

Economic Impact of UK Trade with the EU and Non EU Countries 2000 - 2017

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EXECUTIVE SUMMARY

As the negotiations with the EU approach the October 2018 decision point, the Chequers proposals are being promoted on the generally accepted premise that the UK economy, and manufacturing industry in particular, has benefited from access to the Single Market.

For this contention to be valid, the UK economy would have prospered from the trading relationship with the EU in terms of GDP growth, family prosperity, jobs and investment.

This paper disaggregates the UK's trade with the EU and Non EU countries to determine the economic impact in each case. The paper draws on ONS data, the analysis adopted by the OBR in their "Economic and fiscal outlook" reports and certain metrics used by HM Treasury in their April 2016 report containing their post Brexit 15 year forecasts, (Cmd. 9250).

Between 2000 and 2017, the trade deficit with the EU increased by £57b which:

- reduced the growth of GDP by £57b, or 2.4%, and
- reduced GDP per household, (a measure of family prosperity), by £2,068

Within the overall figures, the **goods** trade deficit with the EU increased by £90b which:

- reduced growth of GDP by £90b, or 4.2%,
- reduced GDP per household by £3,273,
- resulted in the loss of around 1m manufacturing jobs which were effectively transferred to the EU, and
- lost manufacturing investment and FDI to the EU due to the decline in the UK's manufacturing base.

The inescapable conclusion is that between 2000 and 2017, the UK economy has been seriously damaged by trade with the EU, and particularly the trade in goods.

In contrast, the UK recorded a £52b improvement in the trade balance with Non EU countries, largely under WTO terms, during the same period, which:

- contributed £52b, or 3% to the growth of GDP, and
- increased GDP per household by £1,967.

It is clear that the UK prospered from trade with Non EU countries during the same period.

The conclusion to be drawn from this analysis, is that the EU negotiations should unequivocally focus on freeing the UK to trade even more successfully with Non EU countries and not lock the UK permanently into a damaging and inappropriately regulated relationship with the EU.

The Chequers proposals would tie the UK to the constraints of the EU regulatory system, an outcome which, paradoxically, is diametrically opposed to the Prime Minister's statement in New York on 26 September 2018, that the UK will adopt "a consistent and dependable approach to high-standard but intelligent regulation".

The Canadian alternative would free the UK to adopt such regulations and enable the UK to compete more effectively, thereby increasing productivity and prosperity.

This paper also sets the record straight and aims to highlight the Establishment's obfuscation of the divergent economic impact of the UK's trade with the EU and trade with Non EU countries.

The impact of international trade on the growth of GDP

Each year the Office for National Statistics, (“ONS”), reports in the Pink Book on:

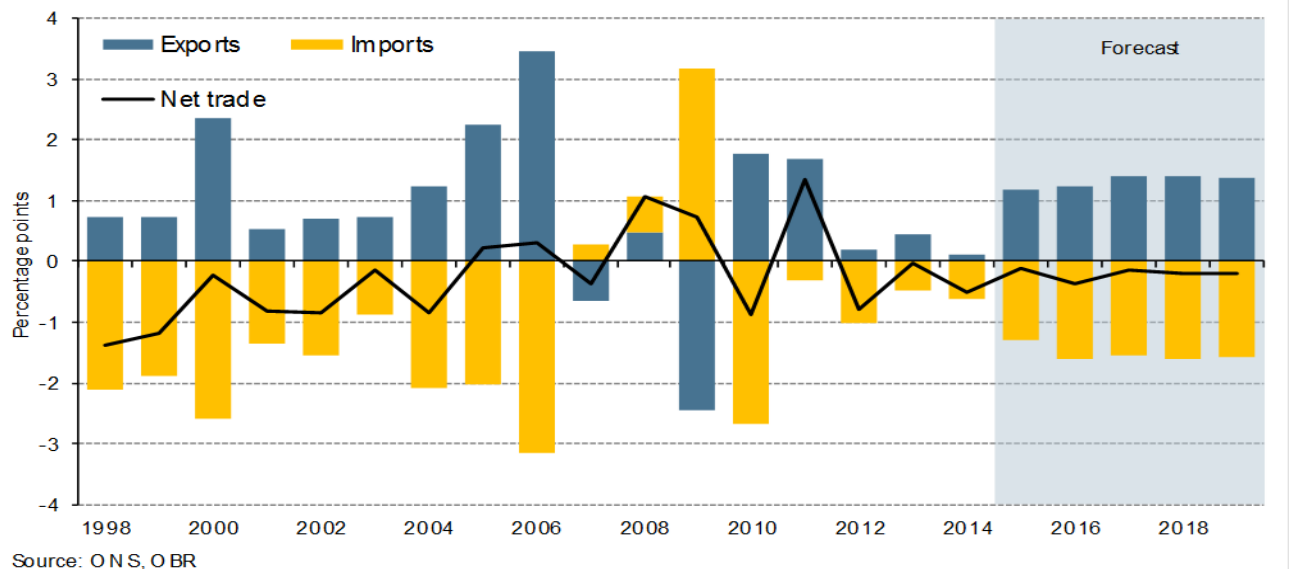
- all exports of goods and services which we sell to the rest of the world, and
- all imports of goods and services we buy from the rest of the world.

