

A Budget for No Deal

How to stabilise and stimulate the economy
in the wake of a no-deal Brexit

The logo consists of a black outer ring, a white middle ring, and a black center. The text 'Centre for Policy Studies' is written in white within the black center.

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About the Authors

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As an independent non-profit think tank, the CPS seeks like-minded individuals and companies to support its work, but retains editorial control of all of its output to ensure that it is rigorous, accurate and unbiased.

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Our Plan for a No-Deal Brexit

1. Cut corporation tax and massively strengthen incentives to invest
2. Give every small business 25 per cent off business rates and employers' NICs
3. Boost infrastructure investment and housebuilding
4. Freeze red tape – and then cut it
5. Implement a £465 tax cut for ordinary workers
6. Freeze council tax
7. Top up the state pension
8. End the benefits freeze
9. Reduce almost all tariffs to zero while helping sectors hit by no deal
10. Commit to having the best customs system in the world
11. Greenlight a new generation of free ports to boost trade
12. Bring high earners and profitable businesses to Britain



Executive Summary

Background and Context

- This report is not an endorsement of a no-deal Brexit. Nor does it seek to minimise the economic challenges that such a departure from the European Union would pose.
- Instead, the purpose of this report is to address the potential consequences of a no-deal Brexit, and come up with practical policy proposals that the Government could pursue in response.
- The exact consequences of no deal are hard to measure. But based on realistic assumptions about monetary policy, fiscal policy, and economic growth, a Chancellor delivering a “Budget for No Deal” could announce a £44 billion fiscal stimulus without the deficit exceeding 4.5 per cent of GDP. The specific recommendations we make in this report are slightly more conservative, with a total cost of around £35 billion in 2019/20.

Boosting Business

- A no-deal Brexit means continued uncertainty. This is likely to hit business investment, which is already a long-standing weak spot for the British economy.
- We therefore propose a series of measures designed to encourage investment, while also making the British economy more internationally competitive, and laying the groundwork for stronger growth in the long run.
- The centrepiece of our proposals to bolster British business is a £13 billion corporation tax cut. We suggest that the headline corporation tax rate is cut to 17 per cent, effective this April. This should be combined with an unlimited Annual Investment Allowance, so that companies can immediately write-off qualifying new capital expenditures against their tax bill. The up-front cost of this proposal is high, but it diminishes over time. The reform should also have a strong impact on growth.
- Our next recommendation is aimed squarely at small and family businesses, whose needs must be prioritised in the wake of a no-deal Brexit – not only as the most vulnerable to any disruption, but as the engines of future prosperity and employment growth. In order to help such businesses in the immediate term, we propose to give them 25 per cent off both business rates and employer’s National Insurance Contributions in 2019/20. This would apply to all companies with a 2018/19 turnover below £5 million – some 98 per cent of businesses registered for VAT and/or PAYE.
- The Government should also take steps to boost construction. First, they should fast-track infrastructure schemes that promise good returns, especially where they will improve freight movement into and across the country. Second, the Government should boost housebuilding through streamlined planning approvals, construction guarantees, and an additional £1.5 billion for new or expanded shared ownership schemes.



- Finally, the Government should improve the general business environment via regulatory reform. In the short term, the most important thing is stability. To that end, the Government should announce an 18-month moratorium on all new burdens affecting business. It should also beef up its existing “one-in, three-out” deregulatory agenda, and begin a consultation exercise with businesses large and small on stripping away the most burdensome EU regulations that will be transferred into British law after Brexit.

Supporting Consumers

- One major risk of a no-deal Brexit is that it leads to rising prices. This could dent consumer confidence and make it hard for “just about managing” households to get by.
- We therefore propose a series of tax and benefit reforms designed boost disposable incomes and support consumer spending.
- The employee National Insurance threshold should be raised significantly, ideally to the same level as the income tax personal allowance – £12,500 for 2019/20. This would increase the average worker’s take-home pay by £620 per year compared with today, without them having to earn a penny more before tax. This policy would cost £11 billion. (We also consider a more modest variation on this policy, which would cost a little under £7 billion.)
- To help protect British households against rising fixed costs, we suggest that Council Tax – including the social care precept – be frozen at its 2018/19 level throughout 2019/20. This would save the occupants of an average Band D home around £80 per year. To compensate councils for any consequent revenue shortfalls, we would give them an extra £1.5 billion of central government funding via the Local Government Finance Settlement.

- The Government also needs to protect the incomes and living standards of those who earn little, or don’t pay much tax to begin with. It should therefore end the working-age benefits freeze one year early, so that those benefits rise by 2.4 per cent for 2019/20, and top up the planned increase in the state pension, so that it rises by a total of 4 per cent in April. The combined cost of this policy is £3.1 billion.
- We reject calls for an immediate, temporary cut to the VAT rate – one of the tools the last Labour Government used in the aftermath of the financial crisis. For now, we believe such a policy would be too expensive to justify its uncertain economic impact.

Keeping Britain Open

- Whatever else it does, the Government will inevitably have to answer serious questions on trade and migration after Brexit. If it comes up with the right solutions, it could limit the supply shock a no-deal Brexit might entail, while also sending an important message about the kind of country Britain wants to be after it leaves the European Union.
- On trade, Britain should unilaterally reduce tariffs to zero on the vast majority of goods, and move as quickly as possible towards widespread tariff elimination in other areas. Our general view is that tariffs are bad for consumers, bad for business, and bad for the economy as a whole.
- Nevertheless, we recognise that the complete and immediate adoption of unilateral free trade could cause serious problems for a minority of domestic producers, sectors, and regions. In some cases, schedules should be established for the gradual phasing-out of tariffs. In other cases, the Government may wish to provide targeted assistance – in the form of time-limited tax breaks – to those worst-affected by changing trade



conditions. Priority, however, should be given to people, not firms – with a particular emphasis on skills retraining.

- Minimising non-tariff barriers to trade is vitally important too. We should continue to welcome EU imports and avoid subjecting them to additional customs checks and bureaucracy.
- More broadly, we need to step up the recruitment and training of customs officials, and invest in streamlining and digitising our customs procedures. Britain can and should develop the most high-tech, efficient customs system in the world.
- We are particularly concerned about the potential impact of complex new trade arrangements on small and family businesses exporting goods to the EU. To ensure such businesses are given every chance of continued success, the Government should establish a voucher

system enabling them to access legal and professional advice related to Brexit. It should also consider a new, SME-focused programme of export tax credits and finance support.

- In our view, free ports have an important role to play after Brexit. The Government should move ahead with establishing a new generation of UK free ports, using trade, tax, and regulatory incentives to increase economic activity and boost deprived areas.
- Finally, we must ensure that Britain continues to attract the world's top talent after Brexit. To that end, we suggest that the Government reforms the visa system for investors, entrepreneurs, and the highest-skilled workers. We also outline a special, time-limited tax incentive designed to encourage high-paid workers (and profitable businesses) to relocate to Britain in the immediate aftermath of a no-deal Brexit.



Introduction

A “no deal” Brexit would be an extraordinary and unprecedented moment for Britain – a decisive rupture with the European Union, and with many of the arrangements that have governed our economy for decades.

There have been multiple forecasts of the effects of no deal, with the majority ranging from the alarming to the apocalyptic. Yet most have focused either on the very short term or the very long: either on the immediate potential for disruption at Calais and Dover, whether shelves will be bare and medicines denied; or on the impact on GDP in a decade’s time of a shift from a European Britain to a global one.

There has, by contrast, been much less analysis of what the Government can and should do in the wake of no deal to stabilise, and ultimately strengthen, the economy as a whole – to maintain consumer confidence, safeguard business investment, and prevent the supply shock of no deal turning into a demand shock, with far more debilitating consequences.

That is the gap this report attempts to fill. It is not intended as a “Year Zero” rethinking of the British economy. Nor is it a blueprint for how precisely we should manage customs at the border or redeploy manpower within Whitehall. It is intended to set out how, in the short and medium term, the Government can safeguard the economy and promote growth in the wake of a no-deal departure.

It is important to stress that we are not saying no deal is our preferred outcome: it would naturally be preferable for Britain to leave in good order with a good deal. At the same time, however, no deal remains a very real possibility – indeed, the default option. Even if MPs manage to delay our departure, it is unlikely the EU will permit endless extensions of Article 50 while the British political class reaches consensus among itself.

It would therefore be negligent not to think about, and prepare for, that scenario. Indeed, it is reported the Government is, behind the scenes, already engaged in such work.¹ And while much about a no-deal Brexit is unknowable, the extent of its impact in both the short and longer terms will inevitably be shaped by the actions the Government takes – in particular, on whether it does everything it can in the wake of our departure to maintain and intensify the dynamism and competitiveness of the British economy, and to support consumers and businesses.

“It is important to stress that we are not saying no deal is our preferred outcome: it would naturally be preferable for Britain to leave in good order with a good deal.”

We have therefore tried to answer the question of what measures a Chancellor standing in the Commons, delivering an emergency Budget to the nation, could and should adopt – both to address the short-term consequences of a “no deal” Brexit, and to signal to consumers and businesses that Britain is still the best place in the medium and long term for them to spend and invest.



Doing so is not only the best way to stabilise the economy over the initial months of Brexit, but will help us to ensure that we make the most of our new freedom in order to grow the economy in the long run.

The economic situation

There will, self-evidently, be a role in a no-deal scenario for monetary policy.

In November 2018, the Bank of England published its “EU Withdrawal Scenarios”, in response to a request from the Treasury Select Committee.² The Bank’s “disruptive” no-deal Brexit scenario had GDP falling by 3 per cent, unemployment rising to 5.75 per cent, and inflation peaking at 4.25 per cent. Its “disorderly” scenario had GDP plummeting by 8 per cent, unemployment rising to 7.5 per cent, and inflation hitting 6.5 per cent. Bank Rate would peak at 5.5 per cent, house prices fall by nearly a third, and commercial property prices by almost half. This is terrifying stuff.

What a lot of people missed, though, was that the Bank wasn’t forecasting such horrendous outcomes: it was war-gaming a “worst-case” scenario to see whether the financial system would be able to survive it. To that end, both scenarios assumed – among other things – that the Monetary Policy Committee (MPC) would respond to rising inflation (caused by new trade barriers and a weaker currency) by raising interest rates.

In reality, it is extremely unlikely that the MPC would respond to a no-deal Brexit by tightening monetary policy. In the wake of the original referendum result in 2016, the Bank pursued an expansionary policy designed to boost lending, cutting Bank Rate from 0.5 to 0.25 per cent, establishing a scheme to lend directly to banks to reinforce the pass-through of that cut to households and firms, and allocating £60 billion to purchase Government bonds

and £10 billion to purchase corporate bonds.³ And there is scope for similarly dynamic responses to a no-deal scenario: in recent comments to the Treasury Select Committee, the Bank’s Governor suggested that the lending capacity that could be put in play by unleashing excess and counter-cyclical capital reserves was four times total bank lending in the UK in 2018.⁴

But while the Bank will have a major part to play, that cannot be the end of the story. It is hard to see the Bank pushing interest rates below zero, for example, and its balance sheet is already bloated from years of post-financial crisis quantitative easing.

Given the widespread concern about no deal, the Chancellor will need to take decisive action in terms of fiscal policy as well, to maintain confidence and create the most attractive possible economic environment. The nature of that action is what this report is focused on.

So what is the context in which the Government will be operating? Already, the economy is suffering. The latest figures from the Office for National Statistics (ONS) suggest that GDP grew more slowly (at 1.4 per cent) in 2018 than in any year since 2012.⁵ Monthly output appears to have dropped by 0.4 per cent in December; manufacturing has shrunk six months in a row; and business investment has fallen for four consecutive quarters. These are provisional figures and therefore subject to revision – but they still paint a worrying picture. Set against that are more encouraging signs: the UK’s employment market is still extremely strong, while tax receipts are high and borrowing low.⁶

There is, however, a wider global pattern of faltering growth. Britain’s economy has defied the most alarming pre-Brexit predictions, but it is certainly true that our economy, and the world’s, is in a relatively frail state.



The key task in a no-deal scenario, therefore, is to limit the impact of any supply shock – the sudden change in how we trade and with whom – and in particular to prevent it from turning into a demand shock, in which confidence among consumers and businesses falls alongside their willingness to spend.

In terms of the particulars, the most widely predicted consequence of a no-deal Brexit would be a further fall in the value of the pound. This would cause consumer prices to rise: the National Institute of Economic and Social Research (NIESR) estimates that in a no-deal scenario, the pound could fall by 5 per cent in the first year, and by 10 per cent within four years – as compared with the exchange rate after a “soft Brexit”.⁷ Lower consumer spending as a result of inflation, plus a general decline in consumer confidence, would act as a drag on GDP and drive up government borrowing.

The impact of sterling depreciation on consumer spending could be offset through a boost to UK exports and a decline in imports, lifting the trade balance. However, tariff and non-tariff barriers could further exacerbate the impact of no deal on prices for UK consumers.

The truth is that no one can predict precisely what will happen after a no-deal Brexit. And the magnitude of the Government’s response will inevitably have to reflect the economic situation.

The fiscal envelope

On the face of it, the government already has scope to respond to any downturn that follows a no-deal Brexit. The Office for Budget Responsibility (OBR) suggests that the Chancellor will have £15.4 billion of “headroom” against his 2 per cent structural deficit target in 2020/21.⁸ And so far, public finance returns continue to exceed the OBR’s expectations.⁹

Yet predictably enough, there are a couple of flies in the ointment. Firstly, the ONS is changing the way it treats student loans in the national accounts from September 2019 onwards. Secondly, the OBR’s fiscal projections assume a smooth exit from the EU, including an initial transition period during which very little changes. If economic growth takes a hit in the immediate aftermath of a no-deal Brexit, the projections will necessarily be different.

