POST-BREXIT BRITAIN AT A TURNING POINT

— SIGNS OF EMBRYONIC CHANGE AND THE FUTURE PROSPECTS —

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SUMMARY

- A little over two years have passed since the UK's "full exit" from the EU, and the country continues to face severe challenges, including weak trade, the cost of dealing with diverging regulations and standards, downward pressure on financial services exports, and logistics impediments and rising wages due to labor shortages.
- The public's expectations for Brexit have dissipated, they want a renewed strengthening of relations with the EU, and there are also signs of change in the Conservative Party, including the emergence of the pragmatic Sunak administration. The most likely scenario is for a Labour government to be formed in the general election of 2024, which will re-strengthen ties with the EU, dynamically develop a trade strategy that promotes net zero initiatives and focuses on the Indo-Pacific, and for the UK to be re-energized.
- Japanese companies should not overlook this changing trend and should reassess the UK's position in their strategies and work with British companies to promote the deployment of superior British technology and business models in the Indo-Pacific where Japanese companies have a wealth of knowledge.

1. INTRODUCTION

It has been six and a half years since the UK voted in a referendum to leave the EU, and more than two years since it concluded the Withdrawal Agreement and the Trade and Cooperation Agreement (hereinafter referred to as the TCA) (Figure 1) and "fully left" the EU[1], but the ordeal goes on. On the political front, the current prime minister, Rishi Sunak, is the country's fourth since the referendum, and the Scottish independence issue and friction with the EU over the Northern Ireland Protocol[2] continue to smolder. On the economic front, macroeconomic performance is weaker than before the withdrawal, and is lagging behind other developed countries. This report examines the UK's direction post-Brexit over the medium to long term.

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[1] The United Kingdom left the EU at 11 p.m. on January 31, 2020 after 47 years as a member and entered a "transition period" until the end of December of that year, during which it enjoyed exactly the same rights and obligations as when it was a member of the EU, except that it was unable to participate in policy decisions.

[2] The Northern Ireland Protocol specifies the treatment of British-ruled Northern Ireland within the EU Withdrawal Agreement signed in January 2020 (to avoid the creation of a physical border between the Republic of Ireland and Northern Ireland, Northern Ireland will be subject to EU regulations, and customs clearance and quarantine procedures will be required when goods move to and from the British mainland). However, the British government began debating the introduction of the "Northern Ireland Protocol Bill", which would unilaterally alter the Protocol, as a result of (1) logistical delays in the movement of goods between the British mainland and Northern Ireland and (2) the refusal of the Unionist (a Protestant group that emphasizes unity with the United Kingdom) Democratic Unionist Party (DUP), which is demanding major amendments to the Northern Ireland Protocol to participate in Northern Ireland's devolved government. In response, the EU launched legal proceedings against the UK for its noncompliance with its obligations, and while it is feared that in the worst-case scenario, a trade war between the UK and the EU could ensue, as discussed below, there is still some movement towards compromise underway, although the outcome remains in the balance.

Figure 1 Changes in the UK's relationship with the EU: Comparison between When Being a Member of the EU and after Concluding the Trade and Cooperation Agreement

	Participation in EU policy making	Access to the single market					Freedom to set trade policy	Free movement of people (freedom to work and reside)	Schengen Agreement	Contribution to EU budget (Note 2)	Alignment with EU law
		Goods		Services (Note 1)							
		Customs duty	Customs clearance		Financial	Transfer of personal data					
During UK membership of the EU	Yes	No	No	Full	Full	Yes	No	Full	Non participatory	Yes	Full
After the UK/EU TCA	No	No	Yes	Limited	None	No	Yes	None	Non participatory	Partial	Limited

Note 1: Cross-border provision of financial services and cross-border transfer of personal data are not included in the TCA, and negotiations on equivalence assessments and adequacy decisions, respectively, are conducted separately. While the adequacy of the measures for protection of personal data was approved in June 2021, approval of the equivalence of financial regulations was only provisionally granted until the end of June 2025 (extended from the initial deadline of the end of June 2022) for clearing houses (central counterparties) for derivatives, and until the end of June 2021 (already expired) for centralized securities depositories for the settlement of Irish securities.
Note 2: Participation in EU R&D programs, such as Horizon Europe, is possible by covering the cost of participation.
Source: MGSSI

2. UK HIT BY THE NEGATIVE IMPACT OF BREXIT

The UK's exit from the EU, with which it has an extensive and multilayered relationship[3], has had a number of adverse effects, including sluggish trade (Figures 2, 3, and 4), costs arising from divergence in regulations and standards (Figure 2), a decline in financial services exports (Figures 2 and 5), and supply chain disruptions and rising prices due to labor shortages (Figures 2 and 6). The Center for European Reform think tank estimates that real GDP will be 5.5 percentage points lower in the period from April-June 2022 than it would have been without the withdrawal, due to weak trade and investment[4].

