

2019 UK GENERAL ELECTION BRIEFING: **UK TRADE AND TRADE POLICY AFTER BREXIT**

Amit Kara, Xuxin Mao and Ana Rincon Aznar
National Institute of Economic and Social Research (NIESR)

OVERVIEW

International trade plays a crucial role in fostering economic growth across a wide range of industries at the national and the regional level. The prospects for UK's international trade are closely tied to the future relationship between the UK and the EU. Voters are being offered a wide spectrum of choices, ranging from continued membership to the EU, a customs union-type relationship by the Labour party, a looser arrangement under a free trade agreement with the governing Conservative party, to trading on WTO terms with the Brexit party. In this Briefing we discuss the UK's current trading position and the prospects for trade in light of the menu of options discussed above.

MAIN TAKE AWAYS

- The UK has a close trading relationship with the EU. Just under 50 per cent of total trade is directly with other EU countries, and the UK is also immersed in intricate global value chains involving EU businesses.
- With the UK's exit from the EU, UK's global competitiveness is under threat because trade is regarded as a key driver of productivity, employment and business creation; it can boost wages and income, and foster knowledge diffusion and technology adoption.
- While striking early trade deals with non-EU countries will be important to help offset some of the drag that will result from more restricted trading arrangements with the EU, NIESR research suggests the benefit will be small even if the UK is able to establish FTAs with all Anglo-American and BRIICS countries.
- Political parties offer a variety of Brexit options ranging from staying in the EU to a hard Brexit. Previous research has established that the closer the link with the EU, the less disruption there will be to trade.
- The governing Conservative party is looking to implement the revised deal that was struck between the EU and the UK in October that is looking to achieve a free trade agreement (FTA). Under this deal, the UK will exit the Single Market and the Customs Union and will instead be

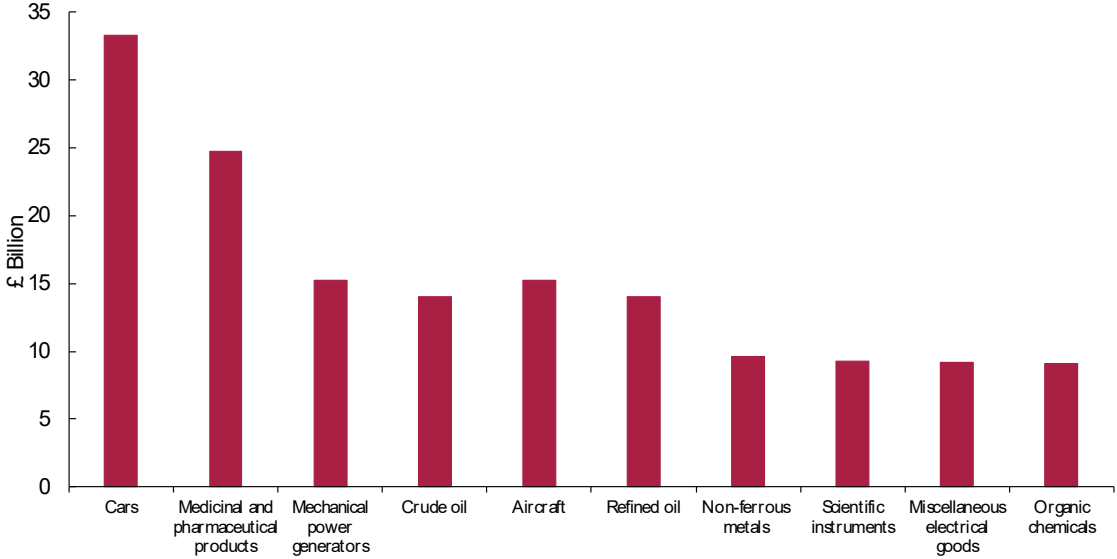
free to strike new trade deals with third countries. The Labour party offers a 'permanent and comprehensive UK-wide customs union' and 'a close alignment with the Single Market'. The Liberal Democrats and the Scottish National Party support continued EU membership. Plaid Cymru favour membership of the EU Single Market and Customs Union and the Brexit party seeks an exit without a deal.

