1. Introduction

The primary objective of this paper is to highlight the need for the IOM Government to undertake a comprehensive risk assessment and create contingency plans due to the possible impacts of Brexit on the Island’s economy and government finances.

The UK economy has been in a strange and unexpected place since 23 June last year when the Brexit vote happened; it has held up better than expected and there was little negative impact on consumer confidence. There is a very good explanation for why this relatively rosy period of economic activity has been occurring - most ordinary consumers have not yet seen their personal circumstances change significantly due to Brexit and they have little capacity to realistically assess how Brexit will ultimately affect them.

No one yet knows what all the consequences of Brexit will be. It will take months and possibly years before the outcomes are fully understood. What we do know is that Brexit is an event of historical importance and that the UK is only at the beginning of what could become a tumultuous spell of unprecedented disruption to many aspects of modern British life and its institutions. In a worst-case scenario, if appropriate agreements with the EU are not satisfactorily completed within a prescribed two-year time frame, the UK could experience a world of self-inflicted economic pain and unpredictable political instability. The stakes could not be higher.
2. Historic Parallels

The complexity and scale of Brexit has few, if any, historical parallels. A good comparison may be the enactment of the 1534 Act of Supremacy which broke England’s links to Rome and established Henry the Eighth as the Supreme Head on earth of the Church of England. A more appropriate metaphor is the story of the exoduses of the Israelites out of Egypt. 3,000 years ago, 600 thousand Israelites decided to leave Egypt and the rule of the Pharaohs. In 2016 the British people decided to do a comparable thing by choosing to leave the EU. In both cases the People decided to leave a larger ‘empire’ and to become independent nation states. They prioritized their own identity, beliefs and history over the benefits that they had when they lived as part of a greater political entity. They wished to be free to, among other things, establish their own laws, form their own trade agreements and control their own borders. In both situations, their departure was a collective act of ‘faith’. The Israelites did not have an easy time of it establishing their promised land; they spent the next 40 years wandering around in the wilderness.

There is a very real risk that ‘post-Brexit’, the UK could find itself in an economic wilderness that the British people might have to endure for several decades. Should this turn out to be the situation, then the IOM’s £1m Budget’s Brexit Contingency Fund will turn out to be little more than a packed lunch.
In some ways, the Brexit leadership is behaving like the leaders of a religious cult; they repeatedly parrot fantastical beliefs about how wonderful life will be for Britains after they have left the ‘oppressive yoke’ of the EU, without providing any substantive proof of how the future will be better. They dismiss anyone who questions their beliefs, label detractors as being ‘bemoaners’, ‘remoaners’ and ‘enemies of the people’. Perhaps worst of all, they fail to provide satisfactory answers to the reasoned questions and arguments put to them by journalists, TV presenters, the House of Lords, members of public; i.e. anybody with genuine concerns for the future of the UK. Whilst this seemingly shallow autocracy can be viewed as an affront to British democracy, a graver fear is that some of the Brexit leaders are out of their depth and are dangerously unprepared for the arduous (potentially perilous) journey ahead.

The reality of what Brexit would mean was never made clear during the Brexit Referendum campaign. Currently all indicators are pointing towards a Brexit that will be much harder than anything considered during the campaign, let alone promised. It is now generally accepted that certain expectations promoted by the Leave team were false pledges and are not going to be achievable. For example:

A significant fall in immigration levels. Immigration levels may actually need to rise because the UK needs immigrants to do jobs that locals either don’t want to do, don’t have the necessary skills or simply unable to do;

Saving of £350m a week. The gross figure of £350m was never valid, as it did not include the £74m weekly rebate from Brussels, nor the £115m spent weekly by the EU on support for the UK farmers, aid payments to British regions, research by UK universities and companies and many other UK-based projects;
Leading Brexit campaigner Michael Gove said that leaving the EU would allow the UK Government to spend an extra £100m a week on the NHS. However, the NHS which already suffers chronic staff shortages, is now facing a prospect of losing tens of thousands of qualified doctors and nurses from the EU countries. Even if the £100m a week is forthcoming, this will not be enough to plug the staff shortage gap caused by Brexit;

Staying in the Single Market or the Customs Union. It is now clear that Brexit leaders have prioritized controlling immigration over access to European markets. The terms of any replacement trade deal and/or customs agreement may not be known for several years;

In practical terms, the UK isn't going to get its sovereignty back. Unless the UK wants to become an international pariah after it left the EU, the UK will still have to comply with numerous 'rules of engagement' set out by various international organisations;

The UK is unlikely to remain a world leader in research and development. R&D funding will almost certainly fall because the UK Government is unlikely to have capacity to match research funding currently provided by the EU.

