**What the first months have told us about Brexit**

**Introduction and summary**

It is still far too early to reach a definitive view on the basis of two months of trade data about how Brexit is likely to work out.

But there are some hints from the data and the diplomatic developments so far and we have tried to analyse them to see what they tell us.

**To summarise**:

It looks as though **Brexit will be ‘harder’ than we had originally assumed** after the Trade and Cooperation Deal was signed.

We are assuming that both **exports to and imports from the EU will settle at a level that might be as much as 15% lower** than would have been the case had Brexit not occurred. Some of the reduced imports will be replaced by imports from other sources.

**The City’s activities will be initially hit by the movement of some activities elsewhere with an estimated loss of activity of about 10%. Our modelling suggests that only a third of this will move to other EU financial centres, the rest moving away from Europe or lost as a result of reduced economies of scale and scope. But this loss could be easily compensated for (our estimates are that the potential gain is twice the potential loss)** by achieving the right post Brexit deals.

**Some of our trade in services is linked to trade in goods and will therefore be affected.** Tourism will emerge from the pandemic in a very different shape so it will be hard to observe the Brexit impact, though **the abolition of the VAT retail export scheme will have a negative impact**.

In principle, the effect on the **UK’s critically important Flat White Economy should mainly be through the impact on its labour force. If the sector can still attract sufficient skills both from the EU and elsewhere it may survive Brexit relatively unaffected**.

Because a significant proportion of the impact of the loss of EU exports will be compensated for by the production of import substitutes, **we estimate that the initial negative effect on GDP will be a reduction of about 0.5% compared with what might have happened otherwise**. **This does not take account of the impact of faster rollout of vaccines and of new trade and deregulation opportunities that might emerge which could easily more than offset this.**

We estimate that **the impact of the earlier rollout of the vaccination programme than would have been possible had the UK been in the EU programme will give the UK economy a one-off boost of about 2% in 2021.**

With Brexit harder than we originally expected, **policy needs to be targeted at taking advantage of the deregulatory and trade policy opportunities that have become available.** **Taxes on anything that is internationally mobile should be reduced to levels as low as possible consistent with equity** (it is important not to discriminate excessively in favour of the internationally mobile, who in general are already the most privileged in society). This relates to companies, residents and tourists especially. **Climate change policies should be smart, to prevent negative competitive impacts.**

**The data**

Trade between the UK and the EU dropped dramatically in January. The value of exports[[1]](#footnote-1) to the EU was 34.1% below its average level for 2020 and 44.3% below the average 2019 level. Imports were also down, but by less: 15.3% compared with 2020 and 28.6% compared with 2019. Not all of this reflected long-term implications of Brexit. In January, trade was impeded by the explosion of the Kent variant of Covid-19 which meant constraints on movements through the Channel ports (lorry drivers needed to queue up at a nearby airfield to take a Covid test before they were allowed to start queueing to cross the Channel). And of course, any business in its right mind on both sides of the Channel will have filled its warehouses to bursting point by end-December 2020 to buy time in the hope that Brexit-induced problems might be resolved before they had to be stocked up again.

The port of Dover estimated that by February traffic had returned to 90% of the average 2020 level. One check that Cebr often applies to international data is to look at trade data from both partner countries with each other. So we have looked not only at the UK data but also that for Germany and France. The French trade data released on 8 April indicated that ‘French imports from Britain jumped 27% to €1.48 bn in February, returning to a level just shy of the monthly average during the second half of 2020’.[[2]](#footnote-2) Data released on 9 April showed that German imports from the UK had recovered from €1.7 bn in January to €2.7 bn in February[[3]](#footnote-3), though still remain 26.9% below the same period in 2020 before Covid started to impact. It is interesting that the official German statistical press release on trade now has a special line item identifying both exports to and imports from the UK.

The UK data on trade in February (released 13 April) shows a sharp recovery from the January level for exports and a smaller one for imports. The value of exports[[4]](#footnote-4) to the EU was 3.3% below its average level for 2020 and 18.4% below the average 2019 level. Imports were also down, by 9.1% compared with 2020 and 18.3% compared with 2019.

