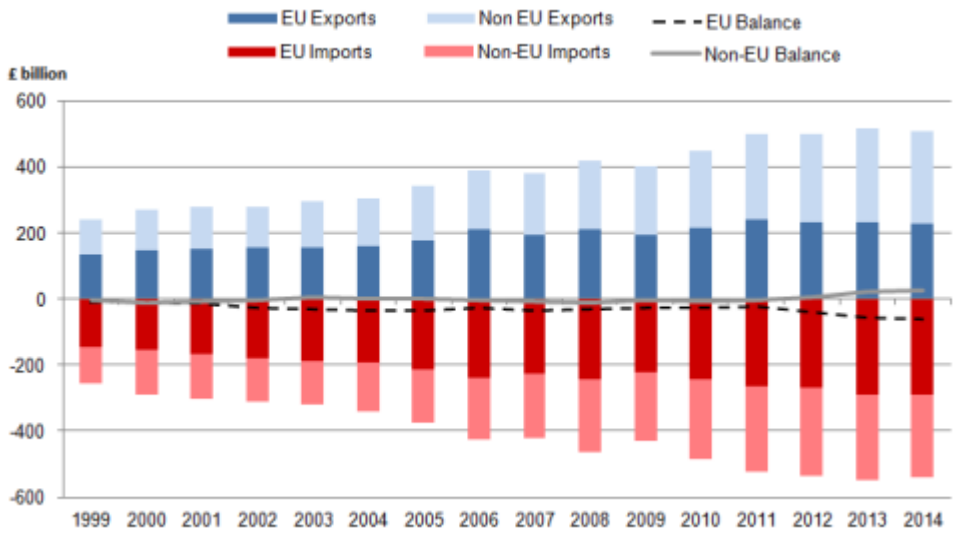
Brexit: utopia, dystopia or PONCE?

written by Clive Bates | 12 March 2016



UK trade with EU (ONS data): interdependency will create massive pressure to preserve the status quo

Updated 29 May 2016

Okay, here are some thoughts on 'Brexit' (British exit from the European Union), which is the subject of a UK referendum to be held on 23 June 2016. I've added a discussion on implications for vaping and the TPD.

- The Brexit Utopia
- The Brexit Dystopia
- Utopia or Dystopia? 12 reasons why it is a dystopia
- An alternative: PONCE – Policy of Non-Capitulation in Europe
- Long term reform agenda
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My view… there is a lot to dislike about the EU: it can be unaccountable, incompetent, over-reaching, arrogant, lawless, captured and dishonest. The more you have to do with it, as we saw recently with the EU Tobacco Products Directive, the more appalling it looks. We witnessed the unedifying spectacle of the amateurish drafting of incompetent but irreversible legislation that will affect millions with no apparent concern for science or evidence while blatantly disregarding even the modest procedural requirements of the EU treaties to consult, prepare impact assessments and minimise burdens. Is anyone

accountable? If everyone is, no-one is.

So why am I in favour of the UK remaining in the EU?

Why Eurosceptics should vote to stay in (the 30-second version)… many people are in favour of leaving the EU because they don't like the EU – fair enough. But they are implicitly assuming that Brexit would remove what they dislike. This is unlikely to be the case. The reality of Brexit would be formed through the suffocating mechanics of trade negotiations, not by walking away from trade relationships. Powerful interests such as major employers will favour maintaining the *status quo* to the greatest extent possible, and this will push us towards a form of exit that actually looks like entry to the European Economic Area and the European Free Trade Agreement – "the Norway option". The EEA comes with everything that euro-sceptics dislike about the EU, but no influence – so it is worse than staying in. A far better approach for Eurosceptics is to remain in and argue for reform from within, through rigorous application of the principles of the EU treaties – a Policy of Non-Capitulation in Europe. The alternative is far worse – severing ties with the EU completely, and inflicting massive self-harm economically and politically.

