EDAS
Economic Development Association Scotland

The Highland Council
Comhairle na Gàidhealtachd

HIE
Highlands and Islands Enterprise
Iomairt na Gàidhealtachd 's nan Eilean

Brexit: The Impact on the Scottish Economy

19th April 2018

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Gary Gillespie
Economic Development Association Scotland
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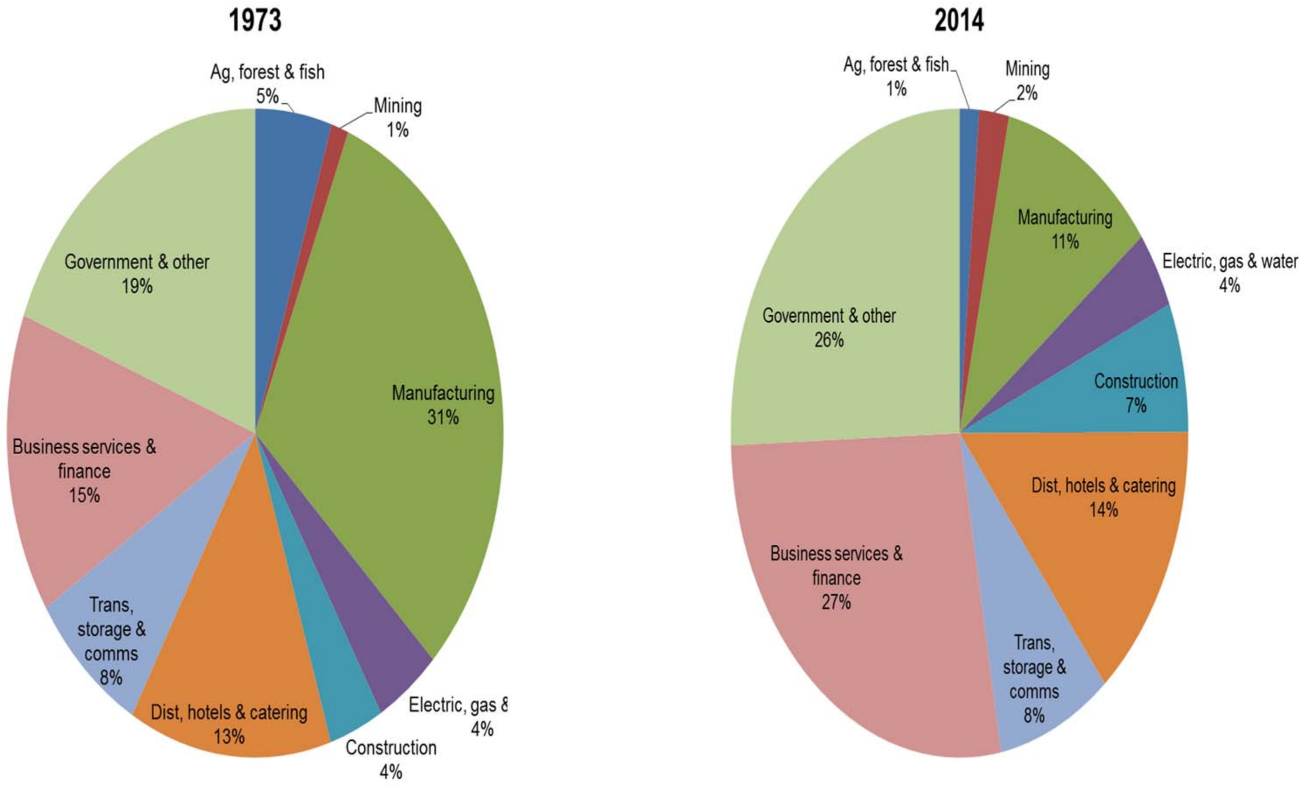
Part 1 – Overview of current arrangements and inherent challenges.

Economies are dynamic and evolve over time…..



Sectoral Shares Scottish GDP – 1973 & 2014. Source: SG.

Trade - Theory

Objective of trade – to improve incomes and living standards.

Trade integration can achieve this by;

- **Trade -** Allowing businesses and consumers to consume a wider range of goods and services than would otherwise be possible.
- **Productivity -** improvements possible through increased competition, improved quality, efficient allocation of capital, improvements in firms rate of innovation and adoption.

However;

- Improvements can include losses to particular sectors and particular groups in society
- The concentration of loss can be a reason for trade protection (recent announcement of Steel tariffs?)
- EU is more than trade….

