Public Affairs 856
Trade, Competition, and Governance in a Global Economy

Lecture 22

4/18/2022

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UW Madison

Spring 2022

Outline

- Brexit
- USMCA

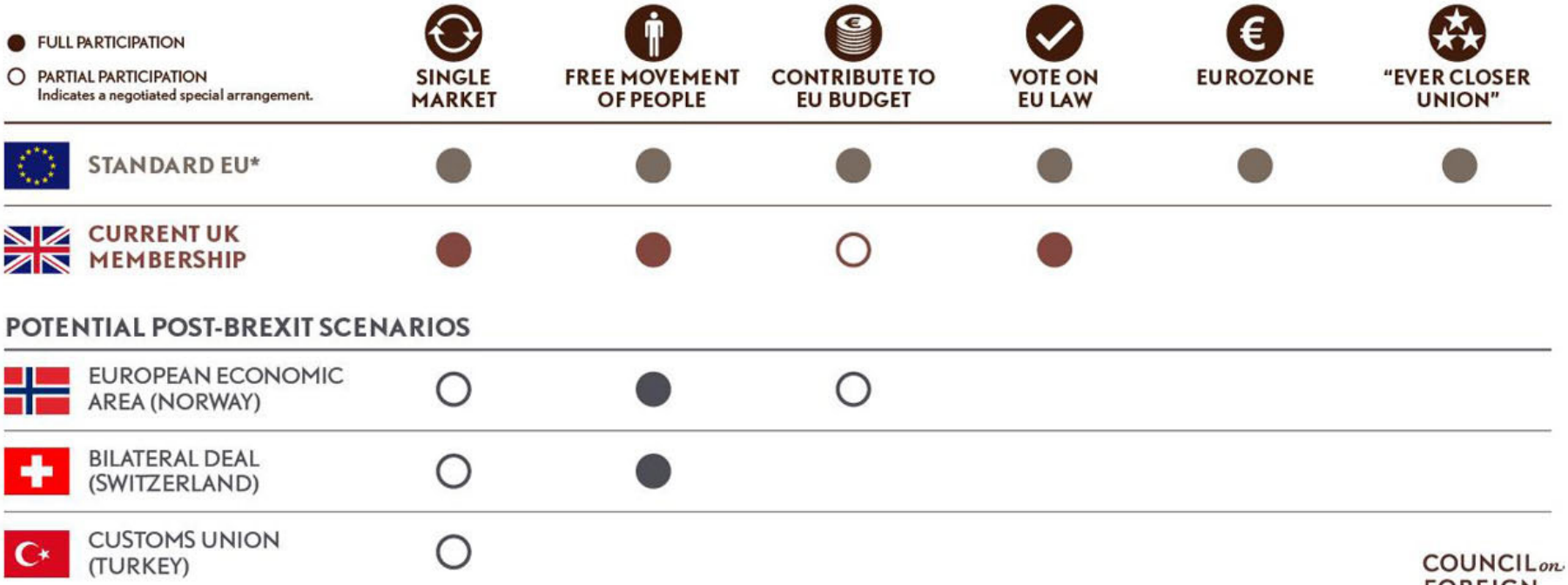
BREXIT

Brexit: Issue Areas

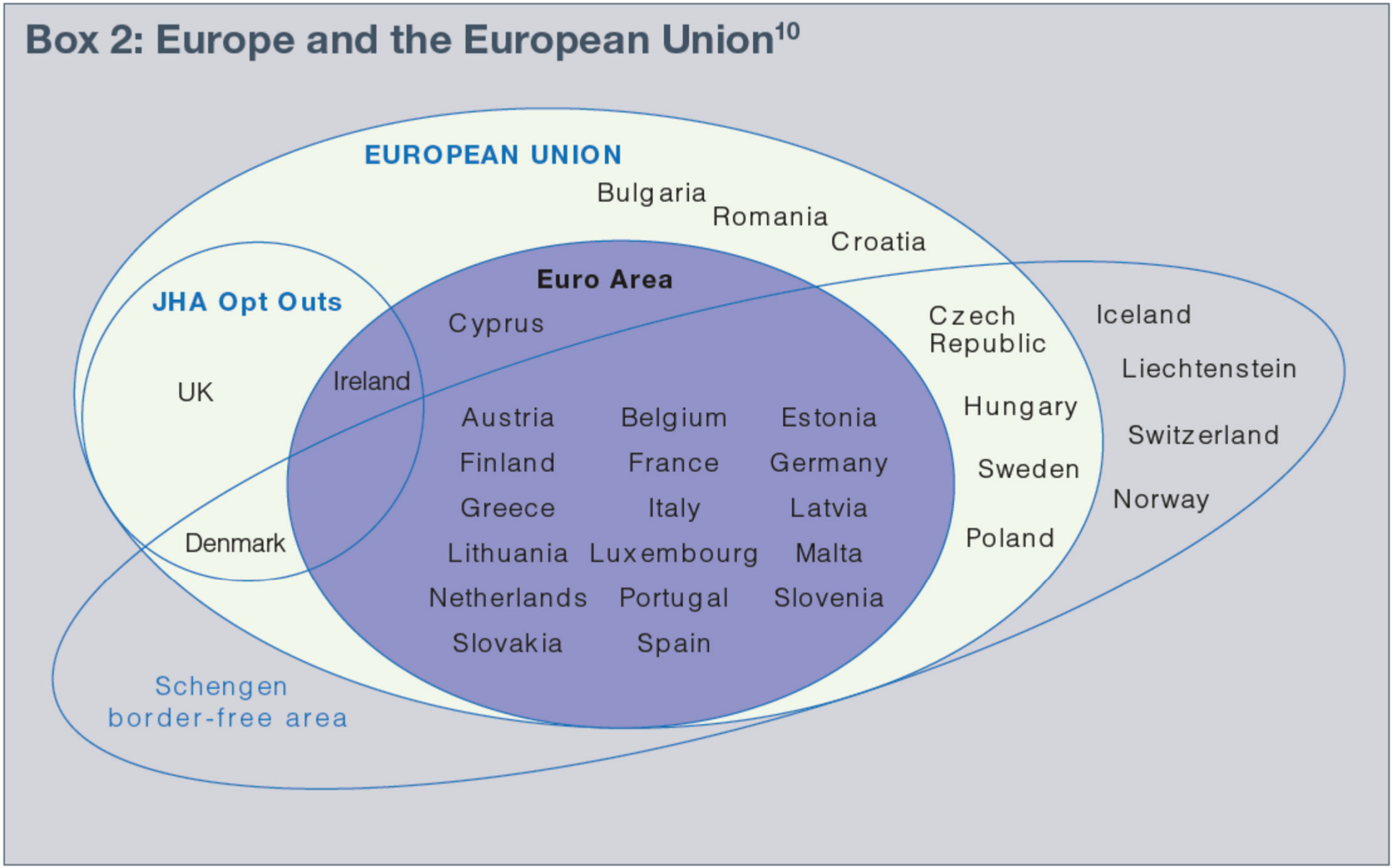
- Trade
- Investment
- Financial services/Passporting
- Immigration
- Budget

How Could the UK's Relationship With the EU Change?

