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Trade, Businesses, and Economy of U.K. Post-Brexit— A Quantitative Analysis

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Abstract

Many studies have been carried out on Brexit's economic impact on the UK, EU27, the US, and the rest of the world. Depending on the assumption of whether Brexit will be a hard Brexit or a soft Brexit, almost all studies predicted Blows to the economies of the UK and the EU, with a more severe blow to the UK economy. With the Trade Co-operation Agreement signed by the end of the year 2020 and the actual divorce of the UK from the EU with effect from 01-01-2021, the actual effects of Brexit came to reflect in various economic data reported by various national and international agencies. This paper makes an effort to analyse these hard data and examine the Brexit impacts on various sectors. It has also taken clues from the various surveys on the problems faced by businesses on the border, shortage of labour, etc. In February 2023, a protocol on Northern Ireland was finalized which became a part of the EU-UK withdrawal agreement that now ensures that a hard border is avoided for the UK export items on the island. This protocol was agreed upon between the United Kingdom, Northern Ireland (UK), and the European Union (EU) as the final settlement designed to protect Ireland's economy and Belfast Agreement. The study concludes that the UK has done a relatively good job of managing the inevitable Brexit disruptions, including transitional measures for border softening. In order to achieve the laudable goal of having the best border in the world by the year 2025, the UK will require streamlining the Regulatory Control Systems. The UK has also entered into a Comprehensive Agreement with Trans-Pacific Partnership. But much is still to be done on the Domestic Regulatory Reforms front. Unless the UK uses the coming years to engage in putting in place proper, meaningful, and comprehensive regulatory reforms, the opportunities for Brexit may be wasted.

Keywords

Brexit, Ireland Protocol, UK economy.

INTRODUCTION

The last 100 years of Britain have been described as a 'managed decline' by Douglas Carswell as the country has itself been reduced from the World's major superpower to a relatively insignificant island off the French coast and this has compelled it to join the European Union (EU) [1]. The UK's initial proposals of 1960s to the European Economic Community (EEC) for membership were vetoed by French President Charles de Gaulle, stating that the UK harboured deep-seated hostility to any pan-European projects and that the UK's economic practices, ranging from Agriculture to working practices, were incompatible with Europe. Only after the then president of France Gaulle stepped down in 1972, the Treaty of Accession was signed and the final validation of the UK's EEC membership commenced w. e. f. January 1, 1973. Thus, the admission of the UK into the EU was fraught with a lot of reluctance and has always been uncomfortable politically also. The first-ever national referendum on the issue of the UK continuing in the EEC was for staying with the EU. The second referendum held in 2016 came out with the decision to leave the EU securing a simple but decisive majority of 51.9% further involving a two-year time period for negotiating the terms of Exit with the EU. Finally, the UK left the European Union on 31 December 2020. In accordance with the 'Withdrawal Agreement', it became a third country in the EU and no longer participated in EU decision-making. However, during the 'Transition Period' negotiations were held to draw out a partnership plan for the future. The long negotiations since mid-2016 resulted in the signing of the EU-UK Trade and Cooperation Agreement (TCA)' signed on 30 December 2020 and proved the final leg of the divorce, fundamentally changing the way trade will take place between the United Kingdom and the EU [2, 3].

What was agreed in the TCA

Through the TCA, the customs formalities were streamlined for the trade between the UK and the EU. The TCA set laid down a basis for zero tariffs and quota-free imports. It supported the businesses in complying with the 'rules of origin', customs, frauds, and VAT. Whereas in relation to the financial services sector, these provisions have very limited application. In other words, with effect from 01 January 2022, the firms were unable to benefit from automatic access to the "EU single market", which meant that the host country's rules would apply to all goods being exported to the EU member states. In order to ensure fair competition, it also included high-level provisions to manage any future divergence of state aid and subsidy control [4, 5].

What does the Windsor Framework cover?

