The ABS blog

November 3rd, 2022

The Brexit Effect | Impact evidence of a major decision

based on the Financial Times documentary of the same name
summarised by Jochen Ressel

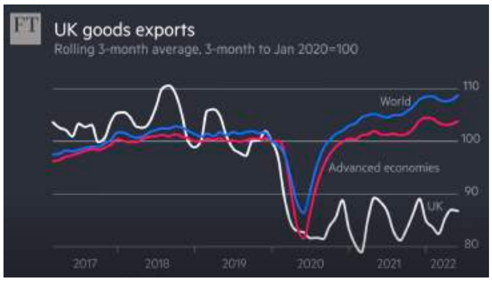
"The decision of the UK to leave the European Union is an act of self-harm" says Chris Giles, FT's Economic Director, very clearly at the beginning of the Financial Times documentary on which this blog is based. I'm summarising the key information as an evidence-proven and statistically underpinned analysis has been lacking so far through all discussions.

Immediate Brexit effects.

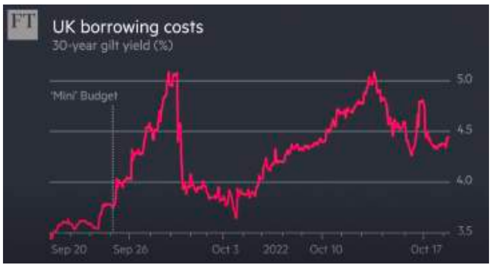
The decision which the British people had to make in 2016 wasn't only about leaving or staying, but it was a major decision impacting prices, investments and trade, as Britain is no longer part of the European single market, not a part of the customs union and got only a very unsatisfactory free-trade agreement with the EU. Boosted by the Covid crisis and additionally because of the major impact the Ukraine war has on economies worldwide the Brexit effects have become obvious for everyone.

But the most visible effect started immediately after the referendum: The loss of value of the Pound Sterling vs the US-Dollar. Although this makes exports more competitive, it increases prices for all imports – and there is the problem.

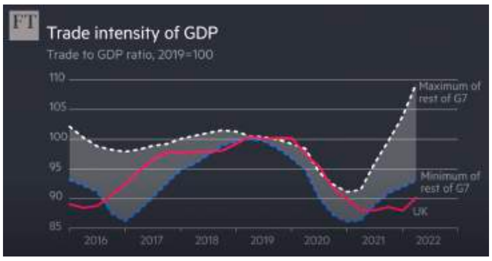
As UK exports have suffered and haven't gone up as they did in other advanced economies, they haven't been able to compensate the additional cost for imports. One of the counterbalances in such a situation is, in any economy, inflation. The devaluation effect showed an inflation-rate which was 3 to 4% higher than elsewhere. Hence this has made people poorer. In numbers, this has been calculated at a net income loss of £870 per household.



But when talking about the Pound Sterling/US-Dollar ratio another dramatic effect needs to be taken into consideration. The UK borrowing cost is increasing dramatically, meaning that it becomes hughly expensive for the UK to borrow the money needed to finance the state on the international financial markets. The worse the currency ratio is, the higher the resulting cost.



The effect on SME's harms the UK economy as a whole.



The overall Brexit impact on UK citizens becomes obvious as the aforementioned comes together with another effect, mirrored in a well-known economic key performance indicator. Whilst other economies have shown a steady recovery of GDP in the post-pandemic time, this effect has not been seen in the UK. Why?

Because the bureaucracy that goes along with exporting goods when not being part of the European single market, makes it almost impossible for small-medium-sized enterprises (SME's) to trade with the European continent. That this is indeed the case can also be measured – in the number of EU/UK trade relationships. As can be seen in the chart, these have dropped by 30% since Brexit occurred.

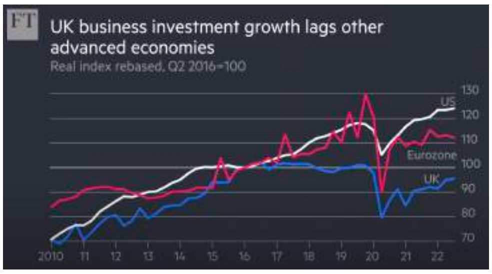
The impact these effects have on wages has been calculated at another £470 per person p.a. – not to mention the tax effect for the UK as trade volumes decline, nor to talk about additional losses for the UK economy as SME's are forced to implement alternative solutions to secure their European business.

An example: As the UK is not part of the European single market and customs union, companies are forced to set up subsidiaries or distribution hubs directly on the continent instead of shipping the products out of the UK.

The effect: No UK-based freight partners are needed anymore and Polish, German and other countries' counterparts do the business instead, resulting in a decreasing number of employees needed by those companies in the UK. But even when shipped out of the UK, it shouldn't be forgotten that any export related bureaucracy and customs add cost to a product, hence harming competitiveness on the European market, and thereby reducing trade volumes.

And this is the long-term danger for the entire British economy and for any growth plan. Pre-2016, UK-based SME's were used to expanding their businesses to the continent as they became more and more successful in their homemarkets. Being part of a European single market, this was easy to do and supported economic growth – but the option to do so disappeared from one day to the next, hence slowing down the UK economy constantly ever since.

The impact on investments.



Business investments have been growing in all advanced economies since 2016, but not in the UK. To reinforce investments, the government incentivised companies willing to invest with huge financial funds, called "Superdeduction", but with very small impact. But it is investment which drives capital and the ability of economies to grow into the future. Hence, this is a decisive factor, if the UK falls behind.

