No deal is the best deal for Britain

Patrick Minford considers the options for the UK as they reach the endgame in their negotiations with the EU, and finds that a No Deal Brexit is a recipe for economic success

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In this piece I look at the options for the UK, and its MPs in Parliament, to consider as they reach the 'endgame' in these negotiations with the EU. I first explain the gains from the default option if no deal is agreed, which is an exit under WTO terms for trade with surrounding side-agreements on other matters, then go on to explain its implications for the proposed Withdrawal Agreement.

A No Deal is in fact the best deal for the UK

In its attempts to force through its EU Withdrawal Agreement the government is painting a No Deal Brexit as some sort of disaster. It is in fact a recipe for economic success, free of the shackles of EU protectionism, budget costs, intrusive regulation and subsidisation of unskilled immigration.

Our estimates of how a full Brexit impacts on the economy

Here is the range of economic benefits I estimate from achieving a Clean Brexit - ie, leaving the Single Market and the Customs Union, regaining control over our borders, laws, and regulations, freeing ourselves from the European Court of Justice, and having the freedom to establish our own trading relationship with the rest of the world?

Over the past two years, the group I chair, Economists for Free Trade, has reported our research at length on the long run effects of such a 'Clean Brexit'. Here I briefly recapitulate the arguments and findings from this research.

A Clean Brexit produces long-run gains from four main sources (Minford, 2017):

1. Moving to free trade with non-EU countries that currently face high EU protection in goods trade

2. Substituting UK-based regulation for EU-based Single Market regulation

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3. Ending the large subsidy the 'four freedoms' forces the UK to give to EU unskilled immigrants

4. Ending our Budget contribution to the EU

The gains under (1) come about because elimination of the EU's protection lowers consumer prices and increases competition in our home market, so raising productivity across our industries. With the economy at full employment and a flexible exchange rate, any jobs lost in industries where higher productivity releases labour will be offset by extra jobs in other (unprotected) industries where productivity is already high and where demand is projected to expand.

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For our calculations on our Cardiff World Trade Model (Minford *et al*, 2015, chapter 4), we assume that protection leading to higher prices of 10% in both food and manufactures is eliminated (our detailed research cited above shows prices inside the EU in both sectors currently are some 20% higher than world market prices). Our estimates are that consumer prices will fall by 8% and GDP will rise by 4%.

For (2), we rely on models of the economy developed by Cardiff researchers (see Minford *et al*, 2015, chapter 2) that assess the effects of regulation on the economy via their effect in raising business costs. We estimate that EU regulation has reduced GDP by around 6%; and that probably about a third of this can be reversed giving us a projected gain of 2% of GDP, or a growth rate 0.15% per annum faster over the next 15 years.

For (3), we have examined the costs to the taxpayer of EU unskilled immigrants owing to the entitlement to the full range of tax credits and other benefits, including free education and healthcare (Ashton, MacKinnon and Minford, 2016).

A further effect is that wages of UK unskilled workers are depressed; this represents a transfer from unskilled workers to the consumers who use their products. Another relevant distributional element is that the taxpayer burden and wage effect are both highly localised in areas of immigration. From these costs, we find that Brexit would save 0.2% of GDP in taxpayer costs.

Furthermore, there would be a particular benefit to UK low-income households of about 15% of their living costs from the combination of ending this unskilled immigrant subsidy and the trade-led reduction in the CPI (MacKinnon, 2018). For (4), we have followed the standard calculations made by the Office of Budget Responsibility and others, arriving at around 0.6% of GDP.

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In total these four elements create a rise in GDP in the long term over the next decade and a half of about 7%, which is equivalent to an average rise in the growth rate of around 0.5% per annum.

If we leave with No Deal, ie. under WTO rules with piecemeal side-agreements, we gain on top of this about £650 billion in one-off present value terms from extra tariff revenues, not paying the Deal's £39 billion, and making Brexit policy changes two years earlier; the EU loses £500 billion from all this.

These gains are questioned by recently published government work: first, the leaked Civil Service report (Civil Service, 2018a, and lately the fully published *Cross Whitehall* study (HMG, 2018a and b). This work is the main source of what could be termed 'Project Fear Mark II'.

