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Post-Brexit Priorities

Clear Blue Water: Policy solutions to create economic growth following Britain's exit from the European Union and stimulate a long-term recovery in the economy.

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Clear Blue Water: Policy solutions to create economic growth following Britain's exit from the European Union and stimulate a long-term recovery in the economy. The need for divergence from rules inherited from the existing framework of EU trade policy, regulations, and directives.

by
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We finally formally left the European Union on January 31st 2020, a day of freedom, well sort of! The Brexit deal was far from perfect to say the least and there is plenty of scope to tweak and abandon parts of the deal, namely and probably most notably, the Northern Irish Protocol. Here is what we think Britain's post-Brexit priorities should be to ensure that leaving the EU is as great a success as we always hoped it would be.

Scrap the Northern Irish Protocol

A huge sticking point of the Brexit deal which was ratified by the UK Parliament in December 2019 and then the European Parliament in late April 2021, this is a disastrous clause in the deal which separates Northern Ireland from mainland Britain. There has been staunch and a great deal of opposition, and rightly so, from several groups ranging from the DUP, several Conservative backbenchers, the UUP, the Brexit Party and the ever fantastic Baroness Hoey, who spoke to The Bruges Group about the disaster which has occurred as a result of the NIP.

Northern Ireland is left in a worrying position and their position as a member of our United Kingdom may be seen to be hanging in the balance. Perhaps, this may even fuel the SNP's charge for independence in Scotland, after all, Northern Ireland will have different arrangements to the mainland UK, something First Minister Nicola Sturgeon has been pushing for. In the next few months, we need to reevaluate the Northern Irish Protocol and work constructively with our friends in the DUP as well as the European Commission to resolve this glitch in the legislation.

Northern Ireland has a new First Minister, or it will by the end of June, and that is likely to be the new DUP Leader, Edwin Poots MLA who won the party's leadership contest following the resignation of Arlene Foster from both positions. Both MLAs and DUP MPs are staunchly opposed to the Protocol and Foster said that, "London and Brussels need to acknowledge the damage done by it"; the DUP also arranged a petition to scrap the NIP, which received over 140,000 signatures and was debated in Parliament in February 2021. Mrs Foster said of the petition, "I think it was an indication of how strongly so many people right across the United Kingdom felt about the issue that that petition took off in the way that it did."

Lets not forget that the Northern Irish Protocol isn't impossible to abandon but the government must show strength and leadership on this issue, after all as an ERG statement said, "We will no doubt be told that the EU will never renegotiate the protocol - just as we were repeatedly assured they would never reopen the Withdrawal Agreement, or indeed abandon the dreaded 'backstop', which the protocol eventually replaced when they subsequently did both. We will not let matters rest there." Now let us hope that the Prime Minister uses the same vigour and bulldog spirit he used to budge the EU on the actual WA and trade deal, to abolish the Northern Irish Protocol who has been instrumental in disrupting the free flow of goods between Great Britain and Northern Ireland.

The border in the Irish Sea must be scrapped as soon as possible for us to function as a truly United Kingdom, it is a complete underminement of the Good Friday Agreement, which everyone held in such high regard during the Brexit negotiations. In fact, the architect of that agreement and former Leader of the Ulster Unionist Party, Lord Trimble said he felt "personally betrayed" by the Protocol and says it "wilfully tears it up" when referring back to the GFA. Perhaps more worryingly though, the now Conservative Party peer suggested if issues around the Protocol weren't resolved soon it may see a return to unrest in Northern Ireland, "If the genuine grievances and resentments caused by the protocol are not addressed politically, then there is real potential for those who have engaged in past violence to take action again into their own hands" and that a restriction on goods entering and exiting Northern Ireland posed a represent "a real and present danger to the lives of people living in Northern Ireland".

In conclusion, the man in charge of Brexit negotiations, Lord Frost must hold strong and stand his ground against the EU bureaucrats but also against the UK's devolved governments following revelations that an SNP delegation had approached the European Commission without first telling Westminster. In more promising news, Lord Frost, the former Chief Negotiator, has made clear his discomfort with the EU ignoring the terms of the trade agreement over Northern Ireland and has accused the Commission of having "disregard" and not "fulfilling their part of the agreement", so there does remain hope yet, especially if Frost plays his cards right and holds his ground in his dealings with the EU.

No Tax Rises!

