Stop performative Brexit and do what works for the British economy

Brexit has left its mark on UK international trade, although, so far, the effect has been smaller than economists expected. ***Dennis Novy***, ***Thomas Sampson*** *and* ***Catherine Thomas*** *review recent UK trade performance and argue that the next UK government should acknowledge the costs of diverging from EU trading rules and recognise that the importance of the EU market for the British economy cannot be fully compensated by trade with non-EU countries.*

Brexit caused major changes in UK trade policy, most notably the UK's exit from the European Union's (EU) single market and customs union at the start of 2021. UK-EU relations are now governed by the Trade and Cooperation Agreement (TCA) – a comprehensive free trade agreement that ensures zero tariffs and zero quotas on UK-EU goods trade. Overall, the performance of UK trade has been encouraging for services, but the performance of UK goods trade has been disappointing. There are early signs that UK supply chains with the EU may be disintegrating. This should not come as a surprise since goods trade is where Brexit has introduced most new trading frictions.

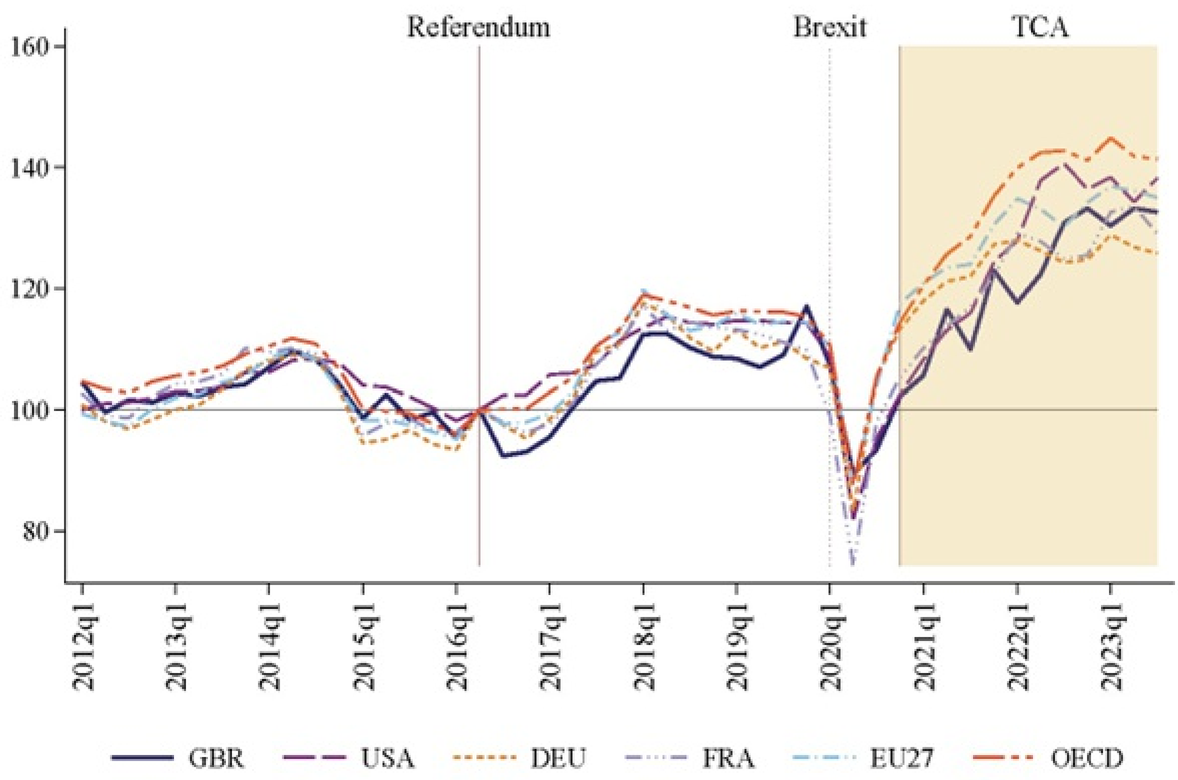
The UK is now less integrated with EU countries, and there are new costly non-tariff barriers for UK firms trading with Europe. The next government has a decision to make: continue to diverge from EU regulations and have more trade barriers go up, or change approach and improve EU trade relations.