Figure 2 The negative impact of Brexit

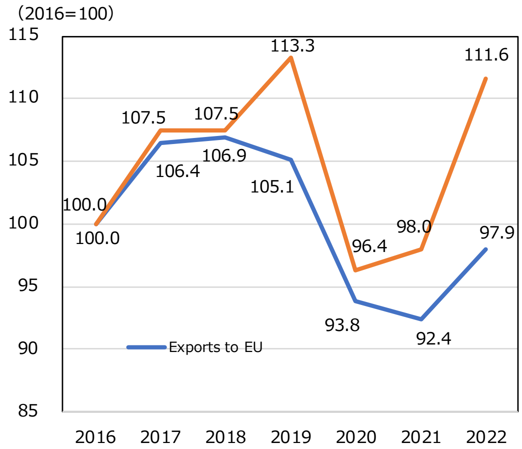
Area	Effect of Brexit	Economic impact
Trade	➢ Zero tariffs on all items when rules of origin are met. However, customs procedures (customs declarations and inspections, animal and plant quarantine, etc.) that did not exist when the country was a member of the EU are now required.	➢ Downward pressure on trade due to higher costs and longer lead times (Figures 2 and 3). ➢ Exports have been particularly weak, with the volume of exports to the EU down by 2.1% in 2022 compared to 2016, the year of the referendum.
Regulations& Standards	➢ When the UK was a member of the EU, it complied with uniform EU-wide regulations and standards in sectors such as chemicals and machinery. ➢ When the UK left the EU, it established its own independent regulatory and certification systems, forcing companies operating in both the UK and the EU to deal with two sets of regulations and certifications.	➢ Compliance with the REACH (Registration, Evaluation, Authorization, and Restriction of Chemicals) regulation for chemicals is a typical example of a case in which companies operating in both the UK and EU are required to register under the new UK REACH regulation. ➢ According to the UK's Department for Environment, Food and Rural Affairs, the additional costs to the chemical industry associated with the introduction of UK REACH will amount to 2 billion pounds (about 320 billion yen).
Financial services	➢ Upon leaving the EU, the UK lost its single financial passport rights (Note 1). ➢ While the EU's granting of equivalence (Note 2) to the UK is under review, to date, equivalence of CCPs (Central Counterparty = Central Clearing House) (Note 3) for derivatives has only been granted on a temporary basis until the end of June 2025.	➢ Although there is some transfer of EU stock, OTC interest rate derivatives, and other transactions from the UK market to the EU market, individual EU countries have various exemptions for licensing and approval from the viewpoint of economic rationality, etc., and the overall decline in UK export of financial services to the EU is moderate. The transfer of jobs and assets from the UK to the EU by financial institutions is also limited. ➢ However, this trend may accelerate in the future due to increasing pressure on financial institution transfers, such as the European Commission's proposal in December 2022 for a bill that would mandate the use of EU CCPs for some euro-denominated derivatives transactions.
Movement of people	➢ The "freedom of movement of persons" (the freedom to work and reside) between the UK and the EU no longer applies, and a new immigration system based on a points system (Note 4) has been adopted.	➢ While the number of migrant workers from the EU has decreased significantly, the number of migrant workers from countries outside the EU has not increased enough to offset the decline. ➢ There has been a particularly large decline in EU migrant workers in the transportation, warehousing, accommodation, restaurant, wholesale. retail, automobile servicing, and construction industries, and the labor shortage has become a serious issue. ➢ The government's response has been limited to temporary stopgap measures, such as increasing the issuance of short-term visas; the labor shortage has become chronic, and rising wages are contributing to the acceleration of price increases.

Note 1: The single passport system for financial services allows licensed financial institutions based in any country in the EEA (European Economic Area = EU member states and Iceland, Norway, and Liechtenstein) to operate freely in other EEA countries under the same license.
Note 2: Equivalence is a system whereby the European Commission permits financial institutions in a third country outside the EU to operate freely in the EEA if the financial regulations of that country are deemed equivalent to those of the EU. Japan, the US, and other countries have been granted equivalence in relation to several financial regulations.
Note 3: A CCP is an institution positioned between the seller and the buyer in financial transactions, such as derivatives transactions, that guarantees fulfilment of settlement by becoming a party to the claim or obligation.
Note 4: Points are awarded based on certain criteria (possession of skills, English language ability, job offer, etc.), educational requirements, supply and demand requirements, annual income requirements, etc., and visas are issued only to persons who exceed a certain number of points.
Source: Created by MGSSI based on various sources of information

[3] The EU accounts for about 50% of the UK's trade and direct investment.

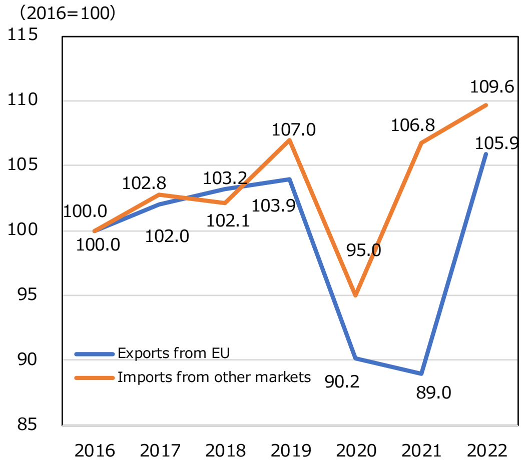
[4] Bloomberg estimates that the impact of the withdrawal has lowered real GDP in the UK by 3.9 percentage points as of July-September 2022. While it is true that the UK economy has been weighed down by the withdrawal, these estimates should be viewed with some degree of latitude.