The Brexit Utopia

With Brexit, so the argument goes, we will be free of Europe's asphyxiating bureaucracy, ludicrous rules, and wasteful budget contributions. Unwanted foreigners will disappear, and the flow of ~~useful plumbers, builders, hospitality workers and fruit pickers~~ opportunistic economic migrants will cease.

Our trading outlook will be global, our parliament will be sovereign, our borders will be secure, and we will once again punch above our weight in international affairs. Hateful EU legislation will be consigned to a giant skip outside the Palace of Westminster where our newly empowered and democratically accountable representatives will toil over refashioning UK regulation along liberal, small-government lines. We will be victorious, happy and glorious, and the EU will no longer reign over us. God Save The Queen.

The Brexit Dystopia

Hmmm… the problem with Brexit is that it is very unclear what it will actually look like in reality: "*we just don't know the counterfactual. No-one does*" as a civil service friend put it while we were discussing it recently. I know the statement above is a caricature, but we can be certain of one thing: *Brexit in reality will look nothing like the visions of the Brexit enthusiasts*.

A tale of two Nigels: even Brexit supporters differ radically in their expectation: some want a buccaneering free trade liberalism (Nigel Lawson), other a more protectionist Little England (Nigel Farage). Which is it? The trouble with not having a clear view of Brexit looks like it has allowed opportunistic politicians (or the cynically self-interested) to paint their own dreamy utopian ideas onto a blank canvas, notably the odious Boris Johnson (see Liar, conman – and prime minister? – Nick Cohen and here, here, and here).

To get a feel for what Brexit will actually be like, we need to sense how the various negotiations would play out in reality. Those negotiations will be a Herculean bureaucratic undertaking (see UK govt guide) thrashed out in grim negotiating rooms between people under orders not to give an inch and unhappy to be there. Some call this 'Project Fear', but as Anatole Kaletsky points out in *Prospect*, there's a lot to be said for being fearful of things that will hurt you.

So how will it go… consider the following 12 points:

Utopia or Dystopia? 12 reasons why it is a dystopia

1. The EU has incentives to make Brexit painful for the UK – the 'Norway option'

The remaining 27 members states have strong incentives to ruthlessly protect the integrity of the rest of the EU and to make exit difficult and painful for the UK, *pour encourager les autres*, to deter future exit threats and related calls for special treatment (see France's plan for a bloody Brexit). Under the terms of the exit provisions (article 50) of the EU Treaty, the 27 will run the negotiation and be in a position to dictate terms and, frankly, to be awkward. They will have more pressing things on their minds (refugees, Euro stability, Russia, etc) than making

life easy for the nation state that is walking out on them. They will protect their own interests at all times, try to capture businesses fleeing from Britain and administer a punishment beating wherever they can. Their incentives (and UK's) will be to maintain the status quo with the least effort – i.e. the easiest option for everyone is that UK joins the European Free Trade Association (Iceland, Liechtenstein, Norway and Switzerland) and trade with the EU through the European Economic Area (EU member states plus Norway, Iceland and Liechtenstein) – dubbed the "Norway option" by Brexit supporters who, amazingly, think this is a good idea. But the Norway option (and agreements like it) will mean: accepting EU migration; paying into the EU budget; accepting single market regulation; facing tariffs where there is no alignment (e.g. farming); accepting EFTA's 3rd country trade agreements where they exist – but having no say in EU policy-making or legislation. Ian Birrell's report from Norway is a good introduction to this. I can't think a more self-defeating approach. Why is this the inevitable course of Brexit? Read on…

2. The Faustian bargain – single market access comes with EU regulation

Unfettered access to the single market will come at a price and that price will be compliance with EU single market legislation and common commercial policy. We can choose full access to EU markets or to reject EU regulation, but not both. The more we want access, the more we will have to comply with EU regulation. The EU would soon fall apart if it didn't require this – it cannot allow every member state to write its own rules for participation in the single market: why wouldn't every country want to do that? We can choose more EU access if we accept more EU regulation (like the EEA) or less access and less EU regulation if we just revert to a WTO-based relationship with the EU, or perhaps we sign on to the Trans-Atlantic Trade and Investment Partnership or something in between, like the agreement with Switzerland. Or how about something modelled on this 2014 preferential Deep and Comprehensive Free Trade Area agreement with Ukraine? It eliminates nearly all tariffs, but…

