Beyond Brexit

The original motive for writing this article was my appearance June 9th on the ITV programme "Good Morning Britain", which is watched by about 3 million people, but is quite silly. The programme came to Pisa convinced of a domino effect of Brexit causing other EU countries to leave the EU. The presenter, Kate Garraway was very pro-Brexit and had packed it with representatives of the Northern League. My interview was not live and given the bias of the programme, not surprisingly was not broadcast after.[1]

One of the effects of the programme was to make me realise that Leave winning was a real option. I therefore wrote down my views and started to circulate them, but soon realised that most of my contacts were in the Remain camp. This reminded me of Benjamin Disraeli, twice Prime Minister of Britain in the 19th Century, who wrote the novel, *Sybil, or The Two Nations* (1845), in which he describes p.65-66:

" '*Two nations; between whom there is no intercourse and no sympathy; who are as ignorant of each other's habits, thoughts, and feelings, as if they were dwellers in different zones, or inhabitants of different planets*'... '*You speak of-*' said Egremont, hesitantly. '*The Rich and the Poor*.'"

On the 23 June 2016 the UK voted in favour of Brexit, with the Leave campaign winning by 52% to 48%. The referendum turnout was 71.8%. Considering Leave and Remain as "two nations", distinction can be made between:

- In general rich vs. poor, but not only;
- Young vs. old;
- London and the South East, Scotland (62%), Northern Ireland (56%) and Gibraltar (95.9%) strongly in favour of Remain in contrast with the rest of the UK.

With these divisions the referendum could lead to the end of the United Kingdom. Scotland has requested to remain in the EU (and the Scottish Parliament voted unanimously in favour). However, Nicola Sturgeon's approaches to the EU have been met with reticence in some circles (Donald Tusk, Mariano Rajoy) probably because of fears of knock-on effects for separatist movements such as those in Catalonia, Corsica and so on. In Northern Ireland parties such as Sinn Féin, the Social Democratic and Labour Party and the Protestant Ulster Unionist Party voted in favour of remain, while the Protestant Democratic Unionists were pro-Brexit.

[1] In view of the general level of debate it was hard to pitch it right. In my interview I said I thought that The UK was sleepwalking into a really dangerous situation. The Leave camp want Britain out of the Single Market, but the Single Market has benefited everyone, including Britain. They are talking about alternative trade arrangements, but I said that negotiating trade agreements takes years, creating uncertainty. Introducing different arrangements would probably mean reintroducing the border between Northern Ireland and the Republic. Brexit is likely to lead to a renewed request by Scotland for independence. On immigration the UK has an opt-out of EU policy so we are talking about immigration from EU countries. The main EU immigrant groups in Britain are the Romanians, the Poles and the Italians. In Italy we have over one million Romanians who are essential for care services and the building trade.

Introducing different arrangements for trade and immigration would probably mean reintroducing the border between Northern Ireland and the Republic setting back the peace process, which has been carried out over decades and was facilitated by the EU framework.

A possible solution is the "reverse Greenland" model that would entail redefining the UK territory in a way that would allow England and Wales to leave the EU, while permitting Scotland, Gibraltar and possibly Northern Ireland to remain. The model is based on the 1985 experience of letting Greenland leave the EU while Denmark remained.

Brexit was a referendum that could and should have been avoided, and was called largely in response to divisions within the Conservative Party. Writing in the Financial Times of June 25-26, Nick Clegg (former leader of the Liberal Democrats) stated:

"*My greatest anger is reserved for David Cameron and George Osborne – notwithstanding the dignity of the prime minister's resignation. They and they alone are responsible for bringing our great country to this sorry pass. This need never have happened. When we were in coalition with the Conservatives I was repeatedly asked by them to agree to a referendum on their terms. I refused point blank because elevating internal party rows to a national plebiscite is not good enough…*"

The leaders of the Leave campaign were genuinely surprised at their own success: Nigel Farage subsequently resigned as leader of the UKIP, while Boris Johnson dropped out of the competition for the Conservative Party leadership. The slogan was to "*take back control*", but with little idea of how to use it. The two major political parties have been completely splintered. According to the BBC of 27 June, the Queen was very annoyed (but perhaps we can live with that!).