The net difference between the UK’s exports and imports is the UK’s trade surplus or deficit; historically the UK has had a trade deficit.

Increases in the trade deficit reduces UK growth and reductions in the trade deficit increases growth. This is borne out by the independent Office for Budget Responsibility which, for instance, reported on page 79, at 3.106 of Cm 9024, “Economic and fiscal outlook – March 2015” that:

“This means that the trade deficit widens in 2015, subtracting 0.1% from GDP growth in 2015”.

Similarly, the Chart on page 80, “3.37: Net trade contribution to real GDP”, illustrates how increases in exports add to growth and increases in imports reduce growth of GDP.



The 2018 Pink Book records that during the previous 17 years, the UK’s trade deficit increased from £20.7b in 2000 to £25.9b in 2017, an increase of £5.2b. This resulted in a relatively small impact on UK’s GDP in 2017 of £2,041b.

However, when the UK trade with the EU and trade with Non EU countries is considered separately a very different picture emerges.

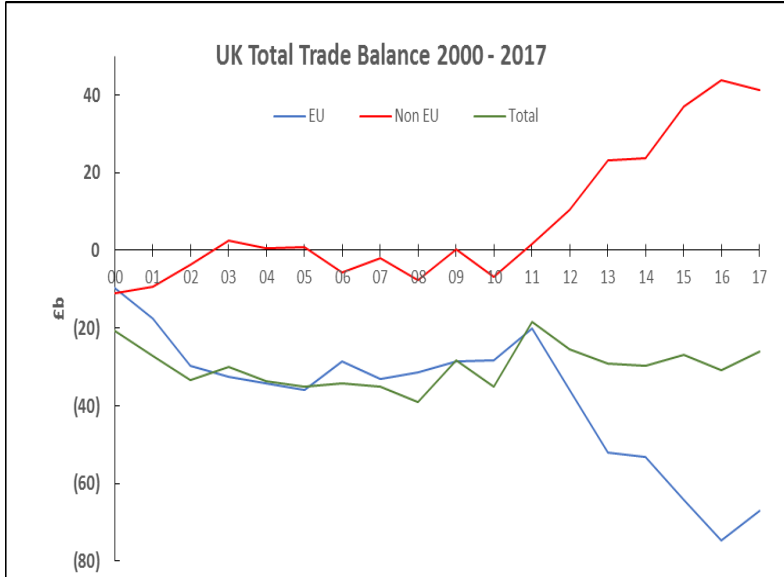
Increase in the UK’s trade deficit with the EU

In the 17 years since 2000, the UK’s exports of goods and services to the EU have grown by 87% from £146b to £274b in 2017. By contrast, the UK’s imports from the EU have grown by 118% from £156b to £341b.

The net effect is that our trade balance with the EU has widened from a trade deficit of £10b in 2000 to a massive trade deficit of £67b in 2017.

In contrast, a growing trade surplus with Non EU countries

When we look at the UK’s trading position with Non EU countries we see that a deficit of £11b in 2000 has turned into a surplus of £41b by 2017. This demonstrates that our trade with Non EU countries, largely on World Trade Organisation (“WTO”) terms, has been very successful and has made a £52b positive contribution to UK GDP growth over that same 17 year period.



