

The economic stakes of Brexit : an Irish point of view

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Module doctoral UEPol Politiques Européennes

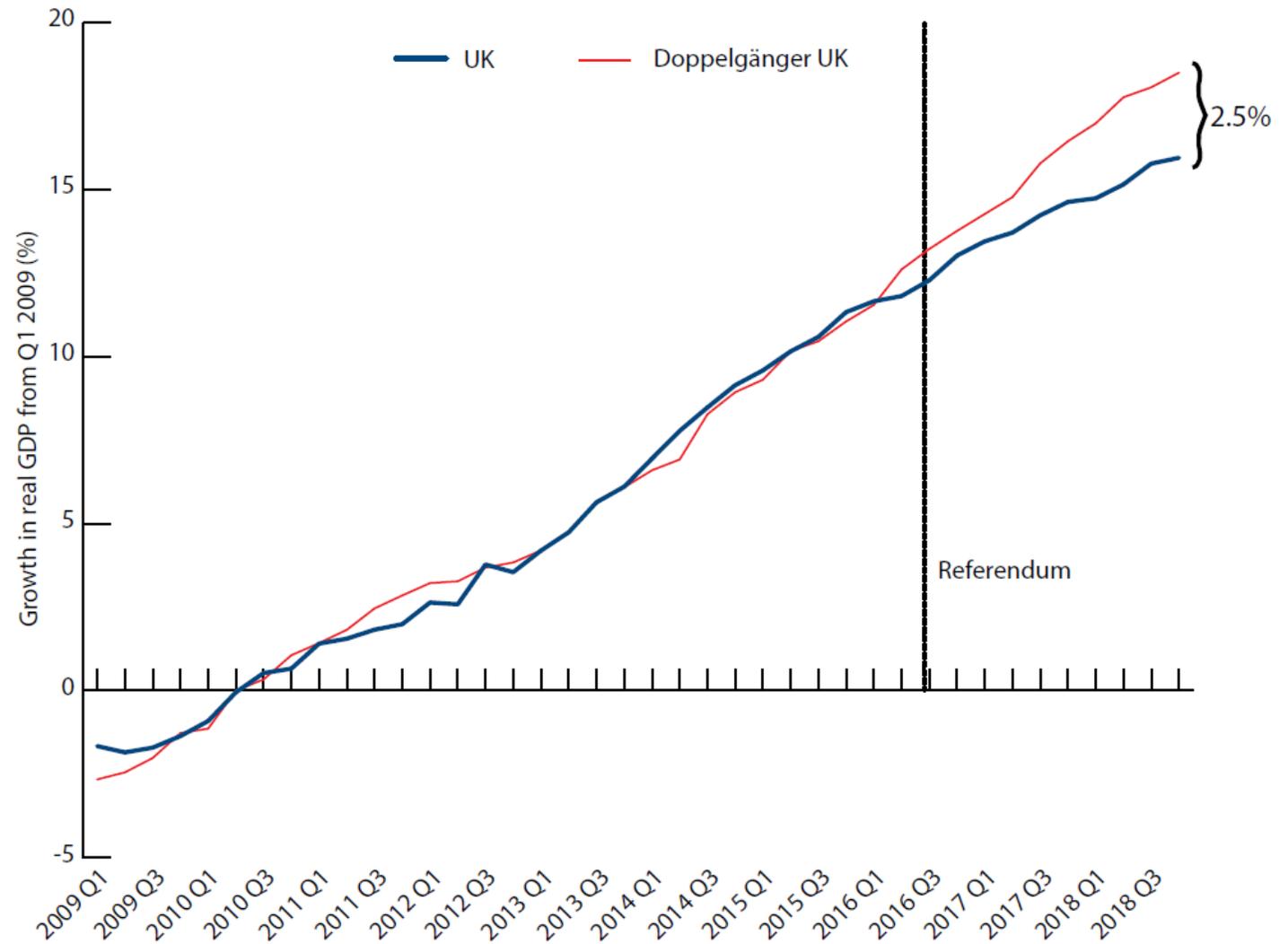
8 July 2019, Rennes



UK Lancaster
House speech
January 2017
'Plan for
Britain' sets
out UK
negotiating
priorities

