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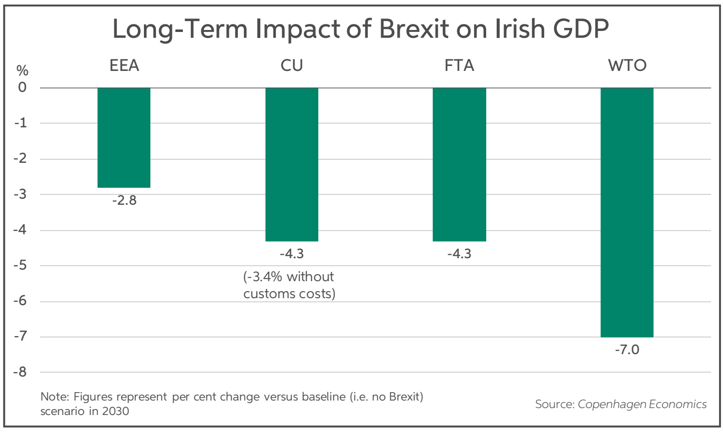
New report highlights regulatory costs of Brexit

A comprehensive study of the likely impact on the Irish economy of Brexit was published recently by Copenhagen Economics (CE). The report was prepared for the Irish Government. **It is different from most other reports in that it takes into consideration not only the impact of tariffs, but also non-tariff barriers** that give rise to additional administrative and compliance costs, as well as the increased **costs associated with regulatory divergence**. Given the comprehensive assessment of the costs of Brexit, it is not surprising that the CE analysis shows a larger negative impact on the economy from Brexit than most other studies, including the November 2016 ESRI report, which did not consider **increased regulatory costs.**

The report examines the long-term impact of Brexit on the Irish economy under four different types of EU-UK trade scenarios, namely; a European Economic Area (EEA) scenario like Norway, a Customs Union (CU) scenario, a Free Trade Agreement (FTA) scenario and a World Trade Agreement (WTO) scenario. **The report assesses the likely future state of the Irish economy in 2030 under these various scenarios relative to a non-Brexit baseline,** where the UK remains a full member of the EU. A key consideration for each scenario is to what extent are they capable of reducing the higher trade costs that will arise from Brexit. **The results show that GDP is between 2.8% and 7% lower by 2030 under the various scenarios** than otherwise would be the case.



Under an EEA scenario, there is duty free trade on most products, some barriers to trade in services and close regulatory alignment. This is not a full customs union, though, and thus there are costs from border inspections, as well as tariffs on some products and some restrictions on trade in services. GDP is 2.8% lower under this scenario.

In a CU scenario, there is duty free trade on most products, but still some customs procedures and costs. Furthermore, customs unions do not involve services and do not cover regulatory issues for trade in goods. Thus, there is a higher risk of regulatory divergence than under the EEA scenario. As a result, GDP is 4.3% lower in the CU scenario. However, this can be reduced to 3.4% if customs procedures are minimised.

A FTA scenario has duty free trade in most products, but there are customs controls and costs as well as the risk of regulatory divergence for both goods and services. FTA agreements don't usually cover services. The fall in GDP is the same as in a CU where customs procedures are not minimised, at 4.3%.

In the WTO Scenario, trade is governed by WTO rules and other agreements. Where trade agreements don't exist between countries, tariffs and quotas are imposed, though generally not on all products. There is no free trade in services and significant customs costs. The risk of regulatory divergence is higher than in the other scenarios. GDP is estimated to be 7% lower by 2030 under the WTO scenario.

The circa 3-7% hit to GDP is significant but it occurs over a long period of time until 2030. Translated into annual average growth rate terms, the CE report says Brexit would **lower the growth rate of the economy by between 0.2-0.5% per annum over a twelve year period.** Thus, it is not like a recession where all the impact is condensed into a one or two year period. **The Irish economy would still grow at a solid rate.** The CE report also looks at **the short-term effects and concludes that GDP would be between 0.5% (EEA scenario) and 2% (WTO scenario) lower some two years after Brexit in 2020**. The CE report did not take into consideration any measures taken by the government to lessen the effects of Brexit or how Brexit might impact FDI inflows.

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Agri-food the sector most impacted by Brexit

Ireland has very close trade links with the UK. Some 15% of Irish exports go to the UK. However, for indigenous industries, most notably the agri-food sector, the UK is an especially important market taking close to 40% of their exports. In addition, the CE report notes that two-thirds of Irish exporters make use of the UK land bridge to access continental European markets. Meanwhile, over 25% of Irish imports of goods come from the UK. The CE report shows that **Brexit will have negative impacts on the Irish economy in all the scenarios** it analysed. There will be negative effects on Irish trade, with adverse knock-on impacts on production, GDP, employment and wage growth.

The impact of Brexit is particularly large for some sectors as a result of a combination of the large scale of Irish-UK trade in the sector and the extent of the effects of Brexit on the specific sector, especially increased regulatory costs. The CE report identifies five sectors that account for the vast majority of the total impact of Brexit, namely agri-food, pharma-chemicals, electrical machinery, wholesale & retail and air transport.

Agri-food is by far Ireland's biggest indigenous industry and very reliant on the UK market. Not surprisingly, then, it is the sector in which the largest impacts occur, with trade and production predicted to fall significantly below the non-Brexit baseline level by 2030. The impacts are driven by a combination of tariffs, customs costs and the risk of regulatory divergence, with beef, dairy and processed foods the most affected industries under all scenarios.

Pharma-chemicals is not overly dependent on the UK market, but it is Ireland's largest export sector and a significant contributor to GDP. Moreover, 23% of the imports in the sector come from the UK according to the CE report. The impacts in this sector are almost exclusively driven by the risk of regulatory divergence and increased border costs that will add significant administrative costs. Tariffs in the sector are very low as a result of WTO agreements and so are not really an issue.

Electrical machinery is another large export sector in Ireland. According to the CE analysis, 17% of its exports are to the UK, while 30% of its imports come from the UK. Again, WTO tariffs are very low in this sector so the impact in all the scenarios is very much driven by the risk of regulatory divergence.

The **wholesale & retail trade** is a big sector of the Irish economy and a very large employer, especially when the restaurant and accommodation sectors are included, as CE did in this analysis. There are close links between the retail sectors in Ireland and the UK, with many chains operating in both markets. The sector will be impacted by tariffs, customs controls, border costs and regulatory divergence across a broad range of imported goods from the UK, most notably processed foods. The sector will also be impacted by a drop in consumer demand resulting from Brexit.

Air transport is very important to Ireland and could also be impacted by Brexit, with EU rules requiring airlines flying within the EU to be majority EU owned. Irish airlines could lose access to the intra-UK market if Britain opts to operate the same rules. The UK could also lose access to the EU's open skies agreements. With fewer routes out of the UK, this will affect air transport with Ireland.

Other service sectors will also be impacted by Brexit such as financial services, ICT and business services, tourism and the electricity market. The CE reports notes that although the impacts are small on a macro level, they could still be significant for the individual sectors.

The CE report concludes that the best possible outcome of the negotiations on trade between the EU and UK would be an agreement with no tariffs, large quotas for agricultural products, low border costs, continuing unfettered operation of land bridge route via the UK, minimum regulatory divergence and low barriers for trade in services. This suggests that **the best outcome for Ireland of the Brexit talks would be either the UK remains in the EEA, which seems unlikely, or the UK and EU form a full customs union**, with no requirement for border checks on movement of goods thereby minimising customs procedures and little divergence on regulations between the UK and EU, including for services.