The protocol, and the joint solutions under the Windsor Framework, include new arrangements that respect the integrity of both the UK and the EU single market. These arrangements include:

- Customs—facilitation for trusted traders.
- VAT and excise—making sure that there are no illegitimate consequences of VAT and excise rules in Northern Ireland.
- Agri-food (sanitary and photo-sanitary rules)—facilitating retail goods to enter Northern Ireland.
- Medicines—ensuring supply of new medicines to Northern Ireland.
- State aid—clarifying when state aid is applicable to subsidies that have a genuine and direct link to Northern Ireland.
- Pet travel—facilitating pet travel between Great Britain and Northern Ireland.

The Consequences of Brexit

The United Kingdom, open economy has a relative advantage in the Services Sector, which is primarily dependent on trade with the EU. Brexit has a diversified effect on various sectors like trade, employment, transportation, economy, financial services, labour availability, etc. [6]. However, Brexit was majorly an economic gamble which could diminish Britain's place in the world. However, little attention was paid to the economic implications of a campaign that came to be dominated by immigration.

Trade

The sum of exports and imports relative to the GDP, often called Trade Openness, of the UK in 2015 was 0.57 compared to 0.86 for Germany and 0.28 for the United States (World Bank 2017). However, the UK's share of exports and imports with the EU was 44% and 53% respectively in 2015. [7, 8]This is the reason why most of the researchers believed that after Brexit, because of customs difficulties, bureaucratic red tape, etc., the UK will suffer from a decline in trade. New rules took effect on January 1 and required to completion of all the customs formalities for goods. Similarly, for meat and dairy products, health certificates were required. Because of these formalities, British exports to the EU fell by about 15% while the exports of agri-food dropped by above 25 percent. Figure-1 below shows the export of goods to EU and non-EU countries separately and the total exports of goods.

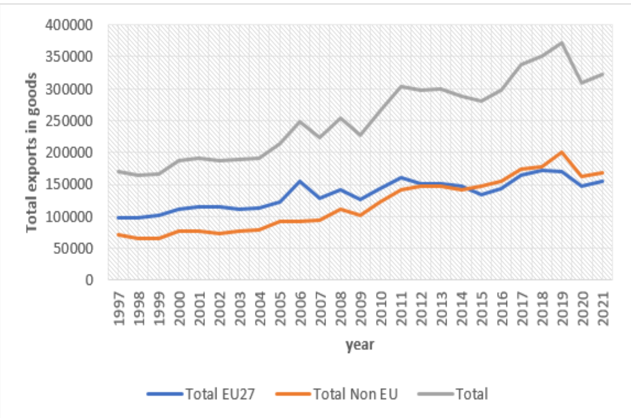

Figure 1. Annual Exports in Goods

It can be seen that the export of goods to non-EU countries has increased and surpassed the figure of export to EU27 countries from 2015 onwards and it continues to do so. Moreover, the total export of goods reduced from 2019 to 2020 and then partially recovered in 2021.

Similarly, the imports' trend in respect of goods is shown below graphically in Figure-2. It can be seen that the import of goods from non-EU countries has also exceeded that from EU27 countries in 2021. Similar to the export trend, the total import of goods has declined since 2019 with a partial recovery in 2021. It is, therefore, evident that imports and exports have declined from 2019 to 2020 and recovered partially in 2021. However, these changes are not solely attributable to Brexit as the incidence of Coronavirus coincided with this period of time. Nevertheless, it can perhaps be safely derived that the trade has started shifting partially out of EU27 countries.