Figure 3 UK export volumes



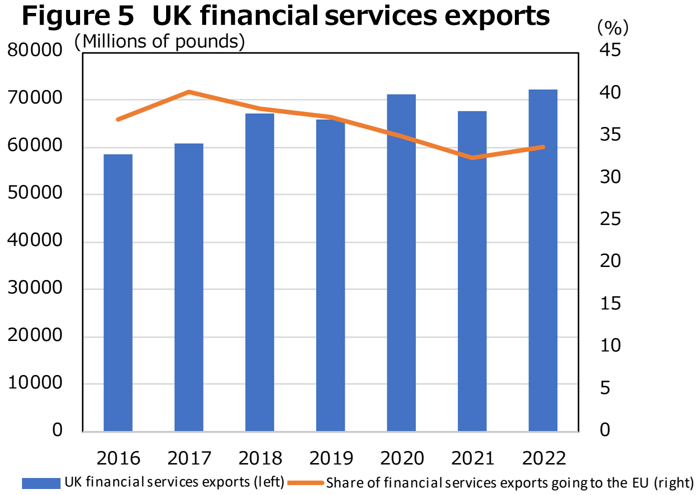
Source: Created by MGSSI based on ONS data

Figure 4 UK import volumes



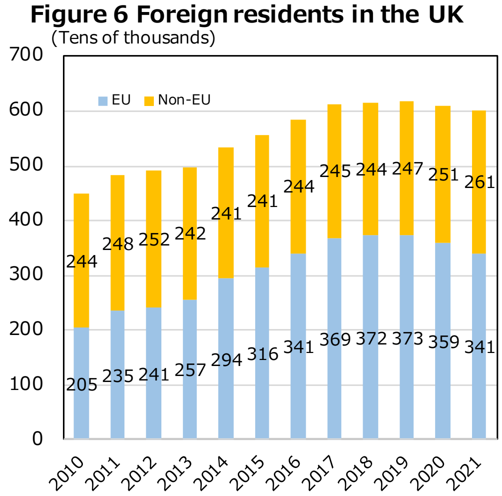
Source: Created by MGSSI based on ONS data

Figure 5 UK financial services exports



Source: Compiled by MGSSI based on ONS data

Figure 6 Foreign residents in the UK



Source: Created by MGSSI based on ONS data

3. CHALLENGES TO ACHIEVING ECONOMIC REVITALIZATION THROUGH GROWTH STRATEGIES

In March 2021, the UK government launched a post-Brexit growth strategy aimed at overcoming the negative impact of reduced access to the EU single market through measures such as (1) flexible policy management[5], (2) freedom in the setting of regulations, subsidies, and tax rates, and (3) development of liberal trade policies, all of which became possible as a result of the withdrawal from the EU (Figure 7).

3-1. Three core strategies

The growth strategy consists of three core elements: (1) levelling up across the UK, (2) supporting the transition to net zero emissions, and (3) promoting Global Britain.

(1) Levelling up across the UK

The aim is to raise the economic level of the people and regions that have been left behind in terms of prosperity and reduce disparities by promoting large-scale infrastructure development. Some specific examples include

[5] EU legislation is proposed by the European Commission, and is jointly adopted by the Council of Ministers, which is made up of ministers from the 27 member states, (adoption is by qualified majority voting, which requires the agreement of at least 55% of the ministers representing at least 65% of the population of the EU member states) and the European Parliament, which consists of 705 members (adoption by a simple majority vote). There is a great deal of diversity among EU member states in areas such as income level and industrial structure, and it often takes a long time to harmonize views when making policy decisions. Brexit has enabled the UK to make quicker decisions in various policy areas.

(1) the HS2 high-speed rail project connecting London and the north of England[6], intercity transport development, and motorway construction, (2) construction of 870,000 houses between 2021 and 2024, and (3) construction of 11 free ports offering tax exemptions and simplified customs procedures.

Figure 7 Post-Brexit growth strategy — Build Back Better: Our Plan for Growth —

Three core strategies		
(1) Levelling up across the UK	**(2) Supporting the transition to net zero**	**(3) Promoting Global Britain**
➢ Aim to reduce disparities by raising the economic prosperity of the people and regions that have been left behind. ➢ To achieve this, take measures such as the construction of HS2 and intercity transportation improvements. ➢ Establish a £7.1 billion National Home Building Fund to build 870,000 homes in FY 2021-2024. ➢ Relocate 22,000 civil servants from London to the regions. ➢ Build 11 freeports across the country (8 in England, 1 in Scotland, 1 in Wales, and 1 in Northern Ireland). ➢ To implement these policies, transfer authority from the central government to local governments.	➢ Aim to achieve net zero GHG emissions by 2050. ➢ Following on from the Ten Point Plan for a Green Industrial Revolution launched in November 2020, a Net Zero Strategy outlining a more concrete plan to achieve net zero emissions was announced in November 2021. ➢ In April 2022, in response to the crisis in Ukraine, the UK announced its Energy Security Strategy and launched a spate of other climate change strategies in rapid succession (see Figure 8). ➢ Various targets are revised upward with each strategy announcement.	➢ Strengthen ties beyond Europe, particularly with the Indo-Pacific region, where the world's geopolitical and economic center of gravity is shifting at an accelerating pace. ➢ (1) Position the conclusion of FTAs with the US, Australia, and New Zealand and participation in the CPTPP as the cornerstones of its FTA strategy, (2) strengthen trade, investment, and financial ties with China, India, and Brazil, the leading emerging economies, (3) strengthen relations with the Commonwealth countries, and (4) promote liberalization of trade in services, where the UK has a comparative advantage.
Three pillars underpinning strategy implementation		
(1) Infrastructure	**(2) Workforce skills**	**(3) Innovation**
➢ Invest £600 billion of public money in broadband, rail, roads, cities, and other areas in FY2021-2025. ➢ Invest £22 billion in the construction of HS2, a high-speed rail line connecting the north and south of England, and £4.2 billion in the development of intercity transportation. ➢ Invest £27 billion in freeways and major arterial roads in FY 2021-2025. ➢ Invest £5 billion in broadband development. ➢ Invest £12 billion in support of net zero initiatives. ➢ Establish a UK infrastructure bank.	➢ Enhance training in advanced technology. ➢ Create free courses for lifelong learning. ➢ Focus on the quality of apprenticeships and make the apprenticeship system easier to use for employers.	➢ Focal areas to include life sciences (genomics, digital health), digital (AI, quantum computing, digital twin), clean energy (offshore wind, hydrogen, CCUS), and fintech. ➢ Measures to help finance innovation include (1) reviewing regulations on investment in high-growth companies by pensions, and (2) establishing a new Future Fund with £375 million of public funds. ➢ Attract the best and brightest high-skilled workers from around the world.

