



United Kingdom

What if Brexit never happens?

- The UK parliament has given the government the green light to trigger Brexit, which it will do before the end of March 2017.
- Prime Minister May's hard line towards Brexit is potentially the most damaging position for both the UK and the EU.
- Yet things could change over the next two years, which is not much time for conducting negotiations, but a very long time from a political perspective.
- For the moment, anything is possible, even what is currently considered impossible. Maybe Brexit will never happen.

It's almost done. Within the next few days, the UK will officially trigger article 50 of the Lisbon Treaty signifying its a priori irrevocable exit from the European Union (EU), after 44 years as a member. This will start a 24-month negotiating period in which London and Brussels must agree not only on the terms of the divorce, but also on their future relations.

Yet there is no obligation to reach an agreement, and anything is possible, including the possibility of failure. If the March 2019 deadline passes without an agreement, the EU would apply its common foreign trade regime to the UK by default, including trade tariffs, VAT advances, border controls, and visas for UK nationals. Of course, the UK would reciprocate. The risk of escalation would be high, as would the cost of breaking off relations.

A hard Brexit is doomed to fail

For the UK, which conducts half of its trade with the EU, maintaining a hard line on Brexit could be courting disaster. A recent CEPII¹ study shows that for the UK automotive industry alone, a reciprocal common tariff of 10% would trigger a 3% drop in sales, i.e. 48,000 production units, thousands of job losses and a 6% increase in automobile prices. But this is only the minimum impact, since the scenario did not take into account any plant closures.

And it is just one example: all sectors integrated into global trade stand to lose out from Brexit. In air transport, agrifoods, aeronautics, chemicals & pharmaceuticals, and mechanical engineering, intra-group trade is the norm. Moreover, access to the single market does not depend solely on tariffs: it is also defined by thousands of technical, environmental, sanitary and social regulations. Eliminating them would be so disruptive that it becomes simply inconceivable, in the strict sense of the term.

And that is not all. Brexit – especially a hard Brexit – also threatens the very integrity of the United Kingdom. In Scotland, but also in

Northern Ireland, the majority of the population voted to remain in the EU. They are finding London's hard Brexit hard to digest. Nicola Sturgeon, Scotland's First Minister, has just confirmed her intention to hold a new referendum on Scotland's independence, in late 2018 or early 2019.

But one man's pain is not another man's gain: EU member countries would have nothing to gain if the UK decides to go it alone. The EU would not only have to forego a net annual financial contribution of several billion euros², but the UK makes a profitable trading partner. Its advantageous tax system and status as an international financial marketplace attract capital and allows it to cover its deficits easily... This has led to numerous trade surpluses in the EU. The UK is one of France's rare sources of a foreign trade surplus.

No exit for Brexit?

Like the Nash equilibrium in game theory, individual strategies towards Brexit have a collective cost that surpasses that of compromise, which becomes the only possible solution. The incentives for reaching a compromise could be economic: nature abhors a vacuum, and the UK would see trade weaken as the deadline for Brexit approaches. Any investment decisions that do not harm the outcome are bound to be postponed until tomorrow. And the people's desire to shake things up will probably weaken with the first sounds of breaking glass.

The two-year period that lies ahead will be very short for conducting negotiations, but excruciatingly long from a political perspective. The cards could be reshuffled again and again. But what will be the new deal? One solution is a soft Brexit, in which the UK leaves the EU but remains a member of the European Economic Area, like Norway, Iceland and Lichtenstein. The UK would maintain free access to the single market, but in exchange it would continue to make a financial contribution, albeit a smaller one. And it would still have to respect the four fundamental freedoms: the free movement of goods, services, capital and people, which would be a major concession for the advocates of a hard Brexit.

Although not as bad as breaking off relations, a limited separation would not be a good solution either. The UK would gain some freedom from EU rules (Norway, for example, is allowed to protect more its agriculture), but in exchange it would lose influence over EU rule making. Moreover, belonging to the European Economic Area would not guarantee that its financial sector could continue to benefit from banking passports to do business in the EU. The City is arguing for a system of equivalences, but implementing it risks taking much longer than two years. Enough time for the UK to reconsider its choice and for its citizens to return to the voting booth?

¹ Centre d'études prospectives et d'informations internationales (CEPII). See Mayer, T. 2016. "Brexit, Trumpit: the end of regional trade agreements? Consequences for the automotive industry." Lettre du CEPII, n°371, November 2016.

² 11.5 billion euros in 2015.