Just how different is a difficult thing to gauge. For the purposes of this report, we have used as our starting point the version of NIESR’s no-deal Brexit forecast that assumes an accommodative monetary policy. This shows the British economy grazing the line between standstill and recession in 2019/20, with annual growth averaging below the central “soft Brexit” forecast thereafter.¹⁰

Combining the fiscal impact of a smaller economy with the student loan revisions suggests public sector net borrowing equivalent to 2.5 per cent of GDP in 2019/20 – without any further policy changes.¹¹

It would not be unreasonable, in our view, for the Government to temporarily accept a rather higher budget deficit as it seeks to deal with the fallout from a no-deal Brexit – even if that means suspending its fiscal mandate in the short term. Of course, we mustn’t go too far: there must be no return to the double-digit deficits that Britain ran a decade ago, let alone the kind of spending and borrowing spree proposed by the Labour Party in its most recent manifesto. The need to support and stimulate the economy in the short term must be underpinned by a long-run commitment to fiscal responsibility.

With that firmly in mind, this report is written on the basis that public sector net borrowing should not exceed 4.5 per cent of GDP. This is a little lower than the deficit in 2014/15, and would give a Chancellor delivering a no-deal Budget



around £44 billion to play with in 2019/20 – roughly 2 per cent of GDP. The specific recommendations we make in this report are slightly more conservative, with a total cost of around £35 billion in 2019/20.

The UK-EU divorce settlement

For many people, there is an easy way to fund a post-Brexit stimulus package: the £39 billion “divorce settlement” that has been agreed between the EU and the UK as part of ongoing Brexit negotiations. This £39 billion would no longer have to be handed over to Brussels, and could instead be put towards domestic priorities. So how do we account for that possibility in this report?

Legally, the specific financial settlement contained in the text of the draft Withdrawal Agreement is null and void if we leave the EU without a deal. As a matter of EU law, we may not have to pay a penny – as the House of Lords European Union Committee has pointed out.¹² At the same time, there probably are certain liabilities that we could be pursued for under public international law, as Attorney General Geoffrey Cox admitted when outlining the Government’s legal position in December 2018.¹³

“It would not be unreasonable for the Government to temporarily accept a higher deficit as it seeks to deal with the fallout from a no-deal Brexit.”

Politically, refusing to pay any part of the “divorce settlement” would garner significant ill-will and damage the UK’s position in any further talks that may be necessary. On the other hand, simply agreeing to pay up without any withdrawal agreement being concluded would mean giving up an important piece of negotiating leverage and, at least in some respects, shelling out taxpayers’ money while getting absolutely nothing in return.

Ultimately, *realpolitik* would probably dictate some compromise – Britain agreeing to settle any legal obligations, but actually paying rather less than the proposed £39 billion.

The net fiscal result of this is not straightforward to calculate, since the payments are spread over years and UK funding may well replace EU in areas like agricultural support and regional development: the Budget in 2018 contained a provision for “Assumed spending in lieu of EU transfers”, which rises as “Expenditure transfers to EU institutions” falls, from £3 billion in 2020–21 to £9.4 billion in 2023–24.¹⁴ There is also money which the Government has already set aside for Brexit preparation and no-deal preparation in particular.

Compared with current plans, the UK could certainly redeploy some of the £39 billion under a no-deal scenario. Given the inherent political uncertainty involved, we have not relied on such savings. But they would help to bring down the deficit projected above – or, indeed, allow the Chancellor to further ease fiscal policy if it became necessary.

The policy response to a no-deal Brexit

Ultimately, the impact of a no-deal Brexit on the public finances is impossible to estimate before it actually happens. There will doubtless be efforts made to agree transitional arrangements to minimise the impact on both sides of the Channel, an intensification of attempts to sign trade deals elsewhere, and so on.

In fiscal terms, there will inevitably be areas of government where spending will need to increase in the long-term – our borders and customs procedures, for example, or those areas such as agriculture or medicines regulation where we have ceded the relevant competence to the European Union.

There may be increased costs to the Government driven by higher inflation, or currency devaluation or non-tariff barriers



making it more expensive to purchase certain products from overseas. There are also likely to be unanticipated short-term costs which only emerge as the no-deal scenario unfolds.

This report, therefore, does not contain an exact prescription: rather, we evaluate and propose a range of measures the Government could undertake to boost the economy in the event of a no-deal Brexit. Our primary concern has been to work with the grain of the economy, suggesting measures which will have the maximum short-term impact while moving the economy in a more pro-growth direction with minimal distortion to its operations – all within the fiscal framework set out above.

The focus of this report is on three things. The first is business investment. The slowdown in growth since the referendum decision is in significant part attributable to the fact that this has stagnated – making the UK economy's wider performance, in particular its continued job creation, all the more impressive.

In the wake of no deal, the Government will need to take bold action to reassure businesses that are thinking of moving overseas or scaling back their operations. It should particularly focus on supporting small and family businesses, which are not only more vulnerable to any disruption, or change in trading terms, but are and will remain the engine of job creation – and are often overlooked by Whitehall in favour of their larger cousins.

Similarly, given the UK's reliance on foreign direct investment – which it has an extraordinary track record in attracting – it will need to provide compelling reasons why firms should choose to invest here rather than in a country with easier access to the EU's larger market. The only way to do that is by making sure that Britain has the most welcoming business environment possible, in which investment is rewarded rather than penalised.

The second area is maintaining consumer confidence. How can we ensure that people keep spending – in particular, that already strained family budgets are not overly impacted if prices rise after no deal?

Our guiding principle has been to ensure that voters still have money in their pockets – that ministers do whatever they can to counter or mitigate any rising prices, but also that the public get to keep more of their own money to compensate. One of the key lessons from previous shocks is that any measures on this front have to be long-term rather than short-term, in order to provide certainty and confidence.

“Put simply, the UK cannot afford to turn in on itself in the wake of a no-deal Brexit.”

The final section of this report considers a third imperative: keeping Britain open. Put simply, the UK cannot afford to turn in on itself in the wake of a no-deal Brexit. We must avoid hastily throwing up barriers to trade, and instead focus on doing whatever we can unilaterally to maintain and even boost commerce across Britain's borders.

This agenda will not only be vitally important in the event of a no-deal Brexit – it is also one for which voters instinctively grasp the rationale, whatever the form of our departure from the EU.

In a December 2018 ComRes survey for the Daily Express, the public agreed by 65 per cent to 13 per cent that “After Brexit, the UK should position itself as the lowest-tax, business-friendliest country in Europe, focused on building strong international trade links”.¹⁵ This was backed not just by Leave voters but also Remain voters, Labour voters, and across all age groups, regions, and class statuses.

Whatever the nature of the Brexit settlement, that is surely an enviable ambition.

Our Plan to Boost Business

Cut corporation
tax to

Bring forward
investment in
cost-effective

Prioritise small
and family
businesses

Impose an
**18-month
moratorium** on
new regulation, and then

Let companies write
off all investment in
plant and machinery

Support housebuilding and put
£1.5 billion
into new shared ownership schemes

Give **98%** of
companies a quarter
off business rates and
employers' NICs



Part 1 – Boosting Business After a No-Deal Brexit

In the short term, one of the most pressing threats from a no-deal Brexit would be a fall in business confidence.

Businesses may respond to the uncertainty by putting off plans to hire, invest, or expand – or even by contracting and laying off staff. Standard & Poor’s forecasts for a no-deal Brexit, for example, show fixed investment falling by 1.4 per cent in 2019 and 2.5 per cent in 2020.¹⁶ The erection of barriers to the European market may lead some firms to move jobs and operations overseas, or deter international companies and investors from putting money into the UK.

“It is essential that the Government responds to a no-deal Brexit by introducing a slate of policies designed to encourage companies to invest in the UK.”

These challenges would be significant even at the best of times, but the fact is that Britain already has a long-running issue with business investment. This predates the Brexit referendum, and is almost certainly a key contributor to our patchy record on productivity since the financial crisis (all things being equal, productivity rises when more capital is invested per hour worked).

How bad is the problem? Well, the ONS estimates that from 1995 to 2015, the UK had the lowest average business investment of all OECD nations.¹⁷ In late 2017, business investment was only 5 per cent above its pre-financial crisis peak – compared with a 60 per cent increase

over the decade after the 1980s recession, and a 30 per cent increase following the 1990s slowdown.¹⁸ Little wonder, then, that productivity had dropped more than 20 per cent below its pre-financial crisis trendline.

Lacklustre business investment has been even more of a weakness since the Brexit vote – probably reflecting widespread uncertainty about the future business environment. As the Institute for Fiscal Studies (IFS) pointed out in its October 2018 “Green Budget”, the Bank of England expected, before the referendum, that business investment would add 1.8 per cent to GDP between 2015 and 2018, making up one-quarter of all economic growth.¹⁹ In reality, business investment added only 0.3 per cent to GDP over that period. What’s more, the rate of business investment growth in Britain fell significantly behind that of Germany and the United States. By contrast, consumer spending held up much better than expected.

Given this background, it is essential that the Government responds to a no-deal Brexit by introducing a slate of policies designed to encourage companies to invest in the UK. We need to send a clear message to the corporate world that, whatever form Brexit takes, Britain is open for business – that Government will do all it can to help you create jobs, build or expand factories, or start and grow a company. Free access to European markets did much to attract businesses to Britain – in its absence, we need to ensure that we retain our competitive advantage by making this country as receptive to business of all stripes as possible.



There are many potential ways of doing this, but we recommend that the Government focuses on four vital elements.

First, the Government should make it more attractive to do business by announcing a major corporation tax cut, lowering the headline rate. Equally important, however, is that it should also introduce a much more generous tax treatment of business investment – addressing a key weakness of the British corporate tax system. This would be expensive in year one (we estimate £13 billion of lost revenue) but the cost would diminish thereafter. We also expect this tax cut to have a significant positive impact on GDP over the medium term: the evidence from the United States and elsewhere is that promoting business investment is an extraordinarily effective way to unleash growth.

“The Chancellor should announce an 18-month moratorium on new regulatory burdens.”

Second, to ensure that small and family businesses are not hit by any cost pressures that may emerge after a no-deal Brexit, the Government should take steps to temporarily slash the tax burden for such firms. The best way to do this is by focusing on the taxes that companies have to pay whether they are profitable or not: chiefly, business rates and employers’ National Insurance Contributions. We suggest that firms with a 2018/19 turnover below £5 million – that’s 98 per cent of all businesses that have registered for VAT or PAYE – should be given 25 per cent off their business rates and employers’ National Insurance Contributions in 2019/20.

Third, we suggest the Government fast-tracks shovel-ready infrastructure schemes that promise a good return on investment – particularly those related to transport and freight movement. The goal should be to sign contracts and break ground as

soon as possible – not as part of a crude “holes in the ground” fiscal stimulus, but to bring forward investment, provide greater certainty to the construction industry, and make growth-enhancing improvements to Britain’s transport and trade infrastructure.

We should also provide significant guarantees to the housebuilding sector to ensure that homes continue to be built – not just as one of the best ways of stimulating the economy, but as a solution to a pressing national need. (This could be aided by a “planning holiday” to encourage development, especially when it comes to uncontroversial proposals such as applications to build on brownfield sites with few residential neighbours, or extensions to existing buildings.)

Fourth, we argue that the Government should move swiftly to reduce the burden of regulation on British business. At a bare minimum, the Chancellor should announce an 18-month moratorium on new regulatory burdens, to give businesses certainty about the environment in which they will operate, before pursuing a beefed-up deregulatory agenda. And even if we assume that the Government will, based on its past statements, be reluctant to dilute workers’ rights post-Brexit – and may continue to shadow EU standards on goods and agriculture in the hope of concluding a swift free trade agreement – there are many further areas in which we could promote growth and attract investment by adopting better and more business-friendly regulatory standards than those imposed by Europe.

Needless to say, these are not the only policies that a Chancellor responding to a no-deal Brexit could pursue. For example, a vehicle scrappage scheme could boost the car industry and, depending on its design, encourage people to trade polluting diesel vehicles for cleaner, newer models. And there are plenty of other tools the Government could use to deal with



specific problems if they emerge after a no-deal Brexit.

However, we believe that such measures are best kept in reserve – to be deployed if there is indeed a sharp and sustained downturn. For now, we argue that the best way to proceed is via a broader-based approach that focuses on creating a more-investment friendly tax regime, a better environment for (and increased focus on) small and family business, a less burdensome regulatory regime, and a faster-moving infrastructure pipeline.

Reform corporate taxes to stimulate investment

An obvious way to boost business in the wake of a no-deal Brexit – and one which is doubtless already under discussion in Government – is to bring forward the planned reduction in corporation tax from 19 per cent to 17 per cent, so that it takes effect this April rather than in 2020. Bringing forward that tax cut would cost the Treasury around £4 billion in 2019/20, assuming no dynamic effects (which are likely to materialise, given the positive impact of previous tax cuts). But because that rate is already scheduled to come into force next year, the cost for 2020/21 and beyond is effectively zero.

Lower corporation tax rates are always welcome. They send a very clear message about a Government's stance towards enterprise. They help to attract global business and international investment. Crucially, they increase returns to capital and tend to be associated with higher real wages. So given the relatively low cost of bringing forward the planned corporation tax cut, an immediate rate reduction to 17 per cent after a no-deal Brexit makes a great deal of sense.

