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# Taking Stock of Brexit

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# Taking Stock of Brexit[1]

In this policy brief, I will briefly outline economic implications of Brexit focusing on trade, investment and migration effects. While it is unclear what this change will entail for the UK in terms of bilateral trade policy and single market access, the trade implications of introducing barriers to trade and integration are clear-cut.

The United Kingdom has gained from being part of the single market, which has allowed it to partake in goods and services trade at lower transaction costs than normally encountered in international trade. While transaction costs to trade have become low enough for international production to be geographically fragmented across the globe (as an example the production network of a Barbie doll span 17 national borders), the trade interdependency of EU member states is unprecedented. This unleashes large gains from trade and production specialisation for EU member states, which are reinforced by the free movement of capital and people as foreign investors and workers contribute to expand national production constraints.[2] There is strong scientific evidence that these gains are substantial (see, e.g., Badinger 2005, Crespo et al. 2008, Henrekson et al. 1997) though researchers are currently working to better quantify these gains (Campos et al. 2019). Concretely, the EU membership gains has widely exceeded its costs for the UK.

A comparison needs to be made to the future negotiation outcome to assess implications of Brexit, which implies that the numerous research studies and reports on this topic critically hinge on the assumptions of what Brexit will entail. Disregarding farfetched assumptions such as a complete unilateral trade liberalisation on the UK's part (Sampson et al. 2016), there is uniform evidence that the UK and remaining EU member states will incur losses in terms of forgone trade gains. Geography matters when it comes to trade because trade costs add to sales prices, which means that the UK trade relationship with EU member states cannot easily be compensated by strengthened trade relations with non-EU countries.

What is the range of scenarios that could results from the negotiations? A lofty deal like the arrangement set up between the EU and Norway that would give continued access to the single market is out of bounds if referendum arguments are taken seriously as Norway contributes to the EU budget, adopts most of EU's regulation and allows worker mobility through its participation in Schengen. While the idea to 'cherrypick' some freedoms in the single market may make political sense for a departing member, it is completely at odds with the foundation on which the European Union is built. An alternative scenario could be a deep, comprehensive agreement of the type recently set up between the EU and Canada. The trade gains reaped from such an agreement are certainly smaller than the ones accrued through membership but would allow the UK and EU member states to pertain some of the trade gains in areas liberalised through the agreement. The least attractive scenario is the so-called WTO scenario, where the UK and the EU would trade on so-called most-favoured-nation terms. Given the extensive utilisation of free trade agreements among WTO members, this type of agreement provide low trade gains (as its benefits are determined by the country's relative trading conditions vis-à-vis those of its competitors). To make matters worse, it may be that the global multilateral trading system will be severely damaged and unable to deliver a 'fair level playing field' much longer as the US administration is currently blocking a functioning dispute settlement procedure in the WTO. While the Commonwealth system has merits in terms of forging stronger trade relationships for the UK, the trade gains that can be reaped via the system are not comparable to those acquired from EU membership.[3]

In today's globalised world, a predominant share of world trade takes place within multinational firms that exploit international cost advantages and

[1] The Institute for European Studies Policy Briefs do not necessarily reflect the views of the Institute for European Studies but those of the author.

[2] The founding fathers of the European Economic Cooperation was envisioning this scenario in setting the stage for European integration in the 1957 Rome Treaty.

[3] Among the many reasons for this, two important ones are the UKs geography and trade composition.

market opportunities. Foreign firms want to invest in member states as this gives them direct access to the single market. The 'Celtic Tiger' experience from the mid-1990s was predominantly driven by investments of US multinational firms. The EU provides a much larger and more attractive market than the UK, implying that many multinational firms that previously invested in the UK will relocate to the EU. In the anticipation of Brexit, firms in some industries have already done this. Less investments are translated into less production and ultimately less jobs, hurting the UK economy. The converse argument can be put forward for EU member states that gain foreign direct investment inflows due to Brexit (such as Germany). To let go of the chance to affect EU legislation can be costly, not the least in areas where the UK is strongly competitive such as the financial sector. Of course, the country will no longer be able to retain its economic position in the Single market in competition with member states with decision-making power to formulate legal text. Precisely because the EU common market is so well-integrated, such power can be crucial for competitiveness.

The reduction in immigration pressure on the UK following Brexit is unlikely to generate positive economic effects. It is well-established among labour economists that there is no such thing as a zero-sum game when it comes to migration inflows, i.e. if anything these lead to efficiency gains in production and so-called complementarity effects when immigrants come with a different skill set than domestic workers have. This is especially important in the UK case as people typically enter the country to work (i.e. the apprehension that EU mobility of persons would lead to social tourism is not justified by the data). It is certainly the case that some will be better off if the UK cuts off its borders to inflows of people. This will necessarily come at the cost of overall living standards, however.

The harsh attitude towards foreigners in the UK (sparked by the Brexit referendum) is also likely to affect areas where the UK has its strongest competitiveness, i.e. innovation-intensive production, not only via its impact on trade and investment but via the relocation of high-skilled foreign workers. The UK has been able to attract top minds from all over the world, who have contributed to make the country strongly competitive in many research fields. These workers are highly mobile and likely to relocate when harassed, giving other countries that are strong in providing research output (such as France) improved opportunities to benefit from their unique talents.

Of course, it is not evident that policy objectives should be based on purely economic considerations. In democracies, voters decide from a menu of policies that can be costly but are deemed necessary. For this to benefit society as a whole, voters need to be informed on the implications of their choices. Hopefully, the strong expertise, know-how and competence available in the United Kingdom will be adhered upon to inform policy-making on the range of policy shifts that Brexit will introduce. This will not only benefit the United Kingdom but also its main trade and investment partner, the European Union.

## References

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## Further information

VoxEU.org provides a research communication portal directed to a broad audience, where some of the numerous studies on the economic implications of Brexit can be found.

The author can be contacted to get specific directions to academic publications on the topic.