Trade Agreements vary.

Increasing integration

Monetary Union	• Free Trade, 4 freedoms and unified currency (eg Euro Area)
Common Market	• Free Trade Area also characterised by the 4 freedoms. (eg the EU)
Customs Union	• Common External Tariff (same import duties) and usually to allow free trade between themselves.
Free Trade Area	• zero tariffs on bilateral trade between partner countries. (eg NAFTA)

The European Union

The EU is the most developed multilateral single market. Based on the so-called **"4 freedoms"**

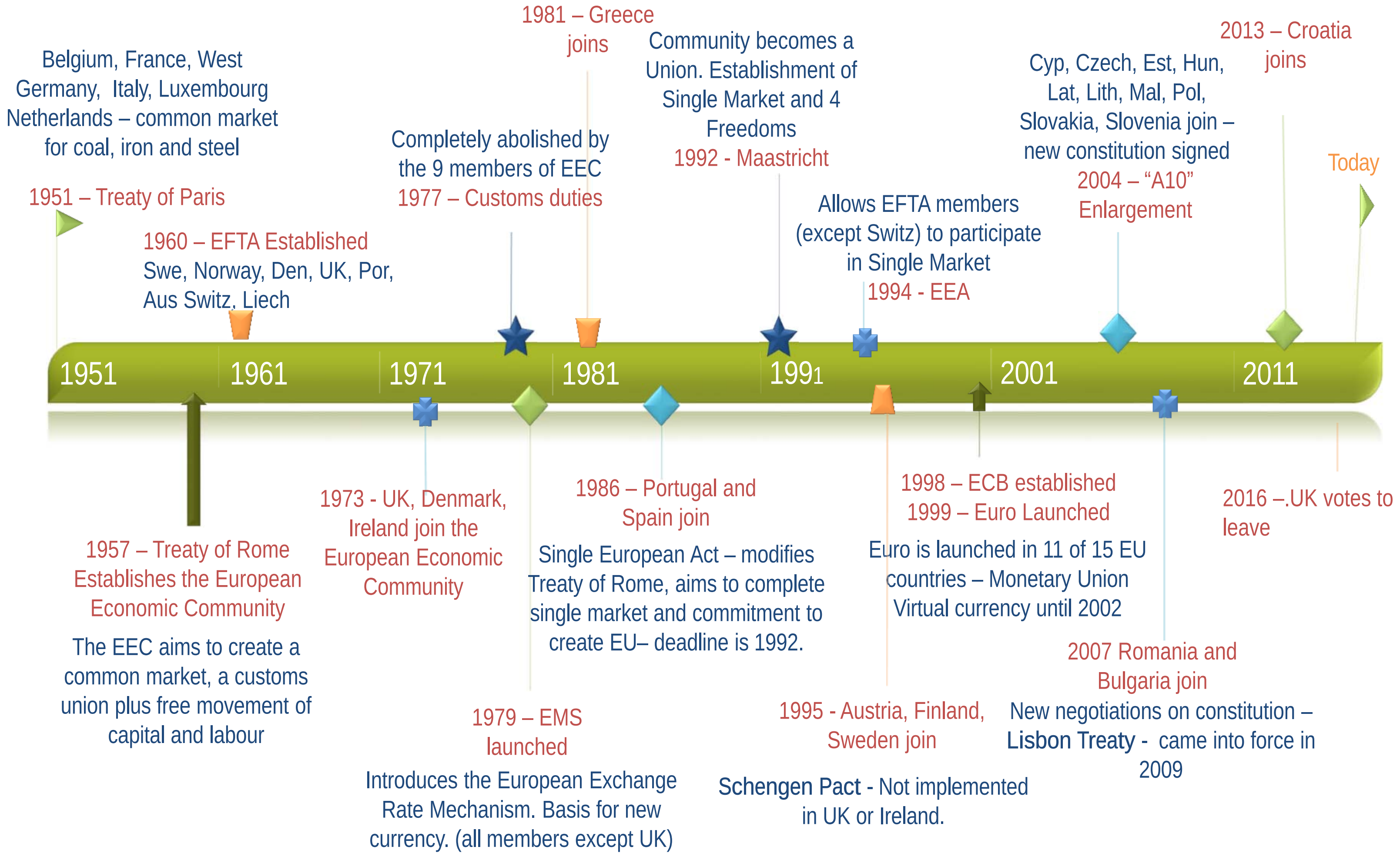
Goods – Common tariff, frictionless trade between countries, particularly important for cross border supply chains.

