COST OF
NO DEAL

The UK in a Changing Europe

Contents

Foreword

How important are the negotiations currently underway between the UK and the EU? And what would a failure to come to an agreement mean? Given the stark and often contradictory political rhetoric around these questions, we at the UK in a Changing Europe thought it was worth trying to suggest some answers. In what follows, we've attempted to tease out what the implications of 'no deal' might mean. We have, as we make clear in the introduction, defined this fairly tightly. By 'no deal' we mean the absence of both a trade deal and an Article 50 'divorce' agreement – what we term a 'chaotic Brexit'. No deal at all, in other words.

The analysis that follows is necessarily speculative. There are, as we pointed out repeatedly during the referendum campaign itself, no facts about the future. In what follows, we merely scratch the surface of what a chaotic Brexit might mean in political, legal and economic terms. So deeply embedded is the European Union in the structures and processes in place in its member states that these implications promise to be far reaching.

As ever, I'm extremely grateful to all those who contributed to this report: Catherine Barnard, Michaela Benson, Charlotte Burns, Adam Cygan, Meredith Crowley, Swati Dhingra, Viviane Gravey, Colin Harvey, Carmen Hubbard, Andy Jordan, Hussein Kassim Simon Marginson, Craig McAngus, Jean McHale, Louise Merrett, Jonathan Portes, Colin Reid, Thomas Sampson, Nando Sigona and Simon Usherwood. As ever, they've tolerated my questions and comments with efficient good humour. Particular thanks to Catherine Barnard and Jonathan Portes who have managed to make of the various contributions we received a clear and coherent whole.

So what does no deal mean?

We've heard a lot about what "no deal" with the European Union might mean for Britain. According to Theresa May, it would be "better than a bad deal." The Chancellor, Philip Hammond, thinks, in contrast, that it would be "a very, very bad outcome," while Jeremy Corbyn says it is "not an option." Boris Johnson, for his part, thinks it would be "perfectly OK," But what does "no deal" actually mean? And what might its consequences be?

Leaving the European Union involves two steps. The first is to tie up the loose ends of membership. This is the so-called Article 50 process, likened by many to a divorce. This is a reasonable analogy, insofar as leaving involves sorting out the practical leftovers of a relationship. In a marriage its finances, the mortgage, the CD collection and so on. For Brexit, it's budget commitments we've already signed up to, Eurocrats' pensions, our share of the European Investment Bank and citizens' rights (what happens to Brits living elsewhere in the EU and EU citizens here). In addition, given the particular sensitivities involved, both sides have agreed to add the Irish border to this list.

That, then is stage one. And, whilst the issues involved are largely technical, they are also immensely politically sensitive, as discussion of money and immigration invariably are. And that's even before we get on to the Irish border.

The second part of leaving is to try to agree on a relationship that works for both parties into the future. With the marriage analogy, that means the kids. The UK government has said it wants a "deep and comprehensive trade agreement". Above and beyond the economics, there are all sorts of other important issues to be dealt with. Cooperation on security, particularly when it comes to being able to track, share information about, and pursue, criminal (including terrorist) suspects is a key one. So too are any arrangements put in place to allow the UK to cooperate closely with the EU on matters of defence and foreign policy. This deal will be far harder to negotiate than the Article 50 deal, for two key reasons.

The first is simply the sheer range of issues that need to be discussed and the huge amount of technical detail that will need to be sorted out. On trade, the negotiators from each side – the UK and all the member states – will need to strike a deal that covers sectors from car manufacturers to banks, from universities to farmers. Agreement on tariff rates will be the easy bit. So-called 'non-tariff barriers' are more important. These are the many thousands of technical regulations which can get in the way of trade in goods and services. Little wonder that most significant trade deals take many years to negotiate.

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The second reason why securing a new deal will be difficult is the politics. Almost any deal worth having, from an economic perspective, will involve the UK surrendering some degree of "control", whether over fisheries (if we want to continue exporting to the EU), money (if we want to continue to participate in pan-European research programmes) or, if we want to follow some version of the Norway or Swiss models that allow most or all of the privileges of Single Market membership, over regulation and immigration. And – a point often missed in the domestic UK debate – the 27 other EU member states are also democracies, whose governments face their own domestic political constraints.

According to the UK government, both deals (divorce and who is going to look after the kids) should be wrapped up within two years (though there is no such stipulation about the trade deal in the EU treaty itself). This seems massively optimistic to us. Even if the divorce can be settled relatively quickly – and that is a very big "if" – because of the complexities we've mentioned above, we see almost no prospect of a "deep and comprehensive" trade agreement within two years.

This was the case on 29 March 2017 when Article 50 was triggered – it is even more so now, given the break we've had for a general election and the ensuing political uncertainty that has thrown key elements of the UK's negotiating position into doubt. Even if, by some miraculous feat of skilful negotiating on all sides, we had most or all of the elements of the future relationship in place, there are multiple legal, logistical, bureaucratic and practical reasons why we wouldn't be able to implement them on Brexit Day itself: no-one believes we will have entirely new customs and immigration systems in place by then.

This means that some kind of transitional arrangements will almost certainly be necessary. These might allow the maintenance of trade with the EU on something like current terms, while the details and practicalities of any long term deal are thrashed out. But here

again nothing will be simple. There is little prospect that the EU27 will allow this unless we agree to the continuation of free movement of people and the jurisdiction of the European Court of Justice during any transitional period.

