantages of Single Market membership remain as clear as ever, *Brexit Central*, 16 July; Michael Burrage (2017) *It's Quite OK to Walk Away: A review of the UK's Brexit options with the help of seven international databases*, Civitas, April.

²⁰ Statistics on UK-EU trade, House of Commons Library Briefing Paper, Number 7851, 7 November 2017; <http://researchbriefings.files.parliament.uk/documents/CBP-7851/CBP-7851.pdf>

²¹ Wolfgang Münchau (2015) Would it actually matter if we left the EU?, *Financial Times*, 18 June. The UK has seen little benefit from its membership of the EU. Annual average real per capita GDP growth was 2.4% during 1950-1973, 1.8% during 1973-1995, 2.6% during 1995-2007 and 0% during 2007-2014.

cause real economic disintegration in Europe and depress the rates of productivity and economic growth.

Furthermore, given the vast complexity of regulations in Europe, and the increasing layers of bureaucracy they entail, it is difficult to see how improvements could be made without a vast overhaul of the structure of regulations and the design of the Single Market. And such a reform has to start from a completely different proposition: Europe's ambition should not be to continue building its Single Market, it should be to create a European market. As reforms are moving closer to areas like digital services, energy, and advanced business services, it is evident that the improvements that can be made in Europe's integration is less about classic Single Market reforms and more about building adequate market institutions and advance structural reform.²²

Second, the EU seriously misallocates resources. Take the EU Budget: 40% goes to farmers, mostly to the richest farmers with the largest farms. Yet agriculture accounts for only 1% of GDP across the EU. The Common Agricultural Policy encourages overproduction. We used to have wine lakes and butter mountains. Now we have the surplus production being dumped in overseas markets. A current example is the dumping of tinned tomatoes in Africa, in particular Ghana, which leads to a significant distortion to the local market and a reduction in the income of Ghanaian tomato farmers.²³

Third, the EU is a political project that is fundamentally anti-democratic as a whole range of European leaders have made abundantly clear:

- 'Europe's nations should be guided towards the super-state without their people understanding what is happening. This can be accomplished by successive steps, each disguised as having an economic purpose, but which will eventually and irreversibly lead to federation' (Jean Monnet, founding father of the EU, letter to a friend, 30 April 1952)^{24, 25, 26}
- 'We're not here to make a single market – that doesn't interest me – but to make a political union' (Jacques Delors, former EU Commissioner)²⁷

²² Federik Erixon and Rosita Georgieva (2016) *What is wrong with the Single Market?*, European Centre for International Political Economy.

²³ <http://news.bbc.co.uk/1/hi/programmes/panorama/2823015.stm>

²⁴ Monnet also went on to say 'I have always believed that Europe would be built through crises, and that it would be the sum of their solutions. But the solutions had to be proposed and applied' (Quoted in John Lanchester (2016) *The Failure of the Euro*, CAPX, 24 October; <http://capx.co/external/the-failure-of-the-euro/>)

²⁵ Michel Barnier, who is favourite to replace Jean-Claude Juncker when his term as president of the European Commission comes to an end, goes further than this and wants a unified Europe and not just a federal Europe (mentioned to Nigel Farage at their meeting in Brussels on 8 January 2018 and reported on Farage's LBC show on 14 January 2018).

²⁶ Adrian Hilton has used the same words in *The Principality and Power of Europe: Britain and the Emerging Holy European Empire*, Dorchester House Publications, Rickmansworth, 1997.

²⁷ John Ishiyam, William J. Miller, and Eszter Simon (Eds) (2015) *Handbook on Teaching and Learning in Political Science and International Relations*, Edward Elgar, p.379.

- ‘We now seek political unification, the construction of a United States of Europe’ (Helmut Kohl, German chancellor, 1991)²⁸
- ‘There can be no democratic choice against the European Treaties’ (Jean-Claude Juncker, president of the European Commission, in ‘Greece: The dangerous game’, *Le Figaro*, 1 February 2015).^{29, 30}

There is supposed to be ‘double democracy’ in the EU – represented by the European Council and the European Parliament – but the reality is that the EU is run by the bureaucrats of the European Commission who run rings around ministers from national governments³¹ as well as EU parliamentarians. The latest example of this is the appointment of Martin Selmayr, former chief of staff (‘head of cabinet’) to Jean-Claude Juncker, as secretary-general of the European Commission in February 2018, following an internally advertised vacancy for deputy secretary-general. There was only one other candidate for this post, Clara Martinez Alberola, Selmayr’s own deputy as chief of staff. She dropped out of the running and Selmayr was duly appointed deputy secretary-general. Within nine minutes of Selmayr’s appointment, the incumbent secretary-general, Alexander Italianer, resigned and Selmayr was promoted to secretary-general, while Clara Martinez Alberola was promoted to chief of staff, Selmayr’s old job. There was outrage in the European parliament, with French MEP Françoise Grossetête describing Selmayr’s appointment as a ‘mystification worthy of the Chinese Communist Party’. But at a parliamentary hearing in March 2018, Günter Oettinger, the commissioner for budget and human resources, insisted that the rules were followed in ‘the supranational spirit of the European public administration’ and Juncker said he would resign if Selmayr’s appointment was overturned.³²

This is little better than authoritarianism – which makes it much harder for the Commission to deal with other forms of authoritarianism in the EU. On 20 December 2017, the

²⁸ John Ishiyam, William J. Miller, and Eszter Simon (Eds) (2015) *Handbook on Teaching and Learning in Political Science and International Relations*, Edward Elgar, p.379.

²⁹ The way in which the 1992 European Communities Act – which took the UK into what became the EU – was passed in the House of Commons by means of a secret agreement between the Tory Chief Whip, Francis Pym, and pro-European Labour MPs, such as Roy Jenkins and Shirley Williams, has also been described as anti-democratic by Tony Benn: ‘It was a coup d’état by a political class who didn’t believe in popular sovereignty. That’s what it was – a coup d’état. The power was seized by parliamentarians. They seized power that did not belong to them and used it to take away the rights of those they represented’ (*Europe: Them or US – An Island Apart*, BBC2, 12 April 2016).

³⁰ A particularly interesting illustration of this statement is the way in which the EU Constitutional Treaty – designed to set up a United States of Europe with a president, a foreign minister, an army, and an anthem – failed to get ratified in 2005 – when the French and Dutch rejected it in referenda – only for it to re-emerge as the Lisbon Treaty which was then ratified by member state parliaments – without a referendum – in 2007 (see James Holland (2017) Europe is still living with the consequences of the Lisbon Treaty, *CAPX*, 15 December).

³¹ This was well illustrated in an interview with former UK government minister Kenneth Baker conducted by Peter Hennessy on BBC Radio 4’s *Reflections* programme on 23 August 2016. Lord Baker reported that it is common for European Commission civil servants to come up with proposals which were rejected by ministers from national governments only to come back with a virtually identical set of proposals a few months after these ministers have moved on to other responsibilities; <http://www.bbc.co.uk/programmes/b07pgvjg>

³² Bruno Waterfield (2018) Anger grows over aide promoted by Juncker, *The Times*, 27 March.

Commission activated Article 7 of the Treaty on European Union (TEU)³³ against Poland citing ‘a clear risk of a serious breach of the rule of law’ on the grounds that the Polish government’s recent reform of the judicial system threatened the independence of the judiciary in violation of the EU’s common values as defined in Article 2.³⁴ The Commission has proposed an injunction against Poland which could lead to sanctions, including the loss of voting rights. However, the proposal requires unanimity by member states and Hungary’s prime minister, Viktor Orban, has promised to block it.³⁵

More shocking still is the way the British establishment of senior politicians and civil servants hid from the electorate the real objectives of the European Union at the time the UK joined in 1973 (what was then the European Economic Community and which became the EU in 1993). This is clearly shown in a classified paper prepared by a senior civil servant for the Foreign and Commonwealth Office in April 1971 and labelled FCO30/1048. The paper – which was initially withheld under the Official Secrets Act – made it clear that the EU was preparing for economic, monetary and fiscal union, with a common foreign and defence policy. It also made clear that ‘Community law’ would take precedence over UK courts and that ever more power would pass away from the UK parliament to Brussels. The paper acknowledged this would lead to a ‘popular feeling of alienation from Government’ and politicians were advised ‘not to exacerbate public concern by attributing unpopular measures... to the remote and unmanageable workings of the Community’. It anticipated that this strategy could last ‘for this century at least’ – by which time the UK would be so subordinated to Brussels, it would be impossible to leave the EU.³⁶

Fourth, is the ‘purposive’ nature of EU law³⁷ which allows the European Court of Justice (ECJ) to interpret and reinterpret the wording of EU laws in line with the European Commission’s (often changing) intentions.³⁸ This is reinforced by the Lugano doctrine whereby the ECJ

³³ More commonly known as the Maastricht Treaty.

³⁴ For an alternative interpretation of Poland’s actions, see Andrea Hossó (2018) Central Europe and Spain show the EU’s double standards in enforcing ‘democratic values’, *Brexit Central*, 3 January.

³⁵ Alex Barker, Michael Peel and James Shotter (2017) EU set for unprecedented rebuke to Poland over ‘authoritarianism’, *Financial Times*, 20 December.

³⁶ Lara Deauville (2018) We were lied to! Secret document FCO 30/1048 kept truth about EU from British for 30 years, *Daily Express*, 12 May.

³⁷ <http://e-lawresources.co.uk/Purposive-approach.php>

³⁸ German lawyer Gunnar Beck argues that ‘It is difficult to overstate the case that the ECJ is neither an impartial nor a conventional court. ... [I]n interpreting EU law the ECJ does not ... accord primacy to the ordinary meaning of words as most other international courts. Instead the ECJ adopts an ultra-flexible approach which allows the ECJ to choose between various interpretative criteria – literal, contextual, purposive and meta-teleological – and to give the greatest weight to whichever criterion best promotes a pro-EU outcome. For instance, this approach allows the ECJ to depart from the wording in favour of a purposive interpretation even where the wording of the relevant provision is neither ambiguous nor leads to an absurd outcome. Purposive interpretations generally give courts far greater interpretative room for manoeuvre than text-based interpretations. Specifically, the problem with purposive interpretations of law is that courts, and the ECJ more so than any other court, do not confine themselves to purposes written into the documents they are asked to interpret and has used the purposive approach to resolve legal disputes concerning the distribution of powers between the EU and its members in a pro-integrationist manner. In this manner, the

claims exclusive competence in increasing areas of private international law.³⁹ This contrasts with the clarity and precision of English laws. A further issue relates to the EU legal convention that everything is prohibited unless it is permitted, which requires constant appeals to the ECJ to grant permission. This contrasts with the English common law tradition where everything is permitted unless it is prohibited.⁴⁰ These factors explain why many EU companies prefer to draw up contracts subject to English rather than EU law because of the greater legal certainty of interpretation.

Fifth, there is the folly of introducing the euro across a group of countries whose economies were so disparate that the operation of a single monetary policy with a single Eurozone interest rate was inevitably going to lead to a pattern of booms and busts in the peripheral states when the interest rate is set to meet the needs of core economies, such as Germany. In addition, the way in which exchange rates were fixed at the start of monetary union resulted in Germany joining at too low an exchange rate, while the peripheral countries joined at too high an exchange rate. This inevitably led to the mainly northern members of the Eurozone, especially Germany, building up large trade surpluses⁴¹ and the southern members, such as Italy and Spain, building up corresponding deficits. In unified or federal states, such as the UK and US, the national government is able to use fiscal stabilisation policies to transfer resources from surplus to deficit regions to prevent recessions in the latter. But Germany refuses to take part in such a 'transfer union' resulting in a widening North/South split on the issue of fiscal and economic responsibility. Germany insists the deficits are removed by the other economies becoming as efficient as it is.⁴² The deficits building up in Target2, the Eurozone payments system, by countries such as Spain and Italy,⁴³ are so serious that it is very likely that the Eurozone will implode – and do so sooner rather

court has over time and without textual support in the Treaties substantially extended the scope of EU law and established its own judicial oversight over many areas of national law. It has not infrequently done so in a departure from clear language in the Treaties or EU legislation'. (Gunnar Beck (2018) The European Court of Justice should not adjudicate Treaty rights in post-Brexit Britain, *Brexit Central*, 4 May).

³⁹ http://www.ce.uw.edu.pl/pliki/pw/y13_niedzwiedz.pdf

⁴⁰ A current example is the General Data Protection Regulation which is having a 'stifling impact' on businesses and organisations that possess 'personal data' which could include anything written about a person in an email, for example, and hence susceptible to a subject access request (see Daniel Stafford (2018) The GDPR chaos is a reminder of how taking back control will allow us to make better laws, *Conservativehome*, 3 May).

⁴¹ Not only within the EU, but also globally.

⁴² The first budget of the new German finance minister, Olaf Scholz, is as rigid as that of his predecessor, Wolfgang Schäuble, in its adherence to balanced budgets, debt repayment and fiscal discipline (Jeremy Warner (2018) Trump may actually be doing some good in targeting the Eurozone's destabilising trade surplus, *Daily Telegraph*, 8 May).

⁴³ <http://www.eurocrisismonitor.com/>

than later.⁴⁴ In the meantime, the southern member states are stuck in a Japanese-style deflation trap.⁴⁵

Sixth, is the demographic ageing of the EU's population, resulting from a combination of rising life expectancy and declining fertility. Europe's share of the world's population has fallen from 20% in 1900 to 7% today, and could well fall to 4% by 2100 when the global population reaches 12bn people.⁴⁶ Jean-Claude Juncker has conceded that 'We are demographically weakened, and will remain so. ...Economically, we see the end of Europe's glorious years compared with what others are doing. ...The European Union is not going very well'.⁴⁷ Douglas Carswell, the former MP for Clacton, somewhat unkindly likened the UK's membership of the EU to being 'shackled to a corpse'.⁴⁸

Seventh, the EU has inadvertently encouraged regional separatist movements to develop in a number of member states in the mistaken belief that these regions can become 'independent' members of the EU 'with a seat at the top table'. Current examples are Scotland, Catalonia and Corsica.⁴⁹ Now, the EU does not directly support this, and Jean-Claude Juncker has made clear that he does not want 'an EU with 95 different countries tomorrow, or the day after. We would lose control. National unity and European unity are things that go together'.⁵⁰ Yet, as US economist Dani Rodrik points out 'the nation state has proved remarkably resilient and remains the main determinant of the global distribution of income, the primary locus of market-supporting institutions, and the chief repository of personal attachments and affiliations...The nation state remains the only game in town when it comes to providing the regulatory and legitimising arrangements on which markets rely'.⁵¹ This view is, of course, inconsistent with Juncker's own federalist objectives for the EU which are likely to lead to a dangerous weakening of the nation states of Europe without replacing them with anything that is sufficiently resilient and robust and which would command the same degree of loyalty.⁵²

⁴⁴ See David Blake (2018) Target2: The silent bailout system that keeps the euro afloat. Italian senator Alberto Bagnai says that 'Everybody now knows that there will have to be a negotiated orderly dismantling of the euro' (quoted in Ambrose Evans-Pritchard (2018) Whoever governs Italy will destroy the euro from within, *Daily Telegraph*, 7 March).

⁴⁵ Ambrose Evans-Pritchard (2018) Bundesbank back in charge of ECB, sending shivers through Italy, *Daily Telegraph*, 8 May).

⁴⁶ Professor Hans Rosling (2017) Don't panic, *This World*, BBC2, 9 February.

⁴⁷ Matthew Holehouse (2015) Europe's glory days at an end, warns Juncker, *Daily Telegraph*, 22 October; http://europa.eu/rapid/press-release_SPEECH-15-5889_en.htm

⁴⁸ Rowena Mason (2012), Britain 'shackled to corpse' of EU, says Douglas Carswell, *Daily Telegraph*, 26 October.

⁴⁹ Virtually every member state of the EU has similar movements, see

https://en.wikipedia.org/wiki/List_of_active_separatist_movements_in_Europe

⁵⁰ 'No repression in Catalonia, Spain is not Yugoslavia', Tanjug, 27 October 2017;

https://www.b92.net/eng/news/world.php?yyyy=2017&mm=10&dd=27&nav_id=102659

⁵¹ Dani Rodrik (2017) *Straight Talk on Trade: Ideas for a Sane World Economy*, Princeton University Press.

⁵² The EU has shown itself to be incapable of controlling its own external borders. Frontex has only 1000 employees.

Eighth, there is increasing euroscepticism in the EU, demonstrated by the East/West split over the immigration and internal security crises. The Visegrád Group, comprising the Czech Republic, Hungary, Poland and Slovakia, is challenging the authority of Brussels by refusing to accept migrant quotas imposed by Brussels. Viktor Orban has said: 'All the institutions of the EU have utterly failed. Neither the European Commission, nor the European Council, nor the European Parliament protected the Schengen Treaty'. Jean Asselborn, Luxembourg's foreign minister, responded by saying that the Visegrád Group's refusal to accept immigrants and relieve the pressure on Greece and Italy was the biggest problem facing Europe. He suggested that only the ECJ could force the group's members to fulfil their migrant quota. Italian MEP Marco Zanni, from the Europe of Nations and Freedom Group, predicted a growing tension within the EU as its leaders fail to address with these issues.⁵³

Finally, there is massive corruption in the EU, well illustrated by the fact that the EU's accounts have not been approved for the last 20 years by the EU's chief auditor in respect of around €100bn of expenditures.⁵⁴

Governed as it is from a centre run by bureaucrats rather than politicians, it is readily apparent that the EU is incapable of reforming itself.⁵⁵ As an institution driven by process rather than outcomes, it is drowning in its own rules and this is stifling innovation.⁵⁶ It should be clear from the above that remaining in the EU is the high risk strategy – not leaving it.