Source: Compiled by MGSSI based on the UK government's "Build Back Better: Our Plan for Growth"

(2) Supporting the transition to net-zero emissions

The Ten Point Plan for a Green Industrial Revolution, the British Energy Security Strategy, and other measures designed to address climate change from various perspectives have been proposed to achieve net-zero GHG emissions by 2050 (Figure 8).

The pivotal elements of the UK's plan for transition to net zero emissions include (1) offshore wind power – expanding offshore wind power generation capacity from the current 10 GW to 50 GW by 2030, (2) hydrogen – securing 10 GW of low-carbon hydrogen production capacity by 2030, (3) CCS/CCUS – creating an industrial cluster of hydrogen and CCUS facilities and making Britain a world leader, (4) EV – banning the sale of new gasoline and diesel vehicles by 2030, and (5) constructing up to eight new nuclear reactors by 2030, tripling output to 24 GW by 2050.

(3) Promoting Global Britain

The UK aims to capture growth in the Indo-Pacific and other regions outside Europe. Key elements in this policy include (1) positioning the conclusion of FTAs with the US, Australia, and New Zealand and participation in the CPTPP as the cornerstones of its FTA strategy, (2) strengthening trade, investment, and financial ties with

[6] A planned new high-speed rail line announced by the UK Department for Transport in 2009. The plan envisaged two phases. The first phase involves construction of a section connecting London with Birmingham (approximately 220 km), while the second phase was to consist of two lines branching at Birmingham, one to Manchester, the other to Leeds (a total length after completion of phase 2 of approximately 530 km), but the line between Birmingham and Leeds has already been axed.

China, India, and Brazil, (3) strengthening relations with the Commonwealth[7] countries, and (4) promoting liberalization of trade in services, where the UK has a comparative advantage.

Figure 8 UK climate change measures

Area	Details
(1) Offshore wind	➢ The aim is to expand offshore wind power capacity from 10 GW in 2020 to 50 GW by 2030 (5 GW of which will be floating). ➢ The approval period for new offshore wind projects will be slashed from four years to one year. Offshore wind power will continue to be included in the CfD (Contracts for Difference) scheme (see note).
(2) Hydrogen	➢ By 2030, the production capacity of low-carbon hydrogen will be 10 GW, half of which will be green hydrogen (hydrogen produced by electrolyzing water using electricity derived from renewable energy sources). ➢ The growth of the low-carbon hydrogen and CCUS industries will be promoted by introducing new business models.
(3) CCS/CCUS	➢ The UK aims to be a world leader in CCS and CCUS, capturing 20-30 million tons of CO_2 per year by 2030. ➢ CCS/CCUS facilities are essential for the production of blue hydrogen to produce the aforementioned large volumes of low-carbon hydrogen, and industrial clusters (Super Places) of hydrogen-related facilities and CCUS facilities will be created, two by the mid-2020s and four by 2030.
(4) EV	➢ The sale of new gasoline and diesel vehicles will be banned by 2030, and all new vehicles sold will be zero-emission vehicles by 2035. ➢ The goal is to expand public charging facilities for EVs from 28,375 at the end of 2021 to 300,000 by 2030.
(5) Nuclear	➢ Nuclear power will continue to be employed as a clean baseload power source. ➢ Up to eight new reactors will be built by 2030, expanding output to 24 GW by 2050, tripling the current capacity. ➢ The construction of small modular reactors (SMR) and research and development of advanced modular reactors (AMR) will be promoted.
(6) Solar	➢ The aim is to expand photovoltaic capacity to 70 GW by 2035, five times the current 14 GW. ➢ Solar power will continue to be included in the CfD (Contracts for Difference) scheme.
(7) Buildings	➢ The installation of new gas boilers will be phased out from 2035. ➢ 600,000 heat pumps will be installed annually by 2028.
(8) Fossil fuel	➢ While the UK will accelerate the introduction of wind, solar, hydrogen, and nuclear power to strengthen its energy security, in the short term, it will seek to make efficient use of domestic oil and gas production. ➢ Specifically, new licensing procedures for oil and gas in the North Sea will resume in the fall of 2022.

