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How Brexit affected the trade of UK firms

The UK left the EU's single market and customs union at the start of 2021, entering into the Trade and Cooperation Agreement with the EU. Rebecca Freeman, Marco Garofalo, Enrico Longoni, Kalina Manova, Rebecca Mari, Thomas Prayer and Thomas Sampson look into what effect this has had on UK-EU trade, and find that it's the smaller UK firms that were hit the hardest, with a significant drop of their exports to the EU.

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How has Brexit affected UK trade? Our [new research](#) studies this question using firm-level customs data on UK goods trade. Working with firm-level data allows us to provide a richer account of the impact of Brexit than is possible using more aggregated data, helping us uncover important differences in the effects of Brexit on small versus large firms.

We show that the UK's exit from the EU's single market and customs union at the start of 2021 led to immediate declines in exports and imports with the EU. However, we also find that firms responded to the shock in ways that dampened the decline in overall trade. While small firms were hardest hit, large firms did not experience a drop in exports. In addition, importers partly compensated for lower EU imports by sourcing more from outside the EU.



Under the Trade and Cooperation Agreement, the UK is no longer a member of the EU's single market or customs union,

which has led to the reintroduction of a customs and regulatory border between the UK and the EU.



The referendum vote in June 2016 created substantial uncertainty, but did not lead to any trade policy changes until January 2021 when the Trade and Cooperation Agreement (TCA) governing post-Brexit UK-EU relations came into force. The TCA is a zero-tariff, zero-quota free trade agreement. However, under the TCA the UK is no longer a member of the EU's single market or customs union, which has led to the reintroduction of a customs and regulatory border between the UK and the EU. We study the effect of Brexit on trade both during the period of uncertainty about UK-EU relations that lasted until the end of 2020, and following the introduction of the TCA.



We estimate that both exporters and importers experienced a sharp and sustained fall in trade with the EU relative to the Rest of the World from the start of 2021 onwards.



To identify the causal effect of Brexit on firm-level trade, we start by comparing changes in trade with the EU versus the rest of world (RoW) within firms from 2012-22. Our analysis controls for firm-specific shocks that affect trade with all countries and for region-specific shocks to export supply and import demand. We find no evidence of a significant decline in either exports or imports with the EU relative to the RoW prior to the implementation of the TCA in 2021. This finding implies that uncertainty and anticipation of future increases in trade barriers following the referendum did not reduce relative trade with the EU.

By contrast, we find that trade responds immediately when the TCA comes into effect in 2021. We estimate that both exporters and importers experienced a sharp and sustained fall in trade with the EU relative to the RoW from the start of 2021 onwards. This fall is driven by smaller firms, particularly for exports. Splitting firms into quintiles, defined by firm employment, we estimate that the TCA reduced relative EU exports by 30 per cent for the smallest quintile of firms and 15 per cent for the middle quintile, but did not have a statistically significant effect on exports amongst the

largest quintile. Figure 1 shows estimated changes in EU relative to RoW exports over time by size quintile – the sharp drop in exports from 2021 onwards is immediately visible for firms in the bottom four quintiles.

