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What is next for Brexit and the UK?

By Angelo Katsoras

Introduction

Ever since the UK voted by a slim margin in June 2016 to leave the EU, the government has been unable to agree on what type of Brexit it wants. Former Prime Minister Theresa May's Brexit deal and several alternatives proposed by Parliament failed to pass. Fearing the economic impact of a no-deal Brexit, the EU agreed to push back the deadline for the UK's exit from March 29 to October 31.

However, May's resignation and the likelihood her successor will not be chosen before July 22 does not leave much time for the new leader to undertake the very difficult task of renegotiating the Brexit deal with the EU and then winning approval for it in the UK Parliament.

This report analyzes the steps that lie ahead for Brexit and the UK.

Conservatives in process of selecting new leader

The next Conservative leader will be selected in two stages: First, Conservative members of Parliament have already whittled down the list of possible contenders to two individuals: Boris Johnson and Jeremy Hunt. There will now be a mail-in vote by Conservative Party members (about 150,000) to determine the winner and next prime minister.

Boris Johnson, former Mayor of London and former UK Foreign Secretary, is the overwhelming favourite to win the leadership race. Of the two candidates he better reflects the pro-Brexit views of the rank and file, and is widely seen as being better able to win back the support lost to Nigel Farage's Brexit Party. His nationalist credentials are further bolstered by his vote to leave the EU and his relentless criticism of the EU during his stint as a journalist for the Daily Telegraph (1989-1994). In contrast, Jeremy Hunt voted to remain in the EU, although he now supports Brexit.

EU likely to accept only non-binding changes

Both candidates have promised to renegotiate the withdrawal agreement with the EU, particularly with regard to the Northern Ireland backstop, which is meant to ensure there will be no return to a hard border after Brexit between Northern Ireland, the British province, and Ireland, the EU member. As long as this backstop (i.e., customs union) is in place, the UK will be unable to negotiate trade agreements with other countries.

Johnson recently proclaimed that, while he was not seeking to depart from the EU without an agreement, preparing for a no-deal exit would provide leverage in negotiations. He also threatened not to pay most of the £39-billion Brexit divorce bill negotiated by May unless better exit terms were offered.

EU officials have responded by stating they would not reopen the withdrawal agreement and have warned that refusal to pay the break-up fee would amount to a de facto sovereign debt default (a view some experts dispute).

Realistically, the most the UK can hope for from the EU is renewed commitment to the non-binding *Political Declaration* section of the agreement regarding its determination to find an alternative to the Irish backstop as quickly as possible.

New leader, same UK parliamentary math

Things will not be any easier on the domestic front. The new prime minister will inherit the same challenges that thwarted his predecessor: a fragile minority government, a divided Conservative Party and a deadlocked Parliament where there is insufficient support for either a soft or a hard Brexit. The only measure to have majority support in Parliament so far is opposition to a no-deal Brexit.

Chances of general election rising

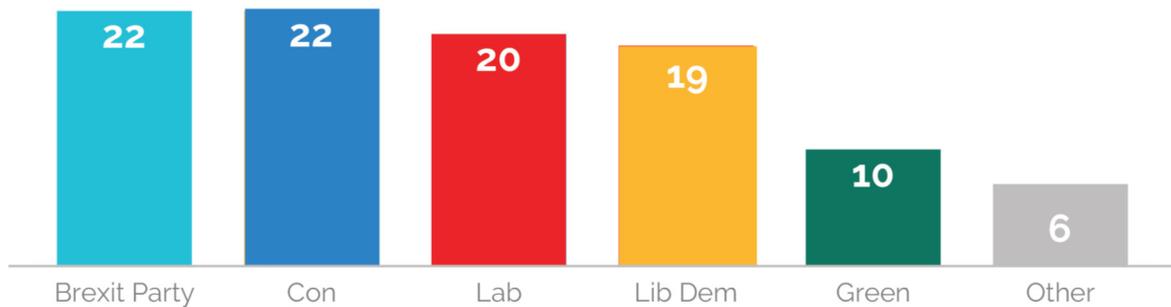
Despite public statements to the contrary, we feel neither candidate will force a no-deal exit through if efforts to renegotiate the Brexit deal fail. The risk of creating economic turmoil and further weakening the Conservatives in the polls would be too great. It would also raise the odds of a successful no-confidence vote, which requires a two-thirds majority in Parliament to succeed. **All this increases the likelihood of an election in the near future.**

Political fragmentation comes to UK

Ironically, despite voting to leave the EU, its politics is starting to resemble the fragmented political landscape of many other European countries. A recent poll had four parties each getting from 20% to 22% of the vote. This is in stark contrast to the last election results in June 2017, when the two main parties – Conservative and Labour – garnered a combined 82% of the vote.

