

The LSE Continental breakfasts are one element of a wider academic programme that aims to understand and inform the process of agreeing Britain's future relationship with the rest of Europe. The breakfasts are private, off-the-record meetings for a select group of distinguished individuals from around the world. They bring together LSE's most renowned academic experts with a diverse group of insightful and influential people to explore key issues shaping the European political landscape.

Meetings are held under Chatham House rules, so that opinions expressed may be reported but not attributed. These seminar-style events typically open with short presentations from two experts, one of which is usually a member of the LSE faculty, followed by open discussion among the group.

In these write-ups, issues raised in the discussions are collected into an essay including references to relevant research and exploring some questions in more depth.



## **BREXIT: How we got here and where we are headed.** *(London, 8 February 2017. Written up by Robert van Geffen)*

This seminar was convened to discuss how the BREXIT process is taking shape, and the factors that were likely determine the structure of the negotiations and their outcome.

### *The BREXIT process*

Theresa May will trigger Article 50 in March, commencing the two year negotiation process, which in fact is more likely to be 18 months given the time needed to get the agreement ratified by the European Parliament, the Council and, as we know, since recently also the UK Parliament.

In terms of immediate next steps following the triggering of Article 50, the European Council will meet to issue guidelines on the negotiating position. It is not clear yet how detailed these guidelines will be. The exit agreement will also need to be approved by a 'super majority' in the European Council of 72% ([House of Commons library](#)). Also the upcoming elections in various member states make the whole process a lot more complicated. After the European Council has given its guidance, the Council of Ministers will give the European Commission a negotiating mandate through negotiating directives. Then Michel Barnier's team can start the negotiations with the UK. Ratification of an agreement in all member states will be necessary as it will touch upon national competences. In some countries, with a federal structure, this would involve the regions as well.

The question has been raised about what can realistically be negotiated in 24 months. It would seem that within that period the exit arrangements and the general outlook for the future relationship should be laid out. A transition period, by Theresa May now referred to as implementation phase in her recent [speech](#), will be needed to bridge the time period between the end of the Article 50 negotiations and the start of the new relationship agreement. This period should also give the UK and the EU time to negotiate the necessary agreements - of which Charles Grant of the CER has identified in a recent [paper](#) at least six.

In order to be able to fruitfully start the negotiations, the UK will need to give more details on what custom arrangements it wants and what the often used phrase "best possible access to the single market" means. Then during the negotiations each member state will bring different priorities to the table which will make the negotiations a very complicated process.

The exit negotiations will inevitably also be about money. The EU, and thereby also the UK, has made legally binding commitments to future payments, for example to pensions of EU staff and MEPs. The bill for these commitments will come when the UK is no longer a member and a solution will need to be found for how this is going to be paid for. It has been suggested by the [FT](#) that the bill could be as high as EUR 60BN.

In order to be able to consider whether the bill that the UK will need to be paid can be used by the UK as a leverage point, it needs to be clear what the sequencing of the negotiations will be. The UK is trying to negotiate about both the exit arrangements and the future relationship in parallel whereas the Commission is arguing that during the Article 50 process only the exit arrangements will be negotiated. This will need to be agreed upon first.

Decisions will also need to be taken about the location of European agencies which are currently based in the UK, such as the European Medicines Agency and the European Banking Authority, as well as about the atomic research centre in Culham. Furthermore, an important issue which will need to be settled during the exit negotiations is the status of EU citizens in the UK and UK citizens in the rest of the EU. It is generally assumed that their rights would be grandfathered.

It should also not be forgotten that although BREXIT is the main political issue dominating the headlines in the UK, this is not necessarily the case in the rest of the EU, with Ireland

being a possible exception. The EU faces a multitude of crises at the moment, is put under pressure by the election of Donald Trump in the US and faces a number of national elections in key EU member states. The forthcoming negotiations will require leadership and a lot of good will from both sides.

In terms of the views of the other member states on BREXIT, the strong commitment of other member states to the EU project was emphasised. The UK is not very good at reading Angela Merkel and underestimates the political commitment to the EU in particular because the UK is mainly part of the EU for economic reasons. The argument that German car manufacturers will tell the German government to give the UK a favourable deal is false as the car manufacturers are much more committed to the EU project than the UK realises.

The impact that the new Trump administration might have on the BREXIT negotiations should not be underestimated. If Hillary Clinton had been elected, the US Government would likely have said, at some point, that the EU would need to get its act together. Trump on the other hand does not like the EU. If the Trump administration is to do anything, it will most likely drive the EU together, possibly even including the UK.

