ABS POLICY PAPER No. 16

The costs and implications of a no deal Brexit

Written by "Senior European Experts" London

September, 2019

Introduction

Should the UK leave the EU on 31 October without agreement with the EU there will be both direct and indirect costs. Both are hard to calculate – it is unprecedented for a country in a single market with 27 other countries to walk away from that arrangement with no alternative agreed. Nevertheless, there is a considerable amount of agreement amongst economic analysts, business people and policy experts as to what the main costs and consequences are likely to be.

Much of the public debate on a no deal Brexit focuses on the short-term implications but the economic impacts of no deal will be enduring. The short-term impacts will result from businesses' lack of preparedness to cope with the immediate introduction of physical checks at the UK's borders with the EU and with the instant removal of the legal framework underpinning large elements of UK businesses' trading activities with and within EU countries. The more enduring impacts will be a consequence of the permanent introduction of economic, regulatory and physical barriers to our closest and largest export market, the application of EU duties to UK exports and UK duties to EU exports, the loss of access to EU services markets, the loss of access to the EU's free trade agreements with third countries and the (virtually inevitable) further decline in the value of sterling.

Background

EU membership and its Single Market provides the legal underpinning for frictionless trade between the UK and other EU Member States, for cross-border contracts and the provision of many services, for citizens' rights, for the verification of safety and quality of products and for police and judicial co-operation. A no deal outcome would remove this legal framework without putting anything comparable in its place. That is why leaving the EU without agreement would be so serious.

The Withdrawal Treaty negotiated by Theresa May's Government in November 2018 addressed all of these issues so as to ensure continuity for citizens and businesses after Brexit day then expected to be on 29 March 2019. That Treaty also included a transitional phase to enable existing arrangements to apply if no long-term agreement had been reached with the EU by 31 December 2020 or if the transitional period had not been extended.

Measures can be taken to mitigate some of the consequences of leaving without an agreement – the most important are mentioned below – but they would fall far short of the existing arrangements and they could not replace the Withdrawal Treaty. The EU has taken measures of its own to limit the impact of a no deal Brexit but these are designed to protect the interests of the remaining EU Member States and would be temporary.[1] It has been suggested that the UK and the EU could reach agreement on some key issues, such as travel and transport, in the aftermath of a no deal Brexit.

Theresa May's Government introduced a number of legislative measures designed to ease the problems caused by a no deal Brexit. Around 600 statutory instruments were passed by March 2019, many of which incorporate existing EU legislation into UK law, and a number of Bills were introduced into Parliament:

- the Trade Bill – to enable HMG to rollover existing trade agreements between the EU and third countries to give continuity to business;
- the Agriculture Bill – to enable support to farmers currently provided through the Common Agricultural Policy to continue after Brexit;
- the Fisheries Bill – to replace the Common Fisheries Policy in the UK;
- the Immigration Bill – to give EU citizens living in the UK the right of settlement after Brexit; and to provide for social security co-operation to continue after Brexit;
- the Financial Services Bill – giving HMG the power to implement EU financial regulations in the UK after Brexit to ensure continuity;
- the Healthcare (International Arrangements) Bill – to implement reciprocal healthcare arrangements between the UK and other countries.[2]

Only the last of these Bills has become law; the remainder were held up in the House of Commons with many substantial issues unresolved and were lost on prorogation. Mrs May did not bring the Bills forward for further debate for fear they would be amended by MPs trying to stop a no deal Brexit or seeking a referendum. Without these Bills becoming law not only will there be gaps in the legal frameworks needed to underpin policy but official decisions will be more open to legal challenge.[3] There remains some confusion, however, about what impact the absence of this legislation would have. For example, the-then International Trade Secretary, Dr Liam Fox, said that the main changes made by the Trade Bill had already been secured by other means.[4]

The cost to citizens: loss of rights

Everyone living or working in the UK, including EU citizens, and UK citizens in the rest of the EU would lose many of their existing rights:

- for UK citizens, all rights that derive from EU Treaties, such as the right to travel, live, work, study or retire in EU countries, would lapse immediately;
- UK citizens living or travelling in the EU at that moment would lose all their rights under EU law;
- UK citizens travelling in the Schengen area (all EU Member States except Bulgaria, Croatia, Cyprus, Ireland and Romania) would need to have a passport issued in the last 10 years and have at least six months validity left;[5] visas might also be needed if the UK failed to agree to the EU proposal of reciprocal visa-free travel as a temporary measure;[6]
- the rules for travel to non-Schengen area EU countries would be determined by those countries (except for Ireland; see below);
- EU citizens travelling to the UK after Brexit day would lose their right to enter and remain in the UK for up to 90 days and would be subject to whatever provisions the Government made to regulate travel and migration from the EU;
- UK citizens (and EU citizens visiting the UK) would lose their right to emergency healthcare treatment when travelling in the EU/EEA;
- UK driving licences, whether for personal or business use, would no longer be recognised in the EU and UK citizens wishing to drive in the EU would need to obtain an International Driving Permit;[7]
- the right to equal treatment (in EU law, the principle of non-discrimination) would lapse for UK citizens living in the EU (and vice versa), meaning that they could be discriminated against on grounds of nationality at work, in terms of public services such as health care and in other ways.

The economic costs

A no deal Brexit would impact on the economy in three phases:

1. Anticipation of no deal – a continuing fall in sterling, pushing up import prices and inflation; loss of business and consumer confidence; a continuing brake on inward investment; some relocation of businesses outside the UK; spending on preparedness measures;
2. Short-term impacts afterwards – considered in this section below; it is important to note that while the Bank of England can intervene in financial markets there is no comparable body with the powers to protect the trading system; how long this phase continued and its severity would partly depend on the EU's response;

3. Long-term impacts – studies indicate a significant reduction in growth over the medium-term with an overall shrinking of the economy and consequent fiscal impacts meaning less tax revenue that could be spent on public services.[8]

The most immediate problems would be:

- difficulties at the ports could mean restrictions in the supply of some goods, particularly fresh food and medicines; 600 lorries a day come friction-free through the Port of Dover carrying fresh produce (see goods trade below); EU temporary measures would allow UK lorries, buses and coaches to continue to operate across the border temporarily but sanitary and phytosanitary controls would apply;[9]
- the impact on consumer prices resulting from the need under WTO rules to impose duties on EU imports (the UK has published its draft tariff schedule[10]), and the likely further fall in the value of sterling, which would also increase interest rates, as the Bank of England has warned;
- the bureaucratic burden on goods exports to the EU, which would be subject to customs, product safety and other procedures; for the 145,000 UK businesses that export only to the EU, this will be a particularly large change from the current position but all businesses exporting to the EU would face additional costs;[11]
- uncertainty about the validity of existing cross-border contracts involving UK and EU citizens/businesses leading to litigation to resolve the confusion;
- the right of UK businesses to establish themselves in an EU Member State or to offer services anywhere in the EU would lapse immediately creating legal uncertainties about the status of those businesses or their services in the EU;
- while the UK and the EU have put in place time-limited rules to ensure basic air connectivity until 24 October 2020 and continued validity of aircraft safety certificates for nine months from Brexit day, these are only temporary and will need a permanent solution. And in the case of air connectivity there will be significant limits on the operations of British airlines in the EU;
- disruption to supply chains in UK manufacturing caused by delays in imports of components, for example Honda requires 350 truckloads a day of components from the EU to keep its production lines running;[12]
- consumer rights deriving from EU law, for example those covering package holidays and cross-border shopping, would be at risk;
- some businesses could collapse because of contractual and other operating difficulties;
- the ability of UK business to prepare for no deal is limited, especially amongst small and medium sized enterprises (SMEs) because they lack capacity and don't know what rules they would have to apply.

Impact on goods trade

- Lorries seeking to leave or to enter the UK at the channel ports would have to go through customs and other checks on both sides of the Channel and tariffs would be payable on goods entering the EU and on goods entering the UK from the EU; the Port of Dover says that two minutes' delay in the processing of lorries leaving the UK would create a 17 mile tailback;[13] the same problems could occur the other side of the Channel, meaning delays to imports as well as exports;[14]
- Ninety per cent of UK goods exports would face tariffs when entering the EU and, although the average tariff is around four per cent, in some cases it is higher at around 10 per cent in the automotive sector and commonly over 20 per cent in relation to agri-food (see below)[15]; in the automotive sector the impact averages about £2,700 per car (the UK exported almost 700,000 cars to the EU in 2018);[16]
- Exporting would be complicated by the fact that the UK would no longer be a participant in the EU's regulatory agencies that are responsible for certifying products sold in the Single Market; for example, medicines, chemicals, vehicles and aircraft (and their component parts) must be certified before sale or use;[17]
- The UK would lose its established trading relationships with those countries with which the EU has a trade agreement or agreements, so it would not be just the UK's trade with the EU that would be affected but also that with many other countries including Canada, Japan, South Africa, South Korea, Turkey, much of South America, most countries in the Balkans and the Middle East;
- In terms of EU imports, under WTO rules the UK would be obliged to impose the same duties it charged on imports from all other WTO member countries; it is sometimes suggested that the UK would charge no duties but that is would be impractical under WTO rules;
- Both the British Retail Consortium and the British Food importers and distributors organisation have warned of significant price increases as a result of the combination of tariffs being levied on imports and from the EU port disruption.[18]