Total trade

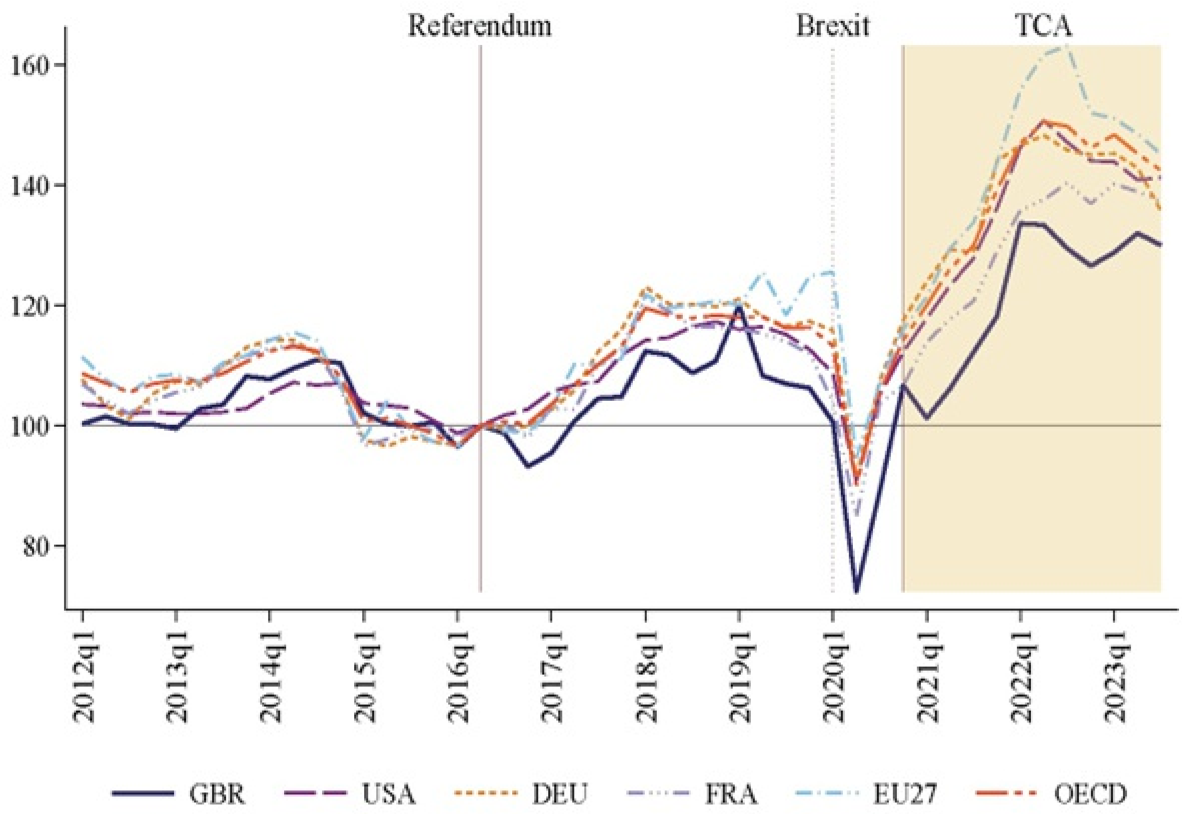
Figure 1 compares the evolution of total exports and imports across countries, relative to their level at the time of the Brexit referendum in the second quarter of 2016. UK exports have grown at a similar rate to those of EU economies such as Germany and France since 2016, whereas UK imports have grown more slowly.

Figure 1: UK total trade in comparison, 2012-2023

(a) Total exports



(b) Total imports



Notes: Goods and services trade converted to US dollars and seasonally adjusted. Indices normalised to 100 in 2016 Q2. GBR = United Kingdom. USA = United States. DEU = Germany. FRA = France. EU27 = Aggregate EU27. OECD = Aggregate OECD. Source: OECD Balance of Payments Statistics.