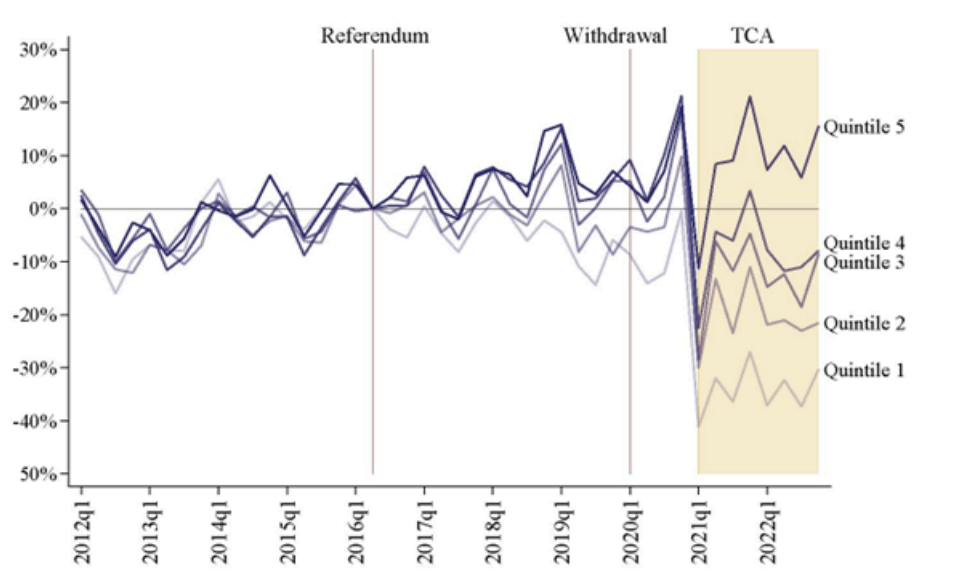


Figure 1: Estimated changes in firm exports to EU versus RoW by firm size quintile

Notes: Event-study estimates showing percent changes in trade with EU relative to RoW by firm size quintile. Firm size measured using average employment between 2013q1 and 2015q4. Quintile 1 denotes the smallest firms and quintile 5 the largest firms.

Source: Freeman R., M. Garofalo, E. Longoni, K. Manova, R. Mari, T. Prayer, and T. Sampson (2024).

“Deep Integration and Trade: UK Firms in the Wake of Brexit.”

Although the direct effect of Brexit was to increase trade barriers with the EU, it may also have indirectly affected UK trade with the RoW. Indirect effects could arise through many channels including supply chain linkages between trade with the EU and trade with the RoW, interdependencies across origins in import sourcing decisions, scale effects, and capacity constraints in production. To study whether Brexit had such indirect effects, we compare changes over time in trade with the RoW across firms with differential exposure to trade with the EU prior to the referendum.



Our analysis shows that the Trade and Cooperation Agreement reduced the survival rate for exporters to the EU

and importers from the EU, especially for smaller firms.



We find no evidence that the TCA indirectly affected UK exports to the RoW. This null result implies that the decline in exports to the EU relative to the RoW described above was caused by a fall in exports to the EU. However, we do estimate that firms with higher pre-referendum EU imports increased their imports from the RoW under the TCA. This implies that the TCA caused importers to substitute from EU to RoW suppliers, which highlights the importance of cross-origin interdependencies in import sourcing. That said, the increase in imports from the RoW does not fully compensate for the decline in imports from the EU, meaning that the TCA reduced total imports from all origins.

We also study whether Brexit led some UK firms to exit foreign markets altogether. Our analysis shows that the TCA reduced the survival rate for exporters to the EU and importers from the EU, especially for smaller firms. We interpret this as evidence that the TCA increased fixed trade costs. Our estimates imply that the TCA caused around 16,400 firms (or 14 per cent of EU exporters) to stop exporting to the EU.

What do our results imply about the impact of the TCA on overall UK trade? Based on a back-of-the-envelope aggregation exercise, we conclude that the TCA reduced worldwide UK goods exports by 6.4 per cent (due to a 13.2 per cent fall in exports to the EU), and worldwide goods imports by 3.1 per cent.

For exports, the relatively small aggregate impact reflects our finding that the negative effects of the TCA were concentrated on smaller firms, while the largest firms successfully maintained export levels. For imports, substitution towards imports from outside the EU partially offset reduced EU imports. These firm-level adaptations to the customs and regulatory barriers introduced by the TCA increased the resilience of overall trade to Brexit in the short run.



In the medium- to long-term, trade losses may diminish if firms can reoptimize their buyers and suppliers, or deepen if

firm productivity, supply chains, and export diversification suffer over time.



There are three important caveats to our findings. First, we only study trade. Firm profitability may be affected differently to trade, for example if Brexit makes sustaining a given level of trade activity more costly. Second, we only study short-term effects during the first two years of the TCA. In the medium- to long-term, trade losses may diminish if firms can reoptimize their buyers and suppliers, or deepen if firm productivity, supply chains, and export diversification suffer over time. Third, we only study goods trade, and do not analyse trade in services, which constitutes nearly half of UK trade.

For exports, our estimate accounts for both lower exports by firms that continued to export to the EU under the TCA, and the increase in the number of firms that stopped exporting to the EU entirely. For imports, we only include the fall in imports for continuing importers; work on incorporating importer exit into the aggregation exercise is ongoing.

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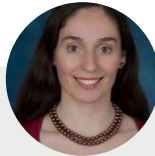
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