Westminster voting intention

If there were a general election held tomorrow, which party would you vote for? %



YouGov | yougov.com

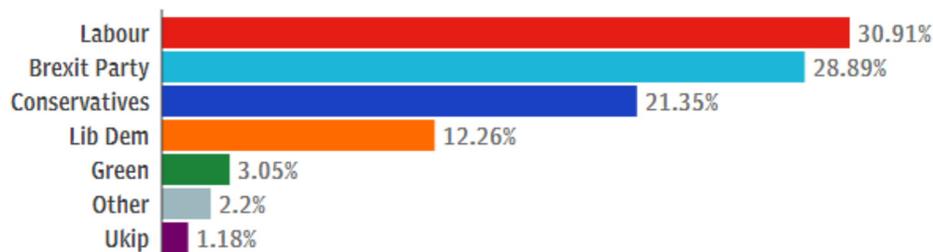
24 - 25 June 2019

Unlike proportional representation, which assigns seats to parties based on the percentage of the total vote they receive, the first-past-the-post parliamentary system awards seats only to the candidate who obtains the most votes in each district. There are no rewards for second place. A significant loss of votes often means an even greater drop in parliamentary representation. The 1993 Canadian election is a case in point. While Progressive Conservatives saw their share of the popular vote fall from 43% in 1989 to 16%, their seat total plummeted from 156 to only two.

Should the Brexit Party decide to run in the next general election, it would risk splitting the centre-right vote and thus increase the odds of a coalition led by, or including, the Labour Party coming to power. A by-election held in early June highlights this risk.

Peterborough 2019 by-election result

Vote share per party (%)



Source: The Telegraph, 2019

This has some analysts claiming that the greatest risk facing the UK today is not Brexit, but rather the election of a far-left Corbyn-led governing coalition. Labour's pledge to renationalize the energy, water and railway sectors has investors particularly nervous, especially since there appears to be strong public support for this policy option. This is particularly true where the railways are concerned. Complaints against the railways range from unreliable service to high ticket prices.

1. Would you support or oppose the railways being re-nationalised?							
	%	TOTAL	Lab	Con	LD	Remain	Leave
Strongly support		29	44	17	25	35	27
Somewhat support		27	27	29	40	30	27
Somewhat oppose		8	4	13	10	7	9
Strongly oppose		7	1	16	4	4	11
Don't know		29	24	25	21	24	26

Source: YouGov, January 2019 (3975 polled)

The risk of vote splitting between the Brexit Party and the Conservatives would not only imperil Brexit, it would also risk bringing Corbyn to power. In light of this, the Brexit Party will likely refrain from running in the next election in exchange for the Conservatives continuing to oppose a soft Brexit, which entails opposing a permanent customs union.

A united pro-Brexit vote would improve the chances of a Conservative victory. However, given that there is no guarantee that all Brexit party supporters would support the Conservatives, it is quite possible that the Conservatives under this scenario would still only garner enough support to form a minority government (refer to chart below). The odds of this occurring would increase if the pro-remain parties agreed to only support a single candidate in certain ridings in order to minimize vote splitting on their side.

Johnson would tempt many Brexit Party voters to vote Conservative

% of people who intend to vote for other parties saying whether each candidate would make them more likely to vote Conservative should they become leader



Source: Telegraph, June 20, 2019

The ever-changing political environment means no outcome can be discounted. Indeed, Labour went from being behind 20% in the polls when the 2017 election was first called to only finishing 2.3 points behind the Conservatives.