Due to low-interest rates, the real taxpayer cost of debt post-Covid is unbelievably small, about 1pc of GDP if we're putting a figure to the statement, and that is equivalent of just an extra 4p on income tax and that would pay the interest on the debt racked up during that last year and a bit. However, it would be a folly of Rishi Sunak, the Chancellor, if he opts to raise income tax, or any tax for that matter, especially as we need to establish ourselves as an economic powerhouse with unmatched economic growth post-Brexit. Tax rises in any field will have the opposite effect to this.

The fiscal rules set out by the last few Chancellors of the Exchequer clearly state that we should be keeping a keen eye on long term solvency and the balance sheet of Britain, most notably who was keen to balance the books, so to speak, was of course fiscal Phil (Philip Hammond) who may have been an agitator in the Brexit debate but was a good yardstick for sound economic policy when it came to solvency and debt to GDP ratio. Solvency is to be assured if the debt ratio is headed below the safe 60pc in the long term, which when we delve deeper into forecasting and long term public finances, we can see that we are reasonably close to the right path to achieve this.

We should, however be less focussed on the short and medium-term deficit targets which seemed to be a bit of an obsession at Number 11 pre-Covid and should be turning our attention to a long-term fiscal plan and foresee how we can manage our balance sheet.

According to the Liverpool Modeling, 2pc off the average tax rate gains 1pc on GDP in the long run by making the labour market more competitive. Also, Second round effects of Brexit through the Fiscal Fund-plus would therefore boost the economy by a further 7pc over the decade from 2020, or another 0.7pc p/a on growth from 2020-2030. The remaining £24 billion extra spend on public services boost growth by raising private productivity, assuming a similar boost, would equate to another 0.23pc per annum, to the growth rate. Hence the whole post-Brexit programme from the new Fund boosts growth in the decade from 2025 by 1pc per annum**.**

As Mrs Thatcher pointed out at one of her final Prime Minister's Questions, whilst responding to an opposition MP, "he would rather the poor were poorer, providing the rich were less rich"; which is why increases in taxation on a personal level makes little sense. The 1980s was seen as a golden age for conservatism and capitalism with Margaret Thatcher in the UK and Ronald Reagan in the US, and the package of tax cuts in both nations was noticeable as both economies went through boom periods. In the UK, we experienced the biggest of which mid-decade with the 'Lawson boom' which referred to Nigel Lawson's cocktail of tax and regulation cuts in the 1985 and 1986 budgets in particular.

A cut in the highest rate of income tax could theoretically boost the Treasury's income by £15bn alone, on the assumption that the rate is reduced from 40pc to 30pc (with the 45pc tax band abolished, raising a projected £1bn of its own accord). This would primarily cause an investment boom and boost innovation but also see a drop in those avoiding tax in offshore bank accounts.

However, a cut in the standard rate of income tax, by just 5pc to 15pc, would raise a ginormous £28bn in theory, this would be down to the fact that consumption would skyrocket. As taxes fall, demand for consumer items logically increases, as it did in the 1980s when the Treasury slashed taxes left, right and centre. Not only would this be positive for the economy, but it would also have a direct effect on employment in Britain, especially in the retail and hospitality sectors which are the most likely to benefit from a tax cut as more people have disposable income to use.

Pro-Business Policies

Brexit Britain should be a beacon of business and trade, a global centre for it. London is already the second financial city after New York; Frankfurt and Paris don't get a look in, and to coin the media's favourite phrase, all despite Brexit.

The Treasury should be encouraging start-ups and entrepreneurial spirit in this country, actually providing incentives to start-up and kick the economy back into action after lockdown. Now there are several ways in which Rishi Sunak can do this, and I hope to summarise them here briefly.

A cut in Corporation Tax from the current rate of 19pc, although the Chancellor has already committed to a new global initiative to increase the rates, there is hope remaining that Mr Sunak could U-turn on this. A slashing of CT by just 10pc could potentially raise an additional £32bn in receipts as a result of inward foreign investment in the British economy. That is not to mention the positive multiplier effect it will have on employment and also the wider economy.

Double Down on Levelling Up

Despite the need to curb our public finances and government spending, it is still very much possible for the Prime Minister to embark on his 'infrastructure revolution' whilst keeping a close eye on the pursestrings. Mr Johnson needs to ensure that he doubles down on his levelling up policy and programme, which won him so many seats in the 2019 general election in the so-called red wall.