It is clear that UK exports of food to the EU are being affected by sanitary and phytosanitary measures in place. Such exports in January 2021 were down 75% according to the Food and Drink Federation[[5]](#footnote-5) with UK exports of fish down 80%. While they have recovered to about 70% of their previous level in February, they remain down.

The interpretation by much of the UK media is that the EU is effectively welshing on the deal with the UK by imposing additional requirements which were not covered in the Brexit deal. The recovery in trade indicated by the February data suggests a different interpretation may be appropriate, of teething troubles followed by a settling down to a level of trade slightly lower than might have occurred pre-Brexit.

It is worth noting that in late March and early April both DFDS and Irish Ferries announced that they were launching new cross channel freight services linking the UK with the Continent, which would be surprising if they seriously expected freight volumes to drop dramatically.

There will likely be a return closer to normal levels of trade for many products as teething troubles reduce and as various rough edges are sorted.

**The analysis**

Most analysis that was carried out pre-Brexit attempted to measure the welfare loss from increased trade frictions. This is a valuable form of normative analysis but what it does not do is indicate what path the key economic variables like GDP, household incomes and inflation might in fact follow.

Our analysis attempts to compare the paths for these three variables, comparing our current forecasts post Brexit with what might have happened in its absence. We have used Cebr’s UK economic model to model the ‘what if’ scenario.

The purpose of this is not to come up with a plus or minus score or to throw blame around but to investigate how much assumptions may need to change and what that might mean for future policy.

So far, we have identified four clear economic impacts that need to be investigated separately.

* Impact on exports
* Impact on import substitutes
* Impact of early vaccine rollout
* Impact of regulatory and other changes

**The Brexit Agreement**

Despite its impressive length of 1,246 pages, the Brexit UK-EU Trade and Cooperation Agreement did not in fact cover very much, though it dipped into a wide range of issues[[6]](#footnote-6). Those of us who welcomed the Agreement did so on the basis that the spirit of cooperation that had led to the Agreement would enable the myriad other areas not covered in the agreement to be sorted over time. The areas covered most fully were cars and fish.

For cars, the UK effectively committed to remain in the single market. The biggest issues related to electric cars and their content. Since most batteries at present are made in China, it was important to ensure that cars including such batteries but assembled in the UK could be sold in the EU (and vice versa!). This deal is temporary but both the EU and the UK intend to build their own battery plants in the near future so the issue should in theory disappear.

Fish are a tiny proportion of GDP – the fishing element, as opposed to the processing of fish, is only 0.02% of GDP in the UK. But fishing is associated with isolated communities and has an emotional and political significance that outweighs its economic importance. And UK fishing communities have a distant folk memory of being badly treated when the UK joined the EU when not only did they lose access to fishing grounds but also found themselves forced to sell up at fire-sale prices to their EU competitors.

Other than these issues, the agreement covered a massive range of one-off issues without really ensuring hassle-free trade. On the other hand, it made sure that there would be relatively few tariffs on trade between the UK and the EU, but without doing much to non-tariff barriers.

So, what will happen to trade?

1. **Trade in Goods**

Perhaps the best starting point is the EU’s own estimates of the extent of non-tariff barriers and the extent to which being in the single market reduces them. This is shown in Table 1 which itself is taken from an EU study using its Quest model[[7]](#footnote-7) to estimate the impact of the reductions in such barriers.

Table 1 EU’s estimate of Non-tariff barriers and impact of the single market[[8]](#footnote-8)



The first column in the Table is the estimated cost of non-tariff barriers (NTBs) pre-Single Market measured as tariff equivalents and the second is the extent to which they can be reduced as a result of joining the single market.

The worst case for the UK post-Brexit is that the NTBs return to their pre-Single Market positions. On worst-case assumptions, the implicit cost of NTBs with the UK is the weighted average of an equivalent tariff of roughly 10% for trade in goods. The UK export elasticity for trade with the EU is typically estimated[[9]](#footnote-9) at 1.5 so a rough calculation is that in a worst-case scenario Brexit would reduce exports of goods to the EU by 15%. It is worth noting however that these impacts are highly concentrated, especially affecting trade by smaller firms and trade in food where the NTBs shown in Table 1 amount to a tariff equivalent of 56.8% and where, because the product is often perishable, any delay can make trade impractical. Cebr research pre-Brexit for ARLA foods[[10]](#footnote-10) emphasised the damage to trade that might result from the reintroduction of both tariffs and NTBs to trade in food.

