

COST OF

NO DEAL

REVISITED



The **UK** in a
Changing Europe

Contents

Introduction	p3
The politics	p5
How would no deal happen?	p7
Political fallout	p8
The economy	p9
The run-up to Brexit	p10
Short-run impacts	p11
Long-run impacts	p12
The legal position	p13
Trade sectors	p14
Sectoral and regional consequences	p17
Impact on the EU27	p18
Immigration and the status of EU and UK citizens	p20
Northern Ireland	p22
Specific sectors	
Agriculture	p24
Fisheries	p26
Aviation	p27
The NHS and pharmaceuticals	p28
Energy and the environment	p29
Financial services	p30
Conclusion	p32

Foreword

The prospect of no deal is looming large again. A summer of speculation – of competing claims about its likelihood and, finally, of technical notices published by the government outlining how we all should cope – has brought it back front and centre in the Brexit debate.

Given the stark and often contradictory political rhetoric swirling around the issue of no deal, we at The UK in a Changing Europe thought it was worth figuring out what it might mean. In a debate characterized by anger, frustration and outright partisanship, we felt a sober and impartial analysis by academic specialists could perform a useful function and help explain to people what, precisely, no deal means and what it might imply.

We focus on what we term a ‘chaotic Brexit’ – a scenario under which the UK leaves the EU with no agreement at all, whether on trade or on withdrawal issues. And of course, the analysis that follows is of necessity somewhat speculative. There are, as we pointed out repeatedly during the referendum campaign itself, no facts about the future. That being said, by deploying academic expertise about the UK’s relationship with the EU across a number of sectors, and utilising a number of social science disciplines, we believe we have identified in a realistic way what the process of falling out of the EU with no agreements in place might imply both for the UK and the EU.

As ever, I’m extremely grateful to all those who contributed to what follows, not least because writing a report as detailed as this in the dog days of summer was perhaps not the kindest thing to impose on our team. As ever, however, they responded enthusiastically and efficiently.

So, thanks to Catherine Barnard, Michaela Benson, Matthew Bevington, Charlotte Burns, Josh De Lyon, Swati Dhingra, John Garry, Colin Harvey, Tamara Hervey, Carmen Hubbard, Hussein Kassim, Craig McAngus, Philip McCann, Jean McHale, Raquel Ortega-Argilés, Steve Peers, Jonathan Portes, John-Paul Salter, Thomas Sampson, Simon Usherwood and Alan Wager for their sterling efforts. As ever, they’ve tolerated my questions and comments with efficient good humour.

I’d like to record my particular gratitude to Alan Wager, who has worked assiduously on this project, and to Jonathan Portes who spent an inordinate amount of his bank holiday weekend helping to make of the various contributions we received a clear and coherent whole. Finally, Lizzie Parker managed the entire process with the calm efficiency we’ve come to expect of her – and got her dissertation in on time.

I hope you find what follows accessible, informative and useful. As ever, do get in touch if you have any questions or (polite) comments.

Anand Menon, director, The UK in a Changing Europe

Introduction

A year ago, we at The UK in a Changing Europe published our analysis of the Cost of No Deal. The government spent much of the subsequent 12 months implying we had been wasting our time, so implausible was this outcome.

No longer, however. International Trade Secretary Liam Fox claimed that it is perhaps the most likely outcome of the Brexit negotiations. The Foreign Secretary, Jeremy Hunt, thinks it would be a mistake we would regret for generations. As a further straw in the wind, both the Danish Finance Minister and Latvia's Minister of Foreign Affairs have rated the chance of a deal as '50-50'. No deal seems to be firmly back on the agenda. And, rounding off the long hot summer of speculation, on 23 August the government began to issue a series of technical notices to businesses and households describing the consequences of no deal, and the measures that should be taken to cope with it.



This document is our attempt to examine, as accurately as possible, but also in plain English, what the implications of no deal would be. We look at the potential impact on our economy (and politics), but also dig down to investigate what no deal might mean for specific sectors and regions, whilst also considering what mitigations might be available to lessen that impact.

As we go on to explain, these implications will depend partly on what precisely one takes no deal to mean. It is also a question of which areas one is considering. The impact of what we label a 'chaotic' no deal scenario will vary widely from sector to sector.

However, it is still possible to think through what might happen in the event that the UK leaves the EU with no agreement on how to tie up the loose ends of membership. That being said, given the uncertainty that would shroud such a situation, we deliberately stop short of attempting to specify, for example, the precise macroeconomic costs of such an outcome.

Let's start with the terminology. There has been, and remains, a significant amount of misunderstanding when it comes to what precisely no deal means. So, let us be clear from the start. By a no deal, we are referring to a situation in which the UK and the EU fail to sign a withdrawal agreement under the terms of the Article 50 process. The outcome often confused with this – where a withdrawal agreement is signed, but no agreement on a future relationship can be reached – is perhaps best referred to (albeit clunkily) as 'no deal on future relations'.

And the confusion is not merely definitional. It is also inherent in the way the 'deal' analogy is interpreted. In most social and commercial situations, no deal implies a maintenance of the *status quo ante*. If I want to trade my car in for a new one, I retain the right to hang on to my old banger in the event the dealership doesn't give me a decent deal. Here, no deal leaves me where I was to start with.

This deal analogy, which works perfectly well for most negotiations, is inherently problematic when it comes to Brexit. The choice is not one between where we are now and where we would be with an agreement. Now that the UK has triggered Article 50, we will automatically leave the EU on 29 March 2019 unless both sides

COST OF NO DEAL REVISITED

agree otherwise. As a result, it is now a choice between leaving with an agreement and leaving without one. In principle, that second option could be one in which many of the numerous rules that regulate the UK's interactions with the EU27 and, via the EU's legal structure, the rest of the world simply cease to apply.

Which brings us to another limitation of the deal analogy. How precisely a no deal situation comes about will crucially determine its implications. In other words, when trying to analyse the implications of no deal, we face many of the same difficulties as businesses and other organisations have done in preparing their contingency plans. This is because there is a potentially infinite range of potential no deal scenarios, from an exit with no bilateral agreements in place to one that has a wide range of emergency deals on things from aviation to medicines.

Take two hypotheticals – equally unlikely, which serve to illustrate the point. In one, British and EU negotiators recognise, with reluctance, that the negotiations have hit a roadblock around which there is no conceivable diversion. It is agreed that there is no point continuing, but that both sides should attempt to minimise the fallout. There follows a period of weeks or even months when, aside from putting in place as much of the necessary infrastructure as possible, both the UK and the EU27 continue talking in order to put in place limited agreements on specific issues such as medical supplies or air transport to mitigate the shock of a no deal outcome.

Alternatively, imagine if the talks break down acrimoniously with threats and counter threats issued by both sides. The British government refuses to consider paying the divorce bill, and the EU refuses to negotiate mitigating agreements unless it does. The UK leaves with no such agreements in place. We might call this the 'chaotic no deal' scenario and its implications would obviously be far different to other no deal outcomes.



The only clearly defined no deal scenario is the chaotic one, in which all agreements between the UK and the EU (and some third-country agreements the UK is only party to via the EU) will cease on the day the UK ceases to be a member state.

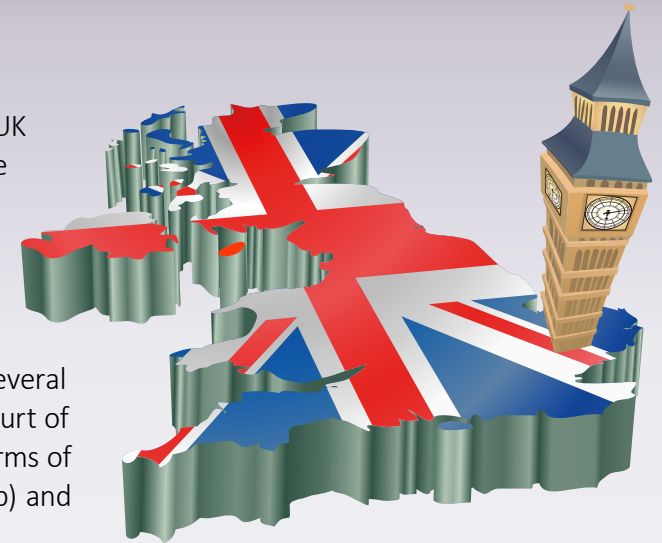
This absolutely does not mean we think that a chaotic Brexit is the most likely outcome. But while it is hard to imagine a situation where no mitigating measures at all are put in place, the implicit hope on the part of the UK government, much in evidence in the technical notices, that in practice both sides would agree to allow most things to continue much as now – a *de facto* but not *de jure* transition period – is almost certainly too optimistic. It is difficult to see how it would be politically feasible for the UK to continue to meet its financial obligations to the EU; and if it did not, it is equally difficult to see how it would be politically feasible for the EU to allow the UK to enjoy many of the benefits of membership.

In what follows, and despite the fact we feel that it is an extreme scenario, we focus on the implications of a 'chaotic no deal'. We consider not only how such an outcome might come about, but also what its impacts might be in legal, political and economic terms and across a variety of sectors. Finally, we consider the range of possible actions, including agreements with the EU that might mitigate the negative effects of any no deal outcome.

The politics

Politics can, as we know, sometimes produce profoundly sub-optimal outcomes. Neither the EU nor the UK government want to see a chaotic Brexit. However, the political dynamics on each side make such an outcome possible.

The fundamental problem remains the same as on the morning of 24 June 2016. While the UK as a whole voted by a narrow but clear majority to leave the EU – and the country and the political class broadly accepted that verdict – there was, and is, no majority for any particular type or manner of Brexit. This contradiction was aggravated by the Prime Minister's decision that Brexit meant not just Brexit but also several red lines (leaving the single market, ending free movement, and ending the jurisdiction of the European Court of Justice). And it has been highlighted and sharpened by the EU27's approach to the negotiations, both in terms of process (the EU27's insistence on discussing separation issues before moving on to the future relationship) and substance – making it clear that certain options (cherry picking) were simply off the table.



The result is that the Prime Minister now presides over both a divided cabinet and Conservative Party. Those divisions also extend to Parliament and, indeed, the country as a whole. While many Brexiters are in favour of a clean break – signing a withdrawal agreement but leaving both the single market and customs union – the Labour Party, conceivably along with a critical number of Conservative MPs, would oppose such an outcome. Nor is there any evidence that such a ‘hard Brexit’, which would be bitterly opposed by business, commands anything more than minority support among the electorate. Moreover, the EU's interpretation of the Irish backstop, outlined in the Joint Report of December 2017, implies regulatory barriers between Northern Ireland and the rest of the UK would be necessary under such a scenario. This too is something it is hard to see a majority of MPs backing.

