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UK Trade and Investment: The Brexit Economic Hit

Author:
David Gow
Editor of *Sceptical Scot*; former European business editor as well as former Germany editor of *The Guardian*; Federal Trust Council Member.

Only a very rash supporter of Brexit could claim that Brexit has delivered on its protagonists' promises: an economy set free to overcome the long-standing problems of sluggish growth and low productivity, attract global capital and high-skilled personnel, and pursue hugely favourable trade deals. Problems that had intensified while we were (supposedly) shackled to a stagnant behemoth: the European Union. Sunlit uplands awaiting around the corner. A new Elizabethan age.

Almost seven years on from the referendum of June 2016 and more than two years since the UK-EU trade & cooperation agreement took effect, the stark reality is that the United Kingdom is significantly poorer. Not only is inflation stubbornly high, often double that of Britain's EU neighbours, but living standards are tangibly declining amid an unusually powerful wave of catch-up strikes. The bottom decile of UK households has disposable income 20% lower than that of their Slovenian peers. Irish GDP per head is more than double that of the UK. Inequality is rife.

"Brexit will cost UK workers about £1300 in lost income each year, say experts" was a recent headline in the (London) Evening Standard, drawing upon studies/ comments from the Office of Budget Responsibility, the Centre for European Reform and the Institute for Fiscal Studies. The latter's director, Paul Johnson, said: "Most analysis, including that of the OBR, suggests that our productivity and economic output will fall by around 4% as a result of leaving the single market.

“What does that mean? Well, in the long run we will all be about that much worse off on average, so people on average sorts of earnings might be £1,000 to £1,500 worse off (before tax) than they otherwise would have been. Of course it also means less money for public services like health and education."

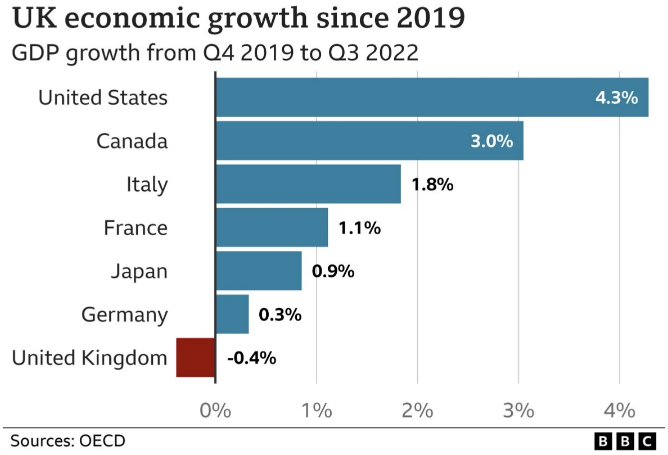
The Federal Trust for Education & Research
University House
109-117 Middlesex Street
London E1 7JF
T: 024 7765 1102
E: info@fedtrust.co.uk

This paper will examine the Brexit impact in terms of trade and investment primarily and compare UK outcomes with those of the EU (warts and all). It argues that, if the UK remains wedded to "making Brexit work" in the words of both Rishi Sunak and Keir Starmer, that is a recipe for further impoverishment. Attempts to reboot the UK economy outside the single market and customs union are doomed to failure. The EU, with its ambitions to be the world's third geo-political/geo-economic power on a par with the US and China, faces many unresolved challenges. It remains work-in-progress. But membership and/or, at the very least, close alignment leading to membership, still offer the UK the best hope of shared recovery and prosperity.

Tomorrow the world

“We are talking about billions and billions of pounds of incremental GDP. That will mean more jobs, more economic activity, more growth.” That was Nigel Huddleston, international trade minister, talking about the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTTP), which includes Australia and Japan, on GB News after the UK signed up to it. The government's own figures suggest this much-touted deal will add 0.08% to UK GDP (though Huddleston's boss, Kemi Badenoch, a strong Brexiteer, insists this is an out-of-date assessment.) Once more, there is little or no evidence that a trade deal with countries in the Indo-Pacific will deliver anything but marginal benefit in the short- to medium-term compared with the £550bn of trade between the UK and the EU. What's more, there is compelling evidence that our trade volumes and values are suffering post-Brexit.