Many in the Remain campaign left their mobilisation until very late, also seeming to think a Leave victory was unlikely. It was only on 22 June that 1285 business leaders sent a signed letter to The Times stating that "*Brexit would lead to economic uncertainty and put jobs at risk*".

In a late plea to voters on 21 June Vice-chancellors of 103 universities wrote a joint letter to The Independent voicing their "*grave concern*" over the impact of a United Kingdom exit from the European Union on UK universities and students, warning that it would undermine the country's position as a global leader in science and innovation and "*impoverish our campuses*". Britain has benefited considerably from EU programmes on research.

The Withdrawal Procedure

Article 50 of the Treaty on the European Union sets out the legal basis and procedure for withdrawal from the EU. Unless a withdrawal agreement is agreed beforehand, two years after notification by the member state of its intention to leave withdrawal will take place. This two-year period can only be extended by a unanimous vote in the European Council with the agreement of the country concerned.

In the case of the UK withdrawal requires an act of Parliament and the referendum only has advisory status.

When David Cameron resigned he announced that he would leave the task of triggering Article 50 to his successor. Juncker responded with the statement "no negotiation without notification". While delayed notification prolongs uncertainty and is opposed in many EU circles and by some member states, it has the advantage of granting time for UK positions to become clearer and possibly even allowing leeway for second thoughts. Nonetheless, the situation is reminiscent of Samuel Beckett's play, *Waiting for Godot*:

"*Let's go. Yes, let's go. (*They do not move*)."*
*"I don't seem to be able... (*long hesitation*) to depart.*
"Such is life."
…
"Let us do something, while we have the chance! It's not every day that we are needed. Not indeed that we personally are needed. Others would meet the case equally well, if not better"
…
Estragon: "*I can't go on like this"*.
Vladimir: "*That's what you think.*"
…
Vladimir: *"I don't understand"*.
Estragon: "*Use your intelligence, can't you?*"
Vladimir uses his intelligence.
Vladimir: (finally) "*I remain in the dark.*"

Withdrawal would require revising UK legislation through repeal of the 1972 British European Communities Act. Untangling 40 years of EU membership would entail little short of a legal revolution. Some 12295 EU regulations having direct effect would cease to apply when Britain left, while it would be necessary to decide what to keep, amend or reject of laws on the UK statute book enacting EU directives.[2]

The scope for further deregulation of British markets is relatively limited, and Britain already has wide autonomy in deciding policies such as defence, foreign policy, education and so on. The very fact Britain was able to hold the referendum demonstrates that it is sovereign. Banks are already drawing up plans to lobby politicians to leave financial regulation intact to limit the disruption from leaving the EU.

The Leave and Remain campaigns

The distinction between the Leave and Remain campaigns has widely been described "Project Lies" versus "Project Fear" respectively.

[2] Financial Times, 22/6/2016.

Key elements of the Leave campaign were the aim to recover British sovereignty "take back control"; a desire to be rid of the "European superstate" and its excessive regulation with a return to a freer market; and a determination to limit immigration. Popular television programmes and tabloids like The Sun and the Daily Mail displayed a total disregard of facts. British politicians have made a habit of denigrating the EU for years so cannot be surprised when this has influenced popular opinion.

In an interview with Sky News of 2 June 2016,[3] asked to comment on the fact that "*the leaders of the US, India, China, Australia, every single one of our allies, the Bank of England, the IFS, IMF, the CBI, five former NATO secretary generals, and the chief executive of the NHS*" were all against Brexit, former Education Minister and one of the front runners in the Leave Campaign, Justice Minister Michael Gove, declared: "*I think people in this country have had enough of experts*."

According to poll by YouGov of 13-14 June,[4] Leave supporters did not believe the opinions of academics, economists, politicians, journalists and experienced business people when it came to the EU referendum.

Politicians are already going back on some elements of Project Lies, which has lead to second thoughts and disillusion by some of those who voted Leave (Regrexit).[5]

On the bus of the Vote Leave campaign was the claim that each week £350 million is sent to the EU, and the promise that this money would be spent on the NHS (National Health Service). According to an Ipsos Mori poll 47% of people cam to believe this claim.[6] However, the calculation failed to take account of payments from the UK budget to the UK or the British rebate. The net UK contribution to the EU budget is about £8.4 billion a year or only 0.5% of British GDP. It has since been announced that much less would be available for the NHS after Brexit.

