COMMENTARY

Boris bravado boosts odds of no-deal Brexit

By Andrew Hammond

> Despite Mr Johnson's apparent dismissal of the impact of a no-deal Brexit to the UK economy, there is a consensus among forecasters that this is wishful thinking. Longer-term predictions aside, the short-term challenge could be particularly intense, with the nation potentially tipping quickly into a downturn.

AS THE final leg of the UK Tory leadership race ends its first week proper, Boris Johnson remains the favourite to become the UK's next prime minister, despite recent allegations over a domestic incident last week with his girlfriend. The maverick former foreign secretary is facing off against current Foreign Secretary Jeremy Hunt in a clash that is seeing no-deal Brexit as the centrestage of debate within the electorate of 160,000 Tory party members – despite the fact that this disorderly outcome to the UK's exit from the EU is still widely misunderstood.

Mr Johnson – who easily finished top this month in polls of Tory MPs in the House of Commons – put this issue upfront again on Tuesday when he challenged Mr Hunt to pledge to leave the EU on Oct 31, come what may. Mr Johnson knows that his "do or die" hard-line stance on this issue will resonate with party members who – as polls indicate – now overwhelmingly want to leave the Brussels-based club. And this comes even if it means major political damage such as the end of the centuries-long union between England and Scotland, which has been frayed by Brexit given the latter's stronger attachment to EU membership.

Amid the frenzy of the current Tory race, and Mr Johnson's political opportunism on Brexit, there is only one current certainty with the UK's exit from the EU. That is, the default position legally is that the nation will depart the Brussels-based club on Oct 31, barring a further extension agreed with the EU-27, whether an exit deal is ratified or not.

Throughout much of the period since the June 2016 Brexit plebiscite, the prospects of the UK leaving the EU with no deal were widely dismissed across much of the political spectrum. However, this is now an escalating prospect with Mr Johnson and Mr Hunt differing over the political implications of this outcome in autumn.

On one side, Mr Johnson has said that the Tory Party will be destroyed, politically, unless the UK leaves on Oct 31. Yet, Mr Hunt had previously declared that leaving on this Halloween date could be "political suicide" for the Conservatives unless a exit deal is done.

The concept of no deal is, even now, widely misunderstood. It would mean that London will automatically leave the Brussels-based club without many, if not all, of the rules that regulate the UK's relationships with the EU-27.

Many economic relationships with the rest of the world will also be undermined as these are underpinned by trade treaties that the EU has agreed. With October approaching fast, only around a quarter of 40 planned post-Brexit trade agreements have so far been signed. G-7 economies, from Japan to Canada, have yet to agree new terms.

One mistake that is frequently made – including in the current Tory leadership contest – is that there is not one single no-deal outcome, but in fact multiple such scenarios. At the extreme end of the spectrum is a disorderly, no-deal Brexit which could prove chaotic, including for financial markets.

A version of this scenario, despite the economic harm that it might cause the UK and EU, remains possible given the dogmatic position of Mr Johnson. By contrast, Mr Hunt's slightly more nuanced approach would hold open the option of a further delay to leaving the Brussels-based club if a deal appears imminent at the end of October.

In the event of a no-deal Brexit, both Mr Hunt and Mr Johnson are likely to want to try to cushion the blow, building on measures that Theresa May's government has put in place. This includes agreements in areas – from civil nuclear cooperation and safeguarding to aviation – that would otherwise fall awry, plus granting road hauliers from the EU-27 the scope to use their licences in the UK after Oct 31.

POLITICAL ACRIMONY

Building on these unilateral UK measures, pressure will also come from key EU countries – such as Ireland and the Netherlands – for Brussels to try to mitigate the worst impacts of a no deal. However, the full scope of these actions across the 27-member community is uncertain given the political acrimony that would come to pass in a no-deal scenario, and at least temporary breakdown in trust is a real possibility, especially if the eurosceptic Mr Johnson is in Downing Street.

Despite Mr Johnson's apparent dismissal of the impact of a no-deal Brexit to the UK economy, there is a consensus among forecasters that this is wishful thinking. Longer-term predictions aside, the short-term challenge could be particularly intense, with the nation potentially tipping quickly into a downturn.

Part of the reason why the short-term impacts could be so severe – despite assertions of Mr Johnson and fellow Brexiteers – is that while it will be viable in the medium to long term for the UK to trade as a third country under World Trade Organization rules (and other international agreements), this will not happen instantaneously. Securing those new trade schedules will not be straightforward, and trading on WTO terms may well have a negative impact for the United Kingdom compared to the status quo, at least initially.

