

The emerging contours of a post-Brexit Britain¹

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Little more than six months after the historic June 23rd 2016 Referendum that lit the touch paper on arguably the most profound reshaping of the politics and economics of the United Kingdom in the modern era, the *Oxford Review of Economic Policy* published a collection of papers on the Economics of Brexit. Our aim at that point was to “bring economic analysis to bear on the main issues [of Brexit]...at this extremely early stage of what is likely to be a very long process.”² The analysis in those papers was primarily focused on the implications of disengagement from the European single market and the economic impact of new arrangements for the trade in goods and services and for changes to the free movement of labour. But we also recognised that Brexit would necessarily reset arrangements across a much wider canvas including law, taxation and regulation, public infrastructure policy, regional and industrial policy, and was expected to have wide-ranging implications in areas such as financial services, agriculture and fisheries, energy and climate change and higher education.

In this issue of the *Review*, published exactly five years later, we revisit many of the same themes – and we do so with many of our original authors. What is striking is that while much has changed since the Referendum, many of the insights from our authors’ initial ‘first draft of history’ papers were highly prescient, despite having been published more than two months before Prime Minister Teresa May triggered Article 50 of the Treaty on European Union (2007) which formally launched the exit process. At that point, the Referendum had provided the government with a mandate to leave but the manner of the departure and the form of the final post-Brexit arrangements remained highly uncertain and highly contested.

After a protracted and often unedifying political process, the Conservative government under Prime Minister Boris Johnson eventually declared it had ‘got Brexit done’ and the UK finally departed from the EU at 11pm (midnight in Brussels) on 31st December 2020.³ We are now a year into ‘full Brexit’ and while much of what can be said about its effects remain tentative – we are still a long way from ‘final drafts’ of history -- the contours of a post-Brexit settlement are beginning to emerge. The Trade and Cooperation Agreement (2020) -- the TCA -- codifies the main elements of the post-exit landscape including arrangements for trade in goods and services, the institutional arrangements and dispute settlements, the mechanisms for cooperation in law enforcement and judicial cooperation. As we go to press, transitional arrangements are still in place across many elements of the TCA, other parts of the Agreement, particularly those on the Ireland/Northern Ireland Protocol, continue to be contested, while large swathes of policy that have been brought back under national jurisdiction, such as agriculture, are still incomplete. Nonetheless, there is now greater clarity across much of the post-Brexit policy landscape and hence a more precise sense of direction.

¹ I thank Simon Quinn, Alex Teytelboym, Ken Mayhew, Isabel Ruiz and David Vines for comments on an earlier draft.

² “The economics of Brexit: what is at stake?”, *Oxford Review of Economic Policy*, vol 33 (S1) 2017, pS1.

³ House of Commons (2021) “Brexit timeline: events leading to the UK’s exit from the European Union” House of Commons Briefing Paper No 7960, 6 January 2021.

But as many have noted, the deep divisions exposed by the Referendum were as much a reflection on the fractured state of the UK as a nation as they were a vote on the UK's relations with the institutions of the European Union. As a result, the political debate on Brexit in the years since 2016 has increasingly been conflated with the domestic 'levelling up' agenda and with debates on regional policy, foreign policy, international relations and international aid. It has also had a profound impact on relations between the UK and Ireland, and between the Westminster government and those of the devolved authorities in Scotland, Wales and, most notably, Northern Ireland.

This duality between the direct and indirect economic consequences of Brexit is reflected in the papers collected here. A first set of papers is concerned with the immediate consequences of choosing to abandon the 'four freedoms' enshrined in the Treaty of Europe, the free movement of goods, services, capital and labour across the EU. The second cluster is concerned with the indirect effects of Brexit, those areas opened up by the Brexit decision where the substance is not about re-defining the relationship with Europe per se but re-defining areas of domestic policy, either those competencies that had previously been delegated to the EU or areas where exit from the EU has altered market conditions. Finally, we also include two essential papers that consider some of the deeper political implications of Brexit, on the balance of domestic political power between the executive and the legislature and on the complex and enduring relations between the UK and Ireland.

The full effects of the changes wrought by Brexit will clearly not be felt for many years, and even then the task of disentangling the impact of Brexit from the effect of other concurrent changes in the national and global economy will be extremely difficult. In more normal times, it might have been easier to say something definitive about the short-run costs and benefits of exit. But timing is everything: on 31st January 2020, just a week after the European Union (Withdrawal Agreement) Act 2020 received Royal Assent, the World Health Organization declared a global health emergency as the Covid-19 pandemic began to spread outwards from Wuhan, China. By the time it fully departed from the EU 11 months later, the UK, and much of the rest of the world, was in the grips of a second and aggressive lock-down.

