BREXIT

THE UK AND THE EU

ASPECTS OF THE LEGAL AND ECONOMIC RELATIONSHIP

New Direction

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The UK's departure from the EU and the discussion about the withdrawal arrangements have been at the heart of political debate in the UK since the 2016 referendum, though for decades the relationship between the UK and the EU has been a focus for public debate.

In the final months of EU membership, a number of questions came to the fore in the UK which may also resonate in the remaining 27 EU member states. Some of these touch broadly on the UK's economic and legal relationship with the EU and raise questions about the direction best for the future, for economic success, legal certainty and constitutional freedom. Three such themes will be discussed here.

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Though the UK's vote to leave was primarily a decision to restore UK sovereignty, and the right of people to determine how they are governed, the referendum decision reflected a range of other but related differences between the UK and the EU - economic, legal and trade.

In particular, it reflected the tensions between Britain's tradition of free trade and competitive markets, underwritten by the Common Law, and the EU's preference for a controlled economy under EU law, interpreted and judged by the European Court of Justice, in a system which has developed to underpin the political goal of ever closer union.

As a result of the UK inclining to the first tradition and the EU to the second and enjoying dominant jurisdiction, tension developed between the EU's legal and economic systems and the UK's. Britain's entrepreneurial productive sectors, both goods and services, were undermined by the rule bound process driven arrangements favoured by the EU and its big corporations and lobby groups. Meanwhile the political and legal system and dominance of EU law undermined the UK's constitutional and legal freedoms of people in Britain: the vote to leave the EU in 2016 reflected a determination to end the compromises attempted and demanded since the UK's EU membership began in 1973.

For individual member states watching developments in the UK, there has been a sense of some fellow feeling with the British position. For many people, the EU model has failed. Democratic institutions and protections have been overruled and citizens both in the founder states and those who have joined more recently are concerned that they no longer have a say on important areas of policy, the UK's constitutional, economic and sovereign powers having been undermined. Economic policy has not been successful for some countries, though may have benefitted others. In Spain[1], unemployment is 14.8 per cent (under 25 youth unemployment is 34.9 per cent - November 2018); in Italy[2] it is at 10.6 per cent (under 24 youth unemployment 32.5 per cent - November 2018), in Greece[3] unemployment is at 18.6 per cent (youth unemployment is at 36.6 per cent - September 2018).

WILL LONDON'S LEAD CONTINUE ACROSS THE FULL RANGE OF BUSINESS AND SERVICES AND AT THE HEART OF GLOBAL MARKET?

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Brexit, the UK and the EU - Aspects of the legal and economic relationship introduces some of the economic and legal questions arising in the relationship between the UK and the EU. Forrest Capie and Geoffrey Wood open by reflecting on the background to the 2016 UK decision to leave the EU in *The UK and the EU, Irreconcilable Differences and Strong Friendships*. The next chapters turn to some less obvious but important matters for the future, economic and legal, which also touch more generally on the relationship between the centre and individual member states. These consider aspects of the economic and legal relationship between both parties. They include the question of payments made to the EU and the implications for the domestic economy, with specific reference to the UK's 'divorce payment'; the role that can be played by different sectors in individual countries given their particular strengths, whether in, or out of the EU, the example here being London as a global services centre; the respective position of the CJEU and UK courts, a question relevant to other member states' judicial position vis a vis that of the EU and its law.

In *The Brexit Settlement and UK Taxes*, the economist, David B. Smith explains that the UK's commitment to pay a sum estimated at around £39bn would be better spent at home. If so, economic estimates are for GDP to be boosted (by up to 1.4 per cent), household consumption to go up (by up to 3.5 per cent), along with private investment (by up to 3.6 per cent). Meanwhile the unemployment rate would fall (by up to 0.8 per cent), as would public sector borrowing (by 1 per cent).

With respect to the ending of EU Law after the transition, in *The ECJ: An Imperial or Impartial Court? Adjudicating Treaty Rights After Brexit*, EU lawyer, Dr Gunnar Beck, emphasises that continued indirect or direct jurisdiction by the European Court of Justice (ECJ) over aspects of the UK's legal, constitutional and economic arrangements, must be resolved. The UK's official position is that ECJ rule and dominance ends after Brexit. But, as Gunnar Beck outlines, the transition arrangements envisage a continuing role during the transition and there is a real danger of its continuing beyond, extending to the future. Dr Beck concludes that from 1 January 2021, full sovereign powers must be returned including the independence of the UK Courts. In particular, independent dispute resolution mechanisms must be agreed.

Turning to the services economy and the global lead over centuries London has maintained as a centre for financial services, rivalled today only by New York. Its dominance has been underpinned by the security of the Common Law and the expertise found in a range of businesses and complex activities. Will London's lead continue across the full range of business and services and at the heart of global market?

1 Ministerio de Trabajo, Datos de Paro, November 2018, http://prensa.empleo.gob.es/WebPrensa/noticias/laboral/detalle/3395

2 Istituto Nazionale di Statistica, Occupati e Disoccupati, November 2018 https://www.istat.it/it/archivio/224515

3 Hellenic Statistical Authority, Labour force monthly data, September 2018 http://www.statistics.gr/en/statistics/-/publication/SJO02/-

Dr Sheila Lawlor
is Director of Politeia, where she directs the constitutional, legal, social and economic policy programme. Her background is as an academic historian, specialising in 20th century British political history. For Politeia she is the author of Deal, No Deal? The Battle for Britain's Democracy *(2018) and* Ruling the Ruler: Parliament, the People and Britain's Political Identity *(2016). Her academic books include* Churchill and the Politics of War, 1940-41 *and she is currently completing a book on 'Churchill and the Politics of Peace' (working title).*

Thomas Sharpe QC considers in *Commercial Law Post Brexit*, London's position as a leading commercial litigation centre in Europe and explains the strong grounds for that continuing. He discusses the strengths on which this position rests such as the quality and integrity of the judiciary and the legal system, the commercial and pragmatic approach to litigation, the strength and diversity of talent, the use of the Common Law and its operation. 'People in banking, sale of goods, insurance, shipping, international trade and competition know they are dealing with judges who understand their world, and with a law that reflects it', he explains. There is also the widespread multilateral adoption of English law clauses in standard industry agreements. Moreover Brexit to a 'greater degree' leaves arbitration untouched.

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These questions highlight some of the costs and problems for the UK of EU membership and the opportunities that can be seized on leaving. For member states choosing to remain in the EU there will be similar questions prompted by the relationship each has with the bloc, and whether or how membership of the EU and the Eurozone can be reconciled with the constitutional and legal freedoms sought by people or the balance they wish struck between economic cost and opportunity for their country. ■

The UK and the EU

IRRECONCILABLE DIFFERENCES AND STRONG FRIENDSHIPS

Forrest Capie & Geoffrey Wood

The vote for Brexit is sometimes described as meaning that Britain is 'Leaving Europe'. That description is nonsense. Britain is indissolubly part of Europe, through geography, history, language, and culture. What Britain voted to leave was the European Union, a body which contains *some* parts of Europe and which aspires to contain also some countries which geographers would not in general regard as in any way part of Europe.

Why was there over time growing unhappiness about Britain's membership of the EU, leading first to the referendum and then to that referendum's result?

In certain senses there is an incompatibility between the British and the European outlooks. The British philosophical and legal roots and traditions are different from those in Continental Europe. The consequence of these different roots and traditions is that the British incline to openness, flexibility, and a focus on the individual, whereas in Europe the tendencies lean the other way, to less openness, to inflexibility, and to a greater focus on the state. These differences were not particularly problematic when Britain joined what it regarded as a trade-promoting Common Market. But they increasingly brought difficulties as matters of law, regulation, and trade were affected by the moves towards ever-greater European Union integration.

The different traditions have led to different economic models. The British leads to free trade and an embrace of globalisation and less regulation. The European model leads to a bigger state, more regulation, and greater protection.

Four matters, each part of Britain's history, made Britain a less than comfortable member of the European Union, as that body is at present constituted, and even more so if its present constitutional aims are confirmed. These are law, regulation, trade, and attitudes to immigration.

LAW

The legal systems of Britain and Europe are fundamentally different. Note the word 'systems'. We do not mean that individual laws are different. That the British drive on the left and most of Europe on the right is neither the result of nor an example of difference in legal structure. Britain has a form of law called Common Law; countries on the European mainland have Roman (sometimes called Civil) Law.

A simple, no doubt over-simple but nonetheless fundamentally accurate summing up of how these differ is as follows. In a Common Law system you can do anything you like so long as it is not forbidden. In a Roman law system you can do anything you like so long as it is allowed.

These differences embody the views about the individual set out above, and also lead to entirely different views of the role of the state. In the philosophy underlying Common Law the state's function is to provide the setting for individuals to do as they wish to further their own interests, constrained only by prohibitions that prevent these actions from harming others. The state is an enabling state. Under the philosophy of Roman law, the state exercises choices for the citizen, and provides a menu of what is deemed desirable from which citizens can choose. The former can lead to a small state, while the latter in general cannot.

Roman Law, going back to Emperor Justinian and in its modern form to the Code Napoleon, works by applying unchanging general principles. Common Law seeks practical outcomes; indeed, judges may begin by finding a solution and then seek legal justification on which to base it. As Oliver Wendell Holmes the renowned American lawyer and longest ever serving member of the US Supreme Court (he served from 1902 to 1932) wrote, 'the life of the Common Law has not been logic, it has been experience.'

This fundamental difference has had a gradual effect, until it became impossible to ignore it.

REGULATION

For those inclined to favour market solutions in economics the guiding principle on regulation is competition where possible, regulation where necessary. Stress is put on the fact that regulation is a tax on activity. It reduces total output. On the other hand for those who believe market failure to be widespread there is a bigger role for the state – more regulation is required. (For many of them government failure seems not to exist.) And it follows from our brief outline of the difference in legal structures that under the European model regulation is ever-more extensive and detailed. Worse still from a practical point of view is that the large bureaucracies required to detail the regulations precisely - as the Roman Law basis requires - spawn further regulation, and so on.

For the Common Law model regulation is viewed as a burden that at minimum requires careful monitoring with a view to reducing wherever possible.

An example comes from the laws governing relations between employer and employee. When laws were being proposed and subsequently enacted to prescribe how the safety of workers in a wide range of industries was to be protected, a trade union leader, Frank Chappell, who was leader of the electricians' union, objected. Not because he had no care for the safety of the members of his union but rather because is his view the existing law was superior. It prescribed a general 'duty of care', and this, he maintained, allowed working practices to adapt so as to be safe in different environments, and as environments changed.