The short-run economic effects of the Brexit vote

With regards to the economic effects of Brexit, we are already well into the dire prognostications of Project Fear (Remain). The Treasury, Bank of England and IMF

[3] As reported by the Financial Times ttps://next.ft.com/content/82a1a548-3b93-11e6-8716-a4a71e8140b0, consulted July 9, 2016.

[4]You Gov https://d25d2506sfb94s.cloudfront.net/cumulus_uploads/document/x4iynd1mn7/TodayResults_160614_EUReferendum_W.pdf, consulted July 9, 2016.

[5] Even The Sun newspaper changed position and an article of 25 June claimed the following possible effects of Brexit: *House prices to go down… fuel prices are predicted to skyrocket…Flight prices may go up as the Open Skies agreement will have to be re-negotiated…It might cost more to buy your holiday Euros this summer…Private pensions are set to decrease in value with the financial market…* https://www.thesun.co.uk/news/1339878/what-brexit-means-for-you-how-the-vote-to-leave-the-eu-will-affect-your-holidays-passports-and-mortgages/ consulted July 6 2016.
See also Fintan O'Toole in The Irish Times of 25 June 2016: "*Did you ever see a slightly drunk man trying that trick with the tablecloth? He thinks he can whip the cloth off the table with a fast, clean snap, but leave all the crockery perfectly intact. He gives a sharp tug and stands back with a triumphant flourish as the plates and glasses come flying to the ground and shatter all around him.*"

[6] Financial Times 9/10 July 2016.

all suggested very high immediate costs of Brexit due to market volatility.[7] The Treasury was perhaps mistaken in trying to put numbers on this, but their major predictions were borne out by events. Sterling fell sharply to its lowest level since 1985 in the first days after the referendum. Uncertainty spread through international financial markets, with what were considered the weaker links such as Italian banks appearing particularly vulnerable. In the UK Households and firms postponed spending and investment decisions.

Even in early days the City began to be negatively affected. Depending on the final arrangement agreed (and when), financial institutions based in Britain could lose their "automatic passport" to operate elsewhere in the EU. Several of the big investment banks and other financial institutions are discussing moving their activities to Frankfurt, Dublin, Paris, Luxembourg or Amsterdam. France announced tax concessions to encourage such moves, and in response the British Chancellor of the Exchequer, George Osborne, proposed reducing UK corporation tax, possibly to under 15%. London could also lose its status as the main location for the clearing of euro-denominated trades. In 2015 the European Court of Justice ruled against a four-year effort by the ECB to bring euro-clearing to the Eurozone, and with Brexit the ECB (backed by France) could revive this attempt.

During the Leave campaign there had been damaging attacks on the Bank of England, including personal aspersions about Mark Carney, its Governor (and his links to Goldman Sachs). On 30 June, echoing Mario Draghi, he announced that the Bank of England would do "*whatever action is needed*" to support growth, which would probably imply more monetary easing. The Bank of England has set aside £250 billion in liquidity to help banks if necessary.

Before the referendum the Chancellor of the Exchequer, Osborne, disclosed a thinly veiled threat to impose an emergency budget in the case of Brexit of £30 billion in spending cuts or tax rises, but given the risk of recession this has been postponed, at least for now.

The European Central Bank maintained that Brexit was an important source of uncertainty and could cost the Eurozone 0.5% of growth over the next three years.[8]

The longer-run economic effects of Brexit

In the longer term, all the main studies, by institutions such as the Treasury, Bank of England, the Institute of Fiscal Studies, the OECD, and IMF, indicated huge costs to Britain of Brexit, whose scale depends on whether Britain opted for the Single Market possibly as a member of the European Economic Area like Norway; chose some form of bilateral arrangement along the lines of the so-called Swiss model or a free trade agreement like that being negotiated with Canada; or went for what is often

[7] HM Treasury (2016b), and IMF (2016). For the Bank of England, see for example, the Statement from the Governor of the Bank of England following the EU referendum result. http://www.bankofengland.co.uk/publications/Pages/news/2016/056.aspx consulted July 6 2016.
[8] Financial Times 30/6/2016.

called the "default option" of the WTO framework.[9] Whichever alternative is chosen negotiating any trade agreement takes years and would have to be ratified by all the EU member states and the European Parliament.