Impact on trade in services

- Difficulties in goods trading would be more visible but the economic impact of the loss of services exports would be considerable; the UK had a £29 billion surplus in its services exports to the EU in 2018;[19] the problem for services is the loss of the right to sell services in the Single Market and the impact of non-tariff barriers (NTBs);
- UK businesses without a subsidiary in the EU would lose the right to offer services in the EU leading to uncertainty as to whether they would be able to continue to operate in the EU and in those countries with which the EU has trading agreements that cover services (g. Switzerland);

- Many UK-based financial services providers would no longer be able to operate in the EU/EEA unless they had a subsidiary in an EU Member State; this would incentivise British businesses to relocate to the EU27; the contractual problems mentioned above are especially serious for financial services;[20]
- Professional qualifications in many fields, including law, accountancy, medicine, and teaching, would no longer be automatically recognised for UK citizens working in the EU or providing services to customers in the EU; for example, the Law Society estimates that legal services turnover would fall by 10 per cent (£3.5 billion a year) and up to 10,000 jobs would be lost as UK lawyers would lose the right to practice in 31 jurisdictions;[21]
- At present a broadcasting licence issued by Ofcom is valid throughout the EU; that would cease to be the case and British-based broadcasters would need separate EU authorisation to continue to operate in EU countries;[22]
- The movement of data between the EU and the UK could become unlawful as the European Commission will only decide whether the UK meets EU data protection standards after Brexit;[23]
- The loss of free movement rights would impact on businesses' ability to move workers between branches across borders;
- The movement of funds between the UK and the EU could be affected, causing potential cash-flow problems for businesses and individuals;
- Cross-border energy supplies, such as through the electricity interconnectors with EU Member States (France, the Netherlands and Ireland) are unlikely to be disrupted but official analysis has warned of "marked price rises" for consumers;[24]
- The line between trade in goods and that in services is increasingly blurred and difficult to determine; a service contract is often embedded in the supply of goods.

Food and agriculture

The agri-food sector is considered particularly vulnerable to a no deal Brexit because of the impact of high tariffs on UK food exports to the EU and the potential effects of port delays on time-sensitive deliveries. Anticipated costs and consequences include:

- a drastic fall in meat exports because of the 46 per cent EU tariff on sheep meat; HMG has suggested it would buy up the unsold surplus livestock at a cost of up to £500 million a year but there must be questions about the feasibility of disposing of hundreds of thousands of carcasses a year;[25] the impact of the loss of markets would be particularly acute in Wales, Northern Ireland and Scotland;
- some alternative markets may be available but are much smaller than the EU market; for example, Japan has agreed to admit UK lamb but the exports would amount to under three per cent of current UK lamb exports to the EU;[26]

- the Government's plan to allow tariff-free entry to some food imports is unlikely to be reciprocated by the EU, meaning more competition for UK farmers and lower levels of exports, threatening the viability of some businesses;[27]
- as 40 per cent of fresh food and drink imports into the UK come via the Dover straits, and Defra anticipates an 80 per cent reduction in capacity after a no deal Brexit on the Dover-Calais crossing, disruption at the ports could affect availability and choice for the consumer;[28]
- leaving at the end of October might have greater impact on the availability of some fresh fruit and vegetables as that is the time when the UK switches to greater imports as the British growing season ends;[29]
- other sectors including beef, where the Government intends to apply tariffs on imports, would see significant consumer price rises; Michael Gove warned that there could be a spike in food prices as a result of these difficulties and increased costs for suppliers;[30]
- the political consequences of problems in the agri-food sector could be significant both because of the impact of food shortages and price increases but also because of the particular impacts on Welsh lamb producers, the Scottish beef sector and Northern Ireland producers of such products.