One important caveat to Figure 1 is that the data are in nominal terms, reflecting increases in prices as well as in quantities. The Office for National Statistics provides estimates of the deflated quantity volumes of trade by accounting for price increases. While nominal exports and imports were 34% and 33% higher, respectively, in 2023 than in 2016, a large share of this increase is due to rising prices. In real terms, exports were 12% higher and imports were 9% higher. For goods trade, UK exports are down by 1% in real terms since 2016, and UK imports are down by 2%.

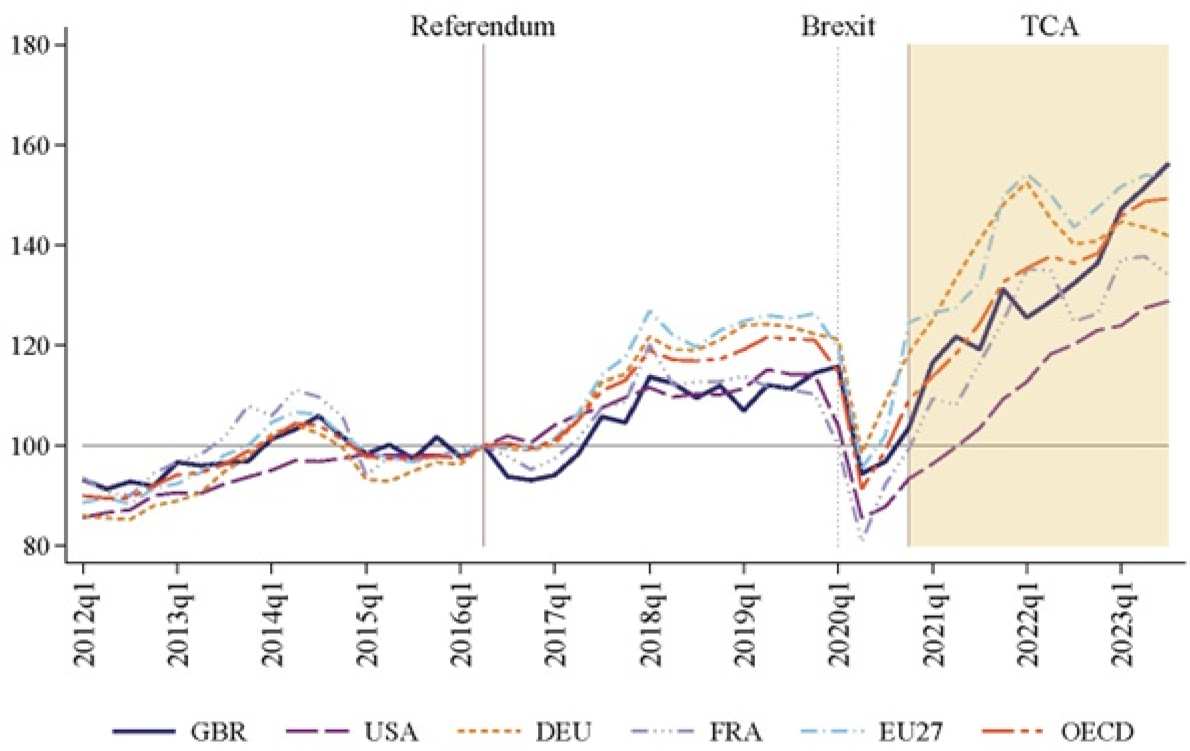
Goods versus services

Figure 2 breaks down trade performance for services trade. UK services exports have grown at slightly faster rates than for other countries since 2019, whereas UK services imports have grown much faster but from a smaller base.

