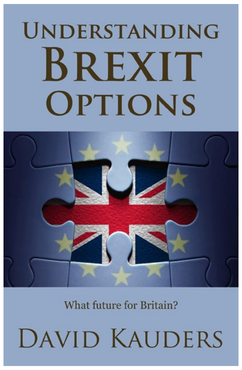
Understanding Brexit Options

What future for Britain?



This book clearly describes other Brexit options available, their impact on the UK economy and on individual citizens resident both in the UK and Europe.

By David Kauders

This edition	Digital (delivered electronically)	9781907230646
Other editions	Paperback / softback	9781907230653

E-book $4.99 £4.99 €4.99, also quality paperback (see website)

David Kauders FRSA was educated at Latymer Upper School, Jesus College, Cambridge and Cranfield School of Management. He is an investment manager and author.

About the book

Is the existing trade agreement good enough?

The basic trade and cooperation agreement has proved woefully insufficient for Britain's needs. It has reduced the supply of doctors, nurses, lorry drivers, agricultural and hospitality workers, bringing pressure and chaos to everyday life. It has hit or will damage exports and employment in fishing, food, artistic and other services and it threatens the peace in Ireland. Leaving the EU internal energy market has increased energy prices *relative* to the rest of Europe. Promised new trade opportunities have vanished.

This book explains alternative relationships with Europe. The detrimental effect on trade in both goods and services that has been caused by leaving the single market was entirely foreseeable. As the United Kingdom's relationship with Europe changes and evolves, the book documents better options that Britain needs but are rejected by its politicians.

Reviews

"The need for a reasoned and sensible debate about the impact of Brexit has never been higher, with continued Government obfuscation about what Britain's exit from the EU will entail. David Kauders' well-researched book concisely explains the different Brexit options available and details their implications, with the case for Britain's continued access to the single market shining through. Kauders' work should be required reading for all those wishing to quickly grasp the consequences of Brexit" - *Lord Bilimoria, Chairman, Cobra Beer Partnership and Cross Bench member of the House of Lords*

"With little clarity over what Brexit entails, 'Understanding Brexit Options' takes its reader through the options open to the UK in its future relationship with the EU. It helps lift the fog hanging over the toughest decision the UK will have to take in this generation." - *Tom Brake*

"'Understanding Brexit Options' by David Kauders illuminates the complexity of the options involved: staying within the single market, within the customs union, or either, or both. Or neither, which is what a hard Brexit would mean, or some sort of associated agreement (which seems the least likely). Brexiteers gave voters no idea of what they had in mind, and for that matter still seem to be at sixes and sevens over what they hope to achieve. Kauders exposes the facile promises of a free trade bonanza after Brexit in an increasingly protectionist world, and the illusion that we can stay in the single market and control our own borders - "have our cake and eat it" in Boris Johnson's dream world. In fact, anyone who wants to be better informed about the best solution, or the least bad, or feels they should be, could do no better than to read this clear analysis." - *Lord Taverne*

Excerpt

Wisdom from our forebears

"A bird in the hand is worth two in the bush" *? proverb*

"[He] warns the heads of parties against believing their own lies"

? Dr John Arbuthnot (1667-1735)

"Men, it has been well said, think in herds; it will be seen that they go mad in herds, while they only recover their senses slowly, and one by one."

? Extraordinary Popular Delusions and the Madness of Crowds, Charles Mackay, preface to 1852 edition

"Just the place for a Snark!" the Bellman cried,

As he landed his crew with care;

Supporting each man on the top of the tide

By a finger entwined in his hair.

"Just the place for a Snark! I have said it twice:

That alone should encourage the crew.

Just the place for a Snark! I have said it thrice:

What I tell you three times is true."

? The Hunting of the Snark, Lewis Carroll

"... they display in particular only a slight aptitude for reasoning, the absence of a critical spirit, irritability, credulity, and simplicity. In their decision, moreover, is to be traced the influence of the leaders of crowds and the part played by ... affirmation, repetition, prestige and contagion."

? Psychology of Crowds, Gustave le Bon, 'Electoral crowds'

Introduction

This book grew out of some private research about Britain's relationship with Europe. Given the risks to the British economy, to the unity of the United Kingdom and to European cooperation, I thought it useful to investigate further. My aim is to provide information and enable the reader to draw logical conclusions, and therefore I have avoided an academic study.

