Brexit Watch

Fortnightly briefing on Brexit developments

Issue 17, 14th December 2017

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DKM Commentary:

Former British Prime Minister, Harold Wilson, is in part remembered for his famed quote 'a week is a long time in politics.' If a week is long, the past fortnight has proved to be almost never ending. Following weeks of purported deadlock in negotiation progress, there was nothing like a deadline to push diplomats over the finish line of Phase One. A deal was almost reached on Monday 4th, however as quickly as it was reported, it was also quashed. As Theresa May met with President of the European Council Donald Tusk in Brussels, the Democratic Unionist Party in Northern Ireland made it clear that the deal of 'full regulatory alignment' would not be supported by their MPs in Westminster, who are currently propping up Mrs May's Government.

Following a few tense days, Mrs May secured wording on the deal that satisfied all parties involved enough to agree to move forward. In the early hours of Friday 8th December, Donald Tusk announced that sufficient progress had been made. He outlined expectations on the UK to adhere to EU law during the proposed transition period, including new laws brought in during that time period. The UK would not have a say in any policies or EU bodies at this time.

Subsequent to these events, the EU Parliament met on Wednesday and voted in favour of proceeding to Phase Two of negotiations with a vote of 556 to 62, with 68 abstentions. MEPs have therefore recommended that the Heads of State of the EU27 agree to move to the next stage when they meet on Friday 15th at the EU Summit.

At home, the Irish government has been praised for its resolve, as Taoiseach, Leo Varadkar, and new Tánaiste, Simon Coveney, faced down a British Prime Minister who for a time was caught between compromising with the Irish to secure progress, or bending to the DUP who have the power to potentially collapse Mrs May's government. The outcome has played favourably for Fine Gael in the most recent opinion polls.

Political Developments

United Kingdom

Phase One deal secured and backbench Tories rebel

As we have come to learn, no week in Brexit can be totally smooth, however, the success of achieving a Phase One deal that appeased both the DUP and Irish government could be seen as a diplomatic feat. This was emphasised by President of the European Council, Donald Tusk, who described the deal as 'obviously the personal success of Prime Minister Theresa May'. Mrs May's fortune has been seen to change quickly, particularly since the snap election, and the trend continued yesterday. Conservative MP Dominic Grieve previously brought forward an amendment which would legally ensure MPs would have a vote on the final deal agreed with the EU. On Wednesday afternoon, at Prime Minister's Questions, Mrs May said government was rejecting the proposal because it could delay key Brexit legislation when a deal is hopefully secured. However, on Wednesday evening the House of Commons voted to adopt Amendment 7 to the Brexit bill, in spite of the government's request to the contrary, in a sign of Tory rebellion. Although it has not led Mrs May to lose a vote up to this point, it is clear that the Tory party is entirely not with its leader. Her authority will surely continue to be questioned by the EU who need confirmation her word will stand.

David Davis faces criticism on impact papers

Following requests by opposition MPs, the Department for Exiting the EU (DExEU), led by David Davis, was under pressure to release the highly discussed impact papers. After months of comments made by Mr Davis and his colleagues on their development, he admitted to the Brexit Committee in the House of Commons that the papers simply 'don't exist'. Naturally, this fuelled ridicule from opposition MPs who were led to believe the draft version they received a number of weeks previous was highly redacted, as opposed to complete. To finish off a mixed week for the Brexit Secretary, where he saw through the completion of Phase One, Mr Davis suggested on The Andrew Marr Show that the UK's commitment was 'much more a statement of intent than it was a legally enforceable thing' sparking outrage in the EU.

Ireland

Fine Gael numbers up in light of successful Brexit negotiations

Last Thursday, the results of the Irish Times/Ipsos MRBI opinion poll were released. In spite of a near political crises the week previous, Fine Gael came out strong, securing an 11 point lead over Fianna Fail, the largest observed since 2015. A five point increase on previous figures brought the Taoiseach's party support to 36 per cent, at the cost of Fianna Fail who saw a drop of four points, to 25 per cent. Given the political tumult surrounding Frances Fitzgerald's laborious resignation a few days earlier, Mr Varadkar's success, with a personal approval rating of 53 per cent (a six year high), has been attributed in part to his firmness when negotiating the final deal.

