BREXiT UNIT

Six gaps in Whitehall's Brexit analysis

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The 'Cross Whitehall Briefing' on the potential long-term economic impact of Brexit is an honest attempt to improve on the analysis published by the Treasury in 2016. Nonetheless, it is clearly wrong to claim, as others have, that the report 'proves' Brexit will be bad for the economy in 'all' scenarios.

The report itself, written back in January, acknowledges that it is preliminary and incomplete. Indeed, it does not even attempt to model the outcome that the government is actually seeking to achieve. The results are also heavily dependent on the assumptions made about non-tariff barriers and future policy choices on tariffs and migration. They include only a skimpy assessment of the scope for new trade deals with the rest of the world and next to nothing on the savings on payments to the EU. In short, there are far from the last word.

What the Whitehall Briefing does…

On 8th March the House of Commons Select Committee on Brexit finally released the PowerPoint version of the 'EU Exit Analysis Cross Whitehall Briefing', which had been leaked to Buzzfeed in January. In short, the report modelled three arrangements for future trade between the UK and the EU, each based on existing precedents:

1. a European Economic Area (**EEA**) scenario (similar to the Norway option), where the UK keeps most of the rights and obligations of the Single Market, but leaves the Customs Union;
2. an **FTA**, where the UK leaves both the Single Market and Customs Union and settles for a standard 'low access' free trade agreement (similar to, but not necessarily as good as, the EU-Canada deal);
3. a 'no deal' **WTO** scenario, where the UK and EU simply trade on World Trade Organisation rules, without an FTA.

The results are presented in terms of the impact on cumulative GDP growth over a 15-year horizon, relative to a baseline scenario (the 'status quo') where the UK remains in the EU. The central estimates (within wide ranges) are that growth would be 1.6% lower than otherwise in the EEA scenario, 4.8% lower in the FTA scenario, and 7.7% lower in the WTO scenario.

These numbers are similar to those published in the Treasury's 2016 report on the long-term economic impact of alternatives to EU membership, which also looked at only three 'off the shelf' options. The latest Whitehall Briefing does make some important improvements to the methodology, including less reliance on 'gravity models' and a more serious attempt to quantify the potential benefits of Brexit. But there are still a great many gaps, as the report itself acknowledges.

Key points

- The Whitehall Briefing (leaked in January but only officially released this month) is not the last word on the potential long-term economic impact of Brexit, despite claims from others that it 'proves' GDP will be lower in 'all' scenarios.
- As the report itself says, it is only 'draft analytical thinking with preliminary results', with many gaps and uncertainties.
- In particular, officials had not yet attempted to quantify the outcome that the government is actually seeking to achieve, including a new and comprehensive free trade deal with the EU that minimises both tariff and non-tariff barriers.
- Instead, the Briefing only looks at three alternative trade scenarios based on existing precedents. It does suggest that the UK might land somewhere in between. But the outcome will depend on talks with the EU that have not yet even begun, as well as future policy choices to be made by HMG alone.

… and, more importantly, what it doesn't

For a start, as the report says, it is only 'draft analytical thinking with preliminary results'. Those painting new numbers on buses also appear to have ignored the warning that 'excessive weight should not be given to single-point estimates, given uncertainties, ranges of opinion on assumptions, global and sector trends and a variety of potential end states'. There are at least six gaps that still need to be filled in.

First, the latest analysis does not model actual government policy. Indeed, the Whitehall Briefing explicitly accepts that two of the scenarios it has considered (EEA and FTA) have already been 'ruled out'. The FTA scenario is more like 'Canada minus' than the 'Canada plus plus plus' that the government is aiming for. The report does refer to an alternative 'Florence Model', based on the principles set out in the PM's speech last September. But, for now, officials have simply assumed that the UK will land somewhere between the three scenarios which the report does quantify.

Second, the results (as in any such study) are particularly sensitive to the assumptions made about non-tariff barriers (NTBs), and the extent to which any future trade deal with the EU can keep these to a minimum. But the Briefing itself recognises, for example, that customs NTBs in the 'Florence Model' could be anywhere between 'high', and 'none', depending on what new arrangements are agreed to replace the Customs Union.

Third, the results of the FTA and WTO scenarios are made worse by the assumption that the UK would choose to impose tariffs on imports from the EU (an option rejected by most 'hard Brexiteers'), rather than maintain the level playing field required under WTO rules by lowering tariffs on imports from the rest of the world. The report does acknowledge the possibility of 'unilateral tariff liberalisation', but merely hints at 'initial analysis' to suggest that the benefits of this would be small.

Fourth, the results in these two scenarios are also made worse by the assumption that the UK government would take the opportunity of regaining control of borders to limit migration in ways that damage the economy. But future policy in this area would also be in the hands of the government to decide, so this is far from inevitable.

Fifth, the report is skimpy on its assessment of the benefits of new free trade deals. The headline numbers only include the boost to GDP from a deal with the US, estimated at a low 0.2% of GDP. It does mention that the inclusion of other deals might provide a total long-term increase of up to 0.7%, but again this seems small. Many previous studies have underestimated the benefits of trade liberalisation, especially when extended to NTBs that the Whitehall report assumes will remain high. These errors are not surprising, since many of these benefits are intrinsically hard to quantify.

Sixth, the savings on contributions to the EU budget are excluded from the main analysis (perhaps because they would not necessarily translate 1-to-1 to an increase in GDP). Instead, they are considered separately in a section on fiscal implications, which concludes they would be dwarfed by the fiscal costs. But these costs mainly follow from the findings that the economy would be a lot weaker. If these findings are wrong, the fiscal numbers are wrong too. It certainly seems odd not to allow any credit for budget savings which might be worth 0.5% of GDP every year over a 15-year period.

Overall, the 'Cross Whitehall Briefing' is an honest attempt to improve on the analysis published by the Treasury in 2016. But it is far from conclusive, and anyone claiming otherwise should read it again.

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- For example, the Briefing recognises that the impact of leaving the Customs Union on customs barriers between the UK and EU could be anywhere between 'high', and 'none', depending on what new arrangements are agreed.
- Here, some have argued it is wrong to model something that the EU may not be willing to accept. But the purpose of scenario analysis is to look at a range of possible outcomes, not to close options down.
- Elsewhere, the Briefing includes only skimpy assessments of the scope for new trade deals with the rest of the world and for regulatory optimisation, and is too quick to dismiss the budget savings on payments to the EU.
- Overall, the 'Cross Whitehall Briefing' is an honest attempt to improve on the analysis published by the Treasury in 2016. But it is far from conclusive, and anyone claiming otherwise should read it again.

The Alternative Brexit Economic Analysis

I was one of a group of four independent economists who contributed to an Alternative Brexit Economic Analysis (ABEA), published by Economists for Free Trade (EFT) on 21st February. (Two of the four authors of the ABEA are members of EFT, namely Roger Bootle and Patrick Minford. The other two, myself and Gerard Lyons, are not.)

The ABEA suggested a range of alternative assumptions, particularly about customs costs and the degree to which NTBs are eliminated. Depending on the inputs, it suggested that the net impact on GDP would be favourable (probably in a range of 2% to 4% over 15 years, relative to remaining in the EU). It could be more, or slightly less, but it would be positive. The key point here is not to debate the exact number. Instead, it is to show that alternative modelling produces very different results from those suggested by the Whitehall Briefing.