- The UK runs a trade surplus in services of around £100bn (in 2018) which helps offset some of the deficit in goods trade. By exiting the EU, service sector trade will then be more exposed because even the most ambitious FTAs have a limited coverage for the services sector.
- All UK regions are exposed to the EU through exports, but the geographical location of exporters is not uniform across the UK. London and the South East, the East of England and the North West dominate this landscape, accounting for around 60 per cent of total exporters of goods. London dominates services trade, accounting for around 1/3 of total exporters.
- As a member of the EU, the UK also benefits from trade agreements with third countries such as Canada, Japan, Turkey etc accounting for around 14% of total exports. Of the 74 countries with which the EU has deals, the UK has signed agreements with 49 of these countries, representing approximately 7% of total exports.
- A loose trading relationship such as an FTA raises the opportunity to strike new deals with other large countries such as the United States, China and India. Our research shows that distance matters and the benefits of these potential deals would not compensate for the benefits that the UK would lose from exiting the EU.

UK trade in key figures

- The total value of UK exports and imports of goods and services (total trade) amounted to around £1,300 billion in 2018, representing 61% of total GDP. The EU is UK's largest trading partner accounting for £642 billion of total trade, or just under half of all UK trade flows (ONS Balance of Payments, 2019).
- Figure 1 shows the main goods exported by the UK in 2018. Car exports amount to £33 billion, that is, almost 10 per cent of total goods exported. The second main manufacturing exports are of medical and pharmaceutical products (7 per cent of total goods exports), followed by mechanical power generators (also 7 per cent), crude and refined oil (10 per cent) and aircraft (4 per cent).

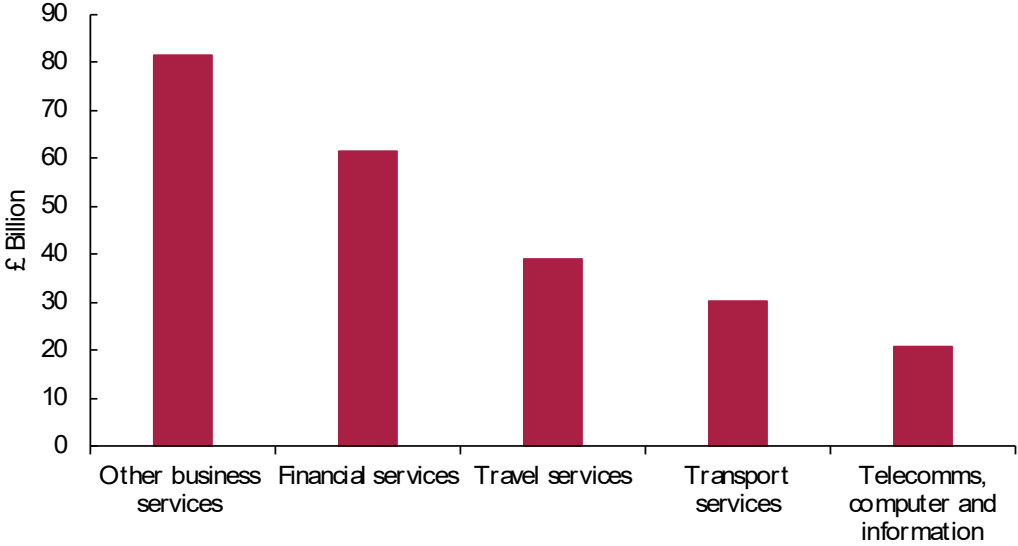
Figure 1. Main UK goods exports, 2018.



Source: Department of International Trade.

- The UK runs a trade surplus in services, which was of £107 Billion in 2018, partly offsetting the deficit in goods trade, which was £-138 billion. The trade balance with the EU was negative (£-64 billion) and the balance with non-EU countries positive (£33 billion).
- Figure 2 shows the main UK services exports (ONS Balance of Payments). The top UK services exports in 2018 was of other business services, which comprises professional, technical and trade-related services. This sector amounts to £81 billion, representing approximately 29 per cent of total service exports.
- The share of EU services trade in total trade has grown substantially since the late 90s, partly because some of the EU agreements that have reduced or eliminated barriers to service trade.
- The second main service export was financial services, amounting for £61 billion, and 21 per cent of total service exports. The financial sector is particularly vulnerable unless the EU grants equivalence. The third main service export was travel services which was of £40 billion and just under 14 per cent of total service exports. These were followed by transport services (£30 billion, and 11 per cent of UK total service exports), and telecoms, computer and information services (£21 billion, and 7 per cent of total UK service exports).