This is why many in Parliament are still seeking to try to prevent a no-deal option, aided by the activist House of Commons Speaker John Bercow. Earlier this month, for instance, there was a cross-party motion – led by Labour – which would have seen the House of Commons taking control of the chamber's business from the government. But the vote was defeated by a margin of 309-298.

There has been shown on previous occasions to be a majority in the House of Commons against a no deal. In January, for instance, a non-binding amendment sponsored by Conservative MP Caroline Spelman and Labour MP Jack Dromey was approved which "rejects the United Kingdom leaving the EU without a withdrawal agreement and future framework for the future relationship".

However, the massive problem facing the MPs who want to avoid no deal is that they cannot just show that there is a majority in the House of Commons and Lords against this option. They also need to overcome the big challenge of cultivating a legislative majority in favour of an alternative outcome – including possibly a referendum or a perhaps even a revised version of Mrs May's withdrawal deal – which has so far proven elusive.

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COMMENTARY

Germany needs to create more internal dynamism of its economy

By Michael Heise

THE German economy is lagging in its growth performance. Even in the group of the euro countries (not exactly a strong growth league to begin with) Germany has fallen to the lower gross domestic product (GDP) growth ranks in 2018 and 2019, just ahead of Italy.

The French economy (often falsely belittled by Germans) as well as the British economy (which has been battered by Brexit) are growing faster than Germany, albeit only slightly.

For now, the weakness of growth in the German economy has not yet become a big issue in the public debate in Germany, mainly because of still rather strong employment data and low levels of unemployment.

Many jobs are being created primarily in the service sector, which thrives on consumer spending. However, it is only a matter of time before the downturn in manufacturing – which has been taking hold for about a full year now – will negatively affect the other sectors.

US-CHINA TRADE WAR

German goods producers have been hit by the slowdown and lately also by the contraction of world trade. The lack of trade dynamics has various causes, with the tariff and broader trade policy conflict between the United States and China ranking prominent among them.

By itself, Germany can do little to heal the weakness of global trade. Therefore, it should do all it can to create more internal dynamism of the German economy through investment and innovation.

Unfortunately, this area of economic activity has been neglected for years. As a result, Germany is losing attractiveness as an investment location, and capital is being exported on a large scale.

In addition, Germany's famed labour productivity has hardly risen since 2017, while wages and non-wage labour costs are rising faster than in other European countries. In the manufacturing sector, the level of wages has for a long time been very high by international standards. That is also true for the level of taxes.

Following tax reform measures in other countries, Germany is once again among the industrialised countries with the highest level of corporate taxes and tax burden imposed on small and medium-size incomes. On top of that, very high average energy prices also keep industrial companies from expanding in Germany.

This triad of high wages, high taxes and high energy prices would not have to be a matter of concern if companies operating in Germany could rely on first-class infrastructure as well as a highly qualified labour supply that would justify those high taxes and business costs. But these traditional strengths of the German economy have been eroding in recent decades.

HALF MEASURES WON'T WORK

It will take some far-reaching political measures to improve the current situation in which the business sector finds itself. And yet, despite all the problems and concerns that are piling up and visible in the trade and investment data, German policymakers are reluctant to address the "old" and unpopular issues such as taxes or non-wage labour costs.

Any meaningful form of tax reform that could achieve beneficial results is rejected out of hand by referring to scarce resources. This is all the more surprising as tax revenues had been rising to record levels, and spending on public consumption increased by rather large bounds.

At the same time, the long-promised abolition of the temporary "solidarity" surcharge, passed at the time to finance the economic integration of the former East Germany into the Federal Republic, keeps getting pushed back.

Simply put, additional public expenditures seem more attractive politically. The biggest spending decisions since the new federal government was formed in 2018 concern further pension increases, the expansion of family benefits and big structural support for regions affected by the end of coal-fired power generation.

Whatever one thinks of these choices, one fact is beyond debate: Such expenditures do not strengthen future growth potential, even though that is urgently needed to support the welfare state in the future.

In conclusion, as much as Germany's politicians want to avoid acknowledging it, policies for growth must urgently address the hard facts of deteriorating business conditions.

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> The management of climate change is a global public good that depends on all countries' efforts to lower carbon dioxide emissions. The effort requires national governments to be held accountable for the success of their international cooperation in delivering such goods.