This has at least two consequences for an assessment of the economics of Brexit. The first is that the pandemic (rightly) drew attention elsewhere. As a result -- and in contrast to the almost paralysing preoccupation with Brexit during the 'phoney war' phase from the Referendum to the beginning of the transition period in January 2020 -- the entire transition period and for much of the UK's first full year outside the EU more or less slipped under the radar, not just in terms of public and parliamentary scrutiny but more importantly in terms of bureaucratic focus and actual policy implementation.⁴ While disputes around fishing arrangements between France and the UK and around the Northern Ireland protocol have recently resurfaced, Brexit and its economic consequences were strikingly absent not just from the Chancellor's Budget in October 2021 but also from UK political debate in general.⁵ Whether inattention and delay at the early stages of planning and implementation matters for the longer-term effect of Brexit beyond the negative effects of the persistence of uncertainty is, however, hard to tell.

⁴ See UK in a Changing Europe (2021) "Brexit and Beyond" (<https://ukandeu.ac.uk/wp-content/uploads/2021/01/Brexit-and-Beyond-report-compressed.pdf>)

⁵ See for example Anand Menon, *The Guardian* 10 October 2021 (<https://www.theguardian.com/commentisfree/2021/oct/10/seldom-mentioned-but-influencing-everything-why-are-so-many-afraid-of-the-b-word>)

Second, robust identification of even the early impacts of Brexit is fraught with difficulties as all standard measures of impact, whether in terms of economic activity, employment, trade, investment and public finance, have been hugely affected by the pandemic and associated lockdown and support measures. The identification challenge is arguably most acute in assessing the impact of the end to free movement. Superficially, the emergence of severe labour shortages in transport, agriculture and key professionals in health and veterinary services – all areas which historically employed substantial numbers of European workers – and the associated disruptions to trade and logistics would appear to point directly to the Brexit-related end of free movement. These ought to be the data on which the size of the ‘treatment effect’ of Brexit should be estimated. But Covid-19 (and the broadly correlated emergence from lock-down) has shocked labour supplies and disrupted supply chains and logistics across the whole of Europe and the rest of the world. So, while at the time of writing, shortages of goods and labour and supply-chain disruptions do appear to be more severe in the UK than many other countries, they are clearly not unique, so that any plausible decomposition is difficult. Nonetheless, best-estimate official forecasts of the long run impact of Brexit on the UK made by the Office of Budget Responsibility in October 2021 suggest a decline in long-run potential output of around 4%, reflecting lower productivity growth due to the reduction in trade intensity with the EU. This compares with their estimated long-run output loss from the scarring effects of the pandemic of 2% of GDP.⁶ These estimates remain highly contingent and the challenges of attribution will remain central components of the economic research agenda for the coming months and years.

Renegotiating Trade and Labour Market Relations with Europe

The centrepiece of the TCA is the reset of the way in which the UK trades goods and services with Europe and hence the rest of the world, and how the end to free movement reshapes the labour market. On the trade side, three features stand out. The first, as noted by Bennett and Vines (this issue), is the observation attributed to Pascal Lamy, former Director General of the WTO, that the TCA has emerged from a unique trade negotiation in which both parties started off from a position of free -- and more-or-less frictionless -- trade and discussed what barriers to erect. The second, as Fusacchia et al (this issue) note, is the TCA ultimately reflects a ‘shallow trading relationship’ with the EU, similar to, but rather more restrictive in key areas than, the EU-Canada Comprehensive Economic and Trade Agreement (2014).⁷ While the TCA provides for the elimination of all tariffs and quotas between the UK and EU, these freedoms are conditional on firms satisfying new and complex rules-of-origin (ROO) requirements as well as facing a range of other non-tariff barriers to trade. Thus exporters (and importers from the beginning of January 2022) face the EU’s standard customs procedures applied to all countries outside the single market; they must satisfy explicit EU-approved testing and certification standards, which in the context of phyto-sanitary standards have already been seen to be expensive for exporters of fish, live animals and food; while the removal of previous single-market freedoms on air and road transport, including the relatively permissive rules on cabotage and related multi-destination haulage, has had profound consequences for logistic and distribution firms, many of whom have already responded by relocating much of their operations to the EU. Third, the TCA provides rather little on trade in services, including trade in financial services.