However, whilst it may be tempting to splurge public finances on infrastructure projects, the Prime Minister must be very careful and selective on how he chooses to level up; for example, a huge white elephant such as HS2 is a gross misuse of this terrific opportunity whilst interest rates are low, which of course they won't and shouldn't be for long. Number 10 should be focussing on cementing the Union together, and as mentioned earlier about the Northern Irish Protocol, he may want to consider joining Northern Ireland to the rest of the UK via a road link, either a bridge or a tunnel from Scotland or the North West of England. Another good example of protecting the Union would be upgrading the road infrastructure between northern England and Scotland as well as the roads between central Scotland and the west of Scotland to improve the road access to the ferry terminals which currently connect Northern Ireland to mainland Great Britain.

Actual meaningful upgrades on our road and existing rail network in the north of England would be far more warmly received than a high speed line costing in excess of £100bn, a project which has spiralled over budget and way over schedule. The Prime Minister should scrap it or at the very least terminate it at Birmingham where work has already begun, the final stage of this massive vanity project won’t reach Leeds until at least 2037 and that’s the most optimistic of predictions! What would be a better allocation of resources would be to actually upgrade the East Coast Mainline, recently furnished with new trains built in Newton Aycliffe in County Durham, track improvements and better infrastructure on the line would be very welcome, as I’m sure it would on the West Coast Mainline too.

The aforementioned programme of tax cuts and pro-business policies would give a total of £76 billion, representing a weighted average tax cut across all income of about 15pc, leaving £24 billion extra (about 1pc of GDP) for spending on public services and infrastructure, something which the Prime Minister is very vocal and keen on and is very much at the centre of the new look Conservative Party focussed on levelling up.

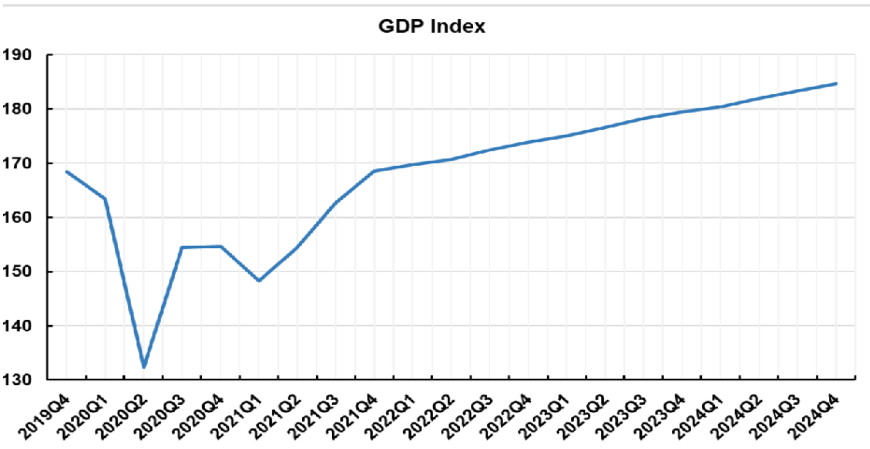
After all, The government has already committed to a £500 million investment at the Nissan plant in Sunderland, contrary to the Project Fear campaign seen all throughout the referendum and in the years following it. This upfront capital investment in the Japanese car manufacturer will see a gigafactory built in the North East of England, which could be joined by Britishvolt’s battery gigaplant in Blyth, and create in excess of 6,000 jobs including for Nissan and in its supply chain. This shows the government's dedication to investing in our communities up and down the country.

Lockdown Recovery

The UK economy was absolutely obliterated by lockdown and we need to really supercharge and energise the economy if we hope to make a decent recovery. The post-Brexit trade deals negotiated and signed by Liz Truss are the first port of call for a global Britain in a post-Covid world and a post-Brexit world and I'm sure everyone will join me in congratulating the International Trade Secretary on her sterling work in finalising some fantastic trade agreements and with several more in the pipeline, the future looks bright for post-Brexit trade.

As Professor Patrick Minford set out to The Bruges Group webinar on March 18th this year, you can see on the graph below that Q2 and Q3 of 2021 forecasts exponential growth in UK GDP which will take us far beyond pre-Covid levels of economic growth and prosperity. Despite an initial setback in Q1 of 2021, when lockdown restrictions were imposed, albeit not as strict as those of 2020, 2021 looks to be a positive year of growth and borrowing is below the levels of that predicted by the Bank of England for this period in Spring 2020.