Note: The CfD scheme is a mechanism whereby the government pays generators the difference between a fixed electricity price (base price) that reflects the cost of investment in specific low-carbon generation technologies and the average price in the UK wholesale electricity market for the duration of the contract (usually 15 years).
Source: Compiled by MGSSI based on the UK's Ten Point Plan for a Green Industrial Revolution, Net Zero Strategy: Build Back Greener, and Energy Security Strategy

3-2. Strategy progress and challenges

However, the UK faces the following challenges, and to date, the fruits of their efforts have been insufficient.

(1) Levelling up

The cost of constructing HS2, the centerpiece of the levelling up project, has ballooned compared to the original plan, and the project has had to be scaled back, including abandoning the Birmingham to Leeds section. As a legacy of former prime minister Truss's disregard for fiscal discipline, which caused turmoil in the financial markets, the Sunak administration is pursuing austerity measures, and there are fears that it will be forced to further scale back its plans.

[7] Composed of the UK and former colonies of the UK, the Commonwealth is a loose association of 56 nations whose members cooperate for a common purpose, including the promotion of freedom, democracy, and peace.

(2) Supporting the transition to net zero emissions

While offshore wind power construction and the creation of industrial clusters for hydrogen and CCUS are progressing relatively well, the degree of progress in each area varies widely, including delays in plans for mass production of batteries to promote the uptake of EVs (such as the collapse of British Volt[8]) and the construction of the Hinkley Point C nuclear power station.

In addition, close cooperation with the EU will be necessary to promote measures to address climate change, such as participation in EU R&D programs and linkage between the EU ETS and the UK ETS. However, there are concerns over the negative effects of a lack of cooperation, including the EU's refusal to allow the UK to participate in Horizon Europe[9] due to friction over Northern Ireland.

(3) Promoting Global Britain

The UK has deployed an active trade policy, and has to date concluded "roll-over agreements" with 67 countries that take the place of FTAs already concluded by the EU, under almost identical terms and conditions. The first agreement to be concluded was the FTA with Australia and New Zealand, which was negotiated from scratch, but there have been strong complaints from the UK's agricultural community that too many concessions were made, especially in relation to livestock products. With regard to the CPTPP, negotiations with member countries began in June 2021, after which talks progressed to negotiations on eliminating tariffs on agricultural and industrial products, with the UK's accession expected by the end of 2023. In the case of an FTA with India, negotiations during the Johnson and Truss administrations focused on goods, but the Sunak administration has shifted the emphasis to the services sector, an area in which the UK excels, and an agreement is expected to be concluded in 2023, albeit delayed from the original schedule of October 2022.

Meanwhile, negotiations on an FTA with the US have been suspended. Although negotiations on an agreement progressed to the 5th round under the former Trump administration, early progress is unlikely due to (1) a stalemate over food safety standards and other issues, (2) factors such as the expiration of the Trade Promotion Authority (TPA)[10] at the end of June 2021, and the Biden administration's reluctance to negotiate new FTAs.

4. STIRRINGS OF CHANGE IN THE UK

4-1. A growing sense of "Bregret"[11] – A clear change in public consciousness

The UK's economic performance has declined since leaving the EU, and is poorer than that of other developed economies[12]. During the period from the referendum up to early 2021, the number of people in the UK who responded that it was the "right decision" to vote to leave the EU in public opinion polls more or less matched the number who believed it was the "wrong decision". However, the gap between the two camps widened after mid-2021 against the backdrop of economic headwinds, with nearly 60% of respondents concluding that it was

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[8] Established in 2019. The company planned to build a gigafactory in Blyth, northeastern England, and begin producing lithium-ion batteries by the end of 2023. The total construction cost was 3.8 billion pounds (the UK government also pledged to contribute 100 million pounds), and the company was aiming for a production capacity of 30 GWH in 2027, but the production start date was postponed several times, financing proved difficult to obtain, and the company went bankrupt in January 2023. This means that the only automotive battery gigafactory in the UK will be the factory that Nissan and its partners plan to build at their Sunderland plant.

[9] An EU R&D support framework with a budget of 95.5 billion euros for the period 2021-2027. The program consists of three pillars: (1) Excellent Science, (2) Global Challenges and European Industrial Competitiveness, and (3) Innovative Europe.

[10] TPA is the overall authority to negotiation trade agreements that is granted to the President of the United States by Congress. Congress cannot modify a draft agreement and can only approve or disapprove it. TPA is essential for ensuring smooth FTA negotiations and ratification, and the majority of FTAs concluded by the US to date have entered into force using the TPA procedure.

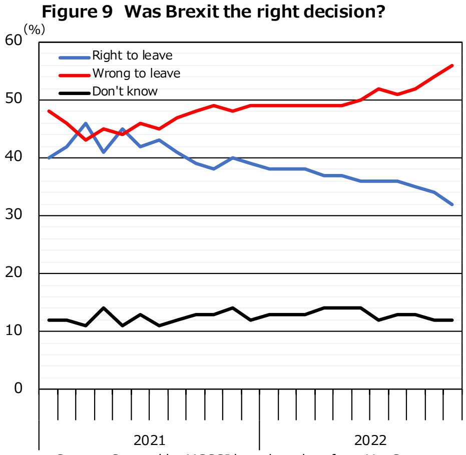
[11] A newly coined word expressing the feeling of regret for voting to leave the EU in the June 23, 2016 referendum. The word is made by combining the words "Brexit" and "regret".