Should we go further? Britain's corporate tax rate is certainly competitive by international standards. The

Tax Foundation's "International Tax Competitiveness Index 2018" ranks us third among 35 OECD countries for our corporate tax rate.²⁰ Yet there are EU countries with lower rates – most notably Ireland, whose corporation tax rate has been 12.5 per cent since 2003.

If we wanted to match Ireland's 12.5 per cent corporation tax rate, it would cost around £13 billion in year one (on a static basis) – but would obviously send a very clear signal about Britain's desire to have a competitive corporate tax regime after Brexit.

“An obvious way to boost business in the wake of a no-deal Brexit – and one which is doubtless already under discussion in Government – is to bring forward the planned reduction in corporation tax from 19 per cent to 17 per cent, so that it takes effect this April rather than in 2020.”

However, we believe that it is possible to get too hung up on the headline corporation tax rate. It is certainly important, but it isn't everything. Indeed, there are other elements of the corporate tax regime where Britain is currently much less competitive internationally, and where reform could have a more pronounced effect on investment and growth.

It's worth looking again at the "International Tax Competitiveness Index" mentioned above. While Britain is ranked third among OECD countries for its corporate tax rate, it only ranks 16th – solidly mid-table – for its corporate tax regime as a whole.

The main thing dragging us down the rankings is our score on "cost recovery" where we rank next-to-last. All 24 of the EU/EEA member states that appear in the index score better than the UK. This is clearly a cause for concern.



But what is “cost recovery” and why does it matter? In straightforward terms, cost recovery is the extent to which businesses are able to write off capital investments against income for corporation tax purposes. In general, corporate tax systems let firms write off day-to-day expenses right away, but require them to deduct the cost of longer-term investments piecemeal over time – the rationale being that capital investments produce income over many years, and should be accounted for that way within the tax system. The UK mostly accomplishes this through an assortment of capital allowances.

The problem is that the more you spread out the tax deduction for capital investment, the less valuable it becomes. Once you factor in inflation and the time value of money, businesses actually end up recovering far less than the full cost of their initial investment. This embeds a structural distortion within the corporation tax system that reduces the return to capital and discourages business investment. And remember: the Tax Foundation scored the UK worse on this measure than almost any other OECD country.

“ After 5 years, US states with full expensing had 7.7 per cent higher employment and 10.5 per cent higher output than comparable states that did not adopt it.”

So if we’re looking to support business and give a big boost to investment after a no-deal Brexit, this is clearly something we ought to consider.

Indeed, there has already been some movement in this direction since the Tax Foundation released its most recent ranking. At his October 2018 Budget, Chancellor Philip Hammond raised the Annual Investment Allowance (AIA) from £200,000 to £1 million for two years from

January 2019. The AIA allows businesses to immediately deduct the cost of qualified investments in plant and machinery against their tax bill. The Chancellor also introduced a (rather stingy) capital allowance for new non-residential structures and buildings.

Those measures were welcome, and will certainly prove beneficial. But we should go much further in our quest to boost investment. Notably, the US tax reform of late 2017 introduced full expensing for short-lived capital investments – complete, year-one deduction against corporation tax of all such expenses for a period of five years. We should match that by making our AIA completely unlimited vis-à-vis new investments in plant and machinery.

But we should also one-up the United States by making the change to the AIA permanent. A short-term measure might boost investment temporarily, but a lasting reform would have a much more pronounced effect on jobs, wages, and long-run economic growth.

When the Tax Foundation modelled the impact of making the US tax reform’s change to expensing permanent, they found that doing so would raise the private capital stock by more than 2 per cent, and GDP and wages by just under 1 per cent each in the long run. Separately, they found that the growth effect of more generous capital expensing was twice that of a similarly sized cut in the headline corporate tax rate.²¹

Real-world evidence on cost recovery is just as encouraging as the theory. According to the economist Eric Ohrn, US states that temporarily adopted full expensing in 2002 and 2008 saw 17.5 per cent higher business investment than states which didn’t.²² After 5 years, the states with full expensing had 7.7 per cent



higher employment and 10.5 per cent higher output than comparable states that did not adopt it. Another academic study, this one from the UK, found that access to more generous capital allowances for SMEs pre-2008/09 increased the investment rate by 11 per cent.²³

Full expensing generates more investment per pound of foregone revenue than a corporation tax cut because it results in a zero effective marginal tax rate on new capital investment. By contrast, a rate cut merely lowers the effective marginal tax rate on old and new capital alike. This suggests that if we want to boost business investment after a no-deal Brexit, focusing on cost recovery is the most efficient way to do it.

Assuming a (reduced) headline corporation tax rate of 17 per cent, we estimate that an unlimited AIA would cost the Treasury around £9 billion of revenue in the year after it was introduced. The initial cost is high, because you would be providing immediate write-offs for new investments, while also continuing to write off old investments in line with the existing capital allowances. But over time those transition costs would work their way through the system as firms finished writing down old investments, leaving you with only the long-run cost of an unlimited AIA – which we calculate is just over £1 billion a year (at 2017 prices).

The changes outlined here – bringing forward the planned corporation tax cut and making the AIA unlimited – wouldn't leave Britain with the perfect corporate tax system. But they would move things decisively in the right direction, boosting investment, supporting growth, and sending out a clear signal that a post-Brexit Britain intended to be more economically competitive than ever.

Policy Recommendation: The Government should bring forward planned cuts to corporation tax, lowering the headline rate from 19 to 17 per cent from 2019/20 on. They should also build on policies announced in the last Budget by making the Annual Investment Allowance unlimited going forward. The cost of this proposal would be £13 billion in foregone revenue in year one, but would fall quickly over time.

Temporarily slash the tax burden on small business

At the CPS, we have been focusing much of our recent research on the challenges faced by small and family businesses. They are in many respects the lifeblood of our economy and our society.

Firms with fewer than fifty employees account for more than 99 per cent of British businesses; they provide 48 per cent of employment and contribute 36 per cent of UK turnover.²⁴ They also create the lion's share of new jobs and will continue to do so.

Yet they are also particularly vulnerable to the rising costs and increased bureaucracy that could follow a no-deal Brexit – if the Government failed to handle it correctly.

In Part 3 of this report, we look at measures the Government could introduce specifically to help small and family businesses that export to the European Union. But the Government should do more than just help exporters. It should also support small business more generally, and ensure that they are not too hard hit by any problems that may emerge in the immediate aftermath of a no-deal Brexit. That is our focus here.

Needless to say, small and family businesses would benefit from the corporation tax cut outlined above, as well as from the more dynamic, investment-led private sector economy we believe our reforms would help to create.

In the short run, however, many small businesses will have more immediate concerns: namely, how can they keep their costs down and their profits up, whatever happens in the wider economy?

If we're looking to reduce the burden of government on small companies, business rates are the obvious place to start.

In a 2017 poll by the Federation of Small Businesses (FSB), 74 per cent of London companies said that business rates were the "single biggest issue affecting their business". The runner-up was "economic uncertainty" – but that was cited by just 36 per cent. The sample size was small and geographically concentrated, but the results give a clear indication of how small businesses feel about business rates.²⁵

The same goes for the British Independent Retailers Association's 2018 "Business Rates Manifesto", which features quotes from a number of business owners: "Business rates are our biggest headache"; "The system is massively unfair"; "The business rates model which was applicable decades ago is simply no longer fit for purpose".²⁶ Such sentiments are entirely consistent with our own experience of talking to small and family business owners – they see it as an unjust burden; an onerous tax that takes no account of how well or badly a business is doing.

Business rates are clearly an area of policy that should be subject to carefully

thought out, long-term reform. This is something the Government should return to at the earliest opportunity. However, a Chancellor delivering a Budget for no deal will need something that makes an immediate impact – something that cuts the burden of business rates for small and family businesses right now.

“If we're looking to reduce the burden of government on small companies, business rates are the obvious place to start.”

In this context, we suggest that the Government announce a significant, year-long business rates cut for all small businesses. It should give every business with a 2018/19 turnover below £5 million – a category that includes 98 per cent of all businesses registered for PAYE or VAT – 25 per cent off their business rates bill in 2019/20. This would cost the Government approximately £850 million in the fiscal year following a no-deal Brexit.

(It is important to note that the Government is currently trialling "business rates retention" in various parts of the country. This allows councils to keep some share of any real-terms growth in business rates revenue. Where our proposal leads to shortfalls in local budgets, these should be offset by central government grants. This doesn't change the cost of the policy; it simply affects who bears that cost.)

There are a few other things to note about this proposal. First, basing eligibility on the previous year's turnover will negate the temptation businesses might otherwise feel to artificially keep their turnover below £5 million. Second, making the cut time-limited should prevent commercial landowners from effectively pocketing the rates reduction by raising rents.



Finally, the obvious problem with a hard cap of £5 million in 2018/19 turnover is that it could create some unfairness at the boundary, with firms just below the cap gaining a competitive advantage over firms just above it. The Government may wish to address this by tapering the 25 per cent relief across some range of turnover spanning the £5 million mark. It could do this without affecting the overall cost of our proposal.

Of course, business rates are not the only tax issue affecting small and family businesses. Employers' National Insurance Contributions are another area of concern. These are levied at a rate of 13.8 percent on wages in excess of £162 per week (£8,424 per year). In the short run, the effect is to raise the cost of employment – once employers' National Insurance Contributions are factored in, a worker earning £25,000 actually costs a business almost £27,300. In the long run, evidence suggests such taxes on labour result in lower wages or higher unemployment.

“ Cutting employers' National Insurance Contributions will help to boost profits, support wages, and encourage companies to create more jobs. ”

Like business rates, employers' National Insurance Contributions should be comprehensively reformed over the medium term. The Office of Tax Simplification has suggested a good way to proceed – indicating that the Government should consider cutting the link to individual earnings, and instead levy the tax on total payroll over a certain threshold.²⁷ The higher that threshold was set, the better things would be for small and family businesses.

Again, though, a Chancellor delivering a no-deal Budget will need something that

can take effect right away, and reduce staff costs for small businesses now. We therefore suggest taking the same approach as on business rates: give firms with a 2018/19 turnover below £5 million 25 per cent off their employers' National Insurance Contributions in 2019/20. The total cost to the Treasury would be £3.25 billion. And as with business rates, the Government could taper the relief if it was worried about unfairness at the turnover boundary.

Cutting the cost of employment in this way would help to prevent small and family businesses from having to lay off staff if a no-deal Brexit results in an economic downturn. Indeed, even if a significant downturn is avoided, temporarily cutting employers' National Insurance Contributions will help to boost profits, support wages, and encourage companies to create more jobs. Alternatively, the Government could devote the same fiscal firepower to a more dramatic cut in either NICs or business rates – but we believe that acting on both will do more to support businesses of all types, and to promote employment.

Temporary cuts to business rates and employers' National Insurance Contributions are big, eye-catching policies that are bound to capture headlines. But it is important to remember that rather more mundane changes can have an impact too.

One such change concerns the Government's "Making Tax Digital" programme. As things stand, small businesses with a turnover above the £85,000 VAT threshold will have to keep all records digitally and submit them to HMRC using approved software from 1 April 2019 onwards.

This is a fine idea in principle, but it may mean an increase in administrative costs for many small businesses at precisely



the moment Britain could be crashing out of the EU without a deal. An independent estimate commissioned by the FSB puts the cost of “Making Tax Digital” to small businesses at £2,770 per year.²⁸ Just as worryingly, the latest HMRC release monitoring awareness of “Making Tax Digital” found that a third of businesses had not made any preparations or did not know the new rules were taking effect.²⁹

There is already a “soft landing” built into the “Making Tax Digital” agenda, with no penalties for poor record-keeping or late filing of returns in the first year. But companies will still need to keep full digital records from this period – the six-month deferral announced for businesses with complex affairs mostly applies to public sector bodies and a very limited selection of smaller organisations, rather than the businesses with the fewest resources available to comply with the new rules.³⁰

We have absolutely no desire to see the digitisation of the tax system unduly delayed – let alone abandoned. Nevertheless, the timing of its implementation for small businesses – coinciding as it does with the possibility of a no-deal Brexit – is highly unfortunate. We therefore recommend that, in the event of a no-deal Brexit, implementation of “Making Tax Digital” should be deferred until April 2020, with a soft-landing period until April 2021.

Any such deferral must also be accompanied by better communication from HMRC regarding “Making Tax Digital” – as the House of Lords Economic Affairs Committee has recommended.³¹ HMRC should set out full details of the next stages of “Making Tax Digital”, including a clear timetable for implementation, so that businesses and software developers alike are able to plan for the long term.

Policy Recommendation: The government should give businesses with a 2018/19 turnover below £5 million 25 per cent off both business rates and employers’ National Insurance Contributions in 2019/20. This would save the average business £1,545 per year, although in many cases the savings would be much larger. The Government should also defer the planned implementation of its “Making Tax Digital” agenda by a year.

Bring forward cost-effective infrastructure projects and boost housebuilding

In 2018, the World Economic Forum ranked Britain 11th for the quality of its infrastructure, which meant that it trailed behind five other European countries.³² Although we have progressed up the rankings in the last few years, many of the improvements responsible for this rise were greenlit before the EU referendum. Since then, the British Chambers of Commerce have urged the Government to support growth by speeding up progress through the “long list of business-boosting infrastructure projects”.³³ It is thought that accelerating investment in infrastructure can help to solve the perennial productivity problem that impedes the UK’s performance on the world stage.

The National Infrastructure and Construction Pipeline has identified £69 billion of spending for 2019/20, spread across 648 projects and programmes.³⁴ However, there are signs that both public and privately funded infrastructure projects are struggling. The Construction Products Association’s 2018 autumn forecasts anticipated that – even assuming a Brexit deal was reached – the sector would grow by only 0.6 per cent in 2019, down from its previous estimate of 2.3 per cent.³⁵ They attribute this largely to the impact



of uncertainty on investment and ongoing delays in the delivery of existing major projects.

