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BREXIT – The End Game

a speech by Sir Brian Unwin KCB, Hon President of the European Investment Bank, to the Austro-British Society in the Banking Hall of the Oesterreichische Nationalbank, Vienna

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Introduction.

It is a pleasure to speak to you in this great city tonight, particularly when Austria occupies the Presidency of the European Union and, by an extraordinary coincidence, the British Prime Minister is meeting her colleagues at Salzburg at dinner at this very moment. It is also a privilege to be in this historic Banking Hall as the guest of my good friend and former colleague at the European Investment Bank (EIB), the Governor of the Austrian National Bank, Professor Ewald Nowotny. The last time I spoke in Vienna Ewald probably wrote most of my speech, but I assure you and him that he is not responsible for anything I say this evening.

The title of my talk tonight is “Brexit – The End Game”. I must confess that I did not choose this – there seemed to be a competition for the most eye-catching title - but it suits me well, since it permits me to range widely over the Brexit debate. It is not, however, a comfortable subject to talk about when passions are so high and views on opposing sides are so strongly held. I am reminded of a dialogue between the famous agnostic British philosopher, Bertrand Russell, and a distinguished Jesuit priest, about the existence of God. After a lengthy exchange, when the whole range of arguments for God’s existence – teleological, first cause, the argument from intelligent design, Paley’s watch and so on were rolled out – their final frustrated words on whether God existed were “He does” and “He doesn’t”! Arguments about Brexit often end like that! So I will do my best to be fair, but you will soon see where my sympathies – or perhaps prejudices - lie.

Before I go further I should also justify my presumptuousness in lecturing to you about Brexit. My credentials are that I spent many years in Her Majesty’s Treasury in London working on European issues, from negotiations on banking law in the 1970s to leading the Treasury team on the British budget problem in the 1980s – the famous campaign to “get our money back”. I hope you will not misinterpret me when I say that I spent the night with Margaret Thatcher at Fontainebleau in June 1964 when we secured our budget rebate. I subsequently spent seven years at the EIB promoting the economic development of the EU. So I can claim to have done my bit on both sides, both for my own country and for the EU collectively. I stress this because there is a tendency in the UK to label anyone who has worked for the EU and opposes Brexit as unpatriotic, or even “an enemy of the people”.

Scope of my talk.

Brexit is immensely complicated. It involves unscrambling some forty five years of integration of EU law and regulation into the UK. By virtue of its EU membership the UK is a party to some 750 international agreements and 60 free trade agreements (FTAs) with third countries, which will lapse if the UK leaves the EU without a favourable deal. A former British Deputy Prime Minister and strong Europhile, Michael Heseltine, compared Brexit to trying to unravel a bowl of congealed spaghetti.

The trouble now is that the bowl itself is spinning round all the time, and its shape keeps changing. However, I will do my best to say something about the June 2016 referendum; to comment on the economics of Brexit; and to speculate on how the “game” is likely to develop. It is not easy to keep up to date, and we may hear of significant new developments from the Salzburg summit tomorrow.

The Referendum

The Brexiteers, including the Prime Minister, Mrs May, a former Remainer, claim that the referendum represents the solemn will of the British people which it would be a betrayal of democracy not to deliver. In my view that is nonsense and needs qualifying. First, the referendum was called by the then Prime Minister, Mr Cameron, to resolve divisions within the Conservative Party and to counter the rise of the right wing anti-EU Party, UKIP (The United Kingdom Independence Party) - and no contingency planning was undertaken for a negative result – in my view almost criminal negligence. Second, the referendum was explicitly advisory, and not mandatory. In other words, it did not bind the government or Parliament to implement its outcome. And thirdly, the winning margin of 51.9% against 48.1% was very narrow. It represented only 37.4% of the electorate eligible to vote, against 34.7% who voted to remain – hardly an overwhelming support for a change of such existential constitutional importance. Moreover, as you know well, no effort was made to allow UK citizens in Europe to vote in the referendum; in fact, many were disenfranchised so that only 264,000 out of an estimated 2 million had a vote.

The referendum was marked by a lack-lustre campaign by the Remain side, too confident of winning; and a wholly mendacious campaign by the Brexiteers, combining exaggerated scare stories about immigration (such as that Turkey would soon join the EU and swamp Britain with 80,000 Turkish immigrants), and demonstrably false claims about the financial benefits of leaving (such as that the end of contributions to the European budget would release £350 million a week for the National Health Service (NHS)). It also now appears that the Leave campaign acted illegally by substantially exceeding the limit of spending permitted under electoral law; and as with Trump, there is even evidence of Russian intervention in support of Brexit.