Equally, should the Prime Minister envisage a ‘softer’ Brexit, it is far from certain the numbers in Parliament would stack up. If a deal along the lines of the recent white paper was pursued – let alone something that resembles more closely membership of the single market and customs union – Brexiters would certainly rebel in high numbers. Such an outcome could only command majority support in Parliament with the backing of substantial numbers of Labour MPs.

It is important to note that avoiding no deal does not require a treaty on the future relationship. The only legally binding text that is needed now is the Withdrawal Agreement, covering ‘separation issues’ – citizens’ rights, the financial settlement (or divorce bill) and Northern Ireland. This will be accompanied by a ‘political declaration’ on the future relationship which, by definition, cannot bind either side. Indeed, given the near certainty of continued upheaval in British politics, the EU27 would be demonstrating a degree of naiveté, not so far in evidence, were they to assume that Theresa May was likely to be in a position to deliver on any promises she makes in such a declaration.

But while this makes reaching an agreement easier in one sense – difficult issues regarding the future relationship can, for now, be skated over with elegant drafting, parked or simply ignored – it also complicates matters in another. The UK Parliament will be asked to sign up to a legally binding agreement to pay the divorce bill and

COST OF NO DEAL REVISITED

CATCH 22



commit itself to some form of backstop for Northern Ireland in return for a non-binding declaration. So even a stripped-back agreement, aiming simply to achieve consensus and secure a period of transition, could well be viewed as sub-optimal by MPs from both wings of the Brexit debate. For this reason, the UK government currently claims that it wants the political declaration to be as detailed and concrete as possible. However, the more detail that is included, the more likely it is to alienate one group or another of MPs.

So this is the government's catch-22: there is little prospect of a majority in Parliament to sign what looks like a blank cheque; and yet the more specific any deal is, the more likely it is to infuriate either the 'clean' or the 'soft' Brexit camp. All of which makes it hard at present to see a clear route to a withdrawal agreement which would command a majority within the House of Commons.

On the EU side, there is a strong desire for a withdrawal agreement. This is not only to avoid some of the negative consequences described below, but also because the Union is committed to ensuring citizens' rights, avoiding an intra-Irish border and, of course, receiving continued payments from London. Moreover, member states are anxious to put the Brexit issue behind them so that they can focus on what appear to be more pressing issues.

But that does not mean the EU will accept any sort of deal. As Michel Barnier has repeatedly made clear, there is an insistence that there is no obvious alternative to the 'Canada' option of a relatively clean break and a 'Norway plus' Brexit involving deep integration into the single market and something approximating a customs union. This is linked to an insistence on the need to preserve the supposed integrity of the single market, limiting the offer to the UK of either full membership or non-membership – but not the partial membership proposed in the white paper. While the EU side would be content with a relatively bland and content-light political declaration, this in turn means that the sort of substantive political declaration sought by the UK appears close to impossible.

Meanwhile, on Northern Ireland, the EU27 are willing to compromise on drafting and public presentation – but, as yet, not on the basic principle that Northern Ireland, and only Northern Ireland, must remain in the EU's regulatory and customs ambit for goods until and unless an alternative is mutually agreed, which all sides tacitly accept is not likely to be any time soon. This, in turn, would be very hard for the UK government – and, indeed, Parliament – to accept.

How would no deal happen?

There are broadly two ways in which we could arrive at no deal. These two scenarios would have quite different implications.

The first is if negotiations between the UK and the EU fail to arrive at an agreement which both negotiating teams can accept. In this case, it is likely that a war of words would commence, with the government, the Conservative Party and large parts of the UK media seeking to blame, *inter alia*, the supposed intransigence of Brussels bureaucrats, President Macron, Chancellor Merkel and the Irish government.



NO DEAL

It would be politically impossible under such conditions for the UK to continue to meet its financial obligations to the EU. This, in turn, would make the EU extremely reluctant to enter into discussions on mitigating the impacts of no deal. More positively, if such a breakdown does take place, it is likely to be in the latter part of 2018, meaning there will be a few months in which, as the potential impacts of no deal become more apparent, both sides will have a chance to step back from the brink.

The alternative is that negotiations are successful, but Parliament rejects the Withdrawal Agreement. In this case, the relationship between the UK government and the EU27 will not have broken down and discussions will continue: these could be either on mitigating the impacts of no deal, or perhaps on extending the Article 50 process for a short period. This window could allow some changes to the Withdrawal Agreement to make it more acceptable. The problem here is that the UK government is likely to delay putting the deal to a vote until the last practicable moment. In addition, both the UK government and the EU will try to claim that Parliament's choice is binary: between the draft Withdrawal Agreement, and a chaotic no deal. This will be an attempt to further intensify the pressure, particularly on MPs sceptical about Brexit but terrified of no deal.

This is not necessarily a credible threat. In practice, a vote to reject the draft Withdrawal Agreement would result in a political crisis and the likely fall of the current government. It is implausible, no matter what the EU27 might say before such a vote, that the Union would tell an incoming Prime Minister, of any party, that the rigidity of the timetable meant that there was simply no scope for any further negotiation, particularly given the implications for Ireland and Northern Ireland.

So, there are a number of possible escape routes – but there is a lot that can go wrong, time is short and political developments in particular are unpredictable. No deal, if it happens, will be the unintended outcome of political misjudgments on both sides of the Channel; and this, in turn, makes it hard to plan for.

Political fallout

Given the political capital expended by both the UK and the EU on reaching an agreement within the Article 50 timeframe, a no deal outcome of any kind is likely to generate considerable acrimony. In particular, there will be a lot of finger-pointing about who is to blame.



This matters on a number of levels. Most immediately, it will complicate any moves to secure emergency deals on critical systems such as air travel, medicines or fissile materials, especially if politicians on either side seek to use such issues to teach the other a lesson or force compromises elsewhere. Mitigations in the form of agreements with the EU would be particular to each sector, meaning the impact of no deal could vary considerably, with certain sectors more vulnerable than others. The difficulty is that we cannot know at this point just how many of these emergency agreements it would be possible to reach in a relatively short period of time and in a confrontational political atmosphere.

Moreover, a breakdown of the negotiations would colour the pursuit of any wider efforts to restart the UK-EU relationship, in terms of the attitudes of both sides and the lack of a clear basis upon which to work. No withdrawal agreement means no political declaration on the future relationship, and it would be wise to assume that the general level of trust and willingness to compromise would be small.

For the UK, the failure of the Article 50 negotiations might also affect negotiations on trade deals with other countries, especially if the no deal outcome resulted in legal challenges from the EU to secure outstanding financial liabilities or concerning breaches of contract. The reliability of the UK as a partner might also be placed in doubt for other, non-EU governments in such a situation.

The impact on the British political system is difficult to predict. A no deal would be likely to precipitate a significant rupture, and potentially a fissure, within the governing Conservative Party. Efforts to stop a no deal would see significant divisions on the floor of the House of Commons. Amendments to the European Union (Withdrawal) Act 2018 (EUWA) confirmed that the government will have to set out the likelihood of no deal in a statement by the end of January, and the parliamentary majority against such an outcome would probably become clear.

How this split would play out is dependent on how the government manages the fallout from a no deal scenario, as well as on the dynamics of public opinion. There has been speculation no deal could drive up public opposition to the EU. Polling evidence throughout the negotiations supports the idea, recently promoted by Jeremy Hunt, that the electorate will see both EU and UK negotiators as equally culpable for a negotiating deadlock. Equally, there is speculation that the ramifications of no deal could lead to a politically significant surge in support for a further referendum and, in turn, support for this in Parliament. Either way, the implications are that an already febrile situation in British politics would be rendered even more so.

The economy

The performance of the UK economy since the Brexit vote has been mediocre, but not disastrous. Growth has slowed, particularly relative to other advanced economies. However, the labour market has remained buoyant, with employment growth continuing on its pre-referendum track.



There is a strong consensus that, to date, the UK economy is perhaps 1 to 2% smaller than it otherwise would have been (and, correspondingly, real household incomes are 1 to 2% lower). The immediate cause of this was the fall in sterling, and corresponding rise in import prices, that followed the referendum result – itself in large part reflecting pessimism about the impact of Brexit on the UK economy. Uncertainty and its consequences for business investment, and the Brexit-related fall in EU migration, are also likely to have depressed growth.

Under no deal, the UK and the EU would revert to trading under rules governed by World Trade Organisation (WTO) agreements. Credible estimates of the long-run impact of this on the UK economy suggest that it would reduce output by up to 10%. However, these estimates in themselves tell us little about the immediate impact of a chaotic no deal Brexit. Rather, they are designed to capture the long-run impact of trading on WTO terms, allowing for a gradual adjustment based on a negotiated withdrawal agreement.

Predicting the short-run effects of a chaotic no deal Brexit is much more difficult. The biggest costs would come not from moving to new regulatory arrangements for trade, but from a partial or complete breakdown of the regulatory arrangements that make trade possible at all. Aircraft could be grounded; British meat may not be certified as safe to enter the EU market; just-in-time production systems used by manufacturers and food producers could break down; border crossings on both sides of the channel could be gridlocked. With sufficient preparation, these costs can be avoided by building the necessary border infrastructure and putting in place regulatory deals to replace existing arrangements.

The forecasting tools used by trade economists are designed to understand long-run changes, not to predict the short-run effects of a complete breakdown in UK-EU relations. For these reasons, it would be foolhardy to attempt to quantify exactly how the UK's economy would be affected by a no deal Brexit. But that does not mean we cannot examine the economic consequences. These can usefully be divided into three phases:

- the run-up to 11pm on 29 March 2019; that is, before Brexit actually occurs
- the short-run impacts of the types of disruption to trade and other economic activity described above
- the long-term impacts of leaving the EU with no agreement on the future trading relationship with the EU.