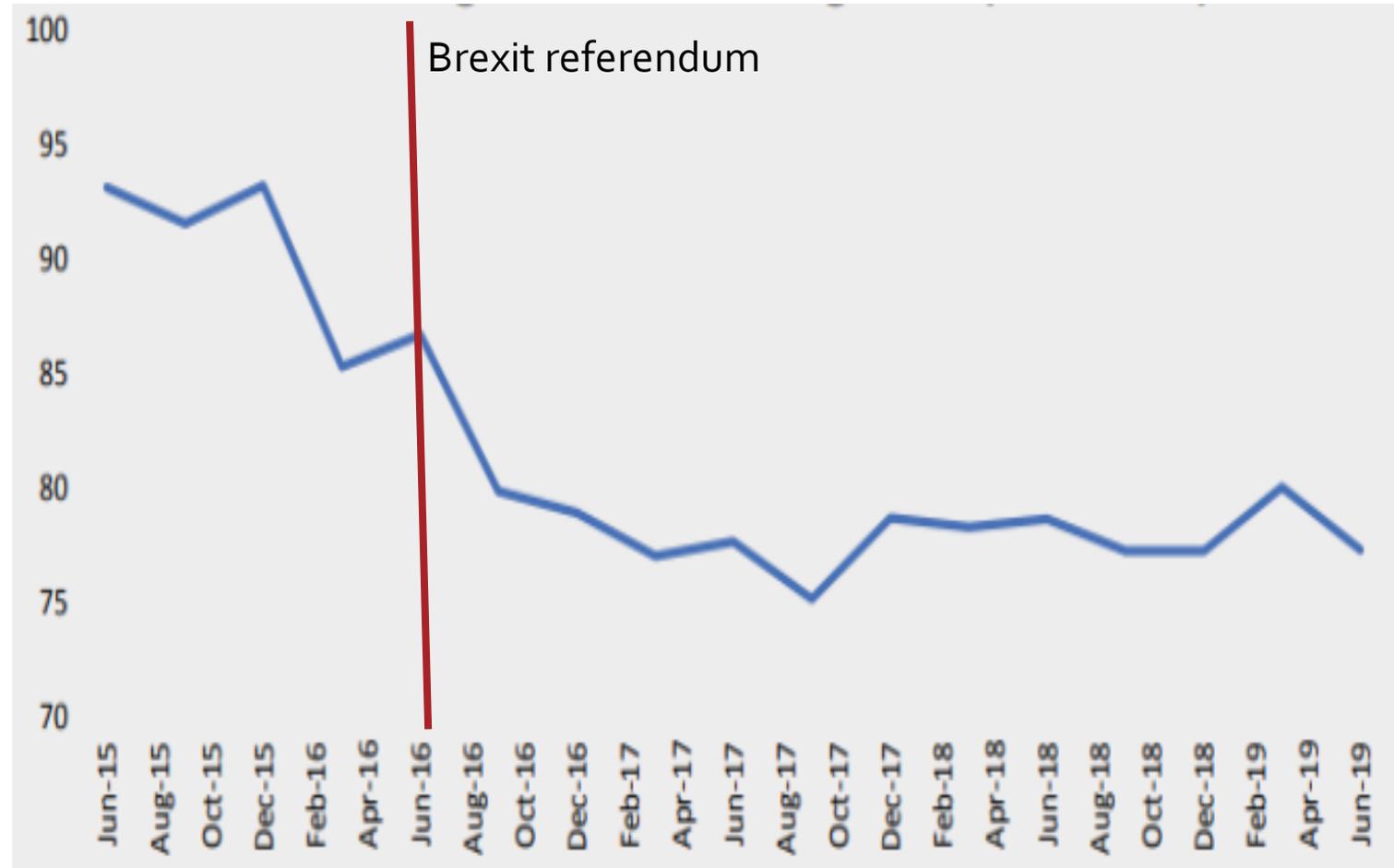
- June 2016 Brexit referendum
- March 2017 Article 50 process triggered
- UK offensive objectives
 - Freest possible trade in goods and services ('frictionless trade')
 - Avoid hard border on island of Ireland
- UK defensive objectives ('red lines')
 - Recover independent trade policy
 - Cease large transfers to the EU budget
 - End direct jurisdiction of the European Court of Justice
 - End free movement of labour from EU countries

The cost of Brexit to the UK to December 2018



Source: Springford 2019

Sterling's effective exchange rate



Source: Bank of England

How Brexit might affect the UK economy

- Increase in trade costs
- Impact on foreign direct investment flows
- Changes to immigration policy
- Regulatory changes
- Productivity growth
- Macroeconomic conditions
 - exchange rate, interest rates

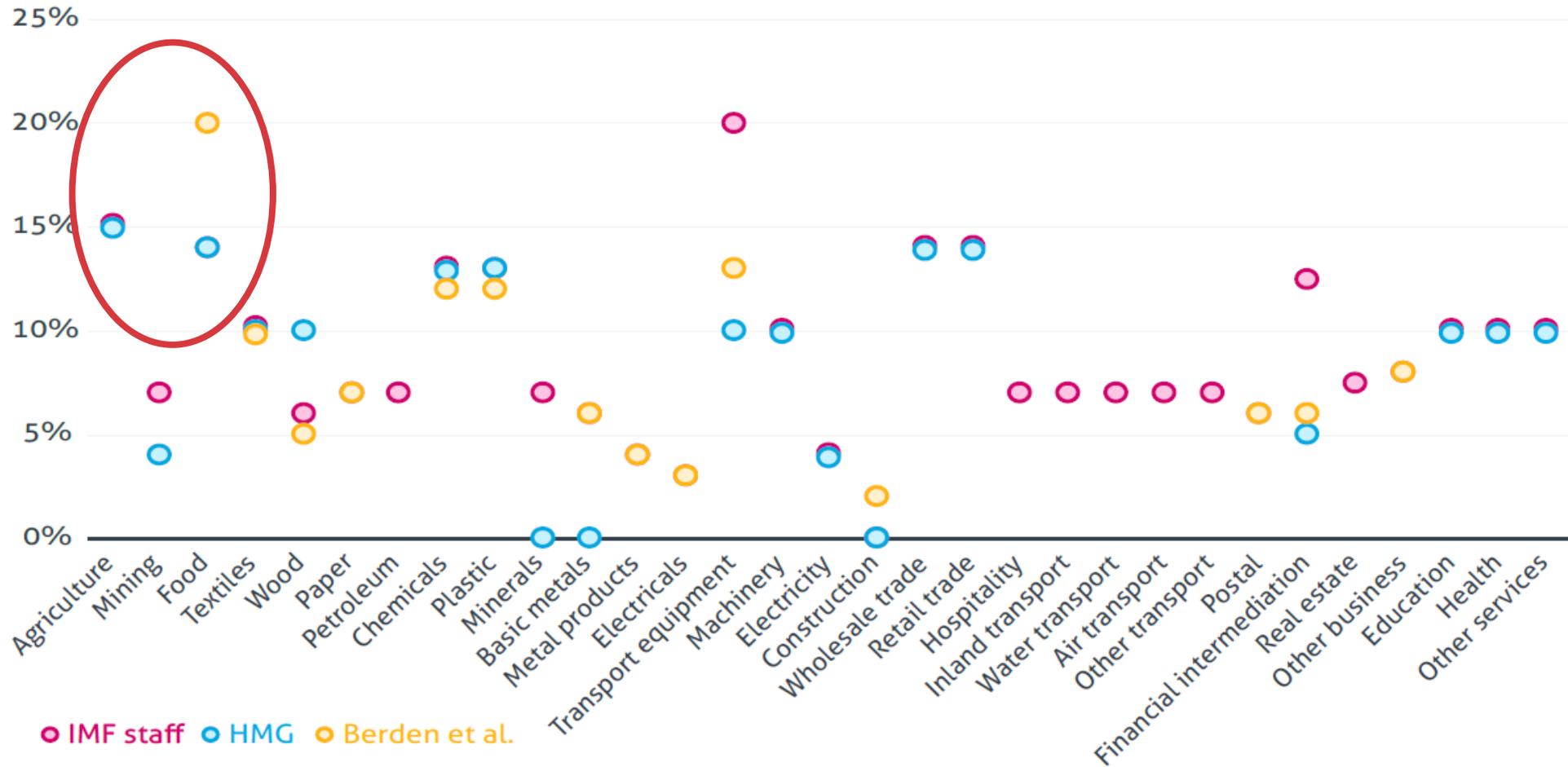
Key parameter inputs into estimation of economic impacts

