IMPACT OF BREXIT ON UK-EU TRADE RELATIONSHIP

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Abstract
This research analyses the different scenarios for the trade relationship between the UK and the EU after Brexit. It analyses three possible models and covers ten years after Brexit. The first one, using the comparative methodology, examines the possibility and consequences of reaching a deal under existing arrangements that the EU has with non-EU countries. The second model will be presented in case of „no-deal" and trade relations under WTO rules. The third model will be analyzed by the computable general equilibrium (CGE) model. All these models suggest that Brexit will change the future trade relationship between UK and EU economy, and consequently will have a significant impact on the UK economy. This is because researches in this context suggest that the EU will impose several restrictions on the British economy after Brexit, which will ultimately have a significant negative impact on its trade within the European market.

Keywords: *Brexit, European Union, United Kingdom, trade agreements, economic impact, trade policy*

JEL Classification: *B17, B27, F13, F4, O24, P33, P45*

I. INTRODUCTION

The United Kingdom left the European Union on January 31, 2020, in the famous Brexit process. With the exit from the European Union, Great Britain remained a part of the single European market and customs union until the end of 2020. This period, which is called the transition period, will last until December 31, 2020, so that by the end of the year, all trade relations between the two trade entities will remain unchanged.

During this period, the two sides are supposed to reach an agreement on what and how level and model of trade will be continued between these two entities after the end of the transition period. The volume of trade between the UK and the EU is very large and the European Union market is the largest single market for the UK. According to Institute For Government, in 2016, trade between the UK and the EU was valued at £520 billion (bn), accounting for 47% of the UK's total trade with all countries (Van der Loo, 2016).

In an exchange with the EU27, the UK sent out products worth over £144bn and administrations worth £90bn to the EU. While the UK had a general shortfall of £82bn on exchange with the EU, it had an overflow of £14bn on exchange administrations, for the most part, because of its serious qualities in monetary administrations, and expert and business administrations.

If the UK fails to negotiate a good trade agreement with the EU, its products will be subject to import tariffs and many other administrative costs. According to an analysis cited by the British Independent, the cost to British exporters based on additional administrative costs alone could be around £ 4.5 billion a year. On the other hand, the UK could reach an agreement that would allow its preferential treatment. If, on the other hand, no agreement is reached between the EU and the UK on a future trade relationship, future trade relations between the two markets could continue under the terms of the World Trade Organization. This scenario seems the most certain for now. But all scenarios are possible at this point. The intent of this research is twofold. It will first analyze possible scenarios and models for future trade relations between the EU and the UK.

The EU has 56 free trade agreements with many countries and several more are in the process of being negotiated. In this research, I will limit myself to the four most likely models. Another goal of this research is to analyze the overall impact of Brexit on the UK economy.

II. LITERATURE REVIEW

There is a wealth of literature and research available on both topics that are the subject of this research. On the eve of Brexit, and especially after its official begin, numerous studies and research have tried to predict and construct a scenario for the future economic relations of the two entities, as well as to overlook the consequences for the British economy.

These numerous studies were conducted and released by government institutions, international organizations, academic economists, as well as independent think tank associations. Due to a lack of predictable scenario, appropriate precedent, as well as substantive data, those studies analyzed immediate effect after the referendum, as well as a long-range implication.

The first main part of this research review these various exercises and predictable scenarios. Almost all studies predict that the effect on the UK welfare will be negative for any potential deal that is negotiated between the two parties (Sampson et al, 2016).

Some studies predict the economic consequences in the event of failure to reach an agreement, i.e. if future economic / trade relations between the two markets take place under the terms of the WTO. The greatness of the impact relies upon the terms under which the UK leaves the EU. Some studies put forward scenarios for different types of exit shock, specifically in a case with „no agreement "and also for an exit under World Trade Organization rules. Comprehensively, the financial effects are anticipated to be generally serious under a supposed 'Hard Brexit', whereby there are no exchange understandings between the UK and the EU, and exchange rules are controlled by the World Trade Organization (WTO).

The least costly outcome occurs when the UK remains a member of the European Economic Area (EEA) (Dhingra et al, 2017). The most widespread and generally expected serious negative economic impact in the case of the so-called "hard Brexit".