So the possible outcomes are not as simple as, to coin a well-known phrase, “deal or no deal”. Indeed, it is possible to identify (at least) four broad scenarios, as follows:

- **Smooth Brexit.** All goes according to plan. We manage to have both the Article 50 and the trade deal signed, sealed and delivered by March 2019; with, where required, agreed transitional arrangements to ensure implementation is smooth.
- **Transitional Brexit.** The Article 50 deal is agreed. Discussions begin on a trade deal and are progressing well, or at least have not broken down; so both sides agree on transitional arrangements, or at least some sort of standstill provisions where little or nothing changes, in order to bridge the gap to a full deal.
- **Cliff-edge Brexit.** The Article 50 deal is agreed, but the trade discussions go nowhere: either they break down, or they have made little progress. So there is nothing to transition to. Meanwhile continuing the UK’s Single Market membership and/or free movement is unacceptable to one or both sides. So on March 29, 2019 the UK becomes a “third country”, with no special relationship of any kind with the EU. WTO rules will apply to the UK’s trade with the EU.
- **Chaotic Brexit.** There is no Article 50 agreement within the two year period, and no extension. The talks fail, because of disagreement over citizens’ rights, the role of the ECJ, money, or perhaps some other issue we haven’t yet focused on. On Brexit Day, the UK ceases to be a member of the EU – but, politically and legally, all the outstanding issues remain unresolved. Meanwhile, as in the case of a “cliff-edge” Brexit, the UK will become a third country with respect to the rest of the EU. There are two ways in which such a “chaotic Brexit”, might come about.
    - A **premature Brexit** would see talks break down acrimoniously, and the UK deciding unilaterally to stop paying its EU contribution and end the supremacy of EU law in the UK with immediate effect. While unlikely, it is possible to see political dynamics conspiring to bring this kind of outcome about.
    - A **timed out Brexit**, where the talks don’t completely break down, but no agreement is reached within the two year period, and there is no extension.

There has been an awful lot of ambiguity about whether “no deal” refers to a cliff-edge Brexit or a chaotic Brexit, and if

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the latter, to which of the two scenarios we have outlined. However, the logic whereby the UK needs to be able to walk away from the negotiating table if it is to avoid having a solution imposed on it applies to both the trade and the divorce negotiations. So the prospect of Brexit without either kind of agreement having been reached is a real one.

In what follows, we focus solely on the "chaotic Brexit" scenarios involving no deal on either Article 50 or trade. This outcome would impact not only on those areas covered by the Article 50 talks themselves – money, citizens' rights, and the Irish border – but on every party of the UK that is currently affected by EU membership, from fishing nuclear power to drug safety.

So what would 'no deal' mean? What would its impact be? Clearly, answering these questions requires a significant amount of speculation. We do not claim to provide precise answers; nor do we attempt to be comprehensive Nevertheless, the stakes are so high that we consider informed speculation to be both necessary and important.

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The politics of no deal

What the British people think of the "no deal" option depends on the question they are asked. On the one hand, voters are inclined to agree with the Prime Minister's claim about no deal being better than a bad deal. At the beginning of May, YouGov found that 48% agreed with the proposition while just 20% disagreed. Opinium did much the same thing at the end of June, and found that 40% agreed and 26% disagreed.

On the other hand, if the prospect of no deal is divorced from Mrs May's soundbite, a different picture emerges. Just after the election, Survation reported that as many as 66% believed that leaving the EU without 'a mutually agreed deal' would be bad for Britain, while just 26% reckoned it would be good for the country. Meanwhile, in May ComRes found that 47% agreed with the proposition that 'Britain should not leave the EU without a Brexit deal in place first, even if this undermines our negotiating position', while only 32% disagreed.

Perhaps the best way to make sense of this is to see the Prime Minister's statement as a truism. Who, after all, would like the UK to emerge with a supposedly 'bad' deal? Meanwhile, the public appear to think that we should at least be willing to walk away from the talks, if necessary. At the time of the manifesto launches, 40% told YouGov that it was a 'wrong priority' to rule out the possibility of leaving the EU without a trade deal, while just 31% reckoned it was a good idea. However, that does not mean that the public are keen on leaving without a deal – not least perhaps because they are inclined to the view that doing so would not be in the UK's interest. According to Panelbase, 38%

reckon that the UK has more to lose if no Brexit deal is reached, while just 28% feel the EU would come off worse.

So the political implications of a chaotic Brexit depend crucially on how it happens. Under a timed out Brexit, the most obvious path is that by late 2018 it becomes clear that there has not been sufficient progress on substantive negotiations under Article 50 and that no amount of extension to the two-year period that ends in March 2019 would unblock this. By mutual agreement, both sides let the clock run out and the UK leaves at the end of the period. Much will turn here on who did what and who blocked what. For both the UK and the EU, there will be considerable political fall-out, so there will be an incentive to blame the other side.

If, however, the Article 50 process comes to an end without agreement because of a unilateral British decision to remove itself from negotiations – maybe even to declare a unilateral and immediate withdrawal from the EU – then the political recriminations would be even more heated.

In both cases, the incentive for the government to blame “Brussels” for the breakdown would be extremely strong. This might also extend to blaming opponents in the UK (“Remoaners” or “soft Brexiteers”) for weakening the UK’s position. Earlier episodes of overheated political rhetoric (the Daily Mail’s “Crush the Saboteurs” headline) would look mild by comparison. While it is possible that the UK public and media would rally behind the government, a bitter and divisive period is more probable.

This is a key point: Brexit is not just about the EU. How the UK acts now and through the rest of the process, whatever the outcome, matters in terms of its own future. This breaks down into two main elements.

- First, the British political system has already been disrupted by Brexit, which is likely to be the defining political event of this period. Without a deal, there will be further profound dislocations and more widespread discontent with the failure of the establishment. Since the UK would be in a position of being outside the EU, the current oppositional views to the government – softening or aborting Brexit all together – would no longer be viable, leaving all sides in a policy cul-de-sac.
- Secondly, the UK would still have to deal with EU partners. If nothing else, Ministers will regularly bump into EU counterparts at NATO, UN, G7, WTO and many other meetings, where they will need to work together. A mutual blame game following a collapse in negotiations will make such cooperation more difficult. In addition, third parties might consider that a UK which terminated its membership of the EU in such a way might not be one with which to conclude any new treaty commitment.

And of course at the same time, the country will have to deal with the very real legal, administrative and economic issues set out below; a faltering economy, and severe fiscal pressures, making it still more difficult to address the underlying economic issues in regions and communities which felt left behind by Brexit.

The legal position

Article 50 is silent on what happens in the event of there being no deal. The text merely stipulates that the 'Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification ..., unless the European Council, in agreement with the member state concerned, unanimously decides to extend this period.' So educated guess work is required. The only certainty is that considerable legal uncertainty will result, mitigated to a certain extent by the structures put in place by the European Union (Withdrawal) Bill (EUWB) (formerly known as the Great Repeal Bill). Years of litigation will be required to sort out the answers to some highly technical, often abstruse legal issues.