Conclusion: two most likely scenarios

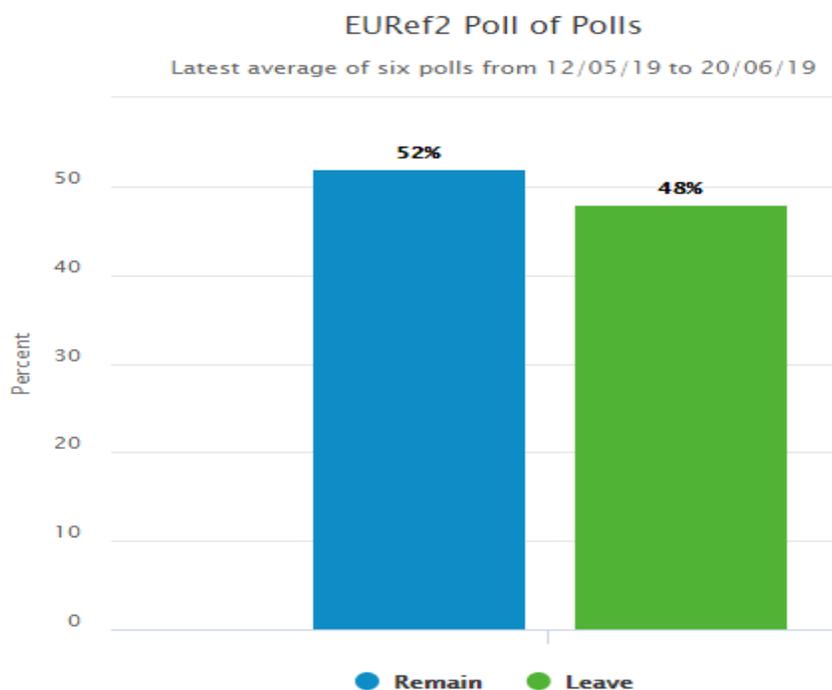
Scenario #1 (55% probability)

The new Conservative prime minister will encounter virtually the same major hurdles as his predecessor in getting a renegotiated deal approved. This increases the probability of an election in the near future. However, the strong chance of yet another minority government means the deadlock regarding Brexit is likely to continue. Under this scenario, a second referendum would increasingly be viewed as the only way to finally break the impasse.

However, holding a second referendum would take at best several months to prepare and further prolong the uncertainty surrounding Brexit. Back in 2016, it took Parliament seven months to agree on referendum legislation, including the formulation of the referendum question. Moreover, British law requires a minimum 10-week campaign period.

Despite public pronouncements proclaiming October 31 is the absolute final deadline, an election would prompt the EU to agree to yet another Brexit delay. The EU would be motivated to go this route for primarily two reasons: 1) to avoid even further economic headwinds at a time when the EU economy is slowing down; 2) hopes that the UK might agree to hold another referendum or simply renounce Brexit altogether.

It is important to note, also, that another referendum would be highly divisive, as close to 50% of the population is guaranteed to be angered by the outcome either way. The *remain* side currently enjoys a narrow lead in the polls.



Source: What UK thinks, June 2019

Scenario #2 (45% probability)

The EU agrees to significant changes in the non-binding *Political Declaration* section of the Brexit agreement further detailing its pledge to quickly negotiate an alternative to the Irish backstop. The new prime minister declares victory and sends the agreement back to the UK Parliament for a vote. In order to avoid another election, and potentially a second referendum, just enough pro-Brexit MPs reluctantly back the deal. The new leader promises to be tougher in the next round of trade negotiations.

It is important to note, however, that even under this scenario certain political parties will likely run on the platform of holding another referendum in the next election. A new mainstream pro-EU Labour leader would be a game changer in this regard. After all, Quebec had two referendums and, not too long ago, many people thought it might hold a third.



What about the EU?

It will continue to be torn between wanting to make life more difficult for the UK to discourage other countries from following its lead and knowing that hurting the world's fifth-largest economy and a major trading partner will only add to the EU's many political and economic challenges.

Indeed, Brexit notwithstanding, the EU is increasingly divided between countries, such as Italy and Greece, that claim austerity measures have been too harsh and the likes of Germany, Austria and the Netherlands, which feel spending limits should be maintained and even tightened in some cases. They cite recent decisions by Italy and France to increase deficit spending as reasons for opposing further EU economic integration, including the creation of a Eurozone finance ministry and Euro bonds. This deadlock makes it near impossible for the EU to agree on vital economic reforms.

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