⁶ “Economic and Fiscal Outlook” Office of Budget Responsibility, October 2021 (CP545)

⁷ Despite repeated claims that ‘getting a Canada-style deal would be straightforward’, as many commentators have noted, the relative size of the UK, its proximity to the EU and its much deeper links through global supply chains, meant that the EU was never going to provide quite the same freedoms as offered to Canada.

Financial ‘passporting’, under which financial institutions regulated in one EU country – including third country institutions such as US investment banks in London -- were able to trade from that location across the EU, has been removed. There is provision for the EU to provide time-limited ‘regulatory equivalence’ on a unilateral basis but with the exception of a couple of small and short-lived arrangements, widespread equivalence is unlikely to emerge, particularly following the Chancellor of the Exchequer’s Mansion House Speech in 2021 (Sunak, 2021)⁸ that hinted at greater regulatory divergence between the UK and EU. (see Hall and Heneghan, 2021).⁹ UK financial services will therefore be treated on the same basis as other non-EU members: in other words, a ‘no-deal’ Brexit for services.

Aspects of the trade and labour market provisions of the TCA are addressed in a first cluster of papers. **Ilaria Fusacchia, Luca Salvatici and L Alan Winters** seek to address the central empirical question of the impact of the changed trade landscape for the structure of UK trade and production. Using a calibrated comparative-static computable general equilibrium model that captures the input-output structures underneath UK trade and production, they provide an important sighting shot on how the increased costs associated with the TCA will induce a significant shift (both for imports and exports) from trade with the EU to extra-EU trade. Not surprisingly, those sectors most exposed to trade with the EU, such as the vehicle sector, certainly suffer disruption, but their model shows how the adverse trade cost shock is transmitted more widely through the input-output. In other words, by focusing carefully on the value-added structure, the consequences are far wider than an analysis of gross trade flows would suggest. The higher costs of UK-EU trade relative to their pre-Brexit regime generates an adverse terms-of-trade transfer from *both* the UK and EU to all other countries (which, given the structure of trade, is borne predominantly by the UK), but at the same time there is a further inefficiency loss due to the diversion of trade as European regional trade integration is reduced. Again, according to this model, these costs will be borne disproportionately by the UK.

Alexander Davenport and Peter Levell of the IFS adopt a similar input-output based approach but in their case they seek to examine the impact of the same TCA non-trade barriers on employment and wages relative to the pre-Brexit situation. Not surprisingly, as with trade flows, earnings are more likely to be adversely impacted in the most trade-exposed sectors. But the relative hit to wages tends to be increasing across the earnings distribution – reflecting the skill bias in UK-EU trade – and, for the same reasons, skewed towards male workers.

These papers provide important general equilibrium insights on how the core provisions of the TCA are likely to affect incentives for trade and employment in the short- to medium term. But their comparative static framing means they are necessarily silent on how induced changes in investment, technology and productivity growth between and within countries and sectors, will play out. It is, of course, these dynamic factors which will ultimately shape the post-Brexit landscape.

The key driver in both these papers is the role of non-tariff barriers. **Adam Bennett and David Vines** are concerned with the potential distortions associated with the non-tariff measures including rules of origin that limit third-party content in goods traded between parties to the FTA as well as other regulatory requirements, limits on cabotage and so forth. They argue that while these regulatory

⁸ <https://www.gov.uk/government/speeches/mansion-house-speech-2021-rishi-sunak>

⁹ Sarah Hall and Martin Heneghan (2021) “Brexit and Financial Services: five years on” Commentary “UK in a Changing Europe” (<https://ukandeu.ac.uk/brexit-financial-services/>)

mechanisms are intrinsic to the design of free-trade arrangements, compared to fully integrated single markets, they may be abused as instruments of protectionism in the new emergent UK-EU trading system. They make a bold argument for a re-crafting of the rules of origin (and administrative NTBs) between the EU and UK in order to distinguish their legitimate role in supporting the post-Brexit free trade arrangement, and their deployment as indirect instruments of protectionism.