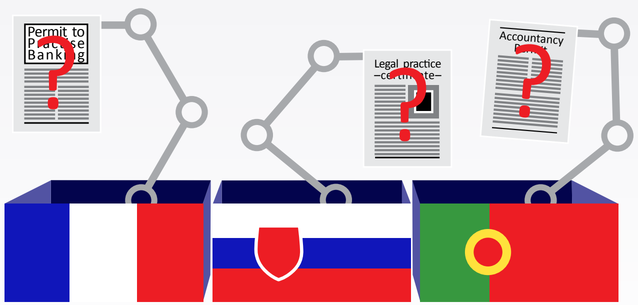
Premature Brexit

If the UK walks away from the negotiations in the next few months, the full legal consequences may not, in fact, be felt straightaway. In principle, the UK will remain a member state and so EU law will continue to apply to the UK. Therefore British individuals and firms will continue to operate under EU law until Brexit day, 29 March 2019. At this point, Article 50 stipulates that the treaties will cease to apply.

The situation becomes more complex if the UK decides not only to walk out on the negotiations but also to renege on its commitments under EU law. In this scenario the UK may decide to invoke the powers contained in clause 19(2) of the EUWB, assuming the EUWB is passed by Parliament without amendment. Clause 19(2) implicitly gives the UK government power to terminate the European Communities Act (ECA) 1972 at any time of its choosing, thereby bringing an end to the supremacy of EU law in the UK and preventing EU law (as a matter of domestic law) from having direct effect (i.e. enforceability) in the UK. This would put the UK in breach of EU law and the European Commission could, at least in theory, bring enforcement proceedings against the UK for non-compliance with EU law.

The effect of this would be that EU nationals and firms would not benefit from EU law in the UK. Instead, the

EUWB will determine what EU rights will continue to apply to them in the UK. The EUWB is intended, at least initially, to ensure a smooth transition between the pre - and post - Brexit position. So, for example, EU nationals in the UK would continue to be able to use their European Health Insurance card (EHIC) in the period prior to Brexit day because the EU regulation on which it is based, regulation 883/2004, will continue to apply in the UK through its incorporation into UK law via the EUWB. EU citizens wishing to visit and work in the UK as EU citizens, and not as third country nationals, may continue to be able to do so because the relevant UK regulations giving effect to the Citizens Rights Directive 2004/38 may remain in force, pending any change introduced by a future Immigration Bill. However, the explanatory notes accompanying the EUWB explicitly say that clause 7 of the EUWB will be used to curtail EU citizens' rights in the event of no deal. It may be that in the case of a premature Brexit clause 7 may also be used to curtail rights for EU nationals in the UK prior to 29 March 2019.



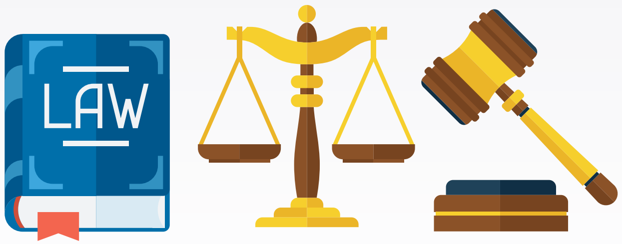
As for UK nationals and firms living, working and providing services in the EU, so long at the UK remains a member they will continue to enjoy EU rights. But for how long will the EU tolerate UK nationals and firms enjoying the rights of EU law in their countries when the UK has made it so clear that it wishes to turn its back on the EU? This leads some to argue that if the UK repeals the ECA as part of a premature Brexit, this may constitute a material breach of the EU treaties which, under Article 60 of the Vienna Convention of the Law of the treaties, would entitle the EU to invoke the breach as a ground for terminating the EU treaties or suspending their operation in whole or in part. This means that UK nationals and firms become third country nationals overnight. Some of the implications of this for individuals are considered in the immigration section.

Timed out Brexit

If the UK gets to the end of the two year period with no deal, Article 50 stipulates that the treaties will cease to apply. This will lead to legal chaos. The UK will no longer be a member state. This scenario will give rise to huge uncertainties, particularly for UK firms exporting to other EU countries or trading elsewhere in the EU. Consider, for example, contracts for the long-term supply of goods between the UK and an EU country. The EU has already made suggestions for transitional rules to govern this situation. But if there is no deal, then these transitional rules will not apply. UK producers of, say, China dinner services – to take a relatively simple case - exporting into Europe will be subject

to whatever tariffs EU law provides. Currently, no duty is paid on those goods crossing an EU border. Following a timed out Brexit, if goods are shipped from Kent to Hamburg in Germany duty will be payable.

The question of who bears the risk of this increase in cost depends on the terms of the contract. If the producer agreed to sell the goods at a price which included delivery 'duty paid', the producer will have to pay the cost. If the purchaser agrees to pay for post, packaging and duties the purchaser will bear the risk. The increase in costs may be significant, but in English contract law it is unusual for contracts to be 'frustrated' (where the contract is set aside due to an unforeseen event which makes, for example, contractual obligations impossible). Just because a contract has become significantly more expensive or less profitable does not render performance

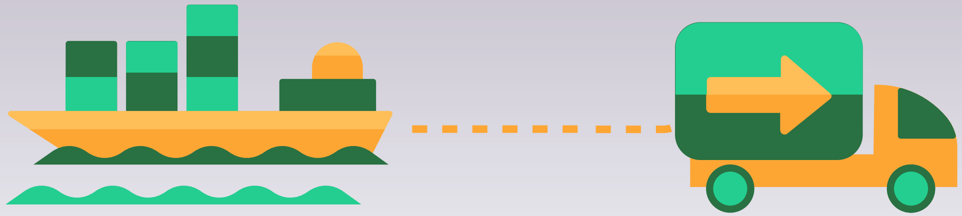


impossible, which is the usual hurdle which has to be met.

When it comes to contracts entered into since the referendum, parties may try to cater for the possibility of no deal as part of a 'force majeure' clause providing, for example, that the contract would come to an end in the event of no deal without either party becoming liable. In any of these situations, the potential negative impact on the export market is clear.