- Different assumptions about how Brexit will affect trade costs
 - Tariff scenarios (FTA vs. MFN (WTO rules))
 - Future UK access to FTAs ('roll-over')
 - Scale of Non-Tariff Barriers
- (to a lesser extent) different assumptions about how much trade is discouraged or encouraged by increasing or reducing barriers to trade.
 - Empirical evidence is based mainly on instances of trade liberalisation

Quantifying the scale of additional non- tariff trade costs

- Top-down approaches
 - Estimate overall size of all existing non-tariff barriers
 - Gravity model using either 'residual' or 'indicator' approaches
 - May overestimate size if it assumes a cost is driven by an NTB when it may be due to something else
- Bottom-up approaches
 - Estimate the cost of each individual barrier and add them up
 - May underestimate size if it fails to include all important costs

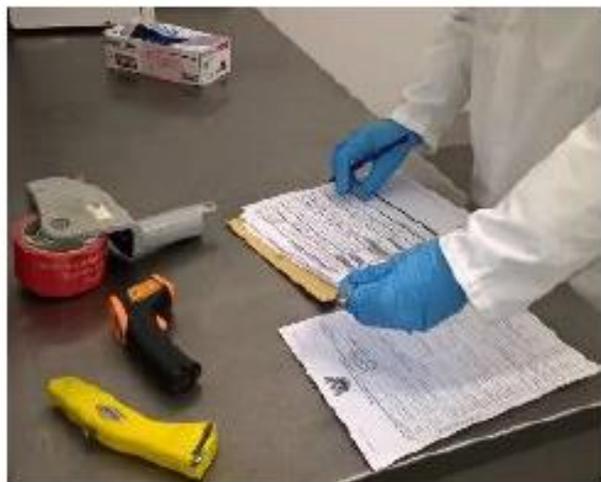
Figure 4: Comparison of estimates of non-tariff barriers by sector (% tariff rate equivalent)



Source: International Monetary Fund, Euro Area Policies: Selected Issues, Country Report No. 18/224, 19 July 2018, retrieved 9 October 2018, www.imf.org/en/Publications/CR/Issues/2018/07/18/Euro-Area-Policies-Selected-Issues-46097

Controls at Border Control Points for products of animal origin

- EU harmonised import conditions
 - Approved countries, approved establishments, agreed model health certificate
- Pre-notification (at least 24 hours)
 - Forward Common Veterinary Entry Document and supporting documents
- Limited number of Border Control Points
- Documentary checks (100% consignments)
 - Verification that documentary details are correct
- Identity checks
 - Seal checks and full identity check
- Physical checks
 - On a proportion of consignments



Frequency of Physical Checks: Adapted from 94/360/EC

| 1-10% | 20% | 50% |
|---|---|---|
| Semen | Fresh meat - beef, sheep meat, horse meat, goat meat, pork | Poultry and poultry products |
| Embryos | Fresh and frozen fish | Milk and milk products for human consumption |
| Milk and milk products not for human consumption | Whole eggs | Egg products |
| Hay & Straw | | Honey |
| Processed petfood | | |
| Blood products for technical use | | |

Figure 1: Forecast long-term impact of Brexit on GDP, relative to remaining in the EU