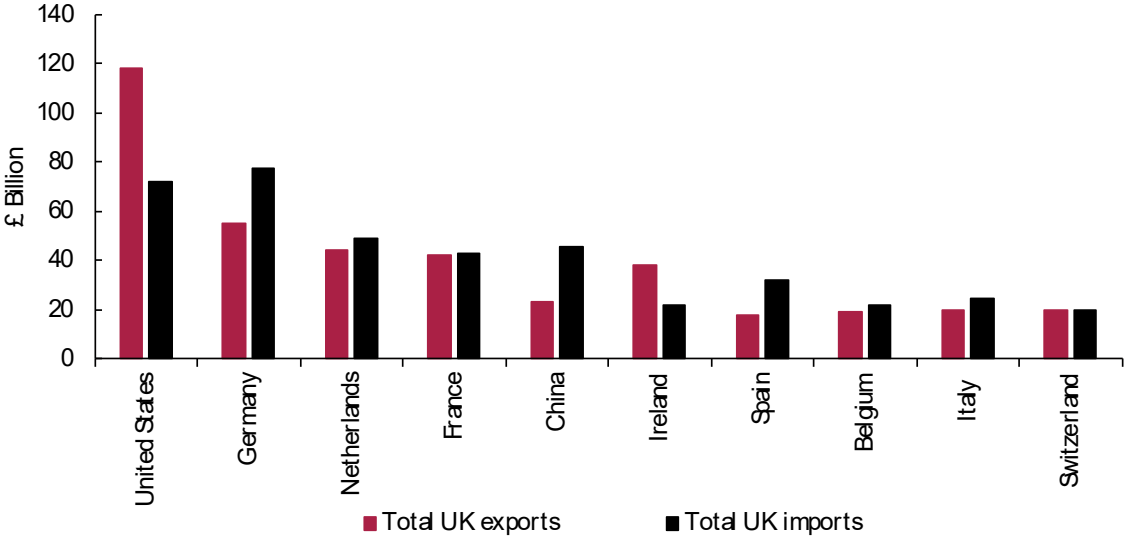
Figure 2. Main UK services exports, 2018.



Source: Department of International Trade.

- Figure 3 illustrates the main UK trading partners in 2018. The US is a main destination of UK exports (£118 billion), followed by Germany (£55 billion), Netherlands (£44 billion) and France (£42 billion). The EU, as a whole, accounts for £290 billion exports (ONS UK Trade). China is in 6th place as a destination of UK exports (£23 billion). On the imports side, the ranking is not too different; Germany is the main country of origin of UK imports, followed by Netherlands and China.

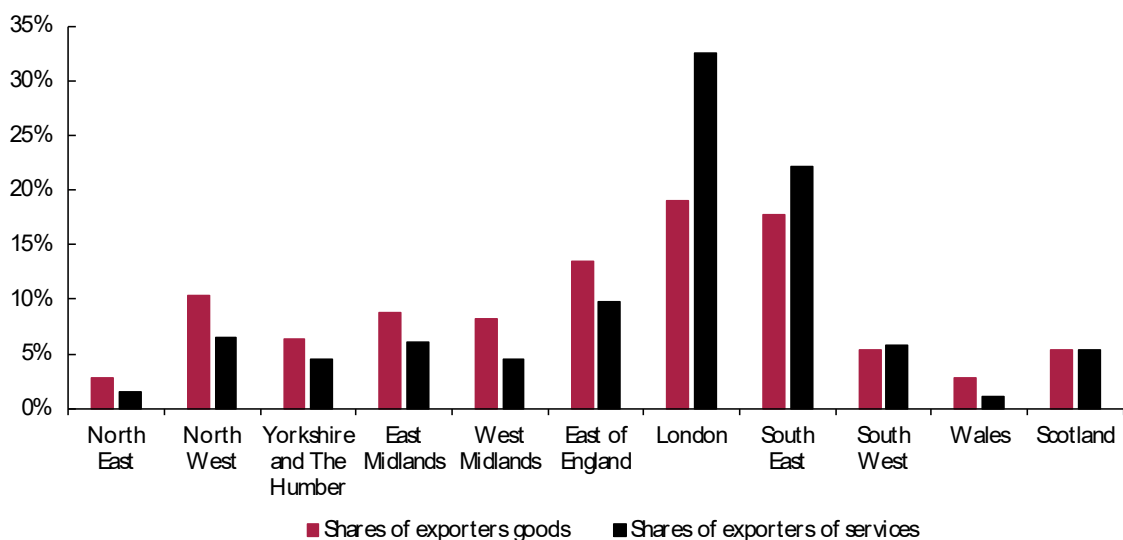
Figure 3. UK Main trading partners, 2018



Source: Department of International Trade.