Chapter 1 is the key that unlocks the door and therefore the main part of the book. It explains the options that Britain has. These options need to be understood more widely, because the particular course of action chosen by the government ? leaving everything and trying for a quick, comprehensive free-trade agreement ? seems dangerous and risky. Because these options are so important, they appear first, with the supporting detail following in later chapters.

Chapter 2 discusses Britain's trade issues in more detail and shows how errors and misconceptions have surfaced. Chapter 3 covers the non-trade factors, notably how to reunite the United Kingdom following the divisive referendum campaign. Chapter 4 deals with Britain's mishandled relationship with Europe, chapter 5 looks at the state of the UK and chapter 6 summarises the main points and deals with the political issue.

The anti-establishment feeling that is now manifesting itself throughout Europe, as in the United States, can be traced to the failure of Keynesian economic stimulus as the limit to debt creation is reached, together with a new economic cycle driven by central bank monetary policies. I call the limit to debt creation the "financial system limit" and the reader will find this and related economic topics discussed in my other books.

In recent months, there have been many claims and counter-claims about the merits of particular relationships between Britain and the rest of Europe. One particularly unusual claim is that Britain will be better off, because countries lacking free-trade agreements with the EU have shown faster growth rates. The claim is based on published statistics, but the countries leading the "we did better" pack are generally low-wage low-price economies: Bangladesh, China, Russia, India, Nigeria, Malaysia, Brazil, Thailand, Indonesia, as examples. Britain is not a low wage economy seeking to industrialise through bargain-basement prices. As the rising rate of resignations of European doctors and nurses from the NHS has shown, Britain has much to lose from its present infrastructure. The argument that Britain can walk away without economic damage lacks context. The evidence presented in this book shows that Britain should stay inside the single market and inside the customs union. If you disagree with this analysis, do at least read this book to understand why Britain has such difficult choices to make.

David Kauders

April 2017

1 Britain's options

Although the British people spoke on 23rd June 2016 and said "we don't feel European", it has become clear that the voting public and those spearheading the Vote Leave campaign were confused about what they voted for. There was no plan because Vote Leave did not expect to win and neither Brexiters nor the civil service had anything in place.

Despite the appearance of a return to normality with a new British prime minister, there is little evidence that anyone has a clue about what Britain should do now to prevent future economic damage from loss of trade. This chapter sets out a view of what the options appear to be. Two of the options are fairly standard in terms of European law and existing arrangements between nations; two others need individual design.

A good leader will get all alternatives out into the open and attempt to quantify each one of them. Good strategy can be formed by balancing the quantitative case with the qualitative, political and emotional cases before taking any action.

The four options are:

"Hard Brexit", a complete break with the European Union.

A "loose arrangement" requiring continuing negotiation which attempts to mitigate the worst problems with Hard Brexit.

"Soft Brexit", staying in the single market as a non-EU associate (which may be inside or outside the EU customs union) ? this is sometimes called "Brexit-lite."

A Close Association agreement within the single market and customs union.

Timetable for the UK to leave the EU

Article 50 of the Lisbon treaty was drafted in the expectation that it would never be used. The opening words are:

"Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.

"A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union."

The key words here are "shall negotiate and conclude an agreement ... taking account of the framework for its future relationship." This means that negotiations about the future relationship ought to be separate from exit negotiations.

Britain has given notice that it is leaving the EU, using Article 50 of the Lisbon treaty that set the two-year exit clock running. Britain has now lost negotiating power, which is why the rest of the EU have said "no negotiations until you give Article 50 notice."

Option 1, a complete break with the EU: "Hard Brexit"

The first option is to completely exit the EU, including exiting the single market. There will be only limited negotiation, because the terms will be forced upon Britain. This option would cause obvious disruption: no free movement from exit day, so no passporting of services, which would send work for banks, insurers and airlines straight to other countries, damaging industries relying on imported labour (construction, food processing, security guards, cleaners and care workers) and resulting in even longer waiting times for National Health Service (NHS) appointments as staff depart or choose not to come to Britain to further their careers.

This is the option favoured by UKIP and the extreme right wing of the Conservative party. It causes the maximum damage to Britain's trade, because changing from European trading partners to distant nations will be extremely disruptive for a decade or more.