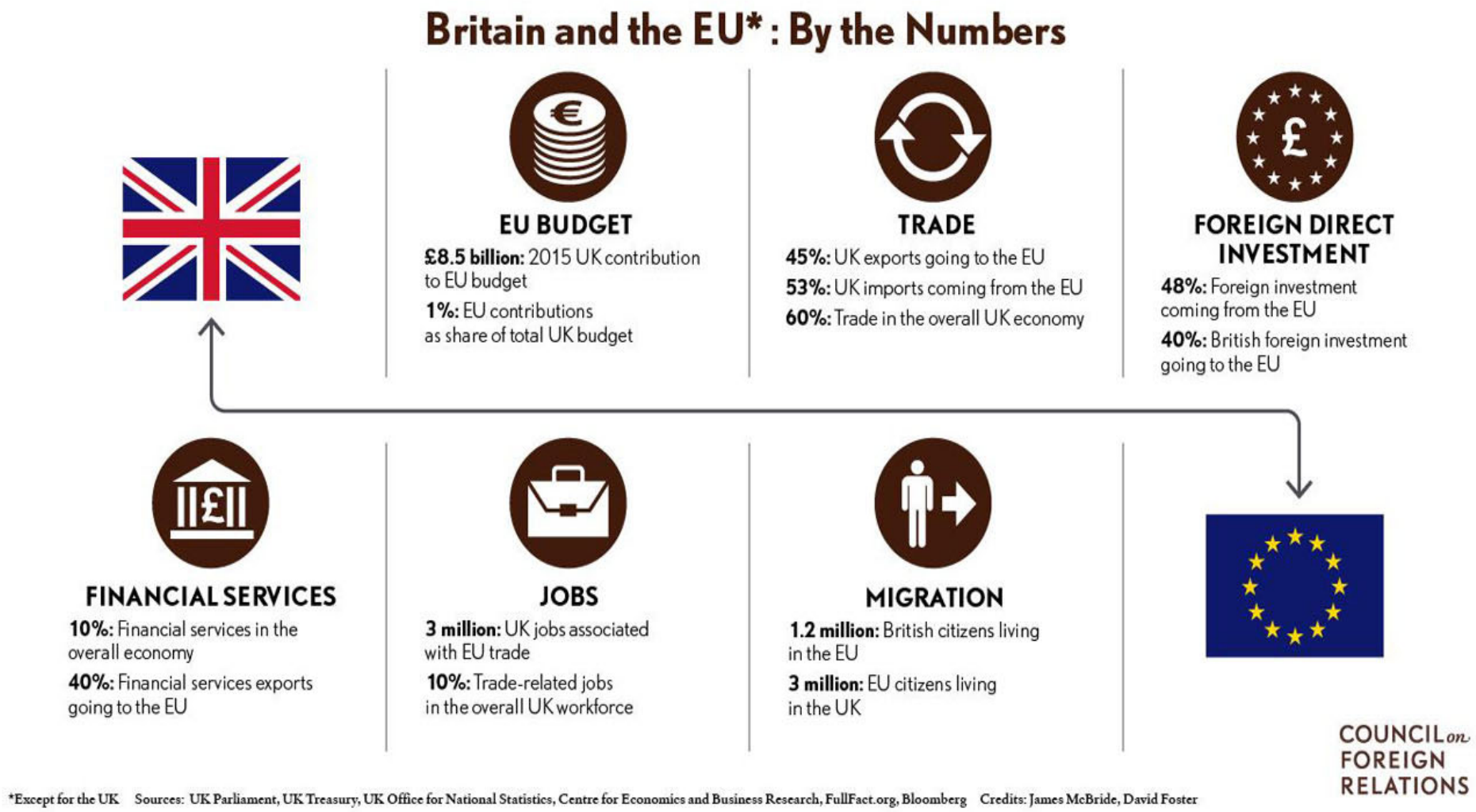
The UK already opts out from parts of the EU. If it leaves, its future could look like Norway, Switzerland, or Turkey, nonmembers with partial participation in the EU.