The legal enforcement of all forms of contractual and commercial arrangements will also become significantly more complex. While, under the EUWB, the EU rules on 'choice of law' (i.e. which law applies to, say, the China contract: English law or German law) and jurisdiction (i.e. which court can hear the case: the English court or the German court) should continue to apply unless 'corrected' by clause 7, the reciprocal arrangements which currently apply, for example, in relation to the enforcement of judgments, cannot be replicated in an English law regime. So, at present, if there is a dispute between an English seller and a German purchaser and the case is heard by an English court which finds in favour of the English seller who is awarded damages which the German purchaser refuses to pay, that English judgment can currently be enforced automatically in any court in the European Union, including in the German courts. If there is no deal, the English seller will no longer be able to have the award of compensation automatically enforced in the German courts, because the English court judgment will no longer be a judgment from a 'member state' court. Instead, the parties will have to rely on national enforcement regimes and so the procedure will be more cumbersome and expensive and enforcement will not be automatic: it will be subject to each member state's own national law requirements and defences.

UK trade



As set out above, both a premature Brexit or a timed out Brexit would mean considerable legal uncertainty around how trade would continue to flow between the UK and the rest of the EU. What is certain, however, is that the current trading arrangements between the UK and the rest of the EU would cease. Moreover, we trade with the rest of the world not separately, but as a member of the EU. So, for example, goods from countries outside the EU are subject to the Common External Tariff when they are imported to the UK, if no special trade deal is in place with the exporting country.

The default position would be that World Trade Organisation rules would apply on trade between the UK and the EU, and between the UK and third countries (including countries with which the EU has trade deals). The UK is a member of the WTO in its own right, and although various procedures would be needed to re-establish our autonomy from the rest of the EU – in particular, we would have to agree “schedules” for goods for which the EU currently has quotas - this might be (relatively) unproblematic and could be done without any disruption to trade - assuming those charged with the process had sufficient time to do it. An unexpected chaotic Brexit, in other words, might not be so smooth.

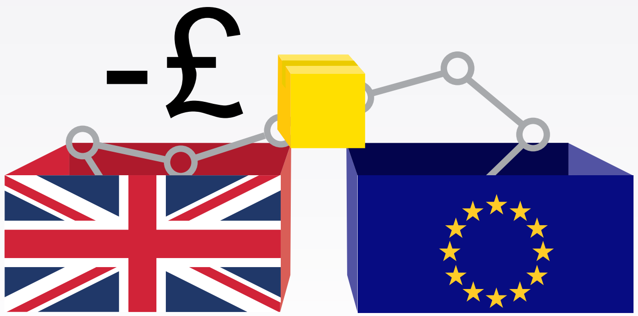
What would a move to WTO rules mean for UK exports? Under WTO rules, each member must grant the same ‘most favoured nation’ (MFN) market access, including charging the same tariffs, to all other WTO members. The only exceptions to this principle are that countries can choose to enter into free trade agreements and they can give preferential market access to developing countries.

This means that exports to the EU would be subject to the same customs checks, tariffs and regulatory barriers that the UK and EU currently charge on trade with countries such as the US. The first impact would be felt at the borders, where in theory all UK exports would have to pass through customs. The practical feasibility of this will vary from port to port – for some busy ports, like Calais, the practicality of this is uncertain. Dover, it is thought, will be particularly badly affected because it lacks the physical space to store all the goods needing to be processed – not to mention managing new immigration checks. Some short-term disruption to trade is likely, over and above that resulting from new trade barriers. Manufacturers, especially but not only the car industry, which rely on complex cross-border supply chains and “just-in-time” delivery of parts, would be severely disrupted and would likely be forced to restructure their supply chains.

In the event of a premature Brexit, the impact of all this would be magnified because there would not be the time and warning needed to put practical arrangements in place.

UK service exporters would also suffer from the loss of passporting rights for financial services, as well as access for other service providers (legal and accountancy services, etc). There would also be consequences for exports to other countries with which the EU has trade deals, including Korea, Mexico, and Chile, where the UK would have to try to replicate some version of existing agreements if it wished to avoid the reimposition of some trade barriers.

What about imports? Here the UK would face a choice. It could simply adopt the same tariff rates as those currently applied by the EU; as noted above, given WTO rules, this would have to apply to both EU and non-EU countries. This would result in some revenue gains for the UK, estimated at about £12 billion; however, this would also lead to a significant increase in prices which would likely be passed on consumers. Alternatively, the UK could, as some Brexit-supporting economists have proposed, adopt a policy of unilateral free trade (as noted above, this would have to apply to all the UK's trading partners). This would benefit consumers but would pose significant problems for some UK sectors, especially agriculture. The revenue benefits would also be lost. In practice, it seems inconceivable that any UK government would go down this road, particularly in sensitive sectors like agriculture (see below) at a time of such economic turbulence.



The estimated economic costs of any plausible scenario are large. For example, the Centre for Economic Performance estimates that a move to WTO rules, with the UK applying the same external tariff as the EU, would lead to a large reduction of about 40% in trade with the EU over the next 10 years. The economic effect of this change would be equivalent to a 2.9% reduction in the UK's income per capita (or 2.6% net of changes in budget payments from the UK to the EU). Adopting a policy of unilateral free trade would mitigate these costs somewhat but only marginally (by about 0.3% of GDP per capita).

Again, the uncertainty and possible lack of warning (depending on the scenario) of a chaotic Brexit would add to the adjustment costs and hence the short term impact. These estimates are based on the medium to long-term impacts of a move to WTO rules. The short-term disruption resulting from the sudden imposition of these rules, in particular potential disruption to trade, is almost impossible to estimate quantitatively, and would depend crucially on the extent to which measures to mitigate the short-term impact were put in place both by the UK and EU27.