In a no-deal Brexit scenario, the Government should act swiftly to speed up the progress of important infrastructure projects, and provide greater certainty to business by signing delivery contracts as soon as feasible.

Yet it would be a mistake, in doing this, to focus on the largest infrastructure projects – such as the three Hs of Heathrow, Hinkley, and HS2. These projects and others like them have become synonymous with delays, overruns, and cost escalation. Rushing into such complex, long-running projects in the name of a no-deal Brexit would likely lead to significant problems further down the line.

The majority of infrastructure spending actually goes on much smaller schemes, which have the added bonus of offering quicker and often greater returns on investment. For example, HS2 is estimated to provide £2.20 of economic benefit for every £1 spent, compared to an average return of £13 for every £1 invested in road maintenance schemes.³⁶ In this context, it is worth reconsidering the advice of the Eddington transport study, which was commissioned by Tony Blair's Labour Government and released in December 2006:

Smaller projects which unblock pinch-points, variable infrastructure schemes to support public transport in urban areas, and international gateway surface access projects are likely to offer the very highest returns, sometimes higher than £10 for every pound spent. However, large projects with speculative benefits and relying on untested technology are unlikely to generate attractive returns.³⁷

In a no-deal Brexit scenario, the Government should take this advice to heart, and focus on fast-tracking those infrastructure project with the most favourable cost-benefit ratios. Looking at the National Infrastructure and Construction Pipeline again, 255 of the 648 projects listed are transport-related. That would be a good place to start.

Notably, the list of transport-related projects includes 21 specific to ports, over three-quarters of which are “small” (under £100m). Four have had their consents approved but no work has started yet. Bringing forward port works as soon as possible will, of course, be critical to avoiding the predicted no-deal bottleneck at the Channel.

“ The Government should focus on the infrastructure schemes with the best cost-benefit ratios. ”

Moreover, despite 90 per cent of containers from deep-sea crossings entering the UK through the south, over half of its cargo is destined for north of Birmingham.³⁸ Northern ports are now preparing for a boost, with investment from Associated British Ports at Immingham expected to support 50 per cent growth there by 2020.³⁹ All but two port projects are privately funded, meaning it is vital that the Government works to minimise the barriers to getting these projects “shovel-ready”. Road improvements for freight movement across the country should also be a priority. (This would support the proposal in Part 3 of this report for Britain to embrace free ports after Brexit.)

Clearly, we would need to ensure throughout this effort that infrastructure work did not disrupt critical trade routes and distribution networks at the worst possible moment; any such upgrades would need to be carefully planned in the immediate aftermath of no deal.

Creating the conditions for better and faster infrastructure projects is a difficult balance, with different levers in each sector. Looking longer term, we recommend that the National Productivity Investment Fund continues to be expanded. Beyond transport, this fund has supported schemes like the 5G Testbeds and Trials Programme, which encourages innovative pilots to improve digital connectivity.⁴⁰ Any new bids for funding should be considered under the new procurement requirements for “social value” brought in after the collapse of Carillion.⁴¹

There is also plenty of scope – and need – for action to sustain and support the domestic construction sector. Housebuilding is not only an excellent way to stimulate the economy, but vitally necessary if Britain is to solve its housing crisis. Centre for Policy Studies analysis has shown that housebuilding figures are ticking up – but from such a low base, post financial crisis, that this decade will see the lowest total number of houses started or completed since the Second World War.⁴² And anecdotal evidence suggests a significant slowdown in construction as Brexit uncertainty bites.

The Government should therefore consider a series of measures designed to boost private housing construction after a no-deal Brexit. Streamlined planning approvals could help to get more home construction projects underway. And if market conditions deteriorated significantly after a no-deal Brexit, construction guarantees could help to ensure that the housebuilding industry doesn't down tools or freeze up.

The Government should also help to at least maintain the current volume of transactions in the housing market – which is a critical driver of supply – by putting an additional £1.5 billion towards new or

expanded shared ownership schemes, which reduce the up-front cost of home ownership and so attract more buyers into the market.

Policy Recommendation: The Government should fast-track smaller infrastructure schemes that promise good returns, seeking to get contracts signed and work started as soon as possible. There should be a particular focus on basic transport infrastructure and on schemes to improve freight movement into and across the UK. The Government should also look to boost housebuilding through some mixture of streamlined planning approvals, construction guarantees, and an additional £1.5 billion allocated towards shared ownership schemes.

Cut the burden of red tape to make British business more competitive

In a 2011 letter to Government ministers, David Cameron wrote that “today, there are over 21,000 statutory rules and regulations in force”.⁴³ It's a statistic that calls to mind Winston Churchill's famous dictum: “If you have 10,000 regulations, you destroy all respect for law”.

Remarkably, no one really knows how much all this regulation costs the British economy. As the National Audit Office points out, the cost of new regulations is assessed, but the existing stock of regulation is seldom evaluated.⁴⁴ The Better Regulation Task Force did make one striking estimate of the total cost of regulation, however: back in 2005, they put it somewhere in the region of 10–12 per cent of GDP.⁴⁵ If true, that would imply a regulatory burden in excess of £200 billion per year today – and must surely act as a significant constraint on business investment in Britain.

In an ideal world, a no-deal Brexit should act as a spur to action on the regulatory burden. After all, if Britain chooses to go it alone, it cannot afford any complacency when it comes to its economic competitiveness. For British businesses to thrive globally, and for the UK to be as attractive as possible a destination for investment, we need a good regulatory environment.

Yet post-Brexit regulation has become a very controversial topic. For every politician who wants to use Brexit as an opportunity to cut red tape, there is another who is adamant that Britain must maintain EU regulatory standards – or even go further than they require. For some it is a matter of principle; for others it is about keeping open the prospects of a future trade deal with the EU.

As things stand, the Government seems inclined to stick with EU regulatory standards. Environment Secretary Michael Gove insists he will “not only maintain but enhance environmental standards as we leave the EU”.⁴⁶ The Prime Minister has promised to maintain current employment rights, and has even proposed a kind of “dynamic alignment” with EU rules, with MPs voting on whether to follow suit every time Brussels makes a change.⁴⁷ According to media reports, “Project After”, the Government’s no-deal planning unit, has given up its earlier focus on radical deregulation.⁴⁸

So given this context, how should the Government reassure business that it is on their side when it comes to regulation? How can it make clear that Britain is committed to regulation that is evidence-based, cost-effective, and supportive of competition and innovation?

The first thing to do is adopt a policy of “do no harm”. Businesses are going to be dealing with a huge amount of uncertainty in the wake of a no-deal Brexit. Government could help by simply pressing pause on any new regulatory

burdens, and adopting an immediate, 18-month moratorium on new regulation affecting business.

The second step should be to beef up the Government’s existing regulatory reform agenda. The current approach – the “one in, three out” rule for new regulations – is well-intentioned and helpful in so far as it goes. But it doesn’t always live up to the surrounding rhetoric.

“ The first thing to do when it comes to regulation is to adopt a policy of ‘do no harm’. ”

For example, a 2014 report by Reform found that the Government had wildly overstated the deregulatory impact of its agenda by ignoring certain regulatory costs – those that related to financial systemic risk or the tax system, and those that originated in Europe. The Government’s calculation of regulatory “outs” was also rather questionable. The upshot, according to Reform, was that the regulatory burden went up by £3.1 billion between 2010 and 2014, rather than going down by £1.5 billion as the Coalition Government claimed.⁴⁹

After a no-deal Brexit, the Government will obviously have no excuse for excluding EU-derived regulations from the “one-in, three-out” rule. Those regulations will simply be items of domestic law going forward. The Government should also broaden the remit of the “one-in, three-out” rule to include costs stemming from financial regulation and the tax system. Finally, it should significantly boost the budget and status of the Regulatory Policy Committee, giving it the power to be a much more effective watchdog. The Government’s assessments of the cost of regulation, and the benefits of deregulation, both require proper scrutiny.

The moratorium on new regulation would send a clear message that the Government was looking to lessen the



regulatory burden on business. Improving its approach to regulatory reform would show that the Government had a practical agenda for making the UK economy more competitive and dynamic in the medium term.

There are also many areas of EU-inspired regulation that should be revisited, especially in areas less likely to fall under the scope of a free trade agreement, or whatever arrangements are eventually agreed to ensure the invisibility of the Northern Irish border. One of the key reasons for leaving the EU is that it sometimes imposes burdensome regulation on us against our will, so it would be strange not to make use of the regulatory freedoms that a no-deal Brexit would give us.

“The Chancellor should consult urgently on regulation with business leaders – especially those running small and family firms – and act swiftly on their recommendations.”

On this front, the Open Europe think tank has outlined a reasonable way to start.⁵⁰ It suggests that a “politically feasible” deregulation could reduce the cost of red tape by nearly £13bn a year – or around 0.6 per cent of GDP.

In some cases, it may be possible to go further than Open Europe suggest. For example, Britain was the only EU member state to oppose the cap on bank bonuses, and neither the Bank of England nor the Financial Conduct Authority think it is a helpful regulatory tool.⁵¹ The Market Abuse Regulation could also be reconsidered; few appear to think it has had a positive impact on the market, and many would like to return to the old system.⁵²

Some UK lawmakers will undoubtedly want to diverge from the EU’s “precautionary principle” approach to biotechnology as well, and adopt

a genuinely science-based approach to regulation of things like genetically modified organisms and genetic editing.⁵³

The EU is famously obstructive of development in many of these areas – in a way that bears little resemblance to the actual risks involved.⁵⁴

Leaving the EU means that Britain could eventually ditch the precautionary principle, and embrace a progressive and informed regulatory framework with regards to technology – granting vital oxygen to precisely the high-end, socially valuable industries which the country should be looking to foster as it embarks on life outside the EU.

This is by no means an exhaustive list of those regulations that could be addressed. We would urge the Chancellor, in the immediate wake of no-deal Brexit, to consult urgently with business leaders – especially those running small and family firms, or innovative start-ups – and act swiftly on their recommendations to remove the EU regulations considered to be most burdensome and counter-productive.

Policy Recommendation: The Government should start by announcing an 18-month moratorium on all new regulation affecting business. It should then bolster its existing deregulatory agenda by making the “one-in, three-out” rule more comprehensive and rigorous. Policymakers should also revisit the stock of EU regulation that will be transferred into British law after Brexit, and carry out an urgent consultation exercise with business aimed at stripping away the most burdensome regulations. In doing so, it should focus particularly on the needs of small and family firms, as well as innovative start-ups.

Our Plan to Support Consumers

Raise the National Insurance threshold so the average worker gets an extra **£465 per year**

Freeze council tax, saving the average “Band D” household **£80 per year**

End the benefits freeze one year early, so that recipients gain an average of **£90 per year**

Increase the state pension by 4 per cent, giving pensioners an extra **£123 per year**



Part 2 – Supporting Consumers After a No-Deal Brexit

As outlined in the Introduction, it is widely predicted that a no-deal Brexit will lead to a drop in the value of the pound.

That would make imports more expensive and therefore push up prices – an effect accentuated by any imposition of tariffs on goods coming into the country. The net effect could be a significant squeeze on household budgets.

The appearance of non-tariff barriers such as new or enhanced customs checks might also push up costs, disrupt supply chains, and lead to temporary shortages of certain goods as businesses scramble to adapt to the new trading environment. Consumer confidence – which is already at its lowest level in more than five years⁵⁵ – would likely take a significant hit. People might adopt a “batten down the hatches” outlook, and rein in their spending accordingly. In a worst-case scenario, this collapse in consumer confidence (alongside business investment) would act as a demand shock, triggering a downturn.

“ A Chancellor delivering a no-deal Budget would want to announce a series of practical measures that put money in consumers’ pockets right now. ”

In Part 3 of this report, we outline a set of steps the Government could take to minimise the cost and disruption in terms of trade, not least via reductions in tariffs. Clearly, though, certain things – such as the exchange rate –

will be largely beyond the Government’s control. That means that a Chancellor delivering a no-deal Budget will want to announce a series of measures designed to boost Britons’ disposable incomes and bolster consumer confidence – to ensure that any rise in prices does not translate into a loss of spending power.

In the long run, of course, the best way to deal with a cost of living crisis would be to undertake a significant programme of supply-side reform, aimed at bringing down the cost of essential goods and services. Economist Ryan Bourne has calculated that liberalisation in housing, childcare, and energy could reduce the cost of living for a two-adult, two-child family from £2,155 to £1,602 per month – a reduction of more than a quarter.⁵⁶

Such policies, however, would take time to have an effect. The spectre of post-Brexit price inflation would require a more immediate, more direct response.

So while there are many potential policies on the cost of living that we would cheer wholeheartedly, a Chancellor delivering a no-deal Budget would want to announce a series of practical measures that put more money in consumers’ pockets right now.

As set out below, one initially tempting policy – a repeat of the 13-month VAT cut introduced by Alistair Darling at the height of the financial crisis – ought to be resisted. In our view, the cost of such a policy would be too high and its economic benefits too uncertain.

Instead, we argue that the Government should significantly and immediately



raise the National Insurance threshold for employees to the same level as the personal allowance – a policy whose short-term cost would be far lower than the VAT cut, but whose impact would be far more dramatic. The Government should also freeze council tax bills, and make up funding shortfalls via the Local Government Finance Settlement. These measures would put hundreds of additional pounds into taxpayers' pockets.