http://www.cfr.org/united-kingdom/brexit-means/p37747



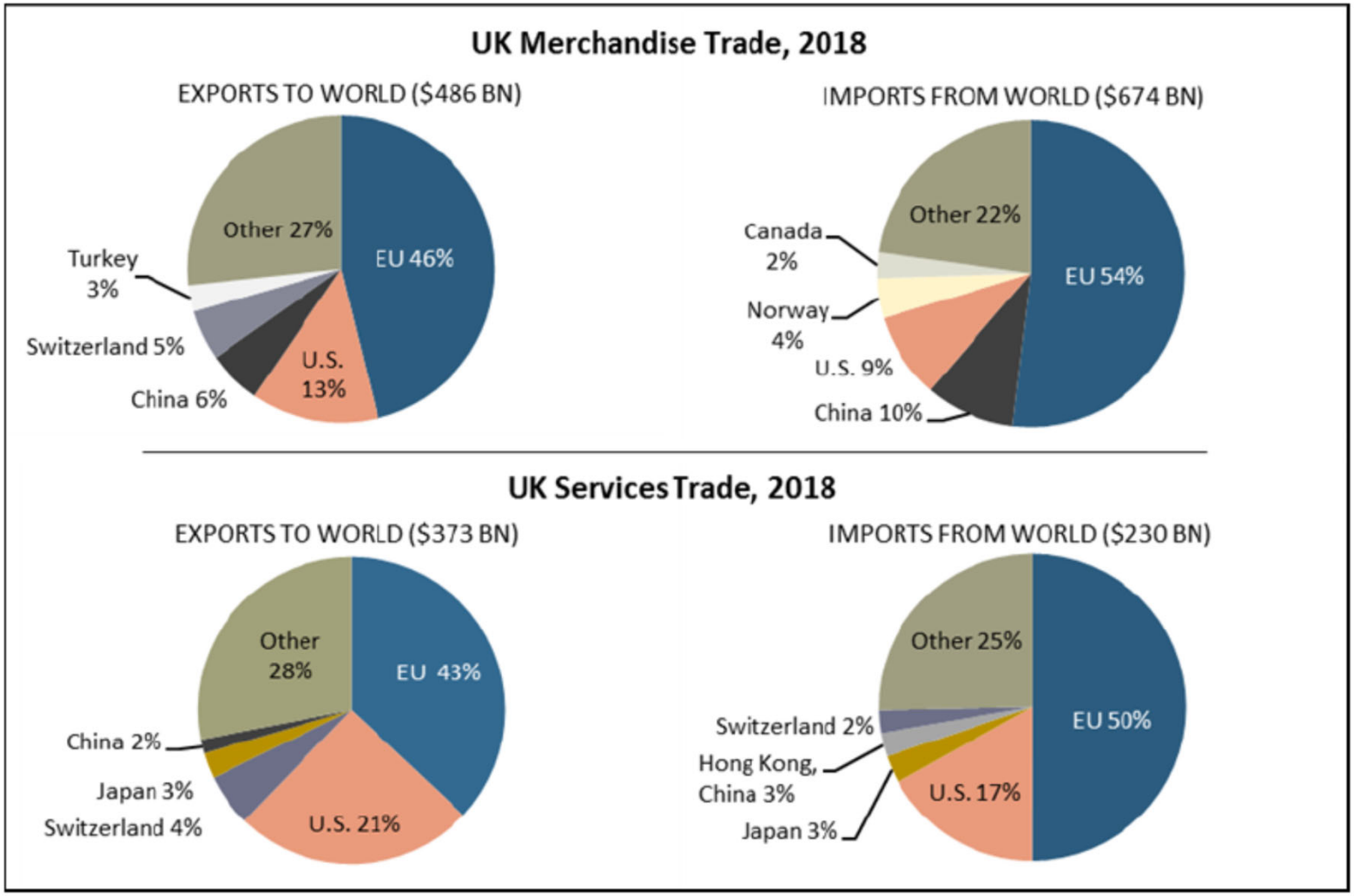
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/504604/Alternatives_to_membership_-_possible_models_for_the_UK_outside_the_EU.pdf



http://www.cfr.org/united-kingdom/brexit-means/p37747

Trade

Figure 1. UK World Trade



Source: Congressional Research Service, (CRS), based on data from the World Trade Organization (WTO), *Trade Profiles 2019*.

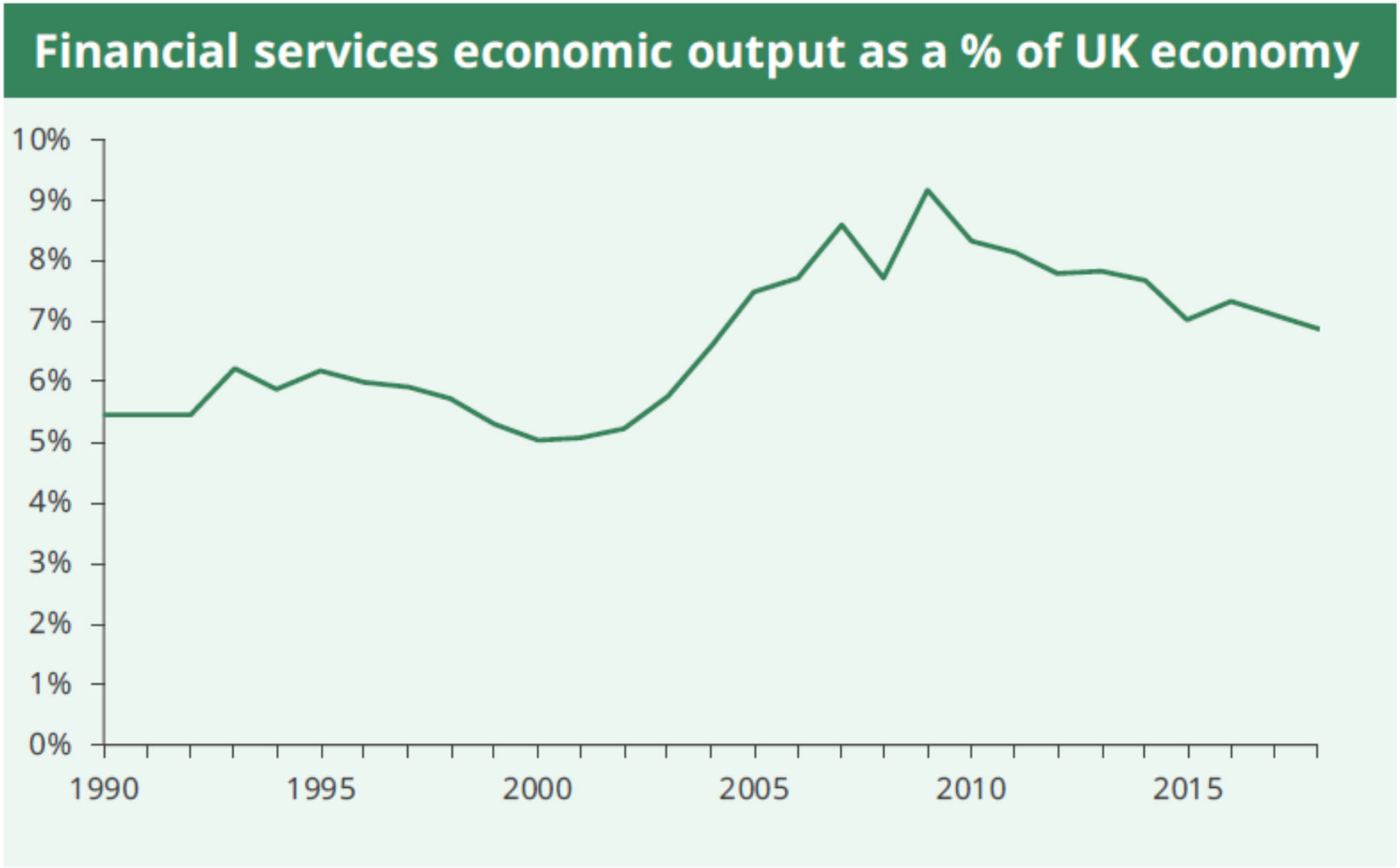
Trade in Services

- The single market is more developed for goods than for services, but it still offers some significant market access for services.
- Under the single market, banks and other financial services firms that are established and authorized in one EU member state can apply for the right to provide certain defined services throughout the EU or to open branches in other countries with relatively few additional requirements (known as *passporting rights*).
- Among other things, professionals in an EU member state also can move freely to another EU member state, benefitting from mutual recognition of professional qualifications across EU member states.

