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The Numbers Behind 'No Deal' – Why the EU Is A Loser

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What are the long term economic effects of 'no deal'?

To answer this question, it is necessary to use a proper trade model. As noted in previous work (Minford and Xu, 2017), the classical model is the best guide to the facts of UK trade, compared to the gravity model (favoured by HM Treasury).

Under a no deal scenario, but one where the UK pursues its announced policy outside the single market and customs union of creating free trade by signing agreements with the non-EU world, the key effect is to lower UK prices of food and manufacturers to world price levels and create competition inside the UK economy with these new prices.

Plainly, with an EU free trade deal with no reciprocal tariffs or other trade barriers, EU goods would also arrive free of any duty or other hindrance in the UK and also would compete with these world prices. We can assume that, in order to preserve their sales, their prices would fall in line. This would occur under high competition as then, otherwise, they would lose all their sales.

However, even under imperfect competition (as in the gravity model), it would be usual to assume that EU producers would price to get the maximum contribution to overheads on all spare capacity beyond sales inside the protected EU. Under the usual assumptions this point occurs when prices are set equal to or just below the competition, because that is the highest price at which the capacity can be got rid of.

For UK producers selling in the EU home market, competition would force their EU prices to equality with world prices: were one UK producer to get more, other producers would divert output to their market, driving prices into line. Under imperfect competition, they would price at the same mark-up over home costs in all markets, so again prices would equal those at home.

Suppose instead there was no EU trade deal and this consisted of existing tariffs being levied mutually by both sides – and the UK agreed free trade agreements with non-EU countries. Then the same logic would apply for pricing by EU producers selling in the UK: they would have to match new competition at world prices, so that their UK prices would remain the same as with a deal. Similarly, for UK producers selling into the EU; home competition (or their common mark-up) would force them to match home competition and so price into the EU at world prices.

So EU producers would now have to absorb the UK tariff; and EU consumers would have to pay the EU tariff on top of the UK world market price. Hence, the tariffs on both sides would be paid by the EU, the UK tariffs by EU producers paid to the UK Treasury, the EU tariffs by EU consumers. Of course, the EU would receive the tariff revenue from its own consumers, making its overall loss equal to the UK tariff revenue paid by EU producers- estimated at approximately £13 billion (Protts, 2016).

On top of this, with no deal, the UK financial settlement and the transition period would not occur. The EU would be short of some £28 billion (the currently projected UK net contribution for the next two years) over the rest of its budgetary septennial to 2020; it would also lose the longer term contribution to net liabilities, reported to be worth another £10 billion or so. Also, because its customs union with the UK would stop immediately, it would lose two years' worth of the terms of trade gain its producers make on its balance of trade surplus with the UK. This gain comes about through the higher prices within the customs union paid by consumers and received by producers, about 20% higher on average on our calculations. Goods sales to UK consumers by EU producers exceed sales by UK producers to EU consumers: this is the trade surplus of around £80-100 billion and 20% of that is around £18 billion a year. So two years' of that would be worth another £36 billion one-off loss.

From the UK viewpoint, paying no financial settlement would be a gain, avoiding the need to pay some £38 billion. Also, with no transition period, the other Brexit gains of free trade, self-regulation and own-border-control would come two years earlier. Those long term gains amount to roughly 6 per cent of GDP, excluding the budgetary transfer, and would arrive in full by say 2030. But no trade deal would mean no transition period and would bring the whole flow of gains in two years earlier. These extra early gains are worth 12% of GDP; when discounted at 3% p.a. they fall to around 9% of GDP, about £180 billion today. The UK would also gain the tariff revenue paid by the EU producers to the UK Treasury, of £13 billion p.a.; which discounted would be worth some £433 billion.

Of course, the short run disruption would be unpopular on both sides of the Channel, with industry and consumers affected. However, UK farming and manufacturing industry has already gained massively from the Brexit devaluation and thereby been given substantial short term compensation for the efforts they must make to raise productivity; those efforts would have to be made rather earlier, but to the benefit of the national interest.

In summary, it would seem that the breakdown of talks would have a positive net present value for the UK comprising a one-off gain of £38 billion on the EU budget, plus £180 billion from bringing forward the non-budgetary Brexit gains, plus £433 billion from EU tariff revenue, some £651 billion in all.

For the EU, it would mean a one-off loss of £38 billion in financial settlement, plus another one-off loss of £36 billion in terms of trade gain, plus the £433 billion from paying the UK its tariff revenue– a negative net present value of £507 billion.

So, a £651 billion gain for the UK versus a £507 billion loss for the EU: it could not be more open and shut who should least want a breakdown. For the UK, a breakdown would be a short term nuisance but a substantial economic gain; for the EU it is both a short term nuisance and a substantial economic loss.

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