The most recent news about school students being forced to abandon trips to mainland Europe or German punk bands being refused entry are the tip of the iceberg, pointing to huge and growing barriers to trade. In the last quarter of 2022 UK export volumes, according to the ONS, remained almost ten percent below 2019 pre-pandemic levels. August bodies such as the OBR suggest this may be an under-estimate with declining volumes set to last for at least another two years. We are, according to Sophie Hale, trade economist at the Resolution Foundation, "bottom of the G7 pack" - just as we are for GDP, with the IMF predicting a 0.3% fall this year.



This has been the pattern since the TCA took effect and the wider picture bears this out. In a 2022 paper Adam Posen of the Petersen Institute for International Economics (and a former Bank of England MPC member) said: "Brexit has reduced UK trade openness, foreign direct investment (FDI) inflows, and immigration growth. New border frictions and higher transport costs pose new barriers to trade, and FDI inflows are unlikely to return to levels reached in the 1990s and 2000s." (In 2021 FDI from the EU did indeed decline but this was more than offset by increased inflows from the Americas and non-EU Europe, according to the ONS.)

Similarly, within the more narrow trade frame, Thomas Sampson and colleagues at the LSE found that the TCA "resulted in a major disruption of UK-EU trade" in 2021 with a 20% drop in imports from Europe and a 25% fall relative to the rest of the world while overall exports were weak. They found that smaller exporters in particular ceased trading because of the costs and red tape involved - and this has been shown to be frequently the case anecdotally and statistically. “It is clear that Brexit has had the largest influence over businesses’ exporting strategies, having created barriers to trade and also increased competition from EU-based firms,” Emma Rowland, trade policy adviser at the Institute of Directors, has said.

And it's not just Europe. “U.K. companies have no markets in which it is now easy to trade,” David Henig, UK director of the European Centre for International Political Economy, told Politico. Looking at global trade in goods between 2019 and 2022, UNCTAD showed that it grew by 25% in the year to February 2022, reaching $6.1 trillion. But, in the same period, the UK recorded 0% (zero percent) growth in exports and a 19% rise in imports. See here where analysts suggest over 40% of the product varieties previously exported to the EU disappeared during the 15 months after January 2021 - from when the TCA took effect in other words.

"We argue that this decline has unfolded in three ways: (1) some exporters have ceased to export to the EU, (2) continuing exporters have streamlined their product lines, focusing on their core products, and (3) fewer new exporters are entering the EU market. This decline has been accompanied by an increased concentration of export values to fewer products and by larger exporters," they say. They add: "An estimated loss of 20–42% of product varieties over the 15 months since Brexit, combined with an increased concentration of export values to fewer products, signifying some serious long-term concerns about the UK's future exporting and productivity."

Of course, Brexiteers dispute these findings. Economists prominent on the Briefings for Britain site, for instance, including some close to Liz Truss of infamous memory but little or no remorse, cheerfully conclude "there is no hard evidence that Brexit has had a negative effect on the UK economy." They claim: "Far from collapsing as some claim, UK trade with the EU has fully recovered after some initial disruption, despite increased trade frictions**.** Underlying trade levels are close to long-term trends. The UK's trade balance with the EU has improved – implying a boost to growth – and even sectors like food and fish have seen exports to the EU proving remarkably resilient." They, naturally, blame unsound evidence used by (pro-EU) economists for the contrary view - while using highly selective facts, time-frames and findings themselves. As the BBC's global trade correspondent has summed it up: ""Global Britain" has become less open. It is lagging behind."

World-beating trade deals

Well, there are 71 the UK has signed since leaving the EU. But, of these, 68 or 95.8% are rollovers, according to our colleagues at UKICE. Of the three new ones, let's take the UK-Japan Comprehensive Economic Partnership Agreement (CEPA) signed so it took effect on Day 1 (January 1 2021) of Brexit Britain. In its first full year, trade with Japan fell, according to the UK Trade Policy Observatory.

The much-trumpeted deals with Australia and New Zealand will eventually yield benefits - though many, not least the Roos and the Kiwis, think it's these countries that will gain the most. Even the most recent decision to join the 11-strong Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) will indeed, as ministers suggest, provide tariff-free relations with some of the fastest-growing markets but the impact on growth will by all accounts be frustratingly tiny.

The EU for its part has 41 trade deals with 72 countries. Two dozen more are in the process of being adopted or ratified, including that with the Mercosur bloc in South America and economic partnerships with countries in East and West Africa. The EU is negotiating with five other countries, including China and India, while 20 further sets of negotiation are currently pending.

