OVERVIEW OF PUBLISHED TREASURY BREXIT FORECASTS

Economists for Free Trade

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After discarding use of its widely criticised 'gravity-like' model used in the initial Project Fear Referendum forecasts, the Treasury has now adopted use of a Computable General Equilibrium model (GTAP from Purdue University) that is similar in structure to the World Trade Model at Cardiff University used by EFT.

The assumptions of the Treasury report/technical annex published on 28 November are flawed in three fundamental ways:

1. **Arbitrary assumptions are employed to produce *de-minimis* benefits for the UK economy from future free trade agreements (FTAs) with non-EU countries** (only a 0.2% of GDP long-term boost to the economy**)**
   - This compares to Australia's estimated achieved gain of more than 5% of GDP from 20 years of trade liberalisation, the Treasury's claim that a UK FTA with the EU alone creates a 3% boost to the UK, and EFT's modelling result that free trade with the non-EU world would boost UK GDP by 3%
   - Given the existing high level of EU protectionism, HMT's post-Brexit potential for reducing non-tariff-barriers (NTBs) is significantly understated
     - Goods: HMT assumes NTBs of only 7% can be eliminated; EFT assumes 16%
     - Services: HMT assumes NTBs of 15% remain post-Brexit; EFT assumes zero as UK has liberal regime for services trade
   - HMT's modelled gains from free trade to non-EU countries is further reduced by a linked chain of three arbitrary assumptions:
     - Of the potential post-Brexit reduction of NTBs listed above, HMT arbitrarily assumes that only half of goods NTBs and a third of services NTBs can, in practice, be eliminated
     - Global FTA coverage is arbitrarily assumed to be only 50%
     - Only a quarter of the remaining potential NTB reduction is assumed to be implemented because the programme is "under development"

     Thus, only ½ x ½ x ¼ = $^1/_{16}$ = 6.25% of the already understated reduction potential for NTBs is fed into the model
   - Yet the positive impact of free trade is one of the most widely accepted tenets of economics

2. **Implausibly high border costs are assumed for the processing of customs declarations, rules of origin certificates, and goods inspections**
   - The Treasury model calculates that these costs reduce GDP by 1.8%
     - This assumes border costs for goods of 6% (even when assuming a UK-EU FTA), which gives rise to a reduction of 1.3% of GDP
     - A further unspecified border cost assumed for services reduces GDP by 0.5% of GDP
   - Such assumed costs reflect a lack of understanding of how modern computerised, pre-declared border procedures actually work
     - Typical actual costs of modern border procedures are well below 1% and the Swiss customs authority reports costs of 0.1%
     - Inspections are intelligence led and consequently rare, often requiring only confirmation of computerised documentation - eg, in 2017 only 1% of UK imports were physically inspected

3. **Imaginary high compliance costs are assumed for exporters/importers to meet hypothetical new non-tariff barriers springing up immediately after Brexit**
   - These costs are forecast to reduce long-term GDP by about 4.4% for an exit under WTO rules
   - Such costs are based on the mistaken belief that the EU will suddenly determine that UK exporters do not meet EU product standards - despite over 20 years of shared rules and standards
     - This behaviour would be illegal under WTO anti-discrimination rules that require importers from all countries to be treated the same – ie, a UK importer cannot be required to meet a standard that is not required of, say a US importer

