

The trade policy uncertainty costs of Brexit

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Does uncertainty over future trade policy affect trade?

“British Steel has blamed Brexit for the squeeze on its finances, adding to the pressure on the government ahead of European elections on Thursday. Union sources said British Steel had lost 25% of orders at its Scunthorpe plant **because of Brexit uncertainty**. EU buyers would have to pay tariffs of 20% on British Steel’s products if the UK left without a deal.”

–The Guardian, Wednesday 21 May 2019

Trade agreements reduce uncertainty over future policy

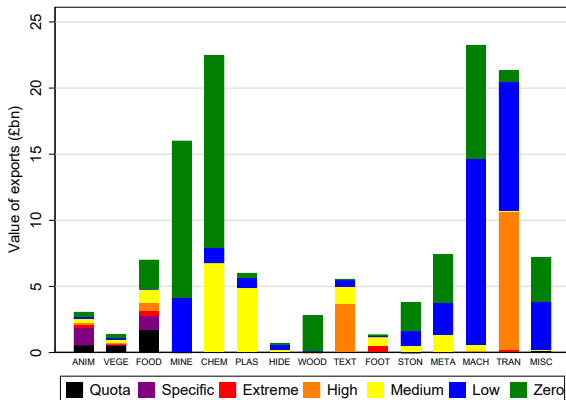
Research on trade policy uncertainty has found that firms respond to changes in expectations about future tariffs.

- More certainty that the current level of tariffs will persist into the future leads to increased entry, investment, and export sales.
 - Portugal's accession to the EU (Handley and Limao, 2015)
 - China's accession to the WTO (Pierce and Schott, 2016; Handley and Limao, 2017)
- A tariff scare - the threat of a future tariff hike - depresses entry into exporting
 - China's experience under WTO antidumping policy (Crowley, Meng, and Song, 2018)

The UK has been experiencing considerable uncertainty regarding its future market access in the EU (not to mention third country EU-FTA partners) since June 2016.

How much trade policy uncertainty confronts UK firms?

Source: Crowley, Exton and Han (2019)



- 1 The size of possible tariff hikes is largest in transportation, textiles/apparel, chemicals and plastics
- 2 Lots of uncertainty about what will happen with products covered by quotas in food and agriculture.

Analysis of UK firms exporting to the EU in 2016

UK firm entry into the EU fell dramatically for products that would face increases in tariffs if negotiations breakdown.

- A 10 percentage point increase in the threat point tariff reduced the entry rate by 10.1 ppt and increased exit rate by 4.9 ppt.

Counterfactual estimates of lost trade

- Firm-product entry in 2016 would have been 5.1% if UK firms were guaranteed zero tariffs on exports to EU.
- Reduced entry accounts for a £226 million (£1.4bn) loss of export value in 2016.
- Number of exiters would have been 4.3% lower in counterfactual with a value of £182 million (£1.1 bn).
- Exports in counterfactual would have been £2.5 billion higher than actual value. [Aggregate exports to the EU were £140bn in 2016.]

The (short run) uncertainty puzzle:

Export value (blue) and volume (yellow) grew post-Brexit...



Source: Office for National Statistics

Source: ONS report, September 2017, Figure 9

Concluding thoughts

In the short run, two important and distinct factors were at play:

- 1 Increased uncertainty over trade policy might have deterred some exporters, but...
- 2 the sterling depreciation provided an offsetting boost.

Today, uncertainty over UK's future relationship with the EU is hitting not only trade but also investment. The longer this goes on, the worse the long term growth consequences of Brexit-induced under-investment will be.