Given the number, magnitude and complexity of the challenges, it is reasonable to assume that many thousands of things will go awry and it will be necessary to implement backup plans and other contingencies. However, the Brexiteers do not seem to have much of a primary plan, let alone any contingency plans. [1] It is therefore possible that the Brexiteers will drag the UK into a never-ending quagmire of unresolved, often acrimonious disputes and legal uncertainties.
4. The Triggering of Article 50 Signals the Beginning of a Difficult Journey

Theresa May’s letter, polite but firm, sets out the UK’s perspective and main priorities regarding future negotiations, primarily:

- a request to negotiate to a free-trade deal in parallel with the Brexit negotiations, and
- a reminder that it is in both party’s interests that ‘security’ in Europe does not deteriorate.
- resolution of the legal uncertainty for expatriates living on either side of the new EU-UK frontier;
- agreement on the principles that will be used to value the UK’s divorce settlement (estimated to be between €40bn and €60bn); and
- resolution of the Republic of Ireland - Northern Ireland border question.

The UK is seeking, in parallel to the Brexit talks, a trade agreement with the EU which is of “greater scope and ambition than any such agreement before it so that it covers sectors crucial to our linked economies such as financial services and network industries.” This is an ambitious agenda on the UK’s part, especially the inclusion of financial services, an industry that is rarely featured in other trade deals. The other focus seems to be on the ‘security’. The letter refers to the ‘security’ on 9 different occasions, possibly as a subtle reminder that the UK is one of only two European nuclear powers, has the largest military and has fought two world wars on European soil in the last one hundred years.

The response from the European Council on 31 March makes it clear that Europeans' priorities for future negotiations are different to the UK’s. Their draft guidelines reiterate that the European Council wants the talks to be orderly and more sequential/ phased than parallel. The EU negotiators also emphasized that their approach to the negotiations will not be punitive, e.g. although EU Council President Donald Tusk said that “the talks will be difficult, complex and sometimes confrontational”, he later added “the EU will not pursue a punitive approach, Brexit itself is already punitive enough.” Nevertheless, the talks on the trade deal will only begin after
‘sufficient progress’ has been made on a number of key ‘exit’ issues, including:

From the UK’s standpoint, the most contentious issue so far is the value of divorce settlement, which includes; unpaid budget commitments, pension liabilities, loan guarantees and spending on UK-based projects. There is also a possibility that the UK will remain on the hook for some of the EU’s longer term budget commitments beyond 2019 i.e. planned spending that was promised to member states but not yet marked as a ‘commitment’ in a budget year.

Michel Barnier, the Commission’s Chief Brexit negotiator has also confirmed that he will pursue Westminster for an exit bill/ divorce settlement. To-date the Europeans have demonstrated that they are united in their resolve to achieve a deal that would foremost benefit the EU citizens, albeit without punishing the UK too much. It is worth remembering that from the EU’s point of view, they need to use Brexit to prove that the costs of leaving the EU ‘club’ are high and that post-exit trading terms cannot be as good as membership terms. Time will tell if there is a chink in their armor and whether the UK’s ‘not so secret’ plan to play one member state off against another will ultimately work to the UK’s advantage. Additionally, the up-coming elections in France and Germany could alter the political landscape within Europe to such extent that the survival of the EU itself would become the number one priority, and then everything would change.