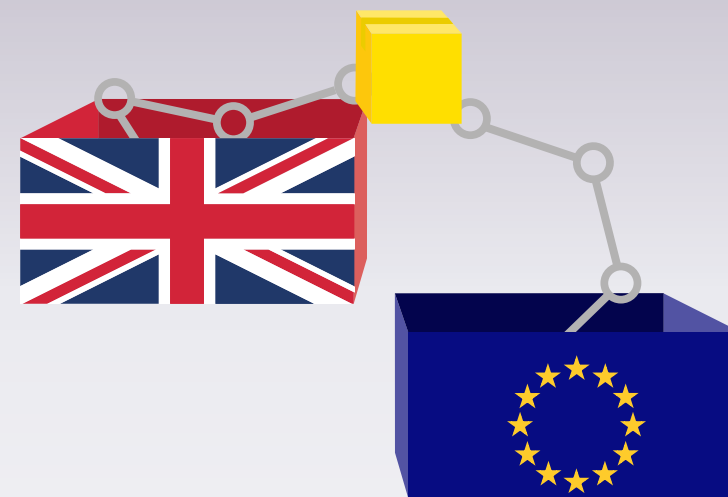
The run-up to Brexit

Nothing, of course, will change in law before 11pm on 29 March 2019. So, the primary mechanism by which Brexit will affect the economy before Brexit Day will be via anticipation effects – that is, businesses and households changing their behaviour as a result of the possibility of no deal. Such impacts are extremely hard to quantify, as was shown by the Treasury's assessment of the short-term economic impacts of a vote to leave, which relied heavily on estimates of such effects and proved largely inaccurate. However, it seems likely that the approach of no deal – a much more immediate and short-term threat than that raised by the actual vote – would have larger impacts, including:

- a further significant fall in sterling, pushing up import prices and inflation, and reducing real wages
- falls in business and consumer confidence, reducing business investment and consumer spending
- some relocation of business activity from the UK to the EU27, in anticipation of the possible disruption of supply chains (some would likely move the other way, although almost certainly considerably less)
- preparedness measures by business (stockpiling, contingency planning for alternative sources of supply, etc.).

To some extent, these would be mitigated by policy actions from the UK government. The Bank of England would be likely to (indeed already has) raise interest rates more slowly than it otherwise would have done. Although the government is unlikely to fund any necessary increase in spending by taxes or other spending cuts, it would let borrowing take the strain. There will be no repeat of George Osborne's threat of a 'punishment Budget', which was widely, and correctly, perceived as scaremongering. It is also important to note that some of these impacts could in principle boost GDP rather than reduce it – preparedness spending or stockpiling by business (or indeed hoarding by consumers) would boost demand and hence be positive for GDP in the short term. UK growth in the second half of 1999, when businesses were worried about the millennium bug, and spending to mitigate its potential impacts, was very strong.

Overall, the economic impact would likely be negative, but not disastrous. The largest source of uncertainty would be consumer spending, which accounts for more than half the economy. If consumers largely ignored the political drama of a possible no deal, the damage would be very much contained. If they sharply reduced spending in anticipation of hard times ahead, the economic impact would be severe.



Short-run impacts

Would no deal lead to a crisis in financial markets? It is not obvious why this should be the case. Sterling would almost certainly fall in the run-up to no deal and remain low, which would have the macroeconomic impacts noted above. But, with a floating exchange rate, this doesn't in itself necessarily constitute a crisis. Nor would falls in equity markets (which in any case would be at least cushioned by any fall in sterling, since it would make UK companies with foreign currency earnings more valuable). And while it is possible, indeed likely, that the UK's credit rating would be downgraded, recent experience suggests that this is almost entirely irrelevant. While it is possible that long-term interest rates on government debt would rise (partly as a result of anticipated higher inflation, partly as a result of anticipated higher government borrowing) there is absolutely no reason to believe that the UK government won't be able to continue to borrow in its own currency at rates which remain low by any historical standard.



Considerably more worrying would be the impacts on consumer and business confidence, and hence spending. Businesses would be hit by rising input prices, resulting both from the fall in sterling and the need to replace EU imports with more expensive ones sourced from outside the EU. Consumers would face rising inflation at a time when they will be trying to reduce discretionary spending, and with little prospect of large pay rises.

Any actual disruption to business activities, through the disruption of supply chains or cutting off access to EU export markets, would come on top of this – and could be very severe indeed. During the financial crisis in 2007-08, the UK's financial system came close to collapse. The Bank of England prevented a complete meltdown by bailing out the banking system. There is no institution that stands ready to protect the trading system in the event of a no deal Brexit. A severe recession, while not inevitable, is clearly a possibility.

Again, however, note that the measured impact on GDP may be less than is suggested by the above discussion. One remarkable aspect of modern economies, at least in developed countries with strong institutions, is how resilient they are to short-term disruptions, whether the result of war, natural disaster or interruptions to trade flows. For example, 15 months after the 1995 Kobe earthquake, which killed 6,500 people and caused more than \$100 billion worth of damage, manufacturing output in greater Kobe was back to normal. Overall, the earthquake probably boosted Japan's GDP temporarily. More recently, Qatar has survived the cutting of trade and transport links with its nearest neighbours (Saudi Arabia and the United Arab Emirates) with relatively limited economic damage, although of course being one of the richest countries in the world with huge natural gas reserves has helped. This is not grounds for complacency – as there are counterexamples – but it should not be assumed that the damage, while real, will necessarily be long-lasting.

Long-run impacts

Paradoxically, it is considerably easier to estimate the long-term impacts of no deal. Historical experience suggests that short-term disruption, even if potentially very severe, is unlikely to make a material difference to the long-term economic potential of the UK economy. Overwhelmingly, it will be the future trading arrangements between the UK and the EU27 (and, to a lesser extent, the rest of the world) that determines the long-term economic impacts of Brexit. And – unlike the inherently unpredictable short-term consequences of a ‘chaotic Brexit’ – these can be modelled quantitatively using standard economic models.

Under a no deal scenario, the default assumption must be that the UK will trade with the EU on WTO terms – that is, without a free trade agreement although, after the dust settles, various bilateral agreements to facilitate trade within the WTO framework would likely be agreed).

A variety of estimates of the impacts of moving to WTO rules have been produced. The most detailed exercise was that conducted by the UK government, using a computable general equilibrium (CGE) model with 57 sectors, which estimated that a WTO scenario would reduce UK GDP by about 8% over the next 15 years (that is, it would reduce cumulative growth over that period from about 25% to about 17%). This is after taking account of some modest positive impacts from deregulation and trade deals with third countries, in particular the US, and assumes the UK implemented a relatively restrictive immigration policy after Brexit.

This estimate is, given the uncertainties involved, broadly in line with estimates made by credible external organisations, such as the Centre for Economic Performance at the London School of Economics, the OECD and others, using both similar CGE models to that of the UK government and the alternative ‘gravity’ modelling approach. Models which produce radically different, and more positive, impact estimates (like that used by Economists for Free Trade) incorporate completely unrealistic assumptions (for example, that UK prices would immediately converge with ‘world prices’ on Brexit, and that the UK would impose no tariffs or non-tariff barriers – even basic safety standards – on any imports), and cannot therefore be regarded as remotely credible.

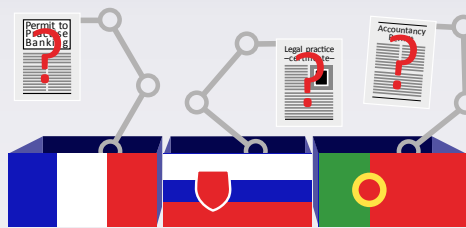
The reduction in GDP implied by the government’s modelling would also have serious fiscal impacts: even after taking account of reduced EU budget contributions, the net (negative) impact would be about £80 billion per year by 2033.

Of course, whatever happens with Brexit, many other factors – including UK domestic economic policy – will drive economic growth between 2018 and 2033. The expectation is still that the UK economy will continue to grow. Nevertheless, there is little doubt that a ‘hard’ Brexit would prove a significant drag on growth over the medium to long term.



The legal position

The EU, as we hear frequently, is a law-based system. And law is one of the most important, yet misunderstood, elements of the Brexit process. Article 50 explicitly provides for a 'cliff-edge' in the event of there being no withdrawal agreement. The text merely stipulates that the "Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification ..., unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period."



In other words, when the Article 50 clock runs out, the UK simply ceases to be a member state, and the treaties no longer apply. In particular, references to member states, or to companies and citizens of member states, whether in EU law or in law in the EU27, would no longer apply to the UK or its businesses and citizens. The impact will be mitigated to a certain extent (as far as domestic UK law is concerned) by the structures put in place by the European Union (Withdrawal) Act 2018 (EUWA), formerly known as the Great Repeal Bill. But years of litigation will be required to sort out the answers to some highly technical, often complex legal issues, unless the EU and the UK come to a belated post-Brexit agreement on how to settle some or all of them.

A no deal outcome will generate huge uncertainties. And legal uncertainty will have far-reaching consequences, particularly for UK firms exporting to other EU countries or trading elsewhere in the EU, as the government's technical notices published on 23 August 2018 indicate. Consider, for example, contracts for the long-term supply of goods between the UK and an EU country. The EU and the UK have already agreed transitional rules to govern this situation, as part of the overall Withdrawal Agreement. But if there is no withdrawal agreement, then these will not apply. UK producers of, say, china dinner services – to take a relatively simple case – exporting into the EU will be subject to whatever tariffs EU law provides for as regards non-EU countries without a free trade agreement with the EU. The EU simply cannot decide to treat the UK differently to other states with no free trade agreement or it will find itself in breach of the rules of the WTO.

The question of who bears the risk of this increase in costs depends on the terms of the contract. If the producer agreed to sell the goods at a price which included delivery 'duty paid', the producer will have to pay the cost. If the purchaser agrees to pay for post, packaging and duties, the purchaser will bear the risk. The increase in costs may be significant, but in English contract law it is unusual for contracts to be 'frustrated' (where the contract is set aside due to an unforeseen event which makes, for example, contractual obligations more difficult to honour). Just because a contract has become significantly more expensive or less profitable does not render performance impossible, which is the usual hurdle that has to be met.



The legal enforcement of all forms of contractual and commercial arrangements will also become significantly more complex. Under the EUWA, EU rules on 'choice of law' (whether German or English law applies to the china contract) and jurisdiction (whether a German or English court can hear the case) should continue to apply. However, the reciprocal arrangements which currently apply, for example, in relation to the enforcement of judgments in the EU, cannot be replicated in a purely English law regime.

COST OF NO DEAL REVISITED

So, at present, if there is a dispute between an English seller and a German purchaser, and the case is heard by an English court which finds in favour of the English seller who is awarded damages which the German purchaser refuses to pay, that English judgment can currently be enforced automatically in any court in the European Union, including in the German courts. If there is no deal, the English seller will no longer be able to have the award of compensation automatically enforced in the German courts, because the English court judgment will no longer be a judgment from a member state court. Instead, the parties will have to rely on national enforcement regimes and so the procedure will be more cumbersome and expensive, and enforcement will not be automatic: it will be subject to each member state's own national law requirements and defences.