Services – Non- tariff barriers : Access to markets, mutual recognition of standard and qualifications.

Capital – Trade has close links with investment. Membership of a free trade area or single market is associated with increased investment (evident in Scotland and UK with formation of single market)

People – Allows people to move across borders to live work and establish companies

Evolution of the EU and European Single Market



Variable geometry of the EU.

Europe's Ties That Bind

The U.K.'s plan to leave the European Union has focused attention on long-standing pacts that govern trade, immigration and the common currency

European Union
28-nation single market of free trade and shared regulation; includes "free movement" of goods, services, capital and people

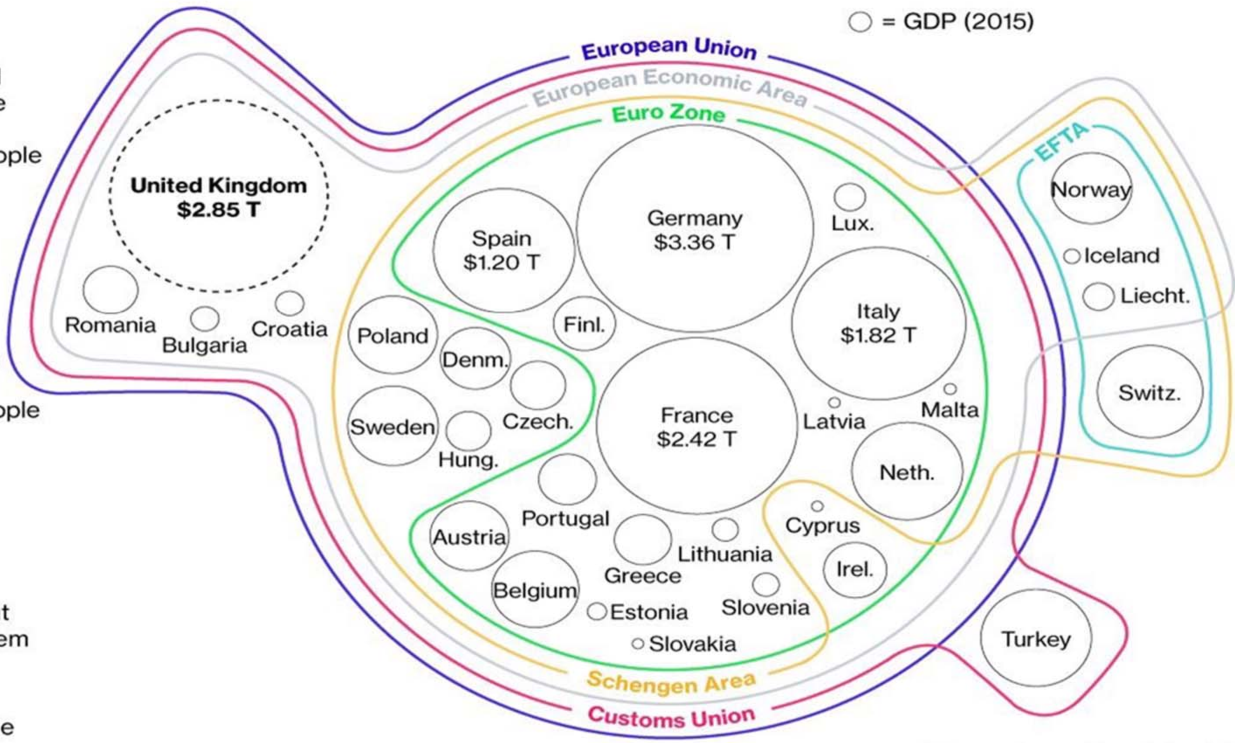
Euro Zone
19 countries using the euro currency

European Economic Area provides access to single market in exchange for payments; has "emergency brake" on free movement of people

European Free Trade Association
Free-trade zone and network of agreements with other countries

Customs Union
Circulates goods without duties, has uniform system for handling imports