Longer-term economic consequences

The largest-scale survey (by HM Treasury, November 2018) found that UK GDP would be eight per cent lower over 15 years than it would otherwise have been after a no deal Brexit.[31] Similar effects have been found in other studies, for example those published by the Centre for Economic Performance, the OECD and UK in a Changing Europe.[32] The Bank of England has advised more recently that, because of preparations for a no deal Brexit in the UK and in the EU, the fall in GDP could be around six per cent rather than eight per cent.[33] Other less negative estimates than the Treasury's (e.g. Economists for Free Trade[34]) have been criticised as being based on unrealistic assumptions (for example that the UK would scrap all import tariffs and abandon even basic import safety standards).[35] The regions likely to be worst affected are the North-East of England and the West Midlands.

These estimates of a decline in UK GDP reflect the problems of breaking with the UK's largest market. Tariffs on UK exports to the EU would mean higher prices for EU consumers and this lack of competitivity would trigger a fall in UK exports to the EU (even if this was partly offset by a fall in the value of sterling). Loss of access to the EU financial services market could drive up the cost of finance in the UK, and reduce competition in other services. It would be difficult to make up for lost trade with the EU, leading to shrinkage in the overall size of the UK economy. The fall in inward investment from the EU and from third countries (who have hitherto regarded the UK as an ideal location for accessing the EU) will also have adverse effects. Finally, higher mortgage rates could result from the fall in the value of sterling. The Bank of England has estimated that this could cause a significant fall in house prices over three years.[36]

A fall in output would affect the public finances. The Office for Budget Responsibility has forecast that in 2020/21, UK public borrowing would have to rise by £30 billion to make up for the shortfall in revenue. In the longer-term, HMG estimates that the fiscal impact would be around £80 billion a year by 2033.[37] This is a substantial loss and in the early years would be compounded by an increase in welfare costs because of the loss of employment.

Other impacts on wider society

There are other, non-economic, costs of a no deal Brexit. They include:

- potential shortages of medicines and other materials needed for NHS treatment, such as radioisotopes, because of delays at the border and/or doubts about regulatory approval following the UK's departure from the European Medicines Agency and Euratom;[38] to mitigate this companies have been building buffer stocks and the Government has agreed shipping contracts to maintain supplies;
- although NHS managers are taking steps to reassure them, there would be uncertainty for EU citizens working in the health and social care sectors, both about their residency and employment rights in the UK and the validity of their professional qualifications; this might lead those on short term contracts, for example, to choose to return home rather than seek further work in the UK, exacerbating staff shortages in the NHS and social care; and is likely to act as a disincentive to new recruits;[39]
- difficulties for British and Irish citizens needing medical treatment on the island of Ireland (there is regular movement across the border to seek medical care);
- difficulties for UK students at institutions in the EU as to their residency rights and access to education finance in those countries;
- civil justice co-operation under the EU treaties would cease, causing difficulties for families as well as companies; alternative arrangements are being made to enable at least some co-operation but they will not be as comprehensive as those under EU law;[40]
- loss of free movement rights leading to higher numbers of retired people staying in the UK rather than retiring abroad;
- pensioners who have lost their entitlement to health care in EU countries might start to return, generating additional costs of £500 million annually to the NHS and a requirement for an additional 1,000 beds.[41]

Impact on crime, justice and security

- The UK would lose use of the European Arrest Warrant to extradite suspects from, and to return suspects to, another EU country, and would have to rely on the less effective and no longer comprehensive 1957 Council of Europe Convention;
- It would lose the right to use other key EU crime and justice instruments such as joint investigations and would be excluded from EU co-operation mechanisms such as those working against terrorism;
- The police and UK Border Force staff would lose access to EU databases, including the Schengen II database which is essential to border control and the criminal records database (ECRIS); and also the Prüm arrangements for DNA records and number plate recognition.

Impact on the Crown Dependencies and the overseas territories

- The Crown dependencies, that is the Channel Islands and the Isle of Man, and Britain's Overseas Territories (including Gibraltar, Bermuda and the Falkland Islands) have a special status within the EU which would lapse;
- This would be particularly serious for Gibraltar because its border with Spain would become an external border of the EU controlled by Spain and subject to EU law; the current border crossing point is extensively used by both Gibraltarians and Spanish people, many of the latter work in the territory but do not live there.