The truth is that the result reflected many factors, not all of which related to the question at issue – membership of the EU. Against a background of years of hostile anti - European propaganda in the UK media, it marked a protest, particularly among older people in the less prosperous and deprived areas of Northern England and Wales, against austerity and neglect by the governing elite in London and Westminster. Concern about immigration, stoked up by racist propaganda, also played a significant part. The protest clearly had something in common with other populist movements, both on the political left and right, in many other European countries – Spain, Italy, France, Germany, Sweden, Finland, Hungary, Poland, the Czech Republic - and here too in Austria. It is disturbing to see that Steve Bannon, Mr Trump’s former henchman, is in Europe cheering them on.

The referendum should not be treated as holy writ. It would be perfectly democratic for Parliament to take a different view when the outcome of the current negotiations is presented to them, and/or for the people to be consulted again in a new vote. I will come back to this later.

Economic Considerations.

I will cover two aspects: what has happened since the referendum, and possible future developments. On the former, the referendum result has undoubtedly damaged the British economy. At a time when the world economy has been growing robustly, the UK has dropped to the bottom of the G7 economic growth table, with an IMF forecast of only 1.4% growth in GDP in the current year- reduced earlier this week to only 1.1% by the British Chambers of Commerce. Moreover, the situation would have been worse if the Bank of England had not kept interest rates down and boosted the liquidity of the financial system. Although the services sector, 80% of our economy, is still performing quite well, productivity overall is abysmally low and manufacturing has slipped into recession – manufacturing output fell by nearly 1% in the second quarter of this year, and is now ninth in the world behind France. The boost to exports normally expected from a sharp currency depreciation – the pound fell by some 17% after the referendum - has failed to materialise

and we still have a worryingly large current account deficit. Indeed, the trade deficit increased further (to £8.6bn) in the three months to June. Ironically, in view of the fanciful talk of switching from Europe to become a more global trading nation (an exporting “super power” as the Minister for International Trade has put it!), over the past year exports and imports to and from the EU have increased faster than those goods to and from non-EU countries. Foreign direct investment (FDI) in the UK, vital for reducing the deficit and stimulating productivity, has also fallen back sharply – by a worrying 90% in calendar year 2017.

The fall in sterling has also increased inflation and, with average earnings only in recent months overtaking prices, household incomes have fallen – the Governor of the Bank of England, Mark Carney, in July estimated that average incomes had fallen by about £900 since the referendum. As a consequence consumption has only been sustained by increased reliance on borrowing, which in turn reduces savings and therefore investment, and could lead to a new credit crunch if interest rates rise significantly – for example, to counter another run on the pound. The effects of restrained consumer spending, combined with a growth in on-line shopping, are causing mayhem on our high streets, where a number of major retail stores have gone into liquidation or, like Marks and Spencer, House of Fraser, and Sainsbury’s, have announced significant store closures.

The main reason for this decline is the uncertainty and lack of progress in the negotiations with the EU. Without greater certainty, major investment decisions simply cannot prudently be taken. Nearly every important sector of the economy – chemicals, pharmaceuticals, aviation, motor manufacturing, nuclear energy, agriculture, horticulture, hospitality, catering and so on - is either postponing investment or in some cases planning to locate elsewhere. The chief executive of Jaguar Land Rover, for example, recently told the Prime Minister that thousands of jobs would be lost if there is no deal. The financial services industry is particularly alarmed and it has been estimated that in the event of an outcome that does not preserve the current “passport” to operate freely in the EU as many as 75,000 jobs could be lost to the City of London, with a corresponding loss of £10bn in tax revenue to the Exchequer. This may be exaggerated, but City concerns are genuine and were hardly alleviated by the exclusion of services from the “facilitated customs arrangement” that the Prime Minister proposed in July; and other rival financial centres, such as New York, Paris, Frankfurt, Dublin and Luxembourg have not been backward in advertising their attractions for relocation.

The second factor causing widespread concern is the Prime Minister’s stubborn commitment to reduce net annual immigration into the UK to “tens of thousands”, compared with some 250 to 300 thousand in recent years. No details of how this is to be enforced have yet been revealed, but any significant reduction in immigration will deprive crucial sectors of the economy of vital labour. Prominent among them are hotels, hospitality and catering, construction, horticulture, and above all our National Health Service (NHS), which depends heavily on qualified specialists, doctors and nurses from the EU and elsewhere. It is already suffering acute shortages; there are currently some 107,000 vacancies, and in the year after the referendum applications from qualified EU nurses to work in the UK fell by over 90%.

