



Brexit has been from the beginning a 'revolutionary' movement of historical importance. It is the most complex and consequential challenge that the UK has faced since the Second World War. It remains a populist ideology, encompassing issues such as an ostensible 'loss of British cultural and religious identity' and the feeling by numerous individuals that they are losing the ability to control their personal destinies in an ever-increasingly competitive globalised world. It goes to the heart of how various groups perceive broader society with greater anxiety and what they hope and fear the future will hold. Arguably, these are the same forces that swept Donald Trump into power in the USA.

From a purely political point of view, Brexit is essentially a belief that by 'taking back control' the UK can stop/ reverse the current emigration trends and build a 'truly-sovereign' post-Brexit economy. This perspective assumes that a confident and 'free' UK will be able to form new, more favourable trading relationships with the wider world, including the EU. It reconciles the inherent tension between benefiting from free-trade with the EU and controlling the flow of migrants, by assuming that the UK can have the best of both worlds. This assumption is central to the Brexiteers' vision for brighter future. Unfortunately, should this vision transpire to be a delusion, then the full consequences of their 'failed experiment' will be borne out by all British people, whether they voted for Brexit or not.

For the foreseeable future, Brexit will be the main backdrop to every major political and economic issue and activity in the UK. In the 15 months after the Brexit vote in June 2016, the UK Government has remained internally split between those who prioritise economic prosperity and those who favour greater control over demographics. Whilst the UK Government continues to formulate its Brexit strategy, deep divisions remain within the country, some of which are simply disagreements about what Brexit will actually mean.

The UK Government's weakened political position, which paradoxically came about because they called an early General Elections in order to strengthen their Brexit mandate, has the potential to undermine Brexit's progress. The results of the 8 June 2017 General Election was referred to on the social media as the 'revenge of the Remainers'. Any further political weakness in the Conservative Party could delay or even derail the Brexit project altogether. For example, opposition movements such as 'Exit from Brexit', championed by the Liberal Democrat Party, are strengthening.

Across the Channel, the EU seems to be perplexed about why the Brexit negotiations are in an apparent stalemate. Michel Barnier, Europe's chief negotiator, indicated that from an EU perspective little progress had been made on the first three issues:

- the post-Brexit rights of EU citizens in Britain and of British nationals in the EU,
- arrangements to avoid post-Brexit hard borders restricting movement between Northern Ireland and the Irish Republic and, most contentious of all,
- the potentially hefty divorce settlement.

Meanwhile the March 2019 clock keeps ticking and at this stage it is uncertain what type of divorce and re-engagement deals the UK will be able to form with the EU, let alone how the UK will (re)negotiate the hundreds of the trade and other deals the UK currently has with the non-EU countries through its membership of the EU.

The final outcomes of Brexit remain far from clear. The harsh truth may be that when the UK voted 'to go it alone', it also inadvertently voted for economic 'self-harm'. The Isle of Man's umbilical dependency on the UK means that the IoM's future economic prosperity will depend on the success or otherwise of the Brexit negotiations. It is vital for the IoM economy that the UK Government avoids a cliff-edge Brexit scenario.

The following 11 Scenarios are presented as possible medium-term Brexit outcomes. These scenarios are not an exhaustive list.

Scenarios 1 and 9 are all Brexit scenarios.

Scenario 1: Brexit is abandoned

The UK populace foresees the potential hazards of Brexit, including the inability to resolve the major divorce issues with the EU, and/or to form new trade deals, which:

causes the GBP to fall further, resulting in

surging inflation, which causes the Bank of England (BOE) to

increase interest rates, which results in

tumbling property, bond and stock markets, escalating defaults on consumer debt, and ultimately

a deep recession.

Popular opinion turns against Brexit. The UK Government withdraws Article 50 prior to the March 2019 deadline. The Brexit project is abandoned before too much irreversible damage is done to the UK and the IoM economies.

Scenario 2: Brexit ‘delivers’ everything that was promised

The Brexiteers are ‘triumphant’. All of Brexit’s major divorce issues (e.g. the terms of and costs of the divorce, the rights of migrants, the border in Ireland) are resolved amicably and a new comprehensive (free) trade agreement with the EU is reached within the two-year negotiating period. The UK leaves the EU and all of its bureaucratic ‘red tape’, takes total control of its borders and its laws, introduces ‘points-based’ migration system that largely restricts migrants to high-skilled/ high-demand occupations and quickly negotiates mutually beneficial trade agreements with numerous non-EU countries. The EU does not challenge the IoM’s taxation policies. The success of Brexit strengthens the nationalists across Europe, placing further questions over the EU’s long-term viability.

The UK and the IoM economies boom.

Scenario 3: The UK and the EU fail to agree trade terms, leaving the UK in a situation where it must trade with the EU and the rest of the world under WTO rules

Any final Brexit agreement, which includes a divorce settlement and a new trade deal, is unlikely to be ratified by each of the remaining 27 EU nations by April 2019 deadline. Therefore, the UK will find itself trading under WTO rules. This is perhaps the most likely outcome of the Brexit negotiations. Note that the EU's trade agreement with Canada i.e. CETA (the EU's trade agreement with the UK will be infinitely more complicated) was signed in October 2016, but has not yet been fully ratified.