Many detailed laws do not guarantee good outcomes. This has been long understood. To quote the Roman historian Tacitus, 'corruptissima republica plurimae leges' (the most corrupt republics have the most laws. (Tacitus Annals).

TRADE

Similar outcomes follow for international trade – as indeed they do for any trading activity. The British have long pursued free trade (often against powerful political forces) and indeed having adopted it almost two centuries ago have preached the benefits and endeavoured to export the doctrine. Europe from the nineteenth century generally resisted that model. The market model shows that maximum gains flow from the free movement of goods. Any interference in that free flow will result in welfare losses. There will always be gainers and losers when moves to free trade are made. But indisputably the benefits to the country overall are greater under free trade.

The desirability and pursuit of free trade flows from the legal tradition of allowing individuals to pursue their own interests. It contrasts with the long mercantilist tradition in Europe with its focus on the centrality of the state and its view of what was best for the country. That latter system also leaves the state more exposed to interest group pressure. Interest groups are successful when representing highly concentrated business or other activities. They have much greater economic power than widely dispersed consumers with little representation. Protectionist policies are frequently the result. And as before, regulatory policies beget regulatory policies. (The recently concluded Canadian EU trade agreement taking 10 years to agree and running to over 1500 pages contains all the evidence needed.)

IMMIGRATION

Britain has long been a country open to migrants, whether or not they be refugees. There have of course been occasional falters in this long and noble tradition, but they have been both rare and small. The reasons for this welcoming attitude are easy to trace. They lie in the individualistic philosophical and legal tradition that held that individuals could do what they liked so long as they did not harm others. Immigrants were therefore welcome so long as they fitted in – not necessarily integrating in the sense of adopting all local mores, but rather behaving in ways that were not blatantly inconsistent with them. (And of course for most of the period there was no welfare state).

There is no reason to believe that the openness of the British traditional liberal mind-set, the tradition of individual freedom so long as it does not harm others, and of kindness to new arrivals, has changed. Britain was after all the first country in the world to have a Jewish prime minister. And perhaps most compelling, Britain has never been plagued, even in the depths of inter-war recession, with unsavoury authoritarian politics of the type that has appeared from time to time in other countries.

NO LONGER IS EUROPEAN LAW LIKE AN INCOMING TIDE FLOWING UP THE ESTUARIES OF ENGLAND. IT IS NOW LIKE A TIDAL WAVE BRINGING DOWN OUR SEA WALLS AND FLOWING INLAND OVER OUR FIELDS AND HOUSES...

Nothing of what is outlined above makes it impossible, or even mildly difficult, for Britain to live on good terms with her neighbours in the European Union. None of it makes it difficult for Britain to trade freely with them. None of it creates difficulty in recognising the acceptability of goods and services produced under the regulations of the EU nor for the EU to accept British regulations. All these regulations, after all, are imposed by democracies with the welfare of their citizens in mind, not by kleptocracies or dictatorships. But what the differences most emphatically do is make it very uncomfortable for Britain to be a member of a union of countries all of which have legal systems of the Roman law type, and which is increasingly governed, as a federation, by a body of law of the Roman form.

Two quotations from Lord Denning, who ended his legal career as a member of the House of Lords[1], make the point.

The first, from 1974, is as follows. 'The Treaty of Rome does not touch any of the matters which concern solely England and the people in it. ... But when we come to matters with a European element. ... Parliament has decreed that the Treaty is henceforward part of our law. It is equal in force to any statute.'[2]

Then, sixteen years later, he wrote, 'Our sovereignty has been taken away by the European Court of Justice. ... No longer is European law like an incoming tide flowing up the estuaries of England. It is now like a tidal wave bringing down our sea walls and flowing inland over our fields and houses...'[3]

That discomfort would inevitably be felt on all sides, not just by Britain. Britain is undoubtedly suited to be a good friend and partner in all economic activity, in which we include the movement of individuals, to the member countries of the EU. But British membership of an EU constituted as it is now seems to be heading would be comfortable for neither Britain nor the EU: British philosophical and legal roots and traditions seem too different from those on the Continent. The Brexit vote should not have been a surprise to anyone who had read Lord Denning. ■

1 What were called Law Lords used to sit in Britain's House of Lords, and constituted Britain's highest court. That court was removed from the House of Lords, and named the Supreme Court, only when it was no longer supreme.

2 H.P. Bulmer Ltd v J. Bollinger SA.

3 Introduction to "The European Court of Justice" (Bruges Group, 1990)

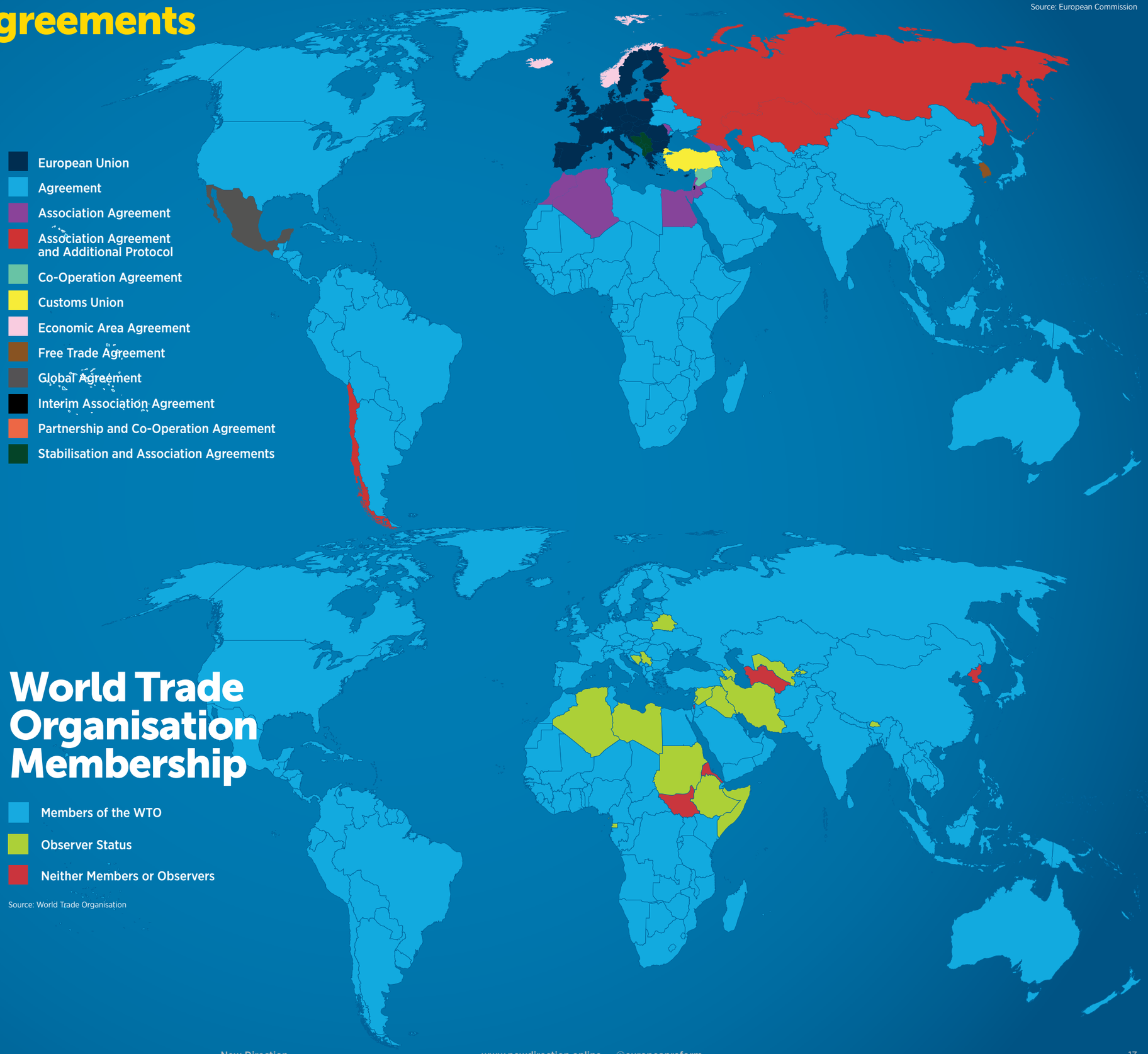
Geoffrey Wood
is Professor Emeritus of Economics at the Cass Business School, City University, and of Monetary Economics at the University of Buckingham. He served as a Special Advisor on Financial Stability at the Bank of England for the decade to 2004. His co-publications include The Oxford Handbook of Sovereign Wealth Funds (London, 2017), of which he was a contributing author, and Monetary Unions: Theory, History, Public Choice, with Forrest Capie (London, 2003).

Forrest Capie
is Professor Emeritus of Economic History at the Cass Business School, City University, and was editor of the Economic History Review between 1993 and 1999. His recent publications include Money over Two Centuries (Oxford, 2012) and The Bank of England, 1950s to 1979 (Cambridge, 2010).