[12] The IMF's World Economic Outlook JAN 2023 forecasts real YoY GDP growth in 2023 and 2024 of -0.6% and 0.9% for the UK, 0.7% and 1.6% for the euro area, 1.4% and 1.0% for the US, and 1.8% and 0.9% for Japan.

the "wrong decision" (Figures 9 and 10). The overwhelming view is that leaving the EU has had a negative impact on the UK's standing in the world, its economy, and the exports of its companies (Figures 11 and 12).

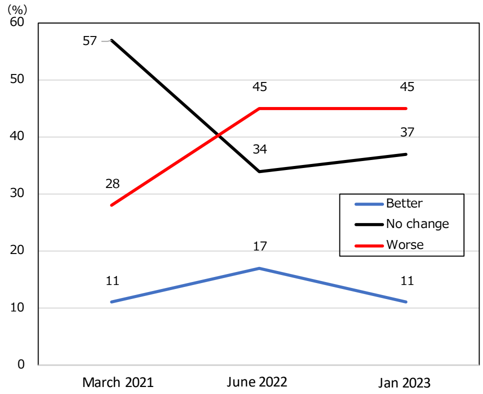
Just under 70% now say that the British government has not handled Brexit well (Figure 13), and voting intention polls give the opposition Labour Party[13] a more than 20% lead over the ruling Conservative Party (Figure 14).

Figure 9 Was Brexit the right decision?



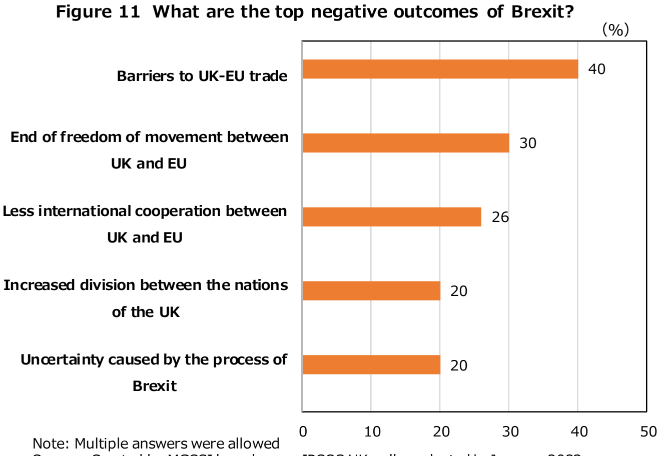
Source: Created by MGSSI based on data from YouGov

Figure 10 How has Brexit affected your daily life?



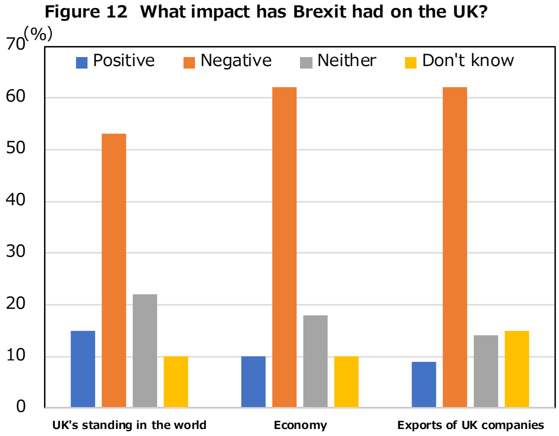
Source: Created by MGSSI based on data from IPSOS UK

Figure 11 What are the top negative outcomes of Brexit?



Note: Multiple answers were allowed
Source: Created by MGSSI based on an IPSOS UK poll conducted in January 2023

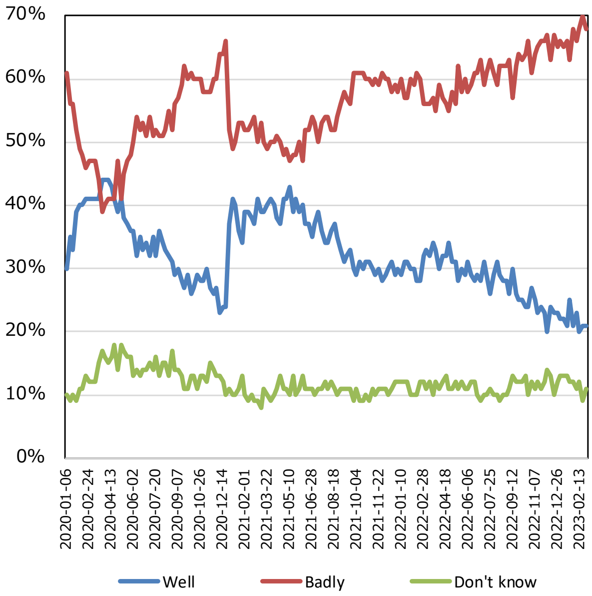
Figure 12 What impact has Brexit had on the UK?



Source: Created by MGSSI based on YouGov poll conducted Dec 14-15, 2022

[13] Under the leadership of Kier Starmer, the Labour Party has shifted from the radical left-wing line espoused under its former leader Jeremy Corbyn, which proposed 1) higher corporate taxes and taxes on the wealthy and 2) renationalization of water, postal, rail, and other services, to a more pragmatic centrist line. Labour's blueprint for government includes the following policy announcements: (1) it will not seek to rejoin the EU, but will promote regulatory harmonization with the EU and build closer ties; 2) it will minimize trade barriers with the EU by amending the TCA; 3) it will deepen cooperation with countries outside Europe, especially in the Indo-Pacific region; and 4) it will pursue decarbonization policies as structural transformation measures to address climate change, growth strategies that are pro-business and create jobs, and regional development strategies.

