



'Instead, the fire happened': Brexit's Impact on UK and International Trade

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UK Economy Impacts

Most leading economic indicators such as PMI index, planning permissions etc. point to a recession in the late 2016 or early 2017.

The internationally focussed FTSE100 has rallied as revenues are largely not in pounds, though the more domestically orientated FTSE250 has fared slightly less well.

Interest rates have been lowered to 0.25% with more decreases expected this year. Another 70 billion of QE is planned, buying government and corporate bonds. Banks will be forced to increase lending. Whether the lower rates will work is debatable, following seven years of 0.5% with little impact, a further drop may not make much difference.

The pound is at a 30 year low against the US dollar, among other major currencies. The forecasts from the big banks are highly divergent.

UK Politics

There's division among voters by age and education – though older generations were significantly less likely to attend university so there may be a degree of covariance. Many young people feel that their parents and grandparents have stripped them of their citizenship – their ability to live, work, learn and love in other countries.

The political parties were also divided by the Brexit campaign. The Conservatives have an uneasy truce among Brexiteers and pro-EU MPs. This will be tested as they debate which kind of Brexit to pursue. Theresa May is the new PM following a brutally efficient leadership contest. The new cabinet is less elitist, and perhaps less liberal. There are three ministers with foreign minister-like responsibilities but the division of labour is presently unclear.

The Labour party is in open civil war which may be perpetuated by Corbyn's win in an upcoming leadership election. UKIP is in disarray now Nigel Farage has left. The Liberal Democrats are still regrouping following the 2015 election. There is no effective parliamentary opposition.

The Conservatives have a small majority of 17, and have a ten-point lead over Labour in recent polls. However a general election seems unlikely this year. May believes she has a mandate and does not need to seek a new one, the illegitimacy of a mid-term Prime Minister is a recent media conceit in her opinion. The public does not like early elections, and often use them to punish governments. There's no legislative rationale for having one. The fixed term parliament act makes it technically difficult, and constitutionally fraught.

Brexit

Article 50 was never intended to be used. Until it is formally triggered the UK is at an advantage but this will cause on-going uncertainty through Europe. Once it is started there's a two year deadline a timeframe that would not be extended unless all 27 members agree to extension.

Six things must be decided and implemented by the UK:

- Britain's legal separation from the EU, repatriating institutions and rules
- A trade and economic relationship with the EU
- Interim cover for the UK between its departure from the EU and the entry into force of the trade agreement
- Co-operation on foreign, defence and security policies
- (Re)accession to full membership of the WTO
- New FTAs to replace those that currently link the EU and 51 other countries

The first four will also require the EU to decide what it wants. There's already division among the French and German's governments attitude to potential FTAs, with Germany currently more open to the idea. Both have elections next year that will impact Brexit. Neither will want the EU commission to run the show completely.

The UK bargaining position is not great. While some point to the UK current account deficit and the fact the UK would become the EU's largest single export market, this is still only 10% of the EU's exports, as oppose to the EU which makes up 50% of UK's exports.

Versions of Brexit

Eurozone: The Eurozone is the deepest level of European integration. It includes: a monetary union based on the euro currency, 'four freedoms' of economic activities (goods/services/people/capital movements), national representation in a parliament to agree on laws related to these activities, among others, and common external trade policy. Legislation in European parliaments covers justice, trade, agriculture, fisheries, and regional development. Eurozone countries include the major economies of Germany, France, Italy, Spain and the Netherlands.

European Union: members maintain national currencies, but otherwise have the same commitments as the Eurozone members.

The **EU Single Market** (EEA) guarantees free movement of the four factors of production, though agriculture and fisheries are not covered (which was seen as an important carve out for the Norwegian fishing industry). EEA agreements require continuous updating so they accord with EU laws on competition, consumer protection, company and employment law, and the environment among other matters. EEA members have no formal input to the creation of these EU laws. The single market includes all EU members and several neighbouring EFTA countries.

European Free Trade Area (EFTA) is similar to the EEA, but with a narrower scope. Switzerland instead has a series of narrowly defined, mutually dependent bilateral agreements on a limited number of areas such as technical barriers to trade, public procurement, security etc. Effectively Switzerland is an EEA member in most regards, and pays into various EU funds as EEA members do. It also has no decision making power into EU laws or regulations.

EU Customs Union: covers only the movement of goods that may travel within the area customs-free, and imposes common external tariffs on all goods coming in. Turkey's agricultural products are excluded.

A **free trade agreement** (FTA) could be designed to deliver high liberalisation of goods, services and capital, while avoiding the vexing issue of migration. Modern agreements such as the TPP and EU-Canada are untested but highly comprehensive, and could neutralise much of the economic impact on the UK and EU.