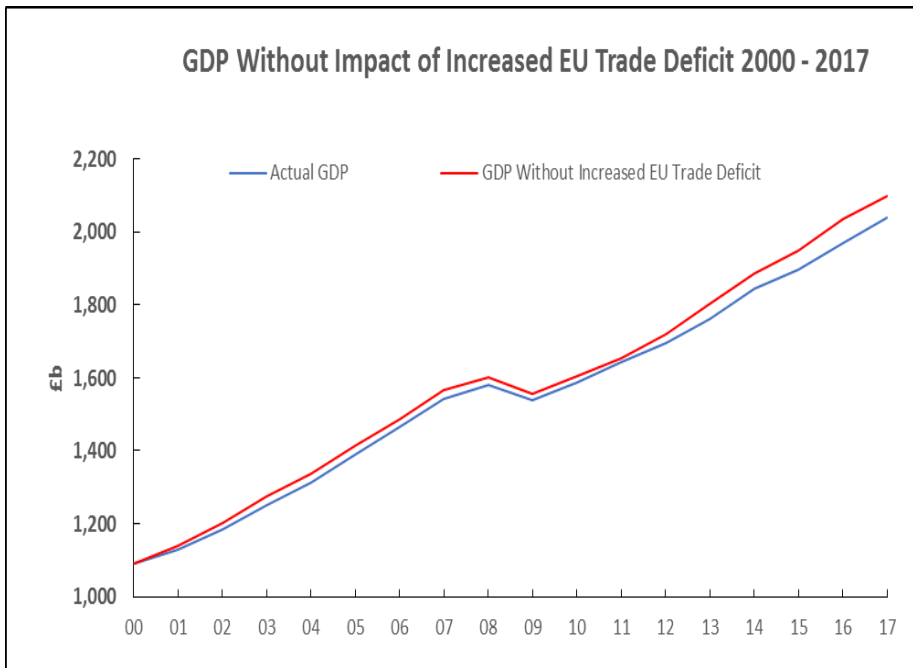
The adjacent chart shows the UK’s external trade balance with the EU in blue and the trade balance with Non EU countries in red.

It illustrates the huge growth in the deficit with the EU, all of which has arisen since the introduction of the Euro in 2000.

Conversely, the UK trade balance with Non EU countries has improved by £52b resulting in a very successful trading relationship which was achieved largely under WTO rules.

What is the impact of the growing trade deficit with EU on the growth of UK GDP?

As the OBR regularly reports, an increase in the trade deficit reduces growth whilst a reduction in the trade deficit increases growth.

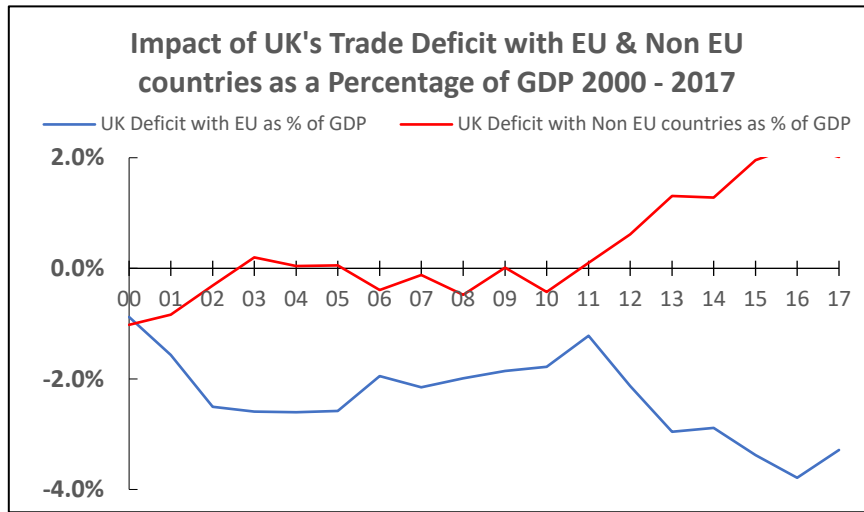


In the adjacent chart, the lower blue line shows actual GDP since 2000.

The steeper, red line shows what GDP would have been if the UK had not suffered from the growing trade deficit with the EU which has substantially reduced growth in UK GDP.

Between 2000 and 2017 the UK’s trade deficit with the EU has grown by £57b to £67b. The direct result of this growing deficit is that UK GDP was £57b less in 2017 than it would have been if the UK had not suffered from the increased trade deficit with the EU.

The following chart illustrates the impact on GDP in percentage terms. Since 2000, the trade deficit with the EU has grown from 0.9% to 3.3% of GDP, an increase of 2.4% of GDP. In other words the UK economy would have been 2.4% larger in 2017 had the UK not suffered from the £57b increase in the trade deficit with the EU over those 17 years.



By contrast, the UK's trading position with Non EU countries improved from minus 1% of GDP in 2000 to plus 2% of GDP by 2017, adding 3% to the growth of UK GDP over those 17 years.

