

Report on the UK Trade Policy Observatory Conference

'Analytical studies of Brexit'

July 2018

This report summarises the UK Trade Policy Observatory's one-day conference on Analytical studies of Brexit, held at Chatham House on the 3rd of July 2018, attended by some 90 people from across academia, business and government. The conference, which coincided with the second anniversary of the UK's historic vote to leave the EU and the establishment of the UKTPO, provided an opportunity to discuss Brexit trade issues analytically, and explore avenues of future research. Six presentations were held over the course of the day, which ended with a roundtable discussion.

Opening remarks

The conference began with introductory remarks from Adam Ward, Deputy Director of Chatham House, in which he highlighted the importance of rigorous research to establish the facts and the data in the Brexit debate. In a time with plenty of punditry around Brexit, he welcomed the conference in providing a space to discuss technicalities of the economics of Brexit, outside an ideological sphere.

Session 1: Brexit and manufacturing jobs

The first session of the day was presented by Michael Gasiorek, Ilona Serwicka and Alasdair Smith from the UK Trade Policy Observatory.

In their research, the presenters use a partial equilibrium multi-market model to estimate the impact of five different Brexit scenarios on output, prices and trade for 122 UK manufacturing sectors. All five scenarios were estimated to have a negative impact on UK manufacturing output and trade on average, and lead to higher prices. 'Textiles, clothing and footwear' was found to be the most negatively affected sector group, with an estimated output fall of 28.4% under a 'no deal' scenario, while under the same scenario food processing sectors could see a growth in domestic production by 9.2%. The study found that high and medium-high R&D sectors may be more negatively affected by Brexit than medium and medium-low sectors. Further, a large proportion of local authority districts were predicted to suffer from employment losses after Brexit, with the most negatively affected districts being Copeland, Fylde, Stratford-on-Avon and Leicester. Finally, the study found that reductions in labour demand would be more pronounced for highly skilled workers than for medium and low skilled workers and that demand for low skilled workers may rise in some parts of the country after Brexit.

The discussion that followed largely centred around the modelling approach. It was clarified that the results have no explicit time horizon, but can be thought of as the vulnerability of manufacturing sectors in the short term, before the impact on supply chains and investment is accounted for (which the model does not capture). Furthermore, the model does not factor in other dynamic effects, such as the impact of Brexit on the free movement of labour and hence on production costs.

Session 2: Brexit: Trade in value added

Luca Salvatici from Roma Tre University focussed on the effect of Brexit on trade in value added.

In a world of Global Value Chains, traditional trade statistics do not provide an adequate representation of supply and demand linkages among economies. The UK needs foreign inputs in order to export, and the first destination of UK exports is not necessarily the final destination. The presentation showed that the relative importance of domestic and foreign value added differ between sectors in the UK, and that on average around 10% of the UK's exports to the EU are actually produced in the EU, with a substantially higher share in sectors such as motor vehicles and electronics. Further, the study looked at the relevance of the EU as a platform for the UK's multilateral trade, whereby the UK's value added exports step through the EU to subsequently reach other destinations. It was showed that the EU, especially Germany and Ireland, is relevant as a platform for the UK particularly to the 67 countries with which the EU has a trade agreement in place. The study's MFN Brexit scenario, where MFN tariffs apply to all countries including the EU, was found to reduce integration with the EU post-Brexit, and the EU would be used less as a platform for exports to the rest of the world.

The discussion provided an opportunity to clarify that while the study predicts a shift in the UK's exports of domestic value added to the rest of the world post-Brexit, this is not costless. Changing the destination and supplier of exports will come with adjustment costs, and the UK may risk dropping out of some value chains.

Session 3: Trade barriers to services within the Single Market

Sebastian Benz from the OECD introduced the OECD Services Trade Restrictiveness Index (STRI), and outlined some preliminary findings of emerging research on the trade restrictiveness within the EU Single Market.

The STRI details services trade restrictions for 44 economies across 22 services sectors. The STRI shows restrictiveness towards third parties and does not take into account any preferential agreements. However, forthcoming work by the OECD looks at the restrictiveness within the EU Single Market. There is no single intra-EEA trade restrictiveness score because both EU law and domestic law matter, with domestic law differing between member states. The relative importance of EU law and domestic law varies between sectors, with domestic law mattering most in telecoms, and least in the air transport sector. The findings presented were still in a preliminary stage and not yet publicly available. However, the results so far showed that while some trade barriers remain, the single market has largely been a success story in liberalising services trade. Comparing the EU's restrictiveness towards third countries with that applying within the single market, suggests that on average the former exceeds the latter by a factor of around four.

The subsequent discussion showed a great deal of anticipation for the release of the data for public use. In response to a question on the difficulties of collecting the data for the STRI index, Dr Benz noted that when the OECD meet with regulators, particularly in developing countries, they often have an incomplete understanding of the economic impact of laws that apply in their countries. The work of the OECD therefore not only generates information for the public, but also educates government officials about the restrictions prevalent in their own markets.

Session 4: UK services trade across regions and modes

Ingo Borchert from the UK Trade Policy Observatory provided an overview of UK cross-border services trade, and discussed the significance of embodied services inputs (mode 5 trade).