Some go further and suggest that the EU shows all the signs of an empire about to collapse.⁵⁷ A recent example of this is Professor Gwythian Prins who builds on the model developed by US archaeologist Joseph Tainter to explain the collapse of ancient empires like those of Rome, Minoa and the Egyptian Old Kingdom.⁵⁸ Tainter's model showed that as empires grow they

⁵³ Jon Rogers (2017) Tusk pens letter to EU leaders BEGGING them to align against UK on Brexit as cracks appear, *Daily Express*, 18 October; Ross Logan (2017) EU's longest serving foreign minister in SHOCK revelation: 'This could destroy Europe', *Daily Express*, 31 October; Joe Barnes (2017) EU to IMPLODE? Italian MEP predicts growing bloc of euroscepticism to challenge Brussels, *Daily Express*, 31 October.

⁵⁴ <http://www.telegraph.co.uk/news/worldnews/europe/11209248/EU-auditors-refuse-to-sign-off-more-than-100billion-of-its-own-spending.html>

⁵⁵ A current example is the Commission's attempt to increase the EU budget during the next multi-annual financial framework from 2021-2027, despite the loss of the UK's contribution (Kai Weiss (2018) Brussels still refuses to face up to the fiscal reality of Brexit, *CAPX*, 2 May).

⁵⁶ The EU Withdrawal Bill is copying 12,000 EU rules and 7,900 statutory instruments onto the UK's statute book. That's around 270 EU rules and 180 statutory instruments for every year that the UK was a member of the EU.

⁵⁷ We should be under no illusion that EU leaders are planning to create a European Empire to take on the US and China. At a speech at the London School of Economics on 28 September 2017, Guy Verhofstadt MEP – chair of the European Parliament's Brexit Steering Group and a former prime minister of Belgium – openly called for the EU to turn itself into an empire: 'The world of tomorrow is a world of empires, and only a united Europe will play a role of significance'; <http://www.lse.ac.uk/Events/2017/09/20170928t1830vLSE/the-future-of-europe>

⁵⁸ Joseph Tainter (1988) *New Studies in Archaeology*, Cambridge University Press.

need to become more complex and initially there are benefits from this. But inevitably the empires become overly complex – there is a dynamic to complexity which cannot easily be reversed – with the additional costs of complexity exceeding any additional benefits to such an extent that the empires eventually collapse; see Figure 1.

Figure 1: The marginal returns to complexity - overly complex empires eventually collapse

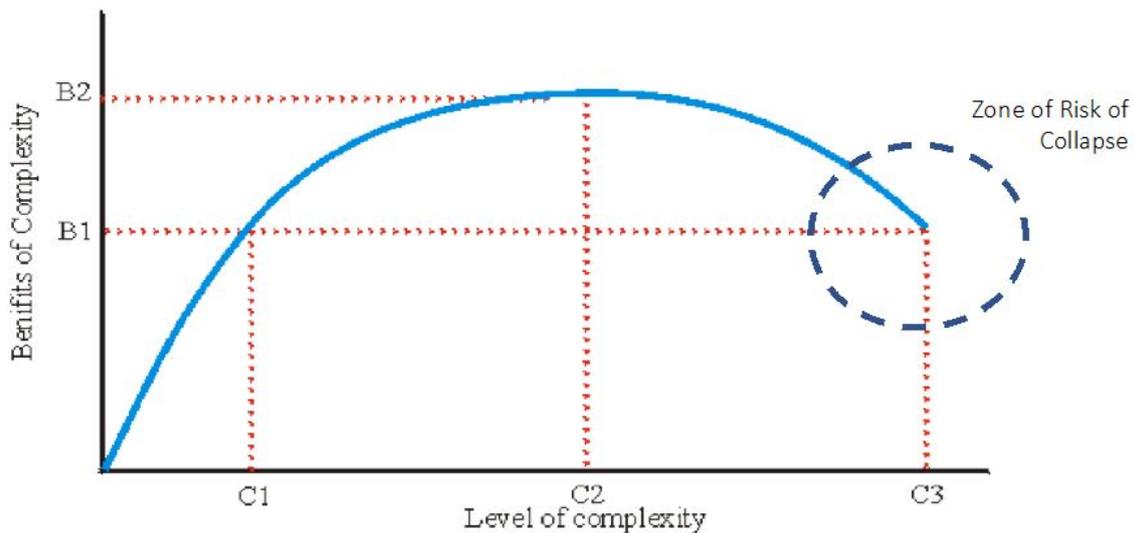
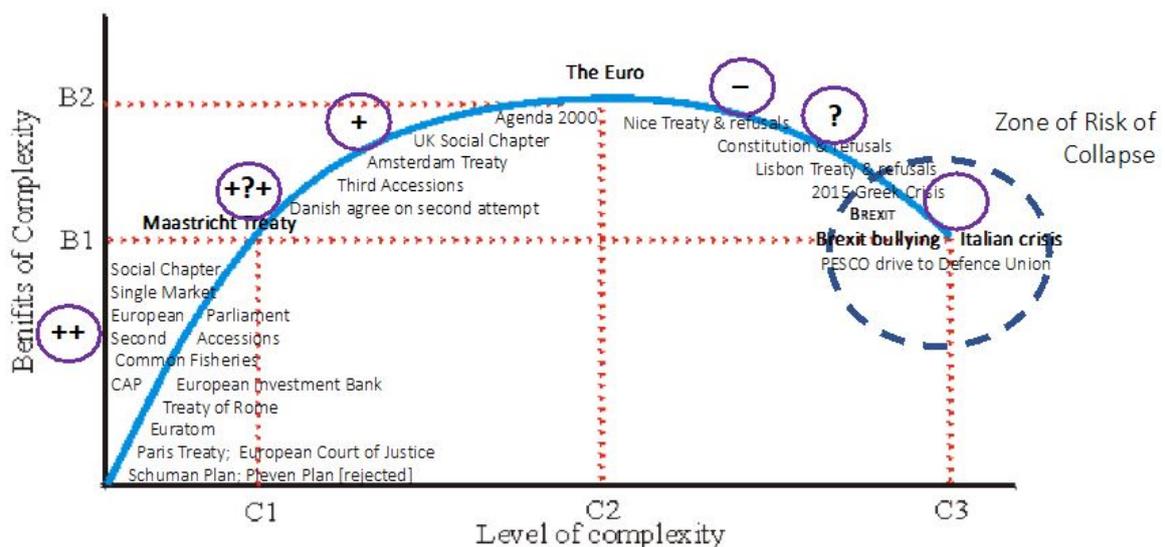


Figure 2: The marginal returns to complexity – the EU superimposed



Prins applies this model to the EU: see Figure 2.⁵⁹ He argues that during the first 50 years of its life from the Schuman Plan of 1950, the benefits of the various integrationist steps

⁵⁹ Gwythian Prins (2018) The EU is at clear risk of collapse – and the ‘remainiacs’ just don’t see it, *BriefingsforBrexit*, 2 April.

outweighed the drawbacks for the promoters of Europe federalism. But from the introduction of the euro in 1999, further additional complexity has produced negative marginal gains and the EU 'has been on the slide as its peoples have come to resent ... the remorseless imposition of the Empire's rules, regulations and interference'.

He identifies two watersheds: the Dutch rejection of the 2005 European Constitution (subsequently reintroduced in the Lisbon Treaty) and the period from 2015, beginning with the Greek crisis, continuing with the German backlash against Angela Merkel's open-door immigration policy, the Brexit vote of 2016 and now the Italian crisis of 2018, following the election of anti-establishment parties in March.

Prins argues that 'All this evidence of citizen rejection, while the "project" responds with further acceleration, has plainly taken the EU into the Zone of Risk of Collapse; and that is where now it stands, shakily but defiant, belittling, bullying, hoping to dishearten the British in order to deter any other prospective escapees and intent on punishing us for our sovereign decision to leave the EU'.

The costs of leaving the EU

In accordance with Article 50 of the TEU, the UK is due to leave the EU on 29 March 2019, two years after triggering the article.⁶⁰

There is a whole panoply of international and EU law which can be used to prevent the UK being given a bumpy ride as it leaves the EU, contrary to the claims of Remainers who repeatedly use scare-mongering terms like 'crashing out', 'cliff edges' and 'leaping into the unknown'.

First, leaving the EU will be analogous to 'state succession' where an existing state splits and the component parts wish to continue existing treaty relationships with other states. A recent successful example of this is the Czech Republic and Slovakia.⁶¹ Further, Lawyers for Britain dismiss the idea that negotiations are too complicated to complete in two years. They argue that an in-principle deal covering most aspects of Brexit is possible in two years, with smaller issues to be resolved later.⁶² When the UK joined common market in 1973, it took less than two years. When Norway didn't join in 1972, it negotiated a trade deal within eight months.

⁶⁰ Article 50 states that 'the Union shall negotiate and conclude an agreement with [the leaving] State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union'. This must be completed within two years of triggering Article 50 on 29 March 2017.

⁶¹ See <http://www.lawyersforbritain.org/int-trade.shtml>: Section headed 'The EU's Free Trade Agreements and the UK'.

⁶² According to Martin Howe QC, chair of Lawyers for Britain: 'Article 50 empowers the EU to agree withdrawal arrangements as a legally binding treaty, and (implicitly) the "framework" of the future relationship but probably only as a political in-principle deal. Article 50 does not cover a trade treaty, which needs to be authorised under TFEU [Treaty on the Functioning of the European Union – formerly the Treaty of Rome] Article 207 on EU external treaties. The EU are taking the line that it cannot legally conclude an external

Second, the UK can, in practice, roll-over (or grandfather) all the forty EU trade agreements with sixty countries by analogy with the 'principle of continuity' under international law, unless these countries positively object. The EU cannot prevent this and the UK does not have to withdraw from those agreements and start negotiations again.^{63,64} The Trade Bill is intended to do just this.⁶⁵ The same would apply to matters, such as aviation and the transport of nuclear material, although this would require the agreement of the EU.

Similarly, there can be continuity of financial contracts, even in a hard Brexit. By combining human rights law and reverse solicitation regimes, there should be no material cliff edge for the performance of existing financial contracts or the servicing of existing customers. Reverse solicitation allows wholesale market customers to opt out of EU financial regulation entirely when buying services from outside the EU. The right to property protects rights under contracts between UK and EU27 businesses that exist prior to Brexit. It arises both in the European Convention on Human Rights, to which the UK and every EU27 state will remain a party and in the EU's own Charter of Fundamental Rights. These property rights protect contracts which have an economic value on Brexit.⁶⁶

Despite this, parliamentarians are still being bombarded with misleading information from people in the City who should know better. To illustrate, Baroness Kishwer Falkner, chair of the House of Lords' EU Financial Affairs Sub-Committee, felt obliged to write to chancellor Philip Hammond warning about the risks to the UK financial services industry from leaving the EU: 'The clock is relentlessly ticking. Witness after witness told us that the financial services

agreement with the UK until after exit has formally taken place. So an in-principle "framework" can and should, if it going to be concluded at all, be agreed within 2 years. The process of reducing an agreed framework into a legally binding text ought to be quite rapid but we need to incentivise the EU to do this rapidly or it could be dragged out by them' (private communication).

⁶³ <http://www.lawyersforbritain.org/int-trade.shtml>. There are some complexities in that 'cumulation of preferences' or 'diagonal cumulation' for rules of origin purposes would work better if there is trilateral cooperation (i.e. between the EU, UK and the third country), but even if the EU is uncooperative on those matters, it cannot prevent the rolling over of the basic trade agreement to apply as between the UK and the third country after the UK's exit from the EU. But it can impose a tariff on goods coming into the EU from the UK if they contain a sufficiently high concentration of components from the third country, despite all three parties having FTAs.

⁶⁴ The claim by Cecilia Malmström, the EU Director of Trade Policy, that 'Britain will not be allowed to roll over its EU trade agreements', is completely without foundation.

⁶⁵ <http://brexitcentral.com/uk-takes-step-towards-independent-trade-policy-government-presents-trade-bill>. The bill contains two other measures: (a) it enables the government to negotiate independent membership of the WTO's Government Procurement Agreement (GPA) which ensures that UK companies have fair access to government procurement contracts worth £1.33trn across 47 countries, and (b) it gives the government power to counter anti-competitive trade practices, such as 'dumping', through a new Trade Remedies Authority.

⁶⁶ *Continuity of Contracts and Business on a "Hard" Brexit: Human Rights and Reverse Solicitation to the Rescue!*, Shearman & Sterling, 31 October 2017.

industry won't be able to continue servicing cross-border clients after 2019 if a transition period is not agreed by the end of this year'.⁶⁷

Third, the Vienna Convention on the Law of Treaties states that the 'acquired rights' of states cannot be taken away suddenly (Article 70(1)(b)).

Fourth, all major economies have legally-binding commitments not to raise tariffs. They can only reverse these measures if they compensate other WTO members.⁶⁸

Fifth, the EU has a legal obligation to allow timely customs clearance of inwards goods from the UK – whether or not a free trade agreement (FTA) is concluded – under the WTO Trade Facilitation Agreement.⁶⁹ This includes obligations to operate a modern customs system, including electronic pre-submission of documents to permit clearance to be given before physical arrival of the goods. Given the foreseeable need for inwards goods customs clearance facilities at the Channel ports from 30 March 2019 onwards, the EU and the Channel-facing member states are under an obligation to take reasonable steps to prepare to provide these facilities.⁷⁰

In practice, customs clearance is now very rapid and efficient. For example, Canada clears 97% of all imports in less than one day via electronic inspection. The 3% requiring physical inspection are cleared within 3 days. Virtually all developed countries have similar statistics: the UK clears goods requiring physical inspection even quicker.⁷¹ Further, HMRC's Chief Executive, Jon Thompson, has informed the Public Accounts Committee that the new CDS (Customs Declaration Service) system should be ready by early 2019 to process 200 million declarations, with back-up from the older CHIEF (Customs Handling of Import and Export Freight) system.^{72,73}

⁶⁷ Quoted in Stephen Bouvier (2017) Finance sector needs Brexit deal by January, says committee, *IPE*, 10 November; <https://www.ipe.com/brexit/finance-sector-needs-brexit-deal-by-january-says-committee/10021722.article>

⁶⁸ https://www.wto.org/english/tratop_e/schedules_e/goods_schedules_e.htm

⁶⁹ WTO (2018c), The WTO Trade Facilitation Agreement; https://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm

⁷⁰ https://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm (ARTICLE 7: RELEASE AND CLEARANCE OF GOODS)

⁷¹ Jean-François Arvis, Daniel Saslavsky, Lauri Ojala, Ben Shepherd, Christina Busch, Anasuya Raj and Tapio Naula (2016) Connecting to Compete: Trade Logistics in the Global Economy, The International Bank for Reconstruction and Development/The World Bank; https://wb-lpi-media.s3.amazonaws.com/LPI_Report_2016.pdf; World Bank (2016) Logistics Performance Index, <http://lpi.worldbank.org/international/scorecard>; Andrew (Sandy) Moroz and Colleen Brock (2016) Note on the Canada Border Services Agency: Customs Clearance and Trade Facilitation, Legatum Institute.

⁷² <https://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/inquiries/parliament-2017/brexit-future-customs-17-19/>; reconfirmed at the HMRC Customs Compliance Conference, 5-7 December 2017; see also <http://brexitcentral.com/case-post-brexit-implementation-transition-periods-yet-made/>

⁷³ There are approximately 132,000 businesses in the UK that currently trade with the EU that have never been required to process customs transactions and are unlikely to have any in-house expertise in that area. To simplify

Sixth, the G20 global principles established in 2009 to reduce systemic financial risk recognise that the free flow of capital is critical for the real economy.⁷⁴ Attempts by the EU to restrict UK bank access to the Single Market would be incompatible with these principles. The European Central Bank (ECB), like the Bank of England, is a member of the Bank for International Settlements (BIS) – the global central bank to the world’s national central banks – which supports a level playing field for its members, implying that EU cannot discriminate against UK-based banks.⁷⁵

Seventh, the Maastricht Treaty specifically promotes capital market integration, not only within the EU, but between the EU and third countries. The Treaty recognises the importance of free capital mobility in order to make monetary union work. Any attempts by the EU to restrict UK-based banks operating in the EU will be incompatible with this treaty.⁷⁶ Further, EU banks in London will be harmed if there is no co-operation, since there will be a requirement for these banks to be turned from branches to subsidiaries which need more capital to operate.⁷⁷

Eighth, there are limits to EU law. The EU has no jurisdiction outside its own borders. It therefore cannot prevent firms in third countries trading or clearing euro-denominated instruments, since these are not legally classified as cross-border activities. However, the EU might attempt to regulate or prevent the participation of EU resident entities in euro clearing activities outside its borders.

Finally, there is the issue of the EU's financial claim against the UK or the so-called ‘divorce bill’ – with initial estimates up to €100bn being leaked to the press. Michel Barnier, the EU’s chief Brexit negotiator, argues that the size of the bill is ‘incontestable’: ‘Commitments have been made [by the UK] and those responsibilities have to be honoured. ...It’s not a ransom. It’s not an exit bill. It’s not a punishment. It’s not a revenge’.⁷⁸ He has also made it clear that

matters, HMRC has introduced a form of ‘self-assessment’, a period return system similar to the way VAT is currently handled. Trusted traders can register as authorised economic operators.

⁷⁴ https://www.imf.org/external/np/sec/pr/2009/pdf/g20_040209.pdf; see also <http://www.un.org/ga/president/63/commission/declarationG20.pdf>

⁷⁵ The list of BIS central banks is available here:

https://www.bis.org/about/member_cb.htm?m=1%7C2%7C601

⁷⁶ The consolidated version of the Treaty on European Union is available here: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A12012M%2FTXT>. See article 21, in particular.

⁷⁷ This is discussed later.

