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## BGA Insight - Departing the EU - destination unknown? Implications of Brexit

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On 31 January 2020 the United Kingdom left the European Union, losing vote and voice. It was a legal departure. Until the end of 2020 the UK will be treated as a member in economic and financial aspects. The critical date is not 31 January, but 31 December 2020. This is when Brexit will be felt in the world of money and products.

Brexit was a vote against the EU. It remained silent of what was to replace EU-membership. During the campaign, Leavers assured voters that nothing substantial would change - Britain would have its cake and eat it, in the immortal and immoral words of Boris Johnson; Britain would retain unrestricted access to the Single Market, an agreement on future trade relations with the EU would be the easiest treaty in diplomatic history.

### **A launch without a place to land**

The Brexit referendum had given the command 'cast off'. But neither the captain nor the crew knew the port of destination, what course to take or which manoeuvres to execute. Nobody had a map with suitable places to anchor. Nobody had the slightest idea about costs or potential profits of this journey.

The confusion of what to make of the Brexit vote was responsible for the tortuous path British politics took under Theresa May. But it was not confusion about Brexit that made her stumble. It was Northern Ireland and the Backstop.

Northern Ireland had played no role in the Brexit campaign of 2016. Once the UK left the Single Market, however, it was inevitable that there had to be either border checks between Northern Ireland and Ireland or between Northern Ireland and the rest of the UK. Neither options were acceptable to the Parliament in Westminster. The result was stalemate.

May's successor Boris Johnson devised a new solution which seemed vague enough to satisfy Parliament. The Protocol that he signed with the EU is couched in blurred language and leaves wide room for divergent interpretations and inconsistent application. The suspicion of bad faith has been growing with Johnson's bravado, his opportunistic remarks and his hoodwinking machinations.

### **A family member leaves**

The EU loses a family member. The UK represented 18% of the EU's economic potential, 13% of its population and more than 20% of its military strength. The EU has lost a member with nuclear weapons and a permanent seat in the Security Council, a country whose traditions in the rule of law, liberal institutions and democratic government were a model worldwide. It is in the EU's vital interest, to keep a departing UK as close to itself as possible; but it is an equally vital EU-interest to keep its own institutions intact and immune from disturbing influences.

### **Only a hard Brexit is a good Brexit**

A hard Brexit is now preordained. The question is only: Will there be some sort of contractual frame or will it be a departure in acrimony and frustration? The EU-27 obviously need a different sort of agreement with a country that lies on their doorstep from one with a country that is beyond the Atlantic ocean. To invoke Canada or Australia as a model is absurd: EU trade with Canada is a fraction of trade with the UK and the EU has no trade agreement with Australia. The situation in Northern Ireland is peculiar to the United Kingdom and therefore makes special arrangements inevitable. The British Government has introduced an Internal Market Bill

that flatly contravenes the Withdrawal Agreement concluded a year ago. The United Kingdom not only flouts the rule of law. It appears as a fraudster whose words cannot be trusted. It has repeatedly tried to renege or to re-interpret texts that seemed agreed. Mistrust and suspicion are creeping in.

At the moment, the British government seems to seek a radical separation from all EU-norms and regulations and unconstrained freedom of action. It proclaims 'Global Britain', implying a return to free trade without quotas and tariffs, without bureaucratic inspections or specifications. This radical idea of free trade is not realistic. Despite globalisation, national markets differ in safety, health, environmental aspects, designations of origin, fight against counterfeited products etc. The EU cannot accept that an economic power like the United Kingdom can export uncontrolled into the Single Market unless its products meet basic specifications of this market. The British government that pushed for the Single Market under Margaret Thatcher knows this well enough.

### **Empty promises and false prophets**

Those advocating Brexit have promised economic independence and a revitalisation of economic ties with Commonwealth countries, taking back control over borders, controlling migration, saving money and higher growth rates. None of these promises stands the test of reality.