Current EU Trade Agreements

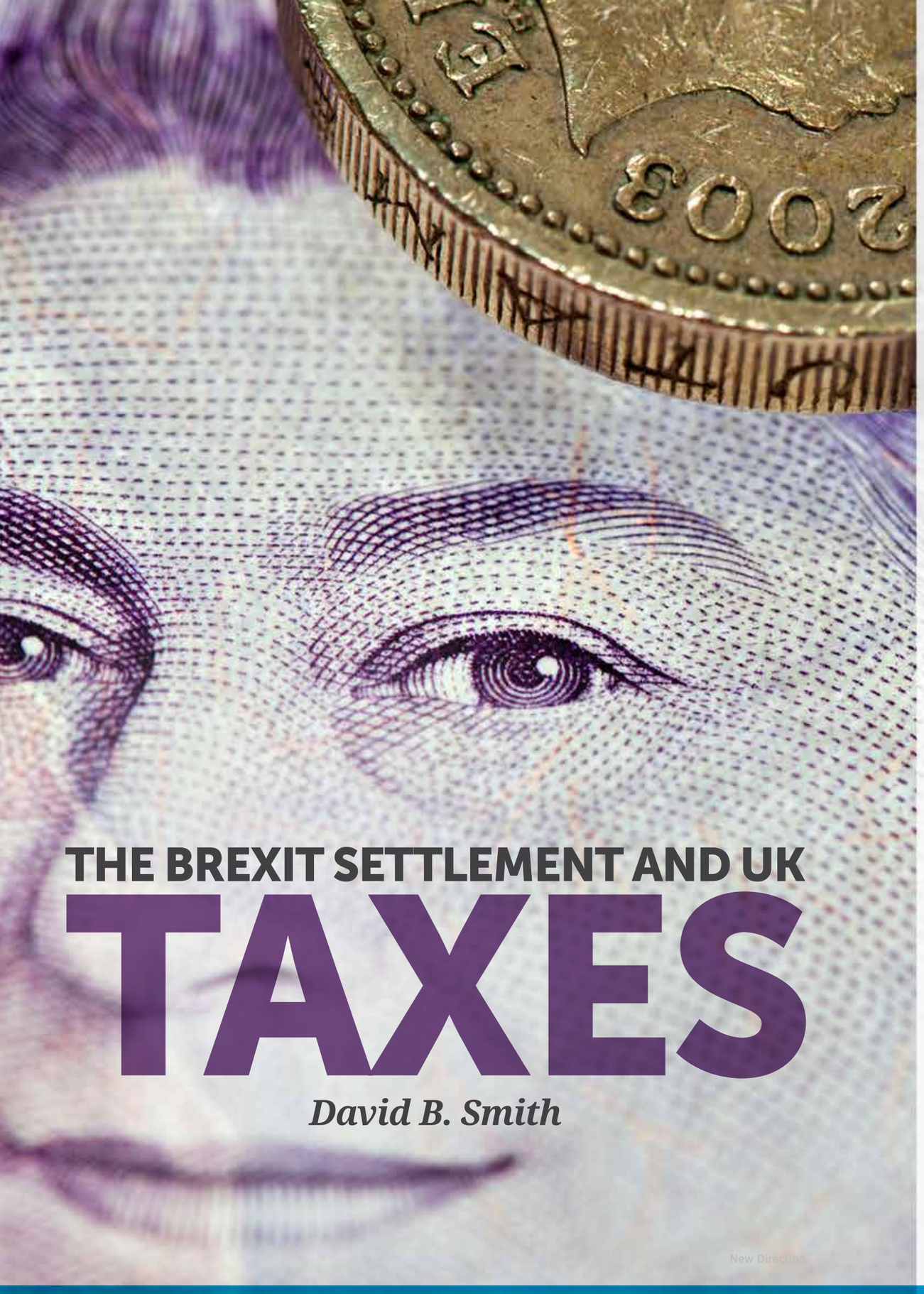
Source: European Commission

- **Albania** (Western Balkans) - Stabilisation and Association Agreement
- **Algeria** - Association Agreement
- **Andorra** - Customs Union
- **Armenia** - Partnership and Cooperation Agreement
- **Azerbaijan** - Partnership and Cooperation Agreement
- **Bosnia and Herzegovina** (Western Balkans) - Stabilisation and Association Agreement
- **Chile** - Association Agreement and Additional Protocol
- **Egypt** - Association Agreement
- **Faroe Islands** - Agreement
- **Georgia** - Association Agreement
- **Iceland** - Economic Area Agreement
- **Israel** - Association Agreement
- **Jordan** - Association Agreement
- **Kazakhstan** - Partnership and Cooperation Agreement
- **Kosovo** (UNSCR 1244) - Stabilisation and Association Agreement
- **Lebanon** - Association Agreement
- **Macedonia** - Stabilisation and Association Agreement
- **Mexico** - Global Agreement
- **Moldova** - Association Agreement
- **Montenegro** (Western Balkans) - Stabilisation and Association Agreement
- **Morocco** - Association Agreement
- **Norway** - Economic Area Agreement
- **Palestinian Authority** - Interim Association Agreement
- **Russia** - Partnership and Cooperation Agreement
- **San Marino** - Customs Union
- **Serbia** (Western Balkans) - Stabilisation and Association Agreement
- **South Korea** - Free Trade Agreement
- **Switzerland** - Agreement
- **Syria** - Co-operation Agreement
- **Tunisia** - Association Agreement
- **Turkey** - Customs Union



World Trade Organisation Membership

Source: World Trade Organisation



THE BREXIT SETTLEMENT AND UK TAXES

David B. Smith

PREFACE

Many people puzzled over why the UK has offered to pay the EU c. £40bn for a Brexit Free Trade Deal. Not only does the obligation not exist to make such payment, but future UK-EU trade could continue to take place under international trade law and WTO rules. These oblige both parties to offer most favoured nation (MFN) terms, facilitate customs arrangements and simplify those for land borders.

Although politically the £40bn seemed to be seen by some as helpful for future relations with the bloc, economically the case *not* to pay £40bn to the EU, but to keep the money in the UK economy after Brexit remains compelling. As the economist David B Smith shows, keeping £40bn in the UK in the years after 2019 would bring a significant Brexit boost. He explains the implications of using the money at home, and provides the economic modelling for three likely scenarios considered in which the UK Chancellor:

- Keeps the money in savings
- Uses it for income tax cuts
- Uses it for VAT cuts

He shows that for each of these there would be good results for the UK on a number of counts. £40bn *kept here and not paid to the EU* would bring a real terms boost to UK GDP (by up to 1.4 per cent), its household consumption (by up to 3.5 per cent), its private investment (by up to 3.6 percent). Meanwhile the unemployment rate would fall (by up to 0.8 per cent), and public sector borrowing (by 1 per cent).

The author concludes that the need for enhanced micro-economic flexibility after Brexit is urgent. A first step would be to increase the free, private wealth-creating sector, particularly in those regions where government expenditure accounts for one half to three quarters of regional GDP.

More generally, the analysis raises wider questions about the true costs to member states of their payments to the EU and the implication for home economies.

Sheila Lawlor,
Director, Politeia.

THE COSTS TO THE TAXPAYER OF AN 'ORDERLY BREXIT'?

The legal and constitutional complexities involved in Britain's convoluted negotiations with its European Union (EU) counterparties have made it easy to lose sight of the opportunity costs of any putative settlement. Governments have no resources of their own, only those that they can expropriate from their citizenries. This means that all the expenditures that appear on one side of the public balance sheet – including the monies handed over to the EU – need to be matched by tax receipts or borrowing on the other. This truism is sometimes called the government's budget constraint.

This analysis considers the tax implications of the financial transfers that the UK seems prepared to hand over in order to achieve an 'orderly Brexit'. To be specific, the sums involved are initially compared with the tax 'ready reckoners' set out each year in *Direct Effects of Illustrative Tax Changes* published by Her Majesty's Revenue and Customs (HMRC). The HMRC calculations make it possible to translate the sums being pledged to the EU on the expenditure side of the public accounts into the number of percentage points that have to be added to income tax or Value Added Tax on the revenue side of the public accounts, for example. The HMRC numbers represent 'static' first-round calculations, however, and do not allow for the consequences of changes in the rate of tax on wider economic behaviour. As a consequence, the second round and ultimate effects may end up very different from the initial static ones estimated by HMRC.

In order to capture some of these longer-run 'dynamic' effects, a number of simulations were then run on the Beacon Economic Forecasting (BEF) macroeconomic quarterly forecasting model. The basic simplifying assumption employed is that Britain leaves the EU at the end of March 2019 and refuses to hand over any more money thereafter. Instead, the money that has been saved is assumed to: 1) reduce public sector borrowing; alternatively 2) to cut the standard rate of income tax, or 3) to reduce VAT. There is no upper limit to how many such scenarios might be performed but these seem sufficient for this analysis.

One conclusion is that there would be substantial macroeconomic benefits from using a large proportion of the £15.1bn VAT and Gross National Income (GNI) to be contributed by the UK to the EU in 2019-20 to fund tax cuts. The HMRC calculations suggest that cutting income tax by 1 percentage point would cost £4.3bn in 2019-20, for example, while a corresponding reduction in VAT would cost £6.2bn. In theory, such arithmetic suggests that an ultra-hard Brexit might allow 3p to be taken off standard rate income tax or 2½ per cent of VAT, other things being equal.

Such a development would not only have powerful demand effects in the short term, but also major, semi-permanent, supply side benefits in the long run. This does not mean that other losses resulting from Brexit, such as reduced export demand and the potential disruption to supply chains, might not outweigh the gains of a reduced tribute to the EU[1]. However,it does suggest that a bold reforming government has options that should be explored and considered if it proves difficult to achieve a reasonable settlement.

GEORGE OSBORNE'S DECISION TO HIKE THE RATE OF VAT FROM THE 'EMERGENCY' 15 PER CENT PREVAILING WHEN HE BECAME CHANCELLOR TO 20 PER CENT WAS ECONOMICALLY DAMAGING AND BADLY HINDERED THE SUBSEQUENT RECOVERY

THE EU FINANCIAL SETTLEMENT

TABLE 1
Britain's VAT and GNI Based EU Contributions

	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
£'s billion	10.1	13.2	15.1	14.2	14.1	14.0

Source: Office for Budget Responsibility Economic and Financial Outlook, 13th March 2018, Supplementary Table 2.40.

Table 1 presents the official figures for Britain's VAT and Gross National Income (GNI) based contributions to the EU given in the Chancellor's 13th March 2018 statement. The VAT and GNI contribution are the main sum of money involved and official projections are available on a financial year basis.

However, there are other ex-UK transfers involved and a UK abatement that reduces the sums handed over[2]. This is partly why we assumed a reasonably modest tax cut of just over £12bn in the model simulations. The other reason is that this allowed for convenient round numbers to be employed where the assumed new tax rates were concerned[3].

There appears to be a consensus that the total amount to be handed over to the EU will be roughly of the order of some £37bn to £39bn.The precise amount will depend on the outcome of the present negotiations but also the future euro/sterling exchange rate. This is because the liability is measured in Euro's. The UK has also accepted responsibility for various contingent liabilities, but these will be excluded from the calculations in this analysis and so not considered further here.

DIRECT EFFECTS OF ILLUSTRATIVE TAX CHANGES

The HMRC tax ready reckoner considers the effects of changing over 70 individual rates of taxation. These include income tax, working tax credits, corporation tax, capital gains and inheritance taxes, national insurance contributions, customs and excise duties, VAT, the insurance premium tax and stamp duty, while separate figures are sometimes given for the effects of a cut or a rise. This is because the distribution of taxpayers changes as rates go up or down. Table 2 summarises this more detailed information by concentrating on just a few of the more important taxes.

