

BREXIT UNIT

Let's get ready for 'no deal'

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A 'no deal' scenario, in which the UK simply leaves the Single Market and Customs Union in 2019, does not have to be the 'catastrophe' that many fear. There would be some new barriers to trade with the EU, but these should be manageable. On the upside, the UK would be able to crack on with its own trade deals with the rest of the world, cut tariffs on imports unilaterally, review EU regulations, and save straightaway on contributions to the EU budget.

The biggest risks may be in areas, such as financial services and aviation, which are not covered by WTO rules. But the UK and the EU could simply agree to continue the current arrangements here separately from the Article 50 process. It may well be better to have a short transition to smooth all this out, followed swiftly by a comprehensive free trade deal. Nonetheless, a clean break in 2019 could still be the next best outcome.

The second-best outcome, perhaps, but certainly not the worst

With Brexit talks proceeding at a snail's pace, the mantra that 'no deal is better than a bad deal' may soon be put to the test. The UK needs to be prepared to walk away if the EU is unwilling to show more urgency and flexibility. Indeed, a clean break in 2019 could still be a good outcome, even if not necessarily the best.

Of course, this partly depends on what 'no deal' looks like. Article 50 requires the EU to negotiate and conclude an agreement with the UK 'setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union'. Without such an agreement, the rights and obligations of the EU Treaties would cease to apply on 29th March 2019.

As a result, the UK would leave both the Single Market and the Customs Union. But this would simply put the UK in the same position as other members of the World Trade Organisation (WTO) with whom the EU does not have a bespoke deal, such as the US and China.

Admittedly, trade with the EU would not be as frictionless as it is now. The EU cannot treat the UK more favourably than other WTO members. This means that the EU would have to apply its common external tariffs to exports from the UK, unless it removed tariffs for everyone else.

However, for most UK exporters this would not be a game-changer. EU tariffs average around 11% for agricultural products and 4% for non-agriculturals. These figures conceal a wide range – cars face a duty of 10% and dairy products 33.5%. Overall, though, the EU's common external tariffs average out at a bearable 5%.

Key points

- If the deadlock in the Brexit talks does not end soon, the UK should be ready and willing to walk away without a deal. This would not be the 'catastrophe' that many fear.
- The UK would then leave both the Single Market and the Customs Union in March 2019. But this would simply put the UK in the same position as the US or China, which both trade extensively with the EU under WTO rules.
- The EU would presumably impose tariffs on goods it imports from the UK. But these are likely to average out at around 5%, which would not be a game-changer.
- UK exports to the EU would also face enhanced customs checks. These non-tariff barriers could be more costly, especially if they disrupt vital supply chains. But both sides would have a strong economic interest in keeping trade running smoothly.

UK exports to the EU would also face enhanced customs checks. If EU countries wanted to be difficult, these non-tariff barriers could actually be more costly, particularly where they disrupt vital supply chains. But this need not happen. EU companies trading with the UK would put pressure on their governments to keep the additional burden to a minimum. What's more, UK goods will be fully compliant with EU regulations at the time of Brexit, so there would be no excuse for lengthy delays.

In the meantime, the UK will need to invest more in its own customs infrastructure (the sooner the better). But the government's latest policy papers have already identified some potential solutions, and even a billion pounds here would be money well spent.

The UK would also have to decide whether to impose its own tariffs on imports from the EU. This would raise prices for UK consumers. However, it would at least help to create a war chest to compensate losers. The UK imported goods worth around £260bn from the EU in the 12 months to August, so an average 5% tax on this trade would raise £13bn annually. In contrast, the UK exported £162bn of goods to the EU over this period, so a 5% levy on these would cost around £8bn. The UK could therefore still come out ahead in a tariff war.

But there is a better way. The UK could choose instead to lower barriers to trade with other countries, rather than introduce them for the EU. After all, one of the advantages of leaving the EU is that the UK can abandon many of the EU's protectionist quotas and tariffs, putting the interests of consumers first.

There would other benefits of a clean break. Leaving the Single Market in 2019 would allow the UK to start a long-overdue review of EU rules and regulations, keeping only those that suit the needs of our economy and people. Quitting the Customs Union would allow the UK to begin to implement free trade deals with the rest of the world.

And the UK could start saving on its EU budget contributions immediately too. This would release another £13bn or so per year for UK priorities – including extra help for sectors, such as agriculture, that might initially struggle in the new environment.

Where are the risks?

That said, 'no deal' wouldn't all be smooth sailing. Firms in the financial services sector, for example, would presumably have to request access to EU markets on the basis that the UK regulatory regime is 'equivalent'. But again, this needn't be a major stumbling block, because the UK would be starting from a position of convergence.

There are many other agreements that would also need to be renegotiated, including access to EU aviation markets, mutual recognition of pharmaceuticals, and cooperation with EU-led organisations such as Euratom. But these arrangements do not depend on accepting the obligations of EU membership. Indeed, their participants already include plenty of countries which are not even in Europe, let alone the EU. 'No deal' on the Single Market or Customs Union would not therefore prevent the UK and the EU from continuing these (mutually beneficial) arrangements on essentially the same terms as today, based on agreements made separately from the Article 50 process.

Finally, there are some crucial areas where a formal deal may not actually be necessary. In particular, the UK could simply implement its proposals on citizens' rights unilaterally. This would put the onus on the EU to reciprocate, but why wouldn't they?

To be clear, a short and well-managed transition leading to a comprehensive free trade agreement would almost certainly be better than 'no deal'. It would be worth waiting a couple of years to get the details right. But if the EU is unwilling to play ball, a clean break in 2019 could still be the next best outcome.

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- The UK would need to invest more in its own customs infrastructure, but even a billion pounds here would be money well spent.
- The UK could choose between imposing new tariffs on imports from the EU, removing existing tariffs on imports from the rest of the world, or a mix of the two. Removing tariffs would be preferable and put the interests of consumers first.
- A clean break in 2019 would also allow the UK to crack on with its own trade deals with the rest of the world, cut tariffs on imports unilaterally, review EU regulations, and save straightaway on contributions to the EU budget.
- The biggest risks may be in areas, such as financial services and aviation, which are not covered by WTO rules. But the UK and the EU could simply agree to continue the current arrangements.
- In the meantime, the UK could simply implement its proposals on citizens' rights unilaterally. This would put the onus on the EU to reciprocate, but why wouldn't they?