This work uses the same modelling approach that we do, after a long period from the time of the referendum in which it queried our methods in favour of a 'gravity' approach (HM Treasury 2016), that it has now abandoned in the face of our criticisms. It now uses a variant of the GTAP model from Purdue University, Indiana. However, its latest work still reaches damning conclusions on Brexit by making indefensibly bad assumptions about Brexit policies and their direct effects.

To start with, its assumptions about 'general free trade via FTAs' are conservative in the extreme. It has stated that gains from their general FTA assumption are only a 0.5-0.8% rise in UK GDP. From this it would seem that they assume either that EU trade barriers are rather small or that barriers are reduced by rather little.

Yet current EU protection of food and manufactures including non-tariff barriers is authoritatively estimated at 20% (Minford *et al*, 2015, chapter 4; also for non-tariff barriers Berden *et al*, 2009). Our assumption of the likely Brexit reduction of protection is deliberately cautious at 10%; it can be thought of as assuming either that only half is abolished or that somehow the EU would itself have abolished half anyway.

With this 10% assumption our Cardiff World Trade Model predicts a 4% rise in GDP (Minford *et al*, 2015, chapter 4). If this 10% is fed into the GTAP model, then UK GDP would rise by 2%, while if all 20% EU protection were abolished it would rise by 4%. Interestingly, a recent study of Australian trade liberalisation over the past thirty years using GTAP (CIE, 2017) finds that its GDP has been increased by 5.4%- a figure rather similar to the gains being discussed for the UK's Brexit liberalisation.

The other key assumption made by the *Cross Whitehall* work is that large costs arise at the EU border for UK-EU trade even if we negotiate 'free trade' with the EU. One element of this appears to be related to pure 'border costs'; such things as time to get paperwork agreed before ships are allowed to unload.

However, these assumptions have been bypassed by the progress of technology and WTO rules for customs procedures (WTO, 2018c; World Bank, 2016). Computerisation has more or less eliminated border costs among developed countries, since almost all cargoes are cleared before reaching port, with only some 2 per cent or so physically inspected, and even this is taking only around a day typically.

Professor Dr Michael Ambühl (ETH Zürich), who negotiated one of the Swiss-EU bilateral free trade deals, estimated that border costs were as low as 0.1% of the value of trade (Ambühl, 2018, slide 8).

Another assumption in the *Cross Whitehall* study appears to be that UK-EU non-tariff protection would spring up after Brexit. The idea seems to be that the EU and maybe the UK too would claim that exporters do not satisfy

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required product standards; thus non-tariff barriers would sprout on the UK-EU border, regardless of any trade negotiations.

However, current WTO rules (WTO, 2018 a and b) outlaw such behaviour as illegally discriminative, given that existing product standards are already exactly obeyed on both sides.

On the basis of these assumptions, the *Cross Whitehall* GTAP model calculates large losses in GDP, variously amounting to between 3 and 7%, depending on the 'closeness' of the eventual EU arrangements. On our calculations, these costs are simply not there in the event of a free trade (Canada-plus) agreement with the EU.

We also have an assessment (Economists for Free Trade, 2018a) of the 'no deal' case within the Cardiff World Trade Model. In this case again non-tariff barriers and customs hold-ups are illegal but tariffs do apply; in our assessment the tariff element damages the EU but not the UK essentially because given that FTAs have driven UK prices to world prices, tariffs in both directions must be absorbed by EU traders.

The *Cross Whitehall* work therefore reaches its conclusions that Brexit reduces UK GDP on the basis of untenable assumptions. When reasonable assumptions are substituted for the extent of the trade barriers eliminated against the rest of the world and for the trivial UK-EU border costs, this reduction is turned into a substantial increase on both the GTAP model, and on the Cardiff World Trade Model. What is more this is true even on the gravity version of that Cardiff model.

The Government in its latest Report (HMG, 2018a and b) has not materially changed its overall estimates of the costs to GDP of the different Brexit scenarios; the critique remains the same; that it is inputting false assumptions - see Economists for Free Trade (2018b).