⁷⁸ Daniel Boffey, Jennifer Rankin and Heather Stewart (2017) UK's financial obligations to EU will be 'incontestable', says Barnier, *Guardian*, 3 May; David M. Herszenhorn (2017) EU clarifies stance on Britain's exit tab, *Politico*, 8 July; <https://www.politico.eu/article/eu-clarifies-stance-brexit-bill-michel-barnier-david-davis/>

unless the UK accepted these commitments, there would be no discussion about the UK's future relationship with the EU after Brexit.⁷⁹

There are three elements to the claim. The first relates to the UK's share of commitments under the current budget spending round which ends on 31 December 2020.⁸⁰ The second relates to the UK's share of liabilities and assets on the EU's balance sheet. The third relates to the UK's share of liabilities and assets of the European Investment Bank (EIB).⁸¹ There are no clear and consistent rules for determining the size of the claim. On the one hand, the EU argues the UK has liabilities beyond the end of 2020, such as ongoing expenses related to space satellites and the future pensions of EU employees, with the UK's share of the latter estimated at between €2.5bn and €9.6bn out of total pension liabilities of €63.8bn.⁸² On the other hand, the EU denies that assets can be taken into account in the calculation. As one official put it: 'The EU assets belong to the union and the EU member states do not have any rights to those assets. There is no shareholding in the European Union. All of the union's assets belong to the union and that includes buildings, other assets tangible and intangible, financial, drinkable and non-drinkable', a reference to the EU's extensive wine cellar.⁸³

The EU's assets are worth €153.7bn:

- Cash — €21.7bn.
- Property — €8.7bn.
- Saleable financial assets — €9.6bn.
- Money in EU budget contributions that have not been paid by member states — €10.4bn.
- Money that was contributed to projects that may not be completed — €45.2bn.
- Repayable loans to member states — €56bn.

The UK's share of that would be between €20-23bn, based on the UK's share of (net (12%) or gross (15%)) budget contributions.⁸⁴ In addition, the UK's shareholding in the EIB is worth around €10bn.⁸⁵

⁷⁹ David M. Herszenhorn (2017) EU clarifies stance on Britain's exit tab, Politico, 8 July; <https://www.politico.eu/article/eu-clarifies-stance-brexite-bill-michel-barnier-david-davis/>

⁸⁰ This current spending round or MFF (Multiannual Financial Framework) between 2014 and 2020 has outstanding commitments or RAL ('reste à liquider') that have not yet been paid of €254bn.

⁸¹ <https://publications.parliament.uk/pa/ld201617/ldselect/ldcom/125/12506.htm>

⁸² <https://publications.parliament.uk/pa/ld201617/ldselect/ldcom/125/12506.htm>

⁸³ Daniel Boffey, Jennifer Rankin and Heather Stewart (2017) UK's financial obligations to EU will be 'incontestable', says Barnier, *Guardian*, 3 May.

⁸⁴ Oliver Wright (2017) Brussels 'must share €150bn assets', *The Times*, 16 February; <https://publications.parliament.uk/pa/ld201617/ldselect/ldcom/125/12506.htm>

⁸⁵ David M. Herszenhorn (2017) EU clarifies stance on Britain's exit tab, Politico, 8 July; <https://www.politico.eu/article/eu-clarifies-stance-brexite-bill-michel-barnier-david-davis/>

According to witness evidence at a House of Lords European Union Committee session on Brexit and the EU budget, the divorce bill could have ranged between €20bn and €70bn, depending on the assumptions made, such as whether the contributions were based on net or gross budget contributions or on the UK's share of the EU population (12.5%), whether the UK has budget commitments beyond 2020, or whether member states that were net receivers of budget payments could claim a share of the EU's assets.⁸⁶ The most commonly reported net figure in the press at the time was €60bn.⁸⁷

Lawyers for Britain and the European Research Group jointly published 'Analysis of the UK's potential financial liabilities and the jurisdiction to enforce them' in September 2017.⁸⁸ The analysis concludes that most of the EU's claims are legally very weak:

- The EU's principal claim [is] that the UK is obliged to contribute to the EU's budget, including substantial elements of it representing forward commitments to ongoing programmes, for a period of roughly two years after withdrawal. This claim is devoid of merit as a matter of international law. For the EU's 'Own Resources Decision' and its 'Multiannual Financial Framework' are legally subordinate to the EU treaties, have no binding force in law independently of the treaties, and therefore cease to impose any legal obligation on the UK on the date when the treaties themselves cease to apply to the UK under Article 50 TEU.
- The EU's second claim relates to the large deficit of its staff pension scheme. The UK could not in any event be liable for a share of that without also having a claim on a corresponding share of the assets of the EU, if a process of valuing the EU's assets and liabilities and then making or receiving a balancing payment on exit were to be undertaken. However, there is no general practice in international law of states making or receiving balancing payments representing the net assets or liabilities of an international organisation when the join or withdraw from the organisation. Moreover no such balancing payments have in fact been made when member states (including the UK itself) joined the EEC/EC/EU. It is therefore difficult to see any credible basis upon which the UK could be said to be obliged to make any net payment when it leaves.

On 8 December 2017, the key principles underlying the withdrawal terms and costs were agreed.⁸⁹ Under a strict interpretation of international law, the costs of leaving the EU are

⁸⁶ <https://publications.parliament.uk/pa/ld201617/ldselect/ldEUcom/125/12506.htm>

⁸⁷ Alex Barker (2017) Brussels focuses on UK's €60bn exit bill before trade talks, *Financial Times*, 19 February.

⁸⁸ <http://www.lawyersforbritain.org/files/the-withdrawal-of-the-uk-from-the-eu--analysis-of-potential-financial-liabilities.pdf>

⁸⁹ Joint report from the negotiators of the European Union and the United Kingdom Government on progress during phase 1 of negotiations under Article 50 TEU on the United Kingdom's orderly withdrawal from the European Union, TF50 (2017) 19, 8 December 2017.

relatively low. However, as both a goodwill gesture and in support of its future relationship with the EU, the UK has agreed to pay up to €45bn towards the accrued liabilities and existing spending programmes up to the end of 2020, and to continue contributing to certain European-wide programmes (e.g., in science, education, culture and mutual security) after formally leaving the EU. In her Florence speech on 22 September 2017, the prime minister, Theresa May, said also she wanted ‘a bold new strategic agreement [providing a] comprehensive framework for future security, law enforcement and criminal justice cooperation’ and was ‘unconditionally committed’ to European security. In addition, she argued that ‘neither the ECJ nor UK courts can be the arbiter of disputes’, indicating that a new ‘strong and appropriate dispute mechanism’ would have to be found.

Given this, leaving the EU should be smoother and more orderly than most commentators have suggested. Yet the EU plans to make it very hard for the UK to leave the EU, according to Christopher Chope MP, following a meeting in early November 2017 between the Exiting the European Select Committee and Michel Barnier, Guy Verhofstadt – head of the European parliament’s Brexit working group – and other MEPs. He concluded that:⁹⁰

the only Brexit deal being offered to us from Brussels would be far worse for the UK than leaving without a deal in March 2019.

Indeed, the only withdrawal deal on offer from the EU would require the UK to agree to the EU’s demands without any guarantee of being able to secure a reasonable future trade deal on terms better than the WTO.

The EU wants to require the UK to agree to its financial demands, to accept that every EU citizen resident in the UK has the right to live in the UK forever and for that right to be extended to parents and children. The EU would also make remaining in the Single Market and Customs Union a pre-requisite to having a frictionless border between Ireland and Northern Ireland.

To add insult to injury, the EU’s negotiators are insisting that any future trade relationship should be made conditional upon a whole raft of protectionist and anti-competitive requirements which would severely handicap the UK’s freedom to negotiate genuine free trade deals with the rest of the world.

Furthermore, it was confirmed that no free trade deal can be agreed in parallel with the Article 50 withdrawal agreement because each of the 27 EU countries would have a veto on that deal – and would exercise it if they would otherwise face competition

⁹⁰ <http://brexitcentral.com/meeting-michel-barnier-guy-verhofstadt-ive-concluded-no-deal-will-better-deal/>

from the UK on tax, employment conditions, safety regulations and relaxation of restrictions on GM crops.

It also became clear to me during our visit that the EU would require that any transitional deal would have to be signed as part of a withdrawal agreement before any agreement was in place on the UK's future relationship with the EU: during the transitional period, the status quo would prevail with the Single Market, Customs Union and European Court of Justice etc. having the same roles as at present; the UK would have no ability to control EU immigration during that period and would not even have the right to enter into trade deals with other countries.

These remarks are entirely consistent with statements made by both the European Commission and the European Council following the agreement made on 8 December 2017. Perhaps this should not, after all, be surprising, since Yanis Varoufakis, the former Greek finance minister, has been warning for months that the people who run the EU believe it is, like the Hotel California, a place that you can check out from, but can never leave.⁹¹

There are some UK parliamentarians who are actively trying to prevent the UK leaving the EU, just like the residents of Hotel California. Their first victory came when they managed to pass an amendment to the EU Withdrawal Bill on 13 December 2017 granting parliament a 'meaningful vote' on the final exit agreement. Lord Andrew Adonis tweeted: 'First step towards defeat of Brexit. And this is before the Lords has got going on the National Betrayal Bill'.⁹²

Others believe that, given the EU's attitude, the UK would be better off by leaving the EU at the earliest possible opportunity. For example, Sir James Dyson told the Andrew Marr Show on 12 November 2017:⁹³

Demanding billions and billions to leave is quite outrageous and demanding it before we've negotiated anything is outrageous. So I would walk away, that's the only way to deal with them... If you walk away, they'll come to us because they want to export all their products to us... we're in an incredibly strong position... We've been very reasonable, they've been incredibly unreasonable, the time has come to walk away.

⁹¹ Yanis Varoufakis (2017) *Adults in the Room: My Battle with Europe's Deep Establishment*, Bodley Head, London. The last two lines of the Eagles song 'Hotel California' are: 'You can check out any time you like, But you can never leave'.

⁹² Lord Adonis has gone further and said: 'I absolutely want to sabotage Brexit' (<http://www.lbc.co.uk/radio/presenters/iain-dale/lord-adonis-admits-i-want-to-sabotage-brexit/>; <http://www.dailymail.co.uk/news/article-5238837/Lord-Andrew-Adonis-declares-wants-sabotage-Brexit.html>)

⁹³ <https://brexitcentral.us14.list-manage.com/track/click?u=d25cbe539be88d77cfaa20e94&id=c3d0c567b9&e=aa18dc94a0>

Similarly, Jacob Rees-Mogg, chair of the 60-strong European Research Group of Eurosceptic conservative MPs, called on the government not to fall into a 'trap' on the divorce bill, and argued the UK should use the EU's need to fill holes in its budget as leverage.⁹⁴

Trading opportunities post-Brexit

Trading opportunities with the EU

The UK's aim is have a 'bespoke and ambitious' free trade agreement with the 'best possible' access to EU markets, i.e., 'an economic partnership that will include getting a good deal for financial services which we've always been clear will be in the EU's best interests as well as ours'.⁹⁵ The UK's preferred starting point for negotiations is the CETA⁹⁶ deal negotiated between the EU and Canada in 2017, but with the additional coverage of services and especially financial services, the UK's biggest export – a deal which has been dubbed 'Canada plus plus plus'.

The European Council's Guidelines of 23 March 2018 for negotiating the future trading relationship with the UK

On 23 March 2018, the European Council issued its Guidelines for negotiating the future trading relationship with the UK.⁹⁷ In terms of trade in goods and services, the EU is willing to offer the following.⁹⁸

On goods, the EU is proposing to maintain a zero-tariff arrangement with reduced non-tariff barriers to trade in all sectors. The EU recognises the highly integrated nature of UK-EU trade in goods, in particular the complex UK-EU supply chains for manufactured goods, and wishes to limit the increase costs to trade arising from rules of origin requirements.

The negotiations will focus on regulatory barriers to trade. The UK has proposed a 'comprehensive system of mutual recognition', together with a 'strong commitment' to

⁹⁴ Joe Watts (2017) Brexit: Theresa May will offer to pay £40bn for 'divorce bill' if trade talks begin, *Independent*, 20 November

⁹⁵ Svenja O'Donnell (2017) May Insists on 'Bespoke' Trade Deal in Face of EU's Rebuttal, *Bloomberg News*, 19 December; James Blitz (2017) What to expect in the next phase of Brexit talks, *Financial Times*, 14 December.

⁹⁶ The EU-Canada Comprehensive and Economic Trade Agreement.

⁹⁷ European Council (2018) *Guidelines*, EUCO XT 20001/18, BXT 25 CO EUR 5 CONCL 2, 23 March. The EU is also offering agreements on the movement of professionals (natural persons) and the mutual recognition of professional qualifications, data sharing, the continued coordination of social security systems, judicial cooperation on family matters such as matrimonial or parental responsibilities, defence, security and foreign policy, and on global challenges, in particular, in areas of climate change and sustainable development, as well as cross-border pollution. In addition, it is proposing reciprocal access to each other's fishing waters on existing terms.

⁹⁸ See also Aarti Shankar (2018) The outline of a future UK-EU economic relationship is emerging, *Open Europe*, 28 March.

maintain regulatory standards as high as the EU and which remain ‘substantially similar’ in the future. While the EU’s Guidelines do not mention mutual recognition, they appear to show a willingness to agree measures on technical standards, such health and safety (sanitary and phytosanitary) standards for the agriculture and food industries. In addition, the EU proposes a framework for voluntary regulatory cooperation. Without an agreement on regulatory equivalence, cross-border trade in goods will have to satisfy testing and approval procedures that will be both expensive and disruptive, particularly for supply chain industries frequently moving component parts across borders.

Switzerland which is not part of the EU, the Customs Union or the Single Market does have a comprehensive mutual recognition agreement with the EU, thereby avoiding border checks. In exchange, Switzerland has adopted EU rules and regulations in the sectors covered by the agreement. The UK has said that it is willing to ‘abide by’ EU rules in key supply-chain sectors – pharmaceutical, chemicals and aerospace – in order to access related EU agencies. The EU will consider allowing the UK to have observer status in key EU agencies – such as the European Medicines Agency, the European Chemicals Agency, and the European Aviation Safety Agency – subject to it abiding by the rules of those agencies and respecting the remit of the ECJ, and paying appropriate financial contributions, but having no role in decision-making.

On services, the EU is proposing a traditional free trade agreement in which there are only limited provisions for trade in services. In particular, services would be provided ‘under host state rules’, meaning complying with different rules in different member states. This would be disruptive for certain sectors – financial services and broadcasting – which currently operate in the EU under domestic rules. The EU is also willing to offer a new bilateral agreement on aviation and other modes of transport, including maritime and rail services.

The UK, by contrast, seeks a much more ambitious agreement in services based on mutual recognition which would allow reciprocal access based on the acceptance that the regulatory regimes are sufficiently similar. In particular, trade in financial services would be covered by ‘the principle of mutual recognition and reciprocal regulatory equivalence’. Nevertheless, the UK government recognises that ‘certain aspects of trade in services are intrinsically linked to the Single Market’, and that this will impact service trade with the EU post-Brexit.

In terms of enforcement of the agreement and dispute resolution, the EU’s Guidelines, while reiterating the ‘the autonomy of the EU legal order’ and the role of the ECJ as the sole interpreter of EU law, do not insist that the ECJ oversees the agreement. The EU also wants a judicial system to deal with disputes ‘to ensure effectiveness and legal certainty’. The UK, in turn, wants a dispute settlement mechanism that is ‘completely independent’, but accepts that the ‘jurisdiction of the ECJ, EU law and the decisions of the ECJ will continue to affect’ the UK after its withdrawal, particularly in respect of the key EU agencies mentioned earlier.

Obstacles

There are a number of serious obstacles to a successful outcome from the UK perspective.

First, the EU and UK have agreed a transitional or implementation period between 30 March 2019 and 31 December 2020, following the UK's departure from the EU on 29 March 2019. The UK would like the deal fully in place by March 2019, but given the EU's obsession with process rather than outcome, the best the UK might get is a framework agreement that sets the broad direction of a deal, with detailed negotiations taking place during the implementation period. Michel Barnier has long made it clear that the conclusion of a deal setting out the future trading relationships between the EU and the UK would take much longer than the two years allowed under Article 50. The problem with this is that, while any deal concluded before the end of March 2019 would just require a qualified majority vote in the European parliament to be approved, any deal after this date would require the unanimous approval of the national parliaments of each member state, a much bigger hurdle to cross. During any transition period between formally leaving the EU and implementing the trade agreement, the UK would be expected to follow EU rules, including the jurisdiction of the ECJ and free movement.

Second, the Withdrawal Agreement reached on 8 December 2017 is potentially very troubling for the UK's ability to free itself from the EU's regulatory orbit, not least paragraphs 49-51.⁹⁹ For example, Paragraph 49 could cause difficulties if a solution to the problem of a 'hard border' between Northern Ireland and the Republic of Ireland cannot be agreed, since, in such circumstances, 'the United Kingdom will maintain full alignment with those rules of the [Single] Market and the Customs Union which, now or in the future, support North-South

⁹⁹ These paragraphs are:

49. The United Kingdom remains committed to protecting North-South cooperation and to its guarantee of avoiding a hard border. Any future arrangements must be compatible with these overarching requirements. The United Kingdom's intention is to achieve these objectives through the overall EU-UK relationship. Should this not be possible, the United Kingdom will propose specific solutions to address the unique circumstances of the island of Ireland. In the absence of agreed solutions, the United Kingdom will maintain full alignment with those rules of the Internal Market and the Customs Union which, now or in the future, support North-South cooperation, the all-island economy and the protection of the 1998 Agreement [subsequently named the 'backstop' solution].

50. In the absence of agreed solutions, as set out in the previous paragraph, the United Kingdom will ensure that no new regulatory barriers develop between Northern Ireland and the rest of the United Kingdom, unless, consistent with the 1998 Agreement, the Northern Ireland Executive and Assembly agree that distinct arrangements are appropriate for Northern Ireland. In all circumstances, the United Kingdom will continue to ensure the same unfettered access for Northern Ireland's businesses to the whole of the United Kingdom internal market.

51. Both Parties will establish mechanisms to ensure the implementation and oversight of any specific arrangement to safeguard the integrity of the EU Internal Market and the Customs Union.

cooperation, the all-island economy and the protection of the 1998 [Good Friday] Agreement'. The Good Friday Agreement covers the following areas of cross-border activity: agriculture, education, environment, health, tourism and transportation.

