Brexit: The view from Europe

As all minds increasingly focus on life after Brexit, the new relationship of the UK with the EU will form a crucial part in shaping the UK's new future. The new relationship will need to be agreed by all 27 of the remaining EU countries and take into consideration wider issues than trade, including the movement of people and capital. Much has been written on the potential impacts on the UK economy of a failure to reach an agreement and the introduction of WTO tariffs rates on trade to and from the Continent. But the impact of such scenario is likely to differ across the EU27 and this may influence their respective negotiating positions and willingness to compromise in order to reach a more favourable agreement. This short note considers which European countries may face the biggest disruption from Brexit – and how that disruption may manifest itself.

Trade in goods

The UK has a large trade deficit with the EU (almost £70 billion, equivalent to 3.7% of GDP in 2015), and the share of UK's total economic output destined for Europe is far greater than the proportion of European output destined for the UK. This suggests that the UK would face far greater disruption than the EU from the introduction of barriers to EU-UK trade.

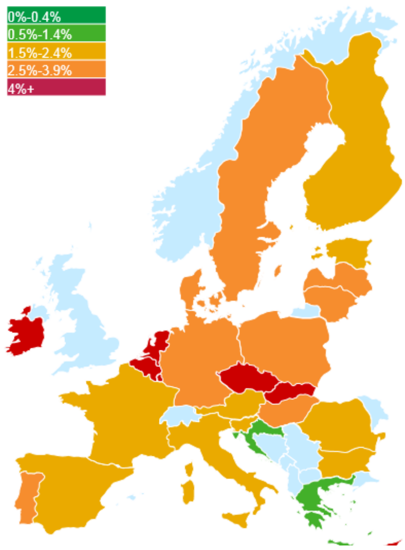
Diving below these aggregates reveals a more complex picture. CEPR's recent publication[1] shows that the UK has a trade surplus with four EU countries: Cyprus, Greece, Ireland and Malta. Despite being net importers of UK goods, these markets are almost insignificant for the UK, with only exports to Ireland noticeable when compared to GDP (1.5% of UK GDP).

The UK, however, is an important export market for these and a number of other small EU countries. Ireland, unsurprisingly, is most exposed to any barrier to exporting to the UK, with goods worth 14.1% of its GDP destined for the UK. Other countries particularly exposed to the UK for exporting goods are Luxembourg (10.1% of GDP), Malta (9.1%), Netherlands (7.6%), Belgium (7.3%) and Slovakia (5.2%), as highlighted in Figure 1 on the right.

Despite large trade surpluses, the largest EU economies are much less reliant on the UK as a market than smaller economies: Germany exports goods worth 3.5% of its GDP (€89 billion) to the UK, France 2.1% (€32 billion), Italy 1.6% (€22 billion) and Spain 2.4% (€19 billion). Together, these countries buy goods worth around 6% of UK GDP.

How countries would be impacted by the introduction of WTO tariffs and, therefore, how eager they will be to reach a more generous agreement, will depend on the significance of the UK economy as an export market to their economies, the rate of tariffs that could come into effect (determined by their export product mix) and the response to any tariff-induced increase in costs by UK customers (their sensitivity to price rises).

Figure 1 - Exports of goods to the UK as a share of GDP



Source: Beetsma et al, in Wyplosz, 2016 (CEPR)