Northern Ireland

Brexit will have a particularly marked impact on Northern Ireland. Although the major parties were on opposite sides of the argument (DUP backed Leave, Sinn Féin Remain) there is widespread political recognition that Northern Ireland presents specific challenges. The position of the DUP in these discussions has altered significantly since the June 2017 General Election. The deal with the Conservative Party means the party potentially wields substantial power and influence (including on Brexit) and although the DUP is in an arrangement with the governing party at Westminster, the power-sharing arrangement in Northern Ireland has collapsed, and negotiations on restoration of the Executive and Assembly continue. These are not ideal circumstances for any suggestion of a 'no deal' approach to Brexit.

The reasons for the level of consensus across Northern Ireland on potential impact (whatever view was taken of the referendum outcome) include the land border with Ireland, the maintenance of the peace process and the difficulties that will arise in maintaining the freedoms that are currently enjoyed across the island, in terms of the movement of people and cross-border trade. EU membership has radically reduced the visibility of the border, in literal and metaphorical senses.

If no agreement was reached, then the consequences for Northern Ireland are serious. While it is arguable that the UK and Ireland would work hard to maintain the special relationship that they have nurtured, and would be protective of the Common Travel Area, a 'no deal' option would mean leaving the single market and the customs union. As a result, there will be a return to some form of hard border; the very thing that everyone seems so keen to avoid. A Brexit in which neither side had time to prepare contingencies, and in which, as we have seen, legal uncertainty would be significant, would, for Northern Ireland, be truly chaotic.

A major concern is the agricultural sector, where much economic activity and service provision is very closely linked with that of the Irish Republic, with some farms even straddling the border. If a hard border is to return and if different tariff arrangements were to operate on either side of the border, this would be likely to disrupt their highly integrated agri-food supply chains and could encourage the illegal movement of animals and other goods.

The suggestion (even in the form of political rhetoric or as a negotiating tactic) that there might be 'no deal' destabilises further an already unsettled situation. Northern Ireland would risk becoming collateral damage in a political conflict between the UK and the EU; the impact would be negative and severe for people, communities and businesses in Northern Ireland and on the island of Ireland.

Agriculture

A particularly complicated set of issues will arise in the agricultural sector. The EU is the UK's largest trading partner by far. In the event of a chaotic Brexit, the default scenario would be that both tariffs and border checks would be reintroduced between the EU and the UK, slowing the flow of trade and affecting the entire food supply chain.

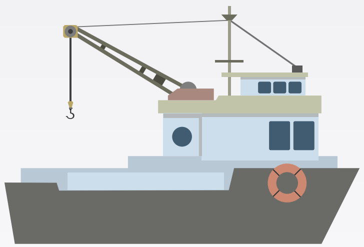
This does not, however, mean generalised food shortages; day to day work on the farm will carry on and public financial support for farmers will continue, at least until the end of the parliament (2022). Will imported food disappear from supermarket shelves? This seems improbable, as major food retailers will be likely to have contingency plans in place to replace imports from the EU with domestic products and imports from outside the EU. Some interruption of seasonal supplies could occur but this is likely to be short term.

However, the impact on the structure of trade, and hence the price and availability of food, would be substantial. The UK will have to abide by WTO rules; this will mean that the UK will trade with both the EU and the rest of the world under the WTO's most favoured nation (MFN) principle, i.e. no discrimination between trading partners. So without a deal, imports into the UK from the EU will immediately become subject to WTO compliant tariffs (and non-tariff barriers), making them more expensive. Likewise, exports from the UK will be subject to those tariffs, and other controls, currently applied by the EU to imports from third countries. Agricultural tariffs are much higher than those on manufactured goods, there are quotas for many products, (for example related to health, food safety, animal and plant health regulations and rules of origin). While exchange rate effects will dominate in the short term, non-tariff barriers will be far more important than tariffs in the medium term.

The UK will need to establish its own tariff schedules (specific commitments) and tariff rate (preferential quotas), but perhaps more importantly it will need to formulate its own, WTO-compliant, domestic agricultural policy. The UK government seems committed to establishing tariff schedules which will replicate as closely as possible the current obligations. However, our present WTO entitlements and obligations are embedded in those of the EU, and will need to be separated with the agreement of both the EU and WTO. This will not necessarily be straightforward if the breakdown of negotiations with the EU has been acrimonious. In any event, it will be time consuming. It is difficult to see how, in the event of a chaotic Brexit – particularly a premature one – the necessary work could be done in advance. What happens in the intervening period is unclear.

So, the impact on agriculture and food prices, while unpredictable, is likely to be large, and will vary by sector. For example, for products where the UK is a net importer, such as fruits and vegetables, pig meat and beef, prices may rise significantly. For (the fewer) products for which the UK is a net exporter, prices may fall, reflecting lower world prices. At the farm level, income will depend on the changes in farm-gate prices (for both outputs and inputs) and on the level of domestic support, and will vary across farm types.

But it seems certain that, overall, imports of food and agricultural inputs, (e.g. fertiliser and pesticide) from the EU will cost more, while the UK's exports will be less price competitive in EU markets. In turn, this will have negative effects both on the UK consumer, who will face an increase in food prices (food prices have already risen sharply in recent months as a result of the fall in the value of the pound), and on our agricultural exporters.



Fisheries

The UK's withdrawal from the Common Fisheries Policy (CFP) has been one of the most high-profile aspects of Brexit. Indeed, the shape of the UK's fisheries policy in the future hinges almost entirely on the deal that the UK and the EU reach when the withdrawal negotiations have concluded. In the scenario whereby the UK walks away from negotiations without a deal, what will happen to fisheries?

Of great importance, whether there is a deal or not, is for the recently announced Fisheries Bill to put in place a legal framework for the day Brexit occurs [in order to replace the CFP and avoid a legal vacuum.] Leaving the CFP means that the UK will have complete responsibility over its Exclusive Economic Zone (EEZ), the term used to denote the territorial waters around the UK. If no deal is reached, and once the UK's obligation to the [United Nations Convention on the Law of the Sea (UNCLOS)] regarding management and sustainability are taken into account, the UK will have access to all of its Total Allowable Catch within its EEZ and vessels from EU member states who once accessed waters around the UK would have no automatic legal right to fish there.