The net result is that the UK economy is 3% larger due to our very successful trading relationship with Non EU countries and 2.4% smaller due to the deteriorating trading position with the EU.

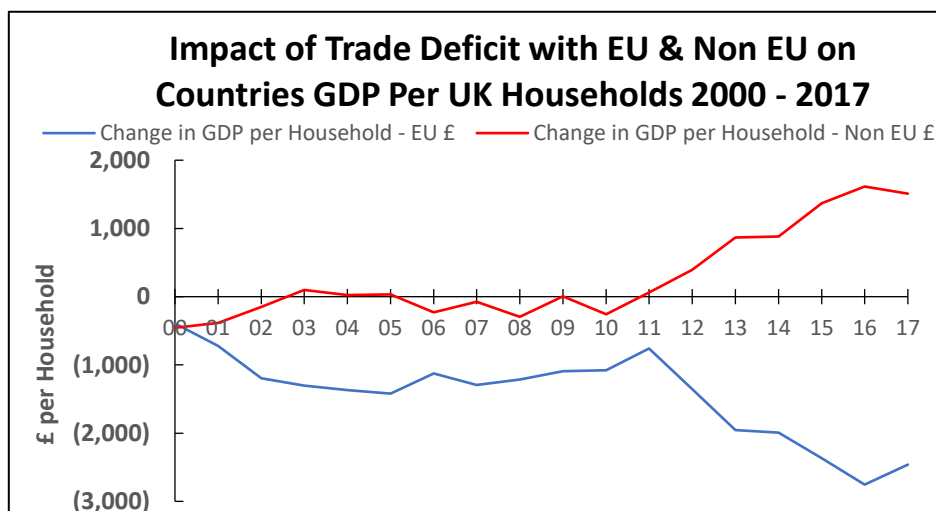
What is the impact on UK families of the increasing trade deficit with the EU?

In April 2016 the *“HM Treasury analysis: the long-term economic impact of EU membership and the alternatives”*. *Cmd. 9250*, reported the Treasury's estimate of the effect of leaving the EU. The projections were that 15 years after the UK leaves the EU:

- GDP would be 6.2% less with a Canadian style trade deal or 7.5% less under WTO rules,
- GDP per household, effectively a measure of UK **prosperity** per family, (similar to per capita GDP), would be £4,300 less with a Canadian type deal and £5,200 less under WTO.

If the same logic is applied to the 17 years between 2000 and 2017, the £52b improvement in the UK's trade with Non EU countries, largely under WTO rules, actually resulted in an overall improvement of £1,967 in GDP per household.

Conversely, the £57b deterioration in the UK's deficit with the EU, reduced GDP per household by £2,068 over those 17 years.



So history shows us that in 2017 GDP per household was £2,068 less due to the increase in the UK's trade deficit with the EU.

Conversely, the improving trade position with Non EU countries increased GDP per household by £1,967 over the same 17 year period.

These figures are not projections; they are facts.

Trade in goods with the EU is the main problem

The analysis so far has focused on the impact of the overall trade deficit with the EU. When trade in **goods** is reviewed separately the position is much worse for the UK.



The adjacent chart shows that UK exports of goods to the EU grew from £113b in 2000, to £164b in 2017, an increase of 45% or 2.2% pa over the period.

By contrast, the import of goods from the EU increased from £118b in 2000 to £259b in 2017, an increase of 119% or 4.7% pa over the period.

The net effect is that the UK's **goods** trade deficit with the EU grew from £5b in 2000 to a massive £95b in 2017, a deterioration of £90b.

What was the impact on the UK economy of the £90b increase in the goods trade deficit with the EU?

The trade deficit with the EU has grown from £5b, or 0.5% of GDP in 2000 to £95b, or 4.7% of GDP in 2017, an increase of £90b, or 4.2% of GDP.

Based on the Treasury's 2016 analysis referred to earlier, UK GDP was £90b, or 4.2% lower in 2017 due to the growth in the goods trade deficit with the EU between 2000 and 2017.

Furthermore, that is equivalent to a £3,273 reduction in GDP per household as a result of the increased **goods** trade deficit with the EU based on the metric used in the Treasury 2016 report.

Another very important factor is the impact on jobs

In 2000 manufacturing industries employed 4,004,000 people in the UK. By 2017 this number had fallen to 2,676,000 representing a loss of 1,328,000 jobs. There are many factors that affect manufacturing employment and manufactured products are the major, but not the only component in goods exports to the EU.