Hard Brexit and the single market

Britain currently has no tariffs or quota barriers on trade with the other 27 EU member states and the three countries that also are parties to the EEA Agreement, i.e. Norway, Iceland and Liechtenstein (the single market). The "Hard Brexit" proposal is to abandon free trade with these 30 countries, hoping to replace this with new free-trade, or nearly free-trade, agreements, both in Europe and elsewhere in the world. Since exports of goods and services to 27 of these 30 countries account for around 12.9% of Britain's GDP (the share of Britain's economy, not of its exports, see chapter 2), it should be obvious that any failure to replace free trade with identical volume and value of free trade within the single market or elsewhere, would damage Britain's economy. World trade is no longer expanding, so anything that reduces Britain's share of EU trade will give someone else an advantage. This is one reason why some EU member states would be glad to be rid of Britain; Britain's loss would be their gain.

There is a basic problem with Hard Brexit. At 12.9% of GDP, Britain's exports of goods and services to the EU exceeds the total share of GDP accounted for by British manufacturing. Only 10% of British GDP arises from all its manufacturing businesses (there may be differences in how these statistics are calculated, but the basic principle is unarguable). Given that some British manufacturing is for UK use and some for export outside the EU, a radical increase in Britain's manufacturing output would be needed plus a major increase in non-EU sales of goods in order to stand still. Why? Goods sales that are subject to tariffs, quotas and customs checks to export to Europe will inevitably be somewhat less than if Britain remained within the single market. It does not help that Hard Brexit also restricts Britain's cross-border manufacturing work, as we shall see shortly.

Services are treated differently from goods in free-trade agreements. Services sometimes need licenses which can be obtained cross-border within the EEA single market. Absent the EEA cross-border provisions, British businesses and those from the rest of the world based in Britain, have to relocate in order to provide the same services throughout the single market. This is why many banks and the Lloyds insurance market are already planning to move work away from the UK. Whereas tariffs, quotas and customs checks reduce sales of manufactured goods, services sold on cross-border passports will be lost completely. Selling more manufactured goods elsewhere in the world cannot compensate for the scale of such losses; and as explained above, the manufacturing sector would need a major renaissance.

Conversely, people residing in Britain cannot easily provide services that are regulated elsewhere in the world. If a business wants to provide banking services to most Asian countries, unless Asian residents travel to the UK to open accounts in the UK, it needs to have a banking licence in the target country and staff on the ground. Even America, the one other big single market for goods in the world, has state by state licensing of many professional occupations.

Britain will have to renegotiate trade with the EU commission which acts on behalf of the other 27 EU member states, who negotiate as one single entity. However, it could strike separate arrangements with the EEA three, since the EEA Agreement, which binds them into the single market, will be severed on exit, unless negotiated otherwise. Because Britain is so dependent on exports to the single market, the trade arrangements with the EU 27 (and therefore also the EEA three) should have been agreed before giving Article 50 notice. This will inevitably mean a new UK-EU agreement which will take time to negotiate. Giving notice first then hoping to negotiate against a deadline, when all power has moved to the EU, is a sure formula for wrecking existing trade. Absent an agreement with the EU, Britain would have no trade agreements on exit day. But Hard Brexit can only produce single market access with tariffs, quotas and customs checks, which will reduce British sales of goods. There will be no passporting of services, which will decimate Britain's financial services industry and its ability to work cross-border.

Hard Brexit will take Britain outside the customs union. Any future free-trade agreement, no matter how advantageous, will be limited by this, in addition to any tariffs and quotas. The situation would be like the present one with the EEA three, where Britain has free trade now but both parties have to operate customs checks. Extending reciprocal customs checks to another 27 countries that are currently major trading partners puts bureaucracy in the works where there is none today. Britain would have to check all commercial goods coming in and each of the other 27 would check commercial imports from Britain. Travellers both ways would be subject to customs controls. One of the main objectives of customs checks is to prevent back-door imports that avoid tariffs and quotas. This matters to Britain, which completes assembly of parts manufactured in other EU member states and manufactures parts that go to other EU member states for final assembly (often called the global supply chain, although it is mainly cross-EU border movement of partially finished goods). In the cases of the EEA three, they are not involved in significant global supply chains so customs checks have little impact. However, Britain has manufacturing that is integrated into cross-EU border supply chains and supply chains such as these need membership of the EU customs union in order to work effectively.