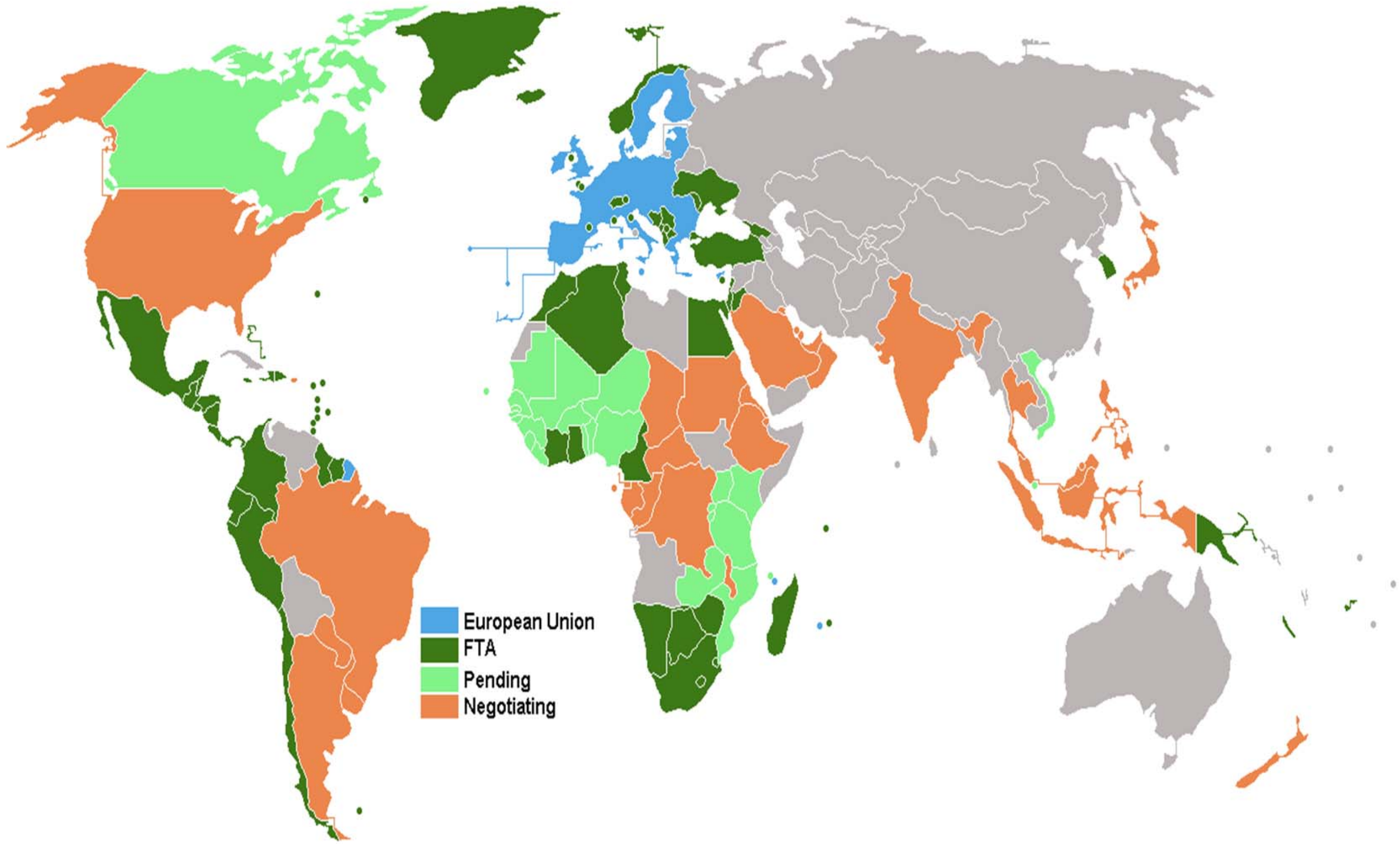
Schengen Area
26-country passport-free travel zone



Sources: EU, ETRA, IMF

Bloomberg Graphics

EU – Preferential Agreements.



Part 2 – Economic and distributional implications of change.

Brexit Represents...

- A loosening of the economic integration built up between the EU countries over the decades post WW2.
- A redrawing of the lines from the perspective of the UK
- Implications for UK and Scotland's economy across each of the 4 freedoms
- Implications for our trading relationship not just with the EU but with all international partners
- Potentially wider implications for workers, consumers and the environment

Brexit – long term implications

SG analysis focuses on six economic areas that are impacted by the type of relationship the UK has with the EU:

- Volume of trade in goods and services with the EU
- Levels of trade tariffs with the EU
- Foreign Direct Investment (FDI) flows
- Productivity growth - level of trade openness
- Levels of net migration
- The UK/Scotland's net contributions to the EU budget

