HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

23 August 2018

Rt Hon Nicky Morgan MP
Treasury Committee
House of Commons
London
SW1A 0AA

Dear Nicky,

Thank you for your letter dated 20 July regarding the government's no deal planning and analysis.

As you know, in July the government published its White Paper setting out a clear proposal for the future relationship we want to build with the European Union. Since publication talks have intensified and the government is confident of reaching agreement on the Withdrawal Agreement and Future Framework in the Autumn.

While we are confident in agreeing a good deal for both sides, as a responsible government we will continue to prepare for all scenarios. As part of these preparations we are going to be releasing a number of technical notices, starting today with more to follow shortly, to set out what UK citizens and businesses need to do in a no-deal scenario.

With regards to the economic and fiscal impacts of no deal, you are aware that provisional government analysis – the January 2018 Cross-Whitehall Briefing – is already in the public domain. That analysis set out provisional estimates for the long-run economic and fiscal effects of three 'precedent' models: an EEA-type relationship, a standard FTA, and a WTO/no deal scenario. None of these scenarios represent the government's stated ambition for our Future Economic Partnership with the EU.

However, this provisional analysis is informative in describing in broad terms the potential economic and fiscal consequences of models of varying degrees of market access, border frictions, regulatory alignment, and other factors – and long-run estimates for the impact of no deal and trading on WTO terms.

This January provisional analysis estimated that in a no deal/WTO scenario GDP would be 7.7% lower (range 5.0%-10.3%) relative to a status quo baseline. This represents the potential expected static state around 15 years out from the exit point. The analysis did not estimate the path the economy and different sectors might take under no deal and the potential for short-term disruption.

The CGE model used by the cross-Whitehall group to study the equilibrium effects of different scenarios in the long term is not well-suited to analysis of short-term developments. Within their statutory mandates, the Bank of England and the OBR produce short-to-medium term forecasts for the UK economy which will reflect their independent judgements regarding the impact of leaving the EU and the likely path of the economy to its new long-term equilibrium.

The January analysis was supplemented with analysis of the potential sectoral, regional and fiscal consequences under these 'precedent' models. Under a no deal/WTO scenario chemicals, food and drink, clothing, manufacturing, cars, and retail were estimated to be the sectors most affected negatively in the long-run, with the largest negative impacts felt in the North East and Northern Ireland.

GDP impacts of this magnitude, were they to arise, would have large fiscal consequences. The January analysis estimated that borrowing would be around £80 billion a year higher under a no deal/WTO scenario by 2033-34, in the absence of mitigating adjustments to spending and/or taxation, relative to a status quo baseline. This is because any direct financial savings are outweighed by the indirect fiscal consequences of a smaller economy.

The initial, January cross-Whitehall analysis is now undergoing a process of refinement in the run up to a parliamentary vote on the deal. However, we expect the analysis to show that for scenarios in which we have higher barriers to trade with the EU there will be a more damaging effect on the economy and public finances. These are conclusions that many other credible external organisations have come to independently, including the IMF, the OECD, the LSE and NIESR.

As mentioned above, none of the 'precedent' models covered in the January analysis represent the government's preferred model as set out in the July White Paper. That proposal is ambitious in breadth and depth. It comprises a comprehensive package for services and digital, minimising new barriers to trade while giving the UK the freedom to chart its own path in the areas that matter most for its economy; while seeking to minimise barriers to trade in goods, both at and behind the border. It is expected that the economic and fiscal impacts of the White Paper model will be substantially better than no deal, protecting jobs and livelihoods and supporting both the UK and EU's commitments to no hard border between Northern Ireland and Ireland.

Finally, I would like to reiterate a previous commitment the government has made: once we have agreed a deal with the EU the government will provide Parliament with the appropriate analysis of that deal ahead of the vote on the final deal.

I will be publishing this letter on the gov.uk website.

PHILIP HAMMOND