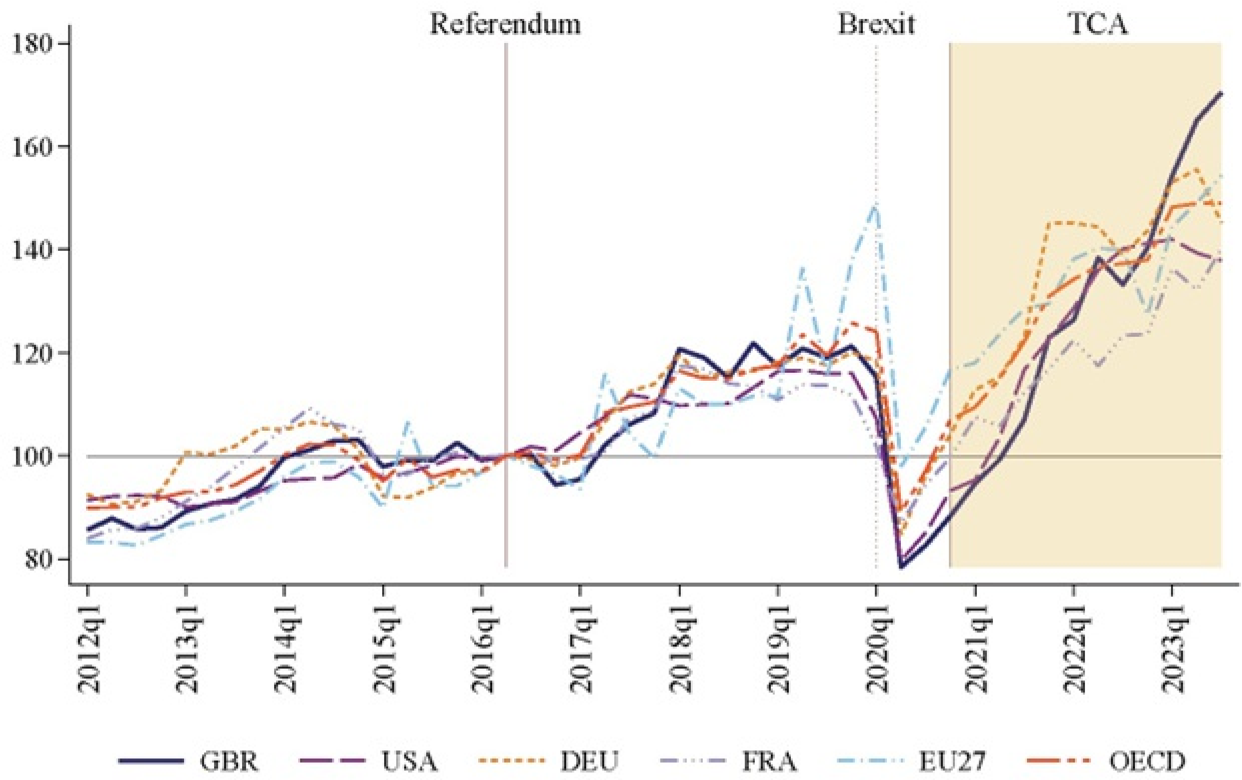
By contrast, Figure 3 shows that UK exports and imports of goods have grown more slowly than for EU countries (and for the United States and OECD countries) since 2016. Consequently, the share of services in UK trade has increased. Services now make up 54% of UK exports and 35% of UK imports.

Figure 2: UK services trade in comparison, 2012-2023

(a) Services exports



(b) Services imports



Notes: Services trade converted to US dollars and seasonally adjusted. Indices normalised to 100 in 2016 Q2. GBR = United Kingdom. USA = United States. DEU = Germany. FRA = France. EU27 = Aggregate EU27. OECD = Aggregate OECD. Source: OECD Balance of Payments Statistics.