The Future

All this is taking place even before Brexit has happened. The future is impossible to predict without knowing what deal, if any, will emerge. But what is certain is that on any Brexit hypothesis Britain will be worse off than if it remained in the EU – a view endorsed in London this week by the IMF Managing Director, Christine Lagarde. An analysis by the government itself earlier this year considered three possible Brexit scenarios over a 15 year period and concluded that in each case there would be significant losses of GDP. For a European Economic Area (EEA) type deal – the Norway solution - the loss would be 1.6 percentage points; for a free trade agreement (FTA) like that between the EU and Canada, 4.8 percentage points; and for a no-deal exit relying only on World Trade Organisation (WTO) rules – the outcome which Mrs May describes as “better than a bad deal” - the GDP loss would be nearly 8 percentage points, which the Chancellor of the Exchequer has estimated would add £80 billion to government borrowing. The sectoral and regional effects of the models were striking. The industries likely to suffer most included chemical, food and drink, cars and

retailing. The areas of the country hardest hit were the north-east, north-west, and the West Midlands, all of which ironically voted heavily for Brexit. The analysis also found that offsetting gains from putative new trade deals would be relatively small.

All economic forecasts are fallible, and none of the actual outcomes may precisely match these predictions. But there is no doubt that the worst assumption, a no-deal Brexit, would be disastrous. Indeed, last week Mark Carney told the Cabinet that it would be as disastrous as the 2008-09 financial crash. If, for example, we had to impose tariffs under WTO rules – which Mr Trump is in any case trying to sabotage - we should need, at great cost, to reintroduce new customs and border formalities, causing queues and delays at our ports and airports. Even a delay of two minutes in the processing of each lorry passing through the port of Dover on an average day would turn the M20 motorway from Dover into a vast lorry park. This would cause disruption to supply chains (devastating, for example, for supermarkets and the car industry, which rely on “just-in-time” deliveries) , leading to increases in food, drug and other prices and corresponding shortages.

On top of all this there would no doubt be another sharp fall in the value of sterling, leading to a further increase in inflation. At the same time, the British government would be faced with the complexity and cost of establishing new regulatory agencies to replace those presently operated by the EU, and of renegotiating the many other EU agreements to which the UK would no longer be a party. At the extreme, for example, if we could not quickly reach some accord with the European Air Safety Agency (EASA) British based airlines might even be prohibited from flying within Europe. As for negotiating new free trade deals, no one with any experience believes that this could be done easily, quickly or on terms as favourable as those which the EU, with its greater population and market, has been able to achieve. It is pure make-believe to imagine, for example, that the America of Mr Trump, who seems bent unilaterally on destroying the WTO and world trading system, would quickly agree to a free trade deal favourable to the UK.

European Investment Bank (EIB).

Since I worked there for a number of years, I must also refer briefly to the EIB - the “house bank” of the EU in Luxembourg, which in terms of lending and borrowing, is by far the largest international development bank. Here we have an extraordinary example of the British government shooting itself in the foot. The bank’s mission is to promote the balanced economic development of the EU, and for this purpose the bulk of its lending over the years has been for large infrastructure projects – transport, energy, environmental protection, and in more recent years social capital such as hospitals, universities and schools and social housing. There are not many major infrastructure projects in Europe in recent years which the EIB has not helped to finance. Since joining the European Community in 1973, the UK, as a leading shareholder in the bank, has benefitted enormously from EIB investment, which has been averaging some €5-7billion a year. When grossed up for associated investment by other banks, this represents some €15 to €20billion of annual project finance in the UK. The UK will lose its automatic entitlement to this finance if it leaves the EU. This will be a serious loss, particularly at a time when FDI in the UK is declining and the current account deficit growing, and will be very difficult to replace. If there is a favourable settlement with the EU, some arrangement might be reached which enables the UK to remain a shareholder and continue to receive EIB finance, but I am not aware that any progress has been made on this. The same considerations also apply to the European Investment Fund (EIF), of which I was also the Chairman, which is the largest provider of venture capital in Europe, and of which the UK is the single largest beneficiary.

What next?