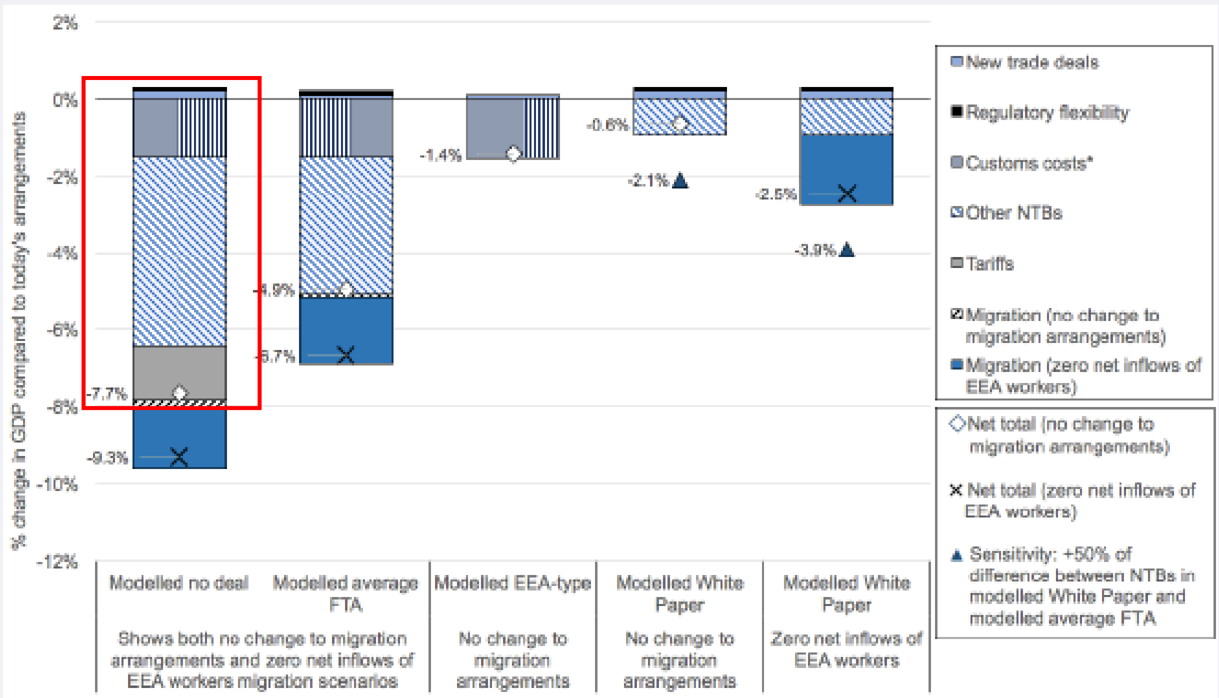
– Fails to understand how trade actually works – ie, as standards change in future, exporters will ensure, from their own commercial interest, that their goods continue to meet other country standards – eg, JLR sells different versions of their cars to the EU, the US, and China

The combined total effect of these assumptions - assuming a WTO exit - is the same as if the UK were to face an effective EU tariff on goods alone of over 30% (of which only about 4% is actual tariffs). In spite of the UK beginning with product standards and regulations identical to those of the EU, this is about one and a half times the effective tariff actually faced by the US, which has different standards and trades with the EU under WTO rules.

When these flawed assumptions (including *de-minimis* gains from deregulation and assumed losses from decreased migration) are fed into the Treasury's GTAP model, it forecasts a reduction to UK GDP of 7.7% (see chart below). Under an alternative assumption of zero migration, this reduction to GDP increases to 9.3%.

These conclusions are rather amazing considering that total EU trade accounts for only 12% of total UK GDP and only about 40% of this trade is UK exports that could be affected by EU restrictions.

Figure E.3: Decomposition of total impacts on GDP compared to today's arrangements for the illustrative no change to migration arrangements and zero net inflows of EEA workers scenarios.



*Central estimates only. *NTB estimates for the modelled no deal and modelled average FTA scenarios are derived from econometric modelling, which does not isolate individual NTB components. Customs costs for these scenarios are shown illustratively in line with the modelled EEA-type scenario estimates.*

This considers trade, migration and regulatory flexibility effects.

Source: Main Treasury Report

NB: In this note we ignore the migration assumptions made by the Treasury which are forecast to create large extra costs. However, these costs are based on absurd assumptions about abruptly cutting off the flow of migrants, when it is generally agreed that skilled migrants will be flexibly treated and unskilled migrants will be allowed in temporarily and without access to state benefits.