Despite Trump's [positive words](#) when Theresa May visited the White House, the UK might find the 'special relationship' between the UK and US does not provide much leverage in the UK-EU trade negotiation. The US President's competences when it comes to trade policy [are limited](#) in the first place, but also the EU is a significantly larger trade partner for the US than the UK.

The question is what the UK does if no agreement is reached at the end of the two year negotiation period. Although it has been said that the UK will fall back on WTO rules, this would only seem to be a legal possibility but not a political and economically viable one.

A question was raised whether the UK could, in two years time, decide to, after all, stay in the EU if it turns out that for example the economic impact of BREXIT is more damaging than expected. In that case probably new elections would be necessary to give the UK Government a mandate to end the BREXIT negotiations and stay in the EU. The rest of the EU would probably accept such a decision if it had the guarantee that the UK had genuinely changed its mind. Although there was no precedent, it would probably be possible to

withdraw Article 50 from a legal perspective so long as it was not a blatant attempt to stop the clock, with the intention of resubmitting notification at a later date.

### *The economic perspective on BREXIT*

The discussion then moved from the political to the economic perspective. When considering the BREXIT impact on the UK economy, it is expected in the pessimistic scenarios that in the medium to long-term growth will be 3-8% of GDP lower than expected. A more detailed analysis of the economic impact of BREXIT is provided in the Centre for Economic Performance paper “The consequences of BREXIT for UK trade and living standards”<sup>i</sup>. In the forthcoming period, the UK Government is facing two challenges:

1. To leave the EU with as little pain as possible
2. To address the question of rebalancing the economy as is necessary

There is a high correlation between the regions that were left behind in recent decades and those that voted for BREXIT<sup>ii</sup>. Statistics show the extent to which certain areas were left behind: in the 1980s 4% of working men with no education were considered to be inactive; now this is 43%. The question is whether the EU was responsible for this. It turns out that in this period significant cuts in public spending have been made. The austerity cuts to public spending in recent years particularly fell on the regions that were already left behind, exacerbating the existing trends. Research shows that the EU has in fact led to wages increasing and prices falling. There is no evidence that immigrants have crowded out the natives, for example in terms of jobs or hospital places. For the regions which supported BREXIT, the impact of globalisation explains only a small part of the story. Technological change was another important factor that has changed the livelihoods of people in these regions.

A [much debated](#) issue in the UK is the imbalance of the economy in the country with London and the South East being much more economically advanced than the rest of the country<sup>1</sup>. Economic research shows that this is due to economic policy in the UK, rather than because of EU membership. The financial services industry for example has been able to grow in London because of domestic policy. In fact, industries in the north have benefitted from

single market access as have SMEs throughout the country due to procurement opportunities. Losing this is expected to have a negative impact on employment.

The impact that BREXIT might have on the UK's financial services industry [has been raised](#) as a particular concern<sup>iii</sup>. It was suggested that the industry might be able to rely on global regulations to argue it remains equivalent to the EU regulatory framework. This could allow firms to continue to provide certain services under a so-called 'third country regime'. However, these global standards are not detailed enough to be able to argue that the UK is equivalent to the EU. Questions could also be raised about the accountability of the FSB which sets these global standards. Regulatory divergence that might come up after BREXIT is the key problem.

### ***Trade as the solution?***

Could more trade help these left-behind regions? The UK Government has said that they want to pursue a global trade strategy. It is however the case that countries mainly trade with countries nearby. As the National Institute for Economic and Social Research recently also argued, the Iron Law of Trade Models is that trade between two countries roughly halves when the distance between the two countries doubles<sup>iv</sup>. In the case of the UK it is therefore more likely to trade with the EU than with other regions elsewhere. The trade with the EU cannot immediately be replaced by trade with India or China, not even when very beneficial trade deals are negotiated.

Striking trade deals with other major economies, as has been suggested, will not be easy. The US for example uses a particular template for its trade agreements that it will continue to want to use. This favours US interests. A number of contentious areas would need to be negotiated before agreement could be reached on a US-UK trade deal, including health care privatisation. Agreeing a trade deal with China [will not be easy](#) either. Given the size of the Chinese economy it is the dominant player in trade negotiations. China recently signed an FTA with Switzerland. Where Switzerland had to immediately abolish its import tariffs, China was given a 15 year phase in period. Also striking a trade deal with India will not be straightforward given the immigration demands that India has put forward.