The second part of the research will be based on Dhingra's (2017) predictions who use the quantitative general equilibrium trade model to estimate the long term costs of Brexit (Dhingra et al, 2017). Her research models cover the UK trade with 40 countries and 30 different trade sectors. Distinguishing between the so-called "soft" and "hard" Brexit, the loss due to Brexit for the average UK household will range between 1.3% and 2.7%. Along with the WTO or no-deal Brexit, the burden of duties on exchange with the EU would build costs for both UK shippers (and subsequently purchasers) and exporters.

The normal EU duty rate is low – around 1.5%. Notwithstanding, at a sectorial level, the effects would be a lot bigger: for instance, for vehicles and vehicle parts, the tax rate is 10%. Since most UK based vehicle creation is sent out and utilizes imported parts, the effects would be amplified (Halilbegovic & Ertem, 2020). The effects would likewise be enormous on farming, where EU levies and shares stay high; this would bring about critical food value expansion for British shoppers.

The main special cases to this rule are that nations can decide to go into unhindered commerce understandings, and they can give particular market access to creating nations. The UK could mitigate the effect on customers by lessening or taking out duties singularly – as long as this is done in a non-unfair way, this would be allowed under WTO rules. Be that as it may, this would impact local makers, particularly in horticulture. Regardless, expanded duty obstructions would not be the most significant effect. The greater part of the expense of working together across fringes originates from non-tax obstructions, for example, outskirt checks, custom controls, and consistence with various item principles and guidelines across nations. These hindrances can't be expelled singularly because they require exchange accomplices to concur on a lot of rules and guidelines which the two of them can acknowledge (Halilbegovic & Sabic, 2018).

While the UK is in the EU, its organizations don't need to experience outskirts checks since they as of now qualify as being consistent with EU rules and guidelines. Under a hard Brexit/"WTO rules" situation, without common acknowledgment understandings for item norms, it is far-fetched that UK items could enter the EU moving along without any more checks at the fringe. After some time, if there is a difference among UK and EU guidelines, UK organizations would need to deliver two diverse product offerings – one for the UK and one for the EU – which would build costs and lessen the seriousness. The effects of non-tax obstructions would be bigger for the administration part, which makes up 80% of the UK economy. Access to the single EU aeronautics advertise requires central command and larger part shareholdings to be situated inside the EU so it can have administrative oversight on wellbeing. UK's administration exporters would likewise experience the ill effects of the loss of 'passporting' rights for money related administrations, just as diminished access for other specialist co-ops like legitimate and bookkeeping administrations. Also, I will include a forecast of The Center for Economic Performance.

This analysis gauges that if there should be an occurrence of „no arrangement" and „WTO governs just" situation would lessen the UK's exchange with the EU by 40% more than ten years. This diminished trade would mean a fall in pay for each head of 2.6% consistently (net of the save assets from no cooperation charges). There would in like manner be longer-term negative effects from lower adventure and all the more moderate proficiency improvement, which are surveyed to be another 3.5% of GDP. Embracing a strategy of one-sided facilitated commerce would moderate a piece of these expenses. Be that as it may, the investment funds from one-sided levy slices are evaluated to be only 0.35% of GDP. The momentary disturbance coming about because of the abrupt inconvenience of these WTO rules could intensify these negative impacts. There are also some studies that, due to the impossibility of accurate assessment, I did not use in the main part of the research, which point out that the overall decline in GDP in the next 10 years in the UK could range between 1% and 10%. Also, different studies expect to range between minus 5% and 6% depending on the methodology. Every accessible investigation conjecture that a critical interruption of exchange connections will force monetary expenses on the two sides, as well.

III. RESEARCH METHODOLOGY

MODELING OF SCENARIOS – POSSIBLE TRADE AGREEMENT AFTER BREXIT

This is a comparative analysis based on a single methodology. The first part and subject of this research are different trade models/agreements between the EU and other entities. In the following section, I will present the four most possible scenarios in the future trade agreements and relationship between the UK and EU. Most of the current discussions on the future trade relationship between the EU and the UK focus and are based on the already existing available models of trade agreements that the EU has concluded with third countries.