Banking and Finance

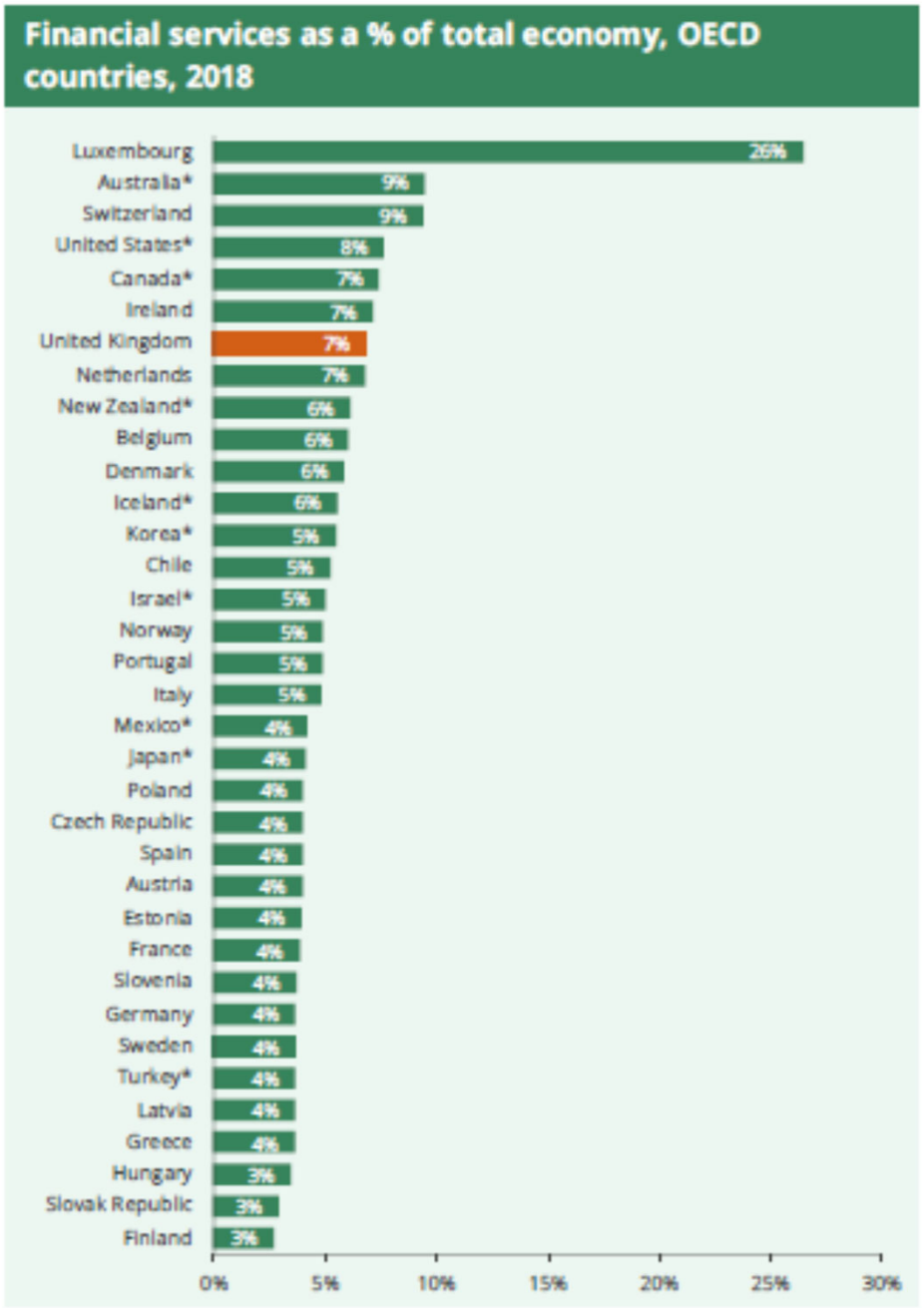
- London is the largest financial center in Europe presently.
- Financial services and insurance make up about one-third of UK services exports to the EU.
- The EU has made clear that the UK will no longer be able to benefit from financial passporting after the transition period.
- Absent alternative arrangements, such as an equivalence decision by the EU, continued trade in financial services may require UK and EU businesses to restructure their operations. Even with a positive determination, the EU could revoke equivalence at any time.
- U.S. and other banks are concerned about losing the ability to use their UK bases to access EU markets without establishing legally separate subsidiaries.