Figure 3: UK goods trade in comparison, 2012-2023

- (a) Goods exports
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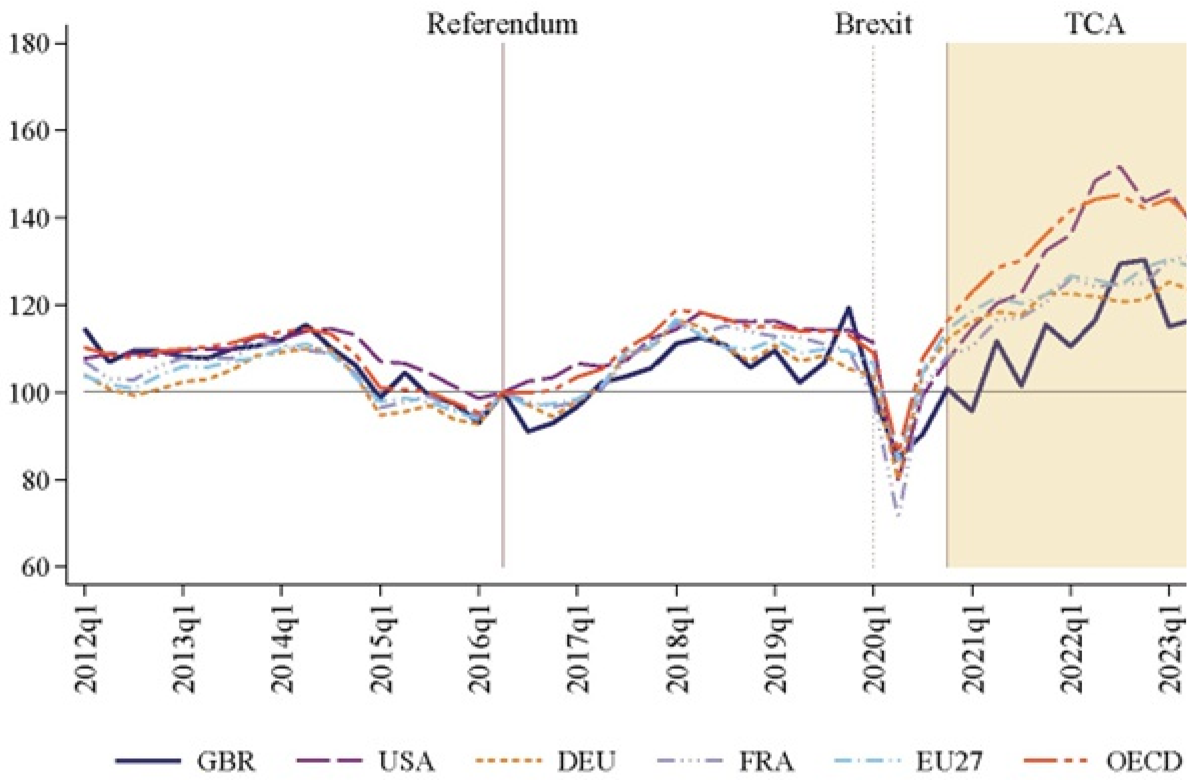

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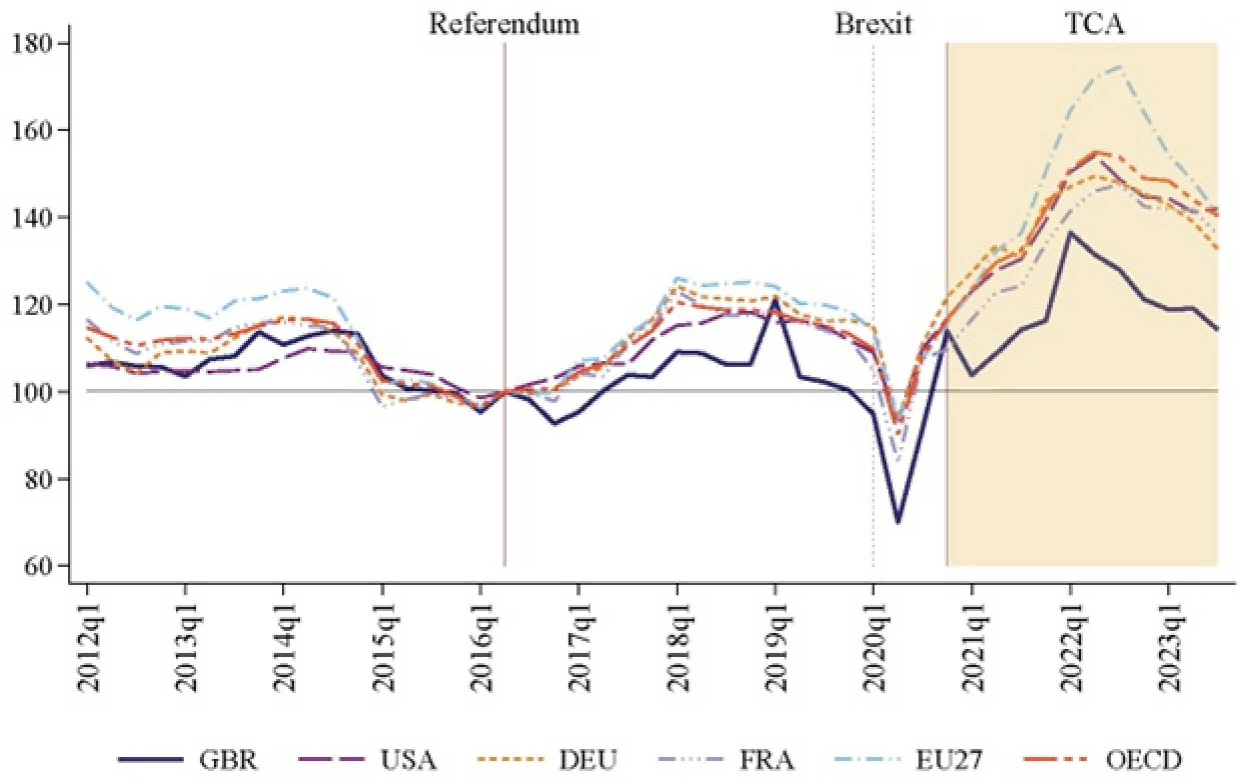
(b) Goods imports