Trading under WTO rules works well for post-Brexit Britain, after all the majority of trade in the world is currently conducted under WTO rules. WTO rules are a very good low-tariff trading system. The UK Government has both anticipated and prepared for this eventuality. It resets its tariff rates to match WTO schedules and invests in the necessary new ports and customs clearance facilities.

Free from the 'shackles' of EU regulations, the UK private sector goes from strength to strength. Over the next ten years the UK, whilst trading under WTO rules, forms 'unilateral trade' agreements with the EU, USA, India, China etc., taking the UK economy from a good situation to even better one.

The IoM economy, by default, enjoys the benefits of Brexit along with the UK.

Scenario 4: The negotiated Brexit agreement means 'business as usual', but the UK makes concessions

The UK leaves the EU but the deal that is reached means that Brexit is Brexit in 'name only'. Under this agreement most existing commercial and demographic relationships between the UK and the EU remain intact. The UK stays inside the Customs Union and/or Single Market and continues to comply with the directives of the European Court of Justice (ECJ). The banks retain their passporting rights and the UK concedes to unlimited freedom of movement for European citizens. In addition, the UK is now able to independently forge new trading relations with non-EU countries. The GBP regains all of its lost ground against the Euro and the USD. The post-Brexit stock market rise reverses but the market does not crash. The 'super-generous' terms the EU granted the UK cause frictions between the remaining 27 EU countries and the EU itself. Equally, whilst the UK appears to be living in the goldilocks world, ardent Brexiteers lament the unrestricted migration of EU citizens and the UK's continuing subjugation to the EU bureaucrats and the ECJ.

As part of the deal, the UK agrees with the EU to a number of important concessions, one of which is that the UK will bring its low-tax Crown Dependencies into line with UK standards. Under this scenario, although UK's domestic politics becomes more divisive, the UK economy continues to grow at a steady pace. The IoM economy, however, faces existential challenges.

Scenario 5: The EU grants the UK an 'as long as it needs' transitional period to both leave the EU and establish new trading relationships

As 'long as it needs' turns into a decade. A full and final Brexit does not become a reality until 2029. Private and public-sector businesses, individuals and mainstream political parties all operate in a state of 'Transition-Brexit', which enables them to gradually adjust to the realities of Brexit. At the end of this 'period in the proverbial wilderness' the UK economy recovers sufficiently for the UK Government to plough some of the promised £350m per week into the NHS. However, living in a political and economic 'twilight' means living with instability, confusion and political weakness.

In the meantime, economic growth is subdued but is adequate to enable the UK and the IoM economies to plod along.

Scenario 6: In March 2019, the UK Government agrees a 3-year transition/ half in – half out period. This agreement temporarily cedes many of the UK's 'right to govern' powers to the EU

This is a version of a so called 'soft Brexit'. It is a political hotchpotch which enables the UK to temporarily stay within the Customs Union/ Single Market but it also remains subject to most EU laws. As the UK Government is unable to take decisive action on any significant issues, it becomes a 'lame duck' administration. The mood among consumers and investors suffers. Because the UK ceases to be a strong and reliable 'sovereign' partner in the eyes of potential future trading partners, relationships with these countries also suffer. Potential trading partners bypass the UK, preferring to deal with the EU directly, which is not only seen as more politically credible, but is a much bigger market. Tensions abound and eventually these 'fudge' arrangements implode, as does the Tory Government. The Labour Party challenges the Government's 'legitimacy' and calls for an early General Election.

The economies in the UK and the IoM are mildly positive but on-going political uncertainties in the UK threaten to destabilise future economic landscape in both countries.

Regardless of which party ultimately holds the power, the Island becomes increasingly vulnerable to hostile Westminster MPs desperate to find ways to ensure their own survival. There is some 'horse-trading' with IoM Government over the VAT agreement, amendments to IoM's tax regime, etc. The IoM economy will be irreversibly damaged.

Scenario 7: UK agrees divorce terms with the EU but finds it difficult to form new trade deals

UK has reached a divorce settlement with the EU and is now out of the Customs Union/ Single Market. The UK is free to create new trade deals all over the world, including with its largest and nearest neighbour - the EU. These are not easy tasks. The UK has a diverse economy and 'one size fits all' deal does not address all of the nuances in such complex environments. The EU makes it clear that from their perspective a trade deal could take some years to negotiate.

Whilst the trade negotiations with EU are bubbling along in the background, the UK attempts to reach out to other powers such as the USA, China, India, Canada, Australia, New Zealand etc. The obstacles here are also significant and complex. These countries sense that the UK is in a weak negotiating position and look to take advantage.