Our assumption long term is that for many small firms trading goods between the UK and the EU, Brexit makes trade with the EU uneconomic. Fortunately, only 13% of trade in goods even within the single market is accounted for by small or medium-sized enterprises. But it would make sense to assume that about half of such trade between the UK and the EU becomes uneconomic.

The impacts on small firms and food will probably account for the bulk of the 15% reduction in exports of goods that we are assuming.

1. **Impact on the City**

The UK and the EU have agreed on a post-Brexit pact on the City, though the content is minimal.[[11]](#footnote-11) Post Brexit, it is estimated that just under 10,000 jobs have been lost from the City to elsewhere and about £1.2 trillion in assets have moved away from the UK[[12]](#footnote-12). Some activities have moved en masse. The Financial Times points to some trading in swaps, sovereign debt and European equities. It does not expect further job losses in the immediate future.[[13]](#footnote-13)

Cebr research has indicated that the worst-case potential loss of business from the City as a result of Brexit would cost the City 15-20% of its revenue. The calculation assumed that €39 bn will be lost by London. Of this, we estimated that €11.5 bn would go to EU-27 financial centres, mainly Frankfurt, Paris, Amsterdam and Dublin (in fact Amsterdam has captured a slightly larger share and the other centres much smaller shares than we had predicted). We estimated that €15.9 bn will go to non-EU financial centres. And we estimated that €11.7 bn would become uneconomic and be suppressed. The early data suggests that the effects may be around half of the worst-case scenario.

But these amounts could be small compared with the opportunities that might emerge post Brexit. These are mainly in two areas:

1. Potential market integration with the US. Clearly, the UK would become a junior partner and this could ultimately prove equally unacceptable as continued alignment with EU regulation ultimately proved to be. But the potential could be massive. The US currently exports about $140 billion in financial services. We predict that market integration could move a proportion of this trade to the UK (say a quarter) but the scope and scale benefits of such a boost would almost certainly enhance the competitiveness of the UK as well.[[14]](#footnote-14) Applying the 29% estimate of the impact of economies of scale and scope from the Brexit study to the potential gains from a US and UK financial services agreement would boost the total impact to £32 billion; coincidentally almost exactly the same as the potential £33 billion loss to the UK from the worst Brexit case.
2. Market integration with fast-growing markets in Asia. The combination of the UK’s market liquidity and the rapid rate of Asian markets growth could potentially be synergistic to the benefits of both areas. In the long term, these could be even greater than those from market integration with the US but the time frame would be rather later.
3. **Impact on other services**

The Flat White Economy, which blends the creative and digital sectors, has already overtaken manufacturing to become the UK’s largest business sector. Ultimately, it is likely that this sector will also become dominant in trade as well.

On Cebr’s definition the sector is now 12.2% of UK GDP and on broader definitions could be as large as 15%.[[15]](#footnote-15)

Currently, such trade is growing exponentially in volume (measured by bytes of data, global digital trade is estimated by UNCTAD to be likely to have doubled between 2019 and 2022[[16]](#footnote-16)).

Measured digital trade is estimated to have remained flat at about 6% of world GDP[[17]](#footnote-17) for the past decade but most commentators believe that this is a serious underestimate of both the level and growth.

And while it might appear that digital trade can flow freely down phone lines, the extent of restrictions on world digital trade is growing rapidly. The OECD keeps a database of such trade restrictions and has observed a substantial increase in such restrictions.[[18]](#footnote-18)

Ultimately, whether the UK’s digital trade is affected positively or negatively by Brexit will depend on the extent to which the UK can leverage digital market access. Some loss of digital market access with the EU is to be expected though the scale and impact are not yet clear. Potentially it ought to be possible to ensure that Brexit delivers a net gain. But this should not be taken for granted.

The other channel through which the **Flat White Economy might be affected should mainly be through the impact on its labour force. If the sector can still attract sufficient skills both from the EU and elsewhere it may survive Brexit relatively unaffected**

Figure 1 OECD estimates of change in the extent of trade restrictions on digital trade



**Import substitutes**

In theory, the impact of Brexit on exports of goods ought to be roughly matched by the impact on imports.