It is apparent from Table 1 that the sums of money being allocated to the EU would permit a noticeable reduction in the main rates of tax and/or the abolition of some smaller distortionary imposts, even on the purely static calculations used by HMRC. The most expensive change considered in the HMRC ready reckoner would be to increase all main income tax allowances, starting and basic rate limits by 10 per cent. This would cost the exchequer £9.4bn in 2019-20, and £11¼bn to £11½bn in the two subsequent years, compared with the £14bn or so EU payment set out for 2021-22 and 2022-23 in Table 1.

THE DYNAMIC EFFECTS OF TAX CHANGES

Purely static calculations such as HMRC's tend to misrepresent the longer term effects of changes in tax rates. This is because they do not allow for the second-round and subsequent effects on the wider economy, including the private sector tax base. It is logically impossible for the government, or any other entity, to raise real resources by taxing itself. This is why GDP which includes government spending, and expenditures funded by government welfare, can be a poor guide to the taxable capacity of the economy when the share of government spending in GDP is changing.

TABLE 2
Direct Effects of Some Illustrative Tax Changes (£'s million)

	2019-20	2020-21	2021-22
Change basic rate income tax by 1P	4,300	4,850	4,850
Change all main income tax allowances, starting and basic rate limits by 1%	990	1,200	1,200
Increase Corporation Tax by 1p	2,000	2,600	2,600
Change class 1 employee main rate by 1p	4,000	4,100	4,200
Change class 1 employer rate by 1p	5,750	5,900	6,050
Change standard rate VAT by 1P	6,200	6,400	6,550

Source: HM Revenue & Customs, Direct Effects of Illustrative Tax Changes, 24th April 2018.

It used to be standard practice for macroeconomic modellers to simulate the effects of changing key tax rates on their forecasting models, as well as other policy tools such as Bank Rate[4]. Indeed, it was virtually impossible for academic modelling groups to get research council funding in the late 1970s and early 1980s if they could not produce such a set of standard simulations. The conclusion drawn by the economists at Warwick, who undertook comparative simulations on all the leading official and academic forecasting models of the day, was as follows (Church et al. (1993) page 87):

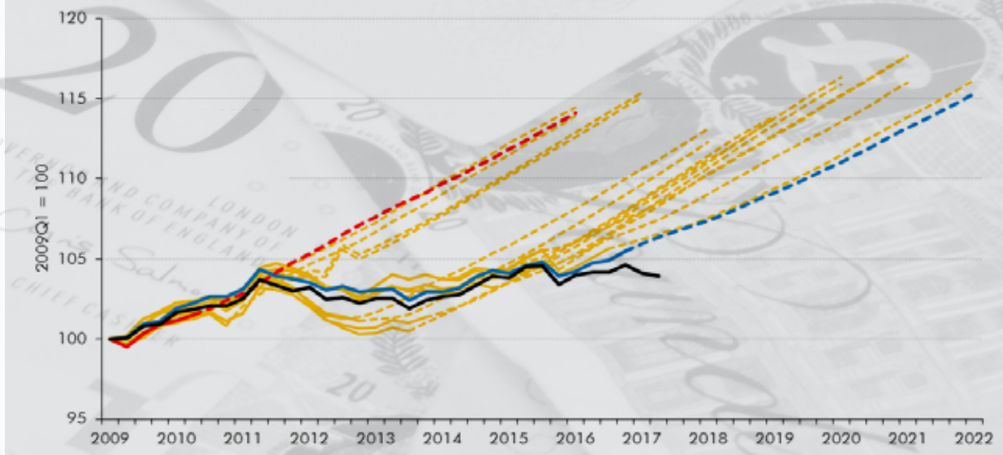
> *"In order to analyse the impact of the various fiscal policy instruments it is essential to consider both direct and indirect effect. For example, the direct effects of tax changes on the government finances can be quantified through an assessment of the size of the tax base to which the tax change is to be applied, and such calculations may measure the short run impact on government revenue quite well. However, over a period beyond the first few months following the tax change, the indirect effects through the operation of the economy as a whole come to dominate. Simulations of models of the macro-economy are the only method of quantifying the size and time profile of these indirect effects.*

Unfortunately, there is now little interest in such work in academia while most contemporary forecasting models have shrunk and do not incorporate a rich enough range of policy tools. The Office for Budget Responsibility (OBR) model now sets trend growth exogenously, for example, and runs its forecasting model on the assumption that output eventually locks onto this assumed trend[5].

This makes it impossible to examine the effects of a major tax hike on trend national output – which would, in theory, both negatively shift down the level of activity and bend the trend downwards – and may explain why officialdom seems indifferent to the possibility that a highly taxed economy will grow more slowly than a more lightly taxed one[6].

It also needs to be emphasised that changing the level and 'shape' of the tax system has implications for both aggregate demand in the short term and, more importantly, aggregate supply in the longer run. In contrast, increasing government spending may provide a short term Keynesian boost to home demand but 'crowds out' aggregate supply in the longer run, once this expenditure inevitably has to be funded through increased taxation or funding in the bond market[7].

CHART 1
Successive OBR Productivity Forecasts (Output per Hour)



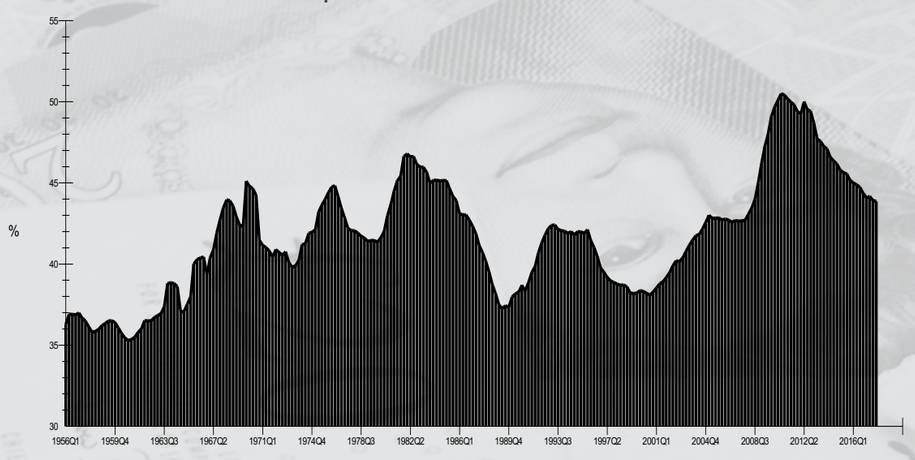
Note: Solid lines represent the outturn data that underpinned the forecasts at the time (the dashed lines).
Source: ONS, OBR

Solid lines represent the outturn data that underpinned the forecasts at the time (the dashed lines).

Successive forecasts
June 2010
March 2017
Outturn

Source: ONS, OBR

CHART 2
Ratio of UK General Government Expenditure to GDP Measured at Factor Cost 1956 Q1 to 2017 Q4



THREE ALTERNATIVE SCENARIOS

The Beacon Economic Forecasting (BEF) macroeconomic model has been employed for live forecasting since the mid-1980s[8] and has maintained the ability to simulate the effects of tax changes that was once the almost universal property of UK forecasting models. For the purposes of this note three alternative scenarios have been run up to the end of calendar 2025 or fiscal year 2025-26. All three scenarios assume that all payments from Britain to the EU cease at the end of the first quarter of 2019 – i.e., an acrimonious no-deal scenario. It is not being claimed that this is politically realistic but it does allow some exploratory analysis based on past relationships.

The first scenario simply assumes that the UK ceases to pay any further sums to the EU after 2019 Q1 but that the relevant amounts are simply saved. Scenario two assumes that the standard rate of income tax is reduced by 2½ percentage points, while the final scenario assumes that the money saved is used to cut VAT by 2 percentage points. These changes were rather arbitrarily chosen because the ex-ante rate reduction amounted to somewhat over £12bn in both cases in 2020-21 according to the HMRC ready reckoner. The results of this exercise are summarised in Table 3. For the sake of clarity, this only shows the end point differences from the base run in 2025 or 2025-26 by which time the model has fully settled down.

TABLE 2
Direct Effects of Some Illustrative Tax Changes (£'s million)