Trade sectors

Under a no deal Brexit, these kinds of legal uncertainties would certainly impact on trade. In addition, of course, the current trading arrangements between the UK and the rest of the EU – which are based on our membership of both the single market and the customs union – would cease. Moreover, the UK currently trades with the rest of the world as a member of the EU. Existing trade agreements between the EU and third countries would therefore no longer apply to the UK: the EU currently has trade agreements in place or partly in place with 83 countries, plus pending agreements with eight countries and ongoing negotiations with a further 21. These include agreements with large economies like Japan, Canada, China and India, and with smaller developing economies like South Africa, Ghana and Peru.

Without such agreements, the default position for UK trade with the EU and all other countries would, as we have seen, be the rules of the WTO. The UK is a member of the WTO in its own right but various new procedures would be needed to re-establish the autonomy of the UK from the EU. Under WTO rules, each member must grant the same 'most favoured nation' market access, including charging the same tariffs, to all other WTO members. The only exceptions to this principle are the right to give preferential market access to developing countries and those countries that have signed free trade agreements.

Consequently, trade with the EU would be subject to the same tariffs, customs checks and regulatory checks that the UK and EU currently impose on third countries, such as the US. This means that tariffs must be applied to all goods and comprehensive customs checks would be needed to ensure the appropriate rates are reported by firms. Furthermore, the UK would no longer be part of the EU system of mutual recognition – whereby each country's standards are accepted by the others – so all UK exports must adhere to EU regulations and vice versa for UK imports. Both customs and regulatory checks would drastically increase trade costs.

The argument, made by some, that WTO rules mean that the EU would not be permitted to impose such regulatory checks – because, at the point of Brexit, we would still be in full regulatory alignment with the EU – is simply untrue. The key provisions of the WTO's trade facilitation agreement are only exhortatory, not legally binding. So there would be absolutely no compulsion on the EU to accommodate the UK in this way, and no reason why they would be likely to do so in the context of an acrimonious, chaotic, no deal Brexit. In fact, if the EU granted greater market access to the UK, it would have to extend it to trade agreement partners like South Korea and Canada that have 'most favoured nation' status with the EU in many areas. Nor do WTO rules provide the comprehensive coverage that their advocates contend; trade in many areas relies on supplementary or parallel agreements, and in some important respects – for example aviation, discussed below – the WTO is almost completely irrelevant.

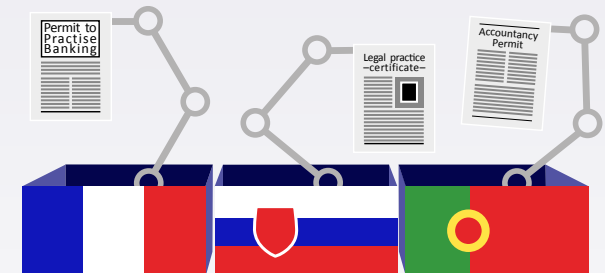
COST OF NO DEAL REVISITED

The current system is designed for the UK to be under the same customs and regulatory procedures as the EU, meaning few or no checks at the UK's borders with other EU countries. The need for new checks would impose a huge burden on UK customs authorities and on ports, airports and at the Northern Irish border. The administrative costs would be sizeable. For example, many firms would need to satisfy rules of origin paperwork, which can add between 4% and 15% to the cost of producing a good.

Dover in particular is likely to be heavily affected as almost all of its trade is with the EU. Currently, as few as two out of 180 lorries are checked. Research suggests that an increase of two minutes spent at the border by each vehicle could more than triple the existing queues on the M20/A20, to 29 miles, meaning nearly five-hour delays. In anticipation of this, a recently leaked local government report outlines plans to turn a 13-mile stretch of motorway into a lorry park and goods holding area to try to ease gridlock, which could be in place until '2023 at the earliest'.

Increased and uncertain processing times are therefore nearly certain in the case of a no deal Brexit, at least in the short term. Many manufacturers rely on complex cross-border supply chains, and 'just-in-time' delivery of parts would be severely disrupted. Firms would face the need to restructure or relocate their supply chains or production plants. Car manufacturer Honda, which requires 350 trucks to carry two million components to their Swindon plant each day, claim that every 15 minutes of customs delays would cost it up to £850,000 a year.

It is not only manufacturing that will be affected. The UK's hugely important service exports, which exceeded the value of services imports by £111.5 billion in the year leading up to May 2018, would also suffer. The OECD suggests that, on average, EU barriers to services trade with non-EU countries are four times greater than those which apply within the EU single market. For example, UK financial services firms would lose their passporting rights, meaning that it would be much more difficult for them to sell financial products to EU-based companies. This would also affect companies from third countries, such as the US, which use UK offices to supply to EU markets, and would consequently lead to a fall in inward foreign direct investment (FDI) in the UK.



The government is implementing plans to help prepare for no deal. The Department for Exiting the EU has issued a number of documents on how different sectors might be affected by a no deal Brexit. Furthermore, 250,000 small businesses will be asked to start making customs declarations. The UK would also need to add to its 5,000 customs staff. HMRC has said that, in the case of no deal, it would need to double that number, with over 1,100 additional customs staff having already been hired.

Businesses are also starting preparations for a no deal Brexit, with the Confederation of British Industry (CBI) reporting that 61% of its members are developing contingency plans for that scenario. However, the vast majority report that this has been difficult due to the lack of information available. The lack of preparation time to adapt business activities would also prove problematic for UK firms.

The UK will also have to compose its own regulations. In the event of no deal come March, MPs expect to pass around between 800 and 1,000 new statutory instruments through Parliament in a matter of days, such as safety certificates for airlines and maintaining the enforceability of financial contracts. Given the short

COST OF NO DEAL REVISITED

time frame, it is likely that many of these will simply be drafted directly from EU law. It would be possible to mitigate some of these impacts, for example by reducing checks on imports from the EU to an absolute minimum by conducting random instead of universal inspections, and by agreeing stop-gap standstill agreements with third countries. But considerable disruption to trade seems likely under any no deal scenario

As noted above, the default position in the case of a no deal would be to apply the same tariff rates as those currently applied by the EU which, under WTO rules, would apply to both EU and non-EU countries. This would generate significant revenue gains – perhaps about £13 billion to the UK – but at the cost of higher prices to British consumers. This would amount to a large, and generally regressive and inefficient, increase in taxes.

Another option, proposed by some pro-Brexit economists, would be to unilaterally drop all tariffs. This would reduce prices for consumers compared to the status quo, at the cost of lowering protection for some industries and reducing the UK's leverage in negotiations for future trade agreements, both with the EU and third countries. The government has given no indication that it is attracted by this approach.

In the long run, no deal would allow the UK maximum flexibility to agree new free trade agreements, since we would start from a blank slate. However, research, including the government's own analysis, shows that the benefits of any new agreements would be dwarfed by the costs of separating from the EU, with even a comprehensive trade deal with the US yielding only relatively modest gains.

New trade agreements typically take around seven years to agree and implement, with the length of negotiations dependent on the depth of the agreement. While it may be possible to agree a deal relatively quickly, any agreement that produces significant economic benefits is likely to take longer. The UK may face additional difficulties: having not negotiated a trade agreement since joining the EU in the 1970s, it might lack the necessary experience and personnel to negotiate quickly and effectively. In the short term, the immediate priority would be to replicate the EU's free trade agreements with third countries, such as Canada and South Korea, to avoid further disruption to trade.

The economic costs of no deal would therefore be twofold. Firstly, there will be direct costs of new administrative burdens and delays, as well as increased uncertainty. Second, these increased barriers to trade will reduce British exports and increase the cost of imports to the UK. Overall, the volume of UK trade would likely be significantly reduced, subtracting from growth both in the short and long term.



Sectoral and regional consequences

The impact of no deal will vary by sector and region. Overall, UK regions with weaker economies (many of which voted Leave) will be more adversely affected. This is because their trade structures are relatively more integrated with the rest of the EU than the UK's most prosperous regions, with the North-East facing the largest potential impact (with the possible exception of Northern Ireland, discussed below). These are economies much less resilient than the prosperous parts of the UK – as evidenced by the enormous inter-regional productivity variations, which today are as big as the those across the whole of the eurozone.

At a sectoral level, manufacturing, retail and logistic sectors currently operating pan-European 'just-in-time' production, operations and logistics systems are most exposed. The most obvious cases here are aerospace firms such as Airbus, major automobile manufacturing firms such as Nissan, Toyota, Jaguar Land Rover, BMW, Ford and Vauxhall, and automotive supply firms such as GKN. Their operations are constantly running on short delivery and production schedules with inventory levels often less than one hour – a system which is essential for ensuring maximum efficiency.

Firms such as these, for whom just-in-time systems underpin the whole logic of their activities, will face huge obstacles to adjusting to the imposition of customs and border checks. Nor can they hedge against any cross-border disruption by increasing local stockholding, because inventory accumulation itself undermines the efficiency and quality of their production and delivery systems. In addition, rapid and widespread switching to local UK suppliers is also ruled out because so much of the value-added in these UK sectors is already imported from across the EU. The UK has no supply base for whole classes of the components required in these sectors. As such, there is a real possibility that such firms would consider shifting most, if not all, of their production activities outside of the UK.

In some cases, relocations could be very swift. In the automotive industry in particular, there is still plenty of spare capacity available in countries such as Spain, Slovakia, Poland and Romania, and spare capacity in the European aerospace sector also exists in Spain and Germany. These countries will jump at the chance to attract such blue-chip firms, not least because experience suggests that significant parts of their supply chains, and especially the higher value-adding components of the supply chain, tend to follow the principal companies. The employment impacts are therefore much greater than the jobs associated with the principal manufacturers.

The firms and sectors heavily dependent on just-in-time supplier systems also include almost all UK supermarkets, UK medical supplier networks and most online retail services. However, in terms of regional impacts, the effects are likely to be more evenly dispersed across the country than is the case with either the automotive or aerospace sectors. This is because the activities of these retail and medical-supplier sectors tend to be much less geographically concentrated than the automotive and aerospace sectors.

Service industries overall will not be as directly affected as manufacturing but will immediately lose some access to European markets. A loss of passporting rights will hit the City of London. However, in relative terms the impacts on financial services and London as a whole are likely to be relatively smaller than the impacts of a no deal on other services industries more dispersed across the UK. This is especially true of those services which are also heavily integrated into manufacturing value chains. Because of the size of the UK services sector, the total economic impact from these effects is likely to be as large if not larger than on manufacturing. However,

COST OF NO DEAL REVISITED

these effects will be much more dispersed and will probably be concentrated on services industries with less political representation or lobbying power such as administrative services, computer programming, and legal and accounting services.