As a simple example, Ford has two factories making car engines in Britain. All their output is exported to other EU member states, where complete cars are assembled. Some of those complete cars are then imported to Britain. Ford is believed to be reviewing its options for manufacturing in Britain. Toyota and Nissan do the opposite: they manufacture parts elsewhere in the EU, import them to Britain where they are assembled into complete cars, then export some of those cars to other EU member states. No wonder the Japanese foreign ministry has asked for Britain to stay in the single market and EU customs union.

The EU will not grant Britain free trade unless Britain signs up for the four freedoms: goods, services, capital and people. Britain will not have unrestricted control of EU immigration and completely free trade, since free movement is at the heart of the free-trade area and is particularly important to achieve free trade in some services.

The argument that some non-European countries have free trade with the EU without free movement and therefore Britain should have the same is irrelevant for two reasons:

Britain is geographically in Europe even though it is leaving the EU.

Britain is a significant exporter of services to the EU via the “passport” which allows many services to be delivered cross-border without further local licences. Some non-European countries having free-trade agreements with the EU do benefit from concessions for financial services, each negotiated individually.

Hard Brexit and the non-EEA existing free trade countries

Britain has free trade with 56 other countries outside the single market as a result of EU trade agreements, that it will lose on exit day. Those 56 countries are all over the world, including Switzerland and seventeen Commonwealth countries, so Hard Brexit will hurt some *Commonwealth trade.*

As a non-EU member outside the EU customs union, Britain can negotiate its own free-trade agreements with the rest of the world. Although formal negotiations cannot start until after exit, discussions can be pushed almost to a conclusion beforehand. However, ratification can still take time as each country’s democratic procedures have to be respected. It follows that even replacing like for like with the other 56 countries will cause some sort of disruption and job losses.

Hard Brexit and the rest of the world

The holy grail of Hard Brexit is that Britain will be able to forge new trade agreements where there are none now, particularly in Asia, the Commonwealth and North America.

Asia is far from an easy trade substitute. The British government restricts visas for teachers of Asian languages, which is not a good start. China will soon be in recession and the Bank for International Settlements has warned about its banking risks. Does Britain want its economic future to depend on a country likely to have a major recession?

India still has to implement its own internal market, instead of each state charging customs duty on trade between states. It is a high volume but low price market place which is not entirely suitable for existing British manufacturing exports. India has asked for easier immigration to Britain, which Britain does not want. It would be unwise to rely on India at the moment.

Japan is very concerned about the risks to its significant investment in Britain, made on the basis that Japanese businesses use the UK as a bridgehead to the EU. Japan is also concerned about Britain's loss of influence caused by Brexit: the EU's embargo on arms sales to China is largely at British insistence. Spain and France (who want to sell arms to China) could change EU policy once Britain has departed. China could then use those imported arms to threaten Japan. Given that Japan only has self-defence forces and relies on America for serious military support, Japan feels let down by Britain. This is an immediate example of the global fallout from Brexit. Brexit has given succour to American isolationism, which would add to the dangers Japan faces. Don't rely on Japan.

There may well be opportunities in Australia, Canada, New Zealand and other Commonwealth countries for new trade agreements, but these are relatively small markets compared to the single market. America is the one bright star where the opportunities are big enough and Britain might forge a new trade agreement. However, both America and Australia have made it clear that they put EU negotiations ahead of British negotiations. In the case of Australia, a new EU-Australia free-trade agreement could well come into force just as Britain leaves the EU. Britain has a trade surplus with America that America would like to eliminate, leaving Britain little to gain.

The issue then becomes, can a trade agreement with America, on its own or with a few other countries, offset all the losses when British trade with Europe is reduced by tariffs, quotas and customs checks, and some services are lost completely? Will 318 million American consumers replace 458 million European ones? Will extra shipping and financing costs deter any trade with such distant countries as America, Canada, Australia and New Zealand?

The services Britain sells to Europe are unlikely to be much use in the American market. American banks reach European markets through London, not the other way round. European banks also place some of their capital market operations in London and will have to move these elsewhere in Europe. Cars made in Britain for export to Europe cannot be diverted economically to America. Britain sells small and medium cars in volume to Europe, but high-specification specialist cars to America. America may be a bonus, but it is unlikely to replace Britain's European trade and European integration.

New trade agreements take time to negotiate, as each partner government must consult its business interests and consider relevant infrastructure: for example, perishables can only be transported by air, which requires convenient airports and road access to them. When the agreements have been negotiated and ratified, new businesses may need to emerge before Britain can exploit the trade opportunities. If significant capital investment is required, or infrastructure developments are needed, then this will take many years.