Finance Is Important



Source: ONS Series KKP5 and KKK9

https://commonslibrary.parliament.uk/research-briefings/sn06193/



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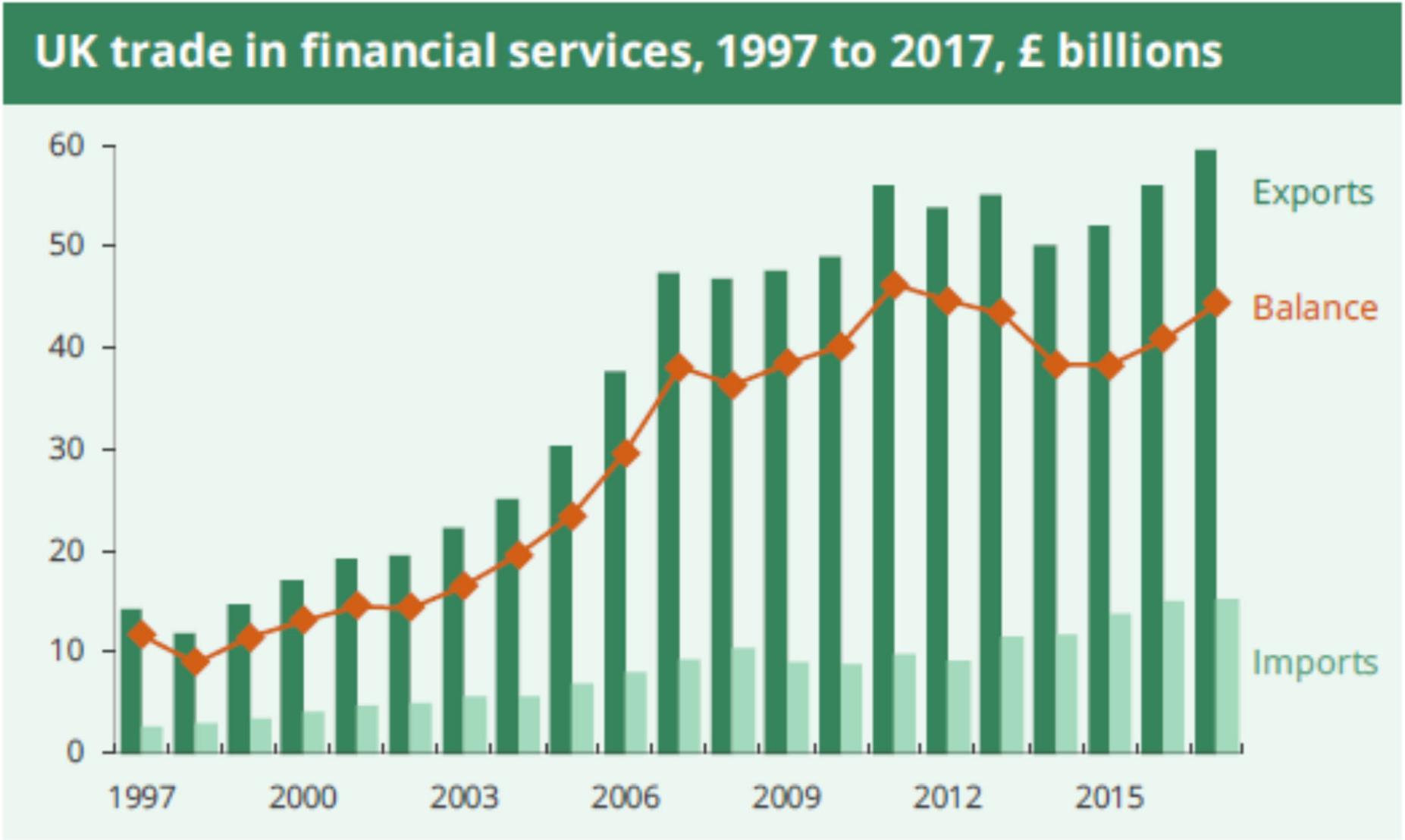
Financial Services Trade



Source: ONS, Pink Book 2018, Table 3.5

43% of exports of financial services are to rest of EU

https://commonslibrary.parliament.uk/research-briefings/sn06193/

Simulation Results

- Many different studies using different methodologies
- Most prominent ones use CGE's (computable general equilibrium) models
- The following list excludes some well-known models that predict net benefit from Brexit, as they rely on implausible assumptions (Minford)

Latorre, Olekseyuk, Yonezawa, & Robinson (2019)

Table 3 Comparison of recent computable general equilibrium (CGE) studies on Brexit (percent change relative to no-Brexit scenario)

	Booth et al. (2015) (Open Europe study)				Ciuriak et al. (2015)				Jafari and Britz (2017)	Minford et al. (2016)	Latorre, Olekseyuk, and Yonezawa (2018)				Ortiz and Latorre (2018a)				Pricewaterhouse Coopers (2016)	
	Soft	Hard	FTAEU+ ROW+ Dereg[a]		Soft		Hard		UK	UK	Soft		Hard		Soft		Hard		Soft	Hard
		UK			EU-27	UK	EU-27	UK	Hard	UK alone	EU-27	UK	EU-27	UK	EU-27	UK	EU-27	UK	UK	
Impact on GDP	−0.81	−2.23	0.64	1.55	−0.24	−0.97	−0.65	−2.54	−4.45	4.00	−0.16	−1.23	−0.35	−2.53	−0.07	−0.50	−0.14	−1.15	−1%	−3.5
Sectoral effects considered																				
Sectoral productivity shocks á la Melitz (2003)									√				√							
Imperfect competition and variety effects									√				√							
Perfect competition		√				√				√						√			√	
Value chains		√				√			√	√			√			√			√	
Barriers considered																				
Tariffs		√				√			√	√			√			√			√	
Nontariff barriers to trade		√				√			√	√			√			√			√	
Nontariff barriers to foreign direct investment		√				√							√							
Rules of origin		√				√														
Macro shocks																				
Foreign direct investment		√				√			√				√							
Migration									√							√			√	
EU budget		√							√										√	
Exchange rate		√				√														
Changes in unemployment rate																			√	
Risk premia/uncertainty																			√	
Dynamics		√				√													√	

a. See text for explanation of this scenario.

Source: Authors' revision.

Table 4 Comparison of recent macroeconometric studies on Brexit (percent change relative to no-Brexit scenario)

	Aichele and Felbermayr (2015)				Dhingra et al. (2017)				HM Treasury (2016a)		HM Treasury (2016b)			OECD (2016)	
	Soft		Hard		Soft		Hard		UK		UK			Hard	
	EU-27	UK	EU-27	UK	EU-27	UK	EU-27	UK	Soft	Hard	EEA	FTA	WTO	EU-27	UK
Impact on	Real income				Private consumption				GDP		GDP			GDP	
	-0.1	-0.64	(-0.36;-0.24)	(-2.8;-1.54)	-0.32	-1.34	-0.82	-2.66	-3.60	-6.00	-3.80	-6.20	-7.50	-1.0	-3.3
Overall approach	New quantitative trade model (NQTM)				NQTM				VAR and NiGEM		Gravity and NiGEM macroeconomic model			CGE and NiGEM	
Sectoral effects considered															
Sectoral productivity shocks á la Melitz (2003)															
Imperfect competition&variety effects															
Perfect competition		√				√			√			√			√
Value chains		√				√									√
Barriers considered															
Tariffs		√				√									√
Nontariff barriers to trade		√				√									√
Nontariff barriers to foreign direct investment															
Rules of origin															√
Macro shocks															
Foreign direct investment												√			
Migration												√			√
EU budget						√			√			√			√
Exchange rate									√			√			√
Changes in unemployment rate									√						√
Risk premia/uncertainty									√			√			√
Dynamics									√			√			

EEA = European Economic Area; FTA = free trade agreement; WTO = World Trade Organization

Source: Authors' revision.