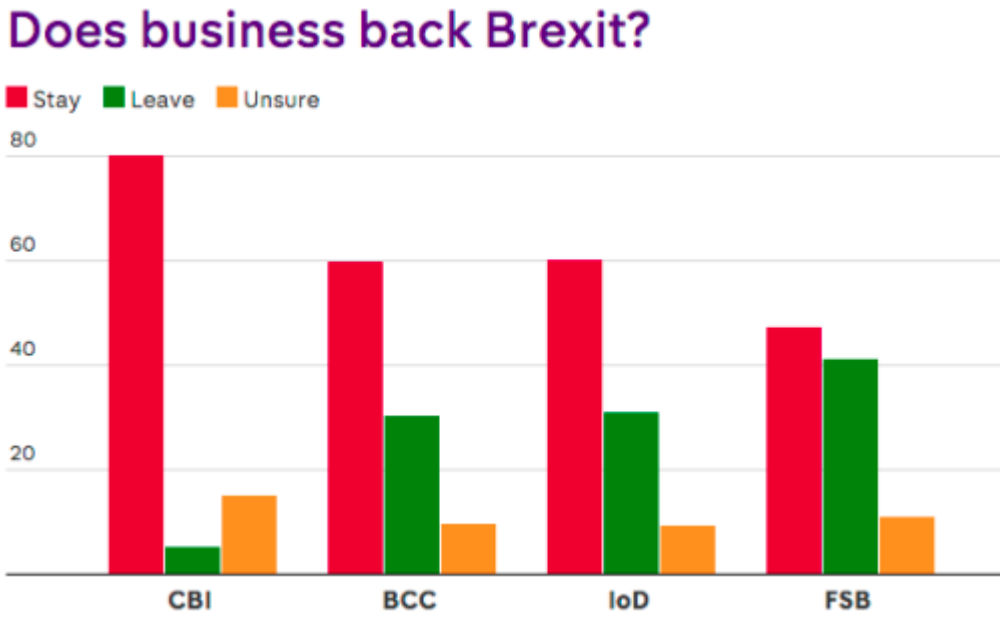
> *Ukraine will progressively adapt its technical regulations and standards to those of the EU. Future negotiation of an Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA) will provide that in specific sectors covered by it trade between the Parties will take place under the same conditions as between the EU Member States.*

So a bilateral trade agreement could be anywhere on a sliding scale – with EU single market access and obligation to implement EU regulation moving together. So what will it look like in reality?

3. Powerful UK lobbies will support the *status quo*

So let's just think how that will play out. We could just ignore the EU and look outwards, but that's not going to happen. 45% of UK exports go to the EU, so we will have a massive and potent lobby of firms and workers who depend on trade with the EU, and they will be pressing the government to retain unfettered access to the EU single market. We also have firms with complex supply chains spread across Europe and staff spread throughout the EU – think of Airbus or Toyota – how would they be helped by a trade barrier between the UK and the rest of the supply chain? This compares to the currently non-existent lobby of hypothetical future businesses and jobs that might arise if we one day rustle up more business in India, Indonesia or Indiana somehow because we left the EU – even though nothing stops this business now. So the government will be under immense asymmetric pressure to keep our access to the EU pretty well as it is – and strike the bargain at the high-access, high-regulation part of the sliding-scale of choices (i.e. favour something like the European Economic Area). And remember, Germany trades very successfully with the rest of the world while being inside the EU – the problem with UK lacklustre trade performance is not down to the EU.

And so let's take a look at where business stands. Channel 4's Fact Check service surveyed the polls of business opinion: FactCheck Q&A: does business back Brexit?