The UK discovers that Donald Trump's 'American First' agenda supersedes the historic 'special relationship'. The USA are now only prepared to do deals that are favourable to American producers. Similarly, Chinese negotiators, knowing full well the attractiveness of their gigantic consumer market for small foreign powers, want to extract from the UK even better terms than those they have in place with the EU. The Commonwealth countries like India, Canada, Australia and New Zealand are prepared to form mutually beneficial trading arrangements, but they too have vested interests and agreeing to any comprehensive deals takes years. A potential sticking point from the UK's perspective is that these countries, India in particular, want easier visa access for their citizens to work and study in the UK. This demand creates a headache for the UK Government who remains committed to limiting migration to 'tens of thousands'. The UK's economic conditions deteriorate and social unrest starts to rise.

The IoM economy is caught up in this mayhem.

Scenario 8: Global financial markets lose faith in the UK's ability to manage its economy

The UK Government, having committed itself to delivering Brexit, is determined to implement Brexit no matter how severe the economic fallout is. Global financial markets lose faith in the UK Government's ability to manage the economy and express their concerns by selling the GBP, an action that leads to sharply rising inflation. Faced with a falling currency and rising inflation, the BOE has no choice but to increase interest rates. Initially it does this in series of 25-point steps but eventually is forced to make larger increases. All of the increases are passed onto consumers. The base rate exceeds 5% by 2020, leaving many home owners with negative equity and many consumers with unpayable debts. Rising interest rates have also caused UK bonds to plummet, wiping out billions from the balance sheets of pension funds. The cost of borrowing rises steeply for the UK Government. Economic growth falls and the UK enters a recession.

Under this scenario the IoM Government's externally managed Reserves lose 25% of their

value and the IoM economy goes into a deep slump.

Scenario 9: No deal(s)

This situation is the cliff-edge scenario that Brexit-sceptics are afraid of. The EU and UK are unable to agree a divorce settlement and nor are they able to conclude a trade agreement. As a consequence, the UK no longer has access to the thousands of international EU treaties and agreements, previously available to it through the UK's membership of the EU. The UK is now a fully sovereign state trading under WTO rules, and free to strike new trade agreements with whomever it wishes. However, because of the multi-faceted nature of the UK economy, reaching new trade agreements with the EU and other countries take time (years).

In the meantime, WTO customs procedures paralyze trade on the UK's borders with the EU and a hard border appears 'overnight' in Ireland. The EU refuses to extend UK banks passporting rights, a decision which causes the banks to relocate more of their operations to the EU. Similarly, airlines and manufacturers also relocate some of their operations to Europe.

The farming sector, hamstrung by the loss of EU subsidies and a lack of suitable workers, comes under pressure from cheap imports. The fishing industry finds itself embroiled in disputes with neighbouring countries over fishing rights and demarcations. Health services, science and education struggle to recruit suitable staff. There is an escalating number of issues pertaining to environmental protection, pharmaceutical, food standards etc.

The GBP falls even further, but in the absence of trade deals local exporters are unable to take full advantage of low GBP. The UK economy is then in an extended period of economic and social disruption, not seen since WWII. The impact on public finances is severe. The ratings agencies react to these adversities and cut UK/ IoM's credit rating AA1 (negative outlook) by a couple of notches. This change increases the cost of borrowing.

Under this worst-case scenario the UK (and the IoM) are in uncharted territory and there is no clear or easy way out. This is disastrous situation for both countries (Writer's note: arguably things may not turn out to be quite this bad, refer in particular to Scenario 3).

Scenarios 10 and 11 are non-Brexit scenarios with potentially negative implications for the UK and IoM.

Scenario 10: The UK Government calls an early election

The UK Conservative Government calls an early General Election. The mere whiff of the possibility that a left-leaning Labour Party, under the leadership of Jeremy Corbyn, could win power and implement its 'socialist' agenda of; higher taxes on corporations and high-income earners, higher spending on welfare, etc. causes investment and consumer spending across the UK to fall sharply. Nevertheless, the Labour Party wins a parliamentary majority and forms new administration in Westminster. The immediate impact is falling GBP, higher inflation and a slump in the stock and housing markets.

As a part of the Labour's endeavour to make society 'fairer for all', Labour leader(s) restate their antipathy to 'tax havens' and threaten to close them down unless they 'come into line'. Companies begin to disinvest in the UK and especially the IoM.

Arguably, Jeremy Corbyn's victory brings the end of the IoM as we know it. This scenario is inherently hazardous for the IoM on many levels.

Scenario 11: Donald Trump makes the world an even more uncertain place

After several months of his presidency, Donald Trump has achieved none of his populist domestic agenda and already spent a great deal of his initial political capital. On the foreign policy front he is becoming increasingly unpredictable, i.e. threatening to pull out from NAFTA, waging unwinnable wars with various countries (e.g. North Korea), initiates a multi-level conflict with China, etc. The more engaged Trump becomes with the rest of the world, the greater the potential that he will also send the global financial markets into a tailspin.

Brexit – 11 Medium-term Scenarios

Written by PAG

Saturday, 23 September 2017 23:53

In this increasingly fraught setting, the UK's hopes of forging a post-Brexit trade agreement with the USA could fizzle out simply because Trump inexplicably changes his mind about what 'fair and balanced trade' with America means. Failure to secure a suitable trade deal with the USA, with whom the UK currently has a sizeable surplus, will be a major setback for the UK Government and will have significant negative economic fallout for the UK and the IoM economies.