The UK government is shedding some of its illusions about Brexit, and softening its position

*Step by step, the UK government is shedding some of its illusions about Brexit, argues **Holger Schmieding** (Berenberg). The United Kingdom has already accepted that it will have to meet the legally binding financial commitments it incurred while it was a member of the European Union (the so-called Brexit bill) and is going along with the EU's timetable for negotiations (divorce issues first, transition deal next, outlines of a future trade deal last). Last Friday saw another set of concessions being made by the Prime Minister.*

In her speech at Mansion House last Friday, Prime Minister Theresa May went one step further, acknowledging that the UK has to face "hard facts" on Brexit and that "life is going to be different after Brexit". If we extrapolate the British learning curve into the future, reason may still prevail in the end with an agreement on a "soft" or "semi-soft" Brexit by October 2018, in time for both sides to ratify it before the UK formally leaves the EU on 29 March 2019. Under such a deal, the UK would maintain access to the EU's single market for goods and for some services on almost the same preferential terms as before.

However, Theresa May is not yet close to such a deal that would minimise the economic damage to the UK. On the most fundamental level, May does not yet seem to acknowledge three key facts:

First, the medium-sized UK earns 12 per cent of its GDP through exports to the EU27 whereas the EU27 send exports worth merely 3 per cent of their GDP to the UK. As a result, any deal will reflect the bargaining position of the EU much more than the wishes of the UK government. Of course, May's plea that both sides will need to be "flexible" to achieve a mutually agreeable result is not wrong. But almost all of the flexibility will have to come from her fragile and bitterly divided government. Whereas a no-deal "hard Brexit" would hurt all sides, it would hurt the UK much more than the EU27.

Second, for the EU27, safeguarding its own cohesion and the integrity of its institutions, laws and regulations matters much more than retaining favourable access to the UK market. The UK will not get a bespoke deal that presents a better balance of rights and obligations than its current EU membership does.

Third, as Ireland is the EU27 country most affected by Brexit, the EU has de facto granted Ireland a veto over the terms of any deal on post-Brexit relations which the EU27 can strike with the UK. If the UK indeed leaves the customs union for goods and/or the common agricultural policy, any arrangement to control – or not control – the flow of goods across the land border between the two parts of Ireland will have to be acceptable to Dublin.

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If we take Theresa May's Mansion House speech at face value, the outlook would be grim. She continues to rule out the only known way to avoid a hard border in Ireland, namely an arrangement that keeps the UK inside the customs union and fully aligned with EU standards after Brexit for all goods that can be easily transported across a border. She also hopes to secure a high degree of preferential access to the EU27 market for financial services while gaining full control over the movement of EU workers into the UK. However, the best the EU27 can offer to a UK that wants to leave the customs union, abrogates the free movement of labour and rejects the jurisdiction of the European Court of Justice is a free-trade deal akin to that which the EU has struck with Canada. That template contains many provisions facilitating the exchange of goods, for which EU27 suppliers often have a comparative advantage over the UK, but few provisions for services, for which the City of London is so far often the best-placed location. In short, such a deal could be quite disadvantageous to the UK. Of course, the UK and the EU27 may well strike a "Canada plus" deal. However, the "plus" would most likely be in continuing co-operation in non-economic fields such as security and defence instead of better UK access to the select parts of the common market which the UK likes most.

The only way to draw hope from the Mansion House speech is to view it as just one of many steps on the long road from British Brexit illusions to an acceptance of reality: the UK government can either insist on its positions and suffer a hard Brexit without a significant deal with the EU or accept the terms for a preferential market access agreement that the EU can offer – or possibly reconsider Brexit once it has become fully clear what Brexit will entail in practice. Over the last six months, the UK position has already adjusted while we do not yet detect any major shift in the EU position. If Theresa May continues to ditch one illusion after the other, making the UK position progressively more realistic without shattering her fractious government in the process, the UK may still end up with the semi-soft or soft Brexit that minimises the economic damage for the UK.

The chance that the UK may reconsider and abandon Brexit remains small. We put it at no more than 10%. As the hard choices which the UK has to make on its road to Brexit become more apparent, the case for staying in the EU may become stronger. However, no Conservative-led government could and would attempt such a U-turn. The only practical way in which Brexit could be reversed would be if early new elections swept a Labour-led government to power that might possibly call a new referendum. The fear that new elections could sweep Labour's hardline leftist leader Jeremy Corbyn to power is one of the few factors uniting the various factions of the Conservatives. As they go to great lengths to avoid that risk, the most likely outcome is that all factions of the Conservatives will continue to support Theresa May as she stays on the road to Brexit, hopefully continuing to adjusting her stance further step by step towards a softer version of Brexit over time.

This post represents the views of the author and not those of the Brexit blog, nor the LSE.

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Date originally posted: 2018-03-06

Permalink: http://blogs.lse.ac.uk/brexit/2018/03/06/the-uk-government-is-shedding-some-of-its-illusions-about-brexit-and-softening-its-position/

Blog homepage: http://blogs.lse.ac.uk/brexit/