Latorre, Olekseyuk, & Yonezawa. (2018)

Table 2 Impact of Brexit on macroeconomic aggregates in 2020
(percent change relative to initial levels)

	Soft (Norway case)		Hard (WTO case)	
Item	**EU-27**	**UK**	**EU-27**	**UK**
		GDP		
Nontariff barriers	-0.10	-0.82	-0.18	-1.47
Foreign direct investment	-0.06	-0.41	-0.12	-0.83
Tariffs			-0.06	-0.39
Total	-0.16	-1.23	-0.35	-2.53
	Private consumption (change in billions of dollars)			
Nontariff barriers	-15.616	-18.950	-29.016	-34.741
Foreign direct investment	-10.585	-11.915	-20.309	-23.485
Tariffs			-9.908	-6.527
Total	-26.178	-30.818	-57.977	-62.701
		Wages		
Nontariff barriers	-0.12	-0.97	-0.22	-1.75
Foreign direct investment	-0.05	-0.29	-0.09	-0.63
Tariffs			-0.10	-0.88
Total	-0.17	-1.26	-0.39	-2.83
		Capital remuneration		
Nontariff barriers	-0.14	-0.98	-0.24	-1.76
Foreign direct investment	-0.07	-0.61	-0.13	-1.11
Tariffs			-0.11	-0.93
Total	-0.21	-1.59	-0.43	-3.34

Latorre, Olekseyuk, & Yonezawa. (2018)

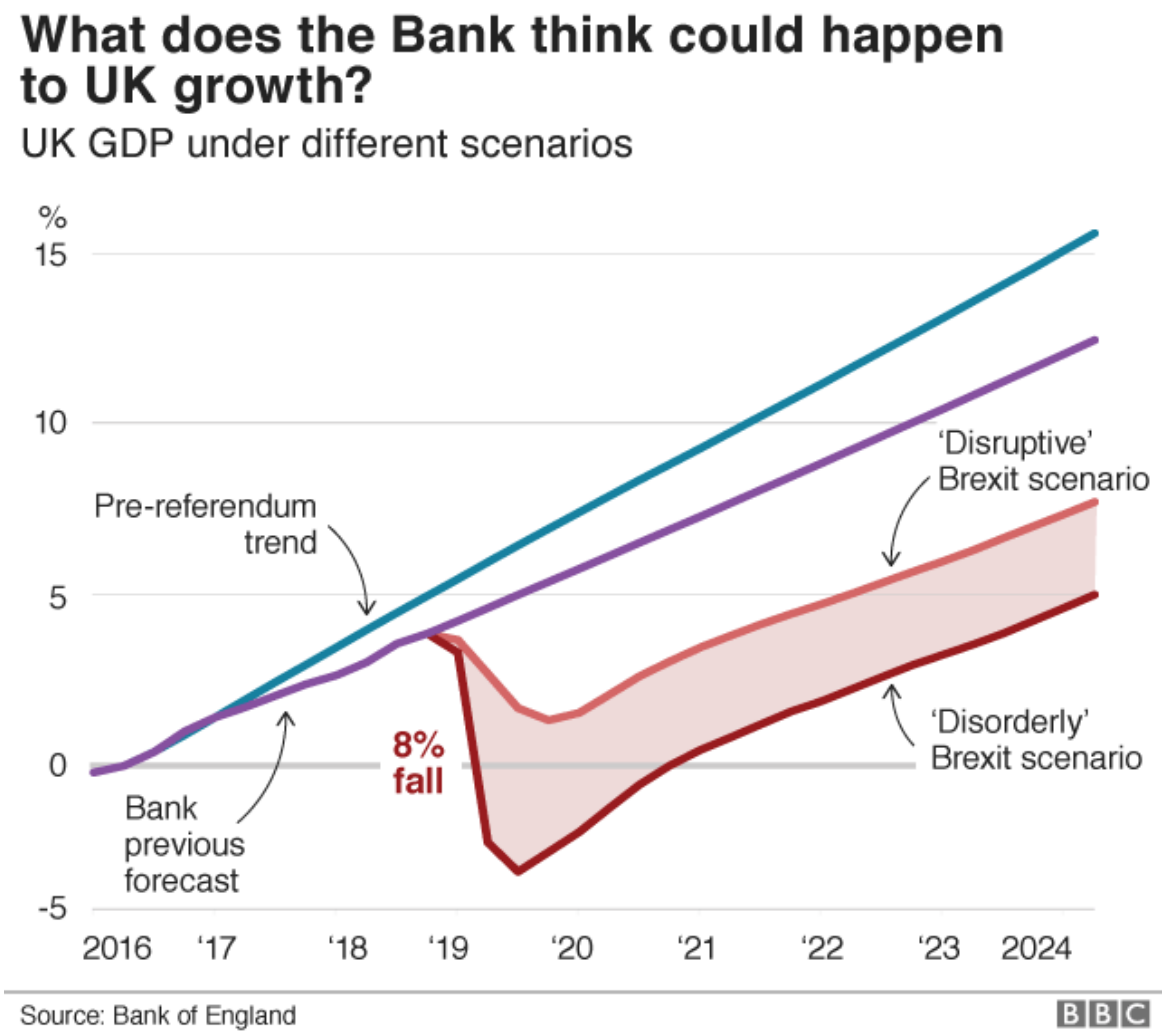
	Aggregate exports			
Nontariff barriers	-1.47	-7.63	-2.52	-12.86
Foreign direct investment	-0.07	0.08	-0.13	0.15
Tariffs			-1.48	-7.98
Total	-1.54	-7.54	-3.48	-16.94
	Aggregate imports			
Nontariff barriers	-1.68	-6.23	-2.87	-10.55
Foreign direct investment	-0.01	-0.22	-0.02	-0.37
Tariffs			-1.66	-6.63
Total	-1.69	-6.44	-3.82	-14.42
	Consumer price index			
Nontariff barriers	-0.08	0.31	-0.16	0.57
Foreign direct investment	0.02	0.02	0.04	0.08
Tariffs			-0.12	0.89
Total	-0.06	0.33	-0.20	1.14

WTO = World Trade Organization

Note: Shaded cells denote losses.

Source: Latorre, Olekseyuk, and Yonezawa (2018).