No, business does not back Brexit. By a big margin, it wants to stay in, especially big business but all sizes too – the CBI's considered view described here: *Brexit: the business view*. And note this is not the special pleading of the City of London, but the nation's major employers. So in the event of Brexit, what will this powerful lobby do? It will try to keep things as much as possible the same as staying in, which is its real preference. So they will favour something like membership of the European Economic Area. It would be a brave government that ignored the nation's employers and raised barriers to trade with Europe – Old Etonians putting the workers to the sword. That'll go down well in 2020.

4. Powerful EU lobbies will also support the *status quo*

But also, the same would apply to the EU as the counterparty. It is sometimes argued that the high level of exports from EU to UK will make the EU more pliable. Actually, the high level of interdependency is a huge incentive for the incumbent beneficiaries to *keep things exactly as they are*. And it's not just German car makers that will want no change, there are the UK-based importers and retailers of EU goods and services, and they will be in the lobby for no change. Although in 2014, EU exports to the UK (£288b) were greater than UK exports to the EU (£227b), these account for 45% of UK exports but only 6% the exports from the 27 member states to UK (or 16% if you take the EU-27 as a bloc and ignore the intra-EU trade). So the negotiating position will be asymmetric, but interests will be strongly aligned with keeping the *status quo* (i.e. something like the European Economic Area) (see ONS for data)

5. UK will lose future single market opportunities

Actually, Britain's global speciality is in *services* – what Britain needs is more single market, not less – we have been pushing for more effort on the single market for services for years. We would be abandoning that. Also, trade in services usually means more migration as services are delivered by people and rely on expertise.

6. Legislation and regulation will not change much even if we have the flexibility

Thousands of pages of EU legislation have been agreed under European Communities Act 1972, and everything else from Brussels is grounded in other primary legislation or applies directly. My guess is a tweak will be made to the European Communities Act, so that everything agreed under it in the past five decades stays on the statute book by default. The only laws anyone will be willing or able to change will be those that *have to be changed* – i.e. those necessary to disentangle the UK from the EU and to reset relations with third countries – and that could be a lot.

But where might we want to do away with hated EU regulation? When the Cabinet Office reviewed EU law in the UK (Balance of Competencies Review) – unsurprisingly, they didn't find too much to dislike. I say unsurprisingly, not because there isn't incredibly poor EU legislation, but because *our officials and ministers negotiated and agreed most of it.* They were marking their own homework and awarded themselves a gold star. So, remember, the bureaucratic substrate in government departments will defend their record in agreeing on past legislation. So they are unlikely to open the drains and start with a blank slate. The official starting point is: *there isn't much wrong with EU regulation (because we wrote most of it)*. So why would they negotiate away access to the EU in order to change regulation they aren't that concerned about? If we aren't going to change that much, why not join the European Economic Area?

7. Redoing trade agreements is a pointless labour which will have worse results

So as we turn our back on Europe we will no longer benefit from EU bilateral trade agreements and will have to start again with the countries that the EU has agreements with – either in force or under negotiation (there's a lot of those). Whitehall does not have the capacity to renegotiate all the hard-fought EU

bilateral deals currently in force and the counterparty nations are unlikely to see it as a priority to negotiate bespoke deals with the UK (e.g this one between EU and Canada runs to 1,600 pages) and the Americans say they have ruled out a UK-only trade deal. They might opportunistically use our weakened position to push against some forms of protection we have 'enjoyed' in the EU or to reinstate protectionist measures they removed in negotiations with the EU. Would our bilateral agreements be better than the ones we have through the EU? I very much doubt it. Luckily, many trade agreements are available to members of EFTA, the European Free Trade Association (Norway, Iceland, Liechtenstein and Switzerland) – so I suspect UK will try to rejoin EFTA. We will also find it difficult to negotiate any trade deals until our arrangement with the EU is settled and our obligations as part of that agreement are clear. The chances are we'll end up signing agreements almost the same as the EU would negotiate anyway.