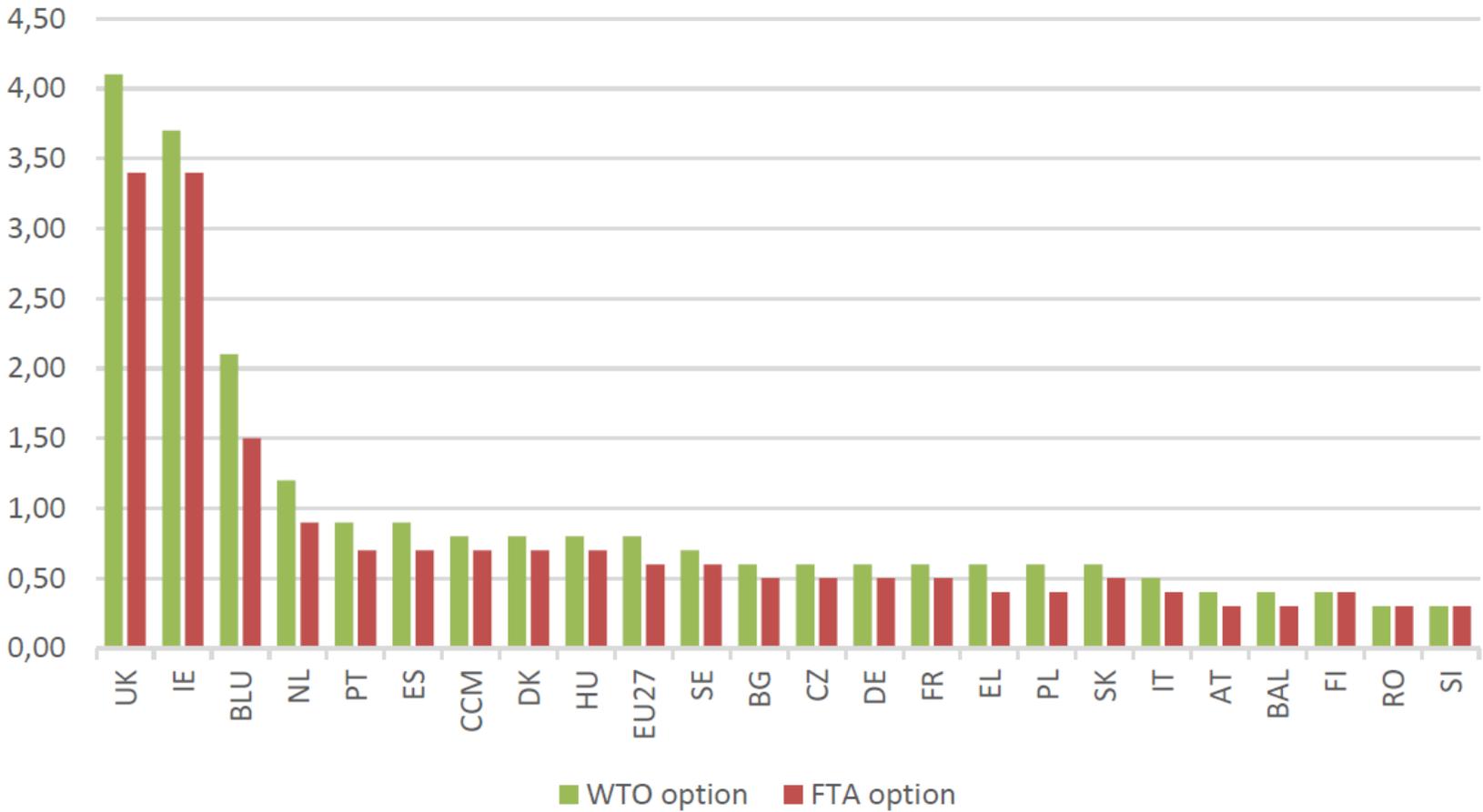


Projections of economic impacts of hard and soft Brexits on the UK

Source: Tetlow and Stojanovic, 2018

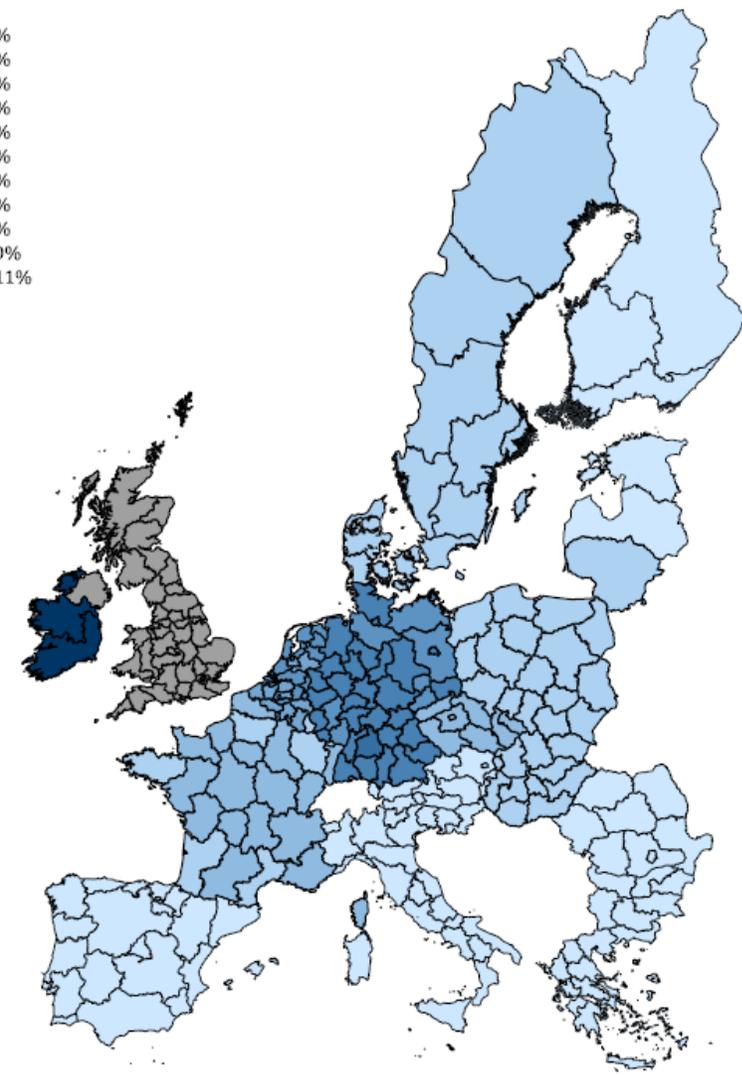
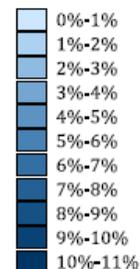
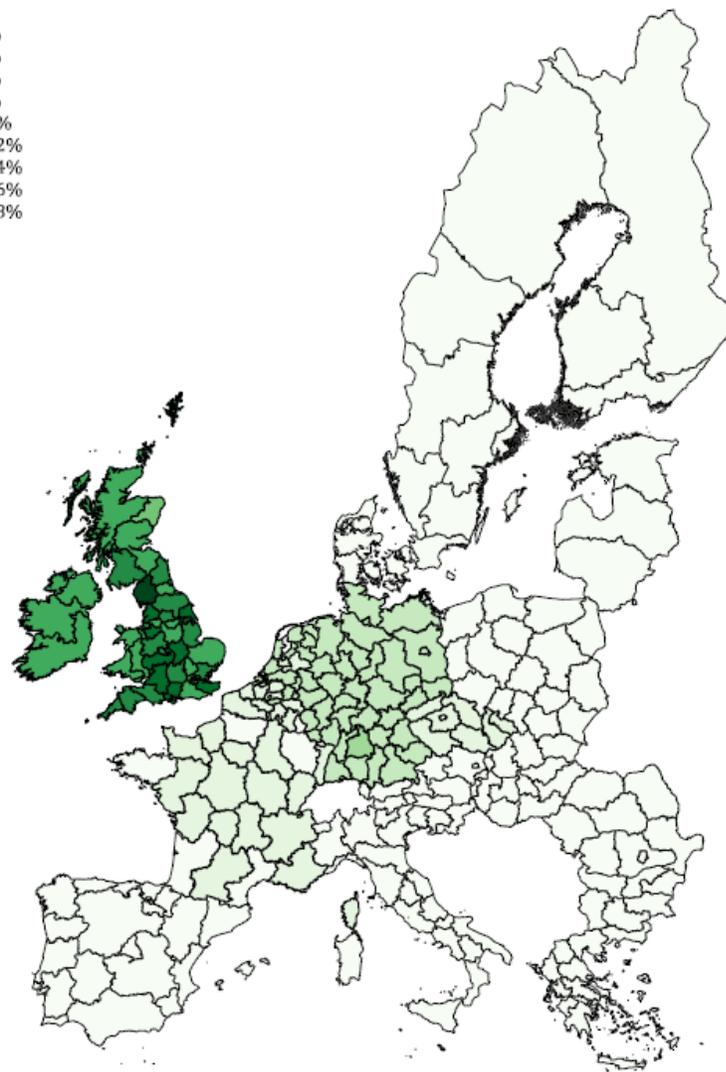
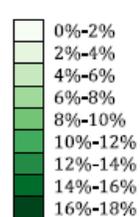