We now come to the end-game – and I am glad we are talking tonight about a game, and not a war, as it is too often portrayed in Britain. Brexiteers are always talking of fighting in Brussels, and Mrs May even called her inner ministerial committee on Brexit a “war cabinet”. Initial agreement was reached at the end of 2017 on a financial divorce settlement, under which Britain agreed to pay some €39 billion into the EU budget, and on a transition period lasting until the end of 2020. The Commission also put on the table a “back-stop” solution to the Irish border question which it insists

should be enshrined in legal terms. But little substantive progress has been made since then. The main negotiations have been within the British government and the Conservative party. As I understand it, the present UK aim is to settle the legal text of the withdrawal agreement under which the UK will leave the EU on 29 March next, and in addition to reach a political agreement on a “heads of terms” – somewhat analogous to a commercial contract - which would describe in sufficient detail the future trading relationship between the UK and the EU, and desirably ensure that during the transition period the existing agreements and agencies to which the UK is now a party by virtue of its EU membership would remain in place.

The precise British position is, however, far from clear. The Prime Minister has formally taken over the negotiations but she is faced with a deeply divided Conservative party and has very little, if any, room for manoeuvre. On the one side are the extreme Brexiteers, who would rather crash out with no deal than accept any compromise; and on the other, Conservative MPs who basically favour remain but are reluctant to oppose the government for fear this would precipitate a general election and lead to the installation of the Opposition Labour leader, Mr Jeremy Corbyn, as Prime Minister. The Labour party is equally divided. The majority of Labour MPs favour remaining in the EU, but many represent constituencies that voted to leave and fear being deselected if they now speak up for remaining or for a very “soft” Brexit. Mr Corbyn himself is unwilling to join the remain camp, having a long record of hostility to the EU on virtually every issue coming before Parliament.

With Michel Barnier so far standing firm on his negotiating brief, which centres on maintaining the integrity of the single market and customs union and the indivisibility of the four “freedoms”, and resisting so-called “cherry picking”, most key sticking points, including crucially Northern Ireland, remain unresolved. In July, at an informal cabinet meeting at her official country home, Chequers, the Prime Minister brought forward a compromise plan for a bespoke customs partnership with the EU - the so-called facilitated customs arrangement (FCA) - under which, astonishingly, the UK would stay in the single market for goods but not services, observe a “common rule book”, and British customs officials would collect EU tariffs on goods passing through the UK en route to the continent. Barnier has ruled this out as “unworkable”, and it was dismissed, with utter contempt, by the Brexiteers, who consider it a sell-out; and it caused the resignation of the Brexit and Foreign Secretaries, David Davis and Boris Johnson. It has subsequently led to an even less credible counter proposal by the hard Brexit faction in the Conservative party, the misnamed European Research Group, led by the extreme anti-Remainer, Mr Jacob Rees-Mogg. The British government, however, still insists that it is “the only credible proposal on the table”, and Mrs May now seems to be offering the EU a binary choice – either the Chequers proposal or no deal. But it is difficult to see it making much headway either in London or in Brussels. To add to her problems, at the end of this month Mrs May will also face the annual Conservative party conference, at which the hard Brexiteers are pledged to reject the Chequers proposal and Mrs May is likely to face a challenge to her leadership.

Time is desperately short. There is little more than 6 months to the 29 March 2019 Article 50 deadline for exit, but the withdrawal agreement and the principles of a new UK/EU trade partnership ought to be settled well before the end of this year in order to allow sufficient time for approval by the UK and European parliaments. It now seems likely that there will be an additional EU summit meeting in November, but Mrs May really should have been aiming to conclude a deal at the summit already scheduled for 20 October. An Article 50 extension, would, of course, provide more time, but although I believe the other member states would probably agree to it, it is highly unlikely that Mrs May could muster enough support within her party to seek it. So even if EU leaders were to agree to some sort of fudged agreement, if only in order to appease Mrs May and avoid the immediate chaos of no deal, we could still enter the post Brexit transition period with most important issues unresolved. One of these is the very question of the integrity of the United Kingdom. This is a really major issue, which has not received enough attention. Scotland, which voted strongly against Brexit, is sure to bring the independence question back to the table, and both the Scottish and Welsh governments are deeply unhappy about lack of consultation with them by the Westminster government, and about the provisions in the UK withdrawal legislation for reassigning

powers taken back from the EU. As the former President of the European Council, Herman Van Rompuy, recently warned, crashing out of the EU without a deal could risk breaking up the UK.