It's time to renew the social contract

Globalisation has weakened the nation-state, and income inequality has widened. BY KEMAL DERVIS AND CAROLINE CONROY

Washington

THE success of Western-style democracy after World War II was based on national social contracts: citizens paid taxes, and the state provided the conditions for steady economic progress, along with secure jobs, a social safety net and redistributive policies that narrowed the income gap between owners and workers. Although the degree of redistribution and the availability of secure jobs varied among countries, the vast majority of citizens bought into the arrangement.

In recent decades, however, globalisation has eroded the post-war social contract by weakening the nation-state. Increased global trade and financial flows have contributed to prosperity, but have also created losers. Income inequality has widened in many countries, and the concentration of wealth at the very top no longer seems tolerable. Moreover, the 2008 global financial crisis dented public confidence in steady economic progress.

Democratic governments now face two main challenges in trying to revive their countries' social contracts. They must ensure a strong and efficient safety net by adapting social and labour-market policies to the new world of work. And they must take concrete steps toward providing global public goods – such as tackling climate change – by securing domestic support for international cooperation.

That will not be easy. Economic disruption, along with concerns related to migration and refugees, has helped to bring neo-nationalist populists to power in several countries. US President Donald Trump's contempt for global rules and multilateral institutions, for example, is compounding other national governments' difficulties in making progress on economic and security matters.

Although unemployment has generally decreased, new technologies and increasing competition from China have created a strong feeling of insecurity in advanced economies. True, the digital economy holds great promise. But it, too, is disruptive and is changing the nature of work – by making jobs less secure and increasing the need for continuous learning. This is also true for emerging countries.

Governments' first priority, then, must be to update their social and labour-market policies to reflect these digital shifts. In particular, social benefits must become fully portable and "owned" by workers, rather than being linked to a specific job.

Some advocate renewing the social contract through a universal basic income (UBI) paid by the state to every adult citizen. Advocates often do not specify clearly the size of the UBI they have in mind and what exactly it should replace, but schemes to provide it to all citizens, even the well-to-do, are simply unaffordable. In the United States, for example, a US$1,000 per month UBI would cost as much as the entire federal budget.

A better option would be a generous negative income tax, or "guaranteed basic income" or GBI. Unlike a UBI, a GBI could be more affordable, and it would give people below a certain income level an incentive to work while having a redistributive effect.

In addition, employees could have individual digital accounts in which they earn points over time to spend on retraining and further education. Such a scheme already exists in France, and could be extended to include unemployment insurance, personal leave and even retirement benefits. The French think tank Terra Nova, for example, envisages a comprehensive points system under which citizens choose a package of social benefits suited to their individual circumstances.

A system like this would require safeguards to protect individual privacy and prevent personal information being used for political purposes. And although individual choice is a key attraction of such a system, some protection against imprudence is also desirable. But with these caveats, a points system with fully portable benefits would fit the new world of work – and could become a cornerstone of a renewed social contract.

The second priority for societies is to include elements in renewed social contracts that facilitate the provision of global public goods and prevent "beggar-thy-neighbour" policies, which produce short-term domestic benefits by harming others, and invite retaliation. Although most policies have primarily domestic effects, globalisation has reached a stage where some outcomes can be achieved only through international cooperation.

These global public goods can be of the "weakest-link" type: non-compliance by one or a few countries could undermine global efforts to address a problem that affects all. Examples include preparing for epidemics, preventing nuclear proliferation and avoiding a race to the bottom on national tax rates.

Other public goods are "additive". Effective climate protection, for example, depends on the sum of all countries' efforts to reduce carbon dioxide emissions.

Providing global public goods is a huge challenge, because there can of course be no social contract between citizens and a non-existing global authority. But the adequate provision of global public goods requires that national governments be held accountable for the extent and success of their international cooperation in delivering such goods.

We are seeing the beginnings of such a link between the domestic and the global with climate protection. In the recent European Parliament election, millions of citizens voted for Green parties that have made combating global warming their top priority. Leaders such as French President Emmanuel Macron have committed themselves nationally to cooperating internationally to tackle climate change. This suggests that cooperation on providing a global public good can become part of a national social contract.

The difficulty of building a new social contract based on these two pillars should not be underestimated. Taxpayers may baulk at the cost of providing comprehensive and flexible social policies for the digital age. And expecting citizens to demand that their governments cooperate more internationally may sound naive, given the apparent rise of neo-nationalism.

But a renewed social contract that responds to the new nature of work and globalisation is essential to reducing current widespread insecurity and anger, and ensuring the future of democracy. In that regard, the support of young voters around the world for political programmes incorporating both pillars provides a strong reason for hope. PROJECT SYNDICATE

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