Projections of economic impacts of Brexit on the EU-27

Losses in GDP (2030) by Member States and type of Brexit scenario (%)



Source: Emerson et al, 2017

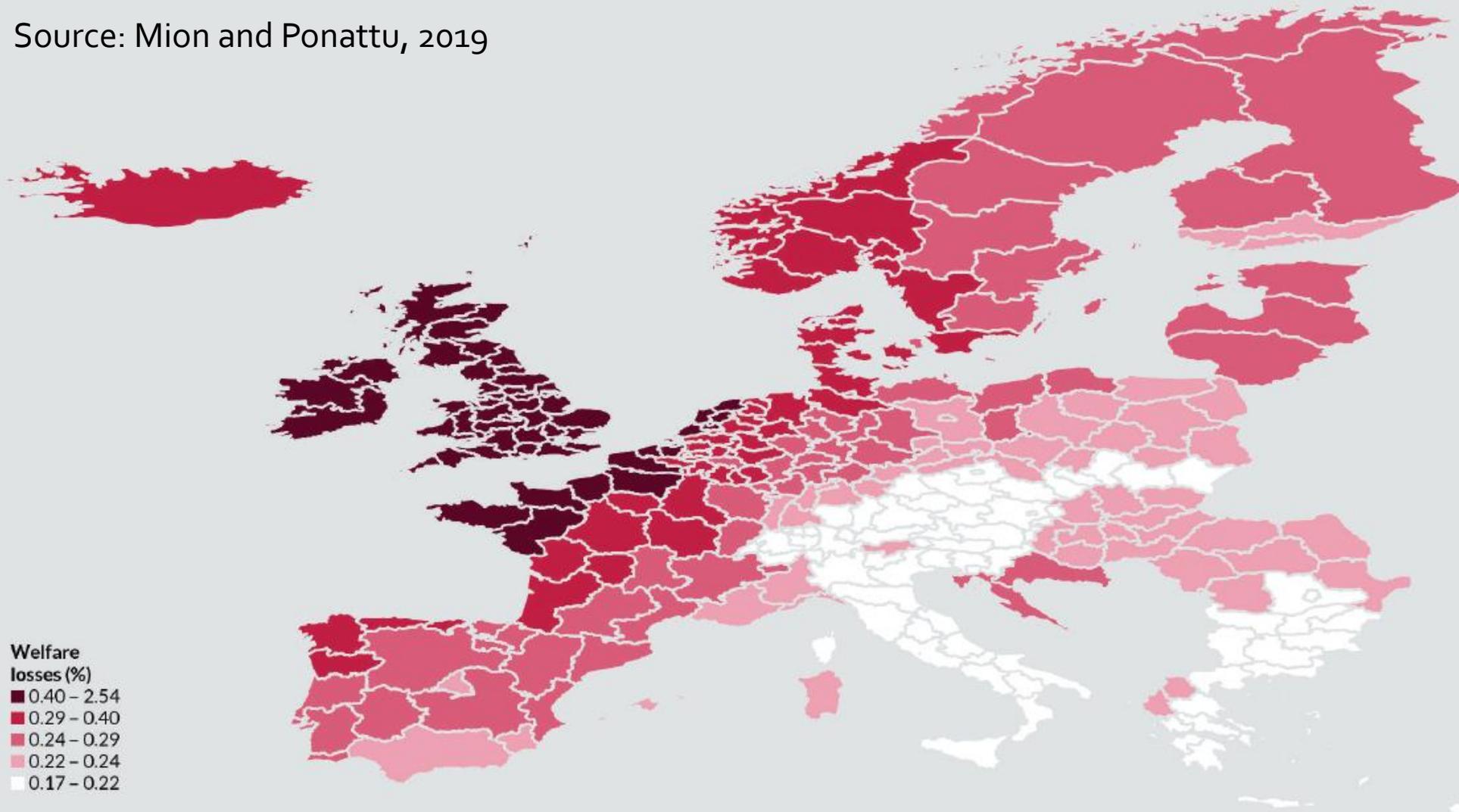
Regional shares of local GDP exposed to Brexit (shares of regional GDP contained in trade flows between EU exporters and UK importers and vice versa)