The border between the Northern Ireland and the Republic of Ireland will become the external border of the EU and the EU will levy the Common External Tariffs. To avoid a new EU-UK customs border, the UK has proposed a 'new customs partnership' (NCP) in which the Common External Tariffs are applied on all goods coming into the island of Ireland with a refund on goods that remain in Northern Ireland. The argument is that this would be no different, in principle, from the way in which the levying of different VAT and exercise rates is done away from the border. However, the NCP has been described as 'unworkable' and 'unviable'¹⁰⁰ and, additionally, 'It would prevent the UK from adopting an effective independent trade policy. It fails to remove the need for customs checks, unless the UK also agrees to regulatory alignment, over which the EU would insist that the European Court would have the final say, and so it fails to achieve regulatory autonomy. It would impose restrictions on the UK which are fundamentally similar to the current Customs Union arrangement between the EU and UK, but without all of its benefits. Other of our potential trade partners are likely to react against it and it will prevent the UK from concluding WTO compliant trade deals, or from improving our own regulatory environment'.¹⁰¹

Shanker Singham prefers the government's alternative 'maximum facilitation' (max-fac) proposal for a bilateral technology-based border agreement similar to that which exists between Sweden and Norway (which is not in the EU) as described by Lars Karlsson, a former deputy director of Swedish Customs, in his *Smart Border 2.0* report for the European parliament.^{102, 103} This could be part of a FTA or under an exemption for frontier traffic under the General Agreement on Tariffs and Trade (GATT) in the absence of a full FTA, allowing 'best practice and available technology solutions to bear in an environment of trust and regulatory compatibility'. Singham points out that only 5% of Northern Ireland's output goes to Ireland¹⁰⁴ and only 1.6% of Irish exports are to Northern Ireland. Only 53 Northern Ireland businesses employing more than 250 people export to Ireland and, subject to meeting capability and security requirements, these businesses could be given trusted trader status – in respect of

¹⁰⁰ Liam Halligan (2018) New Customs Partnership is 'unworkable', *Daily Telegraph*, 5 May; Steven Swinford and Gordon Rayner (2018) HMRC deems May's custom's plan 'unviable', *Daily Telegraph*, 12 May.

¹⁰¹ Bernard Jenkin (2018) The 'new customs partnership' idea should be dead in the water – it is the opposite of taking back control, *Conservativehome*, 30 April; <https://www.conservativehome.com/platform/2018/04/bernard-jenkin-the-new-customs-partnership-idea-should-be-dead-in-the-water-it-is-the-opposite-of-taking-back-control.html>.

¹⁰² [http://www.europarl.europa.eu/RegData/etudes/STUD/2017/596828/IPOL_STU\(2017\)596828_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2017/596828/IPOL_STU(2017)596828_EN.pdf). Karlsson reports that arrangements without a physical infrastructure were successfully trialled on the Sweden-Norway border, but were not adopted because the existing border arrangements were working well and so the cost of a new electronic system was not justified.

¹⁰³ Switzerland also has an electronic customs clearance system with the EU (Adrian Hill (2018) Switzerland: A borderline case, *BriefingsforBrexit*, 6 April).

¹⁰⁴ Worth £3.4bn p.a, less than 0.1% of the EU's annual external trade of £3.5trn.

managing customs declarations and satisfying rules of origin and product standard regimes – similar to the existing Authorised Economic Operators (AEO) scheme. They would submit the necessary paperwork through a joint platform, declare any duty due (e.g., when rules of origin conditions are not met) and report the importer’s address. The consignment would then be sealed to cross the border. Any necessary payments of VAT and import or excise duties would be made afterwards in, say, monthly returns. The 92% of cross-border businesses employing fewer than 50 people would be removed from the border process and would submit simpler quarterly returns. The process would be monitored using electronic or bar code tagging, number-plate recognition, secure smartphone apps and GPS tagging.^{105, 106}

David Campbell Bannerman MEP offers an even more comprehensive solution, recognising that ‘the flow of lorries and vans across the Irish border equates in one whole year to less than three day’s flow on the M25 motorway, and is mostly local’ and that ‘the island of Ireland already has many seamless and invisible borders: for VAT, excise duties, corporation tax and, fundamentally, for a currency: the euro to the South, pound to the North. Adding a customs border is not a major issue and requires little of the creative imagination, political determination and years of resource the peace process needed’.

Building on Singham and Karlsson’s assertion that existing technology and established practices worldwide are more than capable of permitting a friction-free border, Campbell Bannerman proposes a three-tier solution which would avoid ‘spot-checks’ on the Northern Ireland/Ireland land border, with these being done instead at major seaports and airports, as already happens for immigration checks under the Common Travel Area:¹⁰⁷

- *Tier 1: Gold Standard treatment:* Major Authorised Economic Operators (MAEO) for major commercial operations carrying high volume, low risk traffic. The EU already has an operational AEO scheme with lorries carrying stickers in their windows. A similar system is used on the US/Canadian and Mexican borders entitled Free and Safe Trade (FAST). This involves a number of checks in advance and participants declare their cargoes in advance online. No checks are made at the border. The existing ‘trusted

¹⁰⁵ Shanker Singham (2018) How to fix the Irish border problem, *CAPX*, 19 March; <https://capx.co/how-to-fix-the-irish-border-problem/>

¹⁰⁶ These technological solutions are standard under the Transport Internationaux Routiers (TIR) system: ‘The Customs Convention on the International Transport of Goods under Cover of TIR Carnets (TIR Convention, 1975) is one of the most successful international transport conventions and is so far the only universal Customs transit system in existence. To date, it has 73 Contracting Parties, including the European Union. It covers the whole of Europe and reaches out to North Africa and the Near and Middle East’. All transit declaration information is contained in a single document, the TIR Carnet, as well as electronically in advance using TIR-EPD (Electronic Pre-Declaration). (<https://www.unece.org/tir/welcome.html>).

¹⁰⁷ Given that both Northern Ireland and Ireland occupy an island of just 6.6 million people that is on the far western edge of the European continent as well as being outside the Schengen Area, both goods and people can be ‘documented’ at the point of departure/destination, not at the border between the two countries (John Longworth (2018) ‘Max-fac’ will solve Irish question and ensure we leave the Customs Union, *Brexit Central*, 12 May.

trader' scheme works very well alongside: this ensures commercial operators that meet certain standards are given a special status with reduced paperwork, fewer document controls, priority treatment, and reduced delays and inspections. This is again successfully used on the US-Canada border with trucks hardly changing gear.

- *Tier 2: Silver Standard:* A Special Authorised Economic Operators (SpAEO) based too on the existing EU AEO scheme but limited to the island of Ireland. This will be for the majority of participants and be more relaxed and very affordable for the MAEO treatment. Everything would be online and everyone would have their own account. This scheme would work well for the estimated 80-90% of cross border trade in Ireland accounted for by small businesses – SMEs or micro-businesses – which are predominately in agriculture.
- *Tier 3: Bronze Standard:* Pre-arrival Customs Clearance (PACC). This is based on best practice in pre-clearance systems worldwide and is limited to occasional and low-value transactions, and small scale operators in vans. It would all be done online. The PACC's aim should be to clear in as little as one hour before travel, a performance standard major countries meet now. The EU Customs Code already provides for the Simplified/Supplemental Declaration procedure for registered businesses.¹⁰⁸

Giving evidence to the House of Commons Select Committee on Exiting the EU, on 28 November 2017, Jon Thompson, the Chief Executive of HMRC, said 'We do not believe, and this has been our consistent advice to ministers, we do not believe we require any infrastructure at the border between Northern Ireland and Ireland under any circumstances'. These views were confirmed by Niall Cody, Chair of the Irish Revenue Commissioners, who told a Dáil Committee in May 2017: 'I am practically 100 per cent certain we will not be providing new trade facilitation bays. We are not looking at this type of traditional customs point....the scepticism around IT solutions: you always have to be very careful of who you are listening to and what's their various different vested interests....Now the way the customs works, it provides for simplified procedures: Authorised Economic Operators in which the checking is done on goods at the destination point. It's not brought somewhere to have the checks carried out. We have look at the analysis of the figures. A lot of it is construction materials and of course there's the agri-food; but you're not looking at something that's going to distort the EU market'.¹⁰⁹ There already exists an all-Ireland regime for inspecting animals and meat products, as well as enforcement by trading standards officers for other products inside the border.¹¹⁰

¹⁰⁸ David Campbell Bannerman (2018) Practical and technical solutions can resolve the questions about the Irish border, *Brexit Central*, 24 March. See also John Longworth (2018) Max Fac Works – The technological solution to the Irish border customs issue, *Leave Means Leave*, May.

¹⁰⁹ <https://twitter.com/BrexitCentral/status/986165858853629952>

¹¹⁰ Additional support for the max-fac solution comes from NI/Irish commentators, see, Graham Gudgin and Ray Bassett (2018) *Getting Over the Line - Solutions to the Irish border: Why the UK (including Northern Ireland) can leave the Customs Union, avoid a hard border – and preserve the Good Friday agreement*, *Policy Exchange*, May. UK business also prefers max fac since it is based on procedures that already exist (James Blitz

Despite these apparently comprehensive proposals and assertions, some have argued that the max-fac proposal will not solve the Irish border question because of the risks to the integrity of the single market, as well as political risks to the Good Friday Agreement. Peter Foster points out that different product standards and tariffs between the north and south of Ireland mean that it would be impossible to exempt small and medium-sized businesses (which account for 80% of cross-border trade by value) from customs checks, given that many of these businesses feed into bigger business supply-chains: ‘Without a small business exemption, it remains extremely difficult to see how technology can be used to solve the Irish border question in a way that meets that December pledge to avoid “any” infrastructure or checks. ...It is worth noting that this “Smart Border 2.0” would still require “mobile control and inspection units” and “technical surveillance” of the border using CCTV and number-plate recognition technology. For security and political reasons, this is highly problematic’.¹¹¹ Others argue that trusted trader schemes that allow exemptions from daily checks are costly, unwieldy and totally unsuitable in the context of small Irish businesses. Dr Katy Hayward from Queen’s University Belfast argues that it would be using a sledgehammer to crack a nut or in her words, ‘It would be like putting on a full diving suit with oxygen tank and flippers in order to walk through a puddle that one has crossed every day for years without so much as a pair of wellies’.¹¹²

The draft withdrawal agreement between the EU and the UK agreed on 19 March 2018 states (p.1): ‘With respect to the DRAFT PROTOCOL ON IRELAND/NORTHERN IRELAND, the negotiators agree that a legally operative version of the “backstop” solution for the border between Northern Ireland and Ireland, in line with paragraph 49 of the Joint Report, should be agreed as part of the legal text of the Withdrawal Agreement, to apply unless and until another solution is found’.¹¹³

Hugh Bennett describes the EU position thus: ‘The EU’s inflammatory demands are a stark demonstration that they have little interest in conducting the negotiations in good faith.... Far from trying to negotiate constructively towards a sensible compromise, the EU has acted with pure cynicism, putting a hugely contentious proposition on the table which it knows the UK could never possibly accept. Any claims the EU could have had to be acting in the best interests of preserving the delicate political balance in Northern Ireland have been revealed

(2018) Why UK business prefers ‘max fac’ – as a scheme, customs partnership is totally untried and untested, *Financial Times*, 11 May).

¹¹¹ Peter Foster (2018) Why Boris Johnson's 'max-fac' customs plan cannot solve the Irish Border question, *Daily Telegraph*, 9 May. See also Richard North (2018) Brexit: a psychic epidemic, *Euroreferendum*, 19 April; <http://euroreferendum.com>

¹¹² Katy Hayward (2018) How Not to Fix the Irish Border, Queen’s University Belfast, March; <https://www.qub.ac.uk/brexit/Brexitfilestore/Fileupload,814295,en.pdf>

¹¹³ *Draft Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community*, TF50 (2018) 35 – Commission to EU27, 19 March 2018.

as completely hollow; this episode has shown the EU to be interested only in ruthlessly trying to exploit the Northern Ireland issue to push its own political objectives for Brexit.... The fact that it is using the Irish border issue as leverage to try to force this outcome by stealth, while wrapping it up in emotive rhetoric around preserving peace and respecting the constitutional settlement in Northern Ireland, reveals the EU to be a deeply devious and underhand organisation which has few inhibitions over how ruthless and unscrupulous it is prepared to be to secure its own way in the negotiations.... It is worth stepping back for a minute to consider why an Irish border solution is even necessary at all. The UK and the Republic of Ireland could simply make unilateral decisions to maintain an open border even in the absence of any agreed solution for the border. The practical consequences of this would principally be a small loss of customs revenue and a minor increase in the risk of goods circulating which had been deemed legal in one jurisdiction but not in the other, for whatever reason. That is ultimately all that the “integrity of the single market and customs union” amounts to’.¹¹⁴

Nick Timothy, the prime minister’s former adviser, argues that max-fac is the only solution that will enable the UK to negotiate its own trade deals outside the Customs Union. Further, by dismissing it, the EU is ignoring its own negotiating Guidelines: ‘the unique challenges of Ireland will require flexible and imaginative solutions’. He says that the ‘responsibility to find these solutions is not only British but European too’.¹¹⁵

Third, the EU has made it clear that, while it might be willing to consider a ‘balanced, ambitious and wide-ranging free trade agreement’, this is only ‘insofar as there are sufficient guarantees for a level playing field’. In particular, the EU wants an agreement to cover ‘competition and state aid, tax, social, environment and regulatory measures and practices’, preventing the UK from competing unfairly against the EU. In other words, the EU will not permit the UK to escape from the protectionist ‘European model’.¹¹⁶

With the withdrawal agreement signed, the Irish prime minister, Leo Varadkar, said that the EU intends to use paragraphs 49-51 to ‘funnel’ talks to ensure that the whole of the UK would ‘remain in alignment’ with the EU on ‘lots of regulations’.¹¹⁷ This would have to be accepted before the EU would be prepared to start talks on a trade deal. At the beginning of the Guidelines is an ‘evolution clause’, which indicates that the EU would be willing to offer the UK a closer relationship if it changes its position on leaving the Single Market and Customs

¹¹⁴ Hugh Bennett (2018) The EU reveals its true nature with its duplicitous manoeuvres on Northern Ireland, *Brexit Central*, 1 March.

¹¹⁵ Nick Timothy (2018) How Theresa May can get the Brexit she wants – and still keep her party together, *Daily Telegraph*, 9 May.

¹¹⁶ Barnier warns against UK using Brexit to abandon 'European model', *Times and Star*, 20 November 2017; <http://www.timesandstar.co.uk/news/national/article/No-single-market-benefits-or-passporting-rights-after-Brexit-says-Barnier-2de3bed1-e192-4edb-a299-d77584bb1b86-ds>

¹¹⁷ Gordon Rayner, Christopher Hope and Peter Foster (2017) The price of freedom, *Daily Telegraph*, 9 December 2017.

Union. Even in the absence of this happening, the UK's depth of access to the EU services market will depend on how extensively the UK accepts the level playing field obligations. Graham Gudgin warns that 'The Irish Government is playing a dangerous game by demanding that Northern Ireland remain within the EU Customs Union and by threatening vetoes. Ireland – more than any EU economy – needs free trade with the UK but has made no efforts to promote such an agreement in Brussels. Indeed, its main effort has been to frustrate moves in this direction, because the Irish border is being used as a weapon by Brussels to influence the Brexit negotiations to its advantage'.¹¹⁸

The EU's negotiating stance is striking, given that the EU has a trade surplus with the UK of £82bn. But the real explanation for their position is that 'they are terrified' of the trading competition the UK will create against them. According to Katya Adler, the BBC's Europe Editor, the EU are 'very worried' that the UK will become a 'super competitive country' on their doorstep: 'That's what they don't want. They want to keep the UK close, but they want to keep the UK close and locked in'.¹¹⁹

As Ryan Bourne points out, this would make the UK a rule-taker from Brussels: 'Having exited the EU, the UK would have no vote on new Single Market rules, and would be a hostage to potential damaging legislation. ...Harmonised regulation with the Single Market would preclude us from altering existing laws in a more pro-growth direction. ...Regulatory sovereignty is a necessary condition for the UK to sign effective free trade agreements with other countries. The UK is primarily a service-based economy, and will be seeking deals to liberalise those sectors. That requires being able to negotiate mutual recognition of regulatory standards with other major economies. Yet if the UK is an EU rule-taker and does not control its own regulatory frameworks, not only would this increase uncertainty to third parties, but they would have little incentive to agree deals with the UK, opting to deal with the EU directly'.^{120, 121}

Ambrose Evans-Pritchard goes further: 'The Franco-German axis is determined to make a soft arrangement impossible. ... Berlin, Paris, and Brussels have stated with crystal clarity that no deal on services is available. The only free trade pact they are willing to offer is on goods. This is prohibitively asymmetric: it locks in their huge surplus (mostly German) in

¹¹⁸ Graham Gudgin (2018) A post-Brexit Irish border without physical infrastructure is fully attainable, *Brexit Central*, 9 May.

¹¹⁹ BBC Radio 5 Brexitcast, February 2018, bbc.co.uk/programmes/p05299nl.

¹²⁰ Ryan Bourne (2017) Brexit will only mean Brexit if we regain control of economic rules, *Daily Telegraph*, 14 December.