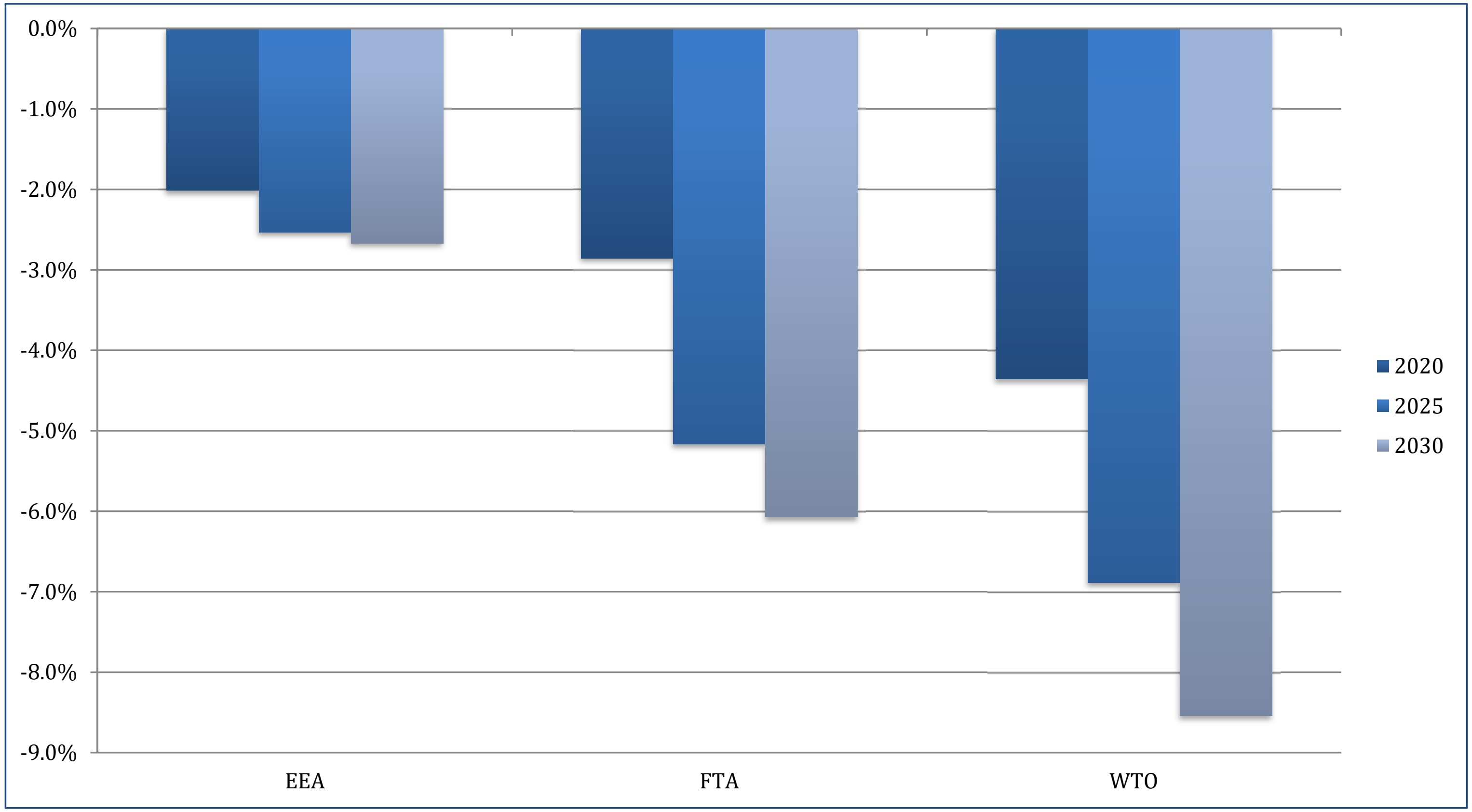
The three alternative scenarios to EU membership examined are:

