

17 Jan 2017

May's way: Feeding a dangerous illusion

by Michael Heise

Since a majority in the UK voted to leave the European Union, the UK government's Brexit plans have remained vague. Although PM Theresa May declared shortly after the referendum that "Brexit means Brexit", precise information on the envisaged new relationship between the UK and the European Union was hard to come by. In her policy speech today on the UK's departure from the EU May has now outlined somewhat more clearly what she understands by Brexit: namely the UK's exit from the single market and the customs union, withdrawal from the jurisdiction of the European Court of Justice and tight controls on immigration from the EU – i.e. the end of freedom of movement. May thus categorically rules out partial EU membership along the lines of the Norwegian model.

May's Brexit position hardly comes as a surprise. A so-called Brexit-lite, with the UK accepting the bulk of EU regulations without the means to influence them in order to keep access to the single market, is neither an attractive vision nor a sensible negotiating position. A clean break and a restructuring of the British economy in some form or other nourish the hope that there will not be a nasty blow to economic growth despite less favorable trading conditions with the EU. However, this scenario is not very realistic. Even a skillfully negotiated free trade agreement will not grant British companies the unrestricted and advantageous access to the single market they currently enjoy. This will mar the attractiveness for direct investment and business activities geared predominantly to serving the EU market. Moreover, there will be an extended phase of great uncertainty about the outcome of the multi-track negotiations: Negotiations on the divorce pact and a free trade agreement with the EU, negotiations with third countries who have a free trade agreement with the EU and with those who trade with the EU under WTO rules. The UK government's intention to conclude a deal quickly is to be welcomed and has buoyed the financial markets, but the actual negotiating process will be tough and drawn-out. And that means that the uncertainty will linger for years. Foreign investment in the UK is likely to remain weak and financial sector firms will start shifting operations to mainland EU.

It also remains unclear what form the new economic model should take that is meant to boost UK prosperity outside the EU. Low business taxes, fewer rules for manufacturers and lighter regulation in the financial sector or on the labor market? All this would require political majorities which are questionable in the UK as well. And other countries would react to any low-tax strategy to attract foreign capital.

From an economic viewpoint it would doubtless be in the UK's interest to put hard Brexit up for debate again (as is now intended in parliament). Maybe political forces can still be mobilized to thwart hard Brexit plans. On one point the EU should be willing to compromise: the freedom of movement demanded by EU countries does not mean free and uncontrolled access of EU migrants to the welfare systems of another member state. In the UK EU nationals were blamed for pressure on the labor market and overloading the welfare state. Restricted or staggered access to welfare

systems would mitigate the pressure from immigration. Other EU member states also have an interest in not overstressing their welfare systems. It should be possible to reach a compromise with the UK.

In addition – whether Brexit or Bremain – policymakers in the UK will need to consider how to cater in future for the weaker members of society who voted overwhelmingly for Leave. This will require a radical overhaul of education and labor market policy. Leaving the EU will hardly improve the prospects of this social class of unskilled workers, low earners as well as pensioners and people who rely on government support.

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