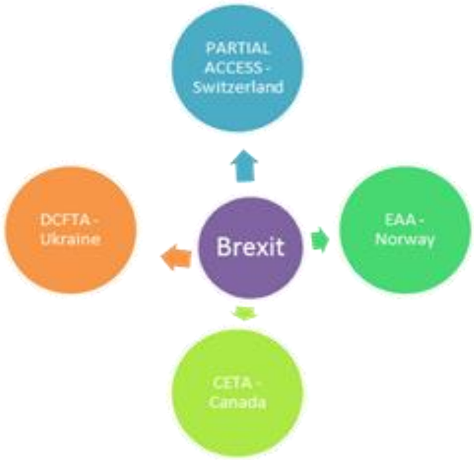

Figure 1-Four possible models and scenarios after Brexit

All these models differ in scope, width, and the effects they have on one side or the other. These models represent different approaches of the two sides and offer a possible basis and solutions for a future trade agreement between the UK and the EU. In this research, I will present four possible and most likely models.

They offer some ideas and insights into what the European side was ready for in the previous negotiations, and how much it was ready to make concessions with the partner side. Certainly, these models are only possible solutions, and there is no guarantee that the UK could negotiate similar arrangements. An examination of four models of the potential trade deal yields also a conclusion, all of them adverse almost for both sides.

IV. EEA - NORWAY MODEL

The Agreement on the European Economic Area is the largest possible access to the EU single market for a country that is not a member of the EU. This agreement extends the internal market with its four freedom to the EFTA states which did not aspire to become members of the EU like Norway, Iceland, and Liechtenstein. They rather opted for the creation of a free trade zone with the European Union. On the other hand, countries such as Norway, but also other EEA countries, have agreed to accept the entire legislation of the European Union's Single Market.

That means accepting close to a thousand directives, and several thousand regulations. EU legislation in this area, the so-called acquits, includes almost half of all EU directives, which in turn is a third of all European Union legislation. The member states of the European Economic Area are obliged to comply with and follow European rules when it comes to competition, social benefits, state aid, and environmental protection.

Conclusion about Hypothesis IV: UK as an EU country member adopted many of these rules, but now circumstances have changed and new trade deals have to be reached. British side had stressed on several occasions that joining the European Economic Area (EEA) would be “unacceptable “because it favors the European Union. The British side claims that the adoption of European rules governing the functioning of the EU Single Market would be a kind of dictate, because these rules would have to be accepted automatically, without the British side having the opportunity to say what they are, and whether they are changeable.

V. CETA – CANADIAN MODEL

The agreement which the EU signed with Canada, so-called CETA (The Comprehensive Economic and Trade Agreement) is considered as one of the best agreements that the EU reached up to now. CETA eliminates 98% of duties and import tariffs as soon as it is ratified and 100% of tariffs within the next seven years.

On the other hand, although the agreement is extremely favorable for the EU, Canada, on the other hand, has less access to the European market and accounts for about 10 percent of the country's total trade with the EU. Comparing EEA, under CETA Canada is not required to align its laws and regulations with the EU, and the deal contains provisions for voluntary co-operation between regulators (Belke and Gros, 2017). In exchanging products, CETA permits a component of common acknowledgment of 'congruity appraisal' in chose regions of merchandise, permitting controllers from either side to survey merchandise to each other's guidelines before they are exchanged.

Conclusion about Hypothesis V: British side does not see CETA as an acceptable solution for the future trade relationship between the United Kingdom and the European Union (Whyman and Petrescu, 2017). The British side points out that this model would establish significant constraints for the two markets so that ultimately neither of them would have significant benefits.

This reasoning suggests that the UK could take a much more protectionist stance towards the EU in future negotiations.

VI. DFCTA – UKRAINE MODEL

One of the solutions for future EU-UK trade relationship analyst suggest is EU's recent association agreement with Ukraine (Dunolp et al, 2020). This agreement allows Ukraine access to the EU single market once it accepts European rules. Under this agreement, Ukraine has almost complete access to the EU market when it comes to goods, except when it comes to agricultural products. Although it has almost unlimited access to the Single Market, Ukraine does not make any financial contributions, nor is it obliged to accept freedom of movement. As in the case of the EEA, Ukraine is obliged to monitor European regulations in the areas of competition, social regulation, environment, as well as to regulate this area under the case-law of the European Court of Justice.

Conclusion about Hypothesis VI: This agreement with Ukraine, indicate that the European Union is willing to accept partial integration of non-member state into the European Single Market. But this agreement was concluded only on European rules, terms, and conditions. To be assessed in partial integration, these countries have to pay a price. First, they must not only unconditionally accept European rules and regulations, but also the supervision of European institutions over numerous economic areas. The most important difference between these countries and the UK is that they are „in processing", but the UK is „out-processing". In essence, the relief and concessions that the EU gives to countries like Ukraine are part of its neighborhood policy, which aims to bring these countries as close as possible to the European Union and to even join the European bloc in a certain period. So, this scenario does not match the prospects of the UK. This scenario and perspective remain unreal and do not comply with the UK's ambitions and outlooks.