This is the crucial problem with Hard Brexit. Replacing existing trading partners with different ones is a wrenching economic change. For sure, the losses will appear much earlier than the gains.

Four questions about trade

There are four major questions that need to be asked of all proposed changes to trading partners:

1. What estimated value of trade, including services, will Britain gain over 5, 10 and 15 years after exit day?

2. What estimated value of trade, including services, will Britain lose over the same time periods?

3. How long will it take to implement the new and therefore how long will Britain's economy be depressed before any improvement occurs?

4. Is there a break-even point at which the expected cumulative gain exceeds the cumulative loss? If so, how many years will it take to reach break-even?

Without figures, nobody will have a clue what they are talking about and the errors of the referendum campaign will be embellished. If Britain has wonderful new prospects that justify Hard Brexit, everyone needs to know what they are, now.

The trade questions will determine the depth and duration of the coming recession. My early estimate of the damage to Britain was broadly 1% to 2% loss of GDP annually; other estimates have appeared from independent sources of around a 2% loss. The challenge for the Hard Brexiters, therefore, is to find completely new trade agreements that will more than neutralise any loss of EEA and non-EEA trade. Absent new trade agreements offering new opportunities for at least 12.9% of Britain's economy, Britain will be made permanently poorer by Hard Brexit. Even if total replacement could be achieved effective from exit day, which is unrealistic, there will be a gap of many years before the changeover is fully effective. At the very least, this has the makings of an economic depression, no matter what the ultimate prize.

Small and mid-sized companies have few revenue streams, and need to develop new services or products quietly while they keep older ones going. Disruptive change hits such businesses hardest. At the other extreme large businesses, with major capital developments, have multiple revenue streams. Thus an oil major can develop one new oil field while earning income from many other oil fields. This is why large businesses are less exposed to Brexit. They can pick and choose what they do, knowing that their ongoing revenue streams will tide them over the disruption. The British government must be careful not to pay too much attention to large businesses; they matter, but are atypical.

Other consequences of Hard Brexit

Individuals are also considering their choices, applying for second passports where they have an entitlement to them, and contemplating emigration if they are highly skilled and attractive to countries welcoming their skills. Racism is on the rise; recession will cause more debt defaults and a further increase in poverty.

Britons living in Europe may return, but immigration of other European nationalities into Britain will decline. Britain could well finish up with two unintended consequences:

1. Emigration of the wealth creators as skilled Britons, skilled Europeans and skilled dual nationals depart to a less insular environment.

2. The return of expatriates, many of whom will be elderly and needing health care. Some may be deserting homes abroad that they cannot sell, so will need social services support (in the credit

crunch homes in Spain had to be abandoned).

Britain could well have a net population increase from these trends and would certainly replace taxes paid by younger workers by extra demand for health care and support for the elderly. Because of these consequences, immigration should not be allowed to dictate strategy.

Travelling in Europe

Britons take it for granted that they can hop on a plane for a holiday, drive through the channel tunnel to go shopping, or take the train to Paris on business. With Hard Brexit, none of these will be easy. It is now politically impossible for Britain to join the Schengen zone. Britons will therefore require Schengen visas for most trips to Europe. Non-Schengen member states such as Cyprus will impose their own requirements.

The Schengen passport-free zone includes Switzerland but not the UK or Ireland; the single currency zone includes Ireland but neither the UK nor Switzerland. At present, Britons can fly from the UK to Switzerland and go through passport control and customs. Take the train from Switzerland to Germany, France, Italy or Austria and there is a customs check on the train but no passport control. Fly back to Britain now from any of those countries and there is a passport control on arrival but no customs check. This simplicity will be lost.

Britain does not have the influence to rewrite the Schengen Agreement, although it might be able to negotiate a simpler process for Britons than the present standard visa rules. Today, someone without a free-movement passport has to apply 15 days in advance, in person, for a visa at the first destination country's embassy in the country of residence (i.e. the United Kingdom). This costs around £50 for a single trip of up to 90 days. Proof is also required of travel medical insurance, confirmed return travel booking and evidence of the ability to maintain oneself while in the Schengen zone. Unless Britain can negotiate continuance of mutual health insurance (the present European Health Insurance Card) and a waiver of proof of financial ability to maintain oneself, visiting Europe for any purpose is going to become rather tricky. Britain cannot revert to the pre-1973 arrangements for visa-free travel because they have been scrapped across Europe, rendered obsolete by free movement.