Citizen's Rights

And there is, of course, the crucial question of citizen's rights, which is of particular interest to many of you here tonight. It needs to be settled precisely in the withdrawal agreement, but I fear I have no definite news or comfort to give you. According to statements by UK ministers, EU citizens in the UK will be given the right to remain, apparently with a "settled status", but this will only apply to those already resident before 29 March 2019, and they will have to register with the Home Office. Since we have no registration system or identity cards in the UK, and given the appalling record of the Home Office in dealing with residence and migration issues, this does not augur well for the future. Nor do we know what would be the position of people entering during the transition period. As for UK citizens in the EU, and their dependants, there is a presumption of equivalent rights to be accorded by the EU, and statements have been made that they will be able to continue in "broadly" the same way as before, but we do not know precisely what this means. In the worst case - no deal - UK citizens will of course automatically lose their EU citizenship when Brexit happens and in principle be treated as third country nationals, with their rights governed by the sovereign laws of each country. The implications of this for pension services, money transfer, access to bank accounts, health care, insurance contracts and so on are uncertain and worrying. This is why many of my former British colleagues at the EIB and other friends resident in the EU are now seeking local citizenship. I am sorry I cannot enlighten you further on this. Of course the best way to resolve the problem is for the UK not to leave the EU.

Conclusions

Boris Johnson said before the referendum that Brexit would be a "titanic success". He may well be right in the wrong sense! It certainly looks like becoming a shipwreck. To quote him again, the Bank of England Governor, Mark Carney, said last month that the chances of a no deal were "uncomfortably high". Given the strength and reckless approach of the pro-Brexit forces in the Conservative party, I cannot disagree with him. Equally, it still seems to me that Mrs May would find it very difficult to win agreement within her party to any deal that would be acceptable to the EU, unless – and this is a possibility - they changed course radically and decided to accommodate her political difficulties in the hope of avoiding having to deal with a more hard-line successor – whether Conservative or Labour. But even if we did end up with such a fudged deal, that would still leave most issues, including citizen's rights, to be resolved during the transition period and prolong the uncertainty. But we should then, of course, fatally have crossed the Rubicon and left the EU – and once this has happened, it would be very difficult to return in the foreseeable future..

Are there any glimmers of hope? Can Brexit even at this late stage be reversed? Thanks to the courage of a small number of Conservative "rebels", Parliament will now have the last say next January on whatever deal the government brings forward; and there are signs that, despite Mr Corbyn, significant sections of the Labour party are moving in a remain direction. Public opinion generally is also beginning to shift, as the damaging consequences of Brexit become more widely recognised and disenchantment with the government's incompetent handling of the situation grows. At the same time, although Mrs May has firmly ruled it out, latest opinion polls show growing support, backed by some of the major trades unions and possibly soon by the Labour Party, for a new Brexit vote – not necessarily a repeat referendum, but asking the public whether they accept the outcome of the government's negotiations. I really do not know whether this will happen or how, but if it does, the game is not yet over. Electoral demography is in its favour. It is estimated that more than 2 million young people, who were not eligible to vote in the referendum and who mostly support Remain, registered to vote prior to Mrs May's ill-fated 2017 election; and many of the older voters, who largely favoured Brexit, will have passed on to a higher constituency. The chances of success would also be greater if this time all UK citizens resident in the EU were allowed to vote.

Wider Concerns

I have one final point. I have so far concentrated somewhat parochially on the damage that Brexit will do to the UK, and on the incompetent way in which the British government has handled the situation. As a loyal British subject, and having worked impartially for governments of different political persuasions over many years, I do not take much pleasure or pride in washing my own country's dirty linen in another country in public. But my opposition to Brexit is based on much wider concerns. At a time when the world is beset with conflicts and crises – climate change, the biggest refugee movements since World War 2, an aggressive autocratic Russia, an expansionist, totalitarian and unpredictable China, major problems with North Korea, Syria, Iraq, Iran, Myanmar and now Turkey, and above all with a unilateralist, anti-democratic wrecker in the White House, bent on disrupting the EU, NATO and the WTO and world trading system – surely it is madness for the UK to be weakening the EU and the Western alliance, where we still broadly share the same values- respect for human rights, freedom, democracy, equality and the rule of law - for the sake of an ill-conceived 19th century illusion of “taking back control” and regaining national sovereignty. Mr Putin must be laughing his socks off. The UK should stay within the EU, working constructively with its partners to address both the many internal problems facing the EU itself, and the wider global issues to which I have referred.

I am sorry to present such an uncertain and gloomy prognosis. It reflects my deep concern at what is currently happening. Like the former US Secretary of State, Madeleine Albright, in her recent book, “Fascism: A Warning”, I believe Brexit is “an exercise in economic masochism that Britons will long regret”. But there is still some hope. Brexit is not yet inevitable, but I must rest my case here and thank you for listening so patiently to me.