### **Global Britain faces head winds**

The vision of Global Britain comes at an inopportune moment. The peak of multilateral free trade has passed. Since 2016, the USA is pursuing a strict 'America first' course. Punitive tariffs are a central element of Trump's foreign policy. The present administration is looking on foreign trade primarily through the lens of protecting jobs in the USA and using tariffs and sanctions as leverage for political ends. If the UK is turning away from the continental EU, the obvious alternative partner is the USA. But in this relationship the USA is clearly dominating, not only because of its size, but also because the UK is under time pressure and has few alternatives. The idea was to have a US-deal before an EU-deal, thus putting additional pressure on the EU. That has turned out to be an illusion. The US-President is in the midst of an election campaign and has to negotiate with rigour. The diktat from Washington could be no less troublesome than the alleged diktat from Brussels. The recent trade deal with Japan covers 2% of British foreign trade. It opens Japan to more exports of Scotch whisky, but it also opens the United Kingdom to cars made in Japan. That will spell the end for Japanese cars manufactured in Britain. The idea of economic independence in an interdependent world is a daydream.

As to the rest of the Commonwealth - most Brexiteers prefer to speak of the Anglosphere - hopes of reviving trade with down under seem flimsy. Before 1973, Australia and New Zealand were among Britain's main trading partners, Britain accounting for 33% or 45% of their foreign trade respectively. Today, Britain's share has shrunk to 3%. Both Australia and New Zealand have integrated into the booming economies of East Asia. Neither of them will bend over backwards to accommodate an antipodean country that has second thoughts about its economic preferences. India has shown little enthusiasm. A trade agreement with China will be difficult not only because a nation of 65 Mio will not have the same weight as the EU-Single Market of 450 Mio, but also because political issues could interfere. It seems inconsistent to

ban Huawei from doing business in the UK and to threaten sanctions over Hongkong while expecting favourable access to the Chinese market.

### **The cake is getting smaller**

Regional and bilateral trade agreements are displacing global free trade. The Covid-19 pandemic is accelerating this trend. World trade is increasingly subjected to reshoring, protectionist trade barriers and regional obstacles. Supply chains are being shortened to make them less vulnerable. Gigantic government aid programmes flow exclusively into national economies and distort competition. This makes accusations of dumping, countervailing duties, punitive tariffs or retaliatory measures more likely. The dispute settlement procedure of the WTO is paralysed. Since the Doha Round in 2008, no world trade talks have been held in WTO format. Only a handful of nations trade on WTO-conditions. World trade is politically charged, moral disapproval manifesting itself in economic sanctions. Even allies are affected by such sanctions. The global economy is expected to shrink by five percent this year. With Brexit, the British are losing privileged access to one of the most productive regional markets with high living standards and enormous purchasing power. They will have to cut a new piece out of a smaller cake elsewhere.

### **Loss of control**

The hope of regaining control of national borders turns out to be an illusion. The Northern Ireland Protocol creates a hybrid role for this part of the United Kingdom: one territory, two systems. Northern Ireland remains part of the EU's economic order without having a say in Brussels. A new control regime will have to be imposed on the Irish Sea that will likely encourage smuggling and black-market activities – perhaps even tolerated by authorities that are inadequately equipped or deliberately turn a blind eye or, if the Internal Market Bill should be approved by Parliament, by a Minister of Her Majesty's Government who knowingly and deliberately contravenes treaty obligations. The political authorities of Belfast will remain excluded from decisions that affect their vital interests, since they are not represented on the Committee that is to implement this agreement. 'Take back control' may apply to London; for the regional governments in the United Kingdom, Brexit means a loss of control.

### **Migration has changed but not dropped**

A core demand of the Brexit campaign was better control over immigration. Migration from EU countries today is less than half of what it was in 2015/16. But immigration from non-EU countries has risen and reached the level of total immigration in 2016. Immigration has not fallen, it has just changed composition. Migratory pressure from non-European countries will continue to rise. Not only will Britain have to find substitutes for the thousands of low paid Eastern Europeans who helped out as nurses, as seasonal workers on the fields or in the building trade. Seasonal workers from the continent return after completing their stint. Seasonal workers from Pakistan, the Philippines or Ghana are less likely to return and will probably try to stay illegally. In the Hong Kong crisis, the Prime Minister has promised residents with British overseas passports unrestricted entry with a work permit. This could affect up to three million Hong Kong Chinese – ten times the current level of annual immigration, and more than all EU citizens currently residing on UK territory taken together. As long as the Common Travel Area with Ireland remains in force, the route via Dublin offers uncontrolled access to the United Kingdom.

By contrast, emigration is increasing. British citizens are applying en masse for citizenship of other countries: in Germany, applications have soared by 3,000%, in Ireland by 800% and in France by 500%.