8. A customs union would fetter UK relationships with the rest of the world

Agreement with the EU that gives open access to EU markets will also require membership of the European Union customs union (like Turkey). That would mean the UK will not be able to negotiate bilateral free trade agreements with third parties (e.g. China or Canada) because these will effectively create a conduit into EU markets for the third party on terms that may not be acceptable to the rest of the EU. So the EU has a trade agreement with Canada and we'll assume under Brexit, UK has a trade agreement with EU. It follows that UK can't have a more liberal trading arrangement with Canada than EU has with Canada. If we wish to have full access to the EU markets with complex customs checks and 'rules of origin' procedures, then we will have to have the same trade agreement with Canada that the EU has – that's just logic, not politics. These issues are particularly acute at the Irish border.

9. Foreign investment at risk as political uncertainty rises

We are closely linked to the EU through foreign direct investment (FDI) and the UK is attractive in part because of its foothold in the EU.

> *The UK had the third highest stock of inward FDI in the world in 2014, behind the US and China. In 2014, EU countries accounted for just under half the stock of FDI in the UK (£496 billion out of a total of £1,034 billion, 48%). This*

compares with 24% from the US and 28% from other countries. The share accounted for by the EU has fluctuated between 47% and 53% over the last decade. In terms of UK investment abroad, the EU accounted for 40% of the total UK FDI stock in 2014.

Source: House of Commons Library briefing UK-EU economic relations

How does Brexit help with a decision to locate a factory in Middlesborough rather than Hungary? One advantage the UK has in FDI is the combination of English language and unfettered access to EU markets – we offer third countries a friendly beach-head from which to trade into the EU. In a vote for Brexit, we will be in turmoil from June 24th for at least two years while exist negotiations go on. Then a possible further ten years as we negotiate trade arrangements with other countries or blocs. All this time, Britain is 'risk on' for foreign investors. The effect of this political/regulatory risk may not emerge as existing factories closing on 24 June, but it's the future investment decisions we should be concerned about. And what about operations that are marginal now – when companies decide where to cut, will Britain be the place to do the cuts? The political classes may think Brexit would be good for cocking a snook at Brussels, but they need to keep in mind places like Tata's loss-making steel plant in Port Talbot – that's one example of many places that do not need any further reasons to be closed down.

10. We might save a bit on the EU budget but not much – but that isn't the point

The various interest groups that have grown fat at the teat of the European cash cow are all predicting the end of the world if there is Brexit. Of course, that is nonsense. I have argued at length (Buddy can you spare a trillion?) that most of what is spent in the EU budget is either a waste of money or ought to be spent within the UK and not funnelled through Brussels. There is no case for net transfers between EU member states either – that is something that should be reserved for really poor countries and disasters. But the beneficiaries, notably farmers and 'the regions', will argue that the losses they incur from the EU budget will have to be replaced by domestic UK spending. We should also assume that we will have to pay something into the EU budget as well. Leaving would also create a demand for UK to pay off any liabilities it has – for example, pensions or existing commitments to make future payments.

The real issue is not savings on the EU budget (which are much lower than Leavers say because of the rebate and the fact that some money is spent in the UK and we would need to spend to duplicate some things Europe does for us), but what leaving the EU would do to the public finances. A weaker economy would reduce tax revenue and increase public spending on unemployment, and these changes may dwarf any savings on the budget. If you think the NHS is going to get £350m per week, prepare to be disappointed – it is the net change in public finances that determine how much more *or less* is available to spend on things the British public like.