Disputes with the EU

The recent indications by the Government that they would not be bound by the December 2017 agreement with the EU to pay £35-39 billion of past liabilities in the event of no deal, and would only pay an unspecified lower amount, would be likely to trigger serious legal disputes with the EU. After exit, the UK's financial obligation will remain under Article 70 of the Vienna Convention on the Law of Treaties. Moreover, the Withdrawal Agreement being derived from Article 50 could not be used by the EU/UK after a no deal Brexit; any new relationship would have to be negotiated under Article 218, giving each of the EU27 a veto over any proposed agreement.[42]

Impact on Northern Ireland

Northern Ireland is in a category of its own because of its land border with Ireland. Not only would the negative impacts set out above apply but, in the absence of any agreement with the EU, Brexit would mean new controls between the two parts of Ireland, in particular for the transit of goods, which would be in conflict with the Good Friday Agreement and the 2018 EU Withdrawal Act.

The agreement reached by the parties in December 2017 made provision for a "back stop" arrangement (as it has since become known) if the two parties were unable to agree other arrangements to ensure the continuance of the Good Friday/Belfast Agreement and to maintain an open border within the island of Ireland.[43]

In terms of free movement of people the Common Travel Area, which allows British and Irish citizens to move freely between the two countries without passport checks, would continue for those citizens. If others were not checked at the border there would be a potential gap in the Government's control over immigration.

If customs controls were re-introduced the economic effects could be significant because of the high degree of movement between the two jurisdictions, for example in food processing; the requirement under WTO rules to impose duties on imports from the Republic of Ireland, and the parallel requirement for Ireland to impose duties on imports from the UK, would cause disruption to trade and have economic consequences.

The political implications of re-imposing borders controls between the two parts of Ireland, which would conflict with the 1998 Good Friday/Belfast Agreement, are likely to be negative and unpredictable. Police and government officials have warned of possible conflict.[44]

The European Commission published in March 2018 a detailed seven page protocol to the draft Withdrawal Treaty, with nine annexes, which proposed arrangements to protect the peace process. These would mean that Northern Ireland would remain in the EU's customs union and in regulatory alignment with the EU; large parts of the Single Market would in practice continue to operate there. This would have the practical effect of establishing a customs border between Great Britain and Northern Ireland – something the Prime Minister has said would be unacceptable. Leaving without agreement will mean the imposition of border controls of some kind under EU rules because the border of Ireland would become the external border of the EU. The UK would need such controls too because of the need to collect import duties referred to above under WTO requirements and because crime and smuggling across the border, which is already a significant issue, would be likely to worsen.

Conclusion

Any survey of the costs and implications of a no deal Brexit is necessarily constrained by the unprecedented nature of the event and unknown factors such as the willingness of the EU27 to agree mitigating measures. Some are reluctant to concede that any difficulties would be more than transitory, although there is little evidence to support this claim. It is telling that the Government refused to accept a proposal from the House of Lords for a joint committee of inquiry by the two Houses into the costs and implications of no deal. A leaked Treasury analysis has warned of significant disruption at the Channel Ports for three months, the potential for severe disruption of trade on the Irish border and predicts price rises in food and energy that would have the greatest impact on low-income households.[45] It is also noted that business preparations vary considerably in extent and quality.

The Government's decision in July to increase the budget for no deal preparations was a necessary step, albeit that some of this funding had already been announced. But it will be difficult to implement all the measures proposed, such as the recruitment of additional border staff, by 31 October.

As the Governor of the Bank of England has pointed out, the economic risks of a no deal Brexit are considerable. The wider social and political implications are more difficult to predict. There will be pressure from the Scottish Government for a new referendum on Scottish independence. The situation in Northern Ireland, already fragile given the failure to form a new cross-community executive over the last two years, will deteriorate in the circumstances of no deal, in particular if direct rule has to be re-imposed.

It is also important to note that a no deal Brexit does not mean that Brexit is done. A long-term basis for the UK/EU future relationship will still need to be negotiated, including longer-term solutions to the issues covered by temporary arrangements to minimise short-term disruption. So no deal will mark the start of a further negotiation – in which the UK will be in a weaker position as a third country rather than a member of the EU.

Settling the outstanding issues relating to debts, citizens and Northern Ireland are likely to be pre-conditions before the EU will negotiate the long-term relationship with the EU.

<u>All the available evidence suggests that a no deal Brexit would come at a high cost.</u>

****