5. A Two-Year Horizon and a Lot of Challenges

The UK now has exactly two years to satisfactorily resolve a large number of significant and complex issues, including:

- Protection of the rights of the 4.4 million citizens living in the UK and EU countries;
- Agree a mechanism to settle the EU’s divorce bill;
- Transfer 40 years’ worth of accumulated European laws and regulations into the UK statute books;
- Establish the basis for new trade deal;
- Establish a new customs regime;
- Ensure that funding for universities and other research organizations is preserved;
- Set up agricultural subsidies;
- Create a new immigration system, including visa rules for EU nationals;
- Retain London’s status as a ‘leading global financial’ center;
- Keep Scotland and Northern Ireland within the UK;
- Solve the land border issue between Northern Ireland and the Republic of Ireland;
- Enable UK airlines to ‘bypass’ the EU’s airline location and ownership regulations;
- Create a new regulatory regime for fishing in UK waters;
- Manage any potential further falls in the value of British Pound (GBP). The value of the GBP will act as a barometer of the market’s perception of how negotiations are progressing;
- Retain Gibraltar as British territory;
- Deliver a good deal for each of the Crown Dependencies;
- Make contingency plans to deal with a ‘no-deal’ outcome.

It seems unlikely that the UK will reach satisfactory new agreements with the EU on all of these issues within the prescribed two-year time frame. Should this be the case, then the EU negotiators have already indicated that an interim solution would be to offer the UK a transition period that would allow negotiations to continue. During this period, which could last as long as three years, the UK would remain a member of the EU, continue to have tariff free access to the Single Market, continue to make monthly membership payments and still remain subject to the rulings of the European Court of Justice.

6. Replacement Trade Agreements and Broader Ramifications
If the UK is unwilling to agree to the principles that will quantify the Brexit divorce bill, then EU trade negotiations will not commence. Refusal to pay the final bill could result in the Europeans taking the UK Government to the Court of International Settlements in The Hague. Moreover, it seems that under any new EU trade agreement, the UK will almost certainly have to pay annual ‘Single Market / Customs Zone Access Fees’, on a basis which is similar to the EU’s current arrangements with Norway and Switzerland. Unsurprisingly, the Brexiteers want to hear none of this. The ‘remoaners’, on the other hand, do. Numerous experts, rational and experienced professionals are finally airing their concerns that Brexit will come with massive costs. It’s not just the €60bn divorce settlement, which will be a precondition to a new trade deal, it is also about how long the EU trade deal negotiations will take, what the terms of that deal might be and what happens if a satisfactory deal can’t be negotiated.

The UK has to negotiate with the 27 EU states, as well as the European Commission and the European Council. The Europeans only have to deal with one party - the UK. Currently 44% of UK exports are vended to the EU and 51% of the UK’s imports come from the EU. In comparison, the UK accounts for only about 17% of the EU’s total exports. This means that UK’s economy is more dependent on the EU than vice versa. A further one sixth of the UK’s trade is facilitated by treaties the EU has negotiated with other non-EU countries. These ‘dependencies’ make the UK’s starting negotiating position inherently weak. Furthermore, the two-year clock is now ticking and if the UK is to avoid a ‘no-deal’ outcome, it needs to get a deal or be forced to settle for a deal that it does not want. Therefore, should it take until the mid-2020s to agree a replacement EU trade deal, then, in the interim, the best outcome that the UK can hope for is that all of the remaining 27 EU member states will agree to three-year ‘transition’ extension.

The leading Brexiteer’s apparent unwillingness to face up to the reality that a ‘no-deal’ outcome is a distinct possibility is of concern. This attitude is exemplified by the UK Government’s recent admission that it has not yet assessed the impact of a ‘no deal’ outcome. Although the fallback position of reverting to the WTO rules has been presented as a viable option, there are few details of what this option would entail in practice. Most trade experts believe that it would almost certainly see the imposition of tariffs on imports and exports between the EU and UK, especially on agricultural products (which could be as high as 30%).

A great irony of leaving the EU is that this ‘event’ is supposedly happening to give the UK the freedom it needs to trade with the wider world, but in doing so it will terminate the UK’s current trading relationships with 27 EU countries, and also terminate the trade agreements that it enjoys, through EU membership, with 58 non-EU countries. Each of these other 58 agreements will also have to be renegotiated and each of these negotiations could take years to finalize.
Trade experts warn that global trade negotiations are usually protracted, complex processes. The successful conclusion of each negotiation will not only be contingent on the rational self-interest of each country, but also on the parties relative bargaining strength and goodwill. These things should not be taken for granted even with ‘friends’ like Australia and the USA.