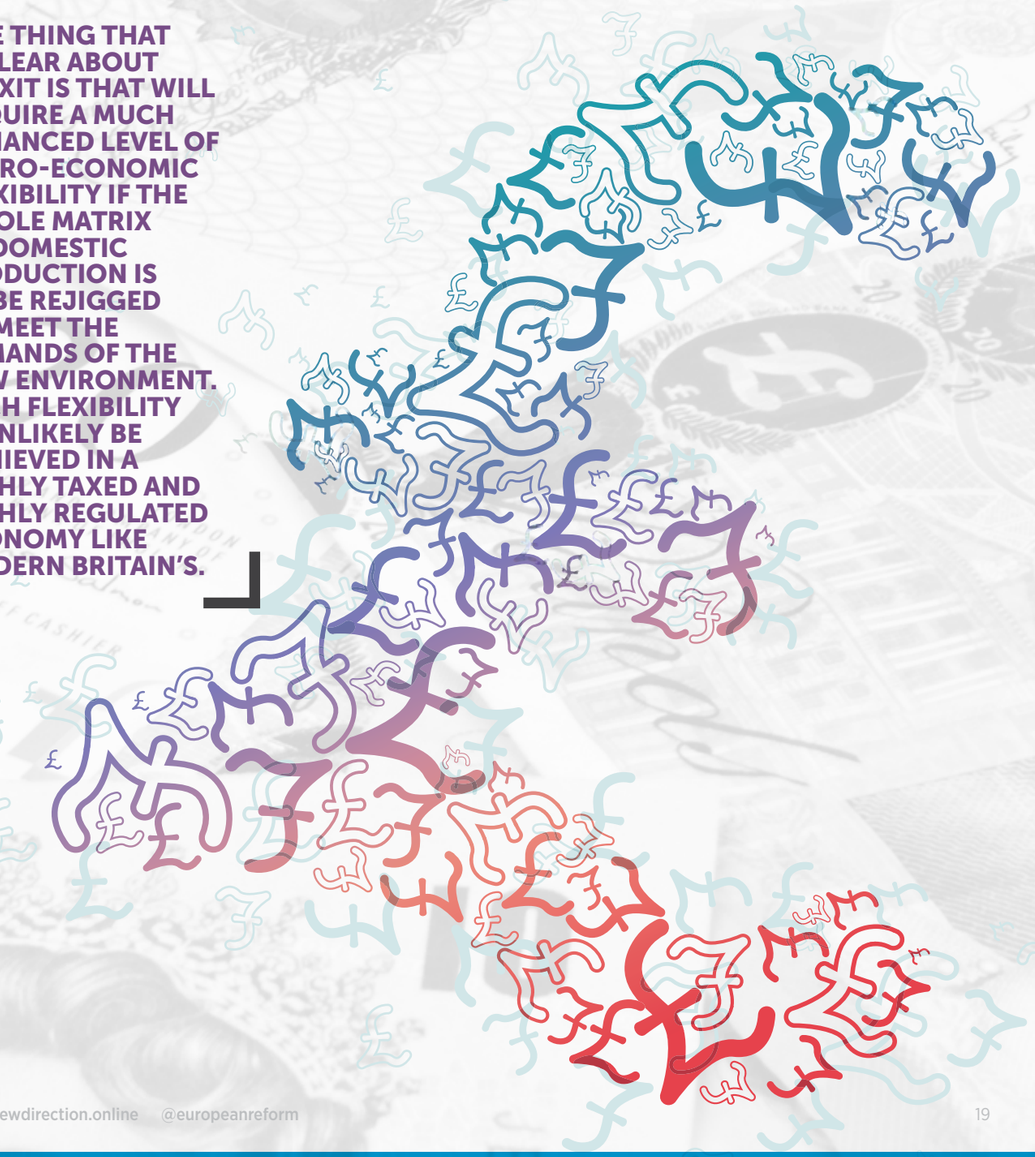
	No Tax Cuts Scenario	2½ per cent of Standard Rate income Tax Scenario	2 per cent off VAT Scenario
Levels			
Real GDP	+0.1	+1.5	+1.4
Real Household Consumption	+0.5	+3.5	+3.3
Real Private Investment	+0.8	+3.6	+3.5
Consumer Price Index	-0.2	-0.4	-2.2
LFS Unemployment Rate (%)	-0.1	-0.8	-0.8
Sterling Index	+1.1	+2.5	+2.5
Bank Rate	-0.1	-0.1	-0.2
M4ex Broad Money	+0.4	+2.2	+1.6
Ratios to Basic-Price GDP (%)			
Balance of Payments Current Account	-0.3	-1.0	-1.0
Public Sector Net Borrowing	-0.9	-0.2	-1.3
Total General Government Expenditure	-0.7	-1.4	-1.7
Non-oil Taxes	+0.3	-1.1	-0.4

Source: Simulations on Beacon Economic Forecasting model carried out on 28th April 2018.

Because the money handed over to the EU represents a pure deadweight loss where the UK economy[9] is concerned, with no short run demand side benefits and adverse supply side consequences arising from the need to fund the expenditure, it should not be surprising that even the no tax cuts scenario sees modest gains from the Chancellor simply pocketing the money. In particular, household consumption is some ½ per cent higher by 2025 and private investment up by ¾ per cent, although the gains to overall GDP are largely offset by higher imports, which are a negative item in the GDP identity. Perhaps slightly more surprising is that the budget deficit ends up almost 1 percentage point of GDP lower by 2025-26. This reflects the tendency of deficits to feed on themselves as each year's deficit adds to the government debt stock and debt servicing costs.

More intriguing are the results of the two tax reduction scenarios which suggest that the UK may now be on the wrong side of the aggregate Laffer curve. In both cases, household consumption and private investment end up some 3¼ to 3½ percentage points higher than in the base run, while overall GDP ends up some 1½ percentage points higher, despite the leakage into increased imports. The main drawback of both tax cutting scenarios is the deterioration of some 1 percentage point of national output in the balance of payments. However, there is also an improvement in the Labour Force Survey (LFS) measure of unemployment of around ¾ percentage point. Otherwise, and unsurprisingly, the VAT cut scenario delivers a significantly lower consumer price index (CPI) by 2025 and also a more substantial reduction in government borrowing of 1.3 per cent of GDP in 2025-26 compared with a reduction of 0.2 per cent in the reduced income tax model run.

ONE THING THAT IS CLEAR ABOUT BREXIT IS THAT WILL REQUIRE A MUCH ENHANCED LEVEL OF MICRO-ECONOMIC FLEXIBILITY IF THE WHOLE MATRIX OF DOMESTIC PRODUCTION IS TO BE REJIGGED TO MEET THE DEMANDS OF THE NEW ENVIRONMENT. SUCH FLEXIBILITY IS UNLIKELY BE ACHIEVED IN A HIGHLY TAXED AND HIGHLY REGULATED ECONOMY LIKE MODERN BRITAIN'S.



CONCLUSIONS

There are six general conclusions from this analysis.

- First, these simulations suggest that the need to finance the large sums of money handed over to the EU may have acted as a cumulative drag anchor on the British economy and partly contributed to persistent Budget deficits[10].

- Second, George Osborne's decision to hike the rate of VAT from the 'emergency' 15 per cent prevailing when he became Chancellor[11] to 20 per cent was economically damaging and badly hindered the subsequent recovery[12].

- Third, it would make political, as well as economic, sense to offset any negative consequences of Brexit on economic activity by cutting the tax burden, even if this implied slightly larger budget deficits in the very short term. The experience of the 1980s suggests that the announcement of a well-articulated programme of supply friendly tax reforms leads to an appreciating currency, not a weaker one, and a surge in private capital formation as international capital flows to the places where anticipated post-tax returns are highest.

- Fourth, a VAT reduction may be more effective in achieving desirable policy goals than an equivalent reduction in the standard rate of income tax. However, this is only a tentative conclusion. It would be useful to see comparable simulations performed using other macroeconomic forecasting models with properly specified endogenous supply sides. This is true of all the analysis presented in this note.

- Fifth, the previous conclusion does not mean that the crazy 'Manhattan Skyline' of marginal tax rates on income that has resulted from the withdrawal of tax credits and the interaction between National Insurance and income tax should not be tackled aggressively through tax simplification and reform[13]. Relatively major cuts in many distortionary tax rates could be achieved at relatively small cost relative to the UK's contribution to the EU and would probably more than pay for themselves in the long run.

- Finally, one thing that is clear about Brexit is that will require a much enhanced level of micro-economic flexibility if the whole matrix of domestic production is to be rejigged to meet the demands of the new environment. Such flexibility is unlikely be achieved in a highly taxed and highly regulated economy like modern Britain's. This is because the free, private wealth-creating, sector is simply too small; particularly in those regions where general government expenditure accounts for anything from over one half up to three quarters or more of regional GDP (Smith (2016) pages 61-65). Unfortunately, there is now a massive policy inconsistency between the current approach - authoritarian, anti-market and highly interventionist - and the market-liberal pro-supply policies needed to make Brexit a success.

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1 There is a widespread view that these trade effects would be damaging. For a contrary view see Minford P. The Economics of Brexit: Getting the Best Deal for the UK (2018).

2 The OBR's 13th March Economic and Financial Outlook has a detailed annex B on The EU Financial Settlement. Table B.1 (page 217) ibid gives some idea of the complexities involved. This is on a calendar year basis, however. While the issue does not seem to have been discussed, it seems improbable that the UK would keep its rebate and any similar concessions if Brexit was aborted.

3 It would not be unreasonable, albeit not precisely correct, to make a proportionate reduction to the calculations in Table 3, if it was felt that the assumed £12bn tax cut was too large.

4 This literature was reviewed in Smith (2006).

5 Something similar is done with inflation where the level of the CPI is predicted to lock onto its 2% target in the long run.

6 Chart 1 is taken from the OBR's October 2017 Forecast Evaluation Report where it appears as Chart 1.1 on page 6. It reveals a persistent tendency to over-predict the level of national output. There is a noticeable resemblance between Chart 1 and Figure 10 on page 101 of Smith (2006) which shows the adverse effects of tax financed public spending on economic growth in a post-neo-classical endogenous growth model.

7 Also, the level of spending remains relatively high by historic standards at not quite 44% of the factor cost measure of GDP in the most recent four quarters (Chart 2). This can be compared with the long run data run back to 1870 provided in Smith (2016).

8 According to the annual Sunday Times review of around 35 UK macroeconomic forecasters, the BEF forecasts came in at no. 11 in 2014, followed by 6 (2015), 12 (2016) and 9 (2017). The latest BEF forecasts are summarised each month in the forecast comparisons compiled by HM Treasury and Consensus Economics. The base run used here does not appear wildly out of line with the current consensus. However, the precise BEF projections inevitably change with each new official data release, which is why they have not been discussed further here.