¹²¹ This view is even supported by Lord Hill, the UK's former EU financial services commissioner, who informed the House of Lords on 30 January 2018: 'One of the reasons I voted "remain" was that I thought it would make no sense at all for a service-based economy such as ours to be bound by rules over which we have no influence. Now that we have voted to leave, the same logic holds – actually the logic is even stronger. ...For an economy that is as dependent as ours is on services, how could we in all seriousness subcontract all rulemaking to someone else?'

manufacturing, while locking out Britain's surplus in services, which partly compensates. Those who talk loudest about cherry picking pick the biggest the cherries. ...My experience as Brussels correspondent and then later covering the Eurozone crisis taught me that Germany usually succeeds in imposing its will, disguising its power behind French camouflage and the EU institutions. My fears have been confirmed by the hostile tone of EU documents since Theresa May went the extra mile to ensure concord at the December summit. Her offers of money and her gestures of goodwill have simply been pocketed. The latest provocation is an internal strategy paper leaked to the *Financial Times* showing that the EU intends to tie Britain down after Brexit by prohibiting or curbing future moves to cut taxes, to deregulate, to carry out an industrial strategy, or make changes to employment law, all under pain of sanctions. It threatens to treat the UK as a pariah if it does not comply. ... Greece's Yanis Varoufakis advised the UK long ago to pre-empt the EU by seizing the initiative before Brussels could react, and above all to avoid being ground down, humiliated, and ultimately broken by the EU "run-around". British ministers did not learn from the battering of Greece. ... [I]t is now self-evident that a soft Brexit is not on offer, except on colonial terms'.¹²²

Fourth, is the position of financial services. The Guidelines state that the EU intends to 'safeguard financial stability in the Union and respect its regulatory and supervisory regime', but there is no mention of financial services in the Guidelines. Jeremy Warner argues that the real problem is with the EU itself: 'It is Michel Barnier...and his masters in Berlin and Paris, who have their heads buried in the sand, not us; at every stage, they see problems rather than solutions'. The UK would like a 'Canada plus plus plus' deal involving financial services. The problem for the EU is that there is no existing off-the-shelf model which involves mutual recognition of financial services and the EU does not want to offer anything more than a 'plain vanilla trade deal that seeks to degrade London as Europe's primary financial centre. This seems to be the attitude of France's Emmanuel Macron, who hopes to use Brexit to steal a march in finance. Good luck with that; Paris is a relatively small city by global standards, lacking in many of London's international attributes. The Balkanisation of finance around Europe would, moreover, be at odds with the bloc's drive for superpower status. To meet these ambitions, Europe needs a credible global financial centre. It is therefore necessary to think of London not as a uniquely British asset, but as a pan-European one which happens to be merely hosted by the UK'.¹²³

Jonathan Ford also believes that it is in the EU's interests to avoid a hard Brexit for financial services, since otherwise the EU is harmed more than the UK. Currently, there is a system of 'passports' which are awarded to banks by their home country regulator and this allows the

¹²² Ambrose Evans-Pritchard (2018) The EU refuses a soft Brexit, so we must invoke the WTO immediately, *Daily Telegraph*, 1 February.

¹²³ Jeremy Warner (2017) Europe has its head in the sand over post-Brexit trade. But there's a way out of the looming impasse, *Daily Telegraph*, 8 December.

banks to operate freely in other EU member states by setting up branches. If passports are no longer accepted after Brexit, then the banks will have to set up separately capitalised subsidiaries and the costs of 'subsidiarisation' would be high for EU-based banks like Deutsche Bank and BNP Paribas, where up to 60% of group revenue comes from investment and transaction banking business executed in London. If these activities are no longer subject to the netting and diversification allowances that comes with passports, then more capital needs to be raised. Consultants BCG have estimated that EU banks would have to find an additional €30bn-€40bn in aggregate, with Deutsche Bank alone having to put in an extra €10bn to capitalise a London-based subsidiary.

It would be expensive for these banks to move this business back to the continent, since they would lose direct access to the London-based, but US Federal Reserve-regulated, CLS International Bank which clears the dollar leg of the \$4trn foreign exchange swaps that take place daily. The EU banks would have to switch to using a smaller less efficient continental-based euro-clearing provider as well as losing netting, and so the effect would be to raise relative costs. Ford concludes: 'Of course, none of this means Europe will cut the UK any favours. Brussels is keen to build up its own financial infrastructure in future. But that means fostering a stronger banking sector, deeper capital markets and the liquidity to support them. None of these goals will be advanced by erecting some financial wall down the Channel'.¹²⁴

By contrast, the UK's proposed approach to the loss of passports – mutual recognition – has been described as sensible and pragmatic by Simon Hills, Director of Prudential Policy at UK Finance.¹²⁵ There are 77 branches of 'incoming' EU and other European Economic Area (EEA) banks operating in the UK that are authorised to take deposits and they lend more than £1trn (or 15 per cent of all loans) to UK residents. The Bank of England's Prudential Regulatory Authority (PRA)'s proposal¹²⁶ is to permit EEA branches to convert to third-country branches, implying that the costs of subsidiarisation can be avoided. A 'third-country regime' is permissible where there is good regulatory cooperation with the host country. This is particularly useful for systemically important wholesale banks, since the PRA can influence supervisory outcomes for the whole group, including the UK branch, via the existing college system or by bilateral engagement combined with prompt information exchange. It still allows the PRA to impose extra governance requirements under the Senior Managers' Regime,¹²⁷ restrict the branch's business model or impose additional liquidity requirements.

¹²⁴ Jonathan Ford (2017) Why a hard Brexit for financial services is unlikely, *Financial Times*, 10 December.

¹²⁵ Simon Hills (2017) Pragmatic approach to oversight of EU banks paves way for Brexit progress, UK Finance, 21 December; <https://www.ukfinance.org.uk/pragmatic-approach-to-oversight-of-eu-banks-paves-way-for-brexit-progress>. UK Finance was formerly known as the British Bankers Association.

¹²⁶ *The Bank of England's approach to the authorisation and supervision of international banks, insurers and central counterparties*, 20 December 2017; <https://www.bankofengland.co.uk/news/2017/december/approach-to-authorisation-and-supervision-of-international-banks-insurers-central-counterparties>

¹²⁷ <https://www.fca.org.uk/firms/senior-managers-certification-regime/banking>

It would be helpful if the EU adopted a similar approach to UK banks, since these ‘outgoing’ banks are important for EU-based buyers of financial services: for every €1 spent by a UK buyer with a EU-based financial services company, EU-based buyers spend more than €6 purchasing financial services from UK-based companies. UK Finance supports an ambitious EU-UK free trade agreement for financial services which would involve ‘a variable approach depending on the likely levels of supervisory concern, a symmetrical approach based on mutual acceptance of regulatory and supervisory cooperation and reciprocity, and the need for an adaptable cross-border financial services framework that can respond to technological developments or other changes. Its application to the supply of outgoing financial services would ensure that EU companies could continue to use London’s international financial services centre to meet their financing and risk management needs’. UK Finance believes the same approach could be applied to all regulatory cooperation in global financial services, not just with the EU. This is because it is important that international standards, such as the Basel framework for prudential banking regulation, are applied in a harmonised way based on transparent implementation and mutual trust between supervisors around the world.¹²⁸

The City of London needs to be able compete aggressively against the rapidly growing financial centres in Asia and especially China. Z/Yen’s global financial centres index for 2018 still puts the City top out of 110 financial centres.¹²⁹ It is top for the most competitive business environment (due to factors such as the rule of law and the strength of its institutions), for reputation, and for the calibre of its financial infrastructure. However, not only are other established centres in New York, San Francisco and Chicago catching up, the biggest improvements in competitiveness come from Hong Kong, Shanghai, and the north-eastern Chinese city of Qingdao, indicating the increasing significance of the Chinese economy in international finance. Zurich, Frankfurt, Paris and Amsterdam are in 16th, 20th, 24th and 50th places, respectively. Miles Celic, chief executive of TheCityUK said that ‘London’s offering continues to be a critical part of wider European competitiveness’, but warned against ‘the self-indulgence of complacency’, which appear to be at the very heart of the EU’s negotiating Guidelines.¹³⁰ Certainly, the UK needs to quickly recover the competitive edge that it has lost in recent years. The WTO has estimated that the City’s share of China’s imports of financial services (mainly insurance) was 3% in 2015, unchanged since 2011. Over the same period, the US share increased from 11% to 28%.¹³¹

¹²⁸ UK Finance (2017) *Supporting Europe’s Economies and Citizens: a modern approach to financial services in an EU-UK Trade Agreement*, September; <https://www.ukfinance.org.uk/wp-content/uploads/2017/11/EU-UK-Trade-Agreement-report-ONLINE-UPDATED.pdf>

¹²⁹ <http://www.longfinance.net/Publications/GFCI23.pdf>

¹³⁰ Jasper Jolly (2018) London remains on top of the world for global financial services says major report, *City A.M.*, 26 March.

¹³¹ Reported in David Wighton (2017) Beijing will still be five thousand miles away after Brexit, *Financial News*, 10 July.

In order to compete more effectively, Barney Reynolds argues that the City London should go further than the PRA's proposals and move either to an 'enhanced equivalence' relationship with the EU or, if the EU does not cooperate, to becoming a 'world financial centre', where the City 'goes it alone'.¹³² Under enhanced equivalence, regulations are accepted as being sufficiently similar, but without actually being identical.¹³³ This allows predictable access by financial institutions to each other's markets in a way that aims for equivalent outcomes for these institutions – which are defined, where possible, by reference to high level international standards, e.g., the Basel rules in the context of regulatory capital. The costs of subsidiarisation are thereby avoided. Reynolds believes that the UK should not be concerned about EU lack of cooperation or EU attempts to grab chunks of the City. Most corporate lending, asset management, insurance, share and currency trading in Europe is done in London and will still do so after Brexit whatever barriers the EU tries to erect.

While no mention is made of financial services in the Guidelines, a leaked draft of an annex¹³⁴ to the Guidelines suggests the EU might be willing to offer 'improved equivalence mechanisms' to cover financial services. This is encouraging since current equivalence mechanisms¹³⁵ used to grant access to third-countries can be unilaterally withdrawn at 30 days' notice and so do not provide the legal certainty that the UK financial services sector requires. Even the European Banking Authority has warned that third-country equivalence mechanisms would not be adequate 'with such an integrated third-country in mind'.

The issue boils down to how much self-harm the EU wants to suffer in its effort to punish the UK for its audacity to leave the EU. The answer at the present time seems to be a lot, although you need to factor in the EU side's negotiating posturing. The consultancy Oxford Economics has estimated that the EU would lose £99.5bn (€112bn) by 2020 in economic output if a comprehensive FTA with the UK is not agreed and trading reverts to WTO rules.¹³⁶ Despite this, the EU refuses to discuss its future trading relationship with the UK, including financial services, until the final withdrawal agreement with the UK has been ratified. Further, while the Bank of England has allowed European firms to continue operating as normal during the

¹³² Barnabas Reynolds (2016) *A Blueprint for Brexit: The Future of Global Financial Services and Markets in the UK*, Politeia, November; Barnabas Reynolds (2017) *A Template for Enhanced Equivalence: Creating a Lasting Relationship in Financial Services between the EU and the UK*, Politeia, July; Barnabas Reynolds (2017) *The Art of the No Deal: How Best to Navigate Brexit for Financial Services*, Politeia, November; and Barnabas Reynolds (2018) *Enhanced Equivalence – A Win-Win Proposition*, New Direction and Politeia, February.

¹³³ Enhanced equivalence is an alternative to mutual recognition.

¹³⁴ <https://www.telegraph.co.uk/business/2018/03/20/city-tug-war-continues-eu-eyes-improved-equivalence-post-brexite/>

¹³⁵ <https://openeurope.org.uk/today/blog/understanding-regulatory-equivalence-an-effective-fall-back-option-for-uk-financial-services-after-brexite/>

¹³⁶ Richard Partington (2018) No-deal Brexit would cost EU economy £100bn, report claims, *Guardian*, 15 January. The cost to the UK economy according to Oxford Economics would be £125bn by 2020. With UK GDP at approximately £2trn, this implies a 6% reduction in GDP. Given that UK trade with the EU before Brexit was 12% of GDP, Oxford Economics is predicting a 50% reduction in trade with the EU after the UK leaves.

transition period, European regulators have refused to provide similar assurances, forcing City firms to continue planning for a hard Brexit in March 2019.¹³⁷

The future trading relationship between the UK and the EU: Building on CETA

In terms of the future trade deal with the EU, the UK should certainly not accept what is on offer from the EU, namely a traditional FTA with only limited provisions for trade in services. Instead, the future trading relationship should build on the CETA trade deal with Canada.

While CETA offers a good starting point, it needs to be extended. It removed tariffs on 98% of goods and on 92% of agricultural products. While CETA does cover some services, it is restricted on others, such as financial and transport services.

In terms of goods trade, the issues of regulatory standards and tariffs need to be addressed. For goods to be freely traded between the UK and the EU, there needs to be either equivalence or mutual recognition of regulatory standards. In addition, there needs to be an agreement on the tariffs set on both intermediate and finished goods imported into both economies. Imported intermediate goods are used in the production of finished goods and this will lead to rules of origin (and hence tariffs) being applied if the finished goods are subsequently exported to the EU and vice versa. The tariffs on finished goods imported from a third country into the UK and the EU need to be the same, otherwise there will be arbitrage possibilities. In terms of the import of agricultural products, there need to be similar health and safety standards for the same reason.

Andrew Lilico suggests that one way of dealing with these issues would be a comprehensive FTA between the EU and UK, with a narrow customs union agreement embedded within it that covered a small number of goods where there is significant cross-border trade. This would cover not only goods crossing the border between the north and south of Ireland, but also between rest of the UK and the EU, such as cars and car parts (the latter being a significant component of existing EU supply chains). Lilico argues this would deal not only with the Irish border problem, but also with the WTO requirement that modern FTAs must cover 'substantially all trade'. It would also mean the UK would be free to implement FTAs with third countries: 'A customs union that just covered cars and car parts would not be inconsistent with the UK doing trade deals with non-EU countries such as the US or Australia. There would merely need to be a carve-out in those deals for cars. But FTAs are allowed to exclude a few specific products and often do so. Provided the deal was tightly enough stated that the EU could not use an automotive sector customs union agreement to restrict the UK's ability to

¹³⁷ Lucy McNulty (2018) FCA chief Bailey 'ready to engage' EU regulators over Brexit plans, *Financial News*, 16 April.

do broader trade deals, an automotive-only customs union would have considerable merit'.¹³⁸

Nick Timothy points to some of the problems of being fully in the EU Customs Union, while not in the EU: 'It would ... mean that Brussels could grant trading access to Britain to other countries without seeking reciprocal access for the UK. And it could agree deals that could cost British jobs – or open up public services to private sector competition – without any say for MPs. This is why Norway and Switzerland, despite their close links to the EU, refuse to join a customs union'.¹³⁹

Shanker Singham, however, warns of the dangers of even being partly in the Customs Union: 'A free trade agreement which includes customs union pacts for specific goods is also problematic because the UK's interests in trade agreements are primarily in services, and we would need maximum flexibility over what we can concede in goods to be able to deliver deals. ...An independent trade policy is not merely an ideological statement. It is a concrete set of policies which allows the private sector to grow the UK economy. If our choices take that off the table, we take real benefits away and we should be clear about that. While many of the UK's Brexit decisions are not binary, the decision to have a real trade policy is'.¹⁴⁰

Trade in services is conducted through four modes of supply, according to the General Agreement on Trade in Services (GATS): cross-border supply (mode 1), consumption by a resident abroad (mode 2), commercial presence (mode 3), and the presence of natural persons (mode 4).

CETA covers all four modes of supply with additional chapters on financial services, international maritime transport, telecoms and e-commerce.¹⁴¹ CETA, like GATS, achieves services liberalisation through key obligations, principally market access which prohibit: quantitative restrictions; and discriminatory treatment of services, service suppliers and investors from the other country. CETA uses a negative list for modes 1, 2 and 3, implying that all services sectors are liberalised, unless they are on the negative list. CETA excludes: non-commercial services to government, audio-visual services, and most air services. There are around 550 further reservations. The presence of natural persons (mode 4) is dealt with separately using both positive and negative lists. These lists and reservations can be modified to suit the new trading relationship between the UK and EU.

¹³⁸ Andrew Lilico (2018) Here's a customs union solution both Brexiteers and Remainers should be able to accept, *Daily Telegraph*, 9 May.

¹³⁹ Nick Timothy (2018) How Theresa May can get the Brexit she wants – and still keep her party together, *Daily Telegraph*, 9 May.

¹⁴⁰ Shanker Singham (2018) Without free trade, Brexit will be nothing more than a damage limitation exercise, *Daily Telegraph*, 9 May.

¹⁴¹ See Julia Magntorn and L Alan Winters (2018) Can CETA-plus solve the UK's services problem?, Briefing Paper 16, UK Trade Policy Observatory, March.

In terms of financial services, Shanker Singham and Catherine McBride recommend that the first task of the UK, once outside the EU, is to review its own financial regulation. It should: 're-examine what financial regulation is appropriate and necessary for its own markets and reject, remove or reduce regulation that is not'; and 'reshape its financial regulations by removing any unnecessary processes and focusing instead on proportionality of the regulatory outcomes in a transparent manner'.

The aim would be to take 'advantage of greater agility in decision making and [to] enter into regulatory recognition arrangements with non-EU countries quickly and simply': 'While financial regulations must ensure financial stability and protect investors from unacceptable conduct, they must also maintain competitive markets and facilitate the growth of new businesses. Financial regulations must not be so complex or burdensome that they restrict access to capital, investment opportunities or the availability of financial products such as insurance or hedging instruments. Regulation based on global standards should apply to companies that are internationally active, but be more proportionately applied to purely domestic companies. Proportionate regimes of regulation and taxation for SMEs, start up and fintech companies enable new market entrants which keeps the economy dynamic. Smaller and start-up companies do not pose a systemic risk and so their regulations should reflect this with "de minimis" exemptions'.

In the process of separating from the EU, certain measures need to be taken by the UK. One will be to develop its own authorised retail investment fund structure to replace the UCITS framework which applies to EU-only domiciled and managed retail investment funds. Another will be to allow EU27 banks to operate as branches in the UK, rather than subsidiaries.