All of these studies suggest that there is a trade off between better access to EU markets for the UK and controlling immigration. The UK has an opt-out of EU immigration, policy so the issue in the case of the Brexit vote is immigration from other EU countries.

David Cameron maintained that the EU refusal to allow the UK an "emergency brake on immigration" was one of the main causes for the Leave victory. If the UK wanted to impose living or working restrictions or limits of use of the National Health and other services for immigrants from other EU countries it would have to negotiate with all 27 other member states together (not individual countries), and arrangements would probably have to be reciprocal. This, together with the fall in the value of sterling, is not good news for the 2 million British living in other EU countries, including the 66,000 in Italy. [10]

EU immigrants in the UK tend to be young and have jobs, so most studies find they are net contributors rather than a drain on UK public finances. According to the OECD, immigration accounted for about half of the growth of the UK in the last decade.[11] EU enlargement would not change the picture very much as negotiations with Turkey are stalled and membership is extremely unlikely, while other candidate or potential candidate countries are relatively small.

Though it is difficult to separate how much was due to the Single Market, the growth of GDP per capita of the UK has been the fastest of the G7 since joining in 1973, having been the slowest between 1950 and 1973.[12] Boris Johnson wanted to combine access to the Single Market with tighter UK curbs on immigration from other EU states. Other member states and EU institutions have said this was not an option maintaining that freedom of movement of labour is an integral part of the internal market ("no cherry picking" according to Merkel, while Tusk ruled out a Single Market à la carte).

The Various alternatives

The "Norway" option: joining the EEA (European Economic Area) and EFTA

To participate in the Single Market like Norway, the UK would be required to accept freedom of labour movement and UK contributions to the EU budget probably nearly on the same scale as before.[13] Norway does not participate in policies such as the

[9] See, in particular, HM Treasury (2016a). Piris (2016) provides a very clear account of the alternatives.

[10] The profound change in the conditions of UK citizens living in other EU countries who were not allowed to vote unless they had been resident in the UK in the last 15 years could be a motive for legal redress and a call for another referendum or election.

[11] OECD (2016)

[12] Financial Times https://next.ft.com/content/e66852f0-3249-11e6-ad39-3fee5ffe5b5b, consulted 6 July, 2016.

[13] According to Piris (2016), the Norwegian contribution per capita to the EU for the 2009-2014 period was just 9% less than that of the UK. Norway is currently the 10th largest per capita contributor to the EU budget, just behind the UK, which is 9th.

Common Agricultural Policy, Common Fisheries Policy, judicial affairs and foreign policy. The UK could sign free trade agreements with third countries, but would have to accept rules of origin requirements. There is a trade off between more market access and accepting EU standards and regulations. The supremacy of EU law over British law on the Single Market would have to be agreed. However, much of this legislation, for example, on protection of the environment and fighting the monopoly power of huge multinationals such as Microsoft or Google has been of benefit also to the UK. Like Norway, the UK would not be able to participate in the UK decision-making process becoming a “rule taker” rather than a “rule maker”. It would probably also have to accept jurisdiction of the EFTA Court.

The Treasury study is the probably the most extensive, and suggests that if the if Britain opts for remaining in the Single Market with an arrangement like Norway, the estimated cost to each British household would “only” be about £2600 a year for each household by 2030.[14]

The EEA option has the advantage of simplicity – the legal framework has existed since 1994. An “EEA Plus” agreement could include other aspects like the Common Arrest Warrant. An “EEA minus” arrangement has also been proposed and would involve a bit less Single Market and a bit more immigration control.

The Swiss option

An arrangement like that with Switzerland, which is covered by about 120 agreements, would involve participation in the EU Single Market, though Switzerland does not have access for services, and in particular, financial services (apart from one agreement on life assurance). However, according to the EU, the Swiss model is “broken” largely because the constant need to ensure regulatory equivalence (Piris, 2016). As a reaction to the Swiss vote in 2014 to oppose unlimited immigration from the EU, the EU has proposed a new agreement requiring Switzerland to automatically update its rules to match those of the EU and to accept the jurisdiction of the European Court of Justice. The EU has also excluded Switzerland from Erasmus exchanges and some of its research programmes.