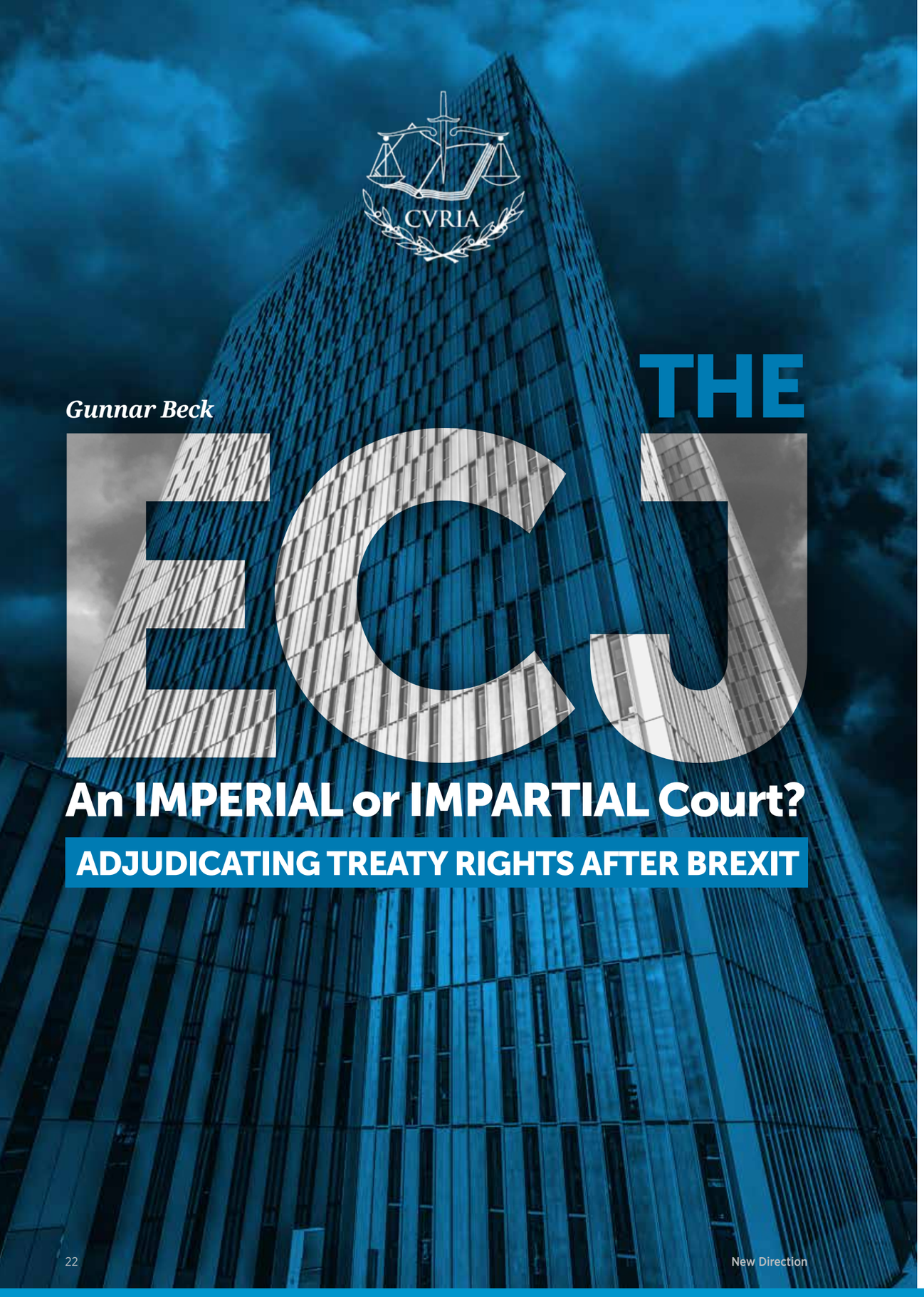
9 The most likely indirect consequence would be a lower exchange rate. However, economists do not agree whether this would be benign, because of increased competitiveness, or malign because of reduced living standards.

10 The 'Big Government' policies of Gordon Brown, first as Chancellor and then as Prime Minister were significantly larger in their adverse consequences, however. In 2010, the ratio of general government expenditure to factor-cost GDP was around the same level as the peak recorded at the height of the 1914-18 'Great War'. It is hardly surprising that the UK economy has consequently suffered many of the phenomena associated with wartime finance including weak private investment, chronic fiscal deficits, tight labour markets, soaring public debt and financial repression.

11 This had been cut from its previous 17½ per cent as a response to the 2008 financial crisis. A return to 17½% would have been defensible. It was the extra 2½ percentage point hike that was, arguably, indefensible.

12 More generally, George Osborne's policies can be considered a perversely damaging 'timorous' Type 2 fiscal retrenchment from the viewpoint of the fiscal stabilisation literature, in that his substantial tax hikes were front-end loaded and overall spending cuts almost negligible. Type 2 retrenchments usually damage growth and fail to achieve their public borrowing targets. This contrasts with Type 1 retrenchments in which taxes are not raised and public consumption is reined back at the outset. Smith (2006), Tanzi (2008) and (2011). The real charges against Osborne are that: 1) having inherited a dreadful fiscal position from Gordon Brown, he failed to rise to the occasion with the needed boldness and determination, and 2) he unduly complicated an already labyrinthine tax structure for political reasons, in a manner that was highly perverse from the viewpoint of the public-finance literature.

13 See Sinclair (2012) for one such programme of reforms.



Gunnar Beck

THE ECJ

An IMPERIAL or IMPARTIAL Court?

ADJUDICATING TREATY RIGHTS AFTER BREXIT

What Role for the ECJ

This focus on the Transition arrangements after Brexit has served to concentrate minds on the real deal which comes into force on 1 January 2021. That, it has been emphasised must return full sovereign powers, not prolong the status quo. And it must apply to the sovereignty of UK Courts.

Yet, one of the most bizarre features of the wider media 'debate' accompanying the negotiations for the United Kingdom's exit from the European Union has been the ready call in many quarters, and the acceptance of precisely such calls in many other quarters, for continued indirect or even direct jurisdiction of the European Court of Justice (ECJ) over aspects of the UK's legal, constitutional and economic arrangements. Astonishingly, such calls are not confined to the envisaged transition period but extend far into the future. Some commentators, and not only die-hard Remainers, want ECJ jurisdiction to continue more or less indefinitely.

As part of the provisional Phase I Brexit deal the UK Government has already accepted that the UK courts will continue to make requests for binding preliminary rulings by the ECJ in UK proceedings involving the determination of EU citizens' rights issued up to eight years after Britain's final departure from the EU.

It is important to emphasise just how extraordinary the demands for a continued role for the ECJ in post-Brexit Britain actually are. As from 20 March 2019 or, at the very latest, from the end of the transition period, the ECJ will convert from being a joint court in which the UK (and a British judge and Advocate-General nominated by the UK) play an equal part, into being a wholly foreign court established under the EU Treaties over which the UK will no longer have any degree of control. Nor will the UK have any say in the appointment of the judges of the court. It is extremely rare for any sovereign state to submit in an international treaty to adjudication of disputes by the courts of the other party to the treaty. The reasons are obvious. Such acceptance of a party to a treaty of the jurisdiction of the domestic court of the other treaty party is demeaning and degrading to its status as a sovereign state, and ii. carries with it the practical and very real risk that such a court will be biased and partial in its rulings.

Dispute Resolution: The Options

The resolution of disputes by binding international adjudication is of course both a common and often necessary feature of bilateral and multilateral treaties. Adjudication can be by bilateral tribunals or arbitral bodies set up under a specific treaty, or sometimes by permanent international courts or bodies, such as the International Court of Justice (ICJ) at The Hague, or the WTO Disputes Panels and Appellate Body. In all such cases, great care is taken to ensure that the body is balanced between the parties.

International adjudication by an impartial and balanced tribunal is the general and near universal international practice. It is also the general practice of the European Union in its treaties with non-Member states (so-called 'third countries' one of which will be the UK from 20 March 2019). The EU has upwards of 50 trade or association agreements with third countries. Of these there are only two which come close to imposing ECJ jurisdiction on non-Member states, and only one creates direct ECJ jurisdiction over another country. The *EU-Turkey customs union agreement* requires Turkey to follow the case law of the ECJ in applying the common rules of the customs union. This requirement arises from the special nature of a customs union, which of necessity requires all customs authorities at its external borders to enforce and interpret the common rules in a rigidly uniform way.

The second EU external agreement which effectively imposes ECJ decisions on non-Member states is the *EEA Agreement*. This is done in order to ensure that the common rules of the EU internal market are interpreted consistently across the EU and across the EEA States. But even in this case, there is no direct jurisdiction of the ECJ over the non-Member states which belong to the EEA: instead, a special EFTA Court has been established consisting of judges from Norway, Iceland and Liechtenstein which interprets the rules of the internal market in their application to those countries.

Because the UK will leave both the EU single market and the customs union, neither the EU-Turkey customs union agreement nor the EEA Agreement can serve as a model for the future EU-UK trade relationship.
The UK Government should therefore unequivocally reject any suggestion for continued ECJ jurisdiction further and beyond the accord reached in the phase I negotiations and in respect of Northern Ireland, irrespective of whether agreement is or is not reached. Not even tiny Andorra or San Marino accept the jurisdiction of the ECJ and instead follow a normal international dispute settlement procedure in their trade relations with the EU, under which disputes are decided by a panel of three arbitrators, one appointed by each side and the chairman being jointly appointed.

Not only is it largely unprecedented for a sovereign State to accept the jurisdiction of the domestic court of another state or international organisation of which it is not a member. There is also a very real prospect that the ECJ would not discharge that function impartially.

The ECJ: Neither Impartial nor Conventional?

The ECJ was established at the same time as the EU (then the European Economic Community) to settle disputes between the EU's institutions and its national Member states and to provide authoritative interpretative rulings of the EU Treaties and EU legislation. It has never discharged that function impartially or in accordance with the established practices of international law. From the early 1960s the ECJ developed a range of principles, such as those of the uniform application and effectiveness of EU law which it then expanded into the general principles of the supremacy and direct effect of EU law over national law. None of these judge-made principles had any basis in the EU Treaties; they are judicial creations which have been accepted and applied by national courts and governments because they suit the integrationist agenda of most EU politicians and senior judges. National courts and governments do not oppose the ECJ, because ECJ judicial activism allows integrationist governments to impose on their countries what most of their electorates would not accept voluntarily, 'ever closer European union.'

It is difficult to overstate the case why the ECJ is neither an impartial nor a conventional court. Central to the problem of judicial activism in the ECJ is the court's unique approach to treaty interpretation which is unlike that of any other international court. The general principles of treaty interpretation are laid down in the Vienna Convention on the Laws of Treaties (VCLT). Article 31 VCLT assigns a primary importance in treaty interpretation to the 'ordinary meaning' of words. It states that treaties shall be interpreted in 'good faith' and that their terms should mean what they say unless, according to Article 32 VCLT, the meaning is genuinely 'ambiguous or obscure' or 'manifestly absurd'. The EU is not a party to the VCLT. However, Article 5 VCLT makes clear that the Convention applies to the EU Treaties just as it applies to all other treaties. Article 5 states: 'The present Convention applies to any treaty which is the constituent instrument of an international organization and to any treaty adopted within an international organization without prejudice to any relevant rules of the organization.' In manifest breach of this provision the ECJ has never regarded itself as bound by the terms of the VCLT and it does not apply the methods of treaty interpretation contained in Articles 31 and 32 VCLT.

Unsurprisingly, in interpreting EU law the ECJ does not therefore accord the same primacy to the ordinary meaning of words as most other international courts including the ICJ or the WTO Appellate Body. Instead the ECJ adopts an ultra-flexible approach which allows the ECJ to choose between various non-hierarchical interpretative criteria - literal, contextual, purposive and meta-teleological - and to give the greatest interpretative weight to whichever criterion best promotes a pro-EU outcome to the case. For instance, this approach allows the ECJ to depart from the wording of the EU Treaties or legislation in favour of a teleological, i.e. purposive, interpretation even where the wording of the relevant provision is neither obscure nor ambiguous nor lead to an absurd outcome. Purposive interpretations generally give courts far greater interpretative room for manoeuvre than text-based interpretations. Specifically, the problem with purposive interpretations of law is that courts, and the ECJ more so than any other court, do not confine themselves to purposes written into the documents they are asked to interpret. Drawing inspiration from its own distinctively integrationist vision of 'ever closer union' between the EU Member states, to which the court also refers as the 'spirit', i.e. a kind of political holy ghost, the ECJ had detected in the EU Treaties, the court has used the purposive approach consistently to resolve legal disputes concerning the distribution of powers between the EU and its members in a pro-integrationist manner. In this manner, the court has over time and without textual support in the Treaties substantially extended the scope of EU law and established its own judicial oversight over many areas of national law. It has usually done so in the absence of Treaty authority and not infrequently in a departure from clear language in the Treaties or EU legislation.