But why is Britain falling behind? What are the investment-reducing factors? Some may argue it is because the UK is a much more service sector-driven economy than others. But the argument is made obsolete when looking to other equally service sector-driven economies, like France. Chris Giles, FT's Economic Director, gives a quite simple reason for the lack of investments in the UK: "The people don't know in which direction the UK economy is developing, inevitably business investments don't grow strongly."

While some may argue that all this is influenced by many other geopolitical aspects, he clearly states: "We have seen negative effects in all areas, in terms of pricing, in terms of investments and in terms of trade, which we can clearly pinpoint as Brexit effects and not as pandemic effects and not as an energy crisis effect – these are clearly Brexit effects."

A budgetting problem as a result.

The Office for Budget Responsibility has forecasted the British economy to be 4% worse off than countries which are in the EU and has valued this at £100bn in lost output. This represents an annual loss of £40bn in tax revenues thereby making the economy poorer by slowing down or even making any growth effect disappear.

An additional side remark: As the new Conservative government under PM Liz Truss announced that creating growth is key, the Mini-budget has been presented as a growth plan-instrument. What it contained can also be seen as a Brexit effect because of the aforementioned – in combination with the pandemic effect and the energy crisis. As financial markets reacted with shock the announcements made, in an analysis provided by Ros Atkins in the BBC series “On the week” (also published on YouTube) it was calculated that the Mini-budget created an additional hole in public finances of £30-40bn in just one week because of the suddenly increased cost for money borrowing (how these costs arise has already been explained above).

To close those gaps – resulting from lower tax revenues (approx. £40bn p.a.) plus extensive additional cost for money borrowing (£30-40bn), the original plans have been pushed aside, and with it the PM and her government, and as the new Chancellor has already said, unavoidable spending cuts and tough decisions need to be made – again making people poorer, instead of creating an economic climate for growth.

“Sovereignity“ meaning additional costs for companies.

“We deregulate and making our own sovereign framework” may sound nice, but what does this mean in reality for the economy? If you deregulate it simply means you build up your own regulatory system with which companies have to comply. Hence it means making separete registrations necessary for the UK market only, as the EU registrations, which cost already UK companies huge money, do not apply for the UK market any longer.

What does “huge money” mean? The UK’s chemical industry for instance has spent £500million in the last decade for registering their products in the EU. But re-registering for the UK market would cost the economy £2bn in total as the government has calculated – and all this for one single market representing only slightly over 67 million customers, instead of the 27 countries comprising the European single market with approx. 500 million potential customers in total.

Guess who is forced to carry these costs. They are simply a factor in the product pricing calculation scheme, hence making products less competitive, more expensive and therefore additionally contributing to reducing real wages.

The Ireland question poisoning EU negotiations.

Everybody knew that the Ireland question would be a critical one for any future negotiation with the EU to achieve progress in cooperation where it is important for the UK economy, e.g. to allow UK universities, scientists and research centres to participate in the EU-Horizon research program, which is of huge importance for the scientific sector. Nevertheless, the UK decided pro Brexit and signed the so-called “Ireland Protocol”, hence it is no surprise that the EU Court of Justice applies rules, as they have been agreed upon that Northern Ireland remains a part of the EU single market for goods.

This has given Northern Ireland a unique position by having one foot in the UK market and the other in the EU single market making this part of the UK an economic success story, as the rules which applied to the entire UK before now simply apply to Nothern Ireland only. The turmoil resulting from this situation is not conducive to improving EU-UK relations or establishing a better basis for future cooperation negotiations.

What is needed now: A honest debate of Brexit effects.

Irrespective of which party forms a government, a debate on how to move ahead is needed. Denying that there are major effects is pointless. Only if the public understands that Brexit has made all people poorer is a debate made possible, especially as the previous Brexit debates have divided parties, society and even families as they were based on lies. A precondition for a successful dialogue is therefore an evidence-based debate: This gives the only chance to find solutions for the economic situation in which the UK is trapped.

Politically it is a trap as well, as any politician who can’t demonstrate the benefit of Brexit by the next election is in serious trouble. And the new PM, Mr Sunak as a Brexiteer of the first hours, is one of those. But up to now, the promised so-called “Brexit dividend” has not been proven and can neither be seen by the public.

Eventually, Chris Giles summarises what is probably the most important learning from Brexit and how it occurred: “We can’t run referendums on very simple economic slogans as this is dangerous and it weaponises economies.” His colleague, Peter Foster, Public Policy Editor of the Financial Times, adds “Brexit is a slow puncture and not a car crash, meaning the economy is not collapsing all of a sudden, but over the time people find themselves in less productive jobs and it makes wages lower as it otherwise would have been.” And all this needs to be addressed openly for putting the UK back on track for economic growth and societal stability.

More than ever, the Austro-British Society is looking forward to your views and comments!

Source

The Financial Times documentary on which is blog is based on is accessible on YouTube via this link: https://www.youtube.com/watch?v=wO2lWmgEK1Y&t=681s

A summary by:

Jochen Ressel is the Secretary-General of the Austro-British Society. He worked several years for a UK company and its HQ in London. He held management positions in various companies and institutions, e.g. as the Executive Director of the Senate of Economy, where he regularly commented on current political and economic developments. Currently, he holds the position as COO of SoccerCoin, a FinTech company active in the field of sports.

The opinions expressed in this article are entirely his and reflect in no way the views of the ABS.