VII. LIMITED ACCESS TO THE SINGLE MARKET – SWISS MODEL

One of the arrangements for future trade relations between the two markets, analysts point to the Swiss model. This approach, which is limited, but also unique among the so-called EFTA countries. EFTA came as a solution after Switzerland rejected accession to the EFA in a 1992 referendum. From then until today, Switzerland has been developing and improving its trade relations with the EU through bilateral agreements. This country has negotiated "limited access" to the EU Single Market through more than 100 special agreements. "Limited access" means that Switzerland has almost entire and barrier-free access to the Single Market for industrial goods (Chapman, 2018). In most cases, it is allowed to sell the product regularly without additional testing and compliance checks. On the contrary, this country has accepted the free movement of people and complied with EU rules concerning the single market to which they are accessing, without having the right to decide what those rules look like.

Switzerland is also required to pay EU financial contributions. It has pledged to pay grants to reduce social inequality in EU accession countries. Lately, the European Union has been pointing out that relations with Switzerland have become complex and difficult to manage and are trying to reform them. EU also points out that a new institutional arrangement is needed to further increase of the market volume of trade and Switzerland's share of the Single Market. Switzerland is equally dissatisfied with the existing arrangements.

Conclusion about Hypothesis VII: It is almost impossible for the UK to reach the kind of agreement that Switzerland has with the EU. This set of bilateral agreements is too complicated, and equally unsatisfactory both within the EU and in Switzerland. Furthermore, this model provides only a limited or partial approach when it comes to trade in goods within the EU market, and even more limited access when it comes to services. If the UK were to accept such an agreement, it would, like Switzerland, always have to change domestic legislation every time it changes in the European Union. Generally speaking, analysts believe that overall such a model would harm the British economy.

The overall conclusion is that the UK prefers the model which falls between Canada and Norway arrangement. On the other hand, the EU may be unwilling to offer anything other than EEA membership (Owen et al, 2017). The UK, despite being the fifth largest economy in the world, is much more dependent on the EU than the other way around, given that 12.6% of the UK's GDP is linked to exports to the EU. On the other hand, only 3.1% of the GDP of the remaining 27 EU countries is related to exports to the UK. That means that the UK is not in a position to dictate rules and conditions on a future deal.

VIII. Trade after Brexit under WTO rules

In this part, I will analyze a possible scenario with "no agreement". That means the future trade relations between the EU and the UK will be conducted under WTO rules. To present that scenario I will use research conducted by the Centre for Economic Performance. According to the "no agreement" scenario, it is improbable that items from the UK could enter the EU without additional border checks. This means companies from the UK could produce in two lines, one for the EU and the other for the rest of the world. This would unquestionably build costs and lessen the intensity of British items. The effect of non-tax boundaries would be more prominent for the administration's part, which represents about 80% of the UK economy.