BoE on “No Deal” Brexit



https://www.bbc.com/news/business-46377309

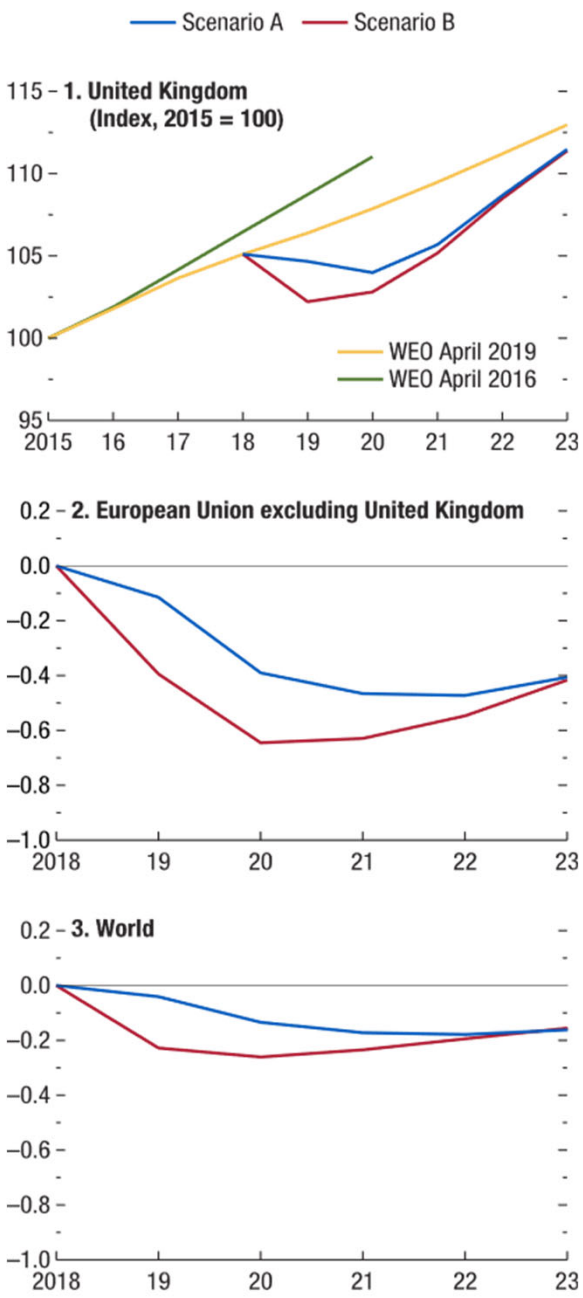
IMF on “No Deal” Brexit

Scenario Table 1. Trade Assumptions in the Baseline, Scenario A, and Scenario B

			No-Deal Scenarios	
		The WEO Baseline	A	B
Trade arrangements	Trade with third countries	The United Kingdom retains access to existing agreements between EU and third countries	The United Kingdom sets tariffs unilaterally to zero on 87 percent of its imports from mid-2019 to mid-2020; the United Kingdom loses access to most existing agreements, secures new agreements by 2021	
	Trade with the European Union	No tariff increases; nontariff barriers gradually increase by 10 percent in tariff equivalent terms	Tariffs increase by 4 percent in mid-2019 (mid-2020 for UK imports subject to temporary tariff regime); nontariff barriers increase gradually by an additional 14 percent (in tariff equivalent terms) relative to baseline	
Border disruption		No	No	Yes
Tightening of financial conditions		No	Small	More severe

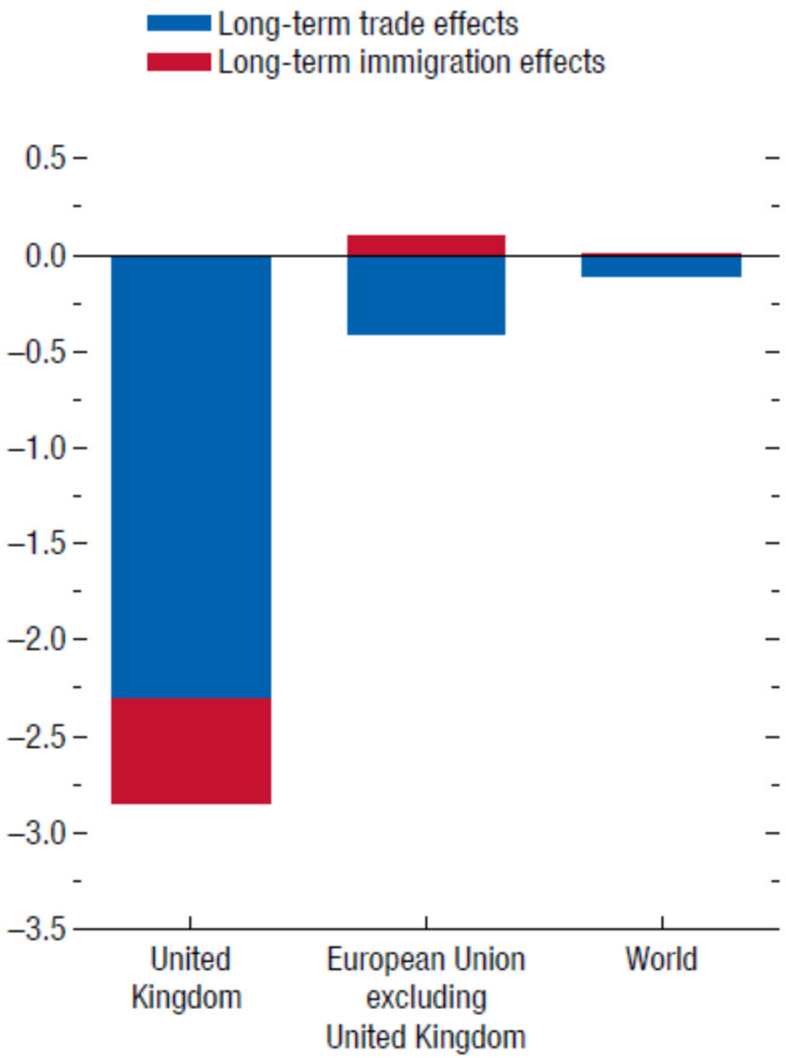
IMF WEO April 2019

Scenario Figure 1. Real GDP in Brexit Scenario
(Percent deviation from control, unless noted otherwise)



Source: IMF staff estimates.
Note: WEO = *World Economic Outlook*.

Scenario Figure 2. Brexit Long-Term Real GDP Effects
(Percent deviation from April 2019 WEO baseline)



Source: IMF staff estimates.
Note: WEO = *World Economic Outlook*.

