



the London School of **Economics**
and **Political Science**

Brexit: A view from Germany

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Lack of Historical Comparisons

- Bismarck's tariff of 1879?
- Dissolution of Austro-Hungarian monarchy post-1918?
- UK's Imperial Preferences 1932?

Germany's triple Brexit problem

- Bilateral effects vis-a-vis UK
 - Exports to UK?
 - BMW/Prosecco problem (UK Foreign Secr. Boris Johnson)
- Multilateral effects vis-à-vis EU-27
 - Germany loyal to EU-27 or its export industry? (UK's Three Brexiteers)
- Worries about Brexit effects on Ireland

Outline of this talk

1. Review of attempts at quantification

- Recent study presented to German gov't (myself not involved)
- In line with studies from the UK

2. Review report of Advisory Board to German Economics Ministry (with myself involved)

- Proposals on multi-stage Brexit
- Proposals on simplified customs procedures



Attempts at Quantification

- Gravity model of multilateral trade
 - Size, distance, border effects, controls ...
 - CEP @ LSE [1], Ifo Institute Munich [2], NIESR London [3]

- Large, negative effects on
 - Trade in goods, even worse in services
 - GDP

- Caveat: 'treatment effects' difficult to identify

- Model predictions might overstate the effects



Predicted trade effects on UK

- Goods: -20 to -40%
- Services -50% or higher



Recent study by Ifo Institute for German Economics Ministry [2]

- 4 Scenarios Hard Brexit
- 4 Scenarios Soft Brexit



Recent study by Ifo Institute for German Economics Ministry

- 4 Scenarios Hard Brexit
 - 1a: WTO basic
 - 1b: WTO with MFN and unilateral zero tariffs
 - 1c: “Global Britain”, 1a plus ambitious FTAs w/ US, CDN, JP
 - 1d: 1a plus 15% NTB with EU-27



Recent study by Ifo Institute for German Economics Ministry

- 4 Scenarios Soft Brexit
 - 2a: Ambitious FTA UK / EU27
 - 2b: 2a plus approximate EEA, reducing NTBs
 - 2c: Customs Union UK / EU27
 - 2d: Conservative FTA UK / EU



Predicted Brexit effects on GDP

	GDP total (bn €)	GDP per capita (€)	Predicted % Change in GDP							
			Hard Brexit				Soft Brexit			
			1a	1b	1c	1d	2a	2b	2c	2d
Ireland	189	40957	-2.03	-1.89	-2.03	-1.63	-0.88	-0.52	-0.77	-0.95
UK	2221	34422	-1.73	-1.13	-1.47	-1.65	-0.57	-0.4	-0.36	-0.6
LUX	49	89942	-1.4	-1.3	-1.44	-1.97	-0.46	-0.37	0.02	-0.56
Malta	8	18605	-1.65	-1.72	-1.6	-2.91	-0.71	-0.46	-0.23	-0.72
GER	2916	35961	-0.23	-0.21	-0.24	-0.18	-0.1	-0.06	-0.09	-0.11
EU-27 avg.			-0.26	-0.22	-0.24	-0.21	-0.11	-0.07	-0.09	-0.12

Source: Ifo Institute (2017, Table 20).



GDP effects of Brexit

- **UK quite badly hit** under Hard Brexit
 - But GDP effects **also** under Soft Brexit
- Even ambitious FTA << Integrated Common Market

Predicted Brexit effects on GDP

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Source: Ifo Institute (2017, Table 20).



GDP effects of Brexit

- **Ireland quite badly hit** under Hard Brexit
- GDP effects **also** under Soft Brexit

→ Effects on Ireland **stronger** than on UK itself



Predicted Brexit effects on GDP

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Source: Ifo Institute (2017, Table 20).



GDP effects of Brexit

- **GER minimally hit** under Hard Brexit
 - Small GDP effects **also** under Soft Brexit
 - All effects **one order of magnitude smaller** than those on UK
- Similar to **minimal effects on EU-27** average



Predicted Brexit Effects on UK Exports

UK Exports		Predicted % Change in UK Exports							
		Hard Brexit				Soft Brexit			
to:	Current level mill €	1a	1b	1c	1d	2a	2b	2c	2d
GER	40459	-50	-46	-51	-44	-24	-15	-17	-24
FRA	35005	-39	-35	-40	-44	-17	-12	-13	-18
IRL	24979	-47	-44	-48	-39	-20	-12	-18	-21
LUX	17880	-22	-18	-24	-43	-6	-6	7	-6
NLD	17707	-49	-46	-50	-44	-22	-15	-19	-24
ITA	16376	-45	-41	-46	-43	-19	-15	-13	-21
BEL	15841	-43	-39	-44	-47	-16	-13	-8	-17
ESP	9744	-50	-46	-51	-44	-23	-14	-14	-26
SWE	8818	-44	-40	-45	-46	-18	-12	-7	-19
DNK	5936	-42	-39	-44	-45	-19	-14	-13	-18
POL	5356	-52	-49	-53	-42	-25	-16	-20	-26
FIN	2831	-49	-46	-50	-44	-22	-16	-15	-20
AUT	2610	-48	-45	-49	-42	-22	-16	-18	-23
CZE	2297	-50	-47	-51	-39	-25	-16	-22	-28
PRT	2295	-45	-41	-46	-44	-20	-14	-13	-20
GRC	1957	-45	-41	-46	-44	-19	-15	-9	-19
HUN	1588	-49	-46	-50	-41	-23	-14	-20	-26
MLT	1492	-40	-37	-40	-46	-17	-10	-13	-16
ROU	1176	-50	-46	-50	-40	-24	-16	-19	-27