We also suggest that the Government ends the benefits freeze one year early and tops up the planned increase in the state pension, so that those who do not work, have low incomes, or are too old to pay National Insurance are not too hard-hit by any Brexit-related inflation that may occur. As with the proposed change to National Insurance, this would give money to all households, but protect those on low and middle incomes the most.

“Ending the benefits freeze one year early would cost **£1.5 billion**; topping up the state pension **£1.6 billion**; and compensating councils for the council tax freeze **£1.5 billion**.”

Taken together, these policies would cost the Treasury a total of £15.6 billion in 2019/20. The lion's share of that cost is attributable to raising the National Insurance threshold, which would reduce revenues by £11 billion. Ending the benefits freeze one year early would cost £1.5 billion; topping up the state pension £1.6 billion; and compensating councils for the council tax freeze £1.5 billion. Clearly, this represents a very significant outlay, but we would argue that bold action is required to make a success of a no-deal Brexit. This is not the moment for half measures.

Ultimately, the goal of the policies detailed in this section is to show British consumers that their disposable incomes will be

protected – and even enhanced – through the UK's exit from the European Union. Whatever currency fluctuations or import-export issues arise, we want to make sure that no one in the UK ends up feeling poorer as a result of a no-deal Brexit.

Resist calls to temporarily cut VAT

If the Chancellor wants to reduce the impact of price rises – one of the main threats from a no-deal Brexit – and boost consumer confidence, changes to VAT seem an obvious option. Indeed, some commentators have already suggested that, in the event of no deal, the Chancellor should temporarily slash VAT – a repeat of the 13-month cut that the Labour Government implemented in December 2008 in the wake of the financial crisis.⁵⁷

It is worth remembering, though, that this VAT cut was quite an unconventional move when undertaken. Indeed, an IFS working paper has described it as “a fiscal stimulus that had never been used in the UK or abroad”.⁵⁸ So we ought to consider how well it actually worked before rushing to repeat the experience.

The idea of a temporary VAT cut, in economics terms, is to create a substitution effect, whereby consumers bring forward spending to take advantage of temporarily reduced prices. How significant that effect is depends on whether the VAT cut is actually passed on from retailers to consumers, and whether consumers really respond to temporarily lower prices by bringing forward spending. It is also important to consider the extent to which more spending now is cancelled out by a slump as soon as the temporary tax cut expires.

In the case of the 2008/09 VAT cut, IFS research⁵⁹ suggests that firms initially responded to the VAT cut by lowering



prices, but that “at least part of that pass through was reversed after only a few months”. The authors find that the VAT cut did encourage consumers to bring forward purchases, which boosted retail sales by 1 per cent and total expenditure by about 0.4 per cent. But they also suggest a significant slump in retail sales (2 per cent) when the VAT cut expired in January 2010. In other words, the evidence is mixed.

It is fair to say that the 2008/09 temporary VAT cut was a qualified success on its own terms. The Government of the day aimed for a 0.5 per cent increase in aggregate consumption, and while the IFS research cited above suggests that the real impact fell slightly short of that, it was still significant. But none of this makes an overwhelming case for a temporary VAT cut in response to a no-deal Brexit.

“ A 2.5 percentage point cut in the standard rate of VAT would cost £15.5 billion in 2019/20. ”

For one thing, cutting VAT would be very expensive – even compared to the other proposals outlined in this report. A 2.5 percentage point cut in the standard rate of VAT would cost £15.5 billion in 2019/20. Taking the main rate down to 15 per cent (as in 2008) would cost £31 billion. That is a lot of revenue to risk on something that, at best, would only provide a transitory fillip to the economy.

Another, perhaps equally important, issue is the structure of VAT as a whole. The main VAT rate only applies to less than half of the total consumption base. Food, for example, is one of the key essentials that may see a price rise in a no-deal Brexit scenario – yet it is largely exempt from VAT. This means that a temporary VAT cut would be a poorly targeted response to the problems that may arise from a no-deal Brexit.

The biggest problem, though, is whether a VAT cut would actually have the intended effect in an inflationary environment – like the one many are predicting in the wake of a no-deal Brexit. In this context, it is quite possible that a temporary VAT cut would simply get lost in the noise of generally rising prices (whether caused by a weaker currency, new barriers to trade, or other factors) and fail to make much of an impact on consumer sentiment and spending patterns.

Given these concerns, calls for a temporary VAT cut after a no-deal Brexit should be resisted. This is not to say that there are no circumstances in which changes to VAT should be considered – obviously, it is a fiscal tool that Government will want to keep at its disposal. But it should not be the first port of call for a Chancellor looking to support consumers in the wake of a no-deal Brexit.

Increase take-home pay by implementing the Universal Working Income

The most straightforward way Government can increase a taxpayer’s disposable income is by taking a smaller bite out of their paycheques – that is, by reducing the amount of income tax and National Insurance Contributions that are deducted through PAYE.

Since 2010/11, the Government has pursued such a policy very effectively, by repeatedly raising the personal allowance – the level of annual earnings that is exempt from income tax – much faster than the rate of inflation. The personal allowance has already risen from £6,475 in 2010/11 to £11,850 today, and is set to rise further to £12,500 for the 2019/20 tax year – a measure that takes effect on Saturday 6 April.



As we pointed out in the 2018 CPS report “Make Work Pay”, raising the personal allowance (a policy originally proposed by Lord Saatchi via the CPS)⁶⁰ single-handedly offset the effects of Britain’s post-financial crisis wage squeeze: “From 2011/12 to 2017/18, average earnings fell by 2 per cent in real terms before taxes. Real take-home pay, however, rose by 1 per cent over the same period. Above-inflation increases in the personal allowance prevented post-tax incomes from falling in line with wages, and thereby helped to protect people’s living standards.”⁶¹

The possibility that a no-deal Brexit will squeeze household budgets and weigh on consumer confidence suggests that a similar policy would pay dividends today. Yet rather than focusing on the personal allowance – where further big increases would do little for the lowest-paid – a Chancellor delivering a no-deal Budget should turn his attention to a more neglected element of the tax system: the primary threshold for National Insurance Contributions.

Our primary proposal to support consumers’ disposable incomes is a simple one: to raise the National Insurance primary threshold to the same level as the personal allowance – from £8,424 today to £12,500.

This threshold has lagged behind the personal allowance: the two were aligned as recently as 2007/08, but the gap between them stands at £3,426 per annum today. There are, according to our estimate, 2.4 million people in the UK who pay National Insurance but do not pay income tax. Indeed, the disparity between the primary threshold and the personal allowance potentially costs them – and everyone else – hundreds of pounds a year in tax.

Our primary proposal to support consumers’ disposable incomes in the wake of a no-deal Brexit is therefore a simple one: to raise the National Insurance primary threshold to the same level as the personal allowance, effective the beginning of the 2019/20 tax year, and to keep them aligned thereafter. In practical terms, that means raising the threshold for employee National Insurance Contributions by more than £4,000 per year – from £8,424 today to £12,500 on 6 April.

That would cost the Treasury £11bn per year in foregone revenue, which is obviously a very significant sum. But it would also increase the take-home pay of someone working 30 hours a week at the National Living Wage – and anyone earning more than them – by almost £465 per year relative to existing fiscal plans.

Another way of looking at this proposal is to consider the effect it would have on someone with earnings around the national average – £24,000 a year, according to the most recent ONS data.⁶² As things stand today, this worker would take home roughly £19,700 after direct taxes. With the personal allowance and National Insurance threshold both raised to £12,500 per year, the same worker would take home £20,320. In other words, even if they didn’t earn a penny more, their take-home pay would rise by £620 a year – an increase of more than 3 per cent – in 2019/20.

That would have a powerful effect on household budgets, and would send a clear and confidence-enhancing message that the Government intended to support consumers through any initial fallout that a no-deal Brexit might have. Crucially, because the change would be permanent – not some temporary tax “rebate” – you would expect people to increase their spending accordingly, helping to support the private sector economy at a potentially quite challenging time.



If the Government was unwilling to spend this much money, there is an alternative. We suggested in “Make Work Pay” that the thresholds for both NI and income tax could be aligned at £12,000 rather than £12,500 – at an overall cost of £6.8 billion rather than the £11 billion outlined here. This “Universal Working Income” would give every worker in the UK the right to earn £1,000 per month without having to hand a penny over to the taxman.

“ A YouGov poll for the CPS showed that **76 per cent** of people agreed ‘everyone should be allowed to earn £1,000 per month completely free of income tax and national insurance’; only **9 per cent** disagreed. ”

This reform would not only give a much greater pay bump to those earning above that threshold than just an increase in the personal allowance, but would also help those on the lowest incomes, at that stage between £8,424 and £11,850, who do not benefit from further changes to income tax.

Making this change permanent would – unlike many of the other measures proposed here – impose a permanent cost on the Exchequer. That cost falls within the “fiscal envelope” we identified in the Introduction of this report, and should not lead to the deficit getting out of control in the short term.

For the long term, however, CPS research has identified various ways such a policy could be funded. One example is shifting to an ISA-style system of pension tax relief that would target savings incentives much better by offering people up-front bonuses for saving. At the moment, we are spending £47 billion a year to incentivise pension saving yet the overall household savings rate has fallen to its lowest level since

records began. Moreover, the top 1 per cent of earners – those who least need an incentive to save – receive roughly twice as much tax relief as the lower-earning half of the working population.⁶³

The Universal Working Income would help everyone, but particularly the lowest earners. It would simplify the tax system, and make it significantly more transparent. And it would be hugely popular: polling carried out by YouGov for the CPS showed that 76 per cent of people agreed “everyone should be allowed to earn £1,000 per month completely free of income tax and national insurance”; only 9 per cent disagreed.⁶⁴

In short, for a Government looking to support consumers after a no-deal Brexit, the Universal Working Income seems like the perfect place to start.

Policy Recommendation: Raise the starting point for employee National Insurance Contributions by £4,076 per year in order to establish a new Universal Working Income – a combined threshold for income tax and National Insurance – at £12,500 per year. This would cost the Treasury approximately £11 billion. (Or £6.8 billion for a £12,000 per year threshold.)

Freeze council tax and increase the Local Government Finance Settlement

It is important to remember that income tax and National Insurance are not the only taxes and costs that most people face. There are many others which we could have focused on in this report – for example taxes on the motorist, which the Government has made a key priority in repeatedly freezing fuel duty, or energy and utility bills.

After careful evaluation, however, we felt that council tax would be the most suitable candidate for further action to ease pressures on voters' pockets. Not only can it make a significant dent in household budgets, but it is often cited as one of the most resented taxes in Britain. In a 2015 YouGov poll, just 17 per cent of those surveyed thought a local tax based on home values was the best way for councils to raise funds.⁶⁵

There are other well-known problems with council tax, aside from its general unpopularity. For one thing, it can be a highly regressive tax, as you tend to pay more as a proportion of your property value the cheaper your property is. This is compounded by the fact that council tax is based on property values that are more than a quarter of a century old, and which bear little resemblance to current market conditions.

As things stand, councils can – and mostly intend to – raise this tax by 2.99 per cent in April 2019 without having to put it to a referendum. They can also increase their adult social care precept by 2 per cent and their police precept by £24. Taken together, these measures would add roughly £80 to the average bill for a Band D home⁶⁶ – a potential double whammy for households already feeling the pinch from higher inflation.

To support household budgets and reassure consumers in a no-deal Brexit scenario, we therefore propose that council tax be frozen at its 2018/19 level for the duration of 2019/20.

Of course, this would blast a hole in local government budgets – which have already come under significant pressure since 2010. Some, including the Local Government Association,⁶⁷ have warned

that councils face an ongoing funding gap, as the demand for local services outstrips councils' ability to pay for them – even without the added cost pressures of a no-deal Brexit.

In this context, the Local Government Finance Settlement for 2019/20 – which envisions a 2.8 per cent rise in councils' core spending power – is unlikely to be enough once council tax is frozen at 2018/19 levels.

To its credit, the Government has made £56.5 million of additional funding available to local councils to help them prepare for Brexit.⁶⁸ That includes £10 million set aside in 2019/20 for “specific local costs that may only become evident in the months after we leave the EU”.⁶⁹ But this money won't go very far when spread across the entirety of British local government.

If council tax was raised by the maximum of 4.99 per cent for 2019/20, this would add £1.5 billion onto the council tax requirement, which stands at £29.6 billion for the current financial year. In order to support local government and to fill any void created by our council tax freeze, we therefore suggest that the Local Government Finance Settlement should be increased by 3.3 per cent in total for the coming financial year. This would give councils an extra £1.5 billion of central government funding in 2019/20.

Policy Recommendation: Council tax should be frozen at 2018/19 levels for the duration of 2019/20. Central government funding to local councils should be increased by 3.3 per cent in total. Implementing this recommendation would cost the Treasury £1.5 billion.



End the benefits freeze and top up the state pension

Our big-bang policy to boost disposable incomes in the wake of a no-deal Brexit – the implementation of a Universal Working Income – is great for workers, who will see their take-home pay rise as a result of lower National Insurance payments. But what about those who pay little tax to begin with: those who lean on the state for income support, and those who are too old to make National Insurance Contributions? Such people are consumers too, and could be hit particularly hard if a no-deal Brexit resulted in significant inflation.

The case for helping those receiving working-age benefits is particularly strong. A freeze on these benefits (excluding those related to disability) came into effect in 2016/17, meaning that most of them remain at the same cash amount as in 2015/16. The result is that those working age benefits have lost around 6.4 per cent of their value over the last four years.⁷⁰ Any spike in inflation after a no-deal Brexit would obviously accentuate that effect.