[1] http://voxeu.org/article/new-ebook-what-do-uk-eu-perspectives-brexit

Figure 2 - Average tariff on goods exported under WTO

Source: Lawless and Morgenroth, 2016

Table 1 - UK trade in services with EU27, 2014

	Exports to the UK (£ million)	Imports from the UK (£ million)	UK trade balance (£ million)	Exports to the UK as share of national GDP	Imports from the UK as share of UK GDP
European Union (27 countries)	64,154	81,275	17,121	0.7%	4.5%
Austria	990	693	-297	0.4%	0.0%
Belgium	2,510	3,236	726	0.8%	0.2%
Bulgaria	298	367	69	0.1%	0.0%
Croatia	331	266	-65	1.0%	0.0%
Cyprus	932	616	-316	6.6%	0.0%
Czech Republic	456	645	189	0.4%	0.0%
Denmark	1,223	3,177	1,954	0.6%	0.2%
Estonia	59	29	-30	0.4%	0.0%
Finland	531	1,237	706	0.3%	0.1%
France	12,027	11,711	-316	0.7%	0.6%
Germany	9,783	12,099	2,316	0.4%	0.7%
Greece	2,140	1,232	-908	1.5%	0.1%
Hungary	469	524	545	0.6%	0.0%
Ireland	5,126	9,483	4,357	3.3%	0.5%
Italy	4,857	7,383	2,525	0.4%	0.4%
Latvia	102	117	145	0.5%	0.0%
Lithuania	144	192	48	0.5%	0.0%
Luxembourg	1,535	3,075	1,540	3.9%	0.2%
Malta	417	1,367	950	6.4%	0.1%
Netherlands	4,320	11,045	6,724	0.8%	0.6%
Poland	1,609	1,600	-9	0.5%	0.1%
Portugal	1,946	1,296	-650	1.4%	0.1%
Romania	319	474	155	0.3%	0.0%
Slovak Republic	188	176	-12	0.3%	0.0%
Slovenia	66	94	28	0.2%	0.0%
Spain	10,257	5,539	- 4,718	1.2%	0.3%
Sweden	1,511	3,600	2,089	0.4%	0.2%

Source: *OECD, KPMG Calculations*

A recent paper by Lawless and Morgenroth[2] estimated that Ireland and Denmark would face the highest average tariff rates (of over 10%) on their exports to the UK under WTO rules, because of the high tariffs on their exports, particularly in the agricultural sector (see Figure 2 on the left). The paper also applied estimates of elasticities to predict the overall impact on trade: the biggest losers from tariffs (as a share of the country's total exports) were Ireland (4.17% of total exports), Slovakia (3.27%) Spain (2.87%) and Germany (2.54%). In Ireland's case, this was primarily due to a concentration on the UK market; for Slovakia and Spain it was high tariff rates; and for Germany price sensitivity of customers for its exports.

These highlight the fact that different sectors in each country will bear the brunt of any impediments to trade in goods. The most commonlyused example is German car production, with one-in-seven (14%) cars made in Germany exported to the UK.[3] Similarly $1.3 billion (14%) of France's wine exports were destined for the UK in 2015, as were $267 million (10%) of Belgian chocolate exports, $35 million (26%) of Danish sausage and $61 million (15%) of Greek cheese.[4]

Trade in services

Data on trade in services is less reliable and up-to-date, but OECD figures for 2014 show that the UK exported services to the EU worth 4.5% of its GDP, and ran a trade surplus of £17 billion (around 1% of GDP), somewhat offsetting UK deficit in goods. Conversely, services worth just 0.7% of EU GDP were exported to the UK in 2014, although again this share was much higher for some smaller countries, as shown in Table 1 on he right.

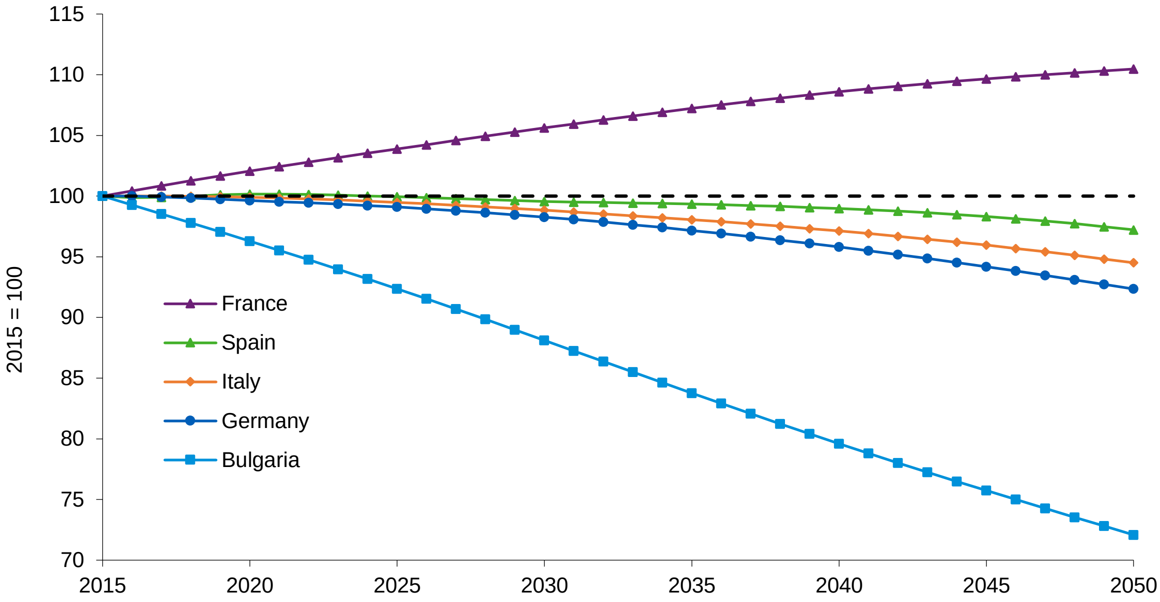
Cyprus, Malta and Luxembourg export a large amount of services relative to GDP, whilst Spain runs the biggest trade surplus with the UK, as it continues to be the top destination for UK residents visiting abroad.