The counterpart to the new trade arrangements is the end of the free movement of labour within the single market and its replacement with a new bespoke immigration system. **Jonathan Portes** provides an overview of this system and of the changing pattern of migration since the Referendum, including the sharp reduction in net migration from Europe. Portes makes the point that the new system, in itself, does not necessarily imply a tightening of immigration into the UK but rather rebalances the system from one which was “...essentially laissez-faire for Europeans, while quite restrictive for non-Europeans, to a uniform system that, on paper at least, is expensive but has relatively simple and transparent criteria, and covers up to half the UK labour market...” Assessing the effects of this system is, however, extremely challenging at present as its introduction was almost perfectly coincident with Covid-19 related lockdowns which led to a dramatic exodus of foreign workers from the UK, both to the EU and elsewhere. It remains unclear whether these workers will return as lockdown eases – and the short-run evidence in the final quarter of 2021 suggests not -- and to what extent substitution of EU workers by those from the UK non-EU countries will ease labour shortages.

Regardless, one of the key questions around the new system concerns the basis on which work visas should be issued and how, in particular, policy should respond to labour shortages: in short, as **Madeline Sumption**’s paper discusses, can policy makers appropriately read labour market conditions and from them identify an optimal degree of tightness in labour markets? Put differently, how should they strike the balance between, on the one hand, recognizing that some degree of labour market tightness generates incentives for training, re-skilling of domestic workers and investment in labour-saving technology, and on the other setting broader set of criteria for entry that emphasise the social return to certain groups of workers?

Complementary inputs: the indirect effects of Brexit

The second group of papers in this issue are concerned with those areas of domestic public policy that are now up for grabs post-Brexit but where the outcomes will play an important role in determining the impact of the direct trade and employment effects of leaving the single market. The domestic policy areas that are ‘opened up’ in this way are vast, including both those competencies that had previously been delegated to the EU and areas where the end of engagement with the single market has altered market conditions at home. Here the papers discuss changes to tax policy and to the framework for public infrastructure investment; the implications for regional policy and for state aid. They also consider implications across three key sectoral areas, agriculture, energy and higher education.

Given the breadth of coverage we cannot do justice to the full richness of these papers here, but a number of important themes emerge. First, in many areas, progress in implementation has lagged, whether because of a failure to appreciate the technical challenges of designing new legislation, because of genuine political contest over the stance of policy, or simply because of the displacement effects of the Covid-19 pandemic. We see this across many of the areas discussed here. For example, as described in the paper by **Dieter Helm**, key elements of the new Environmental Land Management

System (ELMS), the replacement for the EU Common Agricultural Policy, are still being piloted with a full roll-out of new structures only likely to occur over the next three to five years; in the interim funding to the sector will retain elements of CAP-based subsidy and countryside stewardship schemes.¹⁰ Likewise in the area of regional policy and state aid, the design and funding of new instruments such as the Shared Prosperity Fund and the UK Community Renewal Fund (see **David Bell**, this issue). A similar tension between the ambition and opportunity provided by the repatriation of competencies on one hand and a lack of clarity on the other emerges strongly from **Bridget Rosewell** and John **Hargreaves** review of the implications of Brexit for infrastructure policy, a tension that is heightened by a rapidly changing electoral landscape, especially in England and by the rising salience of climate change in domestic political debate.

Second, and partly related, is that despite the allure of *de jure* divergence, close alignment with existing (and future) EU regulations is, and is likely to remain, the *de facto* stance of choice across many policy areas. **Nicholas Crafts**, for example, concludes his review of state aid and subsidy policy by observing that “the degree of restraint on UK subsidy policy will be intermediate between the EU state aid and WTO rules, although probably closer to the former”. Likewise, in the areas of energy policy and, indeed energy security, the forces of convergence and coordination with the EU remain dominant, although the extent to which UK can continue to exert leverage over EU strategy on renewable energy and climate change is likely to diminish (see **Michael Pollitt** this issue). Similar concerns about divergence affect the higher education sector, although this is one area where the dislocation of the Covid-19 pandemic makes it particularly difficult to assess the impact of Brexit. As described by **Ken Mayhew**, the sector faces three major risks: the loss of EU students and student exchanges; difficulties in recruitment and retention of academic and research staff; and, closely related, access to research funding. While European student numbers remained buoyant from 2016 until the pandemic (boosted in part by the post-Referendum depreciation of Sterling) they have fallen very sharply, especially in 2021 as entitlement to ‘home fee’ status disappears. There may well be a pandemic related effect at work on student numbers, but the more serious threat is on research funding and related staff recruitment and retention, driven both by less favourable access to major EU research programmes such as Horizon Europe, which is unlikely to be offset by domestic research funding (a substantial portion of which was provided from the UK aid budget).