GDP Chart



A lot of this growth is in fact coming from foreign investment and exports, post-Brexit trade has flourished despite the Project Fear campaign set out by StrongerIn during the referendum campaign and those Brexit agitators and Remoaners who were determined to see us fail. In the long-run, international trade, free trading opportunities created by being out of the EU, is set to boost GDP by as much as 7pc across the next few years which is resembled by the steady increase following Britain's initial recovery period.

Plenty of Brexit sceptics have constantly argued that the loss of EU trade will cost Britain and that we won't be able to trade with other nations on favourable terms, well as I mentioned previously, that is not the case. FTAs with the rest of the world bring price competition and world prices to the UK without EU tariffs being imposed on those imports, for example, Australian wine or fruit from South Africa.

Professor Minford also points out that China and the US are leading the way in recovery, in spite of new infections in the US, this is mainly due to the confidence in the economy by the gradual easing of lockdown. Southern states like Texas, under the Governorship of Greg Abbott, have abandoned all Covid restrictions and the economy in the state is thriving and well on the road to recovery. The EU remains weak with infections rising still and their disastrous and inefficient vaccination programme lagging.

In the UK, all lockdown restrictions should be completely gone by June 21st, I personally believe they should've been totally scrapped earlier but nevertheless, and the retreating infections as well as a vaccination boost for the over 50s and vulnerable, confidence is also building in the UK. As the graph above shows, Q1 shows a bit of a dip in the V shaped recovery but Q2 and Q3 shows a positive and encouraging trajectory. Should the PM not unlock fully on 21st, Britain could face being stuck in the same debacle as Europe with crippled economies being harpooned once again, which could spur another financial crisis or potentially a sovereign debt crisis.

The OECD also recently raised their prediction for the UK's growth forecast from the initial predictions it made in March from 5.1pc to 7.2pc, which now means the UK is predicted to grow by more than the US (6.9pc) in 2021 and we are predicted to leave the Eurozone behind, they are only predicted to grow by 4.3pc in 2021. Let us also bear in mind that the global average for economic growth in 2021 is 5.8pc so we are now far above the trend and well on our way to economic recovery and prosperity. However, we must keep in mind that we should be embracing trade policy which suits Britain, not anyone else, and we cannot allow protectionism to hinder our economic growth, especially as we now have the ability to have a bonfire of red tape of EU regulation.

Medium to Long Term Forecasting

Output in the UK is forecasted to recover to pre-Covid level by the end of 2021; then is predicted to grow at 3pc per annum, therefore falling back in line with the 2019-24 forecasts at 2pc growth per annum. This would mean that the UK is firmly back in the strong position and on the positive and stable trajectory, which was forecast at this stage in 2019.

Table 1: Summary of Forecast

	2018	2019	2020	2021	2022	2023	2024
GDP Growth[1]	1.3	1.4	-9.9	5.4	8.5	3.3	3.0
Inflation CPI	2.4	1.8	1.0	1.6	5.0	4.0	3.0
Wage Growth	3.0	3.5	1.5	3.1	6.0	5.3	4.2
Survey Unemployment	4.1	3.8	4.5	6.1	5.2	3.6	2.8
Exchange Rate[2]	78.6	78.0	78.2	76.1	74.7	74.0	78.0
3 Month Interest Rate	0.4	0.8	0.2	0.1	1.5	4.5	5.0
5 Year Interest Rate	1.0	0.6	0.2	0.5	1.5	4.7	5.0
Current Balance (£bn)	-82.9	-89.1	-58.4	-51.1	-38.9	-27.8	-21.0
PSBR (£bn)	39.3	49.1	312.3	140.4	96.2	65.3	28.8

[1]Expenditure estimate at factor cost
[2]Sterling effective exchange rate, Bank of England Index (2005 = 100)

As a result of the Covid support packages and bailouts, namely the furlough scheme, although this is similar worldwide, inflation is set to increase substantially from the current rate, and is likely to hit 5pc in the UK by 2022. There is undoubtedly going to be a consumer boom and a commodity boom around the globe and that would set off a huge rise in the money supply. However, with sensible government economic policy, inflation should be tamed back down at 2pc by 2025, which would fall into the Treasury and Bank of England's ideal of 2-3pc inflation rates. The effects and rate of the aforementioned commodity boom can be seen in these graphs below.