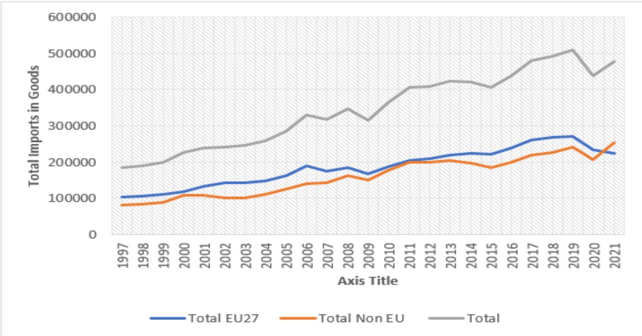

Figure 2. Total imports of Goods in million GBP

Exports and Imports in Services (excepting Travel, Transport, and Banking) have trended as displayed in Figure-3 and Figure-4. The figures are available only up to 2020. It is seen that the export of services has slightly decreased to the non-EU countries, while the export to EU27 has increased marginally from 2019 to 2020. As the actual Brexit started with effect from 01.01.2021, the effect of Brexit will be seen pronounced in and after 2021 [9, 10]. Nevertheless, as the export of services to non-EU countries is about 50% higher as compared to EU27 countries, the effect of Brexit can be expected to be minimal in terms of value. Additionally, the figures may be flattered by the fact that the UK delayed implementing many of its post-Brexit borders controls into 2022 [11, 12].

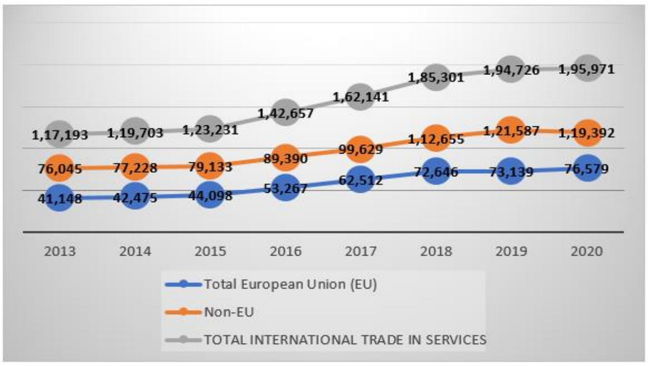

Figure 3. Exports in Services in million GBP

Figure 4. Exports in Services in million GBP

As far as the import of services is concerned, export is more in value than import. From 2019 to 2020, imports from EU and non-EU countries both increased, however more from the EU27 countries.

Table 1. % Change in Trade Openness, Q1 2017-Q4 2021

Japan	17.6889367
Italy	14.4648742
Spain	9.254634047
Germany	8.268519349
France	3.80563048
Australia	0.616934943
United States	-3.662778578
Canada	-4.44879403
U. Kingdom	-6.263503835

Trade openness is defined as goods and services trade as a percentage of GDP. UK trade openness has fallen more quickly than other advanced economies. Figure-5 shows the trends.

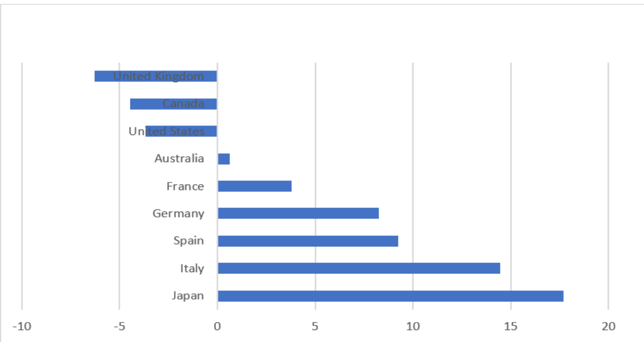

Figure 5. UK trade openness has fallen more quickly than other advanced economies

This is a substantial blow to globalization efforts and maybe in coming years, trade openness will improve when the UK diversifies its trade with other countries. The UK is also trying to finalize a trade deal with India by the end of this year.

The UK has managed the temporary Brexit disruptions as well as its new Border customs model fairly satisfactorily. An ambitious commitment to a streamlined single trade window is made to make the UK border, the best international border by 2025. [13, 14]The U.K. has done very well in trade with countries other than the EU countries, by concluding a de novo deal with Australia in record time.