In the long term, the adverse effects of no deal on inward FDI are also likely to be significant. Whole swathes of the UK's inward FDI are predicated on full access to the EU single market, and on the predictability that the EU legal framework provides. These effects are likely to be evident across both manufacturing and services, and again the UK's poorer regions are likely to be the worst hit. Moreover, the complete lack of sub-state representation in the Brexit process for most of these regions means that these no deal impacts will, in turn, probably set back the UK devolution agenda. All of these adverse effects, on both FDI and regional economic resilience, are in addition to the impacts outlined above. Overall, then, no deal is likely to further increase the UK's enormous interregional inequalities.

Impact on the EU27

As a whole, exports from the EU27 to the UK amount to about 2.6% of GDP, compared to the 12.2% of UK GDP represented by exports to the EU. Consistent with this, estimates of the long-term impact of a no deal Brexit on the EU27 are, relative to GDP, typically less than a quarter of the impact on the EU27. All the most heavily exposed regions are, as noted above, in the UK.

The exception is Ireland, which some estimates suggest could be almost as badly hit as the UK, reflecting the fact that the UK is a very large trading partner, as well as issues specific to Northern Ireland, discussed below. The other EU countries most exposed to a no deal Brexit are Germany, the Netherlands, Belgium and France, with some manufacturing and agricultural producers particularly vulnerable. Essentially, the risks facing these firms are similar to those facing UK firms – tariffs, loss of market access, increased trade barriers, disruption to 'just-in-time' manufacturing processes, and legal and other uncertainties. However, overall, these impacts are far more dispersed, and many parts of the EU will face little observable trade-related disruption from a no deal outcome. In 19 of the EU countries, the level of trade-related exposure to Brexit is less than 2% of national GDP, and in 12 EU countries it is less than 1%.



Politically, however, the failure to secure an orderly conclusion to Brexit would represent another problem for a European Union that already faces many difficulties, both internally and externally. Internally, a no deal outcome will lead to much debate in European capitals about the root causes. If splits had emerged in the final negotiations, those whose ideas were not taken up by the Commission will use it as evidence of their correctness, while those who had been successful will argue that the divisions undermined their position. Such divergences have been more evident around the direction of the future EU-UK relationship, rather than on the terms of the Withdrawal Agreement itself, but the persistence of British attempts to chip away at EU27 unity at this stage might become more successful as pressures build in the final months of negotiation.

That said, the failure to work through a path will make it much easier to argue that leaving the EU isn't a sensible or viable option for other member states, which might then encourage more concerted efforts to improve the system from within. As a result, the failure to navigate a path for British withdrawal might be expected to

COST OF NO DEAL REVISITED

make such a policy seem much less attractive to eurosceptics or populists in other EU member states, especially if the surface manifestations of a chaotic no deal are very visible. At the same time, however blame is apportioned between the UK and the EU for that failure, it will still be possible for those seeking their own country's withdrawal to argue that the bear traps have now been exposed and they can much more simply take their country out of the EU.

Externally, a weaker and likely less constructive relationship with a UK after no deal will reinforce the EU's perception that partners beyond its borders are in short supply and need to be cultivated. This will invigorate the current push to build stronger trading links with countries such as Japan and Australia, as well as to try to prop up multilateral bodies, including NATO, the WTO and the UN. While the UK is not likely to disrupt the European security and defence architecture as a result of Brexit, the EU will be particularly conscious of the potential problems that a more confident Russia might pose.

At least at the level of the European Commission, preparedness for no deal is well advanced. In June 2018, the European Council renewed its call to member states, EU institutions and stakeholders to step up their work on preparedness at all levels and for all outcomes. In the same month, the Secretary General of the European Commission, Martin Selmayr, presented a list of pending and planned proposals for areas where legislative action was necessary.

Some, such as those concerning regulatory approval for cars and food quotas in trade, have already been made. Others, including a change to the regulation on EU visa policy for third countries, which would see the UK placed on the list of third countries requiring a visa or on a visa-free list, and a new maritime route connecting Ireland with the continental North Sea-Mediterranean corridor to ensure continuity of trade between Ireland and other EU member states, are still in progress. Further, the Commission foresees that if the worst happens it would need to be empowered to take action to adopt necessary rule changes.

By July 2018, the Commission had published more than 60 'preparedness' notices that inform citizens and identify what actions need to be taken by governments, business and other stakeholders in order to limit the disruption flowing from no deal. The documents, which cover a full swathe of sectors and activities, are based on a detailed review of EU law and attendant operational requirements. They are summarised in a 15-page text, which makes clear that no deal would lead to the immediate introduction of border checks, the exclusion of UK services from cross-border trade and a legal void for four million individuals – UK citizens living in another EU member state and EU citizens in the UK. An accompanying checklist for businesses notes that firms that import from the UK will need to become familiar with rules governing imports from a third country, that new authorisation from an EU27-based body may be necessary for activities that currently rely on licences issued by UK authorities, that customs and VAT procedures will change, that goods which include a UK-made component exported to a third country will no longer originate in the EU, and that compliance will be necessary with EU health and safety, and environmental standards. Processes governing commodities subject to special permits, as well as the flow of personal data to and from the UK, will also change.

However, while the Commission's approach has been comprehensive, it is largely limited to advising on the legal and regulatory implications of no deal. Implementation – from customs controls at Calais to the fate of UK citizens living in Malaga – will be in the hands of member states, and here, inevitably, preparation is at best patchy. Some countries, in particular the Netherlands, have already invested considerably in beefing up their border operations in preparation for Brexit; others less so. It seems likely that the autumn will see member states – both governments and the private sector – stepping up a gear as the prospect of no deal becomes more likely. As in the UK, this may concentrate minds on the potential damage or harden attitudes further.

Immigration and the status of EU and UK citizens

In the event of a chaotic Brexit, would EU and other EEA citizens living in the UK immediately become illegal immigrants? Would EEA citizens coming to the UK for work, study or tourism require visas – something which would immediately lead to chaos at ports of entry to the UK, and which would be disastrous for UK tourism?

This seems unlikely. The government has promised it has no plans to simply ‘turf out’ EU citizens, regardless of the outcome of negotiations. The main provisions of European Union law on freedom of movement of people have been fully incorporated into UK law by the European Union (Withdrawal) Act 2018 (EUWA) and recent amendments to Immigration rules giving effect to the planned future status of EU27 citizens in the UK. So, the right of EEA citizens (including those from non-EU countries, like Norway, and from Switzerland) to live and work here – and the legality of employers continuing to employ them, hospitals and schools continuing to treat and educate them, and so on – would broadly continue unless and until the UK government or Parliament changes the rules. Similarly, there is no reason why border arrangements and visa requirements would change immediately.

But the status of a million or so UK nationals elsewhere in the EEA would be considerably more complex and potentially much more problematic. It is up to individual member states how they implement EU legislation, which partly regulates the legal status of non-EU citizens, in domestic law. Even with this common legal framework, there is much variation in how EEA countries treat UK nationals now, and this divergence would be likely to widen considerably after Brexit.

Little progress has been made by EU member states in establishing the legislative and administrative mechanisms to implement the provisions set out in the draft Withdrawal Agreement in domestic law – let alone to make contingency plans for what happens if it is not approved. This is a matter of increasing concern for both UK nationals resident elsewhere in the EEA (except perhaps in Ireland, where they already have full rights in domestic law) and the UK government. There must be a serious risk that if the Withdrawal Agreement is not, in fact, agreed there will be nothing at all in place in at least some countries.

If, like the UK, those countries have laws relating to immigration and residence that give special status to EEA nationals, then on Brexit Day those laws, in theory, will automatically cease to apply to UK nationals, because the UK would no longer be part of the EU or EEA. The same mechanism that protects, at least temporarily, EEA nationals living in the UK would also leave UK nationals in the EEA without such protection.

EU member states (with the exceptions of Denmark and Ireland) have implemented key directives on the rights of third country nationals (TCNs), including the long-term residents directive which gives rights to reside to TCNs after five years’ lawful residence in the host country. This is presumably the status that would, in theory, apply to UK citizens: in general, it confers far fewer rights, and no rights for those without five years’ residence.

This would be disastrous for many of those concerned. They could lose the right to reside, to work or to access essential services. They will also need to apply for EU long-term residence status. There are some EU laws on those resident for less than five years, as well as parallel national laws on long-term residence. There would be major question marks over the recognition of professional qualifications.



COST OF NO DEAL REVISITED

In addition, UK nationals travelling to the EU would presumably be subject to the same requirements as third countries – and without an agreement on visa-free access and unless the EU decides to waive visa requirements unilaterally (as it does for a number of countries), this would mean, for most countries, applying for a Schengen visa. Apart from being expensive, it is unlikely the systems of many countries could cope with such a large increase in volumes. There would be immediate large-scale disruption to travel and tourism.

If all this occurred, this in turn would raise the prospect of retaliatory action by the UK, which the government has explicitly threatened. While, as noted above, nothing would automatically change on Brexit Day here, the government would be able to use its new powers under the EUWA, to ‘modify, limit or remove the rights which domestic law presently grants to EU nationals, in circumstances where there has been no agreement and EU member states are providing no such rights to UK nationals.’

In other words, EU nationals in the UK really would become bargaining chips. So the disaster scenario is one where, deliberately or simply through lack of preparation, UK nationals in the EEA are thrown into limbo, while travel becomes much harder; and the UK retaliates, placing a question mark over the status of some or all of the 3.4 million EEA nationals currently resident.

Fortunately, this disaster scenario is unlikely to materialise. Even in the event of a breakdown in negotiations, or the rejection of the Withdrawal Agreement by the UK Parliament, it is very difficult to see how it would be in the interests of either side. The citizens’ rights text in the Withdrawal Agreement – the least contentious part – has been finalised.

That does not mean, as some have suggested, that both sides could or would necessarily agree to implement the relevant part of the Withdrawal Agreement. For example, that includes rules on the precise remit of the European Court of Justice which, in the event of a complete breakdown of trust, might not be acceptable to either or both sides.

More likely is that there might be coordinated but essentially unilateral actions on all sides to ensure that the *status quo* was preserved as far as possible. That is, both the UK and the EU27 would announce publicly that they would continue to respect the existing rights of each other’s citizens, and where necessary the EU27 and member states would take emergency legislative action to ensure this.

This would avert immediate consequences of the sort described above. But it would be a sticking plaster rather than a permanent solution. Over time, uncertainties and legal ambiguities would mount, leading to significant numbers of people with uncertain and unclear status either with respect to residence or other important rights. Businesses in the UK would certainly find it much harder to recruit EU nationals.