### **Brexit does not save money**

The UK's obligation to contribute to the EU budget – so far about £10 billion net per year – will cease at the end of the transition period. But these savings will be offset by huge new expenditure. The UK government will have to provide national subsidies for farmers and fishermen. It will have to build up national authorities for environmental issues, medicine approvals, and product safety. New customs and border controls will be needed, requiring perhaps 50,000 workers and corresponding infrastructure. Preparations for a 'no deal' exit have swallowed £2 billion. The British economy is facing high transformation costs and risks. All larger companies have set up special teams to prepare for the consequences of Brexit at an estimated cost of £5-10 billion. SMEs in particular find it difficult to master the complexities required to adapt to post-Brexit conditions.

After Brexit and Covid-19, tax revenues will plummet, but expenditures will rise steeply. The latest budget estimates for 2020 are alarming: expenditure: £1,050 billion, revenues £780 billion, deficit £270 billion (15% of a GDP likely to shrink by 10%). Some fundamentalist Brexiteers regard this as a boon. Amid the general recession caused by Covid-19 it will become impossible to attribute exactly which part of an eventual decline can be attributed to Brexit.

A hard Brexit will have lasting repercussions on the structure of the British economy. Any analysis has to be tentative as long as the conditions defining the future relationship with the EU are unclear. The following diagrams is an attempt to measure how different branches may be affected.

### **Enduring uncertainty**

The worst effect of Brexit is enduring uncertainty. Investment options need reliable information about of the way ahead. Supply chains and marketing postures need to be adapted to post-Brexit conditions. Britain has lost four years in adapting and modernising through dithering about Brexit. Long term structural consequences of Brexit will only become apparent in 2021. What is known so far is that the automotive sector and aerospace will be seriously affected. Aston Martin, Bentley and Rolls Royce are English icons and cannot be produced anywhere else. But the fate of most of the other car manufacturers is in abeyance. The Japanese have never left any doubt that for them Britain was the gateway to Europe, and once that gate slums shut or tolls become payable, the basic assumption for locating their production in Britain falls away. Airbus could relocate production to the USA, particularly if that could help easing American pressure over imbalances in transatlantic trade.

### **Preliminary Assessment**

Prospects are dim. The best guess is that there will be some sort of agreement. Neither side can afford to let the negotiating process crash. There will probably be a rerun of October 2019: bluster, recriminations, threats, brinkmanship, but a superficial verbal compromise will be cobbled together. But papering over the real differences through verbal acrobatics will not solve the real problems. And there is a considerable probability that whatever is agreed may be re-interpreted nonchalantly by the British Government on second thoughts. The reliability of the British government is not beyond doubt.

Brexit is much more than devising a new trade policy for the United Kingdom. It is an enduring process that will fundamentally alter the structure of the British economy and the mentality of British society. It has upset the traditional balance of the constitutional powers - Crown, Government, Parliament and the people - and it will take great statesmanship to find a new balance. The survival of the United Kingdom as a unitary state is at stake: The United Kingdom could become an Untied Kingdom. Another referendum about independence of Scotland becomes more probable as Brexit becomes harder. A secession remains implausible, however. But relations between Scotland and England will grow acrimonious and controversial. The situation in Northern Ireland is more dangerous and fragile. Border controls between Northern Ireland and the rest of the UK will reinforce tendencies in Northern Ireland to open itself to the south. If, however, the UK should ignore its obligations, forcing Ireland and the EU to institute border controls, the result could be a return of violence and troubles. The IRA would remobilise. On top of all this, the deep divisions within English society persist. Should the results of Brexit turn out to be disappointing (as they most likely are), there could be nasty, perhaps even violent repercussions.

### **Singapore-on-Thames**

A post-Brexit UK will try to emulate Singapore's model: Low taxes, emphasis on financial services and on high tech. It will set out to become more competitive in research and development where it already enjoys some success. The World Wide Web was a British invention. But seeking a future in AI, quantum computing, bioscience, robotics and communication will align Britain increasingly with the United States. This marks the death of the idea of Europe pooling its resources to challenge the undisputed American leadership in new technologies. Britain will evolve either into an appendix of the North American market or into a convenient and cheap workhouse where US high tech companies can relocate some of their business that they have to withdraw from China for political reasons.

Brexit is neither done nor achieved. It is likely to keep British society polarised, fighting about the right path forward. Brexit could mark the moment when Britain, breaking free from the shackles of Brussels, called for free trade in a world turning away from that idea.



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A further analysis of the entire Brexit-process is due to appear in summer 2021.