On the one hand, British fishermen would be able to catch more fish. However, they would also face tariffs, when it came to the export of UK seafood to EU markets, by far the UK's largest export markets; the UK's biggest export market for seafood is France. The only non-EU country in the UK's five largest markets is the USA – in 2nd place. So a chaotic Brexit would be a double-edged sword for UK fishermen, with the potential to expand their catch substantially, but with greatly reduced market access. On the positive side for UK consumers, the likely implication would be a sharp fall in the domestic price of fish.

Aviation

The rules in the European Common Aviation Area – the EU plus a number of neighbouring countries – are simple: any airline that meets standard technical and financial fitness criteria and is owned by the nationals of an EU member state can operate whatever routes it wants within the European Union. Airlines themselves decide where they fly, what capacity they offer, and what fares they charge. EU airlines also benefit from the freedoms under agreements negotiated by the EU with other countries.

Aviation in the rest of the world, by contrast, is governed by an intricate system of bilateral agreements. These air services agreements, which have the status of full diplomatic treaties, set out which airlines from each of the two states are permitted to operate services. They detail which routes designated airlines can serve, how frequently, and what fares they can charge. While the EU's single market is liberal and open, the global system is protectionist and state-dominated.

'No deal' would provoke great legal and regulatory uncertainty. Unlike trade in goods, there is no WTO option in aviation, nor is air transport covered by the General Agreement on Trade in Services. Air services has its own regime and regulatory power lies with individual states. Most specialists believe that, although it might negotiate an air services agreement with the EU bloc in the longer term, in the short term at least the UK would be forced to return to its pre-existing bilateral agreements, which are much more restrictive than the EU's single market. Moreover, UK airlines would lose the freedom to operate services between other EU member states, which they currently enjoy. Similarly, unless a deal is struck, the only services that airlines from other EU member states would be able to operate services to and from the UK would be from their home country only. In other words, a UK passenger could fly Ryanair to Dublin, but not to Barcelona, Milan or Paris.

Uncertainty is already causing agitation among airlines: Easyjet is reported to be applying for an [Air Operator Certificate] in Austria. As well as the decision about whether to move their headquarters to a state that will remain in the EU, airlines need to arrange their schedules a year in advance.

So would planes actually stop flying between the UK and the EU27? In principle, absent measures to mitigate the impact of no deal, that is possible – if only because their lawyers would not let them. But, even assuming that some stop-gap arrangement were to be put in place, it seems likely that there would be very serious impacts, with many airlines reducing their schedules to the UK, both immediately and in the medium term.

Energy and the environment

In the short term, the EUWB will incorporate EU environmental regulations into UK law, and the UK will also continue to be bound by international environmental commitments. So, in policy terms, there would be continuity. However, this would not deal with the monitoring, reporting and reciprocal recognition requirements currently associated with EU membership.

This is a massive task, and would raise at least two risks in the short term; first, that without monitoring and reporting, some environmental protections would be, de facto, considerably weakened. Second, and even more problematic, the danger of the vacuum that may exist in various areas while new arrangements are agreed or approved by international partners, which could do serious damage to business and trade. Even if there is no substantive change in standards and rules, there may well not be time to get wholly domestic systems in place and achieve the formal recognition of the UK's processes and standards that allow trade to take place. For example chemicals product regulations are covered by EU rules. Without equivalent domestic approvals being put in place, UK exporters would find themselves unable to trade with the EU. It is conceivable they might even struggle to do so internationally should there be no UK registration and authorisation system.

In the energy market, a no deal Brexit may mean that the UK has no established safety procedures and systems for the operation of nuclear power plants. These are currently safeguarded under the auspices of Euratom, which the UK has also notified its intention to leave. The UK's nuclear power stations would be unable to operate, which could raise the risk of a move back to coal to stem the shortfall in energy production, with impacts on air quality and climate change goals, a huge expansion of fracking or simply a shortfall in energy production.

Pharmaceuticals

Similar regulatory issues arise with respect to pharmaceuticals. A chaotic Brexit will mean that we would no longer be a member of the European Medicines Agency, and hence part of its approval processes. While the Government has indicated that they would recognise approvals where given by the EU, that would not help us in relation to the recognition of any approvals given to drugs developed and produced in the UK in other parts of the EU.

Clinical trials, including cross-border clinical trials currently in progress, would be adversely impacted. We are due to implement the new EU Clinical Trials Regulation in 2019 - if this is before Brexit we would need to be part of a major EU computer database on which clinical trials are entered; a chaotic Brexit would be likely to disrupt this. Overall, the impact on pharmaceutical research in the UK would be immediate and adverse. In practice, large pharmaceutical companies would have to plan well in advance for such an eventuality, which would presumably mean moving some or all of their research and development activities.

Immigration and resident citizens

Would EU citizens living in the UK immediately become "illegal immigrants" on Brexit Day if we left the EU with no deal? Would EU citizens coming to the UK for work, study or tourism require visas – something which would immediately

lead to chaos at ports of entry to the UK and which would be disastrous for UK tourism?

This seems unlikely. The main provisions of European law on freedom of movement have been fully incorporated into UK law. So the right of EU citizens to live and work here – and the legality of employers continuing to employ them, hospitals and schools continuing to treat and educate them, and so on – would broadly continue unless and until the UK government or Parliament changes the rules. As explained above, the Social Security Regulation, which is important to ensure that, for example, EU nationals will continue to benefit from the EHIC card, will be given legal effect in the UK through the EUWB. Similarly, there is no reason why border arrangements and visa requirements would change immediately,

But how long would this position be sustainable? Without any agreement, EU citizens in the UK would be in a form of legal and political limbo – not illegal, but with their status at best anomalous. This would particularly be the case for those who have no documentation certifying their permanent residency – the vast majority – and for the very large minority who could not, as of Brexit Day, qualify for permanent residency under the current rules since they lack five years of residence.

It would of course be open for the government to regularise this by, unilaterally, implementing some form of the proposals that they have already tabled in the Article 50 negotiations (and set out in the policy document published on 26 June 2017). But, having made these proposals contingent on reciprocity from the EU27 - which would be highly unlikely to be forthcoming if the negotiations break down, since there is no reason the EU27 should accept the UK's terms on this particular issue – unilateral action may pose political difficulties. Moreover, the UK government may come under considerable political pressure to water down some of the protections already proposed in the policy documents, Indeed, the explanatory memorandum accompanying the EUWB explicitly states that it would be used to restrict the rights of EU citizens in the event of no deal.