It is important to remember that there were good reasons for the benefits freeze: lowering the real level of benefits over time helps to improve work incentives and reduces the cost to the taxpayer. As a rule, such measures have proved popular among voters. Nevertheless, it would be not just callous but politically disadvantageous for the Government to be seen to be leaving those on benefits to suffer the full effects of any post-Brexit price rises while cushioning the impact on the working population.

The Government already plans to end the benefits freeze in 2020/21. However, given the need to support consumer confidence and boost incomes after a no-deal Brexit, we recommend bringing forward the end

of the freeze by a year, so that working-age benefits rise in line with CPI inflation for the 2019/20 financial year. This suggests a 2.4 per cent uprating effective this April.⁷¹ Any further spike in inflation that resulted from a no-deal Brexit would then be built into the 2020/21 rates.

The Joseph Rowntree Foundation has suggested that removing the benefit freeze one year early would cost £1.4 billion, with 25.7 million benefit recipients set to gain an average of £90 for 2020/21 based on full rollout of Universal Credit.⁷² However, working-age benefits are currently spread over Universal Credit and the legacy benefit system, with just 36 per cent of claimants estimated to have been rolled on to Universal Credit by 2019/20 and 60 per cent by 2020/21.⁷³ When current rollout projections are taken into account, the cost is closer to £1.5 billion.⁷⁴

“It would be not just callous but politically disadvantageous to leave those on benefits to suffer the full effects of any post-Brexit price rises.”

What about those who are too old to work? In recent years, pensioners as a class have definitely had a better deal than the rest of society. While working-age benefits have remained frozen for four years, pensioners have benefited from the “triple lock”, which has seen the state pension rise annually by the highest of inflation, average earnings, and 2.5 per cent. On current uprating plans, this will see pensions rise by 2.6 per cent in 2019/20 in line with earnings.

Nevertheless, to make sure that pensioners also feel a boost to their incomes in a no-deal Brexit scenario, the Government should consider “topping up” the planned increase in the state pension by an



additional 1.4 per cent, so that the total rise for 2019/20 is 4 per cent. Compared to current fiscal plans, this would mean that people receiving the new state pension got an extra £123 over the course of the year. The cost to the Treasury would be just under £1.6 billion compared with current plans.

Policy Recommendation: End the working-age benefits freeze one year early, so that these benefits rise by 2.4 per cent for 2019/20. Top up the state pension so that it rises by 4 per cent for 2019/20. The combined cost of this recommendation would be £3.1 billion.

Taken together, the proposals here would cushion – or even outweigh – any impact of rising prices post-Brexit. They would also avoid distorting the tax system – and leave people with more of their own money to spend or save.

Putting the Universal Working Income at the heart of this agenda would embed a hugely popular tax cut within the PAYE system, reaching 2.4 million people who have been excluded from rises in the personal allowance and guaranteeing to every worker that the first £1,000 they earned would be completely tax-free. This would not merely help workers cope with rising prices post-Brexit, but encourage more people into work in the first place.



Our Plan to Keep Britain Open

Invest in
developing the most
efficient customs
system in the world

Reduce almost all
tariffs to zero, for
EU and non-EU
goods alike

Prepare to help
the worst-affected
firms, sectors,
and regions

Keep things
moving at the
border by waving
through EU imports

Establish a
“one-stop shop”
to help exporters
with every aspect
of post-Brexit trade

Offer tax breaks to
high earners and
profitable businesses
that move to Britain
after Brexit

Develop a **new generation**
of free ports to attract investment to
“left-behind” areas

Give SMEs
£2,000 vouchers
to spend on independent



Part 3 – Keeping Britain Open After a No-Deal Brexit

Until now, this report has been concerned with the things that may happen after a no-deal Brexit, and has made a variety of recommendations designed to support consumers and boost businesses.

This final section takes a slightly different approach. It focuses on the policy areas that the Government must inevitably deal with in a no-deal Brexit scenario – namely, tariffs, customs, and migration.

The way the Government handles these issues will have profound consequences for the same businesses and consumers we set out to protect in Parts 1 and 2. After all, the severity of any supply shock that may result from a no-deal Brexit will largely be determined by how we deal with these border questions in its immediate aftermath. And the scale of that supply shock will, in turn, determine how great a hit there is to consumer confidence and business investment. In short, much rests on the kind of policies we outline below.

“ Our view is that tariffs are bad for consumers – especially when inflation is already a concern – but also bad for most businesses, and for the economy as a whole. ”

Yet the way the Government approaches tariffs, customs, and migration if no deal with the EU is concluded by March 29 will also say a lot about the kind of country Britain intends to be after Brexit. Will it be “Global Britain” – a statement of openness and ambition? Or will it be “Little England” – a pessimistic retreat into our shell?

We choose the former course, and emphatically reject the latter. For Britain to thrive after Brexit, it must be open, optimistic, and eager to seek out new opportunity. At the same time, if Britain does turn in on itself in the months ahead, it won't just betray the spirit of that 2016 referendum result; it will also needlessly make the transition from EU membership to independence much more painful.

Accordingly, the analysis that follows takes the imperative of keeping Britain open after Brexit – to both trade and talent – and identifies realistic, practical ways the Government could proceed.

On trade, we make the case for unilaterally abolishing tariffs on the vast majority of goods, and for moving as fast as possible to eliminate tariffs in other areas. Our view is that tariffs are bad for consumers – especially when inflation is already a concern – but also bad for most businesses, and for the economy as a whole.

Nevertheless, we are not blind to the difficulties immediate tariff abolition could cause some firms and sectors. We therefore outline a number of ways the government could soften the blow, ease



the transition, or help people to adapt. A balance between politics and economics must inevitably be struck.

When it comes to customs – and non-tariff barriers to trade more broadly – we take a similarly hard-headed approach. First of all, it is vital that we don't cause chaos at our ports by erecting unnecessary barriers to European imports.

Instead, every effort should be made to treat those European imports just as we do today, and wave them through the border with the minimum of fuss.

But this isn't just about EU trade: we should be aiming to have the best and most efficient customs system in the world full stop. That requires investment in people, processes, and technology. It may not be the most glamorous topic in contemporary political economy, but becoming the best of the best at processing cross-border trade flows will undoubtedly pay dividends in the long run.

“ A no-deal Brexit gives us an opportunity to create a new generation of free ports – potentially in some of Britain's most deprived areas. ”

Our views on tariff and non-tariff barriers come together in perfect harmony when it comes to the case for free ports – special economic zones that exist outside the usual rules and structures governing a country's international trade. Free ports have outstanding international pedigree, and are a proven way of increasing trade – as well as driving regional development. A no-deal Brexit gives us an opportunity to create a new generation of free ports – potentially in some of Britain's most deprived areas. We should take it.

We should also be mindful of the impact that a no-deal Brexit could have on businesses that currently export to the EU – particularly those small and family businesses, and start-ups, which may be least able to deal with all the additional paperwork, hassle, and costs that will come with “third-party” status. We suggest a number of ways that the Government can help such businesses adapt to the changed environment, while also promoting export sales more generally.

Finally, as well as being open to trade, post-Brexit Britain must be open to talent. We need to ensure that the world's best and brightest continue to see Britain as a place where they can make their fortune. To that end, we propose visa reform for investors, entrepreneurs, and the highest-skilled workers. We also outline a special, time-limited tax incentive designed to encourage high-paid workers (and, indeed, profitable businesses) to relocate to Britain in the immediate aftermath of a no-deal Brexit. Traditionally, such people have not needed much persuading to come to these shores. But in a context of extreme uncertainty, we think a more active approach to courting high-fliers may be worthwhile.

Ultimately, the recommendations we make below are about minimising the inevitable downsides of a no-deal Brexit, while also setting Britain up to take advantage of the opportunities it may present further down the line. They are also designed to send a loud, clear message to Britons and their trading partners alike: whatever happens, this country is and will remain open for business.

Reduce or abolish tariffs on imports

Recent reports suggest that the Government is considering unilaterally abolishing almost all tariffs on imports



in the event of a no-deal Brexit.⁷⁵ This is somewhat controversial since, according to the World Trade Organisation's most-favoured nation (MFN) rule, Britain cannot drop tariffs against EU goods alone: in the absence of a recognised free trade agreement, cutting tariffs on EU goods to zero would mean applying the same treatment to all imports – regardless of where they came from.

(There is a case that the UK and EU could maintain preferential treatment towards each other under Article XXIV of the GATT treaties as they negotiate an FTA. However, this would require not only a cooperative no-deal environment – with a clear plan and schedule for reaching a UK-EU free trade agreement – but also the acquiescence of other WTO members.⁷⁶)

In our view, the Government is on the right track: unilaterally abolishing tariffs is the right approach to take in the wake of a no-deal Brexit. Tariffs might protect particular industries in the short run, but scratch beneath the surface and it quickly becomes clear that they are bad for consumers, bad for business in general, and bad for the economy as a whole. However, this would need to be done in a calculated and calibrated fashion – a zero-tariff environment should be the desired end state, but there will undoubtedly need to be a period of adjustment, particularly in the fraught circumstances of a no-deal Brexit.

But why is cutting tariffs desirable? Let's take the impact on consumers first. We've already discussed how a no-deal Brexit could cause a drop in the pound, which would drive up the cost of imports, and therefore make goods more expensive for consumers, putting a squeeze on their living standards. Introducing tariffs on goods coming from the EU – which is the only legal alternative to setting tariffs at

zero in the absence of a trade agreement – would make matters worse, driving up the cost of goods even further.

An October 2017 report from the Resolution Foundation and the UK Trade Policy Observatory helpfully modelled the effect of introducing MFN tariffs on food and goods from the EU.⁷⁷ It found that these tariffs would raise prices by 2.7 per cent on average.

That overall figure masks some significant variations: dairy prices would go up by 8.1 per cent, meat by 5.8 per cent, and vegetables by 4 per cent.

Plainly, this is the last thing consumers need after a no-deal Brexit.

What about unilaterally abolishing tariffs? The same study suggests that this would reduce the price of food and goods by 1 per cent on average. Again, though, the effect is not the same for every item in the consumer's shopping basket: the price of clothing and footwear would fall by 3.4 per cent, the price of meat by 3.2 per cent, and the price of fish by 2.7 per cent.

The gains from unilateral free trade are, according to this modelling, smaller than the losses from introducing tariffs. But they still represent a significant boon to the British shopper – a way of offsetting the price effect of a weaker currency, and boosting consumer confidence.

“ A report from the Resolution Foundation and the UK Trade Policy Observatory helpfully modelled the effect of introducing MFN tariffs on food and goods from the EU. ”

Few would dispute the impact that tariffs – or their absence – have on consumer prices. But what many people do not realise is that getting rid of tariffs helps businesses too. For one thing, if



getting rid of tariffs lowers the price of some previously “protected” good, that leaves consumers with more money to spend elsewhere in the economy – so that what one producer loses, another tends to gain.

More importantly, however, many businesses are themselves consumers of imported goods. That means that tariffs hurt them as well. Let’s say you put a tariff on imported steel, for instance. In the short run, that would obviously help the domestic steel industry. But it would also hurt any domestic business that used steel in its production process – manufacturers and construction firms may, for example, suffer rising costs and become less profitable as a result.

This isn’t idle theory: it is precisely what happened when the US Government introduced tariffs on steel in 2002, in response to a surge in imports. Sure enough, domestic steel production increased while the tariffs were in effect, but higher steel prices also led to 200,000 jobs losses – and \$4 billion in lost wages – elsewhere in the economy.⁷⁸ More Americans lost their jobs as a result of steel tariffs than were employed in the entire US steel industry at that time.

It’s worth making a broader economic point here as well. The purpose of a tariff is to shield domestic industry from competition – that’s why they call it “protection”. In the long run, however, sheltered industries will inevitably become less efficient and less competitive. What’s more, tying up capital in “protected” industries prevents the British economy as a whole from specialising in those areas where we have a genuine comparative advantage. The net result is lower productivity, lower economic growth, and – over time – correspondingly lower living standards.

“ The real benefit of trade is in the imports consumers and businesses gain access to. ”

Some argue that even if zero tariffs are desirable, lowering or abolishing them before we have signed free trade deals with other countries is a mistake – like throwing away the best cards in our hand before a game of poker. As Shadow Trade Secretary Barry Gardiner put it when news broke that the Government was considering unilateral free trade after a no-deal Brexit, “the Secretary of State appears not to understand the basic logic of trade negotiations: your side wants the other to liberalise their markets and reduce tariffs on the goods you export to them. If you have already reduced all your tariffs to zero you have nothing to negotiate with.”⁷⁹

This argument has a superficial appeal, but is actually wrong both in theory and in practice.

It would of course be better if all countries adopted free trade. But the real benefit of trade is in the imports consumers and businesses gain access to. Import tariffs are thus not some asset to be bargained away carefully – they are a direct cost to our own people and economy. To oppose free trade as a negotiating tactic is like saying you won’t stop poking yourself in the eye until your neighbour agrees to stop poking himself in the eye as well. It is a self-defeating approach.

Then there’s the real-world evidence, which suggests that trade negotiations are both viable and worthwhile even in the absence of tariffs. As the Cato Institute’s Ryan Bourne pointed out in a recent Telegraph column:



Hong Kong imposes no import taxes, but has FTAs with China, New Zealand, EFTA countries (Iceland, Norway, Switzerland and Liechtenstein) and Chile. Ninety-nine per cent of imports enter Singapore duty free, but the country has FTAs with China, Australia, New Zealand, India, Japan, Korea, EFTA, Turkey and the US.⁸⁰

The crucial point to realise is that non-tariff barriers (discussed below) are a vital part of modern-day trade liberalisation. So there's still plenty to talk about – and bargain with – after you've reduced all your tariffs to zero.

