Brexit: An Interesting Compromise, but It Could Be Hard to Get It Through

The British government and the European Union (EU) have recently come to an agreement on how the United Kingdom is going to leave the EU. It is mainly a roadmap for how the split will take place on March 29, 2019. The agreement confirms that there will be a transition period until at least the end of 2020. During that time, the United Kingdom will continue to be part of the European common market, but will no longer be represented on the EU’s political decision-making bodies. The agreement also confirms that the United Kingdom will have to pay the EU approximately €398B.

However, it does not settle all the disputes and uncertainty concerning Brexit. The 599-page document merely skims over the ties that will unite the United Kingdom and the EU after the transition period, although it does indicate that a free-trade agreement would be desirable. There is still no real solution to the Irish dilemma. A backstop compromise touches on both those issues: if the Irish border problem has not been settled by the end of the transition period, the United Kingdom will enter into a customs union with the EU for an indefinite time. That compromise would significantly limit the U.K.’s freedom to act after Brexit. It would have to accept some European regulations and would not be able to make any new bilateral trade agreements with other zones or countries.

The agreement with the EU has disadvantages, of course, but what it does do is to prevent a complete departure from the EU (Hard Brexit) next spring. From an economic standpoint, the worst-case scenario would have been to have no agreement at all, because that would have meant the sudden reappearance of both tariff and non-tariff trade barriers. Most analyses suggest that, and the International Monetary Fund (IMF) recently estimated the loss of real GDP at 6.0%. A free-trade agreement would reduce that cost by half. Britain’s NIESR estimates the cost of a Hard Brexit at 5.5% and the cost of the recent agreement at 3.9%. That is measured against an ideal economic situation where there would be no Brexit at all. The Bank of England’s economic analysis of the agreement should come out on Thursday.

IMPLICATIONS

It is not at all certain that the United Kingdom–EU agreement will be ratified. The British Parliament will have to vote on it, likely on December 11, and the government is in quite a shaky position. Theresa May’s Conservative Party, which will be in a minority if its Northern Ireland allies abandon it, is strongly divided over the European issue. Up to a hundred Conservative MPs could vote against the agreement. If Theresa May cannot pick up votes among the opposition Labour Party (which is also divided), the agreement will not be ratified in Parliament. The government could fall, elections could be called, and a Hard Brexit would become more likely. Alternatively, there could be a new referendum, but what would the issue be? The agreement or simply Brexit? If that were to happen, polls indicate that 54% would favour staying in the EU.

The uncertainty over the whole Brexit issue is already hurting the British economy. Passage of the United Kingdom–EU agreement should ease the uncertainty, but not make it disappear entirely. It would be to the advantage of both the U.K. and the European economies that their future trade relations be pinned down as soon as possible.

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