The status of UK nationals elsewhere in the EU would be considerably more complex and potentially much more problematic. It is up to individual member states as to how they implement EU legislation in domestic law. There is much variation in how EU27 countries treat UK nationals now, and that this divergence would be likely to widen considerably after Brexit.

Further, while the UK government plans to pass the EUWB, which will attempt, as far as possible, to incorporate EU legislation in UK law, there will be no equivalent in other member states. If, like the UK, they have laws relating to immigration and residence that give special status to EU nationals, then on Brexit Day those laws, in theory, will automatically cease to apply to UK nationals.

What happens then? EU member states (but not Denmark and Ireland) have implemented key directives on the rights of third country nationals (TCNs), including the long term residents directive which gives rights to reside to TCNs after five years lawful residence in the host country. This is presumably the status that would, in theory, apply to UK citizens: in general it confers far fewer rights, especially for those without five years residence.

This would clearly be disastrous for many of those concerned – they could lose the right to reside, to work, or to access essential services. It is of course possible that individual member states may take action, either directly through legislation, bilaterally via a deal with the UK, or indirectly through benign administrative neglect, to ensure that the worst consequences of this scenario do not materialise. However, absent an EU27 wide agreement, it seems highly probable that in at least some countries some UK citizens would find their lives disrupted.

And this, in turn, would make it much harder, politically, for the UK government to take unilateral action to guarantee the rights of EU citizens in the UK; if any one EU27 country began, for example, to restrict the right to work or access healthcare of resident UK citizens, it might be hard for the UK not to retaliate. And if pensioners who have retired to Spain cannot get healthcare many will return to the UK.

In the absence of an overall UK-EU agreement, then, and given the complex legal landscape across the EU in relation to citizens' rights, two broad scenarios seem plausible. Under the first, even after negotiations failed to deliver a deal, both the EU27 and the UK would seek to reassure resident citizens, by unilateral actions, legislative change, and administrative forbearance, at least in some key respects. However, over time, uncertainties and legal ambiguities would mount, leading to significant numbers of people with uncertain and unclear status either with respect to residence or important rights.

Eventually, both the UK and individual EU27 countries would be obliged to clarify the position in some form, either through a deal between the EU as a whole and the UK to resolve this specific issue, or as series of bilateral deals. But meanwhile considerable numbers of citizens would be likely to "vote with their feet" and return home.

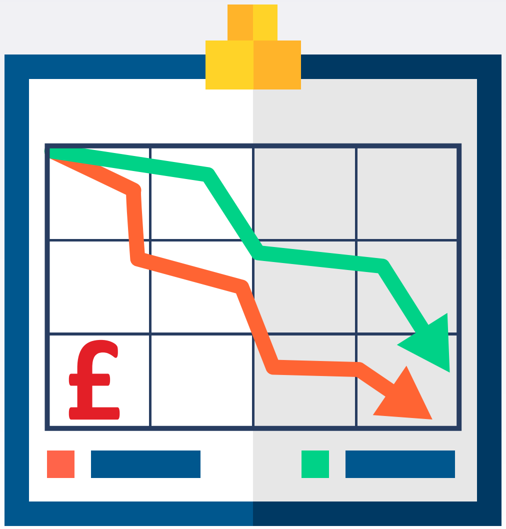
This doesn't sound ideal, but it is the optimistic scenario. The pessimistic scenario is that the sudden legislative vacuum in some EU27 states leads to substantial numbers of UK citizens finding themselves in limbo very soon after Brexit

Day, resulting in significant hardship. The resulting political and media reaction would mean that the UK government finds itself under pressure to retaliate by taking action against EU citizens resident in the UK, at least those who have not yet qualified for permanent residence. The political and economic consequences – and the lasting ill-feeling on all sides that would likely result – are sufficiently horrific that this scenario seems unlikely, but it is not impossible.

The economy

So what does all the above add up to? As explained above, a chaotic Brexit would affect not just those importing and exporting from the EU, but several other key sectors, as well as throwing a cloud of legal uncertainty over much of the economy – and we have made no attempt to be comprehensive. It is therefore certain that the impact of a chaotic Brexit on the UK economy would be felt well before Brexit Day.

Before the referendum, many economists expected that a vote to Leave would affect the economy almost immediately, because of its impact on business and consumer confidence (although no academic economists undertook the kind of short term forecast exercise performed by the Treasury and the International Monetary Fund). In fact, although there was indeed an immediate sharp fall in confidence, this was quickly reversed, as people realised that nothing very much was going to happen in any practical sense in the short term. Both businesses and consumers carried on more or less as before, until the fall in the exchange rate began to exert upward pressure on inflation.



However, if "no deal" begins to look certain or even likely – still more so if we unilaterally decide to abrogate our membership - this will change. Business in particular will be aware that there will be a sharp regime change, in legal and regulatory terms (although see the comments on the EUWB above), on Brexit Day. Leaving aside the impacts on individual sectors, likely macroeconomic impacts would include:

- A further significant fall in the exchange rate. Pre-referendum predictions that a vote to Leave would result in a 10-15% fall in sterling proved accurate. A further fall of similar magnitude could be expected;
- A (consequent) rise in inflation, and fall in real wages and consumer demand. These impacts would probably materialise more quickly than in 2016-2017, that is soon after the breakdown in negotiations;
- A fall in business confidence. Unlike the referendum, this would likely be sustained, and translate quite quickly

into a slowdown in investment, particularly in sectors reliant on trade with the EU (either exports or imported components) or where regulatory certainty is important for investment decisions.

The reaction of financial markets (beyond the exchange rate) is harder to predict but, at least in the short term, would not necessarily have a major impact on the economy. Long-term interest rates remain at historic lows, despite persistently high deficits over the last decade, and their failure to react to political events (there was no significant market reaction to either of the last two general elections) suggest that short-term fiscal policy changes have little or no impact. No doubt the credit rating agencies would further downgrade the UK, but, as in the past, they can safely be ignored. Stock markets would be likely to react as they did to the referendum result – that is, falling in dollar terms compared to other markets, but with some companies, particularly those with earnings denominated in foreign currency, seeing share prices rise in sterling terms.