But of course, many of the substitutes for imports of goods from the EU might well be imported goods from other countries rather than domestic production.

But if, as with exports, the big impact is on imports of foods, there might be some mitigation from the UK having post-Brexit access to relatively cheaper food on the international market outside the Common Agricultural Policy.

In terms of quantities, the UK traditionally imports more from the EU than it exports to the EU, particularly for goods. The initial data for January and February show falls in both exports and imports of about equivalent amounts in absolute terms.

Using the same analysis as that for trade in goods, it is likely that imports of goods from the EU should in the longer-term fall by around the same proportion, 15%, as exports because of increased non-tariff barriers.

A paper published in the University of Munich’s RePec network reports interesting findings based on a very detailed input-output model-based analysis of the impact of Brexit after allowing for import substitution[[19]](#footnote-19). Its conclusion is interesting: *‘The first remark we can draw is that in both scenarios the losses are significantly lower for the United Kingdom and for each EU27 member state. In particular, here the UK is no longer the most affected country. Rather, estimated losses in the UK ranging from a LiVA of $1.4 billion in the soft Brexit scenario to a surprisingly negative LiVA, i.e. a gain of $10.6 billion in the hard Brexit scenario. This corresponds to a drop in value added production as a percentage of GDP of 0.05 per cent under a soft Brexit and to a rise of 0.4 per cent under a hard Brexit scenario’.*

We have made the less extreme assumption than the Munich study that half the reduction in imports from the EU is replaced by imports from elsewhere and half from domestic production.

**Vaccine roll out**

The UK has made a success of its vaccine rollout. The country was early to finance vaccine R&D and pay for vaccine factories to be built and purchased large amounts of each of the likely vaccines at an early stage. It has also, unlike most other countries, both managed a rapid vaccine rollout and also ensured that priority was given to groups at risk. Although it might have been possible to do that had Brexit not occurred, it would have been less likely.

The EU has been relatively less successful. It first tried to centralise purchasing to beat the vaccine producers down to a low price at a time when the UK was financing them. Although the actual signing of the deals with the vaccine companies by the EU was almost simultaneous with the UK, the UK involvement with the vaccine companies was earlier and more cooperative. When it was clear that the UK was making a success of its vaccine programme and hence making a success of something that was Brexit enabled, this seemed to generate some unusual behaviour in various European politicians. The EU first triggered Article 16 of the Northern Ireland protocol allowing it to take unilateral action (without even following the procedures set out for triggering the provision) and then on the same day untriggered it. At various times, the EU has suggested an export ban for vaccines, made misleading statements about the lowest cost vaccine made by Astra Zeneca, the Anglo Swedish company, and raided factories.

Yet despite this, in reality, little has actually happened to change the course of events. Some vaccines exports that were to destined for Australia have been banned but the UK has made this up from its surplus of vaccines.

The UK has not been seriously impeded, while the vaccine roll out in the EU may have been hindered more by increased fears about the dangers of the vaccine. Despite this, EU vaccination programmes do now seem to have been accelerated.

Meanwhile, the UK’s faster and better-targeted rollout of vaccine means that the UK’s economic recovery post covid is starting earlier than that in Continental Europe. We estimate that this will boost UK GDP this year by 2% compared with where it might have been had the rollout been in line with the EU average. But please note that this is only a one-off boost in one year only. By the end of the year, both the UK and the EU must expect to be fully vaccinated, although there remains the possibility of further mutation requiring further vaccination.

**Northern Ireland**

Brexit was always going to cause problems in Northern Ireland, where the Good Friday Agreement, which largely reduced violence in the area, was associated with the removal of most visible border barriers.

While the UK was in the EU this was not a serious problem (though the cattle track near my grandmother’s birthplace in Kiltyclogher about a mile from the border was allegedly used to ensure that EU farming subsidies could be obtained for any animal bred nearby in both the UK and the Republic).

Meanwhile not only is Belfast Harbour, which stretches right into the middle of the city, the best natural harbour in the British Isles and has therefore traditionally accounted for a third or more of the Republic’s trade in goods, but also the UK is the ‘land bridge’ connecting the Republic of Ireland with the Continent for a substantial amount of trade.