Growth

According to the Budget responsibility office, even before Britain split from the EU, the UK economy had already shrunk by about 1.5 percent since 2016 [15, 16]. This phenomenon was caused by a fall in business investment and partly by the shifting of some of the business activities to the EU in anticipation of higher trade barriers. The percentage GDP growth rate of the UK, EU27, and Germany is shown in the following figure-6.

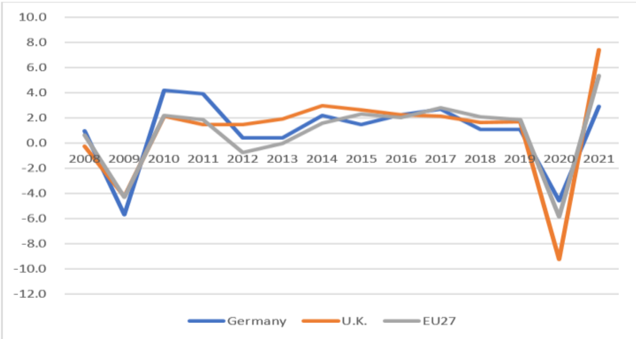

Figure 6. % GDP Growth

It can be seen that during the pandemic the GDP growth rate was negative in the case of all three countries i.e., the UK, EU27, and Germany. But the maximum fall was in the case of Britain. This may include some effects due to the Brexit vote. But in 2021, there was considerable recovery but many other countries like India have registered much better recovery than the UK. While the underperformance of the UK economy is undisputed, there are many factors like covid-19, apart from Brexit.

These variating data may also be due to varying experiences of covid-19 pandemic.

FDI Inflow

FDI inflow as a percentage of GDP has declined drastically since the time of the Brexit vote in 2016, and then improved slightly till 2020. These trends compared with similar data with respect to other countries from 1970 to 2020 are shown below as in figure-7. This is because of the uncertain regulatory environment in the U.K. after Brexit.

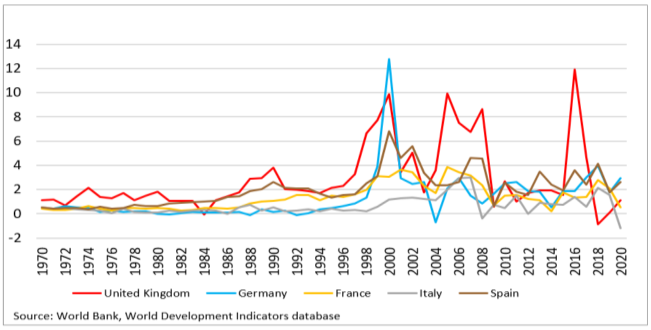

Figure 7. Foreign direct investment inflows as a share of GDP, 1970-2020

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With Brexit in existence, seamless entry of goods and services to the EU Single Market cannot be expected. As the EU and the UK now form two distinct markets with different regulatory environments, the borders cannot be smooth as customs formalities are required to be completed now. Nevertheless, the TCA will ideally serve to limit many disruptions, businesses, stakeholders, and customers will most likely be impacted on both sides of the borders. Brexit may cause FDI to fall in the UK due to no more 'direct approach' to the EU single market, making it a less attractive destination for MNCs.

Maximum FDI is received in the financial services sector in the UK. However, there is a minimum mention of financial services in the TCA, and has been left the same to future discussions as presently, 'pass porting rights' are not available which hitherto were available with such businesses.

One of the other major impacts of Brexit will be that the companies situated outside of the US which were hitherto solely dependent on the UK to access the EU single market, will have to find alternatives to avoid establishing their ancillaries in the UK and the EU, which will cost them dearly and also not to forego the previously existing advantage of frictionless movement of their goods and services. These difficulties faced by many firms may adversely impact the flow of Foreign Direct Investment in the UK as the earlier landscape is now missed.

Inflation: Many major high-income economies are suffering from inflation as much as 40-year highs. Most of them are facing major supply shocks to their economies due to various factors like the first wave of Covid-19 and global supply chain disruptions for critical goods, and energy and food prices shocks caused by the Russian invasion of Ukraine in February 2022.