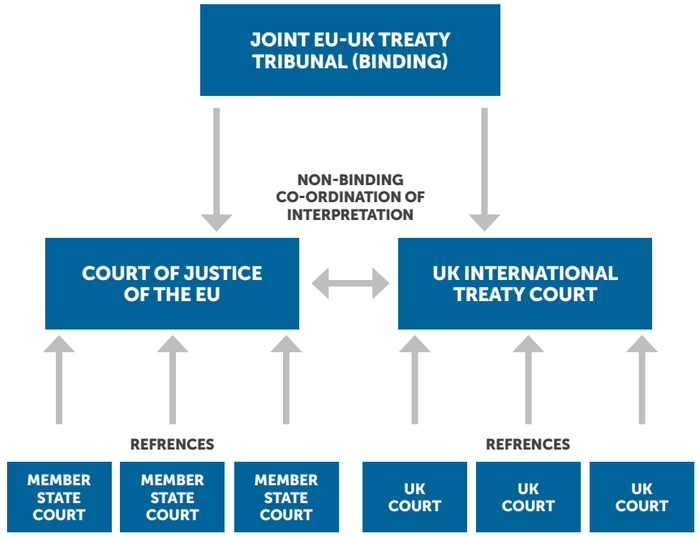
The ECJ was set up to act as an arbiter between the EU and its Member states but it has never been a real arbiter who applies agreed rules impartially. Once the UK leaves the EU and no longer has either a judge or Advocate-General on the court, the ECJ will accord the UK even less respect than it has done so during the time of British EU membership. The ECJ, let there be no doubt, is particularly unsuited to the task of impartial adjudication on bilateral treaty obligations assumed by a non-Member state.

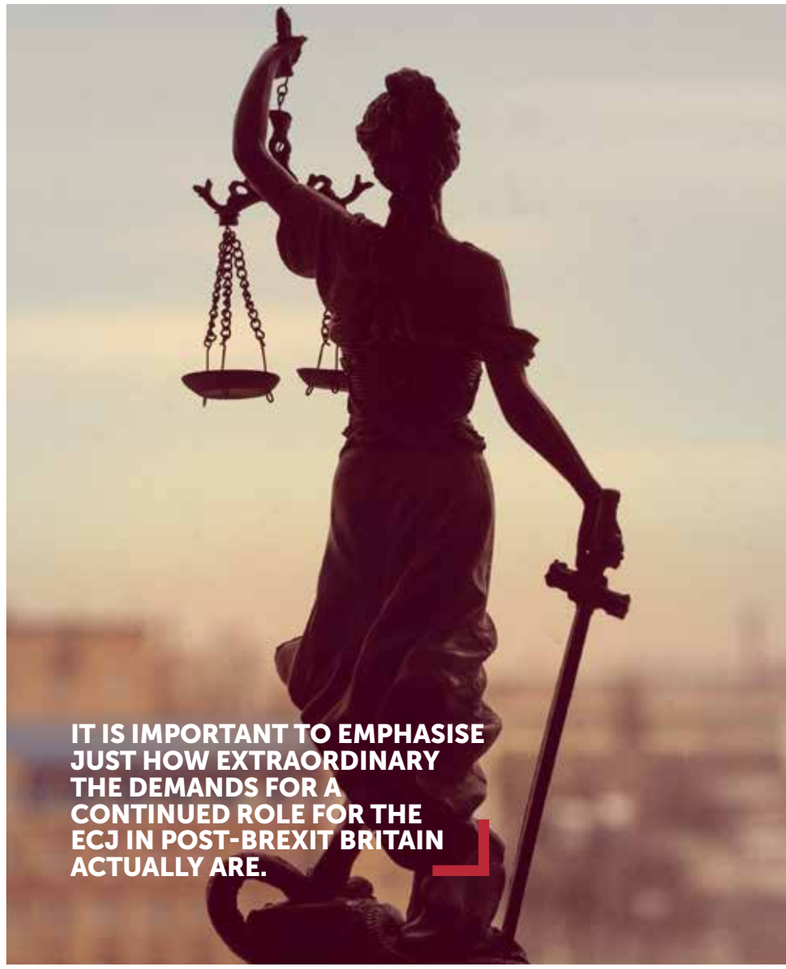
CENTRAL TO THE PROBLEM OF JUDICIAL ACTIVISM IN THE ECJ IS THE COURT'S UNIQUE APPROACH TO TREATY INTERPRETATION WHICH IS UNLIKE THAT OF ANY OTHER INTERNATIONAL COURT.

A Symmetrical Adjudication System

International law provides many impartial alternatives to ECJ jurisdiction. One such alternative system of impartial adjudication has been proposed by me, Martin Howe QC, and Francis Hoar.

This proposal would create a symmetrical adjudication system between the EU and the UK, where each would have a central court - the ECJ within the EU and the International Treaty Tribunal (ITC) within the UK - reaching decisions in individual cases on the interpretation of the agreed provisions of any EU-UK separation and trade agreement. Under ordinary principles of international comity between courts of different countries which are interpreting common treaty provisions, it is to be expected that each court would pay respect to the decisions of the other and, although not bound to follow them, would seek to follow them wherever possible. This system would mean that the occasions when a persistent divergence would arise between the interpretation of the treaty rights by the ECJ and by the UK's ITC would be rare. To deal with such divergences, a bilateral international arbitral body (the EU-UK Treaty Tribunal) would be available at bilateral level, which would sit ad hoc and lay down binding rulings which would be followed by both the ECJ and ITC. The proposed impartial adjudication would follow established international practice in that it is impartial and balanced in composition between the parties. It would respect both the ECJ's position as the highest court with the EU as well as the UK's post-Brexit status as an independent and sovereign subject of international law.





IT IS IMPORTANT TO EMPHASISE JUST HOW EXTRAORDINARY THE DEMANDS FOR A CONTINUED ROLE FOR THE ECJ IN POST-BREXIT BRITAIN ACTUALLY ARE.

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Thomas Sharpe QC

COMMERCIAL LAW POST BREXIT

PREFACE

I am not one of those who believe that Brexit is bringing forth an apocalypse. At the risk of sounding complacent, I think the economic changes will be less marked than some think. Nor do I think I am being Panglossian in saying that the economic effects of Brexit will be beneficial in the medium to long term. From my discussions with American, Japanese and German clients I do not foresee any corporate emigration from the UK; nor I do not see the UK acquiring pariah status in the competition for inward investment; I do not envisage any decline in economic activity or increase in unemployment; or any fiscal crisis. That is my view of the background to commercial law, post-Brexit.
Thomas Sharpe QC

The Challenges

For the Commercial Bar there are distinct challenges. At a general level, not necessarily all caused by Brexit but certainly exacerbated by the robotic and slow process of disengagement, there is no doubt that other would-be centres of litigation and legal advice are taking advantage of the uncertainty to sharpen up their acts. We know that (I am sure well-meaning) doubts have been expressed about the utility of 'English choice of law' clauses going forward, fuelled by doubts about future enforcement within the EU (see below). We also know, for example, of the Dutch attempts to provide a competitor to the Commercial Court, with proceedings in English; we know of French attempts to reform their insolvency laws to attract business from London; and the German courts are keen to build on their expertise to win business in private and follow-on competition actions. This is not confined to the EU: Dubai has created a commercial court; Kazakhstan is doing so, assisted by recently retired English judges. Singapore wants to be a hub for international arbitrations (which is one reason why my own chambers opened up a highly successful annex there).

Some of this would have happened whatever. The financial rewards are just too high to be ignored. But there is little doubt that Brexit has provided opportunity, added impetus and credibility to the efforts to win a bigger slice of a major business. And, as someone who plies a modest living as a competition lawyer, I can hardly argue against competition. The UK courts have responded in various ways for cheaper and quicker procedures especially for SMEs (though many of the UK initiatives preceded Brexit). If this improves the speed and quality of adjudication, and lowers costs, everyone benefits, even clients.

Thomas Sharpe QC
is a barrister at One Essex Court. He specialises in all aspects of EU, Competition Law, WTO trade disputes, UK regulatory proceedings and investigations and commercial judicial review. He appears in the European Courts, the CMA, CAT, and UK High Court and has been called to the bar in Hong Kong and in the Caribbean. His practice covers litigation and advice in UK and EU cartel proceedings, abuse of dominant position, state aids and UK and EU merger proceedings, spanning competition law, utility regulation, judicial review and European law. He has recently advised on many aspects of Brexit and acted in the Miller case in the Supreme Court.

London's pre-eminence

I am broadly optimistic that London will remain the preeminent commercial litigation centre in Europe, for the following principal reasons:

- The high reputation of the judiciary: they are non-political, very experienced litigators, of high intellectual quality, cannot be bought, and are hard working. These are characteristics which are not uniformly found elsewhere in the EU and cannot easily be replicated (and should not be jeopardised by short term cost savings on pay and pensions).

- Secondly, the English approach to commercial litigation is…well, commercial and, where necessary, pragmatic. People in banking, sale of goods, insurance, shipping, international trade and competition know they are dealing with judges who understand their world, and with a law that reflects it. The Common Law is remarkably pliable when needs must, and is supplemented by helpful procedural features such as disclosure and cross-examination which are not found everywhere. Note also the widespread multilateral adoption of English law clauses in standard industry agreements.

- Thirdly, London has a concentration of excellent legal advisers and a cohort of accountants, economists and expert witnesses, all established in the jurisdiction and familiar with it.

- Lastly, to a great degree Brexit leaves arbitration untouched and this draws on the concentration of talent I mentioned.

Tackling the problems

Brexit does however create a few problems which, ideally, will need to be addressed. I do not regard any of them as fatal to the future of London's role in commercial litigation but some resolution is desirable. Not all of them can be dealt with in this brief analysis but the more important are issues of jurisdiction and enforcement and how we continue to handle competition cases. There is also plenty of scope to deal with future trade disputes between the EU and the UK, possibly by creating a special tribunal to hear such cases.