Source: Chen et al, 2018

Welfare losses related to a hard Brexit

Source: Mion and Ponattu, 2019



Based on a counterfactual equilibrium analysis of a hard Brexit scenario. Welfare corresponds to the change in income that, given initial prices, would allow consumers to reach the same utility level corresponding to the counterfactual equilibrium.

The future relationship – the UK Chequers proposal July 2018 (1)

- A **free trade area** for goods
 - Avoid the need for customs and regulatory checks at the border
 - businesses would not need to complete costly customs declarations
 - enable products to only undergo one set of approvals and authorisations in either market, before being sold in both.
- A **common rulebook** for all goods including agri-food
 - UK would commit by treaty to ongoing harmonisation with EU rules on goods necessary to provide for frictionless trade at the border.
 - Participation in EU rule-setting agencies as a non-MS
- A new **Facilitated Customs Arrangement**
 - would remove the need for customs checks and controls between the UK and the EU as if were a combined customs territory

The future
relationship –
the UK
Chequers
proposal
July 2018 (2)

- Regulatory flexibility for services
 - accepting the UK and the EU will not have current levels of access to each other's markets.
- Level playing field provisions –
 - UK would commit to apply a common rulebook on state aid
 - cooperative arrangements between regulators on competition established.
 - UK and the EU agree to maintain high regulatory standards for the environment, climate change, social and employment, and consumer protection – meaning UK would not let standards fall below their current levels.

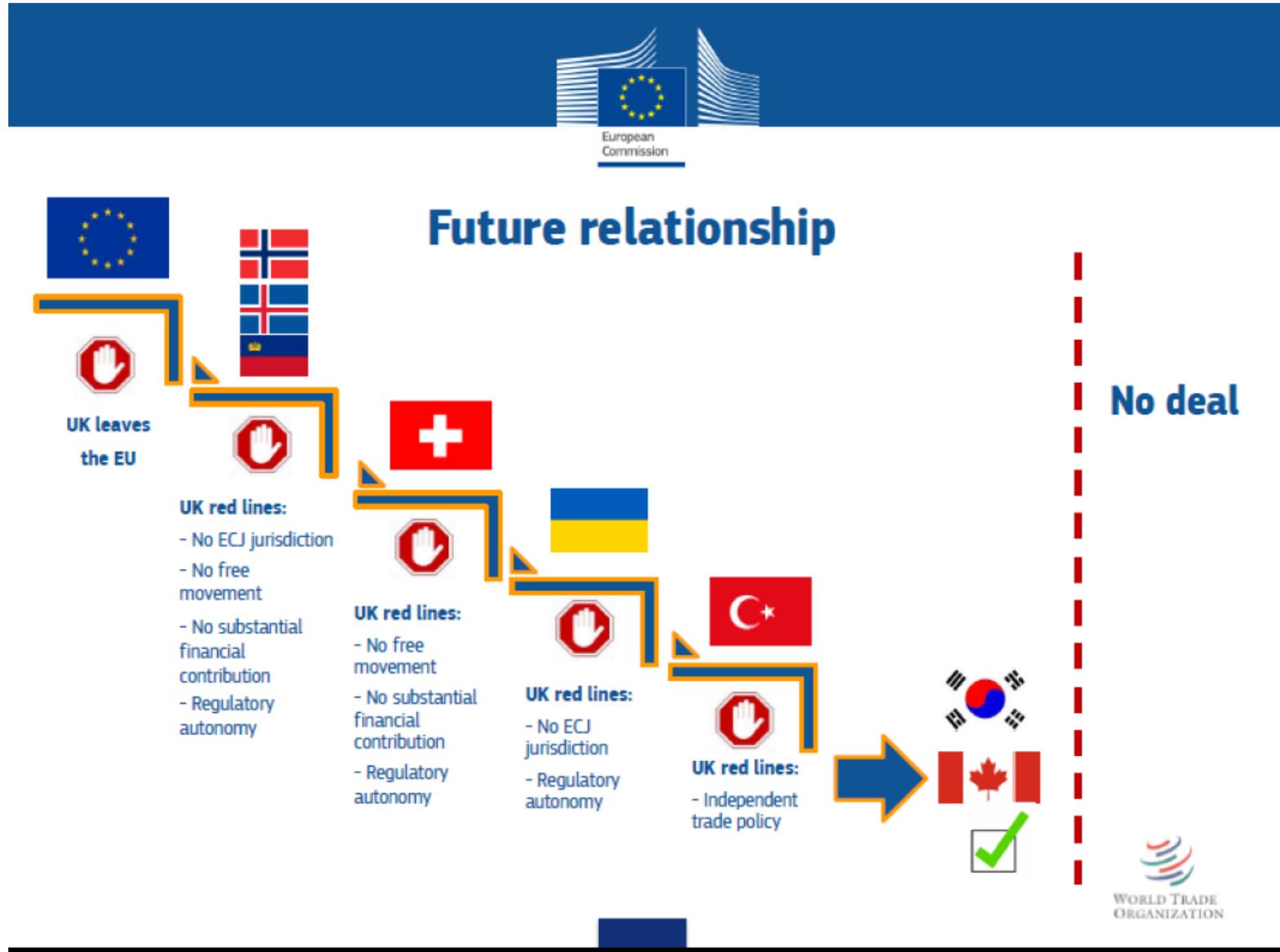
The future
relationship –
the UK
Chequers
proposal
July 2018 (3)

