

# July Economic Update - Part 2

This section is relevant to those who are trying to make sense of the current political scene and its implications for Brexit.

When forecasting up to two or three years ahead, normally one can take the Government's vision and objectives and work through the implications for consumers and businesses, and their economic prospects.

As I write this, there is no clarity from the Government, so I will begin with my assessment of where I think things currently stand and then make some forecasts based on this which will be in section 1. I do not claim to be right. I am a patriot but not a nationalist, and I am fully aware of confirmation bias which is that humans only select information which supports their point of view.

The first May Government was committed to hard Brexit based on a narrow majority for leaving the EU. This means putting sovereignty first (getting our country back from the unelected suits in Brussels) at the expense of close economic ties. The European Court of Justice (ECJ), the free movement of EU workers, the Customs Union and the single market would play no part in British life.

The election changed this. May is substantially weakened, the new Parliament is unlikely to pass all the legislation required for a hard Brexit, even with the support of the DUP.

There is now likely to be a softer Brexit, but what might it look like?

The Queen's speech contained eight key items of legislation which Parliament will vote on over the next two years.

The Repeal Bill will transform all 19,000 pieces of EU rules and regulations into British law. And then Parliament must legislate on immigration, fisheries, customs, nuclear safety, international sanctions, trade arrangements, and agriculture.

The negotiation with the EU, now underway, is about the divorce agreement. Only when this is agreed can we negotiate the future relationship.

The labour party won 40% of the vote (the Tories 42.3%). But such is our democracy, the Tories have 317 seats and Labour 262 seats. Many voices are calling for a softer Brexit believing this to be the new will of the people (this is difficult to prove).

Ruth Davidson the leader to the Scottish Tories has called for a softer Brexit. Michael Gove, the once hard leaver, has joined the cabinet and is suggesting a rethink. The DUP who hold the balance of power in Westminster want to keep the open border with the South.

The cabinet and the country are divided.

May lacks the authority to impose discipline within the cabinet. Boris Johnson is his usual unguided missile, with no grasp of the details, and pro cake and eating it. Hammond wants more cake for everybody. Liam Fox wants to leave the Customs Union so he can do trade deals with the rest of the World.

Many voters see both Boris Johnston and Jeremy Corbyn as authentic.

In so many ways Corbyn and Johnston are similar. They are both prisoners of the past, and neither has any grasp of economics. Johnston wants to know 'what this Customs Union thingy is'. Corbyn thinks companies, and the top 5% of income earners, will fund his economic programme.

The facts are these: 25% of income tax receipts are paid by 0.5% of UK adults, and 50% is paid by 3% of UK adults. 1% on income tax raises £5.5Bn, 1% on NIC raises £4.9Bn, and 1% on VAT raises £5.2Bn.

Unfortunately the electorate is, for the most part, ill informed. Some believe there is a Government money tree; others believe the EU is an unelected behemoth which, for 40 years has crushed British dynamism and its ability to sell world-class products and services around the World. They appear to be unaware of the success small and medium sized German companies are having exporting round the World from the EU. Last year Germany exported \$80Bn to China. The UK \$15Bn.

Sun readers have an average reading age of 8. The Guardian - 14. The 400,000 FT readers are mostly London-based with an average reading age of 14. The Telegraph has a million readers, their average age is 61, reading age unknown but they are always wondering where they left their glasses and why they walked into the room!

Many Eurosceptic MPs are backing May in the hope she will deliver a hard Brexit. They have threatened her with a leadership contest if she wavers. The Mail and Telegraph support their views.

May has to have two scripts: one for the hardliners and one for the rest. And this makes it impossible for her to lead effectively.

It is a mess but what will be the likely outcome?

I am assuming a transitional deal, followed by a new customs union with the EU. A customs union is a trade bloc which creates a free trade area behind an external tariff. Within the trade bloc there are no customs duties so goods can move freely between member countries. The customs union negotiates with other blocs and countries for mutually beneficial tariff reductions. After 4 years of negotiations the EU is about to sign an agreement with Japan. The EU and Japan together account for 20% of Global GDP and 39% of exports.

A softer Brexit is a combination of four things.

First some limited curbs on the free movement of labour. This already happens in the EU. Belgium deports EU citizens who do not work and cannot support themselves, Germany is limiting EU workers in their construction industry to keep wages rates up. When workers from Eastern Europe flooded into the UK in 2004, it was not Brussels who demanded it, it was the Blair Government. Brussels points out that the UK is much more lax than other member countries in checking residency, giving unqualified access to health care, and welfare benefits.

The first thing we should do is tighten up our procedures. Then agree some sort of emergency brake which the UK could apply if required. However the net flow of EU workers will fall steadily over the next 5 years due to greater opportunities in an ever growing EU.

Second, the UK will stay in the EU regulatory agencies. There are 34 key agencies which affect food, air travel, drugs, the trading of bonds and shares to name a few. These agencies play a crucial role in ensuring common standards across the customs union. It would make no sense for us to duplicate them, especially when funds are limited.

Third, the ECJ would continue to oversee and rule on trade and regulatory matters. This would be necessary to ensure the customs union worked without friction.

Fourth the UK would agree a customs union with the EU, within their existing customs union.

So for the electorate we leave the existing customs union, but join a new one in our own interest and on our terms.

It is this which is crucial for the prosperity of the UK. The new customs union would mean Britain accepts the common external tariff, enjoys free movement of goods without new paperwork across the 26 countries, and existing supply chains would not need to be reconfigured.

Liam Fox would protest because the UK would not be allowed to negotiate free trade agreements in addition to the 56 countries already agreed for us by the EU. These agreements only cover goods and agriculture. Fox is at liberty to negotiate services free trade agreements with whomsoever he wishes. These are notoriously difficult which is why there are few in place round the World.

The timing: We leave on 29 March 2019; immediately, we agree a transitional deal which will look like the above. This deal then becomes the new arrangement. We are not in the EU but we are agreeing to a customs union to protect jobs and maintain growth.

If the hard brexiteers in Parliament reject this, then the next PM in 2022 will be Jeremy Corbyn. It's their call.

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