Deal or No Deal? The Sequel

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The title of this blog, as many no doubt will note, invokes a quiz programme hosted by Noel Edmonds which ran on Channel 4 between 2005 and 2016, in which contestants played for a cash prize by randomly opening 22 boxes and thereby potentially winning up to £250,000. There was no skill involved – the game was virtually pure luck and simply involved guessing.

And so with the Brexit process, as we approach the end of the transition period of Single Market and Customs Union membership come 11pm GMT on the 31st December this year, that there remains an element of randomness as to whether the UK and the EU will reach a deal on a new trade agreement.

For we wake up this morning with news claiming that a compromise appears to have been worked out on EU vessels' access to UK fishing waters[1]. However, the big issues of regulatory alignment (the so-called "level playing field provisions around state aid, employment standards, environmental standards etc.) and what sanctions to put in place if one or the other party violates the agreement, are still outstanding.

It was always odd that fishing should figure so prominently in negotiations, given that it comprises less than 0.1% of UK GDP and only employs about 10,000 people directly. Yet such is its emotive force with many that the UK Government felt the need to push for a clear Brexit "dividend" here; with EU sources suggesting that the agreed position on fishing is that changes to current quotas will be effected through a five to seven-year transition period.

However, whilst failure to reach agreement on fishing might serve as a convenient prop for the UK Government to proclaim that it walked away from a deal if the EU was threatening our interests, the far more substantive issue was always going to be about regulatory alignment and the policing of a trade agreement thereof.

For the economic logic of the type of Brexit being pursued by the UK Government (a basic zero-tariff zero-quota trade agreement with some add-ons) only has an economic logic if it gives the UK freedom to diverge away from EU regulatory thresholds if it so chooses. This is the real meaning of “take back control” – the right of the UK Government to allow, say, the import of chlorinated chicken from the US in pursuit of a trade deal there.

Little wonder then that the German and French governments have insisted on tougher sanctions against the UK should be imposed by the EU, were it to diverge from future EU regulatory standards; namely being able to impose tariffs unilaterally on UK exports to the EU. And that UK Government sources state that negotiations will collapse if this demand is not withdrawn over the next 48 hours.

I do not think that the EU will withdraw this demand (though never say never). The UK Government in turn has protested that it should be accorded the same conditions of market access as Canada enjoys with its trade agreement with the EU.

However, as has been noted (e.g., by Clément Beaune, France’s minister for European affairs), the UK trades ten times as much as Canada does with the EU and hence any regulatory undercutting by the UK would be a more severe problem for EU members and be regarded as unfair. And so it may all become apparent tonight, when Boris Johnson again speaks to Ursula von der Leyen, the President of the European Commission, following their phone call on the weekend.

It has been well attested by the vast majority of experts on the subject that the economic costs of “no deal” will be particularly severe, with the Office for Budget Responsibility in its latest report that this would have an initial 2% hit on output next year – coming on top of an estimated rise in unemployment to 7.5% as the Government winds back Covid-19 support measures next spring.[2]

However, the focus on “deal or no deal” obscures the fact that even if – and it’s a BIG if – the UK manages to secure a trade agreement with the EU, this will still come with a significant cost, as businesses have to cope with the introduction of more red tape in the form of new procedures and checks. These will come into force on the 1st of January regardless, and include:

Customs Declarations for goods in-bound from and outbound to the EU – each consignment of a particular good will now require the trader to complete a customs declaration form, the costs of which have been estimated as between £15 to £56 (with a total estimated cost to business of at least £6 billion)[3].

UK Global Tariff (UKGT) – this will replace the EU's Common External Tariff on January 1st and will apply to all goods imported to the UK unless said country has or is covered by a trade agreement with the UK, is a developing country or some particular circumstance applies that warrants a suspension.[4] To allow for time for businesses to adjust, the Government has introduced a staggered six month period of import duty imposition, with the import of "controlled and non-controlled goods" from the EU being allowed without having to make an entry summary declaration.[5]

Sanitary and phyto-sanitary (SPS) checks – those exporting food products to the EU (or to Northern Ireland if the produce is deemed capable of being sold on to vendors in the Irish Republic) will face new checks at border crossings on animal and plant products. At a designated Border Control Post, they may be subject to documentary checks, identity checks or physical checks.[6] However, as the majority of these installations are still under construction, this will take some time to implement completely.

Changes to VAT collection – on January 1st the UK (with the exception of Northern Ireland) will leave the EU's VAT (Value-Added Tax) area. As a result, vendors won't charge VAT, but buyers will have to pay VAT to HMRC at the place at which they are imported, which in turn could pose cash-flow challenges to businesses who are not VAT-registered and until the end of this year have typically not had to charge VAT on the sales of goods between the UK and EU countries.[7]

As negotiations enter their final phase, the looming imposition of these new regulatory burdens – deal or no deal – will leave the UK in a weakened position come January 1st 2021. Against the certain costs of leaving the EU regulatory orbit, the purported gains from Brexit – be it a trade deal with the US, or joining the 'Trans-Pacific Partnership' – seem ephemeral and receding.

Perhaps a better analogy than to a defunct quiz show would be do you shoot yourself in one foot or both of them?

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[1] https://www.theguardian.com/politics/2020/dec/06/major-breakthrough-on-fishing-rights-brings-brexit-deal-closer

[2] https://obr.uk/overview-of-the-november-2020-economic-and-fiscal-outlook/

[3] https://inews.co.uk/news/brexit/businesses-face-billions-customs-declarations-costs-brexit-536304

[4] https://www.gov.uk/guidance/uk-tariffs-from-1-january-2021

[5] https://www.gov.uk/guidance/declaring-goods-brought-into-great-britain-from-the-eu-from-1-january-2021

[6] https://www.instituteforgovernment.org.uk/explainers/future-relationship-gb-eu-border

[7] https://www.instituteforgovernment.org.uk/explainers/tax-brexit