Third, developments in the area of tax policy highlight an important aspect of the (non) divergence, namely ‘third-party’ constraints. As **Judith Freedman** and **Glen Loutzenhiser** highlight in their review of post-Brexit tax policy, while much of the rhetoric around taxation in the Brexit campaign held out the prospect of aggressive tax competition – the notion of ‘Singapore on Thames’ – the reality has, to date, been more prosaic. On the one hand, the exit from the EU has increased the complexity around VAT administration but on the other it has been global considerations, in this case led by the OECD’s broader tax reform programme (as well as the pressure of a post-Covid recovery) that is likely to constrain policy on corporation tax.

Law and politics

Two final papers top and tail the issue. **Catherine Barnard** describes the legal mechanics entailed in the re-patriation of the body of law and regulation from the Commission to the UK – a very literal

¹⁰ See Defra (<https://www.gov.uk/government/publications/environmental-land-management-schemes-overview/environmental-land-management-scheme-overview>)

description of the process of ‘taking back control’ and how this ultimately creates the framework for many of the other issues discussed here. But the essence of this paper is an argument of how, despite the rhetoric that Brexit was an exercise in restoring the sovereignty of the UK *parliament*, it has by wholesale delegation of powers in fact served to strengthen the hand of the *executive*.

The final paper, by **Mary Murphy**, examines the possible implications of Brexit for UK-Irish relations, both in the short- and the long-run. The 1998 Belfast Agreement (the Good Friday Agreement) was premised to a large degree on the idea that national frontiers and indeed the meaning of state sovereignty would become increasingly less salient as the European Union evolved, and this sense developed over the next two decades as the border between Northern Ireland and the Republic of Ireland effectively dissolved, with checkpoints and military watch towers being dismantled, and as the institutions of North-South cooperation took root. The ugliness of the highly-contested Ireland/Northern Ireland Protocol thus reflects the near impossibility of reconciling the incompatible objectives of Northern Ireland exiting the EU as part of the UK (despite the strong Remain majority in the Referendum) while retaining the open-border and deep partnership with Ireland and the EU as envisaged in the GFA. Inevitably, discussion of the short-run is highly contingent – and as we go to press negotiations continue between the EU and the UK around the Protocol – but perhaps the more challenging aspect of Murphy’s paper concerns how Brexit has, a century on from the trauma of the partition of Ireland, brought a new seriousness to discussions on re-unification on the island of Ireland, and how this might be economically managed. This includes some provisional evaluation of the economic costs and challenges in relation to future constitutional change for the island of Ireland and the UK, a discussion that inevitably connects with wider British constitutional issues including calls for Scottish independence and the possible break-up of the UK itself.

Conclusion

A widely held view, especially amongst those who voted Leave in the 2016 Referendum, is that Brexit was fundamentally a political project anchored solely on the question of the sovereignty of the Westminster parliament over that of Brussels. In this sense, ‘taking back control’ was an end in itself, a view that finds support in the latest British Social Attitudes Survey which finds that while Leave and Remain voters are no less polarised than they were in 2016, Leave voters are decisively more positive about the government’s ability to act in the interests of the nation.¹¹ Brexit has been done and is now a matter of historical record. Hence from this ‘sovereignty above all else’ perspective a forensic focus on the economics of Brexit is a distraction or, at best, incidental. From an economic perspective, however, the Brexit process is only just beginning. Our view, unsurprisingly, is that regardless of any assessment of the politics of Brexit, an understanding of its implications for the economics of the UK and for economic policy remains essential, on both positive and normative grounds. The papers in this issue of the *Oxford Review of Economic Policy* deliver on both criteria. First, while they do not profess to be forecasts, they provide a framework for thinking about the impacts – both positive and normative – of Brexit on trade, production, human capital, migration and employment and their sectoral and spatial impacts. Second, they provide a perspective on the state of debate – and likely implications – across a range of policy areas that are the domestic complement to the ‘pure exit’ component of Brexit. Over the medium term, it is this combination that will ultimately determine the

¹¹ British Social Attitudes Survey, 38 (October 2021) (<https://bsa.natcen.ac.uk/latest-report/british-social-attitudes-38/introduction.aspx>)

nature of the structural and economic transformation brought about by the decision to leave the EU. Third, they help us think through some of the deeper political economy implications of Brexit, on the internal dynamics of the UK and its relations with the rest of Europe and most acutely, Ireland. The process is just beginning and the full effects of the changes wrought by Brexit will not be felt for many years, and even then the task of disentangling the impact of Brexit from the effect of other concurrent changes in the national and global economy will be extremely difficult. We are, therefore, perhaps already writing the agenda for an issue of *OXREP* in another five years!