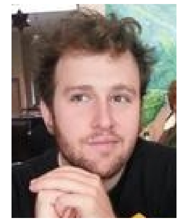
Brexit will inevitably hurt UK exports, slowly but surely

blogs.lse.ac.uk/brexit/2017/05/09/brexit-will-inevitably-hurt-uk-exports-slowly-but-surely/

2017-5-9

Leaving the EU will matter a great deal for trade, writes ***Pierre-Louis Vézina****. He argues that in time, Brexit will surely hurt UK exports.*



Most experts are convinced Brexit will hurt UK exports. That's because we've learned from past episodes that removing trade barriers does actually boost trade. On average, bilateral trade is around 40% larger after trade agreements are signed. But we don't really know about the reverse effect, that of undoing a trade agreement. It hasn't really happened before. It's probably not *minus* 40%. Trade agreements bring about new trade relationships, they create new business links, and they allow firms to introduce their products in new markets. These relationships persist. It takes time to find the right supplier, the right products, to write up contracts and establish trust relationships. Firms would rather not do this too often. So undoing a trade agreement probably does not destroy as much trade as signing a new one creates.

The dismantling of colonial empires actually tells us a bit about the persistence of defunct trade agreements. When colonies gained independence in the 1960s, trade with the metropole did not suddenly collapse. It did erode slightly, but colonial empires actually still shape today's trade patterns. So, will Brexit reverse all the trade gains brought about by deep EU integration? Probably not. It will hopefully hurt trade only slowly and it won't undo everything from one day to the next.

And there's even another reason why trade patterns should persist, at least in the short run. It's because foreign multinationals, who trade a lot, don't want to move. Many are part of clusters, like car plants in the West Midlands, and agglomeration forces are hard to put in reverse gear. Industries like banking, fashion, and technology have clustered in parts of London and now benefit from a dense talent pool and a constant flow of ideas. This has become such an important locational advantage that industries don't dare to move yet. Few firms have announced moves to France or Germany. It will take a very hard Brexit to undo those clusters.

Also, Britain can't defy gravity. The EU is not only an ex-partner, it's also a neighbour and the largest market in the world. Exports to the EU will continue to be sizable. Large deviations from such gravity forces require sanctions or embargos. Even a hard Brexit shouldn't have that pull, hopefully.

***Don't you mean freedom fries buddy?* Image by Señor Codo, licenced under (CC BY-SA 2.0)**

So the emergence of good old tariffs and other trade barriers will probably not harm as much as liberalisation helped. But there will be blows. In particular, the deterioration of Britain's image abroad, and not just in EU countries, should hurt its exports. This is what happened to French exports to the US when France decided to vote against the war in Iraq. France-bashing became mainstream and ubiquitous across US cities, French fries became freedom fries, and French exports to the US fell by 15%. The same thing happened to German car sales in Greece when the German government bullied Greece over debt payments. Flagship products like Minis or Burberry scarves could be hit. Consumer boycotts do hurt trade. The lowered opinions of Europeans about the British could further reduce exports. Economists have shown that bilateral opinions, captured by the Eurobarometer public opinion surveys or even by Eurovision voting patterns, have a relatively large effect on trade. The confrontational British government at odds with EU counterparts could aggravate the problem as even political skirmishes sometimes reduce trade. When the Japanese government brought back a history textbook that ignored Japanese war crimes of World War II, the Chinese government got really upset and Japanese firms doing business in China lost much market value. So if the divorce gets hostile, exports could be hurt badly.

There's another issue we need to pay attention to. The hostility towards immigrants could also have a large effect on trade. Migrants have been identified as key to trade between countries. They know how to do business with their origin country. They have market knowledge, they speak the language. They can navigate through the bureaucracy. The French who work in banks in London are the ones making the phone calls to French companies and that go to meetings back home to establish contacts. This leads to trust relationships that foment trade. Migrants also like to import nostalgia from back home. The retired British in the South of France order from Marks and Spencer. Most worryingly, migrants do not want to live in a country where the government is openly anti-immigrant and where crossing the border is a painful experience. They thrive on an open world. Loudmouthed officials and border agents could deter not only immigration but also business travel, even if new visa restrictions are not imposed. Less business travel means fewer face-to-face meetings and fewer deals. Across US States business-class air travel is directly related to the volume of exports, especially in sophisticated products.

Brexit could thus be quite damaging for UK exports in the long run. The drop of the pound has already mirrored this bleak future. Thankfully this may attenuate the other negative Brexit effects by making exports cheaper and giving them a slight boost. But the damage done could be long-lasting.

This post represents the views of the author and not those of the LSE Brexit blog, nor the LSE.

***Pierre-Louis Vézina** is a Lecturer in Economics at King's College London.*