Q&A-Expect double digit drop in 2021 UK-EU trade volumes; Britain likely to be part of fewer European supply chains in long term: David Henig, ECIPE

A doubled digit drop in UK-EU trade volumes could be expected in 2021, as UK will be part of fewer European supply chains over the next few years, reducing manufacturing imports and exports, **David Henig, UK Director at the European Centre for International Political Economy (ECIPE),** told the Reuters Global Markets Forum on Monday, January 11.

"Various sectors are going to be under strain, including car manufacturing, financial and professional services, and engineering," he said.

Henig expected Brexit to cause UK's GDP to fall by 4%-6%. But, "there should be some improvement in the UK's global trade position, as businesses seek new markets, and new sources of imports," he said.

"Much depends on the level of adaptation in the UK economy," he added.

Following are edited excerpts from the conversation:

Q: With Brexit negotiations scarcely covering the financial services sector, how would the Trade and Cooperation Agreement get impacted, considering assets close to 1.2 trillion euros exited London in the first 10 days post-deal?

A: We do expect there to be a UK-EU agreement on financial services, by March is the intention, with some element of equivalence. But clearly, there are going to be barriers between the UK and EU financial services sectors in the future, and these will have an impact. Some business will move to the EU. Some perhaps the U.S. I expect London to remain strong, but you can't expect the EU to be happy with London being the main financial centre for it.

Q: Do you see conditions under which there would be an alleviation in the truck shortages/jams that EU-UK businesses are facing? What sort of policies need to be brought about to ease these?

A: The new barriers between the UK and EU, whether in financial services, goods transport, or freedom of movement, etc, are here to stay. All can be eased with agreements between the UK and EU, such as equivalence for food or financial services, but we can't expect the EU to give the UK a good deal.

Plus, the UK government is not at this stage wanting to go back to the EU with more requests. So, for the next few weeks we can expect to see continued issues, hauliers and others will get used to the new requirements, but there will always be vulnerabilities. In the medium term, you can expect further agreements, but not yet.

Q: Do you have forecasts on how exports and imports of UK goods and services will fare in 2021 in comparison to 2020?

A: It is very difficult to predict 2021 UK-EU trading figures because of COVID-19, for the same reason that 2020 figures are also awaited with interest. Without the COVID-19 effect, it would have been reasonable to expect some level of drop in trade, (but) with COVID-19, it is likely to be much more dramatic.

Exact forecast is difficult because we don't exactly know how Brexit will affect activity in European supply chains. This kind of barrier being raised has not happened since supply chains became so much a part of the global economy. But I would not be surprised by Brexit causing a double-figure drop in UK-EU trade volumes.

Q: Could you give us a peek into what the inside of Brexit negotiations were like on Britain's end through the last four years, and what path/areas of focus you see the Department of International Trade (DIT) engaging on in the years ahead?

A: The UK's Brexit negotiations were always the work of a small team -- first led by Ollie Robbins under Theresa May, then by David Frost under Boris Johnson -- not teams that engaged particularly strongly with business or their own colleagues in the wider government. Hence, why many issues of detail may have been lost. Plus, there was a lack of realism about the EU position throughout.

One of the challenges going forward will be to take what has been a small effort and put that into other government departments, we don't know which the DIT have a busy programme ahead. As well as new deals with Australia, New Zealand, the U.S. and joining the CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership) as priorities, the initiative to replicate existing EU trade deals now requires renegotiations with Turkey, Mexico, South Korea and Canada. That is a big task ahead, as well as managing day-to-day trade issues, and keeping an eye on bigger trade issues like the future of the WTO.

One thing DIT and EU negotiators have had in common up to now has been a difficulty in focusing on particular sectors, such as financial services - what is it we want to do, with whom, how are we going to make this happen. There is little strategy. That has to be a UK priority for the coming year.

Q: Do you see changes occurring in the composition of trade between the EU and Britain, and what could those be?

A: You would expect changes to the composition of trade flows when you put new barriers in place. Various sectors are going to be under strain, including car manufacturing, financial and professional services, and engineering. These are, however, some of the largest components of UK-EU trade! Over a few years period, I would expect the UK to be part of fewer European supply chains, reducing the manufacturing imports and exports.

I think that services, although affected, (will) be able to overcome the barriers more easily, and come out relatively stronger. However, this is speculative based on UK's comparative advantage. There are already stories of UK services providers no longer able to access the EU market. But in general, I think in the pattern of UK exports to the EU, services hold up better than goods. For imports, a fall in both.

Q: Does Frankfurt become the default choice of financial capital or do Paris/Frankfurt share this position?

A: Hard to say where is winning the battle to be the EU's new financial centre, there is a lot of talk of no single place winning, but movement anyway. Some recent chatter in the city that if Scotland became independent and a member of the EU then Edinburgh would be well placed for financial services, but that is some way ahead. I suspect it may be some time to see where picks up business from London, across sectors Amsterdam seems so far to have been a big winner, but I'm less sure for different financial services.

Q: Does it seem like the financial sector in London will shrink as a proportion of UK's GDP? How desirable is that given the events of the last decade?

A: If we assume other sectors will also shrink, and London will still be an important financial player then I don't think we can make that assumption. Difficult choices ahead for the UK government as to what sectors it seeks to prioritise. Also, so difficult at the moment to see how the UK-EU economic unwinding will progress. To repeat, we haven't seen anything like this in modern trade. So, we have no particularly good models.

Q: How do you see the impact in terms of GDP, job/wages, inflation, productivity, digitization, say in 10 years, (assuming we can discount the COVID-19 impact by then) compared to where they would have been if Brexit had never happened?

A: Compared to the counter-factual of not leaving the EU a GDP hit of 4%-6% currently seems to be the best forecast. Although we are talking mostly about the UK-EU relationship there should be some improvement in the UK's global trade position, as businesses seek new markets, and new sources of imports. Much depends on the level of adaptation in the UK economy.

Other indicators feel more dependent on domestic policy choices around for example tax and regulation, where the government is undecided between different models, low tax and spend as traditional conservative, or red wall protecting investments which could see government debts remaining at very high level. But the UK model of recent years of low productivity and wage growth, and high employment, seems to be quite set. There is a risk indeed this gets worse if there is a net decline in exports, exporting business typically being more productive.

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