11. UK's ex-pats limit room for manoeuvre on migration

The estimates vary, but between 1.3 and 1.8m Brits live in other EU countries – notably in Spain, Ireland, and France. Think of these British ex-pats as hostages in the Brexit negotiations. Any rights the UK secures for them – for example, to remain where they are or to benefit from healthcare where they are, will require a reciprocal right for EU citizens to remain in the UK and benefit similarly. I can't see any reason why we would deny ourselves the amazing productivity-boosting influx of economic migrants, but just wait until London's professional elites discover they are to be denied their cleaners, nannies, plumbers, and builders… another powerful lobby for the *status quo* will form faster than you can say "*dzien dobry*". What will we do about those sectors of the economy that rely on migrants – fruit picking, farming and food, hospitality, construction, some public services, and some high tech sectors, and the highly internationalised financial services sector?

12. Ireland, Scotland, and Gibraltar

Yikes! Brexit could be highly destabilising refuelling demand for Scottish independence, creating a hard border between Ireland and Northern Ireland, and giving Spain leverage over the future of Gibraltar – more lobbyists for maintaining the trade and regulatory *status quo*. EEA here we come.

Utopia or dystopia?

To summarise, if we approach Brexit as a matter of realpolitik rather than wishful thinking, it doesn't look anything like as promising as its protagonists insist. The likely Brexit outcomes will have the following characteristics:

- no seat at the table – ‘policy by fax’. The Norway option is dreadful
- agreement to implement almost all EU regulation
- paying into the budget and buying off Europe-funded UK interests
- government paralysis for two to five years and possibly longer
- a worse climate for investment and heightened political risk
- limited changes in migration but not in any especially useful way

Norway, basically. Humiliating, pointless, costly and self-harming. So even if you don’t like the EU – as I don’t – Brexit just makes it worse.

The alternative: PONCE or Policy of Non-Capitulation in Europe

You may be quite fed up with the nihilistic tone of all this. Sorry about that. But I think there is a better way than Brexit – and that is to become the bad-boy within the European Union. And by bad-boy, I actually mean good-boy. It just won’t make us popular with some of the more rampant federalists.

I won’t bore you with reflections on what happens to UK officials and politicians when they pass under the English Channel, but there is a Brussels insider culture that is ripe for some bracing disruption. I think we place too much emphasis on doing deals – getting *something* agreed – and not enough on making good agreements and only where necessary. Rather than leaving, the UK should become the fundamentalists about the key principles of the EU treaties, aiming to do much less in Europe but much better. We should have a **Policy of Non-Capitulation in Europe**, in which we stick to the core principles by which the EU is supposed to operate. but rarely does.

To capture what I have in mind, I think everyone representing the UK on EU matters should be issued with a small card with the following pledge:

PONCE: Cut out 'n' keep

And if it doesn't meet these criteria, then our representatives should *always* oppose it and try to win over fellow EU member states. End of story. No deals. No fudging. Not doing the deal is a win in this world. I think we would soon attract a following of liberal North and Central European states and this would point the way to a modernised, less intrusive and more respected European Union. Update: a friend suggests we sharpen this by a willingness to take PONCE-fails to the Court of Justice, *on principle*. I add the further suggestion that we publish legal advice if measures don't comply.

No doubt there are people who will guffaw and say we do all that anyway. But we don't. Were *any* of these questions even asked, let alone answered in the case of the TPD Article 20? Emphatically no – they just can't have been or it wouldn't be such a mess. The approach was to seek an agreement at all costs and figure out how to accommodate all the idiosyncratic (i.e. bonkers) positions of member states and MEP groupings no matter what it meant for businesses, free trade, consumers and public health.

Longer-term reform

I think the Prime Minister's efforts at reform were too narrow and lacked ambition – and the time to get them agreed. Longer term (over several years), we should aim for deeper reforms to the EU – but from inside. Here are a few ideas…

- Narrowing the focus of EU activity to issues that *require* coordinated international action and reversing scope-creep
- Curtailing the Commission's power of initiative – e.g. the Council should

request legislative proposals by QMV
- Reducing the number of Commissioners and directorates-general
- Much stronger 'better regulation' challenge for new regulation
- A better mechanism for member states to challenge defective regulation or some sort of 'red tape challenge' system
- Eliminating the CAP and structural funds (most of the budget) within three 7-year financial frameworks
- Relying on the European Investment Bank and European Bank for Reconstruction and Development for developing poorer parts of the EU – not net transfers through the EU budget
- Relying more on domestic political scrutiny of EU measures than on the more remote European Parliament (UK reform)
- Developing associate membership status for countries on a long road to full accession
- Electoral reform for European Parliament elections to create a better relationship between MEPs and citizens
- Almost forgot and added later: get rid of the absurdly wasteful split between Brussels and Strasbourg.