Notes: Goods trade converted to US dollars and seasonally adjusted. Indices normalised to 100 in 2016 Q2. GBR = United Kingdom. USA = United States. DEU = Germany. FRA = France. EU27 = Aggregate EU27. OECD = Aggregate OECD. Source: OECD Balance of Payments Statistics.

EU versus the rest of the world

How much of the aggregate changes in UK trade shown above are due to leaving the EU? A natural starting point when looking for the trade effects of Brexit is to compare changes in UK trade with the EU to changes in UK trade with the rest of the world (RoW). This comparison disentangles Brexit effects on EU trade from other factors that affect trade with all countries such as Covid-19, economic growth, inflation and supply chain shocks.

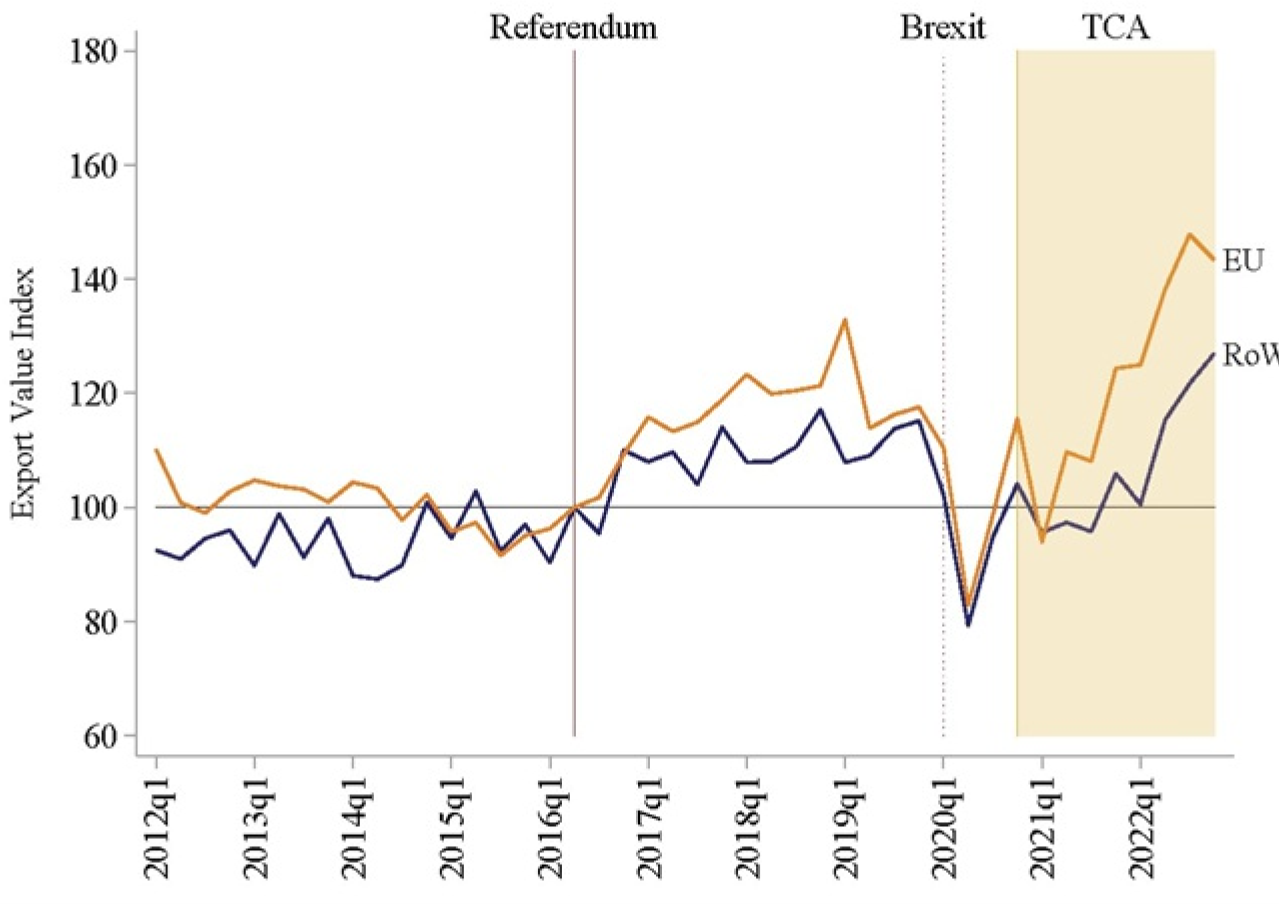
> Brexit is still playing out. Not only is the economy still adapting to the new trade regime, but not all new trade barriers such as customs checks have