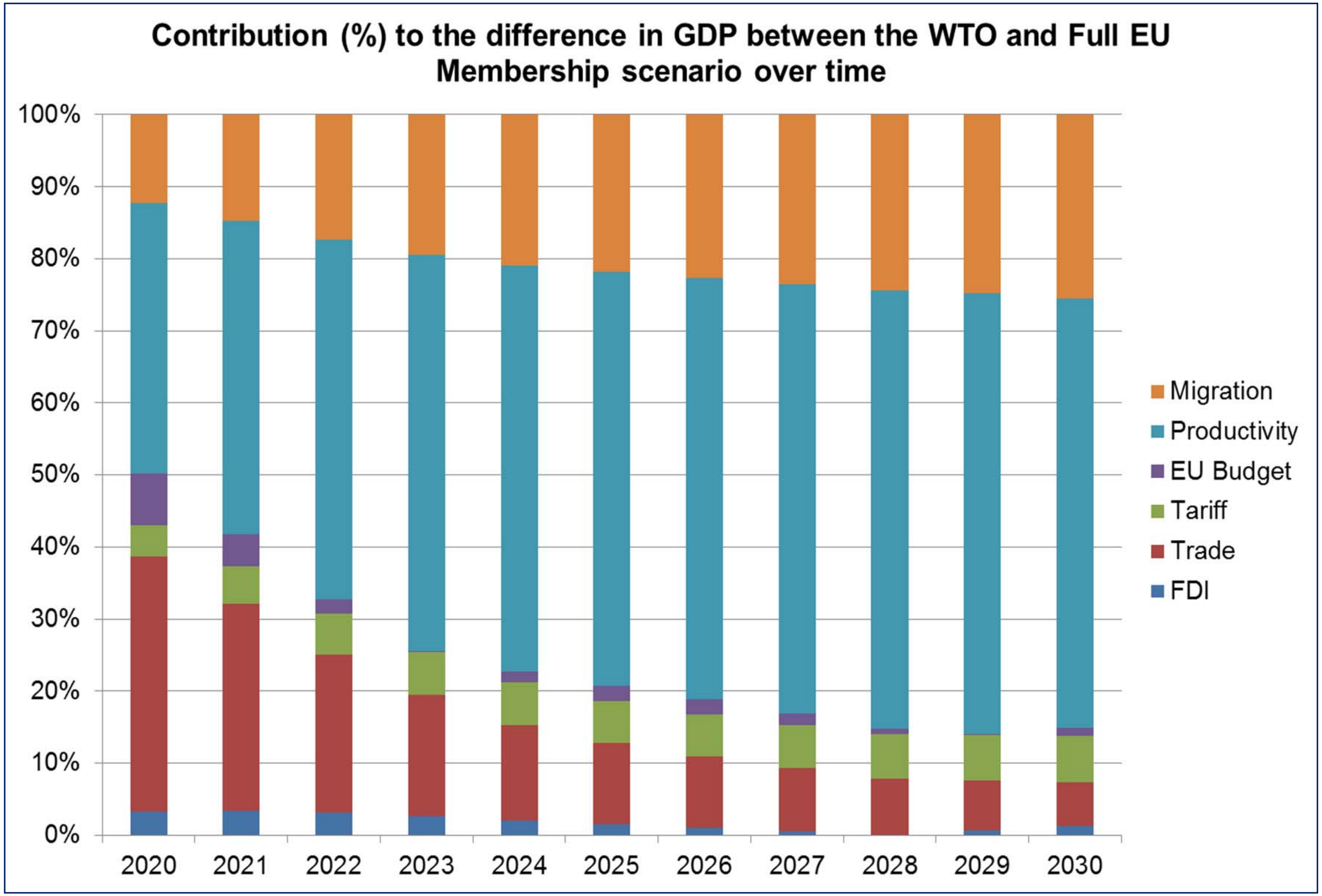
a. World Trade Organisation (WTO) style relationship;
b. a form of Free Trade Agreement (FTA):
c. participating in the European Economic Area (EEA).

Summary of Modelling Assumptions

Shock	EEA	FTA	WTO
Reduction in export market share in the EU	-23%	-29%	-50%
Increase in tariffs on trade with the EU	0%	0%	5%
Productivity	-2.4%	-3.5%	-5%
Reduction in inward FDI flows and Investment	-10% FDI (-1.5% private investment)	-17.5% FDI (-2.6% private investment)	-24% FDI (-3.5% private investment)
Population	No change	-2% UK / -2.8% Scotland	-2% UK / -2.8% Scotland
EU budget savings, % of GDP	No change	0.30%	0.30%