These various leakages mean that special arrangements were going to have to be made. The Northern Ireland Protocol in the Withdrawal Agreement set up such procedures which effectively kept Northern Ireland in the Single Market.

Since a different part of the Good Friday Agreement states that the status of Northern Ireland cannot be altered without the consent of the majority of the population, there have been fears that this contravenes the Good Friday Agreement. There is certainly a belief amongst the loyalist community that EU negotiators have been trying to ensure that ‘losing Northern Ireland was the price the UK should pay for Brexit’. Meanwhile, aggressive enforcement of the Single Market rules on the movement of goods between Great Britain and Northern Ireland in the early months have created problems for the Northern Ireland Protocol. There has been rioting and quite serious violence on the loyalist side, presented as a result of the upsetting of the status quo enshrined in the Good Friday agreement.

The UK government and the EU are working on a solution to this. In the long term, smart ledger technology will make physical border checks eventually unnecessary.[[20]](#footnote-20) But in the interim, a certain amount of flexibility will be necessary. The Northern Ireland market itself is too small to be a serious breach of the walls of the Single Market. And while a modest amount of ‘having its cake and eating it’ would probably be on balance helpful to the economically depressed region and would help reduce the province’s myriad social problems, it understandable that both the rest of the UK and the EU (especially the Republic of Ireland) would not want the province to achieve so special a status that it massively diverts business away from either country simply on the grounds of its privileged status. A combination of light-touch enforcement and some system of monitoring to prevent excessive abuse seems the obvious way to deal with this anomaly.

**Net impact**

We have run the trade impacts through the Cebr model, allowing for a 15% reduction in exports to the EU and a 7% reduction in total imports (15% offset by the fact that about half of the substituted imports will be substituted for by imports from elsewhere). Running this through the model gives an estimate that the net effect on UK GDP is a small hit of about 0.5% after 3 years. Prices are 0.1% higher and disposable income is 0.2% lower.

This takes no account of any potential stimulus from additional trade deals that would be enabled by Brexit.

**Conclusions**

It does appear that the form of Brexit is emerging is much closer to a ‘hard Brexit’ than we assumed.

This is likely to reduce trade in both directions. In addition, the UK faces an impact from a certain amount of lost activity from the City of London.

The effects of these are likely to reduce UK GDP by perhaps as much as 0.5% in the short term, though the supporters of Brexit would argue that this will soon be made up as a result of the greater flexibility that Brexit allows.

They would point to the success of the vaccine programme which should give UK GDP a one-off boost of around 2% of GDP in 2021 and hint that other such gains will emerge.

Some people might ask ‘should the UK abrogate the trade and cooperation deal?’ This question is not academic: the EU has delayed ratifying the deal, though it appears to be planning to do so by the end of April. Until the EU ratifies the deal, it remains provisional and although the UK has ratified it, it would be possible in practice to ensure the EU does not complete the ratification process.

Looking at the data, our view is that on balance the advantages of completing the deal are greater than those of abandoning it. Abandoning the deal would not make Brexit any less hard and would remove a lot of the UK’s negotiating power to mitigate non-tariff barriers. It would remove the laboriously negotiated deal for the motor industry. It would unravel many other side deals covering items like driving licences and travel.

The only area where abandoning the deal would in theory benefit the UK would be through allowing the UK, in theory, to take back the whole of the UK national waters for fishing. But the UK fishing industry cannot sell what it currently catches and would certainly not be able to easily sell any additional catch it made with further access to the fishing waters. And the extent of any possible economic gain would be tiny.

It seems to be the case, based on the February data, that the non-tariff trade barriers are gradually being reduced and that shippers are becoming familiar with the new requirements for paperwork. The EU seems to be working with the UK government to solve the Northern Irish problems and although the vaccine issue generated some odd behaviour, in reality little has actually happened that has damaged the UK.

Looking at other areas, the UK needs to look more aggressively to find areas where its tax and regulatory barriers to economic activity will boost the economy. One example might be the GDPR regulations which are currently onerous, and which inhibit trade with other countries.

The tax system needs to be targeted at competitiveness. The recent abolition of the VAT Retail Export Scheme for tourists has been shown fairly conclusively to be an own goal doing a significant amount of damage to the UK’s tourism industry and should be reversed. The decision to raise corporation tax also looks unhelpful and most serious commentators doubt that it will raise the revenues expected by the Treasury.