European Union

Brussels to outline March date for trade talks following David Davis' comments

Brussels has quashed any hope of expediting Phase Two negotiations following reports that the comments of David Davis, regarding the extent to which the Phase One deal is enforceable, have frustrated EU diplomats. Mr Davis' EU counterpart, Michel Barnier, has said in response that '[the EU] will not accept any backtracking from the UK on their commitments' and suggested that a deal on trade will only be secured if the UK honours their Phase One commitments. In spite of time pressure relating to trade negotiations, the EU is set to finalise a statement on Friday that will set a date of March 2018 for the commencement of trade talks. In the meantime, the EU will develop its own plan for the future and discuss the transition period with the UK. The UK is said to be appealing to the EU today and tomorrow to bring talks forward, so that the is increased time flexibility to secure a final deal.

EU moves forward with historic Japanese trade deal

While the UK and Ireland were entirely consumed with the securing of a Phase One deal last week, the EU got on with its other responsibilities and finalised a trade deal with Japan that has been in the works for four years. The deal, which covers 600 million consumers, and approximately 30 per cent of GDP, will cut tariffs and set mutual standards and regulations. In a joint statement with the Japanese Prime Minister, President of the European Commission, Jean-Claude Juncker emphasised that the agreement 'sends a clear signal to the world that the EU and Japan are committed to keeping the world economy working on the basis of free, open and fair markets with clear and transparent rules fully respecting and enhancing our values, fighting the temptation of protectionism.'

Germany look to be edging closer to the formation of government

In Germany, the Social Democratic Party (SPD) are considering both a coalition and an agreement which closely resembles the confidence and supply form of government seen here in Ireland. It has now been ten weeks since the election that saw Chancellor Angela Merkel unable to form a majority government with her party, the Christian Democrats (CDU). Following the collapse of talks to create a 'Jamaican' coalition with the Green Party and Free Democratic Party, the CDU have described themselves as '[wanting] to begin exploratory talks with the SPD on creating a stable government.' The SPD, who have been in coalition with the CDU since 2013, had vowed to go into opposition following poor election results. The party is reportedly tentative to resume their previous position, but the CDU believe a coalition to be the best way forward at present.

'Home Made' Impact Papers

As mentioned in the previous section, UK Brexit Secretary, David Davis, explained to the House of Commons this week that the highly anticipated impact papers did not exist. The papers were supposedly an analysis of the level of threat Brexit poses to 58 exposed sectors in the UK economy. When pushed on the lack of modelling included in the research, Mr Davis said that '[he is] not a fan of economic models because they have all proven wrong.'

This thinking completely misses the point of economic forecasting. It is not expected that in an open economy like the UK, all variables can possibly be accounted for, or accurately predicted, particularly given the lack of information and high level of uncertainty pertaining to the final Brexit deal that is yet to be established. What is expected, is that when a certain amount of data is available, assumptions must be made to allow the estimation of trends. It is true that forecasts will never hit the nail exactly on the head. But it assumed that some information is better than no information. In the face of Brexit, the total lack of forecasting on the part of the government is being criticised as highly irresponsible by opposition parties, as well as private industries who could engage in more informed Brexit-proofing and planning, should they understand the particular threats facing them in the long term.

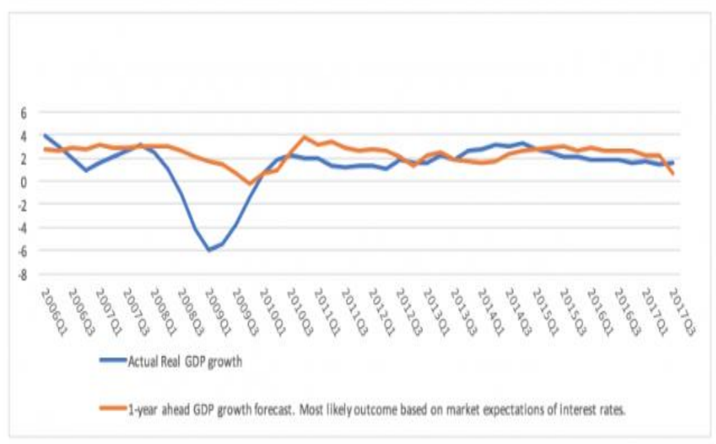
From a political perspective, the lack of analysis might damage the image of the government, at home and abroad, who now appear potentially unprepared for the economic consequences.

Economic argument for forecasting

Professor Costas Milas of the University of Liverpool, recently published an article with the London School of Economics on the need for quantitative forecasts, and challenged Mr Davis' view that they are redundant. Professor Milas makes the well crafted point that without a 100 per cent turn out for the referendum, the final vote is simply a forecast of what the population thinks on the issue. 72.2 per cent of voters cast a ballot in June 2016, and that proportion was used to estimate how the total population felt about the question. In a similar way, quantitative forecasting on the impact of a new policy, is based on a proportion of information that at a basic level, is scaled up while including the impact of relevant variables, to estimate what the full scale effect will be.