Which model is best? From a trade point of view, and assuming Brexit means 'Brexit', the EEA makes the best of the situation. This gives businesses access to the single market, allays the uncertainty to which seems to be destined to plunge the country into recession while repatriating agriculture and fishing policy to the domestic legislature (though these are less significant in Britain's economy). It also means Britain is able to negotiate bilateral agreements with major economies. However this would mean free movement of people, which arguably the voters wanted to avoid most. If the EU does not allow certain measures to lower immigration, they will need to pursue the FTA route.

Some have suggested Britain can **unilaterally liberalise** and drop tariffs across the board. For small, open economies like Singapore, this makes some sense. But for a larger country with a diverse economy it could visit sudden and painful adjustments on those most unable to face another onslaught of globalisation. The negotiating environment is also such that Britain may be desperate for any agreement, but its bargaining power is weaker than when it was part of a 28 member bloc.

Trade With Other Nations

Before any FTAs can be negotiated the UK will need to renegotiate its WTO conditions.

The European Union has a unique structure within the WTO. It consists of 29 "members:" 28 member states plus the EU itself. They all share the "rights" and "obligations" of the organization. Essentially, the UK (and perhaps the EU) will have to negotiate new terms at the WTO. Joining is a very complicated and challenging as our Chinese friends can attest. Because the WTO operates by consensus, any single member can block negotiations. The UK will have to painstakingly negotiate terms of its commitments in goods and services and any other country-specific obligations with each and every one of the 161 other members.

Realistically the UK will need to offer the same or lower tariffs than the EU, as anything higher will be rejected. Just transferring the existing EU commitments over to the UK may not work. Individual countries may hold out for better access than what the UK offers, holding up the whole process.

Quotas are more difficult. Imagine Japan allows 500,000 tonnes of foreign beef in per year. Each Trading partner will have a certain quota allocation in the WTO. Then the EU, which has, say, 100 thousand tonnes, will have an agreement among it's own members as to how to divide that. Will the EU let the UK keep its allocation? Why should it not just keep its allocation and divide it among less people? It is unclear how these negotiations will proceed. But there are hundred of members and tariff lines to proceed through. Once this baseline, WTO relationship is set, the UK can move on to Free Trade Agreements.

New Trade Deals

The EU has many different types of agreements, stretching back decades, that have trade components including long-standing economic arrangements with neighboring countries in Europe. Most of these are designed to integrate greater Europe with the EU.

The EU has several more deals, with Canada, Singapore and Vietnam, awaiting ratification. This may never occur, as each agreement may have to pass 27 national level parliaments for approval in addition to the EU parliament to enter into force.

The UK will lose access to the 51 existing agreements, though most countries will be willing to negotiate separate access for the UK.

Ultimately the UK's bargaining position is weak. It has an inexperienced trade bureaucracy, may possibly be in a recession, may not be able to provide access to EU markets and if the pound stays this low then the UK foreign purchasing power is seriously diminished, weakening export prospects.

Given the mood for trade deals around the world at the moment, especially in light of the TPP and the US elections, why would another national leader take this sort of risk? It will be easier to maintain something like the status quo the UK had, rather than embarking on new deals with major economies in the near to medium term.

Singapore FTA

Singapore signed a trade agreement with the European Union in October 2014. The deal is not yet in force, pending a ruling from the European Court of Justice about an issue over the investment chapter.

Now, however, the agreement may never see the light of day. This is because a new ratification process seems to have started, where each individual parliament must ratify for the agreement to enter into force. The odds of a trade agreement surviving such a daunting process intact with unanimous approval from all those bodies must be low to non-existent.

If the UK alone had to approve a deal, mathematically the chances are obviously much better. There is a shared history, legal system and language. The political risk for Singapore is small. There are already many investments between the two countries, though the ties are not so close as to be a critical risk.

But it is not really possible for Singaporean officials to look at what the UK-Singapore FTA might look like, because Singaporeans cannot tell what sort of arrangements the UK and EU might end up with since neither the UK nor the EU have any idea what sort of arrangements they might end up with either!

Conclusions

This is a time for caution and patience. The hopes of Liam Fox and David Davies that this will be sown up by 2019 are optimistic. Senior civil servants expect it to take five to eight years. Divorce can be painstaking and expensive.

Only Greenland has left the EU before and it took six years to negotiate. Greenland's population would fit inside Manchester United's stadium and it's only significant export is fish.

There are not enough negotiators to organize a football match. The civil service reckons there are about 20 employees with direct trade negotiating experience. It takes maybe 300 – 400 to negotiate a large trade agreement. The EU has done Britain's trade negotiations for about 40 years, so the UK will need to coax them back or look to outsiders for assistance.

There is a prosperous path through these negotiations, but it may mean keeping something similar to the current EU arrangement. This would paradoxically mean less sovereignty than Britain currently enjoys and betray the reasons so many people voted for Brexit.