Change in Scottish GDP relative to baseline of full EU membership

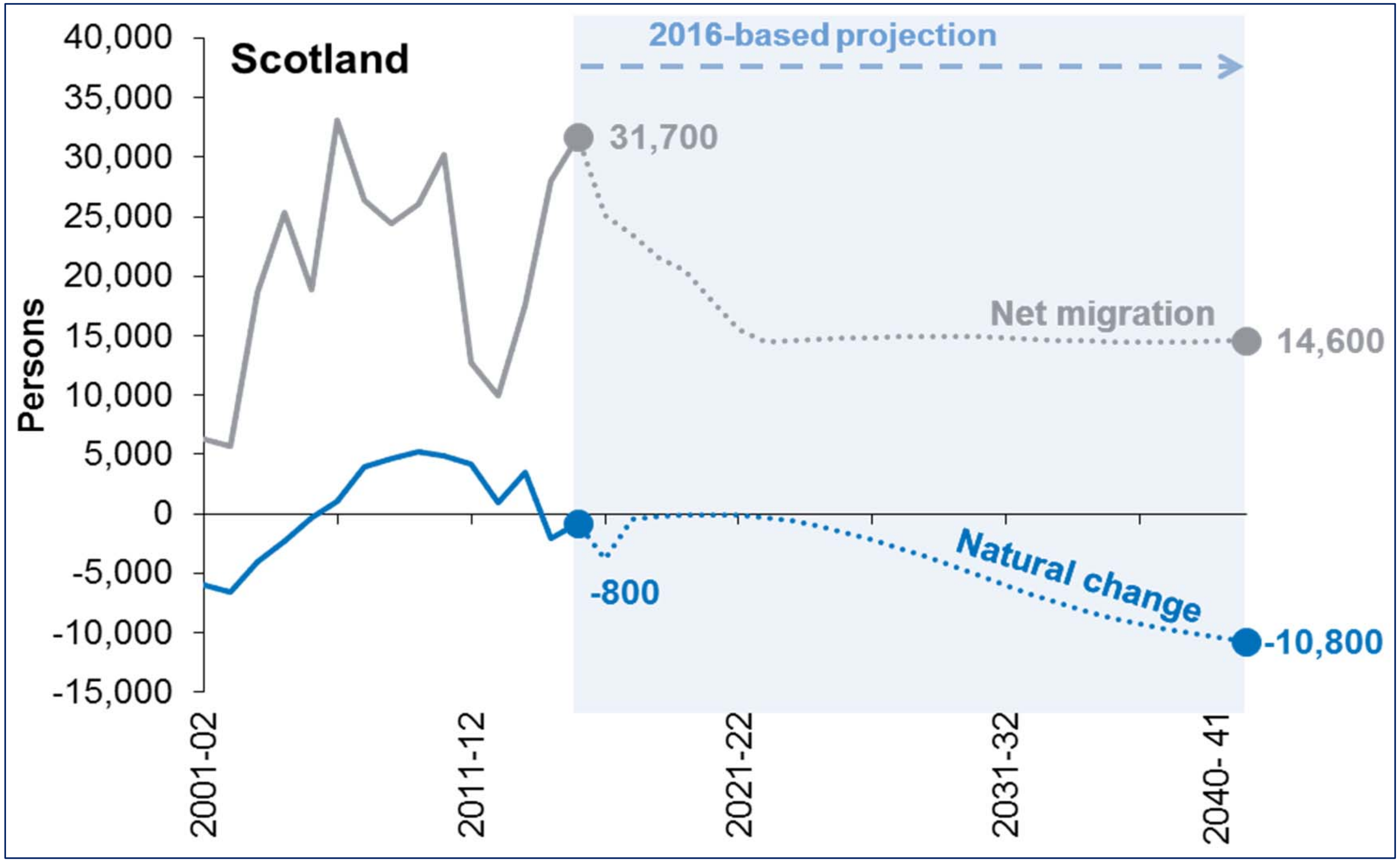



Contribution (%) to the difference in GDP between the WTO and Full EU Membership scenario over time
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
2020
2021
2022
2023
2024
2025
2026
2027
2028
2029
2030
Migration
Productivity
EU Budget
Tariff
Trade
FDI