Effects of Brexit on UK Exports to GER

- **GER** is UK's largest export mkt in EU
- UK exports down by 44-50% under Hard Brexit
- UK exports down by 15-25% under Soft Brexit

Predicted Brexit Effects on UK Exports

UK Exports		Predicted % Change in UK Exports							
		Hard Brexit				Soft Brexit			
to:	Current level mill €	1a	1b	1c	1d	2a	2b	2c	2d
GER	40459	-50	-46	-51	-44	-24	-15	-17	-24
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MLT	1492	-40	-37	-40	-46	-17	-10	-13	-16
ROU	1176	-50	-46	-50	-40	-24	-16	-19	-27

Effects of Brexit on UK Exports to EIR

- **Ireland** is UK's second largest export mkt in EU
- UK exports down by 39-58% under Hard Brexit
- UK exports down by 12-21% under Soft Brexit

Predicted Brexit Effects on bilateral UK/GER trade

		Predicted % Change in UK Trade with Germany							
		Hard Brexit				Soft Brexit			
	Current level mill €	1a	1b	1c	1d	2a	2b	2c	2d
UK exports	40459	-50	-46	-51	-44	-24	-15	-17	-24
UK imports	77189	-33	-30	-33	-28	-9	-5	-9	-11
Balance	-36730	+14.3	+12.4	+13.2	+10.4	-7.5	-6.0	+0.2	-3.3

Effects of Brexit on UK/GER trade

- **Hard Brexit**
 - Bilateral trade down massively
 - UK trade deficit narrows somewhat
- **Soft Brexit**
 - UK exports still down
 - UK trade deficit widens further

Predicted Trade Diversion Effects on GER exports to Ireland

- Low initial level (1/4 of UK exports)
- Up 5-8% under Hard Brexit
- Up 1.8-3.7% under Soft Brexit

German policy problem

- Hard Brexit hits UK harder than GER
 - Effects on GER exports mitigated by trade diversion to EU-27
 - Effects on UK exports mitigated by trade diversion to non-EU
 - Big effects on UK GDP under all scenarios
- Hard Brexit hits EU-27 as little as it does GER
- Hard Brexit hits EIR hardest, more so than UK

Maintain cohesion of EU-27 (Berlin's mantra)

- Policy trade-off: EU-27 vs. UK

- Strictly prefer keeping market integration with EU-27
- Strictly no UK cherry picking
(= no "Brexit à la carte")
- Strictly no bilateral backroom deals GER/UK
- No German leadership on Brexit?

Report of Advisory Board to German Economics Ministry [4]

Unified approach to 3 German policy problems

- Maintain cohesion of EU-27
- Find best response to Brexiteers
- Mitigate impact of Hard Brexit



Best response to Brexiteers

- 2019 timeline unrealistic for FTA
- Give UK more time to avoid WTO Brexit
- Two options for extension
 - Art 50 (3) TEU, extends UK membership
 - Rejoin EFTA and EEA temporarily in 2019 while FTA is being negotiated

Art 50 (3) TEU option

- Extension by European Council (in unanimous agreement with withdrawing member state)
- Pro: easy to implement, as opposed to e.g. ratification by all parliaments concerned
- Con from the UK point of view:
 - Extension of membership, postponed Brexit
 - Extension of jurisdiction over UK of EU CoJ

EFTA as an exit ladder

- Originally designed for flexible conversion to EU at multiple speeds
- Use same flexibility in reverse
- Phase out UK membership at multiple individual speeds
- Optional use of EFTA's third party FTAs during transition period

EFTA pros and cons

- Pro, from the UK point of view
 - Brexit at an early stage
 - Get out of EU CoJ jurisdiction (EFTA has its own arbitration court)
 - Decouple expert negotiations from political symbolism
 - Easy to implement, only need to convince Norway

EFTA pros and cons

- Con, from the UK point of view
 - No Big Bang Hard Brexit to begin with
 - Some risk of watered down final outcome
- Con, from the German point of view
 - Some risk of UK cherry-picking in final outcome

The Green Border

- What if no FTA? (Norway as an example)
- Border posts must be avoided
- So how to establish a customs border?

Remote customs procedures

- Aim: to do the paperwork and levy any tariffs without border checkpoints
 - Easy but not nil under an FTA
 - More difficult if tariff rates differ
- Assumption: customs union not an option

An existing institution: The European VAT Information Exchange System (VIES)

- Customs within the EU do exist - called VAT
- Vat is levied
 - not at the border
 - But at recipient importing firm (goods)
 - Or exporting firm (services)
- Tax offices including UK's HMRC use VIES
 - Every exporter/importer has VAT number
 - Cross-border transaction tracking

→ VIES usable for UK/EU customs procedures



A further simplification: Country of Origin Certificates

- CofO Certificate a costly procedure under existing FTAs → major NTB!
 - Also required when tariff rates are identical
 - Proposal to waive CofO requirement if tariffs identical
- Eliminate large majority of paperwork
- Eliminate major NTB, make future FTA work



Conclusions

- UK perception that GER amenable to backroom deals mistaken
 - Evidence of only minor GER losses to Brexit
- GER top priority is cohesion of EU-27
 - Trade-off between integration with EU or UK
 - Precludes selective UK market integration, a problem for Ireland
- GER very attentive to Irish border problem – VAT Information Exchange System a possible workaround?

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