Eventually, it seems likely both the UK and individual EU27 countries would be obliged to clarify the legal position in some form, either through a deal between the EU as a whole and the UK to resolve this specific issue or as series of bilateral deals. Inevitably, there would be litigation – under domestic law, EU law and the European Convention on Human Rights – as individuals sought to clarify their status. But meanwhile considerable numbers of citizens would be likely to ‘vote with their feet’ and return to their countries of origin.



Northern Ireland

A no deal scenario would raise serious concerns about peace and stability in Northern Ireland. The discussions are already creating anxiety in what is an unsettled constitutional context, given the current absence of a functioning power-sharing executive in Stormont due to disagreements between the two main parties – Sinn Féin and the Democratic Unionist Party (DUP).

If the UK exits the EU without a deal, this will involve the departure of Northern Ireland (and Great Britain) from the single market and customs union which, respectively, help to ensure frictionless trade across the north-south border with regard to tariffs and regulations. The outcome is likely to be a hardening of the border, involving a physical manifestation of the border in some way – such as cameras or border infrastructure. An amendment was added to the EU (Withdrawal) Bill committing the UK government not to put up such infrastructure, a testament to the current disjunction between the current political and legal reality of Brexit for Northern Ireland.

There is as yet no clear plan from the UK government about how to deal with this disruption and mitigate its effects – the ‘technical notices’ released by the Brexit Secretary suggested businesses ‘should consider whether (they) will need advice from the Irish government about preparations’. This was confirmation, in effect, that the UK government cannot make any unilateral guarantees about the economic effect of a no deal outcome.

In addition to economic concerns, there are security risks. Many fear any re-emergence of a hard border due to a no deal exit may prompt attacks from dissident paramilitaries and a consequent return to the days of a (pre-peace process) policed border. In addition, there would be no firm and enforceable guarantees around respect for the unique circumstances of Northern Ireland – including the future of the Good Friday Agreement and the various rights and equality protections flowing from it. The Common Travel Area on the island of Ireland, for example, was a core principal within the Good Friday Agreement that could be in danger of being undermined. Equality rights, equality of citizenship and equivalent rights in both the north and south – salient issues in Northern Ireland – are currently guaranteed by the primacy of EU law and the ability to appeal to the European Court of Justice. These provisions for legal equivalence would disappear in the event of no deal.

There is very little support among the Northern Ireland public for a no deal exit. A departure from the EU that includes leaving both the single market and the customs union attracts the support of only 15% of people in Northern Ireland (only a quarter of Protestants, and 5% of Catholics). By far the most popular way of leaving the EU involves a ‘soft’ UK-wide exit, in which the whole of the UK stays in the single market and customs union (61% of Catholics and 62% of Protestants favour this type of exit).

There are also significant levels of hostility among the general population (particularly among – though not limited to – Catholics) to any emergence of the kind of north-south border controls that a no deal would likely prompt. There exists substantial support for peaceful protests that may occur against such controls, and nearly one in ten Catholics would support the vandalism of new border installations or infrastructure such as cameras.



COST OF NO DEAL REVISITED

Against the backdrop of no existing executive in Northern Ireland, a no deal exit would increase the current levels of instability. It is notable, for example, that the debate on Irish unity is gaining ground as a mainstream conversation in the public life of Northern Ireland – significantly aided by the former First Minister and DUP leader Peter Robinson, who has encouraged serious consideration of how best to address the issue. The no deal option would likely intensify demands for people to be given the chance to vote to leave the UK (and thus remain in the EU). Survey evidence suggests that under a no deal scenario Catholic support for Irish unity would significantly increase, and thus no deal would likely have a profoundly damaging impact on the future of the ‘union state’.

There are also a number of particular policy areas which could be negatively affected. A disruptive Brexit would, for example, have huge implications for energy provision in Northern Ireland, which relies upon energy connectors with the Republic of Ireland. The return of a hard border in Ireland raises the risk that the single energy market in Ireland will not be able to function and supplies of energy may have to be shipped to Northern Ireland from England or Scotland. A no deal may also lead to energy price increases in Ireland, as it currently imports 56% of its gas from the UK.

There are also concerns about the effective delivery of healthcare in Northern Ireland. The prospect of a no deal Brexit coupled with a return to a hard border between Northern Ireland and the Republic raise considerable practical issues for healthcare delivery. There have long been reciprocal working arrangements between Northern Ireland and the Republic of Ireland, supported by EU funding in the past. Children travel to Northern Ireland for ear, nose and throat treatment to avoid waiting lists in the Republic of Ireland. Children’s cardiac surgery finished at Belfast Royal Victoria Hospital in 2015 and children from both Northern Ireland and the Republic are treated in Our Lady Children’s Hospital in Dublin. Ambulances from both jurisdictions regularly cross the border in border towns. In the event of no deal, some of these issues may be able to be resolved through continuation of bilateral agreements.

How no deal might all play out is uncertain, and key questions have yet to be resolved. It has been suggested that the UK government would simply leave the north-south border without controls – regardless of the formal legality of such a step – and dare the Irish to impose controls unilaterally. The Irish government has been ambiguous on how it would respond in such circumstances. The EU, given its legal obligations, not to mention the risk of smuggling, would be unlikely to regard an uncontrolled border as acceptable for more than a very short period.

It is possible that, given the risks, some sort of stopgap solution might be agreed. A form of ‘WTO-Northern Ireland arrangement’ could replace the current draft EU Northern Ireland/Ireland Protocol as a short-term solution, treating Northern Ireland separately to the rest of the UK for a temporary period. But this brings with it a new set of political questions and would be opposed in the UK and in Northern Ireland. What is certain is that no deal poses pivotal questions not just about the economic, but also the political, stability of Northern Ireland.

Specific sectors

Agriculture

UK agriculture has strong trade links with the EU. About 70% of the UK's agricultural imports (food, feed and drinks) – representing about 30% of total consumption – and 60% of its agri-food exports come from and go to the EU. In addition, in some agricultural sectors, a large proportion of the workforce is composed of EU nationals. In the event of a chaotic Brexit, UK agriculture would have to abide by WTO rules, hence trading with the EU and the rest of the world under the 'most favoured nation' principle. Tariffs, border and other regulatory checks – including compliance with health, food safety, animal and plant regulations and the WTO's rules of origin – would be reintroduced between the UK and the EU. This would slow trade and disrupt the food supply chain, at least in the short term.



The UK would also have to immediately negotiate its tariff rate quotas (lower or zero tariffs for a fixed amount of imported products) and the aggregate measure of support (domestic subsidies paid to farmers), which are currently shared with the rest of EU. This will have to be approved by both the EU and all other WTO members and hence will be far from straightforward in the fraught political atmosphere that might be expected to characterise the period after a chaotic Brexit.

These developments will have significant implications on both the sector and the economy as a whole. Agricultural tariffs are much higher than those in most other sectors of the economy, but the sector accounts for only a small share of UK GDP. Medium-term projections, relative to the UK remaining fully integrated in the single market and the customs union, show that trading agricultural products under WTO rules would reduce UK economic output in 2026 by 0.4%.

Increased trade barriers will favour some net import sectors such as dairy, pigs and poultry whilst harming some export sectors, such as sheep and barley. In the case of beef, the imposition of high tariffs as a result of a no deal scenario could lead to a total collapse in trade between the UK and the EU, since the UK is a large net importer of beef from the EU. However, the rise in the domestic price is likely to attract imports from non-EU countries despite the high tariffs. In contrast, the sheep sector, which exports large quantities to the EU, will be negatively affected as the application of 'most favoured nation' tariffs will diminish its competitiveness, leading to a reduction of the volume exported.

Hence, the impact will vary across sectors and be largely dependent on whether the UK is a net importer or net exporter of the relevant commodity. These trade effects could also be affected by the movement of the exchange rate, and possible labour market changes and other non-tariff barriers. Given the dependence of many UK farms on direct payments, their removal would worsen the negative impacts of new trade arrangements and offset positive impacts.

The effects will also differ significantly across the devolved administrations. Specifically, any form of border between Northern Ireland and the Republic of Ireland would be likely to slow their flow of trade, disrupt highly integrated agri-food supply chains and might even encourage the illegal movement of animals and other goods.

COST OF NO DEAL REVISITED

When releasing the first tranche of technical papers on a no deal Brexit, the Brexit Secretary Dominic Raab noted that “people’s livelihoods are at stake”. Part of the mitigation and amelioration of risks to UK farming will come with the maintenance of farm payments and rural development funding. The government has promised farm payments will continue at current levels under the Common Agricultural Policy (CAP) while it remains in office, regardless of the outcome of negotiations. Its no deal advice also reiterated that rural development funding will continue until the end of 2020.

One way to mitigate higher tariffs on exports would be to activate temporary ‘exceptional measures for producers’ such as market price support, coupled-production support and/or private storage aid schemes. The EU itself did this in response to Russia’s ban on agri-food imports. Yet this will raise serious complications, not least how to target the support only at those farmers whose produce is destined for export and to decide on who will benefit and for how long.

Moreover, these instruments resemble the CAP, and the government has insisted that Brexit represents a once in a life-time opportunity to replace the ‘fundamentally flawed’ CAP with ‘our own national food policy, our own agriculture policy, ..., shaped by our own collective interests’. This raises the question as to whether the UK is prepared to revive this ‘fundamentally flawed’ CAP, even as a temporary solution.

However, there are other areas that cannot be fixed by increased spending from the UK government. A certification black hole was a key problem for UK farming flagged up by the first tranche of technical papers. Only organic food and drink exporters certified by an organic control body approved by the European Commission would be legally allowed to export to EU countries – a certification process that usually takes up to nine months to complete. This disruption could be substantial and, for some export businesses heavily reliant on trade with the EU, potentially existential.

For food consumers, a reversion to WTO tariffs would lead to a significant increase in domestic food prices, with more serious effects on poorer households which spend a higher proportion of their income on food. Our estimates for the meat sector and food processing show increases of 7.3% and 3.7% in retail prices, respectively. And these changes would be even higher if sterling depreciated as a consequence of a no deal, as we point out is likely above.

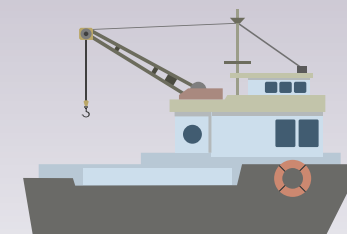
An alternative mitigation strategy is that in order to avoid the increased barriers to imports from the EU that applying ‘most favoured nation’ tariffs would imply, the UK should simply unilaterally adopt low or zero tariffs on all agricultural imports (and perhaps reduce or eliminate regulatory checks). WTO rules would require us to do so for all imports. This would clearly benefit households, who would then have access to cheaper food; however, it would be hugely damaging for some domestic producers. The government has given no indication it intends to adopt such an approach.