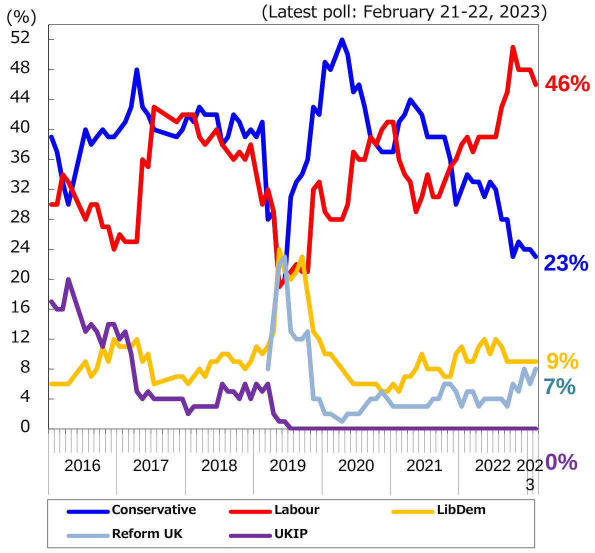
Figure 13 How is the government handling Brexit?



Source: Created by MGSSI based on data from YouGov

Figure 14 UK voting intention

(Latest poll: February 21-22, 2023)



Note: Reform UK was formerly the Brexit Party

Source: Created by MGSSI based on data from YouGov

4-2. Directional change in the ruling party from Euroscepticism to pragmatism

Even within the Conservative Party, the Eurosceptic government of Johnson and Truss, whose top priorities are to regain sovereignty from the EU and curb immigration, even if that would worsen relations with the EU, was replaced in October 2022 by the pragmatist Sunak administration that puts the focus on economic interests. The Sunak administration has steered the country toward restoring relations with the EU, reaching an agreement on a “Windsor Framework” to amend the Northern Ireland Protocol at the end of February 2023 (Figure 15).

Significant changes are also being seen in FTA negotiations. While the previous administration tended to focus on speed in order to show that Brexit is achieving results, the Sunak administration has shifted to a focus on content, without setting deadlines for negotiations, an approach that is highly appreciated by the industrial sector.

5. FUTURE OUTLOOK

Two scenarios can be envisaged for the development of the UK economy over the medium to long term.

5-1. Main Scenario – The economy is reinvigorated by expanding into the Indo-Pacific while reinforcing relations with the EU

Prime Minister Sunak succeeds in gaining the support of the Eurosceptics within the Conservative Party for the Windsor Framework, and gradually promotes the restoration of relations with the EU, while paying due regard to the Eurosceptic faction. The EU also appreciates the UK’s change in attitude, and a degree of improvement is seen in relation to the challenges involved in executing the growth strategy, including allowing the UK to participate in research and development projects. In terms of trade policy, the UK concludes an FTA with India and joins the CPTPP in 2023.

Against the backdrop of the cost of living crisis, the Labour Party wins the general election, which is expected to be held in late 2024, accelerating the improvement of relations with the EU. There is a change in direction towards regulatory harmonization, non-tariff barriers are minimized, and trade with the EU is reinvigorated. There is a more flexible approach to managing immigration from the EU to fill jobs in need of workers through measures such as issuing more visas for longer periods to resolve the labor shortage.