In terms of the UK's future financial services relationship with the EU, Singham and McBride prefer a 'mutual recognition' agreement to one based on 'equivalence'. The mutual recognition framework should be 'based on international standards and common outcomes, with mutual transparency and cooperation between home state regulators, with the provision that such cooperation does not prevent either party from diverging, nor allow any divergence to trigger the loss of recognition'. This is preferred to equivalence which 'does not cover the entire spectrum of financial services, it is granted and withdrawn unilaterally by the European Commission and it is not granted on transparent or consistent criteria: politics, reciprocal benefits and local protectionism all play their part as well as comparable regulations'.¹⁴²

¹⁴² Barney Reynolds has proposed a form of 'enhanced equivalence' that deals with many of these problems: Barnabas Reynolds (2016) *A Blueprint for Brexit: The Future of Global Financial Services and Markets in the UK*, Politeia, November; Barnabas Reynolds (2016) The UK's natural advantages mean the City can continue its dominance post-Brexit, *Daily Telegraph*, 23 November; Barnabas Reynolds (2017) *A Template for Enhanced Equivalence: Creating a Lasting Relationship in Financial Services between the EU and the UK*, Politeia, July; Barnabas Reynolds (2018) *Enhanced Equivalence – A Win-Win Proposition*, New Direction and Politeia, February.

A particular issue is clearing houses (or central counterparties (CCPs)): ‘the European Central Bank and the Bank of England [should] agree to a collaborative arrangement along the lines of the USA and UK arrangement for clearing US\$ denominated instruments by UK CCPs, to address the ECB’s systemic risk concerns regarding euro-denominated transactions’. Further, ‘disputes should be settled in a dispute settlement mechanism by an independent tribunal as is included in most modern FTAs. This will ensure financial market stability and investor protection without confining euro trade to the Eurozone’.

If the EU does not co-operate, it is still the case that ‘the national regimes of each member state, regarding overseas providers, professional or qualified investors, reverse solicitation and characteristic performance,¹⁴³ could allow non-EU service providers to offer investment services and activities to clients in that member state without requiring authorisation or registration in the EU’.

The UK also needs to build relationships with financial centres outside the EU. According to Singham and McBride, the UK should ‘consider forming an alliance with other global financial centres to agree an acceptable mutual recognition regime. Such an alliance would give the combined bloc a strong negotiating position when discussing regulatory matters with global regulatory and standard setting bodies and other countries. This alliance could include other financial centres such as New York, Chicago, Tokyo, Singapore, Hong Kong or even the Crown Dependencies and Overseas Territories that have established adequate home regulatory standards in key financial service sectors such as banking, asset management, insurance and reinsurance. Outside the EU, the UK should evolve its own regulations and work with other financial centres and international standard setters to create a more competitive regulatory environment globally’.¹⁴⁴

The MEP David Campbell Bannerman is confident that a CETA+++ deal will be agreed between the EU and the UK:¹⁴⁵

the negotiations are actually going far better than everyone thinks. Even the European Parliament’s own federalist negotiator, Guy Verhofstadt, has said that ‘80% of the deal is done’. Whilst there is a lot of heat about the Customs Union in the UK, the EU (to be fair) is quietly content to pursue a free trade agreement with us. Not only that, they

¹⁴³ Characteristic performance is used in conflicts law to determine which country’s law applies in the absence of an express or implied choice of law.

¹⁴⁴ Shanker Singham and Catherine McBride (2018) *Improving Global Financial Services Regulation*, Institute of Economic Affairs, May. See also Catherine McBride (2018) A mutual recognition agreement in financial services is in both the UK’s and EU’s best interest, *Brexit Central*, 9 May.

¹⁴⁵ David Campbell Bannerman (2018) Don’t be disheartened, *Brexiters – here’s why we should be confident and upbeat*, *Brexit Central*, 4 May.

are already offering us what some call a 'CETA++' deal based on the Canadian trade deal CETA or what I term 'SuperCanada'.

Take it from someone who has spent nine years on the European Parliament's Trade Committee, this is not insignificant. They are offering us the biggest, deepest, best deal they've ever done. The first '+' to CETA is that they are proposing a 100% tariff- and 100% quota-free deal with the UK. Before saying this is insignificant, ask the Australians and New Zealanders: they are pursuing a similar trade deal with the EU based on CETA but they are not getting 100% tariff- or quota-free access...

The second '+' being offered on top of CETA is services. OK, the third '+' of deeper services and financial services does need adding, but the EU is basically accepting the UK's 'red lines': Mr Barnier said exactly this in our Strasbourg debate in March: no Single Market, no Customs Union, no ECJ. That means a trade deal, and that means CETA++/SuperCanada.

Others are not so sure. Take Ambrose Evans-Pritchard for example:¹⁴⁶

This country is in a very dangerous situation. As if we need reminding, Michel Barnier told us pointedly this week that every national parliament in the EU – not to mention the Walloon assembly – will have a veto on the UK's future deal with the European Union.

His message was that this veto will be exercised unless Britain accepts EU governance over everything from tax policy to competition, regulatory standards, and environmental rules, and accepts the sweeping extra-territorial reach of the European Court (ECJ). "Nobody should underestimate the risks," he said.

Indeed not. The withdrawal treaty itself could be blocked at the last moment by the European Parliament or by challenges from any quarter at the ECJ. What is clear is that Brussels is exploiting this latent threat, hoping to pressure Britain into staying in the customs union and remaining subject to the core legal machinery of the EU.

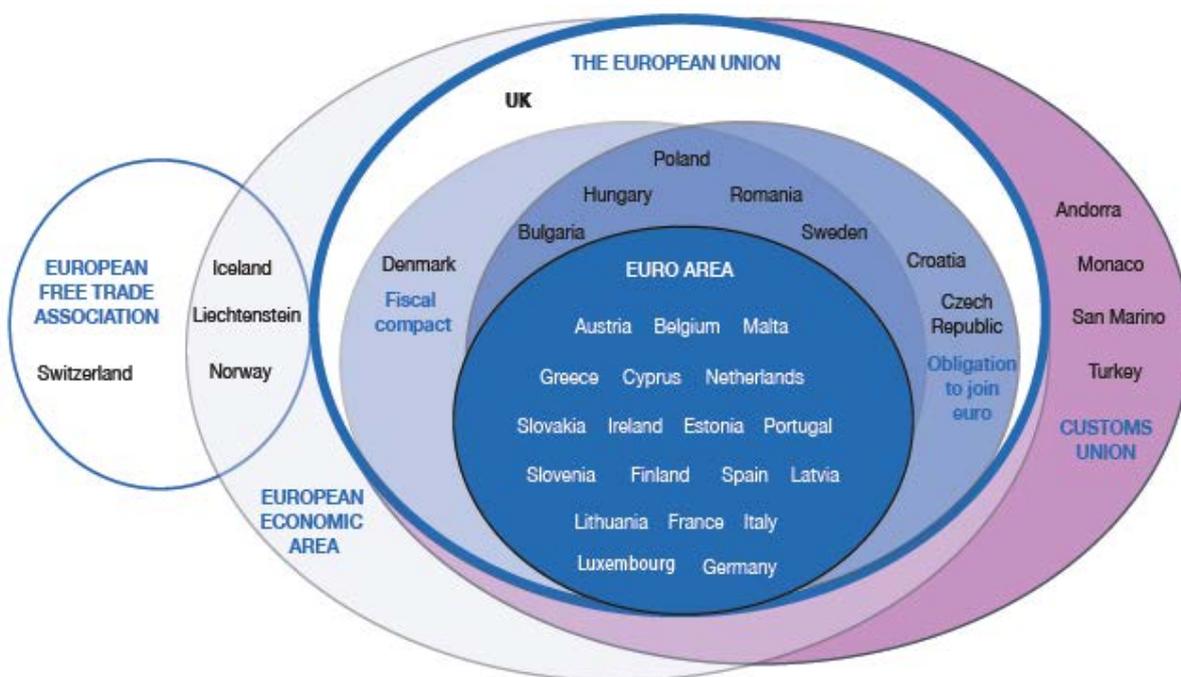
By the time we find out whether the veto is real, it will be too late for the UK to fall back to the austere but defensible foundations of the World Trade Organisation. Britain may be faced with the choice between a chaotic rupture at the 11th hour or capitulation to intolerable EU demands.

¹⁴⁶ Ambrose Evans-Pritchard (2018) Let us have a snap Brexit election to decide on the poisonous customs union, *Daily Telegraph*, 25 April.

The past conduct of these negotiations strongly suggests that the terms will amount to colonial legal status under EU suzerainty – a Brexit from Hell. Such an outcome would risk a slow slide towards civil war.

Further, despite Guy Verhofstadt’s apparent acceptance that ‘80% of the deal is done’, he is also saying that Brexit could be delayed for years unless Britain makes further concessions to the EU. These involve the UK agreeing to new ‘association agreement’ with the EU that would provide an umbrella treaty to link trade, security and other broader aspects of the relationship, but would leave the UK as a ‘rule taker’ from the EU, by having to accept significant parts of future EU laws. While this proposal is supported by Ollie Robbins, the UK’s chief negotiator, Jacob Rees-Mogg said: ‘This is not my vision of the relationship the UK will have with the EU. It sounds like second-tier EU membership and therefore is unattractive. We want to be a third country like Canada, Australia or the US, not a country that is continuing regulatory association with the EU and is bound into specific control structures’.¹⁴⁷ In addition, the clock is ticking and there is a real danger that the UK could leave the EU, but be stuck in both the Customs Union and the Single Market on a semi-permanent basis – abiding by the rules of both, but without any voting power.¹⁴⁸

Figure 3: Trading Blocs in Europe



Source: Figure 1.B, HM Treasury analysis: the long-term economic impact of EU membership and the alternatives, Cm 9250 April 2016

¹⁴⁷ Peter Foster and Gordon Rayner (2018) Guy Verhofstadt: Brexit will be delayed unless Britain makes further concessions to EU, *Daily Telegraph*, 27 April.

¹⁴⁸ Paul Goodman (2018) The consequences of Customs Union indecision. How Britain could end up with EEA-lite – formally or informally, *Conservativehome*, 9 May.

Trading opportunities outside the EU

Figure 3 shows the trading blocs in Europe. The two main trading blocs, apart from the EU, are the EEA and EFTA. UK membership of these would also severely constrain the UK's freedom to set its own regulatory standards and to negotiate trade deals with other countries because of their close links to the EU's Customs Union and Single Market.

The UK therefore needs to look to other parts of the world and the EU itself acknowledges that 90% of future growth in global GDP will be outside the EU.¹⁴⁹ There are two areas in particular with attractive trading opportunities.

The first is the Anglosphere (principally the US and Commonwealth countries, such as Canada, Australia, New Zealand and India) and other countries interested in FTAs, such as Japan. These comprise what Shanker Singham calls a 'New Prosperity Zone'.¹⁵⁰ Singham argues that 'the direction of travel of international trade thinking is towards countries recognising each other's regulatory systems if they achieve the same ultimate goal of regulation, even if the underlying regulation differs'.¹⁵¹ As a striking illustration of this, Japan and the UK have just agreed to complete a quick deal on mutual recognition of each other's goods and services standards when the UK leaves the EU.¹⁵² This is in marked contrast to the EU's bureaucratic approach and what Philippe Legrain calls Brexit's stark trade off with the EU: 'if the UK wants its regulations and standards to diverge from those of the EU, it will inevitably suffer a big loss of exports, especially in services, to its main trading partner. To have any hope of offsetting those losses, the benefits from deregulation and new trade deals with the rest of the world need to be very large indeed.'¹⁵³

The Anglosphere alone accounts for 33% of global GDP, compared with around 20% for the EU (once the UK leaves).¹⁵⁴ The former Australian High Commissioner, Alexander Downer,

¹⁴⁹ <http://www.europarl.europa.eu/sides/getAllAnswers.do?reference=E-2015-014997&language=EN>

¹⁵⁰ Shanker Singham (2017) *A Blueprint for UK Trade Policy*, Legatum Institute, April.

¹⁵¹ Shanker Singham (2017) A narrow-minded Brexit is doomed to fail, *CAPX*, 4 December.

¹⁵² Japan, UK eye post-Brexit mutual recognition of trade standards, *Reuters*, 15 December 2017.

¹⁵³ Philippe Legrain (2017) This government doesn't understand Brexit's trade-offs, *CAPX*, 7 December.

¹⁵⁴ The Commonwealth comprises 53 countries with a total population of 2.4bn people, linked by a common language and constitutions based on common law, a combined GDP of 13.5% of global GDP, and trade flows between them of \$560bn. There is a so-called 'Commonwealth effect', namely that business costs are 10-15% lower for Commonwealth countries dealing with each other compared with non-Commonwealth countries of similar size and GDP. However, the Commonwealth could be much more pro-active in achieving greater trade liberalisation between members, pro-competitive regulation and property rights protection. For example, beef, dairy, lamb, and poultry producers could be better integrated in global supply chains as the world's demand for protein increases. Similarly, the Commonwealth could influence the financial services regulatory agenda so that poorer countries in the Caribbean and Africa had better access to finance (Kate Andrews (2018) How the World can benefit from the Network Effects of the Commonwealth, Institute for Economic Affairs, 15 April; Ruth Lea (2018) The Commonwealth advantage: trading with the bloc offers buoyant economic prospects, LSE blog, 18 April; George Parker (2018) Theresa May to offer Commonwealth post-Brexit bonus, *Financial Times*, 15 April).

states: 'We are encouraging the UK and the EU quickly to establish a new, mutually beneficial relationship that sustains the economies and global influence of both. We are also keen to strike a free trade agreement with the UK. That shouldn't be too hard to do because we are like-minded free traders who know that protectionism makes people poorer and costs jobs. Finally, we have another hope: that Britain will continue to recognise that it is a global power with global responsibilities, not just a regional player. If it does so, this will mean Australia and the UK finding yet more ways to work together and promote the values and objectives we share'.¹⁵⁵

Similarly, the US Commerce Secretary, Wilbur Ross, says: 'There should be a free trade agreement between us once the UK is on its own. We're huge trading partners with each other and our economies are in many ways more similar to each other than either of us is to most of Europe. So there's all the logic in the world for the US and the UK to be not only good trading partners, but FTA partners.The EU talks a good job on free trade, but in fact it practises extreme protectionism'. He added that signing a bilateral deal with the UK was likely to be easier than signing an FTA with the rest of the EU and that any negotiations would not 'take a decade', but would be 'much shorter'. He also agreed that it would be better for US-UK trade relations if the UK were fully out of the Single Market and the Customs Union: 'It gives the potential for a more intimate relationship with us if you're out of it. [That's] simply because you can do your own negotiating, you don't need Brussels to do it and in fact right now, you're required to have Brussels do it, so that's a qualitative change in the relationship, and given the fundamental rapport between the US and the UK, I have to believe that could be constructive'.¹⁵⁶

The second is to recognise that the global economic centre of gravity is moving to the Pacific Rim and the UK needs to be fully engaged there. China's new Silk Road – 'One belt-one road' trade network between Europe and Asia – comprises 65 countries with 29% of global GDP and 64% of the global population. China's ambassador to the UK, Liu Xiaoming, states that: 'Britain now is China's major trading partner and investment destination in Europe. The Brexit Referendum has certainly not dampened the enthusiasm of Chinese businesses about investing in this country. On the contrary, it opens the door to the possibility of exploring a higher level of bilateral trade and investment arrangements...London's financial services sector stands to benefit from the ongoing internationalisation of the renminbi, if it continues to sell the City as an offshore centre for the currency. For China and the UK, renminbi internationalisation is an important part of our co-operation in [the] financial sectors. It is an area where we can dovetail respective strengths and produce mutual benefits'. He added that as the renminbi becomes a reserve currency, 'that will give London a further advantage and allow offshore RMB business in London to grow at an even faster speed'.¹⁵⁷

¹⁵⁵ Alexander Downer (2016) Australia is backing Brexit Britain all the way, *Daily Telegraph*, 17 December.

¹⁵⁶ Kamal Ahmed (2017) Ross backs post-Brexit UK-US trade deal, *BBC News*, 6 November.

¹⁵⁷ Tim Burke (2016) Brexit won't dampen China's enthusiasm for UK, says ambassador, *Financial News*, 11 October.

The Confederation of British Industry reports that the UK did £55bn of trade with China in 2016, making it Beijing’s eight biggest global trading partner. The only two non-Asian countries to surpass this were the US and Germany, with £386bn and £112bn of trade, respectively. Guy Dru Drury, head of the CBI’s branch in China, said: ‘The Sino-British relationship is a great success story. As we delve deeper into the Golden Era of ties between China and the United Kingdom, we have so much to offer each other, and British business is keen to play its part. From cars to chemicals, and services to schools, British organisations – especially many smaller companies – are tapping into a growing market in China, one that plays to the UK’s best competitive strengths. With the consumer market worth over £3.3trn, instantly recognisable British products are a particularly strong match for a growing generation of affluent Chinese. Moreover, this relationship creates thousands of jobs in the UK and China, raising living standards and boosting productivity. As the UK forges a new global trading future, it is well ahead of the curve in making the most of its relationship with the world’s fastest growing economy. By making inroads into China’s lesser economically known regions, the UK stands to profit from China’s move from manufacturing and infrastructure into technology and services’.¹⁵⁸

Table 2: WTO – Most favoured nation tariffs	
Tariff (%)	Weight (%)
0	43.7%
>0% to 5%	45.9%
>5% to 10%	7.5%
>10%	3.0%
Average tariff ≈ 3.2% (using 50% as the average tariff above 10%)	
Source: www.brexittoolkit.co.uk ; Sir David Ord, Bristol Ports	

The ‘no deal’ scenario is not that bad

If there is a ‘no-deal’ Brexit agreement between the UK and EU, the worst-case scenario is to trade with the rest of the world – including the EU – on the basis of WTO most favoured nation (MFN) tariffs.¹⁵⁹ The UK is free to set its own tariffs, but the same tariffs must be applied to all countries (unless a FTA is agreed with specific countries or trading blocs). Table 2 shows that the average WTO-MFN tariff is around 3.2%.¹⁶⁰ Of course, financial services and aviation etc are not covered by WTO rules, so a separate agreement with the EU would need to be implemented for these. There are also non-tariff barriers: Kee and Nicita (2017) estimate that average NTBs imposed by the EU on imported goods, despite being discriminatory and hence illegal under WTO rules, are equivalent to an additional tariff of 3.6%.¹⁶¹ The sum of tariff and

¹⁵⁸ Nick Gutteridge (2017) ‘Ahead of the curve’ British trade with global giant China booms as rest of EU lags behind, *Daily Express*, 3 November.