Recently, Minette Batters, the president of the National Farmers’ Union stressed: “The UK farming sector has the potential to be one of the most impacted sectors from a bad Brexit – a free and frictionless free trade deal with the EU and access to a reliable and competent workforce for farm businesses is critical to the future of the sector.” So, while a chaotic no deal Brexit will benefit some UK farm sectors, others will be badly harmed. And the main losers will be UK consumers, who will face a sharp increase in food prices.

COST OF NO DEAL REVISITED

Fisheries

The UK government recently published its fisheries white paper. Although this provides some indication of its approach to fisheries management after Brexit, significant questions remain. However, if a no deal scenario comes to pass, the UK will leave the Common Fisheries Policy (CFP) in its entirety, and legislation will be required to create a strong legal framework in order to replace the CFP and avoid a legal vacuum. Reaching agreement with the devolved governments over the shape of a common framework for fisheries will also be crucial, and the continuing disagreement between the Scottish and UK governments on this matter will need to be resolved as a matter of urgency.



Fish, of course, are unaware of international boundaries, and the UK would still be bound by its obligations to the United Nations Convention on the Law of the Sea. This requires the UK to sustainably manage its fish stocks and cooperate with neighbouring coastal states (including the EU) where they straddle Exclusive Economic Zones (EEZs). In addition to the EU, the UK's EEZ borders both Norway and the Faroe Islands, and so it would have to cooperate with them too.

Leaving the CFP means that the UK will have complete responsibility over its EEZ. Theoretically, the UK would have access to all of its Total Allowable Catch (TAC) within its EEZ, and vessels from EU member states who once accessed waters around the UK would have no automatic right to fish there.

On the one hand, this no deal scenario may look good for UK fishers. The UK would have full discretion regarding the entry of foreign vessels into UK waters and could allocate more quota to UK vessels.

However, there are diplomatic implications to this approach, especially as several EU member states benefit from access to the UK's waters. Firstly, some UK vessels rely on reciprocal access to other EU member states' waters. A no deal scenario might also see the imposition of tariffs on UK seafood to EU markets. Indeed, the UK's biggest export market for seafood is France, with the only non-EU country in the UK's five largest markets being the US in second place – the UK exported 96,501 tonnes of seafood in 2016 to France.

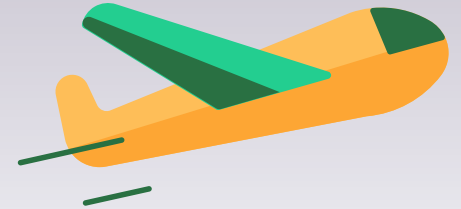
The threat of non-tariff barriers under a no deal scenario is also significant. A recent report has highlighted that the UK's shellfish sector (which is the largest of the UK's three fishing sectors and accounts for over a third of the value of all fish landed by UK vessels) is particularly vulnerable to a no deal outcome, as it is largely dependent on live exports. Any delays at the UK-EU border would impact the quality of this high-value product and its attractiveness to European markets.

The likely impact of a no deal scenario is therefore very mixed: UK vessels dependent on access to other member states' waters, or, more importantly, access to EU markets would suffer, potentially very severely; those fishing primarily in UK waters for the domestic market might benefit. UK consumers might also benefit, at least in the short term, particularly if fish previously destined for the lucrative export market had to be sold domestically at lower prices.

The government's mitigation strategy in key policy areas has been to manage disruption through unilaterally retaining the *status quo*. However, this approach seems unsustainable in the case of fish. Maintaining current levels of EU access to UK waters would be politically problematic in the event of no deal; the pressure on the government to reclaim control of UK waters would be substantial.

Aviation

Brexit in any form will be disruptive for airlines, but failure by the UK and the EU to reach agreement would leave the industry in chaos. Because the sector has its own system of regulation, based on the 1944 Chicago Convention, there is no WTO safety net in aviation. Moreover, although the Chicago system has provided a stable framework for the development of aviation since the second world war, it is unwieldy, difficult to change and restrictive. Baseline technical standards are codified by the International Civil Aviation Organization, which has 192 signatory states, and air services are regulated by bilateral agreements which governments use to designate the airlines that can operate services and the routes they can serve.



In Europe – the UK's biggest market – the EU has created its own regulatory order that combines liberal access for airlines with high safety standards and advanced passenger rights. Under EU law, any EU airline can operate services on routes to, from, between and within EU member states, provided that EU nationals have a controlling stake in the company and that it meets defined technical and financial fitness criteria. EU aviation also has an important international dimension. Through the European Civil Aviation Area, the single market in air services applies to eight neighbouring states, including members of the EEA, as well as to EU member states. In addition, the EU has negotiated bilateral air services agreements with third countries, including the US and Canada. Therefore, the rights of UK airlines to serve these markets are regulated by EU agreements.

The industry is following the Brexit negotiations with considerable anxiety. Predictability is important in a sector that is so heavily regulated and where airline companies aim to be able to sell tickets a year ahead and so have their schedules in place six months in advance. Hence, the transition agreed in March 2018 was warmly welcomed within the aviation sector since it promised continuity until the end of 2020 – provided, of course, that a withdrawal agreement can be reached.

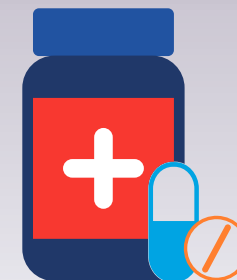
The failure to reach such an agreement would be severely disruptive. Without one, the safety certification for UK aircraft will lapse on 29 March 2019, UK airlines will lose access to EU markets, as well as to the third countries with bilateral air services agreements signed by the EU, and EU airlines will no longer be able to operate services to the UK. UK passengers will no longer be protected under EU law, and customs formalities for cargo moving across borders between the UK and the EU will be necessary.

Some argue that these fears are exaggerated and that it is in the economic interests of both the UK and the EU to avoid such a scenario. It is true that contingency measures could be mobilized to retain basic connectivity – for example, the UK could grant access unilaterally – but such steps would merely limit the damage. They would certainly not provide for a continuation of the advanced system that currently exists. A UK-EU air services agreement, as well as UK bilaterals with third countries, would take years to negotiate, as each side aims to secure the best deal for its airlines under uncertain conditions. As intimated above, there are no guarantees that such contingency measures could be successfully negotiated in what might be a tense atmosphere following the breakdown of talks.

COST OF NO DEAL REVISITED

The NHS and pharmaceuticals

There are a number of potential impacts of a no deal Brexit for the NHS. Some would be immediate. First, there is the prospect of delays in access to medical supplies used in treatment. Imports from the EU are particularly important in relation to some products, such as human insulin, which are not currently produced in the UK. Similar concerns regarding the impact of border delays have been expressed regarding access to radioactive isotopes, though the UK government has stated their supply will not be affected. Concerns have also been expressed about the impact of a no deal Brexit on pharmaceutical supplies exported from the UK to other EU member states by the drug company AstraZeneca.



The government and NHS have indicated these supply questions are being addressed, and have launched the Medicines Supply Contingency Planning Programme. The Secretary of State for Health in August 2018 stated that the government was working with pharmaceutical companies to ensure a six-week supply of medicines, and assured the industry there would be further information given in September. However, at a local level there will be no stockpiling of medicines. Clearly such plans will need to be extensive and robust to ensure that there is no adverse impact on patient health. It is unclear as to whether a six-week supply will be sufficient. There are also plans to airfreight products such as medical isotopes with a short shelf life where needed. Inevitably, were such arrangements needed, this would impact on NHS resources.

Secondly, in the case of no deal, the UK would no longer be part of the EU drug approvals process. While the Medicines and Healthcare Products Regulatory Agency (MHRA) undertakes approvals for the UK under what is known as the decentralised drug approval process, the UK would not have access to the centralised approval processes run by the European Medicines Agency (EMA) which enables drugs to be given market authorisation approval across the whole of the EU. Moreover, certain drugs such as paediatric and orphan medicines (those developed to treat rare diseases) are currently only approved at EU level via the EMA. The MHRA would need to establish new approval systems for these at domestic level for which new legislation would be needed. The government guidance published in August 2018 stated that the MHRA will issue consultations in relation to these issues, and consequent new law which will be needed in autumn 2018. This is a very tight timescale for action.

On top of this, questions remain concerning the extent to which the UK would, as a result of a chaotic Brexit, become a second or third priority launch market for drugs. The guidance indicates that in relation to orphan and paediatric drugs, the government will consider the use of 'incentives'. However, uncertainties still surround future alignment with EU law in the area. The government has indicated that, in relation to the new Clinical Trials Regulation due to come into force later in 2019, it intends to 'align wherever possible'. Even if it does, the UK will be excluded from other aspects of EU regulation notably the new EU clinical trials database.

Under a no deal scenario, the UK would also no longer be part of the approval process for medical devices such as cardiac pacemakers, hip prostheses, breast implants and pregnancy tests. Approvals are undertaken currently through notified bodies – companies authorised to award CE marks for medical devices, and hence EU authorisation. However, after Brexit those notified bodies in the UK would be unable to provide CE marks which would be recognised automatically by other EU member states. The government, in its recent guidance, has indicated that the intention is to continue as far as possible the current regulatory system and, in addition, to implement amendments to the law in this area bringing us in line with new EU Medical Devices Regulations that will come into force in 2020 and 2022 respectively. Yet devices approved in the UK would no longer automatically be recognized in other member states. As in other policy areas, the UK's exclusion from access to EU vigilance and other data systems will be disruptive.

Thirdly, the European Health Insurance Card (EHIC) which gives rights to access medically necessary state-provided healthcare in another member state will cease to apply. This means that individuals travelling to the EU after Brexit would be strongly advised to ensure that they have medical travel insurance. It could also mean that patients dependent on kidney dialysis who, under the EHIC arrangements, can obtain dialysis in another EU member state while on holiday would be unable to obtain it. Uncertainties also surround the position of UK patients in another EU member state undergoing emergency treatment in a hospital at the time the UK leaves the EU. They may be subject to charge by the hospital treating them for the remainder of their care.

In addition, while the Withdrawal Agreement would safeguard the rights of UK citizens resident in other EU member states to reciprocal healthcare, this would not be the case under a no deal Brexit. Unless they were already entitled to healthcare treatment in that member state – for instance because they had their own private medical treatment – they might be obliged to pay for it. There have already been concerns expressed about additional costs to the NHS if elderly patients currently treated under healthcare systems in the EU return to the UK for treatment in large numbers.