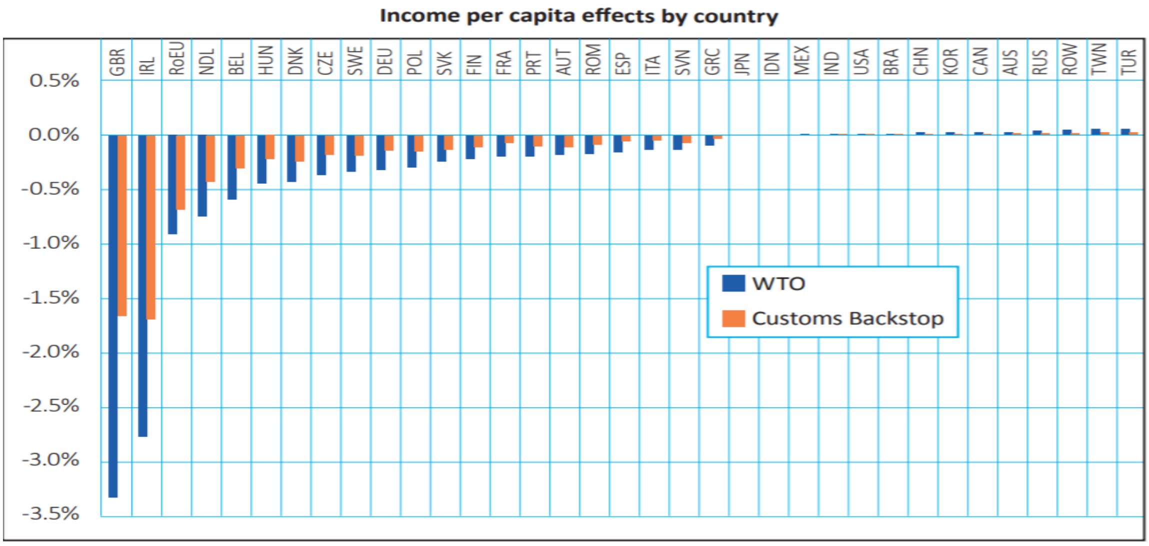

Figure 2- Impact by country

Source: Centre for Economic Performance

The Center for Economic Planning predicts that if the UK does not reach an agreement, future relations are based on WTO rules, over the next ten years the volume of trade with the EU could be reduced by 40%. This reduced trade would result in a 2.6% drop in revenue per capita per year. Additionally, there would be a drawn-out negative student from less venture and more slow efficiency development, which is assessed to add up to another 3.5% of GDP. Their modeling also shows that revenues in the case of reaching an agreement had fallen by 1.7%, and in the case of continued trade under the terms of the WTO, the decline in revenues was 3.3%

IX. Simulations with General Equilibrium Trade Models

There is also another spectrum of predicting the economic consequences for the UK after leaving the EU. Since early 1990, Computable general equilibrium (CGE) model have been widely used to analyze trade policy issue including unilateral trade liberalization, multilateral tariffs reforms, and so on. The most common approach to analyzing the economic consequences of Brexit is a simulation using a general equilibrium model (Burfisher, 2017). The general equilibrium model (CGE) allows us to assess the impact of GDP, welfare, wages, capital expenditures, along with the development of total sectoral production. The aim is to model important links in the economy in the medium and long term and to assess the possible impact of changes in trade policy on the economy. Swhati Dhingra in its 2017 analysis provides a complete cost estimate between the UK and its trading partners in the medium and long term based on a general equilibrium model. The model covers 40 countries and 30 sectors and includes trade in intermediate goods. (Dhingra et al, 2017). I will not go into details of that research conducted under the above methodology, but in the following table, I will only present possible scenarios and expectations in general. Distinguishing between an optimistic and pessimistic scenario, they estimate that on the horizon of 10 years, the export from the UK to EU could fall ranging from 14% to 43%.

Table 1- Overall change in UK trade flows after Brexit

Scenario	*Horizon*	*Total UK export*	*Total UK import*	*Export to EU*	*Import from EU*
Optimistic	*Short-run*	*-5%*	*-6%*	*-14%*	*-13%*
	Long run	*-9%*	*-8%*	*-25%*	*-22%*
Pessimistic	*Short-run*	*-14%*	*-14%*	*-36%*	*-34%*
	Long run	*-16%*	*-16%*	*-43%*	*-38%*

Source: Ottaviano et al, 2014

X. CONCLUSION

All the analysis concluded in the drafting and preparation of this research indicate that it will take much more than a year before the United Kingdom and the European Union make any agreement on future trade. It will take decades for the UK to amend existing agreements with other countries. Regardless, all available analysis predicts that significant disruptions in trade links between the two markets will have negative economic consequences for both economic entities.

As I pointed out earlier and then presented in this research, there are countless more diverse studies and methods that deal with the impact that Brexit has on the economy of Britain.

Also, no model can fully capture all aspects through which trade affects the entire economy. In this regard, it is not possible to give precise and reliable figures on how much the effects will be on the British economy as a whole. Also, there is no single, absolute, and only reliable methodology that could accurately determine what consequences Brexit will have on EU-UK trade relations, as well as what the consequences will ultimately be for the British economy as a whole.

However, all this research points out that Brexit will have negative consequences for the British economy in the long run. Be that as it may, the EU-27 would have just a disproportionally little portion of the absolute expense, not just because it is around multiple times bigger than the UK in monetary terms, but also because of reasons, for example, the more prominent market intensity of its undertakings. However, analysts predict that it would take up to a decade or more for the UK to negotiate a new agreement with the EU, and also to replace existing trade deals with other countries (Belke and Gros, 2017).

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