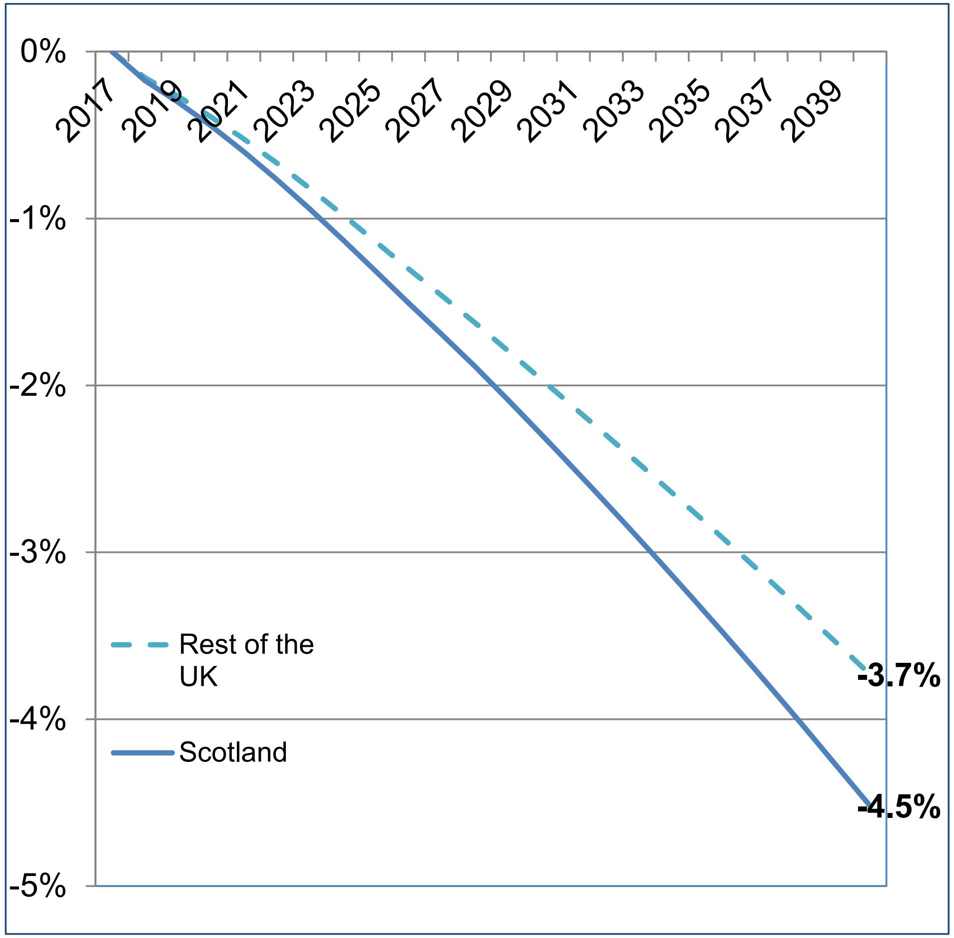
Summary of Modelling Results…

- All of the modelling indicates that there will be level shift in the long term – due to an adjustment period of lower absolute growth as a result of a reduction in economic integration.
- The extent of this will be dependent on the future agreement(s) secured as well as market and agent perception of these agreements.
- Not necessarily a recession or crisis, but a period of time it takes for the economy to get back on to pre-trend growth (assuming the adjustment can happen).
- This adjustment period will also have distributional costs across sectors and regions.
- Different sectors and regions may also be disproportionately affected by the impact of lower migration on the availability of skills and demographic profiles.

Demographics & Migration



Migration



- Similar to OBR assumptions
- assume that without Brexit, overseas net migration would have followed the so-call high migration projection.
- Brexit leads to reduction in migration of c.8,500 fewer migrants per year.
- Real GDP in Scotland estimated to be 4.5% lower by 2040 than it would have been otherwise
- equivalent to a fall of almost £5 billion in GDP by 2040.

Scottish Government Position

- The best way to minimise the economic impact of EU Exit is to stay inside the Single Market and Customs Union.
- It is also the best way to safeguard workers' rights as well as social, consumer and environmental protections that are embedded in our current system.
- Dynamic benefits of Single Market. Potential for further gains from completing the single market and digital single market.
- Free movement - In the period to 2041, all of our projected population growth will come from inward migration.
- Without that, our population will go into decline with implications for the economy and for public services.

Overview/Summary:

- Political vote triggered an economic event, an immediate market response and change in UK macro economic policy (monetary and fiscal).
- Economic forecasts suggest evidence of weakening in the economic data during 2017 and 2018 – compared to pre-Brexit forecasts, and stronger performance in the EU nations.
- However there has been no immediate formal change to UK 'terms of trade' and offsetting effects from Sterling depreciation and macro policy have helped the economy.
- There will be distributional impacts from any changes to 'terms of trade' in Scotland and wider UK.
- These changes will affect the economy through a number of channels including trade, investment, migration and productivity.

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