There is also the question of the impact on health and social care professionals from other EU member states. Some 5.6% of the NHS workforce in England are nationals of other EU member states. A chaotic Brexit would cast in doubt their right to remain in the UK. Longer term there remains the issue of the recognition of professional qualifications from other member states, something which is currently regulated by the EU Mutual Recognition of Professional Qualifications Directive.

In relation to the EU's involvement in blood, organ and tissue safety, the UK would, under a no deal outcome, also be excluded from other reciprocal arrangements such as EU vigilance systems concerning blood and tissue safety databases (Rapid Alert system for human Tissues and Cells, Rapid Alert system for Blood and Blood Components). As far as organ exchanges with other EU countries are concerned, specific (and, as yet, non-existent) arrangements would need to be put in place. In its August 2018 guidance, the government indicated that NHS Blood and Organ Transplant and the UK Human Tissue Authority are currently working on this issue.

Energy and the environment

The European Union (Withdrawal) Act 2018 (EUWA) has incorporated EU environmental regulations into UK law, and the UK will also continue to be bound by international environmental commitments in the event of no deal. Assuming the government manages to adopt all the necessary statutory instruments, a no deal outcome would still allow for a degree of policy continuity for the environment sector. For example, water standards will remain the same.

There are, however, some immediate risks to local air quality in some parts of the UK. A key potential outcome of a no deal is that traffic through our borders will slow down dramatically, leading to 'lorry parks' in Kent. This is likely to raise emissions in the local area causing poor air quality. Moreover, the environmental monitoring, reporting and reciprocal recognition requirements currently associated with EU membership will be lost with no deal, and the government has yet to put in place the institutions and structures to replace them via, for example, a new independent watchdog.



COST OF NO DEAL REVISITED

Replacing these monitoring and reporting functions is a huge task and raises at least two risks in the short term. First, without monitoring and reporting, some environmental protections will, *de facto*, be considerably weakened. Second, and even more problematic, there is a risk of a regulatory vacuum in various areas while new arrangements are agreed or approved by international partners. This could do serious damage to business and trade. Even if there is no substantive change in standards and rules, there may well not be time to get wholly domestic systems in place and achieve the formal recognition of the UK's processes and standards that allow trade to take place.

For example, chemicals product regulations are covered by EU rules. Without equivalent domestic approvals, accepted by the EU, being put in place, UK exporters would find themselves unable to trade with the EU. It is conceivable they might even struggle to do so internationally should there be no UK registration and authorisation system. It is notable that the UK government recognised the important role played by the European Chemicals Agency in its White Paper and suggested that the UK would ideally seek to retain access to the agency – an option that is completely ruled out in the event of a no deal Brexit.

Financial services

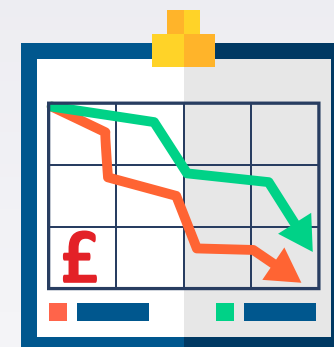
British financial services firms currently sell services to EU clients using a regulatory provision known as passporting. Passporting rights enables firms authorised in the EEA to do business in any other EEA state on a non-discriminatory basis in other member states, without needing further authorisation.

However, under a chaotic Brexit, the UK will no longer have access to this system. UK firms would have to establish branches or subsidiaries in every member state in which they wish to conduct business, compared with the ease of simply exercising their passporting rights to trade wherever they want.

Calculating the impact of this is difficult. For financial services, the issue is not the application of tariffs, but the more complex question of which areas of business firms could continue to offer from the UK, which would need to relocate, and which firms might simply opt to close.

Nonetheless, we can make two sets of comments relating to what might arise if an agreement on the implementation period is not reached. First, there is the question of market access. Firms wishing to maintain their current levels of activity will need to establish an off-shoot, with the appropriate regulatory authorisation, in the EU27. Many are in the process of doing so, but this is a lengthy and complex task which they might have hoped to complete during the implementation period. If that window never opens because the UK and the EU fail to reach an agreement, then we can expect a rapid acceleration in their efforts, and where business lines are deemed no longer viable (because markets cannot be accessed, and new legal entities cannot be established in time) we can expect job losses.

Over the longer term, the fall back for UK firms would be to provide financial services under the cover of 'regulatory or supervisory equivalence'. If the European Commission judges the regulatory or supervisory regime of a third country is equivalent to the corresponding EU framework and matches that of the EU in intent and



COST OF NO DEAL REVISITED

outcome, it may then grant market access. The equivalence of the UK's regime immediately after Brexit ought to be guaranteed (since it is currently embedded in that of the EU, and little is likely to change in the short term); but in the event of a chaotic Brexit, the prospects of achieving the 'enhanced equivalence' set out in the government's Chequers proposals seems very remote indeed.

Second, there are the various regulatory implications of a chaotic Brexit. It might be thought that other financial centres – such as Frankfurt, Dublin, or Paris – would be keen to attract business away from London, but there are regulatory considerations at play here too. Countries are likely to be very cautious before accepting an influx of large systemically-important institutions that might, in the event of a collapse, require state support. This suggests that a typical outcome would be a move that is sufficient to enable a firm to maintain market/client access, but also one that poses least risk to its new host.

Financial firms and markets are heavily regulated and supervised. Problems arise when regulators are not aware of the precise workings of foreign firms operating on their patch – or, indeed, not clear on who is meant to be looking at what, or what is the impact of being the lender of last resort. The financial markets of the EU and the UK are highly interconnected, with firms from one side of the channel selling services to clients on the other, and trading extensively with one another and with entities inside their own groups.

Detailed burden-sharing arrangements, framed in memoranda of understanding (MoU), must be compiled between UK and EU regulators, clarifying who is going to supervise the Frankfurt office of a British firm as it sells services to clients across the EU, for example. Once the UK is no longer inside the EU regulatory framework, such MoUs will need to provide an equivalent regulatory structure to allow, for example, the recovery (or winding up) of a failing entity in the remaining EU when its parent is in a post-Brexit UK. An implementation period would give UK and EU regulators just under two years to put these arrangements in place. Were it not to materialise, there is a very real danger that risk could build up in a pocket of this interconnected financial system.

UK regulators are taking various steps to mitigate the risks of a breakdown in regulatory cover, and in the legal framework. A 'Temporary Permissions Regime' is currently being established, which will allow EU firms currently operating in London the chance to apply for fast-tracked, and strictly time-bound, access to UK markets if passporting suddenly disappears on Brexit Day. EU regulators have not yet followed suit.

Similarly, UK regulators are using special statutory instruments to 'on-shore', and if necessary update or amend, the EU's rule-book for regulatory financial markets. The European Union (Withdrawal) Act 2018 (EUWA) has rolled EU law onto the domestic statute book (with the legal status of 'retained EU law') and a similar exercise will be required at the more detailed level of specific technical standards and rules. This means that in the event of a 'no deal Brexit', the domestic regulatory regime will be ready to take effect immediately. The legal framework, however, leaves open the matters of establishing working practices for the operation and conduct of a business and cross-border supervision.

Conclusion

What the preceding analysis has illustrated is not only that no deal remains a possible – albeit not likely – outcome of the Brexit process, but that it would have a huge impact across a whole range of both regions and sectors. It is important to be careful in the language used to discuss this outcome. The impact of a chaotic Brexit would not be uniform, and indeed, as we discuss, it might be that attempts at mitigation could, in the short term, actually boost GDP. That being said, what is all too clear is that it would also generate genuinely catastrophic outcomes in some respects.

Here, it is worth pausing to consider the frequent conflation of ‘no deal’ with ‘trading under WTO rules.’ This conflation is both disingenuous and dangerous. It is, of course, perfectly viable for the UK to trade as a third country with the EU and the rest of the world under WTO rules (and lots of other international agreements) over the long term. But let us put that in context. First, the negotiation of schedules would be neither automatic nor straightforward. Second, most economists think that trading on WTO terms would have significant negative economic impacts – albeit no more than say a 0.5%/year growth hit over the long term.

But third, and perhaps most importantly in this context, this focus on the WTO as a backstop for our ultimate trading arrangements tells us little or nothing about the short-term disruption, both economic and social, from a chaotic no deal as discussed here. The real impact of a chaotic Brexit relates not to the longer-term trading arrangements developed for the UK but, rather, to the short-term uncertainties associated with the disappearance without replacement of many of the rules underpinning the UK’s economic and regulatory structure. The impacts would be felt in industry sectors from agriculture to financial services; to areas which we take for granted as essential to the UK’s economy and society, such as air transport and drugs; and to our EU national colleagues, friends and family, and to our fellow citizens living elsewhere in Europe.

Of course, mitigations can and will be put in place. But here we need to distinguish between those under the control of the UK government (building new customs infrastructure, stockpiling medicines, creating new regulatory institutions) and those that are not (for instance negotiating memoranda of understanding sufficient to keep flights in the air).

When it comes to the latter, we must consider the potential political context at the time of a no deal Brexit. As we have argued, this is likely to be one characterised by a degree of bitterness and mutual recrimination as each side blames the other for the breakdown of the talks. In addition, the European Union is highly unlikely to be willing to negotiate mitigating actions that are far more important for the UK than for the 27 unless and until they receive, at a minimum, credible assurances that the withdrawal issues can be resolved (which, presumably, will require meaningful concessions from the UK, or a chaotic Brexit would not have occurred in the first place).

So while a chaotic Brexit remains a possibility, either via a breakdown in the negotiations or the inability of British politicians to provide a majority for any conceivable negotiated outcome, its impacts will be severe and overwhelmingly negative. In the short term at least, considerable uncertainty and disruption will result. In all likelihood, the chances of negotiating the kinds of mitigating deals that the government seems to assume will be possible in its technical notices on the pact of no deal seem slim.

It makes sense to plan for, and indeed attempt to mitigate, the worst aspects of a chaotic Brexit. It makes much more sense to avoid such an outcome altogether. This would be an unprecedented mess, both politically and economically, and we’d be in uncharted territory, even with mitigations. And repeating again we don’t think no deal is either likely or desirable, but could happen by accident, and at least we should have an objective idea of the consequences.



The UK in a Changing Europe promotes rigorous, high-quality and independent research into the complex and ever changing relationship between the UK and the EU. It is funded by the Economic and Social Research Council and based at King's College London.

020 7848 2630 | ukandeu@kcl.ac.uk | www.UKandEU.ac.uk |  @UKandEU