¹⁵⁹ https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm

¹⁶⁰ Other estimates assume 4%.

¹⁶¹ Hiau Looi Kee and Alessandro Nicita (2017) Short-term impact of Brexit on the UK’s exports of goods, Vox Blog, World Bank and UNCTAD.

non-tariff barriers at 6.8% just over half the 12% fall in the sterling exchange rate against the euro that followed the Referendum. Even if we assume higher average tariffs of 4% and NTBs equivalent to an additional tariff of 10.5% – as estimated by the UK government in January 2018¹⁶² – the total additional cost of 14.5% is still substantially ameliorated by sterling's depreciation.

The US trades more – under WTO-MFN rules – with the EU than does the UK. In 2015, US goods exports to the EU were \$273bn, while its goods imports were \$426 billion, implying a goods trade deficit with the EU of \$153bn. In 2014 (the latest year available), US service exports to the EU were \$219bn, while its services imports were \$169bn, implying a services trade surplus of \$51bn.¹⁶³ Total US exports to the EU are therefore of the order of \$492bn, while total US imports from the EU are of the order of \$595bn. In comparison, in 2016, total UK exports to the EU were £236bn, while total UK imports from the EU were £318bn.¹⁶⁴

At the time of the Referendum, the Treasury estimated that there would be a 24% reduction in trade and a 7.5% reduction in GDP in the event of 'no deal' which imposed WTO-MFN tariffs and NTBs on trade with the EU.¹⁶⁵ The Treasury used a 'gravity' model of trade to derive this estimate. This model assumes that trade between countries increases with the size of their economies and reduces as the distance between them increases. A change in tariffs and NTBs will change the level of trade and this will have knock-on effects on wider macroeconomic variables, such as investment, productivity, and GDP. Assumptions need to be made about the size of these knock-on effects.

One key assumption relates to the linkage between foreign direct investment (FDI) – which the Treasury model 'assumes' will fall as a result of the reduction in trade – and a consequential change in productivity. However, the Treasury model overestimated the impact of EU membership on FDI inflows. It 'assumes' that EU membership increases both internal and external FDI inflows by 35% – and 'assumes' FDI inflows would fall by the same percentage if the UK left the EU – whereas there has been no significant increase in FDI inflows into EU member states from outside the EU (except for into the UK).¹⁶⁶ Another key

¹⁶² See page 9 of EU Exit Analysis: Cross Whitehall Briefing, January 2018 (prepared for House of Commons Exiting the European Union Committee); <https://www.parliament.uk/documents/commons-committees/Exiting-the-European-Union/17-19/Cross-Whitehall-briefing/EU-Exit-Analysis-Cross-Whitehall-Briefing.pdf>.

¹⁶³ <https://ustr.gov/countries-regions/europe-middle-east/europe/european-union>

¹⁶⁴ Statistics on UK-EU trade, House of Commons Library Briefing Paper, Number 7851, 7 November 2017; <http://researchbriefings.files.parliament.uk/documents/CBP-7851/CBP-7851.pdf>

¹⁶⁵ H. M. Treasury (2016a) H M Treasury Analysis: The Long-term Economic Impact of UK Membership and the Alternatives, Cm 9250, April; H. M. Treasury, (2016b) The Immediate Economic Impact of Leaving the EU, Cm 9292, May.

¹⁶⁶ See pp. 18-19 of Ken Coutts, Graham Gudgin and Jordan Buchanan (2017) How the Economics Profession Got It Wrong on Brexit, Centre for Business Research, University of Cambridge Working Paper No. 493, January. Further, most of what are classified as FDI inflows into the UK are related to mergers and acquisitions, rather than representing genuine new investment.

assumption relates to the linkage between a reduction in trade and a consequential change in productivity. The Treasury model ‘assumes’ a significant fall in productivity in response to a reduction in trade (in part, via the ‘assumed’ reduction in FDI), whereas there is no relationship between the growth rate in goods trade and the growth rate in per capita GDP (a key measure of productivity improvements) in OECD countries over the period 1980-2015.¹⁶⁷ The gravity model also overemphasises the importance of geographical proximity in the case of countries with a high share of services in national output (80% in the case of the UK), since, as Walsh (2006) has demonstrated, services trade is influenced by size of economy and common language, but not by distance.¹⁶⁸

Let’s do a quick reality check. UK exports to the EU amount to 12% of UK GDP, additional tariffs and NTBs lie between 6.8% and 14.5%, and sterling has fallen by 12% against the euro since the Referendum. Yet the Treasury estimates that UK GDP will fall by 7.5%, i.e., the UK will lose nearly two-thirds of its exports to the EU when it leaves the EU, and those exports will not be diverted to other markets. In the words of John McEnroe, ‘you cannot be serious’.¹⁶⁹

The Treasury, in response to the criticisms it received,¹⁷⁰ subsequently changed the model it used. It switched to a ‘computable general equilibrium’ model of trade called GTAP.¹⁷¹ However, the model was calibrated to produce a fall in GDP in the event of a ‘no deal’ of 7.7%, virtually unchanged from the model used at the time of the Referendum.¹⁷² The 7.7% is made up as follows: 1% due to tariffs, 1.1% NTBs (immediate loss of access), 3.4% NTBs (gradual regulatory divergence), 1.3% NTBs (customs) and 0.9% (migration controls).¹⁷³ In other words,

¹⁶⁷ Hiau Looi Kee and Alessandro Nicita (2017) Short-term impact of Brexit on the United Kingdom's export of goods, World Bank Policy Research Working Paper No. 8195, November; <https://ssrn.com/abstract=3036712>. See also Chart 7 in Ken Coutts, Graham Gudgin and Jordan Buchanan (2017) How the Economics Profession Got It Wrong on Brexit, Centre for Business Research, University of Cambridge Working Paper No. 493, January.

¹⁶⁸ Walsh, K. (2006) Trade in Services: Does Gravity Hold? A Gravity Model Approach to Estimating Barriers to Services Trade. Discussion Paper Series, no 183, Revenue Commissioners Dublin.

¹⁶⁹ A study by Oliver Wyman and Clifford Chance in March 2018 estimated the cost to the UK of WTO-MFN tariff and NTBs at 1.5% of gross value added (GDP plus taxes on products minus subsidies on products) or £27bn. This is equivalent to around 11.5% of the value of UK exports to the EU. The cost to the EU27 would be £31bn or 0.4% of GVA (The ‘Red Tape’ Cost of Brexit).

¹⁷⁰ See, e.g., Blake, D. (2016) Measurement without Theory: On the extraordinary abuse of economic models in the EU Referendum debate, City University of London, June.

¹⁷¹ Global Trade Analysis Project at Purdue University. This is a more ‘classical’ model of trade and has both a ‘supply’ side (involving production functions with factors of production, such as labour and capital) and a ‘demand’ side (like the gravity model).

¹⁷² See page 16 of EU Exit Analysis: Cross Whitehall Briefing, January 2018 (prepared for House of Commons Exiting the European Union Committee); <https://www.parliament.uk/documents/commons-committees/Exiting-the-European-Union/17-19/Cross-Whitehall-briefing/EU-Exit-Analysis-Cross-Whitehall-Briefing.pdf>

¹⁷³ See page 18 of EU Exit Analysis: Cross Whitehall Briefing, January 2018 (prepared for House of Commons Exiting the European Union Committee); <https://www.parliament.uk/documents/commons-committees/Exiting-the-European-Union/17-19/Cross-Whitehall-briefing/EU-Exit-Analysis-Cross-Whitehall-Briefing.pdf>.

of the estimated fall of 7.7% in GDP, 5.8% (or 75% of the total) is due to illegal NTBs. This will not happen. Even if there will be new and unavoidable frictional costs, the Treasury has grossly overestimated them. The Treasury estimates that there will be a 1.3% reduction in GDP due to frictional border (i.e., customs) costs. Yet if the same border costs as in the EU's trade deal with Switzerland are applied to the UK, these amount to just 0.12% of GDP, more than ten times lower.¹⁷⁴ The new model has been used to predict that the max-fac solution would wipe 1.8% off GDP.¹⁷⁵ Back to John McEnroe for a comment.

Using different modelling assumptions, Kee and Nicita (2017)¹⁷⁶ estimate that UK exports to the EU would fall by just 2% in a 'no deal' scenario, while Coutts et al (2018)¹⁷⁷ estimate that, by 2030, per capita GDP would be unchanged, while GDP would be 2% lower than otherwise, due to lower immigration.

In other words, a 'no-deal' scenario is not that bad. Further, a 'no-deal' agreement 'would not result in a major slowdown or recession', since policymakers will respond in ways that reduces the consequences. This is the prediction of a study by Capital Economics sponsored by Woodford Investment Management (WIM).¹⁷⁸ While there would be some economic dislocation with growth falling below 1%, the government would react with a combination of low interest rates, low taxes and increased subsidies to counteract the market shock. Mitchell Fraser-Jones, Head of Investment Communications at WIM, said: 'In the event of no deal, the long-term prospects for the UK economy are nowhere near as bleak as many have predicted. ...There is considerable grounds for optimism that the long-term outcomes for the UK economy will be far better than the alarmed consensus would suggest'.¹⁷⁹

¹⁷⁴ Professor Michael Ambühl, Professor of Negotiation and Conflict Management at ETH Zurich and former Swiss State Secretary, who negotiated one of the Swiss bilateral FTAs with the EU, estimates that border costs in the EU-Swiss FTAs are 0.1% of the value of trade. Given that UK trade with the EU is equal to 12% of UK GDP, border costs would amount to only 0.012% of GDP. Further, only 1% of goods are physically inspected (Slide 8 of a presentation at Policy Exchange on 19 April 2018).

¹⁷⁵ Alex Spence and Alberto Nardelli (2018) The Brexiteers' Customs Plan Would Wipe 1.8% Off GDP, Ministers Have Been Told, BuzzFeed, 9 May; https://www.buzzfeed.com/alexspence/the-brexiteers-customs-plan-would-hurt-145000-uk-companies?utm_term=.fbOORWNOM#.hc8ORqex6

¹⁷⁶ Using a direct model of trade which directly calculates the additions to production costs from tariffs and NTBs and uses sector- or commodity-specific elasticities to estimate the impact on demand for exports and imports.

¹⁷⁷ Using a macro-economic model – similar to that used by both Cambridge Econometrics and Oxford Economics – estimated using actual historical data rather than derived from general equilibrium theory and assumptions as in the Treasury model. See Chart 8 in Ken Coutts, Graham Gudgin and Jordan Buchanan (2017) How the Economics Profession Got It Wrong on Brexit, Centre for Business Research, University of Cambridge Working Paper No. 493, January.

¹⁷⁸ *Brexit: where are we now?*, 8 November 2017; <https://woodfordfunds.com/words/blog/brexit-where-are-we-now/>

¹⁷⁹ Woodford Investment Management conducted a poll on Twitter. There were 41,973 responses to the question 'What will Brexit mean for the UK economy in the long run?':

- 45% – We're facing a cliff-edge
- 21% – Slightly worse off
- 13% – Slightly better off
- 21% – It's great news all round

However, the study predicts that a compromise deal will be agreed by November 2018, since 'neither side can be entirely comfortable about the prospect of walking away from the table without an agreement'. This compromise deal is 'not likely to have a meaningful impact on the large proportion of the economy that does not participate in international trade. ...Indeed, there are good reasons to think the British economy will continue to perform well whether or not it is inside or outside of the EU. ...The City of London will likely remain a hub of prosperity after March 2019. London's pre-eminent position as a global financial centre predates the Single Market, and the City possesses intrinsic advantages, which will endure. Due to financial services' outsized importance for the UK, Brexit could help the industry in two key respects. One is that industry may avoid future deleterious regulation from Brussels (such as the potential Financial Transactions Tax), thus helping to retain London as a destination of choice. The second is that, in pursuing its own free trade agreements, Britain may be able to prioritise coverage of financial services in a way which the EU, as a collective entity, couldn't or wouldn't be able to do'.

Lowering tariffs on imports would be even better

Professor Patrick Minford estimates that EU barriers on trade in food and manufactures raise their prices by 20%, or by an average of 8% across all goods purchased. EU trade barriers against the rest of the world reduce UK GDP by 7% (£135bn pa), while the UK remains a member.¹⁸⁰ This is made up of a 4% cut in GDP due to lower productivity¹⁸¹ and a 2% cut in GDP due to the costs of EU regulations.¹⁸² The remaining 1% is accounted for by the net UK contribution (0.6% of GDP), the taxpayer subsidy in the form of in-work benefits to unskilled immigration (0.2% of GDP)¹⁸³ and other factors.

By leaving the EU and removing these trade barriers, the UK will be able to recover this loss in GDP. This will not be without some cost, however. UK companies will face greater competition for the goods and services that they produce and they will have to become more competitive if they are to maintain their market share and increase their exports. This will, in turn, require increased investment in both physical and human capital in order to increase

¹⁸⁰ Patrick Minford (2018) *From Project Fear to Project Prosperity*, Economists for Free Trade, 15 August; <https://www.economistsforfreetrade.com/wp-content/uploads/2017/08/From-Project-Fear-to-Project-Prosperity-An-Introduction-15-Aug-17-2.pdf>

¹⁸¹ UK companies protected by trade barriers are less competitive and hence invest less.

¹⁸² See also Patrick Minford (2018, p.10) *How the Civil Service has misled us on the Costs of Brexit and the Customs Union*, Economists for Free Trade, May; <https://www.economistsforfreetrade.com/wp-content/uploads/2018/05/EFT-How-the-Civil-Service-has-misled-us-on-costs-of-Brexit-and-the-customs-union-May-2018.pdf>

¹⁸³ In-work benefits for 2.4m EEA nationals cost the Treasury £4.4 billion in 2014/15 or £1,800 per capita, equivalent to a 20% wage subsidy (<https://www.conservativehome.com/platform/2017/12/andrew-green-the-immigration-policy-that-we-need-after-brexit.html>)

productivity.¹⁸⁴ But this is the only way in the long run to increase trade and prosperity. As Daniel Hannan's Institute for Free Trade points out: 'We must not shy away from the fact that some people lose out from free trade. But it is vitally important to clarify the scale on which this occurs. Many more people lose out from protectionist policies. The overall effect of an open trading environment on the economy is undoubtedly positive'.¹⁸⁵

Minford estimates that if EU trade barriers on food and manufactures were reduced from 20% to 10%, UK GDP would rise by 4%.^{186,187} As an interim measure, tariffs could be lowered on imported goods that the UK does not have a domestic industry to protect, such as tea, coffee and oranges. Similarly, the 12% devaluation of sterling against the euro following the Referendum raised the prices of imports by 12%; the prices of these imports could be restored to their pre-Referendum levels by abolishing all import tariffs of 12% or less.¹⁸⁸

Finally, we should note the limits to protectionism. Hiding behind the protective wall of the Common External Tariffs did not prevent the share of UK manufacturing in GDP falling from 35% when the UK joined the EU to around 8% now.¹⁸⁹

Negotiating future trade agreements

As Kevin Dowd says: 'The primary objective of trade policy should be to promote the interests of consumers, not producers. The UK's best pro-Brexit trade policy should be to trade as freely as possible with the rest of the world...and avoid deals that focus on other objectives such as

¹⁸⁴ Minford is not the only economist to argue that lowering trade barriers helps to increase productivity. Ian Mitchell believes that Brexit provides a 'genuine opportunity for UK global leadership [in implementing a sustainable, market-orientated agricultural policy] outside the EU in the next decade... [This] would lower prices for consumers, lift the economy's productivity and allow for substantial budget savings to support the environment and public finances... [especially given that there is] no real prospect of substantial reform of the EU agricultural model in the next decade' (The Implications of Brexit for UK, EU and Global Agricultural Reform in the Next Decade, Chatham House, 2 November 2017; <https://www.chathamhouse.org/publication/implications-brexit-uk-eu-and-global-agricultural-reform-next-decade>).

¹⁸⁵ <http://ifreetrade.org/>

¹⁸⁶ Patrick Minford, Sakshi Gupta, Vo Phuong Mai Le, Vidya Mahambare, Yongdeng Xu (2015, chapter 4) *Should Britain Leave the EU? An Economic Analysis of a Troubled Relationship*, Edward Elgar, Cheltenham; Patrick Minford (2018, p.9) How the Civil Service has misled us on the Costs of Brexit and the Customs Union, Economists for Free Trade, May; <https://www.economistsforfreetrade.com/wp-content/uploads/2018/05/EFT-How-the-Civil-Service-has-misled-us-on-costs-of-Brexit-and-the-customs-union-May-2018.pdf>

¹⁸⁷ One of the world's most successful trade liberalisation policies is that of Australia, beginning in 1986. Using the GTAP model, this has been shown to have increased Australia's GDP by 5.4% (see Centre for International Economics (2017) *Australian Trade Liberalisation - analysis of the impacts*, report prepared for the Australian Ministry of Foreign Affairs, CIE, Canberra and Sydney).

¹⁸⁸ As recommended in Patrick Minford (2017) *A Budget for Brexit 2017*, Economists for Free Trade, November.