A key difference with the UK is that the British government is under pressure to conclude its trade deals as rapidly as possible in order to "prove" the benefits of Brexit. The EU is under no such pressure. The outcome, noted by analysts and even some Conservative politicians, is that London is often willing to make bigger concessions to would-be trading partners than Brussels...But there are other notable differences, not least that the EU sees trade policy as inextricably linked to its overall economic strategy of promoting growth, jobs and competitiveness. Indeed, it sees the greatest benefit of an open, fair-trading system as spreading these three around the globe – and adding to peace and stability both intra- as well as extra-EU. Trade is its lifeblood.

But EU trade policy is evolving very rapidly under the pressure of external events such as the war in Ukraine and losing some if not most of the ethical momentum - in terms of sustainable development, human rights - it promulgated in its 2015 iteration. In the 2021 review there emerged a new emphasis on "assertiveness" that is a direct response to the increasingly protectionists stances adopted by the two great rival geo-political players - the US and China. This pre-dates the Biden administration's Inflation Reduction Act (IRA) but not Beijing's Made in China 2025 programme. The IRA has especially concentrated the mind in Brussels where those still promoting open markets and free competition such as Margrethe Vestager, the competition commissioner, are being out on the back foot by Thierry Breton, internal market commissioner, and their boss, President Ursula von der Leyen.

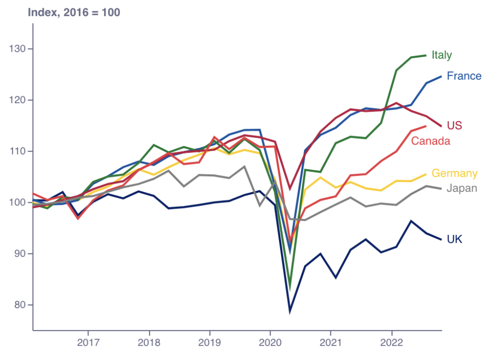
In the next section, on investment, we shall see how Brexit Britain is lagging seriously behind the EU in creating a modern economy built around the twin digital and green transitions. The prospect once more is of greater impoverishment and failure to resolve the UK's endemic low productivity/high inequality problems.

Investing in Britain - or elsewhere?

British politicians of whatever hue - with the odd exception - love to talk about leading the world in terms of digital and green technologies. But the sad truth is more dismal: investment in these technologies is increasingly heading towards mainland Europe, America and Asia. Brexit has accelerated this process.

Business investment, after slumping during the pandemic, regained its pre-Covid levels at the end of 2022. "Business investment had been growing at about 6% per year (1.5% per quarter) between 2011 and 2016, but was flat between 2016 and 2019," point out Jonathan Haskel and Swati Dhingra. That was partly due to just the initial Brexit shock but, they found, it was ten percent lower than it would have been absent Brexit in 2022. That's pretty conservative as an estimate: the Bank of England et al, they add, has calculated a 23% decline via-a-vis no Brexit in 2020-21. UKICE puts it as high as 25%.

Figure 3: Comparison of business investment across G7 countries, constant prices, seasonally adjusted, index 2016 = 100



Source: ONS, Destatis, OECD, Eurostat, US BEA, Statistics Canada, Japan Cabinet Office, istat, authors' calculations.

The automotive sector is illuminating in this regard. In late 2022 the trade body SMMT issued a call for the government to endorse an action plan to secure investment worth £14bn to the overall economy in 2023 alone. "To harness this growth, the sector is calling for a targeted government action plan to safeguard the future of advanced automotive manufacturing and the thousands of British jobs it sustains. Such a strategy should help attract investment in vehicle, battery and fuel cell production; support electrified supply chains, skills and innovation; and deliver the incentives and infrastructure critically needed to drive a healthy zero emission vehicle market," it said. But the reality is also: "Economic instability, trade protectionism, regulatory change, a cost of living crisis, skills shortages and soaring energy costs already some 80% higher than the EU average, are all acting as a brake on its global competitiveness."

Pre-Brexit the UK produced 1.7 million cars; in 2022 output fell to a level not seen since 1956 at 775,014. Honda has since Brexit closed its Swindon plant while Mini will not produce electric cars in Oxford - and Elon Musk has shunned the UK for his first Tesla plant in Europe, preferring Berlin to produce his electric cars. The collapse of battery maker Britishvolt, leaving its proposed plant in the north-east of England seriously at risk, exposes how fake ministerial optimism about the UK economy's future outside the single market/ customs union truly is.

