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Brexit watch

Monthly briefing on Brexit developments

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How to summarise what's happened since our November issue of Brexit Watch? UK Commons vote scheduled...and cancelled. A vote of no confidence in Mrs May as Conservative leader, which she defeated last Thursday by 200 votes to 117 (opinions vary on whether the 200 is a strong endorsement, or the 117 is a fatal blow). Prime Minister May tried to secure additional assurances from the EU, which were not forthcoming. The latest is a political battle with Jeremy Corbyn over a vote of no confidence in the Government.

So what has changed? In reality, and somewhat oddly, given the above, the answer in many respects is, very little. The Withdrawal Agreement is still the only deal on offer from the EU. It still won't pass the UK Parliament. Prime Minister May is still stuck between a rock and hard place, and doesn't appear to have the majority to do, well, anything.

'No-deal' planning is being accelerated on both sides of the Irish Sea as a result, with May planning to allocate £2bn for contingency plans for government departments and Simon Coveney publishing the Irish Government's contingency preparations this Thursday.

One thing that is clear, and we are hearing from our clients, is that the continued ambiguity and a divided political landscape creates a negative environment for businesses. Investment decisions have been postponed here and in the UK, and an increasing number of firms are putting contingency plans into action, as they simply can't wait any longer, without risking the full effects of a no-deal exit.

It is clear that hard line Brexiteers in the UK favour a no-deal to any in which the UK, or part thereof, remains 'tied' to the EU. With 100 days to go until the official exit, ongoing developments indicate that Brexit negotiations will go down to the wire. Our Brexit team estimates that a free trade agreement between the UK and EU is now the most likely scenario, but at only a 25% probability! Other options of WTO, Hybrid or Norway style deals are all at equal likelihoods (20%), with stopping Brexit at 15%. The lack of a clear leader in these options only illustrates the difficulty in predicting, with any level of confidence, where this will end.

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1 Political Developments

United Kingdom

Second referendum

Theresa May has emphatically rejected growing calls for a second referendum. Over the weekend, the Times reported that senior members of the Tory party have been working behind the Prime Minister's back in order to hold a second referendum. David Lidington, the Prime Minister's deputy, held talks with Labour in an effort to build cross-party support for a new vote. Number 10's Chief of Staff, Gavin Barwell, told a Cabinet minister that holding a second referendum was the only way forward. May has repeatedly said that to hold a second referendum would be to break faith with the people, and it would suggest that UK democracy does not deliver.

May wins confidence vote

Theresa May is now immune to a leadership challenge for another year after securing the confidence of 63% of her party in the recent vote of no confidence. The vote was triggered by 48 of May's MPs who were angered by her draft Brexit agreement. Anticipating a heavy defeat of the Withdrawal Agreement, May postponed the Commons vote to try and garner extra concessions from the EU. To help secure her leadership position, she committed to stepping down before the next general election in order to appease those with leadership ambitions, and pledged to seek further revisions on the Irish backstop. However, this has not stopped Jeremy Corbyn tabling a motion of no confidence in the Prime Minister. The motion is in the Prime Minister herself and not the government and thus has no constitutional significance.

Outlook

With the week of 14 January looking like the next date for the Withdrawal Agreement vote, it is unclear what significant developments will take place over the Christmas and New Year period. Counterintuitively, the likelihood of a no-deal has possibly fallen following last week's events. If the current deal does not get voted through in January, a softer Brexit may have a better chance of securing a majority than a no-deal. The deadline for starting the formal ratification process in UK Parliament looks likely to be mid-February in order to have legislation in place by 29 March to avoid a no-deal scenario.

Countdown to Brexit

100Days

Ireland (NI & ROI)

Fianna Fáil have extended the confidence and supply agreement until 2020. This ensures political stability in the Republic of Ireland (ROI) as Brexit negotiations continue. However, Fianna Fáil TD, Lisa Chambers, outlined that due to "abysmal failures" in the health and housing sectors, a general election would have been held in 2019 if it were not for Brexit.

23 months without the Executive

It's almost two years since Northern Ireland (NI) had a functioning Executive. The lack of a devolved government has had clear implications on the Brexit process, but also on investment projects in NI. The chair of the Institute of Directors has stated that a functioning Executive is required to drive the implementation of more than £2bn of infrastructure projects that are currently stalled.

Irish hoteliers concerned about Brexit

9 out of 10 Irish hoteliers are concerned about the impact Brexit will have on their business over the next year. Issue 32 of Brexit Watch outlined the importance of cross-channel travel to ROI from a monetary and social perspective. The Irish Hotels Federation has called on the Irish Government to tackle the high cost of doing business in the sector in order to mitigate against the financial implications of Brexit. However, given the ROI budget recently increased the VAT rate applied to the hospitality sector from 9% to 13.5%, it is unlikely that the sector will see any tax breaks as a result of Brexit.

