

Professor Jun Du and Dr Oleksandr Shepotylo – Written Evidence (TIG0011)

Summary

In response to the call of evidence, we provide evidence responding to the following questions:

1. What have been the overall consequences to date of the implementation of the Trade and Cooperation Agreement and the end of the transition period for GB-EU trade in goods?
2. Do you agree with the Government's decision to delay further the introduction of certain checks and controls on imports of EU goods into GB? What are the advantages and disadvantages of this decision?

Evidence

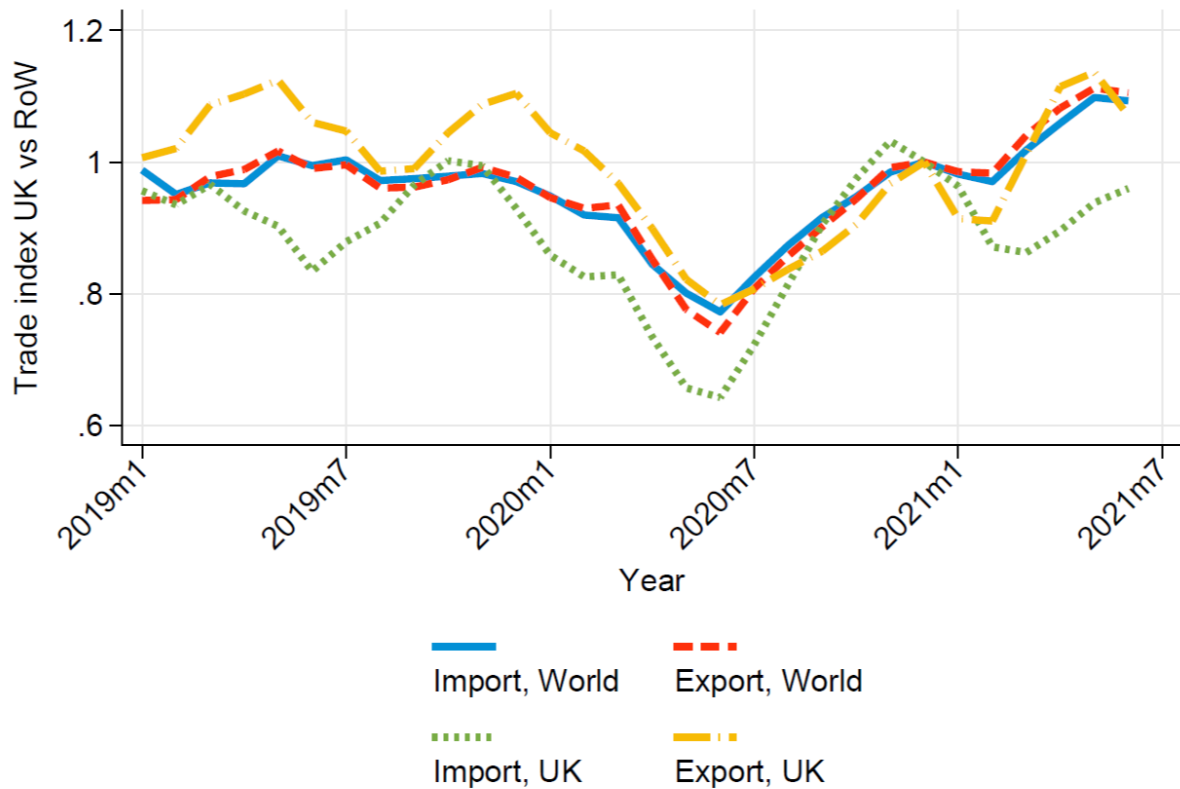
1. What have been the overall consequences to date of the implementation of the Trade and Cooperation Agreement (TCA) and the end of the transition period for GB-EU trade in goods?

The overall performance of UK trade in goods over the period 2020-2021 could be driven by the following factors: (1) UK firms' overall competitiveness; (2) The implementation of the TCA and more precisely additional customer formalities, border checks and controls on goods crossing from GB to EU; (3) The implementation of the TCA rule of origin on manufactured and processed goods; (4) The COVID disruptions; (5) The global value chains disruptions and the shortage due to other factors (such as fuel price increases, HGV drivers, China's power crisis, etc).

As far as we know, there is no rigorous analysis yet to separate these factors and quantify their causal effects in trade in goods. Evidence we provide below is an overall effect.

In 2020-2021, the UK trade with EU has experienced a double-dip recession, first around May-July 2020 and then January-February 2021 (Figure 1 below). The UK shared similar trend of decline in the first recession but with much more severity. The second recession in 2021 seems particular for the UK, as the rest of the world did not witness the significant decline in exports, and experience much more mild reduction in imports. Hence, the recession in 2021 was due largely to factors related to (2) and (3) and to less extent (4) above.