The second major argument against unilateral free trade is that precipitously abolishing tariffs will do untold damage to previously “protected” sectors, causing significant job losses and much ensuing hardship. As Jude Brimble of the GMB union recently put it, “Ministers want to slash tariffs left, right and centre but instead they will be ripping the heart out of our industry and communities. We need Parliament to halt this ideologically-driven industrial sabotage”.⁸¹

“ There are some areas of the UK economy which would lose out in a unilateral free trade scenario. ”

Such fears are, in truth, overblown. For starters, the EU's common external tariff means that we currently levy tariffs on many goods that we don't even produce ourselves. Oranges are one good example: the tariff jumped from 3.2 per cent to 16 per cent in 2016 after intensive lobbying by Spanish farmers. Coffee is another: it isn't grown in Europe, let alone the UK, and yet is currently subject to seven different tariffs.⁸² Getting rid of tariffs where we have no domestic

industry to protect can surely only bring benefits.

It's important to remember too that most of the British economy is not subject to tariffs as things stand. According to the ONS, 79 per cent of British GDP comes from the service sector, where tariffs are not an issue.⁸³ The same goes for construction, which makes up 6 per cent of GDP. That leaves 15 per cent of GDP coming from “production” and less than 1 per cent coming from agriculture. The latter is mostly “protected” by tariffs as things stand; for the former, it's a mixed bag.

Even when British producers are currently “protected” by tariffs, it is likely that many would be able to adapt to increased competition, becoming more productive and/or more specialised in the higher “value-add” segments of their industry. Competition isn't solely about price, after all; there's a lot of money to be made selling premium products to discerning consumers.

It is also important to bear in mind that the average tariff currently levied according to EU rules is less than 3 per cent, and that the impact of tariffs on prices is much smaller than that.⁸⁴ Things like the exchange rate can have just as big an impact on prices – and, after a no-deal Brexit, may actually serve to make British producers more competitive vis-à-vis their international competitors.

The key point here is that getting rid of tariffs is unlikely to be an existential threat to British business.

However, economics is not the same thing as politics. It is unlikely that, in the fraught environment following a no-deal Brexit, a Government with no parliamentary majority will be able to wave a lordly hand at a host of traditional

manufacturing firms and constituencies and say: “Just adapt.” All the more so in areas where the folk memory of the deindustrialisation of the 1980s still lingers.

There are after all some areas of the UK economy which would lose out in a unilateral free trade scenario. A handful of industries – principally agriculture – have never really known life without protection. In these instances, an immediate move to abolish tariffs might cause significant problems before the industries in question had the chance to adjust. What’s more, these problems would be quite concentrated, both by sector and geographically, which would clearly amplify their political impact.

There are several approaches the Government could take to dealing with the losers from unilateral free trade. The first option is to proceed more slowly in a number of sensitive areas with the transition to tariff-free trade. Rather than reducing those particular tariffs to zero overnight, the Government could instead phase them out over a number of years. Ideally, this would involve setting a clear timetable for tariff reductions at the outset, and then sticking to it. The goal should not be to permanently insulate domestic producers from global markets, but rather to give them some breathing space to catch up with their overseas competitors.

The obvious downside of this approach is that it would involve instituting tariffs against currently tariff-free EU goods, as well as maintaining tariffs against products from third countries – at least for a few years. That would undoubtedly hurt the British consumer. As a result, phased tariff reduction of this sort should be pursued only when there is a compelling case for it.

An alternative approach would be to provide temporary and targeted assistance to firms or sectors that are particularly hard hit by the transition to tariff-free trade. If a business – especially one in a deprived part of the country – could show that removing a tariff had clearly and directly impacted their ability to compete in the market, and that significant numbers of jobs were at risk, the Government could offer them a temporary tax break, such as a 12-month “holiday” from business rates and employers’ National Insurance Contributions.

“When jobs are lost because of changing patterns of trade, the right policy response is usually to focus on providing income support, enhanced skills retraining, and dedicated assistance in finding new employment.”

Once again, the goal here must not be to prop up unsustainable business models; it should simply be to ensure that otherwise sound companies do not go to the wall because of a sudden change in circumstances brought about by a no-deal Brexit. This suggests that the availability of this support, and its duration, should be strictly time-limited and explicitly tied to Brexit’s fallout. The Government will not want to set a precedent that sees it called upon to support any future business that suffers an exogenous change of circumstances.

Indeed, while we are responding here to a predictable political imperative to “rescue” struggling industries, from an economic standpoint it is usually better to look past particular businesses and focus instead on the individuals concerned and any major



regional impacts. When jobs are lost because of changing patterns of trade, the right policy response is usually to focus on providing income support, enhanced skills retraining, and dedicated assistance in finding new employment. In other words, where possible we should try to help people adapt to a changing world, rather than trying (in vain) to prevent the world from changing. It is therefore strongly arguable that sustained investment in such initiatives would be a better solution than support for individual firms per se.

Whatever form it takes, Brexit ought to be an act of confidence on the part of the UK – a move to embrace global competition and build a dynamic, outward-looking economy. Unilaterally moving towards setting tariffs at zero would be good for consumers and good for business – and it would send a clear message about the kind of country Britain intends to be after Brexit. We should therefore reduce tariffs to zero immediately for the vast majority of goods, and then move over the subsequent months and years towards eliminating tariffs across the rest of the economy too.

Policy Recommendation: The Government should unilaterally and immediately reduce tariffs to zero on the vast majority of goods – whether they come from the EU or the rest of the world. Even where tariffs are maintained in the short term, the goal should be to eliminate them as soon as possible over the coming months and years.

The Government should not let worries about future trade deals prevent it from abolishing tariffs now. It should, however, be alert to the localised problems that unilateral free trade could cause for a minority of domestic producers, sectors, and areas.

In some instances, tariffs could be phased out more gradually. In others, targeted and temporary tax breaks could be given to the worst-affected. The emphasis, however, should be on people rather than firms, with priority given to investment in skills retraining and adjustment assistance.

Wave through low-risk imports from the European Union

Free trade isn't just about tariffs. In the modern economy, non-tariff barriers are often a much more significant problem.

In developed countries, the most common type of non-tariff barriers stem from differences in regulation. That is, goods or services that comply with regulation in their home country cannot be exported because they do not comply with different sets of regulation overseas. Or, conversely, you may not be able to import particular goods or services because they don't comply with domestic regulations – even though they do meet the requirements of the country in which they originate.

“ The Port of Dover has said that if UK-EU lorries were delayed by an additional two minutes as a result of customs checks, it would cause 17 miles of gridlocked traffic on each side of the border within hours. At the moment, EU lorries take about two minutes to process, whereas for non-EU lorries, it takes twenty minutes. ”

Often, the problem is not so much one of compliance but of bureaucracy. Doing the necessary paperwork to show that you meet regulatory requirements is burdensome and costly; and you may be subject to



inspections and customs checks that slow down trade and disrupt complex, cross-border supply chains.

The EU offers its member states and closest associates a way of dealing with this problem, by promulgating regulations and directives centrally in an effort to standardise regulation across the trade zone.

In a no-deal Brexit scenario, however, Britain will no longer be part of that EU-sponsored regulatory zone. And even though Britain will, in the immediate aftermath of a no-deal Brexit, still be in regulatory alignment with the EU, it will formally be considered a third country.

This formalistic change of legal status may, many fear, result in trade grinding to a halt, as goods shipments suddenly require new and unfamiliar documentation, and face more regular and intrusive checks as they cross borders. Famously, the Port of Dover has said that if UK-EU lorries were delayed by an additional two minutes, on average, as a result of customs checks, it would cause 17 miles of gridlocked traffic on each side of the border within hours. At the moment, EU lorries take about two minutes to process, whereas for non-EU lorries, it takes twenty minutes.⁸⁵

This is a real concern and some disruption in the event of a no-deal Brexit is going to be very difficult to avoid. Obviously, it is in everybody's interest to prevent this sort of border chaos, and so diplomatic efforts to facilitate customs clearance in a no-deal scenario should be a priority. However, there is only so much we can do about how our trading partners choose to respond to a no-deal Brexit.

As with tariffs, though, there is a lot we can do unilaterally to avoid the potential pitfalls of a no-deal Brexit, and to ensure

that goods move through our side of the border as smoothly as possible.

The most important such step we can take is to treat any shipments arriving from the EU the day after a no-deal Brexit in precisely the same way we would have treated them the day before. We should accept all relevant EU regulations and documentation, and refuse to subject imports from the EU to additional checks or bureaucracy.

Encouragingly, this approach seems to be what the Government has in mind already. In early February, HM Revenue & Customs announced that it would implement "simplified importing procedures" for an initial period of one year after a no-deal Brexit. Companies transporting goods would be able to defer making any necessary declarations or paying any required duties until after the goods had crossed the border.

Policy Recommendation: After a no-deal Brexit, Britain should continue to recognise the EU's regulatory standards, and customs officials should "wave through" EU imports at the UK border.

Support exporters and develop the best customs system in the world

Many people who might otherwise be sanguine about the prospect of a no-deal Brexit are concerned – with some justification – that Britain left too many of its preparations for a no-deal Brexit too late. They worry that as a result, the Government has neither the staff nor the infrastructure in place to handle a huge increase in tariff collection and regulatory



checks when we move to “third country” status.

Britain is certainly not as prepared for a no-deal Brexit as it ought to be. Yet the virtue of the unilateral approach outlined here is that it circumvents the bureaucratic problem by choosing not to impose barriers to trade where they didn't exist before – and, indeed, to ease or eliminate them where they did. Necessity can sometimes be the mother of invention.

But this should not be taken as an argument against investing more resources in the UK's borders and trade-support infrastructure. On the contrary: a no-deal Brexit demands that Britain develops the best customs and export promotion systems it can.

Let's remember what's at stake here. In the absence of an agreement with the EU, all UK exporters will have to declare the origin of their goods when trading with our European neighbours. This would quickly become a very costly endeavour for companies with cross-border supply chains, as they would no longer be able to benefit from cumulation agreements with the EU and third countries.

Indeed, the Government estimates that the combination of administrative and compliance costs linked to “rules of origin” regulation is between 4 per cent and 15 per cent of the cost of goods sold.⁸⁶ The OECD suggests that total transaction costs could rise by up to 24 per cent of the value of the good.⁸⁷

This is a particular problem for the 135,000 businesses who currently only export to the EU. The CBI says such firms will face “a huge and unprecedented administrative challenge” to continue their business as usual.⁸⁸ New administrative and compliance burdens also pose a serious threat to “just-in-time” business models,

which are very efficient but also rely heavily on supplies and components from across continental Europe being delivered in tight timeframes. A mishandled no-deal Brexit could quickly become a logistical nightmare for these firms.

Moreover, many businesses have delayed preparations for a no-deal Brexit. In a recent survey, the Institute of Directors (IoD) found that 63 per cent of its members had not yet drawn up any Brexit contingency plans.⁸⁹ Likewise, a survey by EEF found that less than one in five manufacturers were prepared for a no-deal scenario.⁹⁰

At least in part, this apparent lack of preparedness is attributable to the opportunity cost of planning for an eventuality that may never happen. But a lack of clarity from Government about contingency plans is also partly to blame.⁹¹ With so little time left before Brexit, communication will be key to mitigating the effect on exporters. The Government needs to be as up-front as possible about its plans for a no-deal Brexit, so that businesses can lay as much groundwork as possible for whatever changes in circumstances await them.

“In a recent survey, the Institute of Directors found that 63% of its members had not yet drawn up any Brexit contingency plans.”

As part of these efforts, the Government should establish a “one-stop-shop” for all business enquiries around our new customs arrangements.⁹² In doing so, they should take care to make everything as straightforward and easy to understand as possible. Many small and medium-sized businesses struggle to decipher Whitehall jargon. Indeed, the Government should take note of another IoD survey, which found that only a quarter of their



members who had read the Government's technical notices and guidance had found them useful for their Brexit preparations.⁹³ There is a significant communications challenge here, and it is imperative that the Government tackles it head-on.

At the CPS, we are particularly concerned about the prospects of small and family businesses that export to the EU. The last thing we want is for them to lose important customers because they don't know how to handle all the new trade rules and paperwork that will come with Britain's third-party status. Put simply: there's going to be a lot for these companies to get their heads around in the immediate aftermath of a no-deal Brexit, and they won't always have the in-house expertise to manage it – or the financial capacity needed to seek expert advice.

To support these firms, we suggest the Government establishes a voucher scheme that would allow SMEs to get tailored legal and professional assistance on how to respond to a no-deal Brexit. Such schemes are already in effect in Ireland and the Netherlands, and allow qualifying businesses to apply online for grants of about £2,000.⁹⁴ We should follow their lead. The vouchers should be easy to apply for, straightforward to use, and should be promoted heavily by the Government through a variety of media.

Analysis by the IoD found that it would cost about £700 million to give a £2,000 voucher to every UK SME that exports to or has supply chain exposure in the EU.⁹⁵ In reality, it is highly unlikely that take-up will be that high, but the Government should nevertheless reach out to as many eligible firms as possible.

There are further measures the Government could take to reduce the cost of customs procedures for exporting businesses. For example, the British Chambers of Commerce currently issue

advice and Certificates of Origin to exporters on behalf of HMRC. At present, each local Chamber of Commerce charges a fee for its services.⁹⁶ As businesses navigate new trading relationships and cumulation agreements, the Government should provide funding to the British Chambers of Commerce – and other business groups supporting exporters – so that these fees can be waived.