Cross-border services exports are important for the UK, more so than for other major economies. The exports of cross-border services are spatially concentrated, with London and the South East accounting for around 2/3 of the value of these exports. The regions most orientated towards the EU were shown to be the North East, the Midlands and the South East. While cross-border services exports are larger in value, domestic services inputs embodied in manufacturing exports (mode 5 exports) also account for a non-negligible share of services exports. In 2011, the share of services value added in manufacturing exports was close to 40%, of which 21% was domestic value added. In 2015, UK Mode 5 exports contributed around £56 billion to the UK economy. The distribution of Mode 5 exports was found to be more evenly spread across the country than cross-border services exports. Across regions, the orientation of exports was shown to be relatively spread out, meaning that the effect of Brexit will impact every region to some extent.

The discussion that followed centred around trade in mode 5. The study found a loosely positive association between regions that had integrated more intensively internationally (i.e. had a higher share of foreign services value added) and increased growth in manufacturing exports. However, it was clarified that this should be viewed purely as an association without causal inference. There was also a suggestion made for further work to attempt to break down mode 5 trade into specific services sectors.

Session 5: The regional effects of Brexit

The afternoon session began with a presentation by Mark Thissen from PBL, the Netherlands Environmental Assessment Agency.

By disentangling the effect of tariffs on the sales price and the cost of production, the researchers estimate the total effect of Brexit on the competitive position of firms across regions and sectors in the UK and Europe. The UK economy was found to be hardest hit, with differing impacts across UK regions depending on the structure of trade and the sectoral composition of production. The cost of production effect, via the value chain in production, was found to be much larger for the UK than for European countries, indicating that UK firms are more dependent on Europe in their supply chains than vice versa. The study also looked at the impact at a sectoral level, showing that in the UK automotive manufacturing would see the largest increase in production cost, followed by chemical manufacturing sectors. Further, the researchers looked at the regional impact on competitiveness. A number of UK regions were found to benefit from the sales price effect, with their firms gaining a competitive advantage over international competitors that have to pay a tariff to sell in the UK. However, almost all regions would lose due to increases in production cost following tariffs being imposed in their value chains. In total, all UK regions lose competitiveness vis-à-vis international competitors, although some regions gain at the expense of UK firms from other regions that are harder hit by an increase in their production costs.

In the discussion, Dr Thissen clarified how the differing impacts of the sales price effect and the production cost effect could help explain Brexit voter behaviour. The direct tariff effect is relatively easily understood, while the value chain effect is an indirect cost which is difficult to determine and not known to the general public. Some regions may have voted for Brexit based on an expected gain

from the sales price effect, but did not account for the expected losses following the production cost effect.

Session 6: Protectionism and deskilling: Evidence from the Brexit vote

Swati Dhingra from London School of Economics gave the final presentation of the day, discussing the impact of the sterling depreciation following the Brexit vote on worker training in the UK. Worker training is a key policy tool to redistribute the gains from trade, and is a large component of investment in intangible assets, a key driver for productivity growth. The study found that following the Brexit vote and the subsequent sterling depreciation, out of an average of 17% of people who would ordinarily be getting worker training, there was a 6 percent reduction in worker training in the industries most exposed to the sterling depreciation. Thus, firms that were heavily reliant on imported intermediates from countries where the depreciation effect was large saw their import prices increase, and subsequently cut back on worker training. The negative effect on worker training was found to be larger in Northern regions than the South, more pronounced for workers with degree qualifications than those without and higher for native workers than for migrants.

The discussion touched upon whether the observed effects on worker training could be an indication of changes also taking place elsewhere. Dr Dhingra agreed that while firms may be making other changes as well in response to the depreciation, worker training is an area where firms can respond very quickly, and where there is sufficient data to estimate the effects relatively soon after the event. Research in other areas of potential impact is hampered by a significant lag in data availability.

Roundtable: What have economists contributed to the debate and what remains to be done?

The final session of the day was a roundtable discussion, chaired by Chris Giles from Financial Times, with Jagjit S. Chadha from the National Institute of Economic and Social Research, Namali Mackay from the EEF and Linda Yueh, from Oxford University and London Business School in the panel.

The roundtable began with a discussion of how economists performed in the run-up to the referendum and since the Brexit vote. Dr Yueh argued that while most economists could agree that the impact of Brexit would likely be negative, the uncertainties surrounding the forecasts were not sufficiently communicated. While economists are able to make predictions, making statements of certainty about precise forecasts can be problematic. Professor Chadha expressed the view that economists let the extreme results dominate the debate, when these results should have been treated as risks rather than as the central case. Namali Mackay made the point that normally trade negotiations are entered into after a number of years of economic analysis, and the negotiators would work with economists and industry representatives. In the Brexit process, however, the short timeframe has been a significant constraint on economic analysis.

Linda Yueh's statement that "when the politics are the most heated is when economists are the most needed" moved the discussion on to what economists should do now. There was general agreement among the panellists that economists should contribute with evidence-based information and data to assist with the technical expertise that both the government and industry need. Economists can play a key role in providing crucial technical data to inform the government's negotiating position. Namali Mackay stated that in the current state of uncertainty, the advice they give to manufacturing companies is to plan for a hard Brexit since this is the only outcome where there is currently some certainty about the conditions firms would face. The panel agreed that with

the current lack of transparency of the direction of Brexit, economists play an important role in providing analysis of the economic consequences of different Brexit scenarios, to inform both the public, industry and the government.

Prompted by a question from the audience, there was a discussion on the importance of cross-disciplinary collaboration between economists, industry, lawyers and political scientists in order to understand the small but complex and highly important technical details of trade policy.

Summarising the roundtable discussion, Chris Giles gave two specific recommendations for economists going forward; facing a tight timescale, economists need to be specific and nimble, and work collaboratively with business, law, the government and the media.

We would like to extend our warmest thanks to the speakers, as well as to all those attending the conference.