The UK has not negotiated its own trade agreements for decades (it has relied on the competence of EU negotiators) and its bargaining power will remain inherently weak as it desperately needs to form numerous trade agreements. In February 2017, the UK had 35 experienced trade negotiators. It is said it will need 700. There is a working assumption that if the bilateral agreements ‘fail’, then the UK will be ‘saved’ by falling into the ‘safety net’ provided by the WTO’s rules. However, trading under WTO rules will not be problem free or an ideal or easy situation, as other countries will seek to take advantage of the UK’s weakened status. These countries may not always act in the UK’s best interests. Until the UK enters into firm bilateral trading agreements with other countries, it will have to trade on WTO terms and have little scope to offer ‘special’ terms to individual WTO members.

The administrative and legal sides of ‘unpicking/ redrafting’ laws and regulations after Brexit are additional issues. Again, these huge projects, which are only reluctantly mentioned by the Brexiteers, will also be challenging and costly.

Tariffs and tangible non-tariffs barriers to free trade, the limitations of being outside the Single Market/ Customs Union, a second referendum on Scottish independence, hard border controls with the Irish Republic, the spectre of a return of the ‘Troubles’ which could culminate in Northern Ireland’s reunification with the Irish Republic, are all possible factors that contribute to the overall risk associated with Brexit.
7. A Less Certain Future for the Isle of Man

In July 2016, then First Minister Allan Bell described Brexit as a “journey into the unknown for both the UK and the Isle of Man”. On 24 March 2017 IOM Treasury Minister Alf Cannan echoed this sentiment by calling Brexit as a “journey without maps.” Both descriptions seem appropriate.

By April 2019 the Isle of Man could lose its current long-standing right to trade tariff-free with the EU (This right is granted to the Island under Article 1 of Protocol 3 of the UK’s Act of Accession to the European Community). Until there is a viable alternative, the loss of this right in particular means that the Island will face greater economic uncertainty.

Theresa May has assured the IOM Government by letter, saying that “We remain committed to engaging with the Isle of Man as we prepare to exit the EU, to ensure that your interests are properly taken into account.” As comforting as this assurance may seem, the UK Government has made no tangible commitments and has given no bankable guarantees to the Isle of Man. The Island is therefore entering the same period of potential political and economic weakness as the UK, with only vague assurances from Westminster.

The consequences of Brexit will be wide-ranging for Manx economy, but will vary from sector to sector. There will likely only be a marginal impact on immigration as the Island does not allow freedom of movement the same way the UK does, although the recruitment from the EU countries is expected to be severely restricted. This change could negatively impact areas of the economy such as the NHS. The impact on the financial services is likely to be more muted here than in the UK because the Island does not currently benefit from an automatic right of access to the Single Market. The E-gaming industry also looks as if it will be relatively insulated. However, in the absence of satisfactory new trade arrangements the Island’s manufacturing, agricultural, fishing, aircraft, shipping and yachting industries could all potentially be adversely affected. Perhaps the greatest threat is the general economic ‘turbulence’ that will hit the Isle of Man if a suitable deal is not reached.

The Isle of Man was not given the opportunity to vote in the Brexit Referendum. It has however no choice, but to make the best of the result. Although Brexit could deliver certain new opportunities to the Island, there are potentially various serious economic and political risks ahead. For example: will the UK’s departure from the EU ‘table’ expose the Island to the threat of being blacklisted by the EU as a tax haven? In the past, the UK has defended the Island from these types of threats. In the future, it may not be able to do so.
The Isle of Man needs to take a sober assessment of what the Brexit risks might bring in their wake. Ideally, the IOM Government will undertake or commission a comprehensive professional risk assessment of how Brexit could affect every aspect of life on the Island. Part of this exercise should include the development of risk mitigation strategies. It may also be advisable for the Island to appoint a ‘Brexit Minister’. Without being overly melodramatic, Brexit has put the future of the Isle of Man on the line. It is therefore imperative that the IOM Government does all that it can do to prepare the Island for a post-Brexit world.

[1] “When forecasting the outcomes of risky projects, executives too easily fall victim to the planning fallacy. In its grip, they make decisions based on delusional optimism rather than on a rational weighing of gain, losses and probabilities. They overestimate benefits and underestimate costs. They spin scenarios of success while overlooking the potential for mistakes and miscalculations. As a result, they pursue initiatives that are unlikely to come in on budget or on time or to deliver the expected returns - or even to be completed.” Page 252 of ‘Thinking Fast and Slow’, Daniel Kahneman, Penguin, 2011.