While adaptation to the new technologies required to cope with climate change is likely to be required as a result of international obligations, the trick for the UK is to do this in a way that minimises the economic damage. It also makes no sense to achieve this simply by imposing requirements that shift production to more polluting production environments.

The government needs to look at its GDPR regulations to see if they are not excessively onerous.

Other regulations such as those on genetically modified products need to be examined carefully. The EU stance is extreme and hardly supported by the science.

The right approach to the teething problems from Brexit is not to scrap cooperation but to make the UK more attractive so that people want to do business with us.

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1. Seasonally adjusted, excluding non-monetary gold and precious metals. Source: <https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/uktrade/february2021#main-points> [↑](#footnote-ref-1)
2. <https://uk.finance.yahoo.com/news/brexit-weighs-french-exports-britain-091110630.html> [↑](#footnote-ref-2)
3. <https://www.destatis.de/EN/Press/2021/04/PE21_175_51.html;jsessionid=482D1A3A9B65E80A9815A80F80896CE4.live741> [↑](#footnote-ref-3)
4. <https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/uktrade/february2021#main-points> [↑](#footnote-ref-4)
5. <https://www.fdf.org.uk/globalassets/resources/publications/uk-eu-food-and-drink-trade-snapshot-jan-2021.pdf> [↑](#footnote-ref-5)
6. https://ec.europa.eu/info/relations-united-kingdom/eu-uk-trade-and-cooperation-agreement\_en [↑](#footnote-ref-6)
7. <https://ec.europa.eu/info/sites/info/files/economy-finance/dp094_en.pdf> Table 3.2 page 11. It is worth noting that Cebr (and I personally) have used the Quest model for modelling the impact of transport improvements to reduce trade frictions in the EU economy. [↑](#footnote-ref-7)
8. <https://ec.europa.eu/info/sites/info/files/economy-finance/dp094_en.pdf> [↑](#footnote-ref-8)
9. <https://ec.europa.eu/economy_finance/publications/economic_paper/2010/pdf/ecp432_en.pdf> [↑](#footnote-ref-9)
10. <https://www.arlafoods.co.uk/overview/news--press/2017/pressrelease/uk-government-urged-to-protect-british-dairy-farming-in-brexit-negotiations-1893834/> [↑](#footnote-ref-10)
11. <https://www.reuters.com/article/britain-eu-finance-idUSL8N2LO62D> [↑](#footnote-ref-11)
12. <https://www.fnlondon.com/articles/up-to-7000-financial-services-jobs-lost-since-brexit-bank-of-england-governor-says-20210106> [↑](#footnote-ref-12)
13. <https://www.ft.com/content/79f231fe-3c39-41ca-9c33-6713b1834f76> [↑](#footnote-ref-13)
14. Our analysis for the EU of the impact of Brexit incorporated an estimate that besides the direct loss of activity, a further 29% of economic activity would be lost as a result of lost economies of scale and scope. [↑](#footnote-ref-14)
15. <https://cebr.com/reports/the-flat-white-economy-five-years-on-now-established-as-the-uks-leading-economic-sector-28-bigger-than-manufacturing/> [↑](#footnote-ref-15)
16. <https://unctad.org/system/files/official-document/der2019_en.pdf> Figure 1.5 [↑](#footnote-ref-16)
17. <https://www.queensu.ca/sps/sites/webpublish.queensu.ca.spswww/files/files/Events/Conferences/TradeInstitute/2019/2018%20OECD%20Digital%20Trade%20and%20Market%20Openness.pdf> [↑](#footnote-ref-17)
18. <https://www.oecd-ilibrary.org/trade/barriers-to-trade-in-digitally-enabled-services-in-the-g20_264c4c02-en> [↑](#footnote-ref-18)
19. <https://mpra.ub.uni-muenchen.de/92835/1/MPRA_paper_92835.pdf> [↑](#footnote-ref-19)
20. See Cebr’s report on this: <https://www.longfinance.net/media/documents/Economic_Impact_Of_Smart_Ledgers_On_World_Trade.pdf> [↑](#footnote-ref-20)