¹⁸⁹ Patrick Minford (2018) *From Project Fear to Project Prosperity*, Economists for Free Trade, 15 August; <https://www.economistsforfreetrade.com/wp-content/uploads/2017/08/From-Project-Fear-to-Project-Prosperity-An-Introduction-15-Aug-17-2.pdf>

regulatory harmonisation'.¹⁹⁰ In the words of the then Lord Mayor of London, Jeffrey Muntevans, at the City Banquet at Mansion House on 26 October 2016, the UK should agree a 'consistent and forward-looking Brexit strategy' in order to secure a 'bold, bright, buccaneering post-Brexit future'.¹⁹¹

There are a range of factors contributing to a successful trade policy:¹⁹²

- Provide the highest possible quality of product or service at the most competitive prices
- Exploit comparative advantage, which in the UK's case is more in services than in goods,¹⁹³ and more in high-tech goods than standard mass-produced goods
- Actively seeking to reduce non-tariff barriers to trade, by, for example:
 - agreeing mutual recognition or equivalence of products and services to reduce dual certification and border checks
 - recognising that increasingly there are global standards which reduce the need to negotiate local standards that are different
 - taking maximum advantage of international law and multi-national agreements to circumvent barriers
 - and building trust, backed up by effective enforcement of trading standards.
- Agree a dispute resolution procedure which also specifies actions in the case of non-compliance
- Make the easiest deals first
- Provide effective support for exporters.

While this is all pretty obvious and is broadly accepted by the government, it needs restating to counter the arguments from those with vested interests that trade deals are very complicated and take seven or more years of tough negotiations to agree. They can be agreed in under two years.

¹⁹⁰ Kevin Dowd (2017) *A Trade Policy for a Brexited Britain*, Institute for Economic Affairs Discussion Paper No. 85, August. In March 2018, the consumers' association Which? issued a 'Consumer Charter for Brexit' in which it wanted the Government to deliver a Brexit that puts consumers first: 'We believe that the success of Brexit will ultimately be defined by what it delivers for consumers and what matters to them most – standards, choice, rights and price'; <https://www.which.co.uk/policy/eu-exit/2439/consumer-charter-for-brexit>

¹⁹¹ Lord Mayor calls for a bold Brexit plan, *Financial News*, 26 October 2016; Mark Sands (2016) The Lord mayor will tonight tell the City to draft plans for a "bold, bright, buccaneering" post-Brexit future, *City A.M.*, 26 October.

¹⁹² FTAs negotiated under WTO rules also tend to have agreements on, e.g., agricultural import quotas, competition and anti-dumping, government procurement policies, intellectual property (IP), investment and capital mobility, and dispute resolution.

¹⁹³ Although 80% of UK GDP comes from services, only 45% of the UK's exports (which account for 30% of UK GDP) is in services, and only 38% of the UK's service exports (5% of GDP) go to the EU. James Harris (2017) *Revealing the export map of Britain – what ONS is learning about international trade in services*, Office for National Statistics.

But no amount of successful negotiation of a trade agreement is going to help if you are not putting the customer first. A City of London Corporation spokesperson is reported to have said: ‘London faces increased competition from across the globe and today’s findings [about London’s place as the world’s leading financial centre discussed above] show just how other cities are hot on the heels of our capital. As a global financial centre, we can’t afford to rest on our laurels. It is essential that the financial and professional services sector gets the right sort of outcome from the Brexit negotiations – one that focuses on jobs and growth across the City’.¹⁹⁴ All very good, but no mention of the customer at all. Putting the consumer first means that regulations should be the least restrictive in terms of market competition. It also means recognising that the ‘precautionary principle’, so often used by the EU to ‘protect’ consumers, is more likely to be used as a protectionist device for shielding local producers from international competition.¹⁹⁵

Similarly, no amount of successful negotiation is going to help if you are not offering the most competitive prices, as De La Rue discovered in March 2018 when it lost the contract for printing the new British passport to the Franco-Dutch company, Gemalto, which offered £120m less.¹⁹⁶

The UK has a number of comparative advantages. One key one is the ‘human capital endowment’ of educated and skilled labour, critical to being a global supplier of educational, scientific, financial and professional services. Another is ‘institutional endowments’, such as the English language and a world class legal framework.

It is remarkable that services are not included in standard trade deals,¹⁹⁷ given that services trade is considerably more important than goods trade in most developed countries. The UK should be at the forefront of changing this when it rejoins the WTO as an independent country.

There are a whole range of ways to reduce NTBs – which in any case are discriminatory and hence illegal under WTO rules – while at the same time securing the greatest protections for IP in our leading service sectors, such as, biotechnology. These include:

¹⁹⁴ Jasper Jolly (2018) London remains on top of the world for global financial services says major report, *City A.M.*, 26 March.

¹⁹⁵ Processed chicken comes to mind which faces an 88% tariff if it is imported into the EU.

¹⁹⁶ Dia Chakravarty (2018) Global Britain puts the interests of taxpayers ahead of misplaced economic nationalism, *Daily Telegraph*, 24 March.

¹⁹⁷ The EU-Canada deal (CETA) has over 550 restrictions in trade in services. For example, for legal services, this includes EU nationality and commercial presence requirements for service provision in some member states (See page 21 of EU Exit Analysis Cross Whitehall Briefing, January 2018); <https://www.parliament.uk/documents/commons-committees/Exiting-the-European-Union/17-19/Cross-Whitehall-briefing/EU-Exit-Analysis-Cross-Whitehall-Briefing.pdf>

- Agreeing mutual recognition or equivalence of products and services to reduce costly non-tariff barriers, such as dual certification and border checks¹⁹⁸
- Recognising that increasingly there are global standards (e.g., the world-wide harmonisation of intellectual property law;¹⁹⁹ and in many aspects of financial services, such as banking, insurance and securities trading²⁰⁰) which reduce the need to negotiate local standards that are different
- Taking maximum advantage of international law and multi-national agreements to circumvent barriers (e.g., the WTO Most Favoured Nation (MFN) principle of non-discrimination;²⁰¹ the legal obligation to allow timely customs clearance of inwards goods under the WTO Trade Facilitation Agreement;²⁰² agreements on product regulations,²⁰³ on services trade and regulations²⁰⁴ and on government procurement contracts;²⁰⁵ the G20 global principles of 2009 which recognise that the free flow of capital is critical for the real economy; the BIS support for a level playing field in financial services; and making use of ‘reverse solicitation exemptions’ which allow financial institutions to provide cross-border services to a wholesale client without being registered or authorised in that client’s state, provided that the services are provided on the initiative of the client²⁰⁶)
- Building trust, backed up by effective enforcement of trading standards.

It is important to separate product/service standards from non-product/service standards, i.e., regulations that specify how a product or service is made, how people making that product or service are employed, environmental pollution standards etc. The former are necessary to ensure customers get the quality of product or service they expect. The later can be a disguised way of restricting competition. It is also important to agree standards, ideally globally, in key areas supporting the global digital market, such as technology and

¹⁹⁸ Non-tariff barriers are now the biggest barriers in international trade.

¹⁹⁹ The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), 1995.

²⁰⁰ For example, the Basel Committee of Banking Supervision (BCBS), the International Association of Insurance Supervision (IAIS), the International Organisation of Securities Commissions (IOSCO) and the G20’s Financial Stability Board (FSB). The purpose of these organisations is to avoid systemic risks, the fragmentation of markets, protectionism and regulatory arbitrage. See Shanker Singham and Catherine McBride (2018) *Improving Global Financial Services Regulation*, Institute of Economic Affairs, May.

²⁰¹ Shanker Singham and Catherine McBride (2018) *Improving Global Financial Services Regulation*, Institute of Economic Affairs, May.

²⁰² WTO (2018c), The WTO Trade Facilitation Agreement;
https://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm

²⁰³ The Agreement on the Technical Barriers to Trade (TBT), 1979, and the Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures, 1995 (covers food safety and animal and plant health).

²⁰⁴ General Agreement on Trade in Services (GATS), 2000; Trade in Services Agreement (TiSA) currently being negotiated by 23 members of the WTO which account for 70% of world trade in services.

²⁰⁵ WTO Agreement on Government Procurement (GPA).

²⁰⁶ Barnabas Reynolds (2017) *The Art of the No Deal: How Best to Navigate Brexit for Financial Services*, *Politeia*, November; *Continuity of Contracts and Business on a “Hard” Brexit: Human Rights and Reverse Solicitation to the Rescue!*, Shearman & Sterling, 31 October 2017.

telecommunications, e.g., convergence on data standards (including the storage and transfer of personal data) and rules on roaming to avoid high charges for consumers.²⁰⁷

A dispute resolution procedure needs to be agreed, with an independent adjudicator.²⁰⁸ This would not only deal with issues relating to product and service standards, conformity assessments, and rule of origin, it would also deal with other features of trade policy, such as FTAs with third countries. It would also need to cover actions in the case of non-compliance, as well as sanctions in the case of dumping etc.

Critical to the UK's success as a global player in international trade and a promoter of free trade agreements is its future trade agreement with the EU. This will have a significant influence on our subsequent trade deals. There will be a path dependency, making it considerably more difficult to agree a liberal deal with other countries if we have been forced into the protectionist one that the EU wants. This is because the world has weaponised trade, as the current spat between the US and China makes clear, with the ultimate losers being US and Chinese consumers. As Shanker Singham points out: 'So far, in the year since Article 50 negotiations commenced, it is the UK that has made concessions to the EU, which the EU has pocketed and offered little in return. This trajectory cannot, obviously continue'.²⁰⁹ Further, waiting until the last minute deal will play into the hands of the EU, just as it did with the divorce bill.²¹⁰ To counter this, the UK must be prepared to walk away without a deal and continue preparation for a 'no deal' outcome.²¹¹

The challenges here will nevertheless be formidable, given the EU's obsession with bureaucratic complexity. For a flavour of this, see this EU-commissioned study:

Much of the current debate about the future trade (and economic) relationship is oriented towards a series of available models, derived from existing agreements between the EU and third countries. "Norway" (EEA), "Switzerland" (a series of bilateral agreements), "Turkey" (a customs union), "Ukraine" (an association agreement), "Canada" (CETA, a free-trade agreement) and the "WTO" have become mainstream in public debates. These models/agreements represent different approaches and levels of relationship or integration, and have a range of divergent features. At a political level, the EU side broadly argues that a choice must be made between these different models, whereas the UK side advocates a tailor-made,

²⁰⁷ CBI (2018) *Smooth operations: An A-Z of the EU rules that matter for the economy*, April; <http://www.cbi.org.uk/insight-and-analysis/smooth-operations/>

²⁰⁸ Adjudication can be by bilateral tribunals or by permanent international courts or bodies, such as the International Court of Justice (ICJ) or the WTO Disputes Panels and Appellate Body.

²⁰⁹ Shanker Singham (2018) We need to start acting like the independent nation that we are about to become, *Daily Telegraph*, 31 March.

²¹⁰ Liam Halligan (2018) A hurried Brexit will play into the EU's hands, *Daily Telegraph*, 24 March.

²¹¹ James Forsyth (2018) To solve her Brexit conundrum, the PM must be able to walk away if she has to, *Sun*, 24 March.

*bespoke agreement. Clearly, the fact that the EU has concluded a range of different types of agreements with third countries shows that there is scope for some creativity, and a choice of levels of intensity in the configuration of the future relationship. However, what is often missing from the debate is a deeper understanding of the basic distinction between what this study will term the **market integration and trade liberalisation** paradigms. That distinction divides the different models, with Norway, Switzerland and Ukraine broadly on the market integration side, and Turkey, Canada and the WTO on the trade liberalization side. This is a divide which, if not unbridgeable, is deeper than is often assumed. The reasons and causes are of an economic, political, and particularly also of a legal and institutional nature (lawyers would in fact say “constitutional”).²¹²*

In terms of sequencing, the easiest deals will be with like-minded countries, such as New Zealand, Australia, Canada and the US.²¹³ New Zealand, for example, has near-zero tariffs – the average tariff rate is 1.4% – and few other trade barriers.²¹⁴ Shanker Singham recommends we should apply to join the Trans Pacific Partnership (TPP), given the importance of Asia to future world economic growth.²¹⁵ The UK’s experience of negotiating the future trade deal with the EU – the first time it has done so in 45 years – will be very helpful in this respect.

Finally, as Michael Burrage argues, future trade agreements will not be enough if British companies do not respond by increasing their level of exports and it is important to help companies to do so. The government is doing its bit with the Department for International Trade (DIT) offering various trade promotion functions – such as providing risk assessments of world markets, funding participation in trade shows and appointing local trade advisors – tips for exporting via social media, entrepreneurial dealmakers/mentors for start-ups, and the designation of experienced diplomats as the ‘trade commissioners’ for those parts of the world they know best. In addition, the Office for National Statistics has introduced data tools which help to identify the trade flows in goods between the UK and 234 other countries, which will help producers and policy makers establish priorities for future trade agreements.²¹⁶

²¹² Policy Department for External Relations (2018) *Future Trade Relations between the EU and the UK: Options after Brexit*, Directorate General for External Policies of the Union, PE 603.866, EP/EXPO/B/INTA/2017/18, March.

²¹³ Deals with New Zealand and Australia are well under way, and President Trump has said he is willing to do deals with countries with similar economic backgrounds.

²¹⁴ Kevin Dowd (2017) *A Trade Policy for a Brexited Britain*, Institute for Economic Affairs Discussion Paper No. 85, August.

²¹⁵ Shanker Singham (2018) We need to start acting like the independent nation that we are about to become, *Daily Telegraph*, 31 March.

²¹⁶

<https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/articles/tradingoodscountrybycommodityexperimentaldata2011to2016/2018-04-16>

However, as Burrage also points out, much more needs to be done by the 2,500 trade associations in the UK to redirect their members towards export markets by encouraging them to become certified as Authorised Economic Operators under the World Customs Organisation (WCO) programme, which simplifies and fast-tracks customs procedures throughout the world. The programme is 'is likely to become especially important for UK trade with the EU27 post-Brexit, as well as with China, Japan, the US and other countries with which the EU currently has mutual recognition agreements (MRAs). The UK is a laggard in this programme. Germany currently has ten times more AEOs than the UK, and no UK association seems to have thought it worthwhile to help its SME members with the quite rigorous and time-consuming certification process'.

Trade associations need to become 'research-intensive organisations whose primary goal is to know everything there is to know about the potential global markets for their own members' products or services. And the best way it may do that is by forming a relationship with them based on shared access to, and command of, the market analysis tools of the International Trade Centre (ITC) in Geneva. These provide international trade data in the form of comparative tables, graphs and maps alongside other key variables that affect trade, such as international demand, GDP, applied and bound tariff rates,²¹⁷ non-tariff barriers, trade agreements and rules of origin requirements of partner countries. They thereby provide an array of powerful indicators and measures of export performance... [In addition], the DIT should now be setting in motion wholly new, research-based relationships between government, trade associations and their members, as well as universities, with the aim of creating a wholly new environment which encourages and equips UK companies to break with past habits and face the export challenges and opportunities of Brexit'.²¹⁸

Conclusion

The UK's prospects for trade and prosperity after Brexit will be inversely related to the size of the tariffs on international trade that the UK itself sets. The lower the tariff barriers, the brighter the prospects will be. A study by the UK Trade Policy Observatory at the University of Sussex estimated that if the UK imposed WTO-MFN tariffs on EU imports after Brexit, this would increase the 'average cost of living by around 1% and increase it for 8% of households by 2% or more'.²¹⁹ Similarly, the Treasury predicts a 7.7% reduction in GDP in the event of 'no deal' in which the UK retained the existing Common External Tariffs with the rest of the world and also imposed the same tariffs on trade with the EU. But why would the UK government do this? It would be a policy choice, not a consequence of Brexit.

²¹⁷ The bound tariff rate is the MFN WTO tariff rate, while the applied tariff rate can be less than this.

²¹⁸ Michael Burrage (2018) Ministers must urgently ramp up engagement with trade associations to get more British firms exporting, *Brexit Central*, 3 April.

²¹⁹ Clarke, S, Serwicka, I, Winters, L A (2017) Will Brexit raise the cost of living?, *National Institute Economic Review*, Issue 242, October; <https://www.niesr.ac.uk/publications/will-brexit-raise-cost-living>

So long as the UK government liberates itself from the protectionist mindset of the EU – which regards trade as a weapon – and reduces trade barriers after Brexit, and UK businesses respond positively to the challenge of increased international competition, the prospects for UK trade and prosperity post-Brexit are very bright indeed. EU barriers on trade in food and manufactures raise their prices by 20%, or by an average of 8% across all goods purchased. If these barriers were reduced from 20% to 10%, UK GDP would rise by 4%. Removing excessive Single Market regulatory burdens could add another 2% to UK GDP. If anyone questions the plausibility of these numbers, they only have to look at Australia’s move to free trade which added 5.4% to its GDP.

Furthermore, on the basis of both international and EU law, the monetary costs to the UK of leaving the EU should be fairly low. Similarly, the frictional costs to both the UK and the EU of their post-Brexit relationship should also be low.²²⁰ However, as a consequence of both the concessions made to date by the UK in order to demonstrate its goodwill and the hard line taken by the EU in order to discourage other member states from leaving, these costs could well end up being much higher than they need be for both sides. The EU’s ‘level playing field’ demand, laid out in its negotiating Guidelines for a future trading relationship, is worse than a standard ‘no compete’ clause when a senior employee leaves a company. The EU wants to put the UK on permanent gardening leave. It would effectively prevent the UK from achieving regulatory autonomy or from pursuing an independent trade policy. To avoid all this this, it is vital that the issues raised in this article are fully recognised.

We should also bear in mind the counterfactual and ask what it would be like to remain in the EU. The EU is like the Titanic, but with a big difference. Whereas Captain Edward Smith of the Titanic did not see the iceberg in his path, Captain Jean-Claude Juncker and First Officer Michel Barnier of the good ship ‘European Union’ know full well that there is an iceberg – indeed multiple icebergs – in their path, but believe that their collective political will is strong enough to plough straight through: it is going to be a very bumpy ride for those remaining on board.

²²⁰ In the EU-Swiss FTA, only 1% of goods are physically inspected and the actual ‘frictional’ cost to traders at the border is only about 0.1% of the value of the goods. Presentation at Policy Exchange on 19 April 2018 by Professor Michael Ambühl.