Oil Price: North Sea Brent (in Dollars)

Commodity Price Index (Sterling)
(Economist, 2015 = 100)

The UK's debt to GDP ratio at the end of 2019/20 was 76.1pc which equated to £1621bn. Now it is projected at the end 2024/25 to be 81pc, mainly due to the long term effects of the Covid support packages and other intervention measures. However, by the end of 2034/5, the ratio is forecasted, rather positively, to be around 50pc, assuming nominal GDP growth is 5pc; alternatively, this ratio would be 55pc assuming nominal GDP growth 4pc. This should come with the caveat that this is on the condition that government borrowing doesn't once again spiral out of control or another economic cataclysm like lockdown occurs again in the meantime.

Public Finances

As Margaret Thatcher once said, "There is no such thing as public money, only taxpayers' money", and the cost of lockdown has of course come at the cost of you and I, the taxpayer, nobody else. There is now a need to beat our public finances and government debt into shape, and we must especially avoid raising taxes which would only hinder economic growth.

Of course the way out of all of the government borrowing was through quantitative easing, when the national bank purchases government bonds, in our case the Bank of England, in the case of the Eurozone, the ECB and so on, so forth. This is by no means a long-term strategy as it is effectively 'free money' - or at least the closest we'll ever get to that, but that relies on one thing, and that is of course, every other major economy must be doing the same and as we now know, other economies are starting to veer back onto the road to recovery, QE is no longer an option for government spending. Therefore, the Bank of England must now offload some of the government debt bonds into the private sector in order to protect the UK taxpayer, avoiding a potential financial crisis.

Another policy that the Chancellor should introduce, mainly to protect the taxpayer and the government itself from overpaying, is to issue perpetuities paying interest on coupon only which would therefore lock in the current low interest rates, should any bonds or debt be issued or sold off to the private sector.

In order to restore Britain's public finances, we need to tighten the money supply and raise interest rates, now that may sound like a counterproductive policy but borrowing is out of control from the public sector so now is a good time for infrastructure investment but this could have untold negative consequences further down the line. Currently, we have interest rates around 0pc which is dangerous for lenders and could cause another financial crash, after all it was sub-prime mortgages which collapsed the Lehman Brothers over a decade ago which spurred the Global Financial Crisis and we could be looking at something similar if interest rates remain this low.

These two measures would allow Britain to regain control of her monetary policy and allow us to manage inflation and stop it spiralling out of control, as we saw in the 1970s.

The Debt and Solvency

Over the decade from 2022 to 2032, the government's spending package adds £1 trillion to the national debt, taking it to 79pc of GDP in 2034 at constant nominal GDP growth of 4pc. With the growth rate higher in this period by 1pc, the tax intake each year (about 38pc of GDP in the baseline) rises cumulatively by 1.3pc i.e. by 0.5pc of GDP, paying off debt directly by 25pc of GDP (0.5pc x10 factorial); the debt ratio in 2034 reaches 50pc, about same as the pre-package rate. Therefore, the package proposed in this analysis, and in line with Boris Johnson's levelling up agenda, excluding HS2, is pretty sustainable in the long-term, provisioning that the infrastructure investment doesn't exceed our means, which is of course not guaranteed.

The one thorn in the side of Mr Johnson is of course his carbon net zero targets which could seriously scupper the solvency and debt stability situation in the UK. The government has committed to be net zero by 2050 but this comes with untold and constantly spiralling costs to the working man and woman. Although this is a pretty key issue and central to the government's policy of late, I feel it would be an injustice to include it here and will publish a further analysis on the targets and policies in another report.

Conclusion

Prospects for fast post-Covid recovery seem pretty good but there is a need for bold policies which promote free trade, better regulation, tax and supply-side reforms. In addition to all of this, the whole thing needs to be supported by fiscal policy on the demand side and inflation must be restrained by monetary policy. However, on the whole, the fiscal package can be afforded through tax proceeds of growth and positive multiplier effects as a result of the suggestions made.

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THE BRUGES GROUP

The Bruges Group is an independent all–party think tank. Set up in February 1989, its aim was to promote the idea of a less centralised European structure than that emerging in Brussels. Its inspiration was Margaret Thatcher's Bruges speech in September 1988, in which she remarked that "We have not successfully rolled back the frontiers of the state in Britain, only to see them re–imposed at a European level…". The Bruges Group has had a major effect on public opinion and forged links with Members of Parliament as well as with similarly minded groups in other countries. The Bruges Group spearheads the intellectual battle against the notion of "ever–closer Union" in Europe. Through its ground–breaking publications and wide–ranging discussions it will continue its fight against further integration and, above all, against British involvement in a single European state.

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