

Why we won't know the true impact of Brexit on trade for some time

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On Tuesday, the Office for National Statistics produced an initial analysis of the UK's trade in goods during the first quarter of 2021. Fascinatingly (but perhaps unsurprisingly) it showed a dramatic drop (almost one quarter) in trade with EU countries relative to the same quarter in 2018.

The reason for comparing so far back in time is clear. Last year, trade was affected by the emergence of the novel coronavirus. During the latter portion of the first quarter, trade was impacted by the imposition of a lockdown in the UK on 23rd March and somewhat earlier for some of our EU partners. Earlier in the quarter, similarly dramatic measures in China and elsewhere also had a major impact.

The first quarter of 2019 isn't an accurate point for comparison either as many businesses (on both sides of the Channel) stockpiled due to the first of several negotiating deadlines. As such, Q1 of 2018 is indeed the most recent point of comparison. However, Q1 of 2021 was affected by COVID, both in the UK (which was under national lockdown) and elsewhere.

Nevertheless, it is somewhat instructive to compare EU and non-EU figures. The former shows a dramatic drop relative to the latter (non-EU trade in goods fell by just under 1%, compared to over 23% for EU trade in goods). Taken at face value, then, Brexit appears to have had a huge negative impact.

This, too, is misleading, however. Trade with the EU was unusually high in the final quarter of 2020 as many businesses sought to stockpile goods. Moreover, the lockdowns associated with COVID have been more stringent in Europe than elsewhere during the first quarter of 2021.

As such, EU demand for many goods was depressed below normal levels at the start of 2021. Moreover, many businesses had significant stockpiles to draw upon, reducing their reliance on trade. Finally, the beginning of 2021 was associated with a number of initial problems at the border than should gradually be ameliorated (mostly relating to Brexit, but also due to the imposition of COVID-related restrictions requiring a negative test result from drivers).

This notwithstanding, we can glean some information, providing we are suitably cautious about what it tells us. Trade with the EU dropped precipitously in January, but then staged a significant recovery in February and March. This strongly suggests that the ¼ fall in goods trade observed during Q1 is an exaggeration.

Nevertheless, even in March, considering EU trade in conjunction with non-EU trade it is clear that there has been a significant shift. Exports to the EU in March 2021 were £1.3bn lower than in March 2018 whereas those to non-EU countries were only £0.4bn lower.

In essence, this implies a circa £1bn shortfall in exports to the EU relative to what one would expect to see. The largest contributor to this by far is trade in "material manufactures" with fuels, chemicals and food making up the balance. Much of the former appears related to trade in metals and rubber, some of which will relate to reduced industrial production in the EU (where the UK is a much larger supplier than to the rest of the world, for fairly obvious geographical reasons). Some, however, will be permanent.

The shortfall in the export of fuels is not concerning given changing demand patterns and a concerted desire to shift away from fossil fuels in the near future anyway. It's reasonable to expect

most of the loss in food exports to be permanent given the stringency of rules in this area. Similarly, it is not unreasonable to expect a substantial chunk of the fall in chemicals exports to be permanent.

I would guesstimate that the immediate act of leaving the EU Customs Union and Single Market has probably reduced (goods) export volumes by around 2-5%. However, not all of the impact has been felt yet and some might have taken place before 2018. Certainly anecdotal evidence suggests that EU customers decided not to renew contracts with some UK suppliers due to concerns over Brexit.

Similarly, investment decisions have a substantial impact on trade over quite long time horizons. We know that Honda and Ford have both closed UK plants recently and it remains to be seen what the substantive impact on trade by investment decisions of other, less prominent, firms might be in the medium term. We do know that it is almost certain to be negative. Some sectors face additional barriers being phased in over time.

Taken together, it seems probable that the new non-tariff barriers that Brexit has imposed have had (and will continue to have) a significant negative impact on goods exports to the EU. This appears to be between 1% and 10%, although it's more likely to be somewhere in the central part of this range – around 5%. There is enormous uncertainty due to the volatility of trade figures.

The impact on imports (and hence overall trade) cannot be ascertained with any certainty. Partly this is due to the fact that most controls on EU imports have yet to come into force and partly it is due to dramatic changes in UK demand as a result of COVID-19 and associated restrictions (away from EU-manufactured items like cars and towards items manufactured elsewhere, particularly electronics).

The impact on services trade is likewise going to take some time to ascertain. The loss of “passporting” rights for UK industries (notably finance) will have some impact as will various other changes, although most work estimates the probable impact on services trade will be smaller than that on goods exports, reducing the overall impact of Brexit on trade.

To sum up, Brexit does appear to have had a deleterious impact on trade and probably GDP as well. It is highly likely that it has had a negative impact on overall UK living standards (particularly given currency movements). Nevertheless, the impact thus far is smaller than many of us thought it might be.

All of this needs a big caveat – the data are extremely volatile and there is huge uncertainty over any estimates. Finally, the longer-term impacts will take some time to unfold and will partly depend on policy in both the UK and the EU.

1. <https://www.ons.gov.uk/businessindustryandtrade/internationaltrade/articles/theimpactofeuexitandthecoronavirusonuktradeingoods/2021-05-25>