[2] http://www.esri.ie/pubs/WP550.pdf

[3] https://www.vda.de/en/services/facts-and-figures/annual-figures/automobile-production.html

[4] KPMG calculations based on UNCOMTRADE data.

Figure 3: Projected Population Growth of selected EU countries



Source: UN Department of Economic and Social Affairs

Labour force

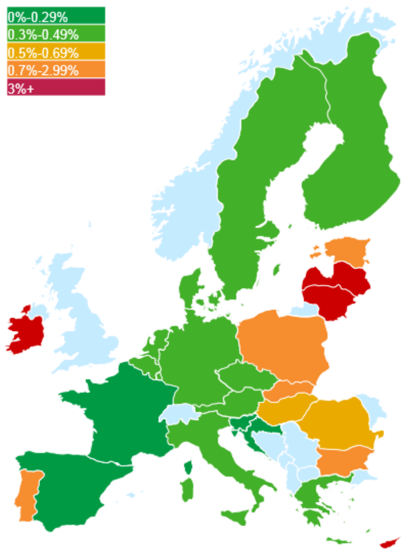
Migration from EU countries to the UK can have a number of impacts on their economic growth, as it can act as a drag on both their production capacity and potential consumption. Many European countries are forecast to see shrinking populations, notably Germany, Italy and Spain (although none as much as Bulgaria as shown in Figure 3 below). All three of these have significant numbers of citizens in the UK and may benefit from a return of workers back home, provided employment opportunities can be found to accommodate the expansion in the labour supply.

On the other hand, remittances from emigrants can make a significant contribution towards national income. Latvia, Croatia, Hungary and Lithuania are the most reliant on remittances in the EU, all with over 3% of GDP coming from abroad.[5]

Although Poland, where remittances from the UK amount to 1% of GDP, has the highest absolute number of citizens in the UK (over 700,000 according to the CEPR[6]), this amounts to just 1.8% of its population, far lower than the 10.7% of Irish, 9.7% of Cypriots and 7.6% of Maltese citizens living in the UK (see Figure 4 on the right). Of bilateral remittance flows between the EU-28 countries, UK to Poland ranks 11th (the largest flows are from Luxembourg to France).

As shown in Figure 5, estimates based on UN 2015 data show the largest concentration of British citizens can be found in Spain (over 300,000), with large numbers also in Ireland (over 250,000), France (over 185,000) and Germany (over 100,000). But, whereas many migrants from Europe to the UK come to work, many UK citizens in Europe (and notably Spain) go there to retire. A report by ICF commissioned by the European Commission estimated that

Figure 4 - proportion of population resident in the UK



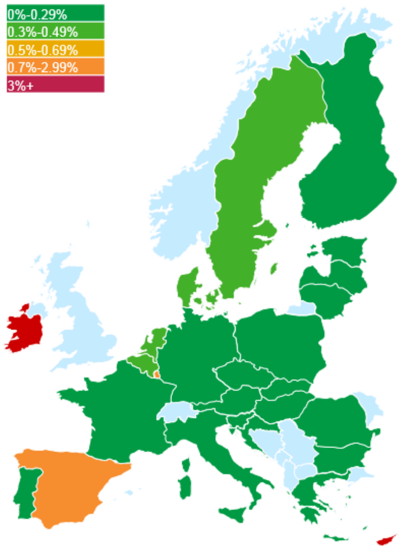
Source: Beetsma et al, in Wyplosz, 2016 (CEPR)