Current State of Play

- Effective now - N. Ireland is to maintain regulatory alignment with the EU to preserve an open border with the Republic of Ireland
- At the end of the transition period, the UK (incl N. Ireland) is expected to leave the EU customs union and pursue an independent national trade policy.
- For now, UK stays with EU standards so no need to inspect closely, and inspections take place anywhere (incl ports) instead of border

https://crsreports.congress.gov/product/pdf/R/R46730

Current State of Play

- Outside the EU customs union, the UK would regain an independent national trade policy
- The unlikely prospect in which the UK remains a member of the EU single market or customs union would provide more barrier-free access to the EU, but the UK would have to follow most EU rules without having a say in how those rules are made.

https://crsreports.congress.gov/product/pdf/R/R46730

Summary?

"There is no good Brexit"

-- Jean Claude Juncker, former European Commission President

Looking Forward: Policy Initiatives

- The UK's priority is to launch negotiations with the US, Australia and New Zealand. The UK signed an agreement in principle with Australia on 16 June 2021.

- The government continues work to reproduce effects of existing EU trade agreements. It is also considering joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

https://www.gov.uk/government/collections/the-uks-trade-agreements

USMCA

aka NAFTA2.0

Table 1.Proposed USMCA Select Changes to NAFTA

Sector	USMCA	NAFTA
Autos	75% ROO; 70% steel and aluminum requirement; steel must be melted and poured in region; wage requirement.	62.5% ROO; no wage requirement; no steel and aluminum requirement.
IPR protection	Biologics: No commitments (10 years in original text) Copyright: 70 years	Biologics: No commitments Copyright: 50 years
Government Procurement	U.S.-MEX only; CAN to use WTO GPA	Trilateral commitments

https://crsreports.congress.gov/product/pdf/IF/IF10997

Table 1.Proposed USMCA Select Changes to NAFTA

Sector	USMCA	NAFTA
Digital Trade	Cross-border data flows; restricts data localization	No commitments
Investor-State Dispute Settlement (ISDS)	Not applicable to U.S.-CAN disputes; U.S.-MEX disputes restricted	Trilateral commitments
State-owned enterprises	SOEs to adhere to market forces	No commitments

Source: CRS from USMCA Agreement.

https://crsreports.congress.gov/product/pdf/IF/IF10997

US ITC Analysis

Table ES.1 Economy-wide impacts of USMCA (changes relative to baseline in 2017)

	Value	Percent
U.S. real GDP (billion $)	68.2	0.35
Employment (1,000 full-time equivalent workers)	175.7	0.12

Source: USITC estimates.
Note: Dollar value is in 2017 prices.

Table ES.2 Impacts of USMCA on U.S. trade (percent changes relative to baseline in 2017)

	Exports (%)	Exports (billion $)	Imports (%)	Imports (billion $)
U.S. trade with Canada	5.9	19.1	4.8	19.1
U.S. trade with Mexico	6.7	14.2	3.8	12.4

Source: USITC estimates, USITC DataWeb.
Note: Exports and imports include both goods and services.

https://www.usitc.gov/publications/332/pub4889.pdf

Impact: Rules of Origin (ROOs)

Table 3.7 Estimated changes in prices and consumption in the U.S. market due to the USMCA's automotive ROOs (percent changes relative to the baseline, unless specified otherwise)

	Small cars	Mid- to full-size cars	Multi-passenger vehicles	Pickup trucks
Average price in the U.S. market	1.61	0.42	0.53	0.37
Total vehicle consumption in the U.S. market	-2.35	-0.59	-0.40	-0.51
Total vehicle consumption in the U.S. market (thousands of vehicles)	-75.7	-16.9	-32.9	-14.8

Source: USITC estimates.

Table 3.8 Estimated changes in the production of and trade in U.S. vehicles due to the USMCA's automotive rules of origin (ROOs) (thousands of vehicles; percent changes relative to the baseline)

	Small cars	Mid- to full-size cars	Multi-passenger vehicles	Pickup trucks
Change in U.S. vehicle production for North America	-33.2 -2.96%	-24.2 -1.23%	-43.5 -0.94%	-2.0 -0.07%
Change in U.S. exports of vehicles to Canada	-4.3 -3.53%	-1.1 -1.24%	-5.4 -1.21%	[a] 0.02%
Change in U.S. exports of vehicles to Mexico	-2.1 -5.99%	-0.4 -2.42%	-0.4 -0.52%	[a] 0.03%
Change in U.S. imports of vehicles from Canada	-7.7 -2.15%	3.0 1.00%	-8.3 -0.72%	[a] 0.00%
Change in U.S. imports of vehicles from Mexico	-82.0 -9.55%	-2.1 -0.88%	-19.3 -3.31%	-12.7 -2.26%
Change in U.S. imports of vehicles from the rest of the world	40.8 3.92%	4.8 1.04%	32.5 1.33%	[a] 0.00%

Source: USITC estimates.

[a] Less than 0.1.

https://www.usitc.gov/publications/332/pub4889.pdf

Policy Uncertainty Reduction?

Table 2.6 Impact of modeled provisions that reduce policy uncertainty on the economy-wide effects of USMCA (percent changes relative to the baseline)

Impact of provisions reducing policy uncertainty	None	Moderate	High
U.S. real GDP	-0.12	0.35	1.21
U.S. real output			
Agriculture	-0.22	0.18	0.88
Manufacturing and mining	0.37	0.57	0.88
Services	-0.13	0.17	0.71
U.S. employment	-0.04	0.12	0.40
Agriculture	-0.15	0.12	0.58
Manufacturing and mining	0.28	0.37	0.51
Services	-0.07	0.09	0.38
U.S. wages	-0.06	0.27	0.86
Agriculture	-0.18	0.23	0.94
Manufacturing and mining	0.25	0.50	0.94
Services	-0.10	0.23	0.84

Source: USITC estimates.

Note: Columns reflect different simulation specifications as follows:

None: Does not incorporate the impact of provisions that reduce policy uncertainty for international data transfer, cross-border services, and market access and nonconforming measures in investment.

Moderate: Reproduces the results of this study as previously shown in table 2.2.

High: Gives additional weight to provisions that reduce policy uncertainty for international data transfer, cross-border services, and market access and nonconforming measures in investment, as suggested by some economic research.

https://www.usitc.gov/publications/332/pub4889.pdf

USMCA: Summary

- USMCA was only a slight modification on NAFTA
- Some were proposed for TPP
- What big modifications occur are negative: Rules of Origin tightening for automobiles
- The net gain due to USMCA comes entirely from the decrease in uncertainty
- But USMCA comes with a sunset provision