In the article, UK GDP growth forecasts are plotted against actual outcome are shown (see Figure 1.) to show the use of quantitative estimation in capturing an elusive but vital measure of the economy. There is justified room for criticism as the global financial crisis was not predicted, and therefore left economies unprepared for its effects.

Figure 1: Actual GDP % Growth versus 1 Year Ahead GDP Growth for the UK, Q1 2006 – Q3 2017



Source: Milas, C. 'Brexit assessments: ignorance isn't bliss — quantitative forecasts do matter' Available here.

It is understandable that Mr Davis would suggest this as reason enough to avoid forecasting as a tool to base policy on, however, it could equally be seen as irresponsible given what is at stake. The failure of missing such a consequential recession in the past will not be forgotten, but it is hoped that lessons have been learned as a consequence.

What external analysis is available?

The OECD has revised down its estimates of GDP growth in the UK to 1.2 per cent in 2018, and 1.1 per cent in 2019. In its Economic Outlook, the organisation suggests that Brexit will have a negative impact on the economies of Germany, Ireland, Latvia, the Netherlands, South Africa and Spain. If the forecast is somewhat accurate, the OECD has said 'this pace of growth will not be sufficient to prevent a moderate rise in the unemployment rate' which has been an issue for the government.

The FT looks at a number of sectors and the current threats facing each. With respect to the services sector, 85 per cent of British workers are employed in a services related industry which exports 40 per cent of its output. In 2015, £89 billion worth of services were exported to the EU 27, and £68 billion was imported. Naturally financial services is a particularly concerning industry within that group, as it will require access to EU markets to be effective in many cases. There are currently one million people employed in a financial services related role in the UK. Manufacturers are particularly exposed as the UK and non-EU markets are not large enough to support the output of producers in the home market. There is also a concern around a decrease in global talent in high-skill manufacturing positions which will also hamper growth.

The ESRI has also produced a working paper on Modelling the Medium to Long Term Potential Macroeconomic Impact of Brexit on Ireland for a more academic analysis of the subject.

Job Watch

Relocation and Business News

Financial Times forecast far fewer bank employee moves in wake of Brexit

This section of the Brexit Watch publication was first devised as a way of keeping track of jobs that were relocating away from the City once the UK lost access to the single market. In particular this related to positions in the financial services industry, of which it was estimated there could be up to 5,000 employees moved to Dublin. However, in spite of a string of announcements over the past 18 months, the Financial Times has undertaken extensive analysis of recent announcements, and believes the final estimate of jobs lost in London to be overstated. EY has predicted that up to 10,500 jobs would leave London on Day One of Brexit, however the FT believes this number could actually be closer to 350. The paper's analysis suggests that only 6 per cent of jobs are at risk of moving, particularly after a Phase One deal was achieved last week. It is thought that banks are currently holding their breath to see the outcome of trade talks, following renewed hope that a hard Brexit could be avoided.

Increased interest in working in Ireland following Brexit effects

Global job searching site, Indeed, have published statistics on search trends in the EU. The firm's EU base is in Dublin, and has recorded an increase of 33 per cent in searches for Irish positions from their EU site users between 2015 and 2017. This is in line with a decrease of 15 per cent in searches for UK positions in the first nine months of 2017 alone. Economist for Indeed, Mario Mamertino, said Brexit was 'clearly giving many European jobseekers pause for thought.' With news of jobs in both tech and financial services coming to Ireland in the next year, opportunities will be provided to EU workers that will hopefully counteract some of the jobs lost in the UK.

Ireland is the most business friendly for ease of paying taxes in the EU

Ireland's corporate tax regime has been in the news recently, with particular emphasis on Facebook's choice to cease moving ad revenue through the Irish jurisdiction for taxation purposes. PwC and the World Bank have released the Paying Taxes 2018 report in the last fortnight. In good news, the Paying Taxes report places Ireland 1st amongst its EU colleagues for ease of paying taxes, and 4th globally, up from 5th place in the previous year. The report also shows the proportion of taxes a business will pay, made up of profit taxes, labour taxes and other. In the EU and EFTA, Ireland has the 5th lowest proportion at 26.0 per cent, with France having the highest level at 62.2 per cent. Another factor in defining the ease of paying taxes is the time to comply in hours. Again, Ireland leads the EU and EFTA pack here with 82 hours taken on average, in contrast with the area average of 161 hours, and the most time consuming of 453 hours in Bulgaria.