If the government wanted to go beyond simply helping exporters cope with the impact of a no-deal Brexit, and actively promote export sales, there are a couple of obvious things it could do. The first would be to introduce a system of export tax credits that would allow companies to offset some of the special costs of running an export business against their tax bill. Another idea would be to expand UK Export Finance, which provides insurance to exporters and loan guarantees to banks that provide them with operating credit. In both cases, a focus on SMEs would be welcome and appropriate – it would target the help where it was most needed, and circumvent accusations of crony capitalism.

Of course, helping small and family businesses to export need not necessarily involve spending a lot of taxpayers' money. In many cases, good results could be achieved through export mentorship schemes run by local business associations or, indeed, under the auspices of Local Enterprise Partnerships. The goal of such schemes would be to connect successful exporters with small and family businesses looking to grow their export sales, thereby helping to spread knowledge and best practice.

In addition to these policies designed to help firms manage the transition to a new trading system, we propose a series of measures to actually drive down the uncertainty and costs associated with customs checks.



First, the UK should update its customs processes in a way that is compatible with the 2016 Union Customs Code (UCC). This would smooth the path towards any future agreements between Britain and the EU. The UCC includes measures like the use of electronic transport manifests and online pre-arrival and departure declarations to speed up queues at the border.

Sadly, it is extremely unlikely that the new online Customs Declaration Service will arrive in time for March 29, 2019. Nevertheless, updating and accelerating this programme while bolstering the existing CHIEF system will be key to easing the administrative burden from day one.

As well as improving online systems, it is important that there are enough boots on the ground, both to help companies comply with the new trading rules, and to physically keep things moving at the border. In October 2018, the Permanent Secretary of HMRC told MPs that it will need 5,300 new customs officials in the case of no deal, but only 2,300 had so far been hired.⁹⁷ Fast-tracking the recruitment and training of new customs officials is therefore essential. We might not have the full complement in place before Brexit day, but at least they would be coming on stream as rapidly as possible.

The Government should also look to streamline other parts of the trade process – both to free up its own resources and to reduce the accounting burden on firms. For example, traders should be allowed to claim import VAT as an input credit at the same time as declaring VAT liability – in one simultaneous transaction.⁹⁸

Likewise, postponed accounting to make import VAT deductible from a company's tax liabilities could help with the future implementation of centralised clearance systems. Making the UK's VAT regime work

for business is vital to ensuring that cash flow and working capital costs do not affect their competitiveness and increase costs for consumers.

Finally, the Government should be prepared to “think big” about the future of the UK's customs system.

Britain currently ranks joint 9th in the World Economic Forum's “Burden of Customs Procedure Index”. Many of the top-ranking countries in this index have used digitisation and simplification to improve the efficiency of their customs procedures. Finland requires just four documents to either import or export, taking under two hours to fill out the paperwork for either process.⁹⁹ Likewise, the United Arab Emirates has invested heavily in an advanced online system for integrating trade, supply, and payments.

Within three years, the Government should set itself the goal of topping that World Economic Forum index, and having the most efficient customs procedures in the world for EU and non-EU goods alike. A no-deal Brexit demands nothing less.

Policy Recommendation: The Government should communicate its plans for a no-deal Brexit very clearly to business as soon as possible. It should set up a “one-stop shop” to support exporting businesses, and give eligible SMEs £2,000 “vouchers” to spend on legal and professional advice related to Brexit.

The Government should streamline and digitise its customs procedures, and fast-track the recruitment and training of new customs officials. It should also set itself a three-year target of developing the most efficient customs procedures in the world.



Move ahead with a new generation of free ports

If the proposals on tariffs and customs checks outlined above were implemented in full, they would do a great deal to minimise the impact of a no-deal Brexit on trade, and to reduce the possibility of the UK economy suffering a significant supply shock after March 29.

If the Government was able to go as far as we propose, Britain's customs and tariff arrangements would be among the most convenient in the world, which would doubtless be attractive to international exporters.

But leaving the EU's customs union also enables us to establish a new generation of "free ports" around the UK – as Rishi Sunak MP suggested in a 2016 report for the CPS.¹⁰⁰

Free ports, or "free trade zones", are geographic areas within a country that are given a special legal status placing them outside the normal customs and tariff arrangements which apply in the rest of the country. Goods can come in and out without incurring the costs and administration they would otherwise have faced. Free ports have been used across the world to attract investment and manufacturing activity, create jobs for local people, and promote greater trade flows.

There are 3,500 free trade zones across the globe, in 135 different countries, employing 66 million people.¹⁰¹ Perhaps the most famous free port in the world is Jebel Ali in the United Arab Emirates, which now accounts for 20 per cent of the UAE's foreign direct investment. China's "Special Economic Zones" now account for 20 per cent of the country's GDP, and around half of its FDI.¹⁰²

“There are **3,500** free trade zones across the globe, in 135 different countries, employing 66 million people.”

Different countries have approached the concept in different ways, and there is huge variation in how Governments have chosen to implement special status for their chosen areas. Broadly, however, free ports fall into four main categories:

- **Duty Exemption.** Products enter the Zone without incurring import tariffs or duties. This allows the products to be processed, and perhaps combined with other products or engineered into finished goods, for eventual re-export to a third country.
- **Duty Deferral.** For goods that ultimately enter the host country, duty is deferred and payable only when the goods leave the Zone, not when they first arrive. This allows companies to warehouse and process goods in the Zone before incurring duties, improving cash flow cycles and making just-in-time inventory management easier.
- **Tariff Inversion.** Finished goods often command a lower tariff rate than their component parts. This incentivises importing finished goods rather than importing high tariff components and using domestic manufacturing to create the actual product. A free port allows a company to import components tariff free, manufacture the final product in the Zone, and then pay a lower duty rate on the finished product when it enters the host economy.
- **Tax Incentives.** Temporary financial support to incentivise beneficial and genuinely new economic activity. Typical examples include lower VAT rates on goods brought in through the Zone, reduced rates of corporation tax for companies located within it, tax credits for local research and development activity, and lower rates of employment tax for newly created jobs. Some regulatory flexibility can also be offered, such as simplified planning processes. These sorts of incentives typify the Special Economic Zones in China.



In practice, most real-world examples of free ports will not fall neatly into any one of the four categories above, with many utilising a mixture of these policies depending on the particular circumstances and desired impact.

Given our geography, we are especially well-placed in Britain to take advantage of the opportunities free ports can offer. Ports already play a hugely important role in our economy, with 96 per cent of all UK trade by volume, and 75 per cent by value, passing through them.¹⁰³ The UK also possesses world-class port infrastructure that is capable of handling and capitalising on the new opportunities a free-trade zone programme would create. UK ports are large enough, competitive enough, and have access to the private capital needed to make the policy a success. Perhaps not surprisingly, the British Ports Association has called on the Government to further consider the free ports concept.¹⁰⁴

Free ports also present an opportunity to rebalance the UK economy, both in terms of revitalising non-service sectors of the economy, and encouraging investment and growth in regions which have suffered from the decline of traditional industries. Of the UK's 30 largest ports, 17 are in the bottom quartile of local authorities when ranked by the ONS's Index of Multiple Deprivation.¹⁰⁵ One such area is Teesside in the North East of England. The mayor of the Tees Valley, Ben Houchen, has championed the idea of a new free port in his area as a way to attract businesses and regenerate towns like Middlesbrough and Redcar.¹⁰⁶

Of course, free ports do not necessarily have to be ports. Sunak's original report acknowledged that it would also be possible to pair a free-trade zone with an airport – the Geneva Freeport, perhaps the world's leading storehouse of art and other treasures, is entirely landlocked. There could be significant economic benefits from applying the model to air cargo too – and indeed to railheads at the end of

freight lines, which like our ports are often located in relatively disadvantaged parts of the country. This would have the happy side effect of helping to ease pressure on existing customs posts, since checks and inspections on the cargo would be carried out well away from the border.

Finally, even if the UK does adopt zero tariffs and streamlined customs more broadly, the free ports concept could be adopted on the Special Economic Zone model, with tax and regulatory incentives used to encourage new economic clusters in Britain's coastal regions, or other deprived areas in need of regeneration.

Policy Recommendation: The Government should consider establishing a new generation of free ports in the UK, using trade, tax, and regulatory incentives to encourage additional economic activity.

Ensure that Britain continues to attract the world's best and brightest

The final piece in the puzzle when it comes to keeping Britain open is ensuring that we continue to attract the top talent from around the world. We want to make the UK as appealing as possible to people with the ideas, skills, and money needed to build businesses and drive economic growth.

Fundamentally, there are two things we need to do if we want the best and brightest to keep coming to Britain. The first is to improve the existing visa system, so that it is fit for purpose in a post-Brexit world.

As things stand, the Tier 1 visa system is overly complex. The complex and costly sub-visas for investors, graduates, and entrepreneurs routinely receive fewer applications than their annual caps.

After a no-deal Brexit, Britain should make reforming these visas a priority.



They need to be simplified, streamlined, and promoted more effectively. Indeed, it is worth asking whether we really need to have any caps on the highest-skilled immigrants at all – Britain only benefits from such people’s presence here.

When it comes to entrepreneurs – the kind of immigrants we should recruit most ruthlessly after Brexit – reform is already on the way in the form of the new Start-Up Visa announced by Home Secretary Sajid Javid in June 2018. Once up and running, the Start-Up Visa will create a legal entry route for budding entrepreneurs who are endorsed by universities, venture capital firms, business accelerators, and other approved organisations.

As the Entrepreneurs Network’s Philip Salter has argued, a sensible next step would be to roll the Tier 1 (Entrepreneur) Visa into the Start-Up Visa. As long as the Government keeps a careful watch on the organisations able to provide Start-Up Visa endorsements, it should be able to dispense with the Tier 1 (Entrepreneur) Visa’s financial requirements. These simultaneously prevent applications from many genuine entrepreneurs, while attracting unsuitable candidates looking for a ‘cheap’ alternative to the Tier 1 (Investor) Visa.¹⁰⁷

Indeed, Salter points out that the Tier 1 (Investor) Visa needs reform too.¹⁰⁸ Right now, it gives people who invest £2 million in the UK the right to live and work here, and eventually to apply for permanent residency. But a lot of this “investment” goes into government bonds – which might help the Treasury, but doesn’t do an awful lot for the wider economy. A better approach, says Salter, would be to significantly reduce the size of the required investment (to £500,000, or perhaps even lower) while also restricting it to investments that are eligible for the Enterprise Investment Scheme or for Venture Capital Trusts. Such a move would provide more funding for start-ups and scale-ups, while also attracting more genuine investors to the UK from overseas.

This is, necessarily, not a comprehensive survey of the post-Brexit immigration

system. That would require a lengthy report all of its own. Nevertheless, these policies would be a good place to begin in attracting the world’s best and brightest.

The second thing the government should do to bring top talent to Britain is devise a special tax regime that encourages the highest-paid workers to relocate here in the immediate aftermath of Brexit.

We could follow the example of the Netherlands: when high-skilled workers take jobs there, they can get a fixed tax-free allowance worth up to 30 per cent of their wage for the first five years.¹⁰⁹ The minimum salary to qualify is €37,296 for most workers, and €28,350 for the under-30s. Those figures seem low for the UK, and a permanent scheme might risk simply giving a big tax cut to people who would have moved here anyway. But we could say that anyone who moved here before the end of 2020, on a salary of more than £100,000, would get a special personal allowance equivalent to 30 per cent of their salary for five years. That would give the highest earners a strong financial incentive to relocate here, notwithstanding the inevitable uncertainty that a no-deal Brexit would entail. We could also consider applying a similar principle to companies – perhaps exempting the first £500,000 of annual profit from corporation tax for five years, provided that they relocate here before the end of 2020 and employ at least ten people full-time.

The great thing about both these policies is that – provided they attract people who otherwise would have stayed away – they actually bring money into the Exchequer, while also contributing to the growth and dynamism of the British economy.

Policy Recommendation: Reform the Tier 1 Visa system to make it easier for the highest-skilled workers to move to the UK. Expand the Start-Up Visa. Develop a set of time-limited tax incentives to encourage people and companies to move to Britain in the immediate aftermath of Brexit.



Conclusion

No one should be in any doubt about the challenges that a no-deal Brexit would pose.

Yet no deal is a scenario that we as a country must be prepared for. And although some painful economic disruption is all but inevitable, there are still things the Government can do to mitigate the risks, while also laying the groundwork for a brighter economic future.

We have focused here on three specific challenges: the need to boost businesses in a time of uncertainty; the need to support consumers in a period of rising prices; and the need to keep Britain open and outward-looking at this critical moment in our long history.

In each case, we have recommended specific policies designed to address the particular, short-term issues associated with a no-deal Brexit. But we have tried to ensure that these are not just panic measures. On the contrary, much of what we recommend here is right for Britain in the long term as well.

For business, we have sought to promote capital investment, boost infrastructure and housebuilding, and reduce regulatory burdens.

For consumers, we have tried to increase disposable incomes – principally by letting people keep more of their own hard-earned cash.

The alignment of short- and long-term interests is perhaps most obvious when it comes to international trade. The very things the Government should do to mitigate the immediate impact of a no-deal Brexit – reducing tariff and non-tariff barriers to trade – will also make the British economy more competitive and productive in the long run.

Taken together, the reforms proposed in this report would, if enacted, send the strongest possible message about the country that Britain wants to be after Brexit. And that message would be one of dynamism and openness – whatever the economic outlook in the short term.

Ultimately, the precise form that Brexit takes will not, by itself, determine Britain's prospects in the 21st century. Whether we prosper or stagnate in the long run will instead be down to the economic policies that the Government and its successors pursue in the years to come. That means advancing enterprise, ownership, and opportunity whenever and wherever we can – and making Britain a country and an economy that is competitive with allies and rivals old and new.



Notes

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