Case study: Brexit and vaping

And with one bound they were free!

Many vapers hope Brexit would free them from the ludicrous Article 20 of the EU Tobacco Products Directive. I don't think it would. Here's how I think it would go.

- We are likely to negotiate a settlement that requires compliance with single market regulations. So we could leave the EU and still have the TPD, with no say on its future. This is not certain but the most likely outcome in my view (see above). **Whether we exit or remain, the most likely outcome is continued TPD compliance indefinitely through some arrangement like the EEA**.
- Even if we don't have to have the TPD after Brexit, we will definitely have it over the crucial next few years while our exit is negotiated (process). The EU Tobacco Products Directive comes into effect 34 days before the referendum and would remain in force while we negotiated a withdrawal agreement. The treaties cease to apply when that withdrawal agreement enters into force or no later than two years after notification. There are

two possible flexibilities in this – the length of time after the referendum that UK notifies the EU and extension of the two years by agreement with the other member states. So we will have mandatory TPD compliance for *at least* two years and possibly much longer – any damage and rationalisation of the market will take place over that period.

- Even if the UK can change it after a few years, I doubt we will. Why would this be a priority in the UK when Parliament is likely to be jammed up with legislation that has to be changed and civil servants and ministers overwhelmed with sorting out more pressing exit conditions?
- Even if we could change the TPD and did, would it make much difference? I doubt it. Tobacco/nicotine policies have a habit of going in one direction only and being indifferent to evidence. Look at the snus ban, for example – supported by the UK.
- The UK is now among the more progressive voices on tobacco harm reduction – its influence would be lost on a subsequent reform of the TPD. If we have to comply anyway (by law or by default), we really need more progressive voices in the room as this directive evolves.
- By the time we could get something other than the TPD it could be time to review the directive anyway (report under Article 28) – that has to be done no later May 2021. It would be better if the UK was in the room as the next iteration of the directive was formulated. It

Case study: a historical note – UK vs EU on vaping

Rescued by the European Parliament… Among the worst ways to regulate e-cigarettes would be to treat them as medicines – doing this would have wiped out almost all the market leaving a few tobacco companies standing, with products designed to please regulators rather than customers. Yet this was the policy of the UK government from 2010-2013. But the only reason we don't have mandatory medicine regulation for e-cigarettes in the UK is because this policy was reversed in the *European Parliament* on 8 October 2013, after a brilliant pan-European lobbying campaign by vapers.

Unaccountable UK… The UK was planning to adopt medicine regulation irrespective of the EU but was influential in promoting medicine regulation as the EU regime of choice for vaping. Our own Westminister parliament would not have

even been asked (and if it had been asked, it would have agreed): it would have been an administrative decision by the MHRA to interpret the Medicines Act to apply in this way. And as noted in the comments, the UK has a poor record on drug policy more generally – see this critique of the New Psychoactive Substances Act.

Why is the tobacco products directive so poor? One reason, perhaps the main reason, why the TPD is so dire is that the entire deliberative legislative process was consumed and wasted arguing over the UK-promoted and the Commission-adopted idea of regulating e-cigarettes as medicines. The efforts required to overcome fundamental misunderstandings meant there was no space to discuss what should be done in a rational regulatory regime – and the actual TPD Article 20 was all cobbled together in few secret amateurish political meetings after the medicine proposal was defeated. Responsible member states should have pulled the e-cigarette proposal out of directive and called for a careful rethink. Where was the UK urging caution and moderation? It wasn't.