Option 2, a loose arrangement

Various political hints from the British government suggest that it is considering leaving the single market but trying to obtain its benefits without the obligation to accept free movement and perhaps without paying for the cost of running it.

Some existing EU free-trade agreements do provide for mutual recognition of other countries' regulation. Without such an agreement, negotiations for equivalence to EU rules will be needed for every business and trade sector that exports from the UK to the EEA. For example, the new Markets in Financial Instruments Directive provides for equivalence recognition, which Switzerland is planning to achieve. The idea is to do this for as much as possible of British business. Lo and behold! The single market on the sly.

A business that is outside the EEA has three alternative ways into the single market without tariffs, quotas, customs checks for goods and licensing requirements for services:

The business may set up an EEA branch that falls within the jurisdiction of the single market. This causes those activities and jobs that export to the EEA, to move to the branch located within the EEA, because the service must be provided, or goods manufactured, within the single market. This is no help to the United Kingdom.

Where equivalence rules exist, a business may rely on an official application by its government to the EU for industry sector recognition under those equivalence rules. This requires continuing renegotiation every time the rules change. Instead of the single market rules that all EEA member states have to adopt, "equivalence" means the EU bureaucracy assesses the other country's rules and procedures to ensure they are satisfactory. At present, "equivalence" is only available to parts of financial services, which means that some parts of financial services could survive in the UK. However, such survival would be subject to change and interference from the EU every time the EU made a new rule. There is no general equivalence for other services or for goods.

Alternatively, the government of the non-EEA country can negotiate a free-trade agreement that specifies which sectors are included. This is the situation with Singapore, which has a free-trade agreement, including most services, negotiated but awaiting ratification. This can take years to achieve: negotiations with Singapore started in 2009 and the agreement is expected to come into force in 2018 or 2019, just in time for Britain to miss out on its benefits. Whenever negotiations are needed, they can drag on for years and be derailed by a change in market conditions that causes rule changes outside the negotiators' control.

There is no chance that the EU will allow Britain anything like its present free trade and passported services on a sufficient scale to avoid economic damage in Britain, without the obligations that go with single market membership. Credit the EU with the nous to see through the "access" claim. "Access" is a political fig-leaf to hide the paucity of what is possible. Talk of "single market access" is as meaningless as "Brexit means Brexit." Over 100 countries have "single market access" and are subject to the EU customs union common external tariff, with severe restrictions on supply of services.

If anything, this is a worse option than Hard Brexit. Because of the continuing uncertainty, businesses will move elsewhere, slim down, or close completely. No rational business would hang on and hope for an equivalence agreement to descend from the heavens. And so, apart from minor distinctions in tables 1 and 2 later in this chapter, this book will treat this form of unique arrangement as a political chimera and not further distinguish it from Hard Brexit. The damage will be as bad as Hard Brexit or even worse. Certainly no improvement. The song of the sirens said "Come here"; next, the shipwreck.

Option 3, staying in the single market: "Soft Brexit" ("Brexit-lite")

In this option, Britain stays in the single market (EEA) but not in the EU. This would satisfy the referendum result, which was a vote to leave the EU, while preserving most of the trade benefits vis-a-vis Europe. Britain would keep free trade with the EU 27 plus EEA three countries. It would have some control over fisheries, but fisheries control would be constrained by the geographic realities, that British territorial waters would be adjacent to those of eight EU member states operating the common fisheries policy. Free movement means that Britons will be able to travel easily around Europe, as now, compared to the visa restrictions of Hard Brexit.

There are a number of downsides to Soft Brexit compared to Britain's present EU membership: Britain would still be required to pay substantial contributions into the EU budget to meet the cost of running the single market, using the fixed formula in the EEA Agreement in lieu of the member states' periodic budget negotiations, but would not receive any rebates or subsidies.

Britain would be required to implement all single market directives and product specification requirements, but would no longer have any influence in formulating them.

Britain would still have to sign up for the four freedoms (goods, services, capital and people). This would not satisfy those who thought they were voting to take back control of immigration, but that was not part of the referendum question. It was added by the Vote Leave campaigners through the media.