- The UK is intensively involved in global value chains both through buying from third countries (backward linkages) and selling (forward linkages). The strongest backward linkages are with the United States, China and Norway (from the non-EU) and Germany and France (from the EU27).
- Evidence also suggests that the UK can also account for as much as 7% of the total value added generated by the exports of EU countries, which implies that many UK firms will most likely face multiple tariffs and delays in the post-Brexit era.
- In 2018 there were 233,900 exporters in Great Britain (source: Coriolis Technologies). This represents a decrease of almost 2 per cent since 2017. The decrease in number of service exporters from 2017 (2.3%) is estimated to be larger than the decrease in the number of goods exporters (0.9%).
- Figure 4 below shows the geographical distribution of these exporters across the UK regions for goods and services. London and the South East, the East of England and the North West dominate this landscape, accounting for around 60 per cent of total exporters of goods. London dominates services trade, accounting for around one of third of total exporters. Figure 5 illustrates that EU trade is important across all UK regions.

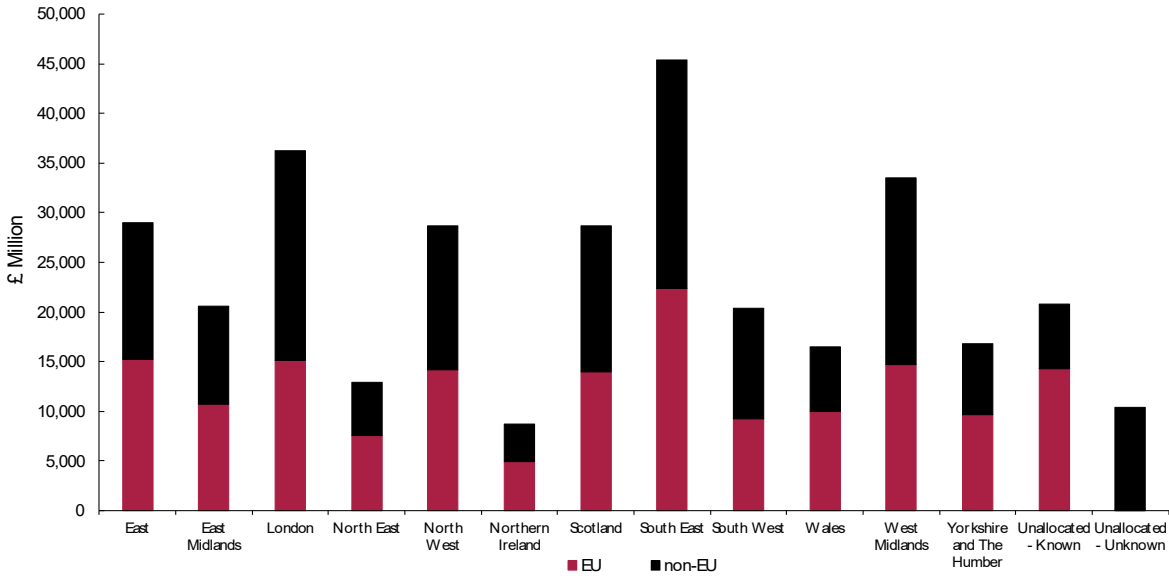
Figure 4 Geographical distribution of exports, 2018



Source: Multilateral Open Platform, Coriolis Ltd.

- There are however, regional and sectoral differences across the UK (Figure 5) The chart shows that the EU is a bigger trading partner than non-EU for most UK regions. The exceptions are London and West Midlands which trade more goods with non-EU countries. Separately, data from Coriolis Technologies suggests that London, South East and Southwest are the only three regions where the number of services exporters exceeds the number of goods exporters.