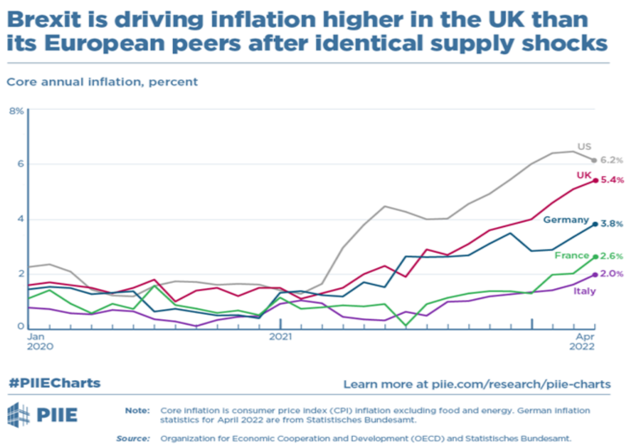

Figure 8. Brexit is driving inflation higher in the UK than its European peers after identical supply shocks

Yet there are significant differences in the inflation experienced by various countries. This has been shown in Figure-8 above. The inflation in the UK has reached an acute level causing a hike in the cost of living. Moreover, the core inflation in the UK is catching up with that in the US. Brexit is believed to be the major factor responsible for the inflation differential between the UK and its European peers as shown in the figure above. The free movement of EU migrant workers has been severed as a result of Brexit. It also introduced new tariffs and non-tariff barriers on imports from the EU, which reduced the purchasing power, triggering inflation.

Exchange Rate of British Pound vis-à-vis EURO

Since 2016, after the Brexit vote, the world economy has dramatically changed. At the beginning of 2021, the sterling was already 15% weaker relative to the euro when compared with its value in 2016 [17, 15]. Although currency movements are caused by many reasons and factors, one of the main factors was the trade friction between the UK and the EU. In addition, continued uncertainty and persistent political instability resulted in financial institutions trying to sell off the pound, driving it weaker. The change in the monthly exchange rate is shown in Figure-9 below.

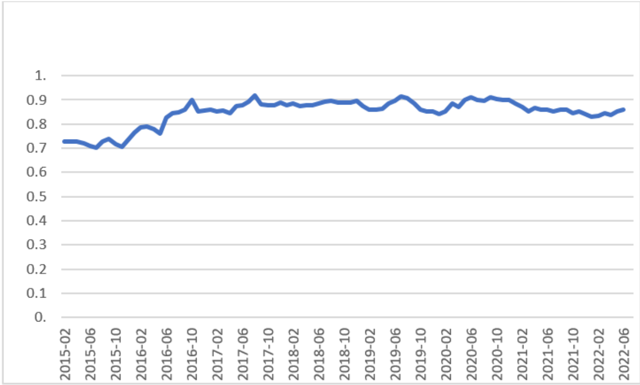

Figure 9. Euro/GBP Exchange Rate

It can be seen that despite uncertainty, exchange rate movements were minor. One of the reasons for the fall in pound-sterling was that foreign goods and services, as well as assets, became more expensive for UK residents. This resulted in aggravated inflation and a higher cost of living.

Labour Shortages

The first year of Brexit saw a plethora of complaints of shortages of labour from across the various sectors of the economy. Although corona pandemic had a substantial influence on the availability of migrant workers, Brexit also resulted in shortages in areas where the EU migrant's dependence has been more, especially the jobs involving lower skill levels [9]. The UK laws granted work visas to the EU and other countries migrants who received wages above a certain level. Therefore, the following labour-intensive sectors, paying lesser wages than the prescribed level for work visas, suffered the most shortages.

Hospitality sector

Hotels, bars, and restaurants struggled with the shortage of staff. Preceding the pandemic, almost one-fourth of workers in the hospitality and tourism sectors were from other countries, and about half of them were from other European countries.