Meanwhile, spurred by the threats posed by both the US (see, for instance, here) and China to its industry, jobs and, ultimately, prosperity the EU has relaxed its state aid (and fiscal) rules to promote investment in electric vehicles and batteries as well as adopting a series of multi-billion public investment programmes such as the Green Deal Industrial Plan and the Net Zero Industry Act. In 2022 one in six cars sold in the EU was an electric vehicle (EV) - and China is becoming the big export hub for EVs in Europe. That's why the European Battery Alliance, a Franco-German initiative that actually works, is promoting with its 440 participants an array of plants across the EU while Brussels is investing €6.1bn in two so-called Important Projects of Common European Interest (IPCEIs) in battery-related projects.

What is clear is that today's EU, unlike the UK, believes in an active industry strategy. Given the scale of American and Chinese competition, bolstered by subsidies, European plants will be unable to survive without public support. David Bailey, professor of industrial strategy at Birmingham Business School, insists that this is the lesson of the Britishvolt débâcle. “We’re lagging very far behind the EU,” he has said. “It requires a much more active industrial policy. At the moment we don’t have one.”

It's not just the automotive sector either. We know that others such as pharmaceuticals and financial services, including fintech, are moving to mainland Europe - and the island of Ireland which is expected to grow 4.9% this year. (The stuff of dreams for Brexiteers.) “The last 40 years,” observed Kieran McQuinn, an economist at ESRI, “have seen a huge divergence between the Irish economy and the UK economy. The last five, six years since the Brexit vote have only increased that disparity.” (Ireland's biggest trading partner by far, however, is the US in value terms while the UK has gone from representing 100% of Irish trade a century ago to just 15% now).

	1973	1979	2000	2019	2020
Population of Ireland (millions)	3.09	3.37	3.81	4.93	4.99
GDP[38] per head Ireland (USD, constant prices, 2015 PPPs)	15,019	18,299	46,873	83,874	88,111
GDP per head UK (USD, constant prices, 2015 PPPs)	21,155	23,163	37,081	45,157	40,741
Net National Income per head Ireland (USD, constant prices, 2015 PPPs)	NA	NA	34,083	44,029	41,881
Net National Income per head UK (USD, constant prices, 2015 PPPs)	NA	NA	31,189	38,126	33,777
UK share of Ireland's goods exports (%)	55	46	22	10	9
UK share of Ireland's goods imports (%)	51	50	31	23	23
EU share of Ireland's goods exports (%)	24	35	40	35	38
EU share of Ireland's goods (%)	26	26	22	33	31

John Springford of the CER and Jonathan Portes of UKICE estimate that the UK has lost 330,000 jobs because of Brexit. That could well be a conservative figure. Of course, unemployment is not a huge economic and social problem at the moment but that could change as history has repeatedly shown us. Immigration and/or freedom of movement - that the UK has lost through Brexit - are vital if the country is going to invest in the future.

Conclusion

The prevailing spoken word of both the current UK prime minister and his potential successor is "making Brexit work" but this is, in turn, one of the world's great oxymorons. There is, on current policies and those cautiously changed ones likely to be pursued by a Keir Starmer government, no prospect of Brexit delivering the public good the UK mainstream political class promises.

In the late 1960s and early 1970s, when the UK first began to seriously entertain and then undertake negotiations with Brussels to join the Common Market, a critical reason for this was the fear and evidence of lagging behind mainland Europe economically. Membership was viewed as a recipe for modernisation - social and political as well as economic. We were still, after all, in that optimistic period the French call *les trente glorieuses.*

Fifty years later the fear and evidence of the UK lagging behind its continental neighbours/partners are greater. This decline, now very stark, has been intensifying since mid-2016 and even more so since 2021 when the TCA took effect and Great Britain finally left the EU's single market and customs union. This paper, drawing on a range of findings, shows how Brexit has affected UK trade and investment, key elements of the economy. It has been profound and can only get worse.

If the UK political class is genuine in its desire to overcome the UK's low growth/low productivity crisis, modernise the economy in a way that realises the digital and green transition and, for this author, critically, mitigate or, better, substantially reduce inequalities of wealth and opportunity, reversing Brexit is an ineluctable solution. Otherwise, as Greta Thunberg put it, the discourse is just more blah blah blah. Or, as our German friends would say, ballaballa.