As also stated in the [UK Government's White Paper on BREXIT](#), the Government has expressed the wish to be outside the customs union. Besides introducing tariff barriers this would, more importantly, also introduce non-tariff barriers. Addressing non-tariff barriers requires harmonisation of domestic regulations such as product standards. For this the support from both sides of the trade relationship is necessary. It normally also involves a dispute settlement mechanism; just at a time when the UK would be looking to leave the jurisdiction of the ECJ. This dispute settlement mechanism is by definition a supranational authority and would be difficult for BREXIT supporters to accept just at a time when the [European Commission has tried to institutionalise](#) the use of such supranational authorities in their dispute settlement mechanisms in other free trade agreements in recent years. These considerations about the future relationship will have an impact on the transitional period.

It is clear that trade policy alone will not help to address the economic imbalances that Theresa May is looking to address. On the other hand, neither will trade barriers. The Government needs an industrial policy and should spend more on trade adjustments decisions as they did help to relieve the pressure of globalisation on these regions. It is important to ensure that net incomes do not decline and for this more wealth distribution is necessary. It will be necessary to develop more economic support for deprived regions. The British Business Bank is helping but it is not enough, much more scaling up is needed.

A point raised was that the forthcoming negotiations will not only be about trade and the economic relationship between the EU and the UK. Other issues such as justice and home affairs cooperation and international security will also need to be negotiated and these are member state, not EU, competences. Could the UK use these issues as bargaining chips in the negotiations as [has been argued](#) given the important role the UK plays in these areas of international cooperation, and that the EU therefore arguably has more to lose than the UK?

Ending the free movement of people will also require negotiations about the status of current EU citizens living in the UK and vice versa. Simply guaranteeing these citizens that they will be able to stay in the countries they currently live in will not be enough; decisions will need to be taken about their rights to social security, health care access, pensions and how qualifications should be treated.

It had been suggested that the UK could be turned into a tax haven to remain competitive following BREXIT. It was thought that the rest of the EU does not take this threat seriously at the moment but there would be retaliations if the UK decided to go down this road. The EU has allowed Ireland to compete with taxes because it is small and does not pose a threat to the economic base of other countries; this would be different for the UK. State aid policies such as those that may or may not have been offered to Nissan are very damaging and do not support a viable economic model in the long term.

All in all, it is clear that the BREXIT process is going to be difficult. The question is how the public will respond if the process turns out to be very damaging for the UK? Will an economic downturn put pressure on people to push back against BREXIT? Will they turn around and agree it was a mistake and should be reversed? Concern was expressed that people might go further to the extreme and xenophobia and distrust of elites would rise.

### Useful references

- LSE Commission on the Future of Britain in Europe, [page](#)
- LSE Centre for Economic Performance, [page](#)
- LSE BREXIT Blog, [page](#)

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<sup>i</sup> Swati Dhingra, Gianmarco Ottaviano, Thomas Sampson and John Van Reenen. “The consequences of Brexit for UK trade and living standards”, available at: <http://cep.lse.ac.uk/pubs/download/brexit02.pdf>

<sup>ii</sup> Agust Arnorsson and Gylfi Zoega. “On the Causes of Brexit”, available at: <http://www.bbk.ac.uk/ems/research/wp/2016/PDFs/BWPEF1605.pdf>

<sup>iii</sup> Niahm Moloney. “Financial services, the EU and Brexit: an uncertain future for the City?”, available at: [http://eprints.lse.ac.uk/67292/1/Moloney\\_Financial\\_Services\\_the\\_EU\\_and\\_Brexit.pdf](http://eprints.lse.ac.uk/67292/1/Moloney_Financial_Services_the_EU_and_Brexit.pdf)

<sup>iv</sup> National Institute of Economic and Social Research. “NIESR’s Director of Macroeconomics comments on the Brexit White Paper”, available at: [http://www.niesr.ac.uk/sites/default/files/NIESR%20Press%20Note%20-%20NIESR's%20Director%20of%20Macroeconomics%20comments%20on%20the%20Brexit%20White%20Paper%20-%20FOR%20IMMEDIATE%20RELEASE\\_0.pdf](http://www.niesr.ac.uk/sites/default/files/NIESR%20Press%20Note%20-%20NIESR's%20Director%20of%20Macroeconomics%20comments%20on%20the%20Brexit%20White%20Paper%20-%20FOR%20IMMEDIATE%20RELEASE_0.pdf)