In 2017, UK GDP was £2,041b and manufacturing was about 10% of GDP, or £204b. On the assumption that 2,676,000 manufacturing jobs were required to produce £204b of GDP, around 13,000 jobs are required to produce £1b of manufacturing GDP.

With the UK's **goods** trade deficit with the EU increasing by £90b between 2000 and 2017 and based on 13,000 jobs per £1b of UK GDP, around 1m jobs were lost in the UK and about 1m jobs gained by the EU because of the £90b increase in the **goods** trade deficit.

Put simply, £90m of goods that had been produced in the UK supporting around 1m UK jobs, investment and Foreign Direct Investment, ("FDI"), are now produced in the EU creating EU employment, investment and FDI.

This loss of £90b of UK manufacturing output had a disproportionate impact on the economy, growth, living standards, jobs, investment and FDI in the Midlands and the North of England which may go some way to explain why the Midlands and the North voted to leave the EU.

Why are the outcomes of goods trade with the EU and Non EU countries so different?

- Non EU countries are growing far faster than the EU and, as they become more prosperous, they have an increasing demand for the type of goods and services that the UK exports,
- Many Non EU countries do not have manufacturing and service businesses which are competitive with the UK and so are more readily available export markets for the UK,
- The EU is now down to 15% of the world market and is estimated to fall to 10% by 2030,
- Much of UK manufacturing industry produce products that are similar to those made in the EU and so face stiff competition.
- £55b, (65%) of the UK's **goods** trade deficit with the EU is with Germany, Belgium and the Netherlands due, in part, to these countries benefiting from what for them is a grossly undervalued Euro in international trading terms.
- That is why the UK had a goods trade deficit with Germany of £31.2b, (more than the UK's total trade deficit of £25.9b), and Germany has a total trade surplus of around 8% of GDP.

The undervalued Euro is one of the principal reasons why UK's goods and total trade deficits have deteriorated so markedly since the introduction of the Euro in 2000.

Far from being a level playing field, the Euro area has engendered substantial and, in the long term, unsustainable trade imbalances, from which the UK, has been a major loser.

Whichever way one looks at the position and whatever challenges might be made to the details of this analysis, the overwhelming evidence is that in the 17 years since 2000:

- the UK has suffered from a £90b increase in the **goods** trade deficit with the EU,
- resulting in 4.2% less growth in GDP,
- a reduction of £3,273 in GDP per household, and
- the loss of around one million manufacturing jobs, and
- less jobs and lower output means less investment in manufacturing and less FDI.

There is no doubt that, far from benefiting the EU as we are told, all the evidence demonstrates that since 2000, the UK economy, families, employment and investment have all suffered badly from the UK's trade with the EU despite being in the Single Market and the Customs Union.

The Chequers proposals represent the worst possible deal for the UK.

In New York on 26 September 2018, the Prime Minister pledged to use low tax and “smart regulation” to make post-Brexit Britain an economic powerhouse and the envy of Europe, by adopting “a consistent and dependable approach to high-standard but intelligent regulation”.

Paradoxically, the Chequers proposals would have precisely the reverse effect by:

- locking UK manufacturing industry into EU product standards, and
- locking the entire UK economy into all current and future EU rules, (the *acquis communautaire*), covering state aid, competition, consumer protection, employment, environmental, and climate change policies, and
- such standards and rules would ultimately be determined by the EU and enforced by the European Court of Justice, (“ECJ”), without any participation or control by the UK.

The effect of the Chequers proposals would be that:

- UK consumers could only buy products that meet all EU product standards, and
- UK exporters could only manufacture and export products to Non EU countries that meet all EU product standards, and
- UK importers could only import goods from Non EU countries that meet all EU product standards.

The resulting EU stranglehold on much of the UK's regulatory system would effectively eliminate any opportunity for the UK to diverge from EU regulations and standards to improve productivity and become more competitive by adopting the **“consistent and dependable approach to high-standard but intelligent regulation”** which the Prime Minister extolls.

That would prevent UK manufacturers and service businesses from innovating and becoming more competitive in both the UK home market and in Non EU countries which now represent 85% of total world trade and are growing far faster than the EU market.

It should also be remembered that over 50% of total UK employment and around 80% of the growth of employment is created by companies with less than 500 employees. Small companies rarely benefit from the Single Market but face the cost of compliance with the EU regulations.

Huge prominence has been given to preserving EU supply chains, particularly in the car industry. In fact 21% of EU car components come from Non EU countries which demonstrates that it is entirely possible for the European car industry to operate successfully by importing components from Non EU countries and much of the industry is increasing procurement from Non EU countries.