- Joint institutional framework to provide for the **consistent interpretation and application of UK-EU agreements** by both parties.
 - This would be done in the UK by UK courts, and in the EU by EU courts – with due regard paid to EU case law in areas where the UK continued to apply a common rulebook.
- Resolution of disputes including through a Joint Committee and binding independent arbitration
 - Accommodating through a joint reference procedure the role of the Court of Justice of the European Union (CJEU) as the interpreter of EU rules, but founded on the principle that the court of one party cannot resolve disputes between the two.

Core principles of the EU's negotiating position March 2018

- Saw the UK proposal as 'cakeism'
- ensuring a balance of rights and obligations, and a level playing field;
- preserving the integrity and proper functioning of the single market, which excludes a sector-by-sector approach and relies on the indivisibility of the four freedoms;
- a country that is not a Member State of the EU cannot have the same rights and benefits as a member state;
- certain liberalisation and integration levels can only be granted on the basis of regulatory alignment and CJEU involvement in order to preserve the integrity of the EU internal market and legal framework
- safeguarding the EU's financial stability, its regulatory and supervisory regime and standards and their application.

Barnier slide presented to European Council Dec 2017



The Political Declaration November 2018

Economic partnership

- Free trade area combining deep regulatory and customs cooperation
 - 100% zero tariffs
 - ambitious customs arrangements that develop the single customs territory provided for in the Withdrawal Agreement, which obviates the need for checks on rules of origin.
 - Regulatory equivalence arrangements for financial services
- Level playing field arrangements
- Provision for mutual regulatory and SPS agreements
- Air and road transport agreements
- New fisheries agreement

The Withdrawal Agreement under Article 50

- Confirming the rights of EU citizens
- Agreeing the financial divorce settlement
- Avoiding a hard border on the island of Ireland
- Transition arrangements

Transition arrangements in the Withdrawal Agreement

- Effectively replicates the benefits and obligations of EU membership for a non-member
- UK would continue to participate in the EU Customs Union and the Single Market (with all four freedoms) and all Union policies (except for CAP and fisheries)
- UK would contribute to the EU budget as foreseen under the current MFF to end 2020

Background to the Irish backstop

- Belfast/Good Friday Agreement 1998
 - Brought to an end decades of unrest which had resulted in 3,500 deaths
 - Overwhelmingly ratified on both sides of the island of Ireland
 - Guarantees equal respect for the two traditions in NI
 - UK undertook to respect whatever status a majority of people in NI wish to adopt
 - Social and economic cooperation on the island of Ireland embedded in one of the three strands of Agreement (North-South strand)

Highly
integrated
supply chains
on the island
of Ireland,
especially for
agri-food

- Food, beverages and tobacco account for 49% of cross-border manufacturing trade.
- Over 35% the milk produced on NI's farms goes to Ireland for processing
- Live pigs go north and live sheep come south for processing
- 3.9 million HGV (Heavy Goods Vehicle) movements across the border annually

The Irish backstop

Joint Report
Dec 2017
paragraph 49

- 1) a solution to avoid a hard border to trade in goods on the island of Ireland and any physical infrastructure or related checks would be achieved in the context of the future EU-UK relationship;
- 2) should this scenario prove impossible, the UK would propose specific solutions for Northern Ireland;
- 3) failing agreement on this as well, the UK committed to 'full alignment of those rules of the internal market and the customs union which now or in the future support North-South cooperation, the all-island economy and the protection of the 1998 Agreement'.