Recognition and enforcement of judgments. Under the Brussels I Recast Regulation (Reg No. 1215/2012) – (the Brussels Reg) provides for the automatic recognition and enforcement of judgments throughout the EU. It also provides for actions to be brought in the member state of domicile as the default.

Following Brexit next year the UK will cease to be a member of the EU; the ECA72 will be repealed; the Lugano Convention (the 2007 treaty between the EU, Norway, Iceland and Switzerland) will cease to have effect on the UK's departure); Rome I (contractual obligations) and Rome II (non-contractual obligations) on choice of law will cease to have effect; and, as with all directly applicable regulations, the Brussels Reg will cease to have effect (Article 36.1-other member state courts would not enforce a judgment in accordance with its terms as the UK will no longer be a member state). Even if the UK legislated unilaterally to retain the terms of Brussels Reg in UK law, it would not be useful as the Brussels Reg is based on reciprocity and we cannot legislate to tell a foreign court what to do, possibly contrary to its own law. The Hague Convention 2005 on Choice of Court Agreements to which the EU signed on behalf of all Member States (save Denmark) would also cease to apply on the UK ceasing to be a member state. At the moment the EU, Mexico and Singapore are signatories and the USA, China and Ukraine have signed but are yet to ratify.

The short term transitional provisions are clear and agreed-existing rules should apply to proceedings started before withdrawal-both in contracts and tort (non-contractual liability).

After that: the UK wants to agree 'new close and comprehensive arrangements for civil cooperation with the EU' (in its statement of 22 August 2017, para 2) which will reflect the current arrangements but outside the jurisdiction of the CJEU. The plan is for Rome I and II to be incorporated into domestic law on choice of law and applicable law and to accede to the Hague Convention, as the UK would be free to do so.

There is no argument that the absence of the provisions of the Brussels Reg would be unhelpful for all concerned. It would add to the costs of enforcement, deny UK claimants the right easily to secure an award in another member state; it might involve parallel proceedings in other jurisdictions as Art 31(2) which provides for a compulsory stay if proceedings have been started in another member state would disappear.

It would be left to the national laws of each member state to determine the enforceability of judgments made in a third country as, of course, they do for judgments made in the USA and elsewhere. But, and this is important, it would also expose undertakings domiciled in the EU to the possibility of being sued in London. This is difficult at the moment given the primacy of 'domicile' under the Brussels Reg.

To resolve this, the UK could accede to the Lugano Convention without re-joining EFTA but only with the consent of the other contracting parties and maintain the status quo. This is a less satisfactory regime than the Brussels Reg and the national courts would have to pay 'due regard' to judgments of the CJEU and national courts of the states bound by the Convention. And, as I mentioned, the UK could accede to the Hague Convention on Choice of Court proceedings in its own right.

The problem lies with the UK's unwillingness to accept direct CJEU jurisdiction in this area. An obvious (perhaps too obvious) answer is to adopt the so-called Danish option - Denmark is not bound by the Brussels Reg - but applies this taking 'due regard' of CJEU jurisprudence but, in the end, Danish courts have the right or duty in certain situations to refer matters to the CJEU.

That option would not be open to the UK as a non-member state, even if it were desirable. In its place the UK could press for a treaty between the UK and EU encapsulating the relevant terms of the Brussels Reg but to be judged in accordance with the principles of international law. It is, of course, highly likely in a cross border dispute involving an EU undertaking, for the matter to get to the CJEU one way or another at the behest of one of the EU parties. We should have no illusions about that.

In my view, it is not the end of the world if no agreement is reached. First, I doubt if easy enforcement within the EU, while highly desirable, is the decisive factor in choosing London as a venue in all but a few cases. There are so many other reasons to do so, as I have described. Absent the Brussels Reg, we will move to the more flexible system which applies to existing litigation involving parties outside the EU, namely, seeking permission to serve outside the jurisdiction (Part 6.37 of the CPR and the gateways under PD 6B); enjoy more flexibility to invoke forum conveniens arguments to attract cases to London; and rejoice in the revival of the anti-suit injunction preventing parties from litigating abroad. EU domiciled defendants would routinely be brought before the UK courts or joined in proceedings and be subject to UK court judgments which, I guess, few would seek to ignore or avoid.

THE FINANCIAL REWARDS ARE JUST TOO HIGH TO BE IGNORED. BUT THERE IS LITTLE DOUBT THAT BREXIT HAS PROVIDED OPPORTUNITY, ADDED IMPETUS AND CREDIBILITY TO THE EFFORTS TO WIN A BIGGER SLICE OF A MAJOR BUSINESS.

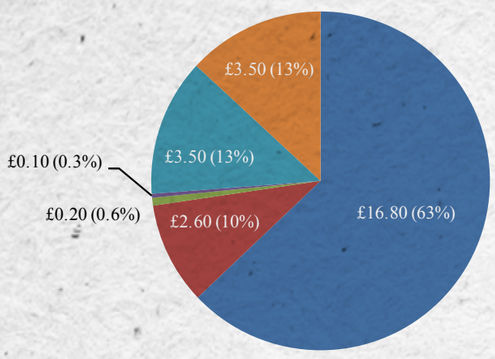
Competition cases and continuity. A similar but less important issue arises in competition law. The Competition Act 1998 is based upon what are now Arts 101 and 102 TFEU. Section 60 requires the Competition and Markets Authority, the Competition Appeals Tribunal and the courts to follow the CJEU so far as is possible and take account of the decisional practice of the Commission. Despite some alarmist nonsense that Brexit will mean a relaxation of the UK competition rules, I know of no plans for any changes and none are justified. The missing ingredient is the extent to which the UK courts and CMA will follow EU practice. Section 60 will, I think, be repealed but I suspect it will be replaced by a formula such as taking 'due regard' or 'due account' of EU law and practice if only to encourage continuity. Some regard this attempt at 'regulatory alignment' as problem free. I think they are somewhat optimistic in thinking that this is a fairly low or shallow test. 'Have regard' means (after the *Brompton Oratory* case) that you will need a good reasoned case to depart from the Euro-norm, whatever that may be. Over time, I hope the good law emerging from other competition jurisdictions, for example, Australia, New Zealand, South Africa, as well as the USA, will get due attention.

And there is another missing link in that at present the UK courts must follow EU Decisions in follow-on actions in the UK courts for damages, leaving only issues such as the quantum of damages to be decided. There is much to be said, pragmatically, for retaining this as it avoids litigation on matters which may well have been decided exhaustively in the Commission and in the European Courts though I have not always agreed with the outcomes of either body. This will further encourage litigation in London as the UK courts are traditionally welcoming to litigation by foreign parties and, to risk understatement, do not always require too strong a link to the UK before allowing proceedings.

The Commercial Bar, preparations and prospects

But in the great scheme of things, I cannot get too alarmed by the future prospects for the Commercial Bar. I do not share the thinly disguised pessimism of the Bar Council or Combar's views on provisions post-Brexit. Prudently, we should assume the worst and anticipate failure to reach an agreement on jurisdiction and plan accordingly: dust off our conflict of laws books, re-read the cases on *forum conveniens*, recover old pleadings on anti-suit injunctions (if by chance we have retained them post-data protection) and perhaps look forward to many more EU domiciled defendants being brought before the UK courts. At the moment about 50% of all Commercial Court cases are between *wholly* foreign parties and from my (inevitably imperfect) observation, the majority of these are non-EU parties.) At the same time, we should acknowledge that there are many other jurisdictions that would love to have a fraction of London's litigation and legal services revenues and the biggest challenges to London lie outside the EU.

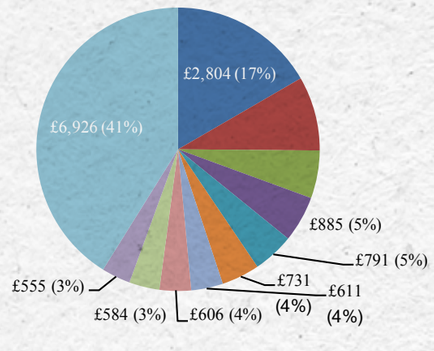
Total UK sales of legal services (£ billion)



Sector	£bn
Business demand	£16.80
Investment	£2.60
Inventory provision	£0.20
Households	£0.10
Exports	£3.50
Public sector	£3.50

Source: *Economic Value of the Legal Services Sector*, The Law Society, March 2016,

Top sources of business demand for legal services by value (£ million)



Sector	£ millions
Financial services, insurance, pensions	£2,804
Legal services	£1,428
Construction	£919
IT services	£885
Wholesale trade	£791
Architectural and engineering	£731
Oil and gas	£611
Rental and leasing services	£606
Management, consulting	£584
Advertising and market research services	£555
Other sources of demand	£6,926

Source: *Economic Value of the Legal Services Sector*, The Law Society, March 2016,

UK Legal Services Sector	2014	2015	2016	2017	2014
Real turnover (£bn constant 2010 prices)	£27.94bn	£28.1bn	£28.06bn	£28.50bn	£28.50bn
% change	-2.20%	0.60%	-0.10%	1.60%	1.60%
Real net exports	£3.47bn	£3.86bn	£3.42bn	£3.72bn	£3.72bn
% change (£bn constant 2010 prices)	9.80%	11.30%	-11.40%	8.60%	8.60%

Source: *Legal Services Sector Forecasts, 2017-2025*, The Law Society, August 2018

The Big Picture – UK services export destinations, 2017

Ten largest UK quarterly trade in services export partner countries Quarter 1 2017 to Quarter 4 2017

	Q1	Q2	Q3	Q4
United States	8,040	8,164	8,489	8,979
Ireland	2,203	2,274	2,718	3,267
Netherlands	1,994	2,462	2,698	2,931
Germany	2,552	2,507	2,742	2,837
Switzerland	2,065	1,906	1,978	2,140
France	1,708	1,807	1,865	2,032
Saudi Arabia	1,334	1,524	1,149	1,207
Luxembourg	832	733	819	970
Japan	759	880	848	855
Spain	725	798	837	808

Source: *International trade in services by partner country, UK: October to December 2017*, April 2018, Office for National Statistics, https://www.ons.gov.uk/businessindustryandtrade/internationaltrade/bulletins/exportsandimportsstatisticsbycountryforuktradeinservices/quarter4octobertodecember2017