[5] http://ec.europa.eu/eurostat/statistics-explained/index.php/Personal_remittances_statistics

[6] http://voxeu.org/article/new-ebook-what-do-uk-eu-perspectives-brexit

125,000 UK citizens in Spain were 'non-active', with 77,000 over the age of 64 as of 2012.[7]

Figure 5 - UK citizens as share of national population



Source: Beetsma et al, in Wyplosz, 2016 (CEPR)

Summary

Table 2 below summarises how strongly different EU countries are connected with the UK in key areas affected by the Brexit vote: trade in goods and services and movement of people.

For many countries, one of the the most important factors to influence the impact from Brexit will be the goods and services they export to the UK. As described above, the effect on domestic economies of migration may be ambiguous. For many Eastern European countries, protecting the workers in and remittances from the UK may be the most important priority, and countries such as Luxembourg, Malta and Cyprus rely on British workers. Spain, however, may be glad to stem the flow of British pensioners to the economy, whilst Germany may be glad to see greater immigration from Eastern Europe and to repatriate some of its own workforce.

Table 2: Brexit impact on Europe 27

	Goods exported to the UK	Services exported to the UK	UK citizens living in the country	National citizens living in the UK
Austria	Low	Low	Low	Low
Belgium	High	Low	Low	Low
Bulgaria	Low	Low	Low	Medium
Croatia	Low	Low	Low	Low
Cyprus	Medium	High	High	High
Czech Republic	Medium	Low	Low	Low
Denmark	Medium	Low	Low	Low
Estonia	Medium	Low	Low	Medium
Finland	Low	Low	Low	Low
France	Medium	Low	Low	Low
Germany	Medium	Low	Low	Low
Greece	Low	Low	Low	Low
Hungary	Medium	Low	Low	Medium
Ireland	High	Medium	High	High
Italy	Low	Low	Low	Low
Latvia	Medium	Low	Low	High
Lithuania	Medium	Low	Low	High
Luxembourg	High	Medium	Medium	Low
Malta	High	High	Medium	High
Netherlands	High	Low	Low	Low
Poland	Medium	Low	Low	Medium
Portugal	Medium	Low	Low	Medium
Romania	Low	Low	Low	Low
Slovak Republic	High	Low	Low	Medium
Slovenia	Low	Low	Low	Low
Spain	Medium	Low	Medium	Low
Sweden	Medium	Low	Low	Low

Source: KPMG Macroeconomics. For goods and services: up to 2%is defined as low; 2% to 5%: medium; above 5%: high. For population: below 0.5%: Low, 0.5% to 3%: medium; above 3%: high.

[7] http://ec.europa.eu/employment_social/empl_portal/facebook/20131014%20GHK%20study%20web_EU%20migration.pdf

Table 2 above shows, unsurprisingly, that Ireland may have the most to lose from a deterioration in economic relationships between the UK and EU, as well as Cyprus, Malta and Luxembourg. The EU's largest economies - Germany, France and Italy – face some risks to their exports of goods, while for Spain, curtailing the inflow of holidaymakers may prove undesirable. Table 2 also reveals the different priorities: for Eastern Europe, securing the rights of workers in the UK may be the top priority, whereas Western and Northern Europe will be more concerned about trade. Some countries have little to lose, notably Italy, and may be more concernedabout maintaining the integrity of the EU and domestic politics than making any concessions to the UK.

With all 27 countries needing to approve any deal, which must also be accepted by the UK, and with different priorities, whether a mutually agreeable position can be reached within two years remains to be seen. However, as this paper shows, most countries have important links with the UK, whether as an export market for Danish sausages, a source of remittances for Latvian migrants, a place of study for Finnish students or a tourist market for Spanish holidays. Collectively, the EU has a lot to lose from a breakdown in economic relationships with the UK and, if it can work together towards a solution based on economic facts rather than domestic politics, many of the potential negative consequences of Brexit may be averted.

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