Figure 15 The Windsor Framework changes to the Northern Ireland Protocol

Item	
Trade	**（1）Transportation of goods from Great Britain to Northern Ireland (establishment of a two-lane system)** ➢ No customs clearance, regulatory inspections, etc. will be required for goods handled by certified traders that remain in Northern Ireland. The Sanitary and Phytosanitary (SPS) controls will be greatly simplified. Transportation of refrigerated meat, which was previously prohibited, will be allowed (green lane). ➢ Customs clearance, SPS, and regulatory inspections will be carried out as usual on goods moving through Northern Ireland to EU member states, including the Republic of Ireland (red lane). **（2）Transportation of goods from Northern Ireland to Great Britain** ➢ Export declaration forms will no longer be required.
Medicines	➢ Medicines sold in Northern Ireland will be licensed by the UK's Medicines and Healthcare products Regulatory Agency (MHRA), not the European Medicines Agency.
VAT · Excise	➢ EU VAT will apply in Northern Ireland, but UK VAT and excise duty will apply on goods that are consumed in Northern Ireland and not at risk of being brought into the EU.
Subsidies	➢ EU state aid regulations applied to companies that could affect trade in goods between Northern Ireland and the EU, but the conditions governing application will be tightened and limited to cases where there is a genuine and substantial effect.
Governance	**（1）Role of the CJEU (Court of Justice of the European Union)** ➢ The role of the CJEU remains unchanged and it has final jurisdiction over the interpretation and mediation of EU law. **（2）Introduction of the Stormont Brake** ➢ A new system (the Stormont Brake) will be introduced whereby the UK government can refuse to apply amendments to EU law that are applicable to Northern Ireland. ➢ However, the brake can only be invoked when (1) the everyday lives of the citizens of Northern Ireland are significantly impacted and other means of resolution have been exhausted, and (2) at the request of at least 30 members of two or more parties in the Northern Ireland Assembly (Stormont; 90 seats).
Expected Effect	
Political effect ➢ If the Windsor Framework can gain the support of the DUP (a Unionist party seeking major amendments to the Northern Ireland Protocol), it will lead to the restoration of an autonomous Northern Ireland government and stabilize the political situation in Northern Ireland. ➢ The agreement on the framework will enhance Prime Minister Sunak's unifying force, facilitate future administration, and may lead to a recovery in support for the Conservative Party. **Economic effect** （1）Improved logistics between Great Britain and Northern Ireland The positive impact on Northern Ireland's economy is expected to include price stability due to improved logistics and investment inflows. （2）Improved UK-EU economic partnership ➢ The withdrawal of the Northern Ireland Protocol Bill by the UK and the abandonment of EU legal proceedings against the UK for default of its obligations will improve UK-EU relations and reduce the risk of a trade war and other uncertainties. ➢ The UK's participation in Horizon Europe and deeper collaboration between the two sides on decarbonization policies can also be expected. （3）Deepening of UK-US trade relations ➢ Because it has a large Irish-American population and President Biden himself is of Irish descent, the US is closely watching the Northern Ireland situation (former Speaker of the House Pelosi has stated that the conclusion of a US-UK FTA is contingent on a resolution of the Northern Ireland issue), progress in UK-US trade relations can be expected.	
Future Procedures	
➢ Following approval by the UK-EU Joint Committee, the two sides will proceed to enact the legislation (the UK will vote on it in Parliament). Introduction of the arrangements will be phased in, with the transportation of goods being introduced during 2023 and other arrangements during 2024.	
Developments to Watch	
➢ The DUP and the Conservative Party's Euroskeptic ERG group, many of whose members have expressed a favorable view of the Windsor Framework, have stated that their final approval or disapproval as a party or group will be expressed after close examination with legal counsel. ➢ Since the Labour Party, the UK's leading opposition party, has expressed support for the framework, its passage through the British Parliament is assured. However, support or rejection by the DUP will have a bearing on the restoration of the devolved Northern Ireland government, and the extent to which the support of Euroskeptics in the Conservative Party, including former prime ministers Johnson and Truss, is obtained will have a significant impact on future policy management.	

Source: Compiled by MGSSI based on UK government and European Commission information

The Labour government maintains the basic direction of the growth strategy adopted under the current Conservative government, such as the promotion of net zero initiatives and the active conclusion of FTAs, while attracting foreign investment in industries where the UK has a comparative advantage such as clean energy, promoting innovation, and dynamically expanding into the Indo-Pacific region, and the UK economy emerges from stagnation and moves toward reinvigoration.

5-2. Important factors influencing the scenarios

However, the following risk scenario may come about depending on (1) the balance of power between Eurosceptics and pragmatists in the Conservative Party [14,15], which will affect the UK's policy toward the EU and trade strategy, including the Northern Ireland issue, immigration policy, and regulatory divergence, and (2) economic trends, which will affect the general election result through changes in the levels of support for the ruling and opposition parties due to the allocation of funds for growth strategies reflecting the fiscal situation and its impact on people's lives.

[14] The Sunak government does not exactly have a solid foundation, and it has been forced to play various games with the Eurosceptics in the Conservative Party in dealing with the Northern Ireland and immigration issues.

[15] The Labour Party has a pro-EU majority, including its leader, Keir Starmer, and only a minority of Eurosceptics, represented by former leader Corbyn, so there is no fierce conflict between the two factions as in the Conservative Party.

5-3. Risk Scenario – The UK drifts under a hung parliament

The Sunak government fails to soft-land the Northern Ireland issue due to resistance from Eurosceptics, who remain a deep-rooted force within the Conservative Party, and relations with the EU remain stagnant.

A combination of a UK economy bottoming out amid a global economic recovery and its leader Keir Starmer's lack of charisma means that the Labour Party fails to win the general election clearly, resulting in a hung parliament[16]. In addition to stagnation in many policy areas such as growth strategy and the immigration system, the UK economy remains sluggish for a prolonged period due to a lack of improvement in relations with the EU. In addition to the deteriorating situation in Northern Ireland, the pro-EU Scottish independence movement gains momentum, driving political instability.

6. CONCLUSION

Japanese companies have been engaged in restructuring their functions in Europe following Brexit, but now that the UK is once again starting to move toward closer ties with the EU, they will need to be flexible in reassessing the UK's position within their European strategies and not overlook this changing trend. At the same time, what hasn't changed are the policies to address climate change and achieve net zero emissions and the Indo-Pacific-oriented trade strategy that are shared by both the Conservative and Labour parties[17]. Japanese companies should consider working with British companies to promote the deployment of superior British technology and business models in the Indo-Pacific, where Japanese companies possess a wealth of knowledge, as well as to capture demand in the UK.

（March 3, 2023）

[16] No party is able to win an overall majority. A minority government or coalition government tends to lead to stagnation in policy making and implementation.

[17] Even if the UK re-establishes a stronger relationship with the EU, since it will not return to the single market, the negative impact of leaving will not disappear altogether, and the need to offset this by strengthening growth strategies will not change. The UK has set its sights on aggressive overseas expansion as well as attracting foreign investment in the clean energy sector.