come into effect yet.

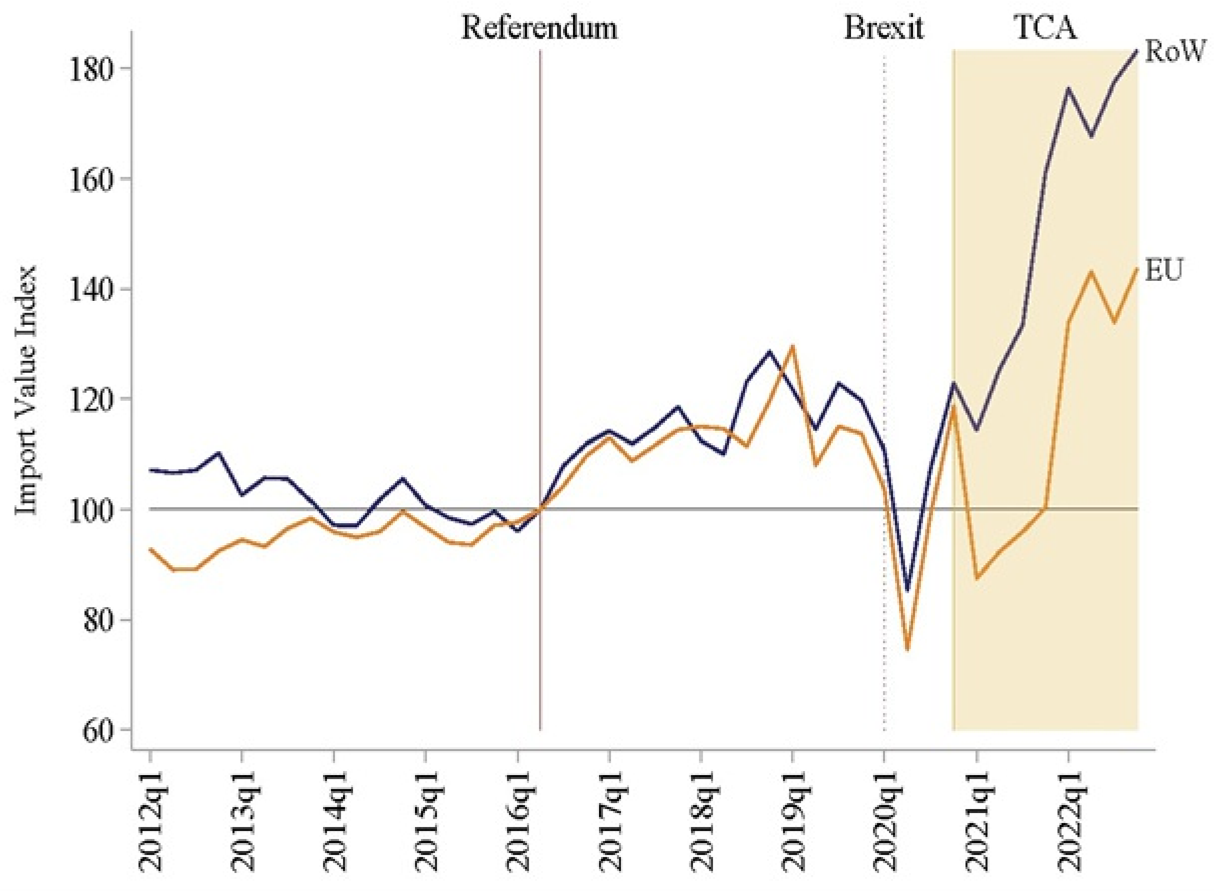
Figure 4 plots goods exports and imports with the EU and the RoW. Figure 4 shows that prior to the implementation of the TCA in 2021, exports to both the EU and the RoW grew at similar rates. But starting in 2021, EU exports have increased slightly more quickly than RoW exports. For imports, the figure also shows parallel behaviour before 2021, but under the TCA imports from the RoW have grown faster than EU imports.