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All the discussion above concerns the long-term effects of Brexit. What then of the associated claims we hear from the continuity Remainers and to an extent from the government about short term chaos from a WTO-based Brexit?

In brief, they are demonstrably false as both UK and EU businesses, including port authorities, have strong incentives to avoid disruption. Both HMG and the EU are also committed to helping businesses in this avoidance, simply because this is an obvious governmental duty for which they are answerable to their citizens.

The economics of the Brexit end-game

We are now entering the final period where the EU must decide how to negotiate its final deal with Mrs May and MPs must decide how to vote on it.

The first thing to say is that the big gain for our economy comes from Brexit, indeed any Brexit that makes the UK an independent sovereign state. This is in practice ANY currently available Brexit, including Mrs May's deal, provided it leads to an FTA with the EU that permits the UK, outside the EU Single Market and Customs Union, to sign free trade deals around the world.

Although there is going to be much legal poring over drafting changes to the proposed deal, political economy, a major branch of economics, enjoins great scepticism about how far legal constraints stop sovereign nations from pursuing their long-term interests. Basically national laws respond over time to the interests of nations; in the case of a democracy like the UK, voters' interests.

Similarly with international treaties, they respond over time to the same interests, since these push their politicians to obey their interests; and no government can bind its successors. So governments leave treaties when they must.

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This of course is why we are leaving the EU. We have chosen to do so by the legally provided route of Article 50 and a long negotiation with the EU.

We did so because the EU is our neighbour and ally; and a 'deal/Withdrawal Agreement' (WA) is a civilised way to change a neighbourly relationship. Had we left the EU before the Lisbon Treaty, we would have had to do so illegally, as there was simply no provision to leave the EU back then. Would that have stopped us? Economics says no.

However, now a WA is not the only way to leave the EU. No Deal is from a purely economic viewpoint, as we have seen, superior: we start afresh in our EU relationships under WTO rules, free of the budgetary costs of a 'transition', and free to arrange a Free Trade Agreement with the EU, just as with all other countries.

Since we can go to No Deal now, so we can also in the future, should the deal-WA prove to be onerous and badly constructed. No Deal is the exit from a Deal that goes bad, too. We are told by lawyers that beyond the EU, we would lose our law-abiding reputation with other countries, if we so repudiated a bad deal signed now.

However, countries do this the whole time with treaties that no longer suit them, and they usually do so with a range of justifications that we too could produce- arguing change of circumstances, failures in the past negotiations, even bad faith. We are talking about real politik.

These considerations are greatly strengthened when one factors in that post-Brexit policy will be unfolding under the international law of the WTO which actively encourages countries to revise their trade treaties towards greater liberalisation. The UK's treaty revision with the EU will benefit non-EU countries, including not just developed countries wanting to sign trade agreements with us such as the US, Australia and New Zealand; but also a long list of developing countries who have suffered greatly from being excluded from EU markets. Accordingly international attitudes to our actions will be entirely favourable.

Of course if we do not leave at all, No Brexit, as is threatened by various current Parliamentary amendments from Remainers, then we gain nothing at all; we remain in the EU, immured in its protection, regulation, immigration and budgetary problems. Indeed, we will probably become much worse off, as these problems intensify - the EU will not stand still, but will almost certainly get worse from our viewpoint.

This could well strengthen the chances of Mrs May getting her deal through Parliament, if the EU helps by removing as clearly as possible the chances of the UK being hamstrung by the 'backstop' over the Northern Ireland border. The majority of MPs that does want the gains from Brexit could well argue: having pushed the May Deal as far as possible, it makes sense to have it, however imperfect, because it can lead, under a suitable government, to a good final relationship with both the EU and the rest of the world.

As rest of the world countries will have a vital interest in their trade agreements with us, they will also support us internationally when we are robust in negotiating an EU agreement that does not get in the way of their agreements.

That 'suitable government' would have to be one that clearly understands the Brexit opportunities and is strong in their pursuit. Sadly this is far from true of Mrs May's government, which has been confused and divided about these opportunities and the policies needed to maximise them. ■

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