Agriculture and Horticulture

Agriculture in the UK was reliant on non-British nationals who used to move from other countries in the EU before Brexit. Till the UK was a part of the EU, its agriculture was protected from competition with French and other countries' efficient farming practices. When this protection was lifted after Brexit, some agriculturists cut planting plans for the year 2022 by more than one-third. Despite the initiatives like "Pick for Britain", it was hard to find workers for agriculture from domestic sources.

Meat and Dairy

The labour shortage crisis in the UK pig industry witnessed a lack of drivers and abattoir workers as also a backlog of animals growing fat on farms.

Lorry Drivers

A supply chain bottleneck since saw supermarkets going empty and petrol stations running deserted. This was due to a shortage of fuel drivers, which was a problem that was present in many other European countries too. But the problem attained a more acute form in the UK due to Brexit. The government needs to take effective steps to make up the shortage by allowing more work visas for longer periods and making wages attractive as compared to other countries, as the efforts to hire from within the country have failed.

Social Care.

After Brexit, many social care workers became ineligible to work in the UK and they had to apply for visas. The government tried to solve this problem by adding the Social Care staff to the Shortage Occupation List (SOL). The staff included in the SOL can be obtained from overseas on One-Year visas. The effect of the measure will be noted after some time.

Industry and Government at loggerheads over Workers' Issue

Brexit caused an exodus of European workers. According to the ONS data, more than 94,000 EU nationals left the UK in 2020 than have arrived. This is just 40 percent compared to the figures in 2019 [10, 17]. The government believes that the industry was over-reliant on the cheap EU workers and has not done enough and not offered enough incentives to recruit domestic workers. On the other hand, the industry criticizes the government for not doing enough for getting workers or liberalizing visas. Hence, the only alternative for the industry is to seek solutions other than immigration.

CONCLUSIONS

Although one year is too short a time to arrive at the conclusive effects of Brexit, one of the striking features was the absence of any mismanagement at the borders. There was no noticeable disruption to the flow of business/trade. Nevertheless, there was much lower-than-expected trade activity in the food and agricultural goods sectors. The overall impact of Brexit on the UK economy and people's living standards appeared negative but uncertain as the effects of the corona pandemic and the Russia-Ukraine war cannot be disentangled at this moment. Perhaps, after a few years, the impact of Brexit on the UK's economy would get clarified. There are potentially confounding factors that caused economic weakness. Nevertheless, it is apparent that Brexit has made it harder for the British economy's supply side to adapt to the reopening of sectors after the lockdown. The way the government handled the situation after Brexit, it can be expected that lower growth with result partly due to depressed trade flow. However, the impact of lower trade on the economy as a whole was not uncertain but the effects of lesser trade with the EU countries will get clearer with time. If the trade performance has been negative till now, the Service Sector performance is still not clear. Perhaps it needs to be reoriented geographically to restore the export of services to the pre-Brexit levels and beyond.

Though teething problems have been posed by shortages of lorry drivers, farm labourers, and abattoir workers, the government has smoothly introduced a new visa regime to replace and reduce the losses. The skilled work visas have also been up-scaled. Especially, the huge spike in workers getting visas is observed in the health and social care sectors.

Moreover, the Windsor Framework entered this year is a post-Brexit legal agreement between the EU and the UK that effectively addresses the roadblocks experienced in the movement of goods between the UK and the EU Single Market through Northern Ireland. The Ireland Protocol introduced green and red channels to the speedy movement of goods meant for Northern Ireland and to reduce the paperwork and checks on the goods destined for Northern Ireland. Another purpose of the agreement is to separate them from goods at risk of moving into the EU. All these steps are considered to resolve many of the problems in the movement of trade between the UK and EU, also restoring the position of Northern Ireland with respect to its relationship with the EU single market. The **Stormont brake** provided in the Protocol gives the right to the North Irish Parliament to temporarily stop any changes to the regulations if their law-makers feared that these provisions will affect the everyday life of Irish people.

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