EY's Brexit team current outlook

Outcome	Likelihood
WTO (No Deal)	20%
Free Trade Agreement (FTA)	25%
Hybrid	20%
Single market / Norway +	20%
Stopping Brexit	15%

Davy Stockbrokers outlined the effect some of the above arrangements could have on GBP exchange rates. Davy list the no-deal scenario as potentially the most damaging, with no Brexit, unsurprisingly, being the most ideal scenario.

2 Economic Developments

Dr. Daragh Mc Greal

Daragh is a Manager with EY-DKM, and undertakes Cost Benefit Analyses, Economic Impact Studies, and market reviews across sectors. Daragh has previously worked in the legal sector and has a postgraduate qualification in European law.

Competition in the EU

Healthy markets in which competition is strong depend on clear rules and regulatory regimes. This has been at the core of EU economic and anti-trust policy since the bloc's inception, and many believe that the EU has thrived due to both competition and to regulation.

Central to the success of the EU has been State Aid rules, by which Member States are generally prohibited from using State resources to grant aid selectively to private firms, if this distorts competition and affects inter-state trade. At the same time, State Aid rules set out the types of aid which are, or may be, deemed compatible with EU law. These are regulated by the Commission, and all relevant State Aid must be notified in advance.

Across Europe, there are significant concerns that the exit of the UK from the EU could present competitiveness challenges for the bloc, if the UK seeks to compete with Member States on unfair terms, perhaps by granting state aid domestically that would not be granted in the EU context.

How could things change?

Assuming the Withdrawal Agreement is ratified by the UK Parliament, competition policy and competition law in the UK will remain exactly as it is now, in line with EU rules, until the end of the transition period at end-December 2020. If no Free Trade Agreement (FTA) is reached in the interim, or if the transition period is extended, the existing arrangements will continue to remain in place.

The key question is, what will happen after either the transition period or in the context of an FTA being agreed? Depending on the outcome, the UK could have varying degrees of flexibility around what it is allowed to do, while political factors may impact what it actually does. Competition rules in principle will continue to apply in the UK, but the workload of the UK's Competition and Markets Authority (CMA) will increase, as work currently undertaken by the European Commission will fall to the CMA. More pressing still, there will be a need to establish a new regulatory regime.

A reformed regime as a risk

Although the current UK government has stated that it intends to transpose EU State Aid rules into domestic legislation, irrespective of whether the UK would exit the EU with or without a Withdrawal Agreement, this may not remain the case in the future.

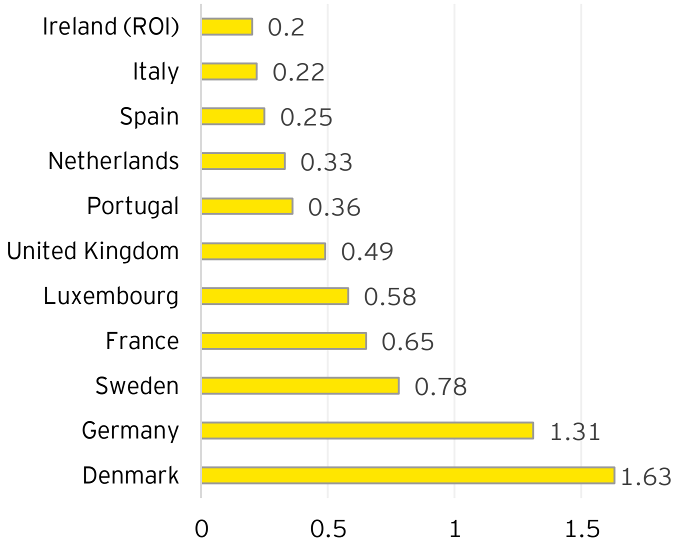
Under the domestic regime, the CMA would be tasked with the role of regulating the behaviour of the UK, and presumably requiring it to recover such aid where this has been granted illegally. In this context, the CMA would be taking decisions which can prove unpopular not only with the public but also with the Government.

By contrast, while it is true that certain EU State Aid decisions can give rise to public and political discontent, the regime's supranational character means that the ability of a Member State to influence the State Aid process is generally limited. The impact of any such attempts is diluted by the Commission's obligation to take into account the effects of an aid measure across all Member States. However, absent of this constraint a future UK government may seek to flex its muscle by providing State Aid in circumstances that it would not have been able to previously.

As it stands, the UK provides a comparatively low level of State Aid to firms, as a share of GDP, at 0.49%. With significant political uncertainty in the UK, both relating to Brexit and to the make-up of future parliaments and governments, a liberal State Aid regime and an increased level of State Aid provided to UK firms could pose significant competitiveness risks to the EU.

In particular, given the integration of the UK and Irish economies, and the fact that Ireland provides firms with the lowest level of State Aid in the EU, in GDP terms, the potential risks to Ireland would be particularly pronounced.

Total State aid (% of GDP, 2016), less railways



Source: European Commission; selected countries

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