Figure 4: UK aggregate goods trade with the EU and the RoW, 2012-2022

(a) Exports EU vs Rest of the World



(b) Imports EU vs Rest of the World



Notes: Indices normalised to 100 in 2016 Q2. Excludes trade in non-monetary gold. Source: HMRC Overseas Trade Statistics.

Figure 4 does not include data for 2023. However, data from the Office for National Statistics shows that the recent downturn in goods exports evident in Figure 3 has been driven by reduced exports to both the EU and the RoW. By contrast, the decline in goods imports shown in Figure 3 is mainly due to lower imports from the RoW.

Aggregate data do not tell us how individual firms have responded to Brexit. [Freeman et al. (2024)]() use customs data to study the impact of Brexit on goods trade at the firm level and whether the impact of Brexit varies according to firm size. They conclude that the TCA led to a much larger fall in exports to the EU for smaller firms. Their estimates imply that the TCA reduced exports to the EU by 29% for the smallest fifth of firms in their sample, whereas the impact for the largest fifth of firms is zero.

This finding is important because it shows that the new export costs created by the TCA primarily hurt smaller firms, whereas large exporters were able to adapt to the new trading environment and maintain their export levels. Since large firms account for the vast majority of trade, Freeman et al.’s results also imply that the TCA has only led to a small decline in overall UK goods exports.

Most existing studies of the trade effects of Brexit have concentrated on goods trade, but available evidence suggests that, at least so far, services trade has been less affected by the TCA than goods trade.

Brexit is not done

Brexit is still playing out. Not only is the economy still adapting to the new trade regime, but not all new trade barriers such as customs checks have come into effect yet. On top of that, the UK continues to deviate from EU policy due to active and passive regulatory divergence. This further increases both trade costs for UK businesses and economic uncertainty. Performative Brexit – deviating from EU rules for the sake of it –will not serve the UK economy well in the long run.

> The UK’s proximity to the large consumer and input markets in EU countries will always present the greatest opportunity for trade.

‘Global Britain’ is an unrealistic strategy for trade

While additional free trade agreements with third countries such as Australia and New Zealand can help to promote UK trade, in terms of the magnitudes involved they cannot compensate for higher trade barriers with the EU. The reasons are threefold.

First, geographical proximity is crucial since international trade falls sharply with distance. In that sense, the idea of Global Britain is a fantasy and cannot serve as a viable alternative.

Second, the EU’s single market is the most comprehensive trading arrangement on the global stage. All these are attractive and cost-saving features for the international operation of UK businesses.

Third, in practice, global trading standards are set by the big three players – the EU, the United States and China. Of these, the EU is left as the only realistic alternative if the UK wishes to be closely aligned with the latest global regulation, let alone shape it.

The UK's proximity to the large consumer and input markets in EU countries will always present the greatest opportunity for trade. The UK therefore faces a basic trade-off: move closer to the EU to increase UK trade and living standards or remain distant from the EU and continue paying the price of new and emerging trade barriers.

This blog post is based on the CEP Election Analysis on Brexit and UK Trade by the same authors.

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