Figure 1 Index of the UK export and import to the EU countries relative to the rest of the world



Note: Trade index, Dec 2020 = 1. Three-month moving average

Trade in 2020: a context

In the 2nd quarter of 2020 at the beginning of the pandemic, the UK trade sharply declined, moving synchronously with the rest of the world.ⁱ The trade collapse was primarily a negative supply shock phenomenon. Du and Shepotylo (2021) find that UK's GDP declined by 9.9% in 2020, which is its worst reduction since 1955ⁱⁱ and compares poorly with the other advanced OECD economies.ⁱⁱⁱ

Overall goods exports contracted by 14.7% in 2020 (from 468.3 billion USD in 2019 to 399.6 billion USD in 2020), likely the worst result among the G7. While the global trade with EU countries experienced a sharp recovery and returned to its pre-pandemic levels by the beginning of 2021, the UK trade experienced another significant. It occurred at the same time when the UK ended its transition period and started the new trade relations with the EU countries.

Trade in 2021

Analysis of the monthly trade data reveals that during the first 6 months of 2021 the UK reduced its trade turnover with the EU countries by 17.6% relative to the same period of 2019 (Table 1 below). Export declined by 11.6%, while import declined by 23.5%. The UK trade reduction occurred at the backdrop of a robust recovery of trade in other countries. In the EU, Germany and the Netherlands increased their trade turnover with the other EU countries by 22.5% and 12.5% consequently. Non-EU countries have also recovered. The US trade turnover with the EU was marginally lower than in the last pre-pandemic year, while the other non-EU countries turnover with the EU increased by 0.8%.

Among different types of goods, the UK export and import of consumer goods to/from the EU has performed particularly poor, declining by 21.2% and 24.6% consequently in the first 6 months of 2021. At the same time, the UK export of intermediate and capital goods remained stable in the first half of 2021. The UK import of capital and intermediate goods from the EU has declined by 24% and 10%. This reflects the particular challenges in traders experiencing customer formalities, border checks and controls on manufactured goods of GB-EU borders. It is noteworthy that the decline is seen from both direction of trade, which suggests that the asymmetric border checks (only for crossing from GB to EU) are not the sole factor at play.

While the presented decline in the UK trade with the EU cannot be attributed solely to the increased trade barriers after the end of the transition period, it should be noted that the UK trade with non-EU countries did not experience a comparable decline, as shown in Table 2. In fact, the UK export increased by 12.4%, while import by 1.3%.

Table 1 Change in trade **with EU** countries in the first half of 2021 relative to the first half of 2019

Country/Region	Change in trade, %			Total*
	Capital	Consumer	Intermediate	
A. Export				
Germany	-3.2	7.7	8	26.4
Netherlands	18.5	19.8	25.8	12.7
Rest of EU	12.1	6.8	12.3	8.3
Rest of the World	12.9	-1.4	20.8	1.7
United Kingdom	-3	-21.2	-0.2	-11.6
United States	-0.6	-3.1	4.6	-9.2
Total	6.1	1.4	11.9	4.7
B. Import				
Germany	-7.5	5.3	4.8	18.5
Netherlands	16	17.8	17.9	12.3
Rest of EU	6.3	6.8	10.5	8.4
Rest of the World	0.3	9.4	7.5	0
United Kingdom	-24	-24.6	-10	-23.5
United States	5.5	3.8	7.3	5.3
Total	-0.6	3.1	6.3	3.5
C. Total				
Germany	-5.4	6.5	6.4	22.5
Netherlands	17.3	18.8	21.8	12.5
Rest of EU	9.2	6.8	11.4	8.3
Rest of the World	6.6	4	14.2	0.8
United Kingdom	-13.5	-22.9	-5.1	-17.6
United States	2.5	0.4	6	-2
Total	2.8	2.3	9.1	4.1

*Total includes capital, consumer, intermediate goods as well as fuels and goods none else specified

Table 2 Change in trade **with non-EU** countries in the first half of 2021 relative to the first half of 2019

Country/Region	Change in trade, %
----------------	--------------------

	Capital	Consumer	Intermediate	Total*
A. Export				
Germany	1.7	1.3	10.3	-0.6
Netherlands	26.4	7.6	14	8.2
Rest of EU	3.3	14.8	12.4	7.3
Rest of the World	4.2	1.5	18.7	5.4
United Kingdom	-0.5	-11.6	2.9	12.4
United States	0.1	1.7	12.2	-1.9
Total	5.9	2.5	11.8	5.1
B. Import				
Germany	18.4	5.6	10.5	13.6
Netherlands	23.2	19	11.9	5.3
Rest of EU	13.5	-2.7	4.7	3.4
RoW	9.3	8.3	5.3	7
United Kingdom	21.8	3.4	17.3	1.3
United States	13.8	8	9.1	7.6
Total	16.7	7	9.8	6.4
C. Total				
Germany	10.1	3.5	10.4	6.5
Netherlands	24.8	13.3	13	6.8
Rest of EU	8.4	6.1	8.6	5.4
RoW	6.8	4.9	12	6.2
United Kingdom	10.7	-4.1	10.1	6.9
United States	7	4.8	10.7	2.9
Total	11.3	4.7	10.8	5.8

*Total includes capital, consumer, intermediate goods as well as fuels and goods none else specified

a. What have been the key challenges for GB-EU trade in goods so far, and how might such challenges be mitigated?