The UK specific proposals to avoid the Irish backstop

- Facilitated customs arrangement ('max fac')
 - Use of digital technologies to eliminate border
- Customs partnership (Chequers proposal)
 - Goods entering the UK would be tracked. If they remained in the UK they would be charged the UK tariff and if sent further to the EU they would be charged the EU tariff which the UK authorities would collect on behalf of the EU and forward

The EU proposal

First draft of
WA Feb 2018

NI-only
backstop

- Northern Ireland should remain part of the EU's customs union and maintain necessary regulatory alignment with the EU goods acquis.
- EU supervision and enforcement mechanisms would apply in NI but not in GB
- Far-reaching EU offer that extended full rights of access to the EU internal market to part of the territory of a non-Member State
- Outright rejection by NI Unionist parties who provided critical support to Mrs May's minority government because it implied controls on East-West trade within UK

UK counter-proposal for the Irish backstop

June 2018

- Recognised that EU approach to backstop favours alignment with EU rules
- Extend the NI-only backstop to the UK as a whole
- Initial sceptical EU reaction
- Eventually included in the Nov 2018 Withdrawal Agreement

The Irish backstop in the Withdrawal Agreement

Nov 2018

In event of failure to avoid a hard border on the island of Ireland through the future relationship, UK commits to:

- remaining in a temporary customs union with the EU (covering all goods except fish unless an agreement on access to waters and fishing opportunities has been reached)
- to conform to specific EU legislation on customs, taxation, the environment, labour law, state aid and competition (so-called 'level playing field' conditions)
- In Northern Ireland, specific additional EU legislation will apply on customs, VAT and excise provisions and certain technical standards relating to goods effectively keeping NI in the EU Customs Union and subject to jurisdiction of CJEU for additional legislation

Political reaction in the UK to the Irish backstop in the Withdrawal Agreement

- Under this model, goods travelling from GB to NI would undergo a new declarations process and, in some cases, regulatory compliance checks
- Opponents of the Withdrawal Agreement argue the Irish backstop could end up either being a permanent arrangement that locks the UK into a customs union with the EU as well as disrupting the internal market within the United Kingdom

The current political impasse

- Withdrawal Agreement voted down in the House of Commons on three occasions since January 2019
 - Exchange of Letters between UK PM and EU Presidents Jan 2019
 - Additional clarifications provided in March 2019 through the 'Instrument relating to the Withdrawal Agreement' and the 'Joint Statement supplementing the Political Declaration'
- EU leaders insist Withdrawal Agreement will not be re-opened
- UK resurrecting 'max fac' proposal, now called 'alternative arrangements'
 - Privately-funded Alternative Arrangements Commission
 - Government-initiated Technical Advisory Group on alternative arrangements established June 2019
- UK Conservative Party choosing new leader and next Prime Minister
 - No deal if necessary on October 31 2019

Proposed UK tariff schedule in event of 'no-deal'

- Clear intent to mitigate damage from leaving EU by liberalising tariffs
- Tariff line view
 - Tariffs eliminated on 95% of tariff lines (only 469 non-zero tariff lines)
 - 92% of UK imports from non-EU countries would be tariff-free compared to 62% now
 - 81% of imports from EU countries would be tariff-free compared to 100% now (and 32% if UK maintained EU tariffs)
 - 87% total imports will be tariff-free compared to 82% today

UK imports under the proposed UK tariff schedule

| Imports facing 0% tariffs: | Currently | UK MFN tariff schedule | EU MFN tariff schedule |
|-------------------------------|-----------|------------------------|------------------------|
| Imports from non-EU countries | 62%* | 92% | 51% |
| Imports from the EU | 100% | 81% | 32% |
| Overall | 82%* | 86% | 42% |

Aim is to keep as much of trade with EU as free of tariffs as possible, but non-tariff barriers are not considered

Unweighted UK MFN tariff would be around 0.7% compared to 7.7% under EU tariffs

Trade-weighted UK tariffs around 1.6% compared to 4.5% if UK applied EU tariffs

Top 5 most imported products from EU, out of products where UK tariffs are non-zero

| HS 4-digit | Product Description | Share of total UK imports | Share coming from EU | Share of EU imports subject to tariffs under the proposal | Average proposed tariffs applied on these products |
|------------|---------------------------------------|---------------------------|----------------------|---|--|
| 8703 | Motor cars and other motor vehicles | 6.9% | 87.2% | 99.98% | 10.0 |
| 8704 | Vehicles - for the transport of goods | 1.1% | 80.2% | 97.5% | 17.2 |
| 2710 | Petroleum oils | 2.6% | 48.2% | 23.7% | 1.6 |
| 1602 | Prepared or preserved meat | 0.4% | 68.0% | 92.8% | 17.7 |
| 0207 | Meat and edible offal of poultry | 0.2% | 96.2% | 98.8% | 11.0 |

Source: Trade data from HMRC for 2017. The average tariff is calculated based on the non-zero product codes within each group. Where specific tariffs are levied, the EU's 2017 ad valorem equivalent tariff has been used and we have assumed that the change in the AVE is the same as that in the specific tariffs.

Implications for Irish border in no-deal Brexit

- UK March 2019 temporary no-deal tariff schedule
 - UK does not intend to require customs declarations, collect tariffs or conduct checks on goods crossing the border into NI from the Republic of Ireland
 - Status of animal health checks not clarified
 - if these goods are transported onwards into GB they would be liable for tariffs
- Irish Government position is that it is not intending to set up border infrastructure with Northern Ireland
 - But how to fulfil its obligations under EU legislation to rest of EU?

The uncomfortable choices now facing the Irish government

- Should it accept a revision of the Irish backstop in the Withdrawal Agreement if that was the price of UK approval?
- Preparing for the negative economic fallout from a no-deal Brexit
- How to manage the NI-Ireland border in the event of a no-deal Brexit?