The irony is that it is the goods trade deficit with the EU that has been most damaging to the UK economy yet it is the preservation of that aspect of the relationship with the EU which is the principal rationale for the Chequers proposals.

In summary, the effect of the Chequers proposals is that the UK would remain locked into the EU regulatory system and would pay a huge price for access to the EU market which has been bad for the UK. Not only has the UK economy been damaged by the impact of the growing trade deficit with the EU on growth, prosperity, jobs and investment, but also because the EU is a relatively small and declining market compared with the opportunities available in the much larger, high growth and more available and often less competitive markets in Non EU countries.

Innovation and competition lead to increased productivity and greater prosperity

Innovation and competition are probably the most important, but often overlooked, factor in the Brexit debate.

The human race is as prosperous as it is today as a result of competition and innovation. It is innovation and competition that increases productivity and increased productivity is the only route to increased prosperity.

Unfortunately, the EU is not about innovation and competition; regrettably it is about standardisation, harmonisation, regulation and a level playing field.

Increased prosperity will only be found by people, businesses, companies, governments, regulatory regimes and taxation systems all innovating and competing to achieve better results and greater productivity.

Increased prosperity will not be found by locking the UK into the EU's regulatory system. That is why the Chequers proposals would be such a bad deal for the UK in the longer term.

The Canadian alternative

The alternative to the Chequers proposals is an agreement similar to The Comprehensive Economic and Trade Agreement (CETA) between Canada, the European Union and its member states which could provide for zero tariffs and relatively free trade between the UK and the EU.

Such an agreement was offered to the UK by the EU President, Donald Tusk on 7 March 2018 but was clearly side-lined by the Prime Minister and the Remain supporting Establishment on the pretence of the Irish border issue. In fact, the Irish border is also one of the barriers to Chequers.

A Canadian style deal would retain tariff free access for goods between the UK and the EU, but crucially:

- the UK would be free of the constraints of all EU laws and regulations, and
- the UK would no longer be subject to the jurisdiction of the ECJ.

Such an outcome would enable the UK to focus on further developing its successful trade with Non EU countries rather than being locked into an unsuccessful, over regulated arrangement with the EU which is a small market in relative decline.

A Canadian type deal would also enable the UK to become more competitive with EU imports in the UK home market.

In fact **import substitution** could be the fastest and most significant short term benefit from leaving the EU. To some degree this is already occurring as EU companies are starting to move production from the EU to the UK to protect their access to the UK market.

Import substitution may also happen in reverse, but as the EU's exports to the UK are £95b more than the UK's exports to the EU, the UK is likely to be the net beneficiary.

The opportunity of faster growth in GDP, GDP per household and growth in jobs and investment also lies with Non EU countries rather than hanging on to what has been an unsuccessful trading relationship with the EU which has damaged the UK in the ways recorded in this paper.

In any event, if no deal is reached with the EU, the record clearly shows that the UK can trade very successfully and prosper economically by trading on WTO terms with Non EU countries.

Ironically, a “No Deal Brexit” has been characterised by the CBI as “falling off a cliff”. In fact at the top of the “cliff” is a very unsuccessful and damaging trading relationship with the EU and at the bottom of the “cliff” is a very successful and prosperous relationship with Non EU countries.

Based on this analysis and the current state of the negotiations with the EU, is it not time for the UK to take control and invite the EU to the UK to negotiate the EU's access to the UK market through a Canadian style free trade agreement because that is what the Brexit negotiations should really be about?

Finally, why are the facts and the analysis covered by this paper neither well known nor interpreted in this way?

The reality is that the pro EU Treasury, the rest of the Civil Service and academic establishments control the information available and the pro EU media, (notably the BBC), and political establishments control the message which is largely pro-EU and anti-Brexit.

A classic example is the Treasury publishing a 201 page report in 2016 on the impact of leaving the EU, (Cmd. 9250), without once mentioning the negative impact on UK growth which has resulted from the ballooning goods trade deficit with the EU since 2000 or the prosperity that has resulted from the UK's very successful trade with Non EU countries, largely under WTO rules.

Finally, it should never be forgotten that most of the issues faced in the Brexit negotiations have been created by unelected bureaucrats in Brussels, who are far more interested in their objective of “**ever closer union**”, than the prosperity of the people of Europe.

The future prosperity of the UK should not be sacrificed on the altar of the Eurocrats' beliefs by their disciples in the UK Establishment.

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Sources: Office for National Statistics, OBR Report and Cmd. 9250.

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