As with the aftermath of the referendum, a policy response would be expected. The Bank of England would be likely to undertake further quantitative easing; however, in an environment of weak consumer demand and business confidence, monetary policy might represent little more than "pushing on a string." In addition, if inflation was likely to rise as a consequence of any fall in sterling, the Bank's room for manoeuvre would be constrained. There would be a case for an emergency fiscal response, in particular to boost public sector investment to counterbalance the likely fall in business investment. However, the government would want to avoid being seen to be panicked into an "emergency" stimulus package along the lines of that introduced in 2008 (when it was part of a coordinated international effort to respond to an international economic crisis, not a domestically generated one).

So just how bad would it be? It is impossible ex ante to quantify the

Immediate impact of a vote to leave the EU on the UK (% difference from base level unless specified otherwise)

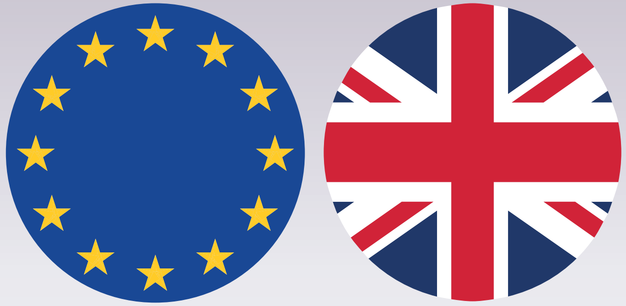
	Shock scenario [a]	Severe shock scenario [a]
GDP	-3.6%	-6.0%
CPI inflation rate (percentage points)	+2.3	+2.7
Unemployment rate (percentage points)	+1.6	+2.4
Unemployment (level)	+520,000	+820,000
Average real wages	-2.8%	-4.0%
House prices	-10%	-18%
Sterling exchange rate index	-12%	-15%
Public sector net borrowing (£ billion) [b]	+£24 billion	+£39 billion

[a] Peak impact over two years. Unemployment level rounded to the nearest 10,000. [b] Fiscal year 2017-18.

impact of "no deal", both because it would depend crucially on its timing and circumstances, and because of the inherent difficulty in estimating the impact of some of the effects described above (in particular "uncertainty") on hard macroeconomic data. However, the Treasury analysis of the short-term economic impacts of Brexit does at least attempt to quantify the economic impact of a rise in uncertainty, the transition to a new, much more restrictive trade regime, and financial market volatility.

The Treasury modelled two scenarios, a "shock" and a "severe shock", differentiated primarily by the (inherently unknowable) degree to which a vote to Leave impacted on uncertainty. In this context, these could be considered as analogous to our "timed-out Brexit" and "premature Brexit" scenarios. The peak impacts, shown below, were estimated respectively at a hit to GDP of 3.6% and 6%.

Of course, it turned out the Treasury was crying wolf over the short-term impact of a vote to leave; uncertainty did not persist, Article 50 notification was delayed, and monetary policy responded. However, for the reasons set out above, these factors are much less likely to mitigate the impact of a "no deal." Remember, the wolf does eat the boy in the end. So, while certainly not to be regarded as valid quantitative estimates, the table above does give a sense of the order of magnitude of plausible short-term impacts of a "chaotic Brexit."



Conclusion

The purpose of producing this short report was not to suggest that a no deal scenario is the most likely outcome of the Brexit process. Nor, and crucially, did we commence this work with a view to illustrating that the impact of a chaotic Brexit would be catastrophic. Rather, we set about the task with an open mind and in a spirit of enquiry. Given the debates about 'no deal,' we wanted to consider in a practical sense what it might mean.

Nor have we tried to be comprehensive. Indeed, we've barely scratched the surface in some areas. What about the chaos likely to occur in a no-deal scenario as a result of the UK crashing out of the 40 or so EU regulatory agencies ranging from the EU Medicines

Agency (discussed above) to the Community Plant Variety Office. It will take significant time, bureaucratic resources and money to set up UK equivalents.

The reality is that chaotic Brexit does not magic the problems away. UK companies will still want to trade their goods and their services with EU states, EU nationals will continue to live in the UK and UK nationals in the EU. For them, a chaotic Brexit leaves them in limbo.

Clearly the implications we have suggested will vary across sectors and, as we have seen in the case of Northern Ireland, regions. And while it is hard to be precise about the implications of a chaotic Brexit, several points can be made.

- A lot will depend on how "no deal" comes about and how much time the government has to prepare, legally and administratively. A "timed-out Brexit", with both sides agreeing to give up and wait out the rest of the period until 29 March 2019, would be the more benign of the two in that it does not (necessarily) imply a total breakdown in trust and provides more time for arrangements to be put in place on both sides unless the EU decides to invoke Article 60 of the Vienna Convention. A "premature Brexit", in which talks break down acrimoniously, and the UK government unilaterally terminates its membership of the EU, and the associated legal obligations, would be even more disruptive;
- Despite the uncertainties, we know enough to say with reasonable certainty that a chaotic Brexit, under either scenario, would be a political mess, a legal morass and an economic disaster. Even with time to prepare, major sectors would face sudden and disruptive change.
- In particular, the impacts of a "hard Brexit" that are generally highlighted and which have been the subject of most analysis to date – for example the move to WTO tariffs for UK trade – while very important in the long run, will not have the biggest economic and political impact in the short run. Legal uncertainty, regulatory limbo, what actually happens physically at borders with the reimposition of customs checks, and the status of resident citizens will all be major issues, with no obvious solutions. Moreover, the potential for tit-for-tat "retaliatory" actions by the UK and EU, in response to actions by one side that are perceived to impact on the interests of citizens or businesses from the other, is obvious.

So – to answer the original question – "no deal" doesn't mean the country would come to a stop. But even under relatively benign conditions and with time to prepare, the impacts would be widespread, damaging and pervasive. It is not possible ex ante to quantify the economic impacts, but it is reasonably clear that they will be comparable to some of worst-case scenarios presented before the referendum. This time, Project Fear would not be scaremongering.

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