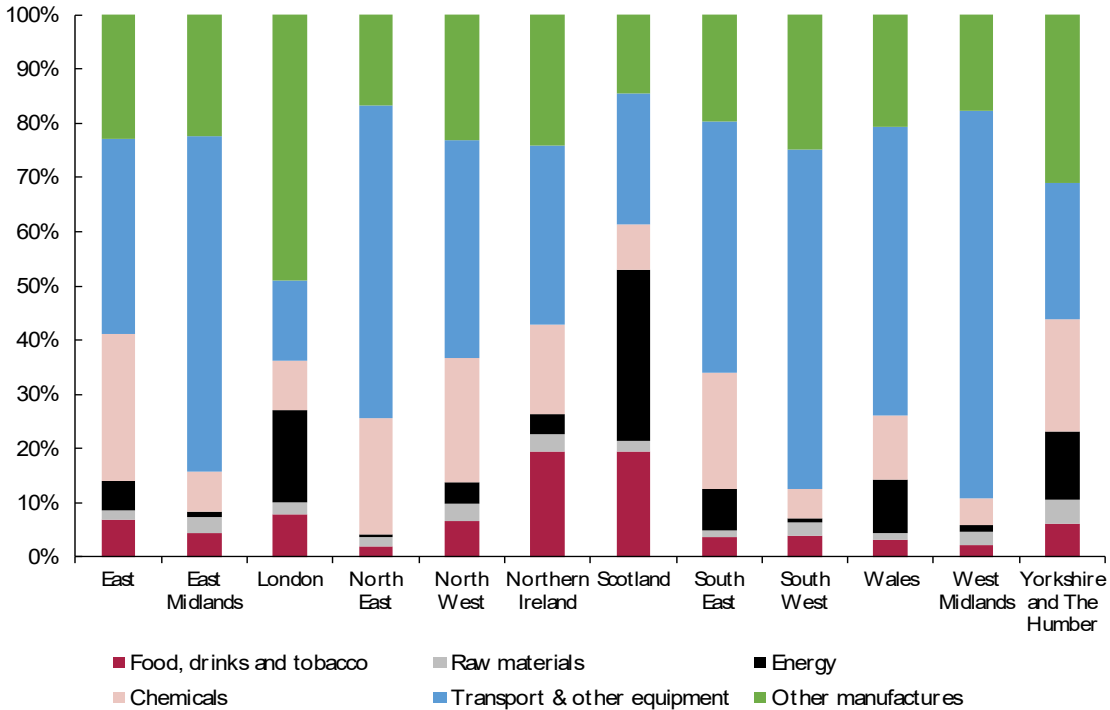
Figure 5 UK export of goods by region and partner country, 2017, £million



Source: HMRC Regional Trade in Goods Statistics data

- Figure 6 shows now the product breakdown of UK goods exports for every region. We can see there is heterogeneity in the composition of exports across regions. Manufacturing of transport (which includes manufacturing of cars) and other equipment dominates the exports of many regions. This is largest in the East Midlands, West Midlands, North East and South West and lowest in London.

Figure 6. UK goods exports by product and region, 2017.



Source: HM Revenue & Customs: Trade Statistics, 2017

Trade deals

- Trade deals vary. The most comprehensive deals such as EU membership cover an exhaustive range of goods and services and provide a framework for legal protection that involves local courts as well as the Court of Justice of the European Union. Membership encompasses human rights protection, environment protection, reduction in technical barriers, mutual recognition of professional qualifications and worker rights to ensure a level-playing field for all member nations.
- Research shows that joining the EU has increased bilateral UK-EU trade substantially (see table 2 below). Restricting the trading relationship to a FTA (as proposed by the Conservative party) could subtract, relative to a scenario where the UK remains in the EU, around 40 per cent of goods trade and 60 per cent of services trade in the long run.
- In comparison, research has shown that a closer trading relationship such as customs union (as proposed by the Labour party) could decrease trade in goods by 25% and services by 50%, again relative to a remain scenario. A 'No- Deal' scenario where the UK trades with the EU under WTO rules would imply larger reductions in trade of both goods and services.