However, many of the economic negatives about Hard Brexit would fall away once it became clear that Britain was negotiating to leave the formal EU institutions but staying in the single market. In order to maintain EEA membership and implement option 3, the UK's participation in the EEA Agreement will need to be maintained. Therefore, the EEA Agreement will need to be singled out from the other treaties to be terminated on exit day, and UK participation retained, which will keep Britain in the single market and keep all the services passports in place.

This may be the only option that can unite a reasonable majority of Remainers and Leavers, since it takes Britain out of the EU's institutions while preserving Britain's European trade. However, it obliges Britain to implement single-market rules made without any British input. This does not satisfy those who demand an end to free movement but, as already explained, immigration should not be allowed to dictate strategy.

There are two variations of Soft Brexit. Both involve staying in the single market. The difference is whether Britain leaves the customs union or stays within it.

Soft Brexit outside the customs union

If Britain chooses to leave the customs union, then it will be free to strike its own trade deals with the rest of the world, just like the other three EEA countries now. The existing 56 trade agreements with countries outside the single market would still be disrupted, in exactly the same way as they would be disrupted by Hard Brexit. British exports to the EU will be subject to rules of origin and paperwork to prove that tariffs and quotas are not being circumvented, and agricultural exports to the EU will be limited by tariffs as agriculture is excluded from the EEA Agreement. Even with Soft Brexit outside the customs union, Britain needs answers to the four trade questions.

Soft Brexit inside the customs union

Staying inside the customs union means that Britain will not gain the ability to negotiate its own free-trade agreements with the rest of the world. It will continue to rely on the EU instead.

There are three important gains compared to Soft Brexit outside the customs union:

Britain would preserve its cross-border manufacturing work.

Agricultural exports to the EU will be maintained as they will not be subject to tariffs.

Britain's existing trade agreements with 56 non-EEA countries will be maintained.

In addition to retaining United Kingdom participation in the EEA Agreement, a new treaty will be needed as Britain would want to insist on the right to be involved in negotiating future trade agreements. This will be a little more complex than Soft Brexit outside the customs union, but simpler than either Hard Brexit or the option that is discussed next: a Close Association agreement.

Option 4: negotiating a Close Association agreement

With this option, Britain would stay in the single market and the EU customs union, and the EU would still negotiate trade with other countries. However, Britain could pick and choose which parts of non-single market European law it would implement, such as environmental law. When Britain's present prime minister was Home Secretary, Britain opted out of all measures for police, justice and home affairs, then opted back in to only those 35 measures that Britain wanted, such as the European arrest warrant. It is possible to negotiate some European law à la carte. Britain would have to apply single market and customs laws made by the EU, but would be free to choose which other EU laws to apply in Britain.

Britain will need the right to participate in trade negotiations and would still have to make budget contributions and lose all its rebates. Again, this satisfies the referendum result and removes the economic negatives about Hard Brexit.

A recent proposal circulated by the Bruegel think tank for a Continental Partnership to replace the EEA is somewhat similar to this concept of a unique Association agreement: in the single market, outside the formal institutions, yet able to influence relevant European law. The problem with any form of Association agreement is that it will take much more than two years to negotiate and implement. The attraction, even if Soft Brexit within the customs union has to be adopted as an interim measure, is that it is probably the only form of Brexit that will satisfy Scotland.

The World Trade Organisation

The World Trade Organisation (WTO) does not of itself provide free trade; its rules say how such agreements are to be negotiated. So when you hear politicians talking about trading under WTO rules, all you are hearing is a variation of the Canadian misunderstanding that we will learn more about in chapter 2. There is no automatic right to total free trade, without tariffs or quotas, under WTO rules. WTO rules are far from an easy solution.

Britain is currently a member of the WTO under membership terms that are common to all EU member states. These require Britain, for each separate class of goods, to either impose no duty on imports from all other WTO members or to impose a standard rate that is the same for everyone. Specific anti-dumping measures (such as for steel, see chapter 2) are therefore impossible, as is retaliation against any country imposing punitive duties. Unless and until Britain renegotiates its WTO membership, it has limited freedom to do as it likes in negotiating its own trade agreements. Both Hard Brexit and Soft Brexit outside the EU customs union are exposed to the risk of a conflict between Britain's EU trading terms, those Britain can negotiate elsewhere, and what Britain is able to do under WTO rules. For its part, the EU also has constraints on what it can offer. WTO rules require the EU to impose its common external tariff on Britain, just as it does with any other non-EEA nation lacking a free-trade agreement: Britain either has a free-trade agreement with the EU or it does not. There is no half-way house.