An association or free trade agreement (FTA)

Many of the Leave seemed to favour a free trade agreement (like Albania, said Michael Gove, but Albania maintained this was just considered an interim arrangement while it is waiting for EU membership). Most FTAs do not provide for free trade, but rather better market access that that provided by WTO rules, and the coverage of services is generally very limited. Canada has been negotiating a FTA with the EU for 7 years now (with ratification being blocked by Romania over visas and by Wallonia over standards). The 2 years deadline of Article 50 of the EU Treaty for withdrawal after notifying the EU would not be long enough, causing years of

[14] The estimates of the costs of the various alternatives presented here are all taken from HM Treasury (2016a).

uncertainty.

The Treasury study is the probably the most extensive economic analysis, and suggests as a central estimate that if Britain opted for a bilateral free trade agreement with the EU like Switzerland, Turkey or Canada (though these have rather different arrangements) the cost to every British household would about £4300 a year by 2030, with GDP being lower by between 4.6% and 7.8% (with a mid-range estimate of 6.2%). The exact statistic can be challenged, but the loss is likely to be substantial.

The WTO option

The Treasury places the cost of moving to a WTO arrangement (like Russia or Brazil) at an estimated £5200 per year per UK household by 2030, or between 5.4% and 9.5% of GDP. The UK would encounter tariffs on its exports to the EU and access for services would have to be negotiated. The Director General of the WTO, Azevedo, has since said that the UK has never been a member of the WTO (which was founded in 1995) so would have to negotiate membership. The last country to do so was Liberia, which became the 162nd member after years of negotiations as these have to cover all aspects of trade.[15]

What sort of treatment could the UK expect?

The EU is concerned about blackmail and the risk of other member states copying the UK model and requesting concessions, though the dramatic events after the British referendum may act as a deterrent for other eurosceptic countries. The Leave camp has argued that the EU is likely to give favourable treatment because it needs the UK as Britain has a large trade deficit (7% of GDP), which is perhaps not the best argument if you are trying to avoid volatility of financial markets. The EU is far more important for the UK (53% of UK imports and 44% of exports were with the EU in 2015), while the equivalent share for the EU exports was about 8% (HM Treasury, 2016a). The main EU exporter to the UK is Germany and the Bertelsmann Foundation (2016) suggests that the negative effect for the UK would be about 10 times as great as that for Germany. Ireland, with about 16% of its exports to the UK (about 40% before EU membership) would be hit relatively hard.

With regards to trade agreements with the rest of the world, the EU has 36 trade agreements with 58 countries and the UK would have to replace these. The economic weight of Britain in the world is much less (by about 5 times) than that of the EU, and outcomes depend on bargaining power. According to the Financial Times of 22 April 2016, in the case of the USA Obama said Britain would have to go to the back of the queue (I'm sure he said "line"!). Since 1973 the UK has not carried out trade negotiations, and according to the Financial Times of 31 May, one of the experts in Brussels estimated that Britain has only about 25 trade negotiators, but would need about 475 (a later article referred to 700-750[16]).

[15] Financial Times https://next.ft.com/content/745d0ea2-222d-11e6-9d4d-c11776a5124d consulted 6 July 2016.
[16] Financial Times, 5 July 2016.

Conclusions

The results of the referendum are only advisory and Brexit has to be decided by Parliament (with most MPs against Brexit). With the extent of the damage and the impossibility of the Leave group to maintain most of their promises becoming evident, “buyer’s remorse” (to use the term coined by Georg Soros) or Regrexit has been setting in.[17] For the time being the possibility of calling new elections with a clear mandate as to whether to remain in the EU or not been ruled out. An alternative option would be another referendum, supported by a campaign of (so far) 4 million people signing a petition in the UK for this purpose. In the case of the 2016 Austrian Presidential election legal redress led to new elections being called, and perhaps grounds could be found on the basis of the scarce respect for the truth of Project Lies. Any possible solution is likely to take some time so the outlook for now is likely to be continuing uncertainty.

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[17] George Soros, The promise of Regrexit – Project Syndicate, https://www.project-syndicate.org/commentary/the-promise-of-regrexit-by-george-soros-2016-07 consulted 6 July 2016.