

BREXIT:

Where Next?

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by David Laws

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Only a year ago, British politics was dominated by the debate about Brexit. It says a lot for the impact of COVID-19 that since early March the virus and its huge economic, health and social impacts have relegated Brexit news to a few paragraphs on the inside pages of one or two Brexit-focused newspapers. But Brexit has in no sense gone away. The end of the transition period on 31st December 2020 looms ever closer, and Boris Johnson has made clear that in spite of COVID, he is not willing to contemplate an extension of this transition period. Boris Johnson may not wish to disappoint the Eurosceptic voters he was able to win over in the December 2019 election, and he may also be calculating that pushing Brexit through during this period of extraordinary economic turbulence will both mask any negative impacts and also put pressure on other EU member states (more nervous than ever about the state of their economies) to strike a pragmatic deal.

The state of play between the UK and EU

Will a deal be done? We are just 3-4 months away from the point where UK and EU negotiators need to be able to conclude their talks if agreements are to be secured with all EU governments before the year end. Angela Merkel has talked of "slim progress" in the talks, and the EU Commission has also stated that there has been "little progress" to date. Meanwhile, the UK government has signalled its clear preference for a deal, but also its willingness to contemplate a "no deal" if necessary.

Boris Johnson's approach to the Brexit negotiations seems as different as can be imagined from that of Theresa May's government. May and the leading figures around her were largely "Remain" supporters who had come to power promising to deliver on the referendum result, but seeking to do this in the least disruptive way possible. In a sense, they regarded Brexit as a problem to be managed, rather than as an economic opportunity. It was clear that whatever they said about "no deal being better than a bad deal", they were not in reality prepared

to contemplate the economic risks of such a "no deal" outcome. EU negotiators understood this, and could therefore afford to be tough with their UK counterparts – anticipating that when push came to shove, large UK concessions could be expected.

However, EU negotiators are now dealing with a very different UK government. In Johnson/Gove/Cummings they are facing people who actually campaigned for the UK to leave the EU, and who apparently believe that the opportunities arising from this decision arise by the UK exploiting its freedoms to differ from the EU, rather than seeking to shadow EU regulatory arrangements in order to win maximum access to EU markets. And they must know that Gove and Cummings are both self-proclaimed believers in "constructive chaos" – the belief that in order to make progress you sometimes have to suffer large short-term costs and disruption. For the first time since the EU referendum, the EU negotiators have to contemplate the possibility that the UK government really would settle for "no deal", with all the economic disruption that would arise from this on both sides of the channel.

Preparing for 1st January 2021

So where are we as of mid-July 2020, and what happens next? Firstly, both the UK and the EU want businesses to understand what might come next, and start preparing in earnest. 1st January 2021 really does look like a date to be taken seriously. But the UK government is worried that many businesses are not yet taking Brexit sufficiently seriously – including the risk of "no deal". A government communications "offensive" can be expected quite soon, to encourage businesses to focus on the changes coming on 1st January, whether or not a deal is struck. The European Commission has also last week published a new paper – "Getting Ready for Changes" – highlighting that whether there is a deal or no deal, businesses need to be ready for new arrangements on 1st January 2021, including more checks and administration at UK borders.

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The biggest fear within the UK government is that Brexit, including a possible "no deal", will occur around the time of a possible second peak in the pandemic. If so, there could be serious supply shortages as consumers panic again about access to a whole range of goods, from household supplies to medical products. If there is a "no deal" on 1st January there can also be expected to be major disruption at channel crossing points and in Kent. The government is particularly concerned about the impact on some sectors if a deal isn't struck and if there are new tariffs and tight checks at borders. The farming, automotive, aerospace and electronics sectors are seen as at particularly high risk.

Can a deal be done?

So what are the chances of a deal being struck? Well, in spite of the lack of obvious progress to date, there are some reasons for encouragement. EU negotiators now have a much clearer sense of the UK government's red lines on issues such as fishing, the role of the ECJ, and regulatory alignment. And many EU nations, including Ireland, Belgium and

Germany, are determined to avoid another major economic shock hitting their economies. On the UK side, there is surely scope for sensible compromise on a deal on fishing rights, on state aid rules, and on the extent of short and medium term regulatory divergence. And the last thing the UK government needs is a second major economic shock, and huge disruption to imports and exports – such an outcome would almost certainly result in the UK economy taking a bigger hit than any other major world developed economy over 2020/21. This would be very risky politically, not least with a new and far more credible and electable Labour Party Leader.

It also needs to be remembered that although Boris Johnson has taken a very hard-line position on Brexit, he has shown himself to be extraordinarily flexible at times to get a deal on departure from the EU – including in late 2019, when he accepted a major compromise over Northern Ireland, which so enraged his DUP allies that his government lost its working majority and was forced into triggering an early General Election.

So in spite of the "slim progress", the stalled talks, and the current stand-off, the chances of a deal in the Autumn are greater than the chances of "no deal" – at present, the most sensible probabilities we can attach to each scenario would be roughly 65% to a deal and 35% to "no deal". 35% is still, however, a relatively high probability given the likely major disruption that "no deal" would represent for an economy already hit for six by COVID. We head towards the Autumn hoping for the best, but aware that in any scenario the UK economy faces major change which poses high risk at such an unprecedentedly difficult time.

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