According to the presented evidence, there is a substantial reduction of the UK trade with EU. It is difficult to disentangle the impact on the UK trade of changes in trade policy between the UK and EU from the structural changes and shortages caused by the COVID-19 pandemics. At the same time, trade flows of the majority of other countries have fully recovered from the pandemics shock and exceeded the levels of the first half of 2019, while the overall trade of the UK is still lower than in the first half of 2019 (Table 3).

Table 3 Change in trade turnover in the first half of 2021 relative to the first half of 2019

Country/Region	First half of 2021 relative to		
	Export	Import	Total
Germany	12.9	16.1	14.5
Netherlands	10.5	8.8	9.6
Rest of EU	7.8	5.9	6.8
RoW	3.6	3.5	3.5
United Kingdom	0.4	-11.1	-5.3
United States	-5.6	6.5	0.5
Total	4.9	4.9	4.9

The UK trade decline is not just due to the challenges of COVID pandemic or the post EU exit transition. It is a result of a combination of (i) UK firm's fallen competitiveness since earlier years after the Brexit Referendum^{iv} (which led to

trade destruction and trade diversion and part of this will not be recovered in a short run), (ii) Challenges due to the implementation of the TCA (customer formalities, border checks and controls on goods which increases costs of trade); (iii) The TCA rule of origin on manufactured and processed goods (which increases costs of trade); (iv) The disruptions in the global value chains (which translates into soaring costs of trade and hampered demand).

For challenges in (ii), the government is doing a lot and it's a period of learning at all levels – businesses exporting and importing from both sides of the UK-EU border, trade services and support organisations and government agencies. Some problems have already and will continue to subside, while communications between businesses and government are crucial to ensure transparency and clarity of new rules. Some of the challenges will become new normal and stay as new non-tariff measures and regulatory barriers to trade. This is the most important area for further investigation in our opinion.

For (iii) rule of origin on manufactured and processed goods, it can be a major issue for some sectors. Automatic sectors have taken a sectoral holistic view to work with the EU to reach a workable agreement on implementing rule of origins. For other sectors that UK businesses are mainly exporting, it can be more challenging to make a similar arrangement. This is where governments supports are required and for risk assessments, alternative supply chains configurations and seeking export finance provision.

In addition, for challenges (i) fallen firm competitiveness, there is no quick fix. The longer term recovery of UK trade decline will really depend on UK firm's productivity.

2. Do you agree with the Government's decision to delay further the introduction of certain checks and controls on imports of EU goods into GB? What are the advantages and disadvantages of this decision?

The delay has mitigated potentially even larger disruptions in the UK supply chains and cushioned further increase in prices that would have been caused by more severe shortages of goods. It allowed to moderate import inflation caused by higher trade costs on the EU goods. From our evidence presented above, the evidence of an asymmetric trade effect due to the asymmetric checks across the UK-EU border is weak.

In the long run, an absence of checks and controls on imports of EU goods into the UK would likely to cause a disadvantage for the UK producers, who are competing with the EU producers both at home and in the EU markets and have already been facing the checks and controls on their goods in the EU countries. However, an important point to make is that the absence or reduction of strict checks and controls on imports from the EU helps build and rebuild goodwill and trusts between the UK and the EU, which going forward will be crucial for any breakthroughs in trade negotiations.

a. In your view, what were the key factors underpinning the decision to delay the introduction of import controls?

Three factors are in play. First, the UK government did not want to cause price spikes for consumer goods and wanted to minimize disruptions of supply chains.

Second, transport infrastructure was not adequately prepared to deal with the changes. Third, the UK civil services were not ready to introduce import controls due to shortage of customs officers, trade policy advisors etc.

Reference

Du, J. and Shepotylo, O., 2021. UK Trade in the Time of COVID-19: A Review. *World Economy*.

Appendix

Table A1 Countries that reported trade statistics in Jan 2019-June 2021

Country	Country
Armenia	Japan
Australia	Latvia
Azerbaijan	Lithuania
Belgium	Luxembourg
Bosnia and Herzegovina	Macedonia, FYR
Canada	Moldova
Croatia	Netherlands
Czech Republic	New Zealand
Denmark	Pakistan
El Salvador	Portugal
Finland	Serbia
Georgia	Slovak Republic
Germany	Slovenia
Greece	Spain
Guatemala	Sweden
Hungary	Switzerland
Iceland	United Kingdom
India	United States
Israel	Uzbekistan

29 October 2021

ⁱ Data source is monthly trade data from COMTRADE. Only countries that provided monthly data for the whole period of Jan 2019 – June 2021 are considered. The list of countries is presented in the appendix.

ⁱⁱ This is based on the earliest data provided by the ONS's GDP estimates, <https://www.ons.gov.uk/economy/grossdomesticproductgdp>.

ⁱⁱⁱ According to OECD projections, at https://www.oecd-ilibrary.org/economics/data/oecd-economic-outlook-statistics-and-projections_eo-data-en.

^{iv} See a separate piece of evidence submitted by Vanino, Du and Douch, collating evidence of how Brexit policy uncertainty has reduced trade.