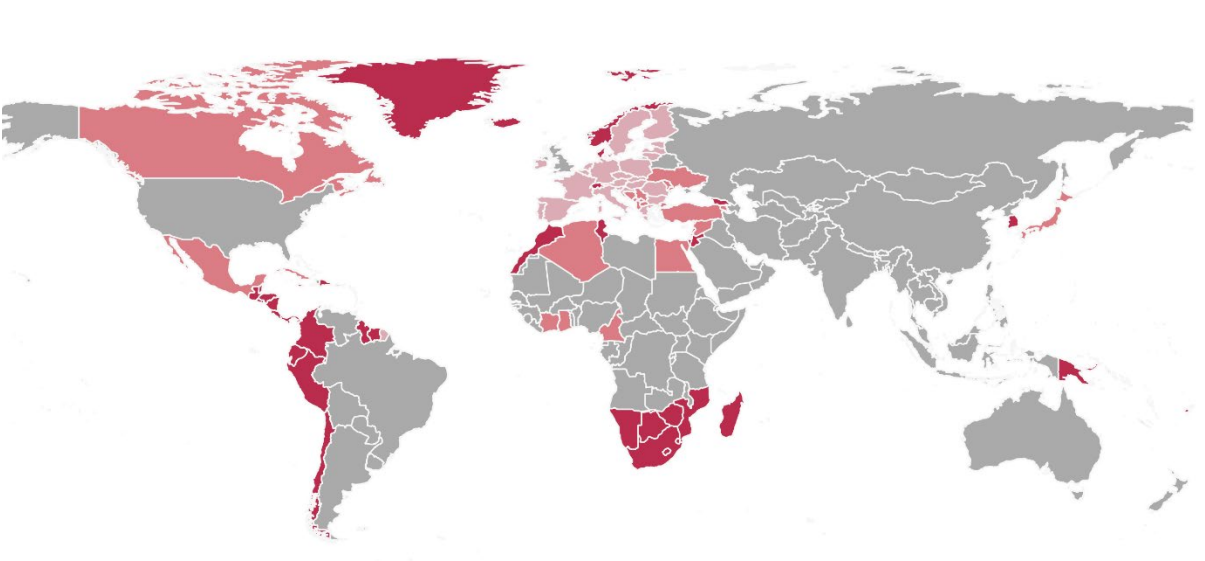
Table 2 Trade Effects on UK-EU Trade Volume of Different Brexit Scenarios (relative to remaining a member of the EU)

	Customs Union	Johnson’s Deal	No-Deal
Goods	-25%	-40%	-55%
Services	-50%	-60%	-65%

Source: Hantzsche et al. (2018) and Hantzsche and Young (2019)

- So far, the UK has negotiated deals with 49 of the 74 countries with whom the EU had trade deals. This covers around 6-7 per cent of total UK exports and around 8 per cent of UK imports. The value of exports to the remaining 25 countries with whom the UK has not signed yet deals amounts to around 7 per cent of total UK exports and 6 per cent of total imports. Figure 7 below summarises the current state of play.
- Striking trade deals with non-EU countries will be important to ensure continuity and to help offset some of the drag on UK trade that will result from the new more restricted trading arrangement with the EU should the UK exit. NIESR research suggests that the benefit will be small even if the UK is able to establish FTAs with all Anglo-American and BRICS countries Hantzsche et al. (2018).
- In addition to third-country deals discussed above, there are important negotiations with the WTO and of course, the EU (Holmes et al. 2016). There are 163 WTO members and after considering the EU countries, and the other with which the UK has already established deals, there is a large group of countries with which the UK will need to agree new trading arrangements.
- In terms of policy action, there is a need to coordinate the activities of the different UK governmental bodies, lenders and exporters to mitigate potential trade risks. More specifically, the UK government can extend the Enterprise Finance Guarantee, provide dedicated funds to small and medium exporters, and encourage banks to provide exporters with not only credits but also government information on their Brexit preparations.

Figure 7. Trade Deals with third countries



Red: Countries with both EU and UK trade agreements
Darker Pink: Countries with only EU trade agreements but not UK ones
Lighter Pink: EU countries
Grey: Countries without EU or UK trade agreements

References

Hantzsche, A. Kara, A. and G. Young (2018), “The economic effects of the government’s proposed Brexit deal”, National Institute of Economic and Social Research November 2018.

Hantzsche, A. and G. Young (2019), “The economic impact on the United Kingdom of a customs union deal with the European Union”, National Institute of Economic and Social Research November 20189;

Holmes, P., Rollo, J. and A. Winters “Negotiating the UK’s Post-Brexit trade Agreements”, National Institute Economic Review, November 2-16.