Since the EU will only discuss trade within the two-year window that has now started, a complex agreement that needs ratification by every country and has to comply with both Britain's present and future WTO obligations (which may change from now) is almost impossible to achieve. Another trade fable is that Britain can declare unilateral free trade, impose no tariffs or quotas on imports from the EU, and pass the loss to British businesses who will pay the common external tariff on their exports to the EU. Since serious consideration is already being given to forcing financial services businesses out of Britain, one can only say that this seems to be an agenda to shut down British trade. Hardly a route to prosperity. The WTO comes into this, because WTO rules demand equal treatment for all WTO members. Therefore if Britain unilaterally abolishes tariffs for all imports from the EU, it must also abolish those tariffs for the same classes of goods on imports from any WTO member anywhere in the world. No basis for future trade negotiations. Also, by its own laws, America can only negotiate free-trade agreements with countries that have WTO membership and tariff schedules in effect: another practical constraint on the dream of free-trade with America.

Evaluating the Brexit alternatives

Hard Brexit, the loose arrangement and Soft Brexit outside the customs union all involve the same disruption to 56 trade agreements with the world beyond Europe, but both variations of Soft Brexit reduce or avoid disruption to European trade. For this comparison, the Close Association agreement is identical to Soft Brexit inside the EU customs union.

Please view table 1 which is available at https://www.sparklingbooks.com/user/downloads/Brexit_table_1.pdf

If Britain is to keep its cross-border manufacturing then its choices are limited to Soft Brexit within the EU customs union or the Close Association agreement. If it is prepared to sacrifice jobs that depend on cross-EU border manufacturing and also lose some agricultural exports, then it can consider Soft Brexit outside the customs union.

For all options, Britain would give up formal membership of the EU, its place in the European council, its commissioner and its seats in the European parliament. This will satisfy the referendum question: “Should the United Kingdom remain a member of the European Union or leave the European Union?”

The arguments for Britain leaving the EU have been nationalistic (British laws for British people, end immigration) or pie-in-the-sky (tariff barriers on our European trade will not matter, we can trade with Asia instead and anyway the EU will give us free trade without any British obligations). With China heading for a recession, the Asian trade argument is as false as the belief that the EU will agree free trade, including free trade in services, with Hard Brexit.

The coming recession

Unlike the disinformation that has preceded past recessions and financial crises, this time round the establishment are working hard to ensure their excuses are ready for the next recession. The previous Chancellor, the Governor of the Bank of England and the Office for Budgetary Responsibility all issued warnings long before the referendum campaign; the present Prime Minister has added to them. Be in no doubt: the slump in commodities will be translated into a global recession. The troubles of oil, steel and retail will spread. Meanwhile, restricting Britain’s participation in the single market will initiate Brexit-related job losses unique to Britain.

There have been a number of attempts to quantify the possible effect of leaving the EU. Within the EU, in a global recession, Britain will simply go into decline along with every other country. Britain’s past destruction of manufacturing in favour of consumption, its repeated asset sales to balance the current account, its poor infrastructure, all point to an inability to withstand adverse global economic forces. Outside the EU there will be interim trade losses, which means that the British economy will perform worse than the European average. Exactly how much worse will only be discovered with the efflux of time. In chapter 2 we will look at what happened when Britain joined the common market in 1973 for clues about a reversal in strategy.

A word about capital markets

Capital markets discount the future by varying time periods. But, just as nations and their economies are interlinked, so are capital markets. The FTSE 100, in particular, largely follows Wall Street. Some politicians and tabloid newspapers have claimed that the recovery in the FTSE 100 in July to September 2016 shows that Brexit will be harmless. This is mistaken. The FTSE 100 is dominated by international businesses that will largely prosper from the drop in the pound Sterling, whereas the FTSE 250 is more representative of British businesses; it has not done well. The level of the FTSE 100 does not foretell the state of Britain when businesses decide to relocate elsewhere should the government implement Hard Brexit. In the meantime, Britons will mostly suffer from the currency's fall.

Sparkling Books Limited, 85 Great Portland Street, London W1W 7LT, United Kingdom
Registered at Cardiff no. 05955447 Member of Indepedent Publishers Guild
sales@sparklingbooks.com www.sparklingbooks.com