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Cumulative Effects of Brexit and Other UK and EU27 Bilateral FTAs on Global Wine Markets

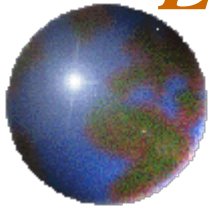
Kym Anderson and Glyn Wittwer

Selected Paper prepared for presentation at the International Agricultural Trade Research Consortium's (IATRC's) 2017 Annual Meeting: Globalization Adrift, December 3-5, 2017, Washington, DC.

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Cumulative effects of Brexit and other UK & EU27 bilateral FTAs on global wine markets



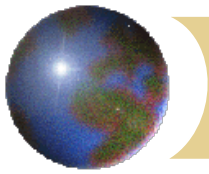
Kym Anderson

Wine Economics Research Centre, University of Adelaide
and

Glyn Wittwer

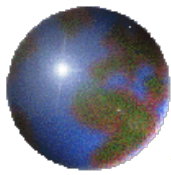
Centre of Policy Studies, Victoria University

Annual conference of the *International Agricultural Trade Research Consortium*
Washington DC, 3-5 December 2017

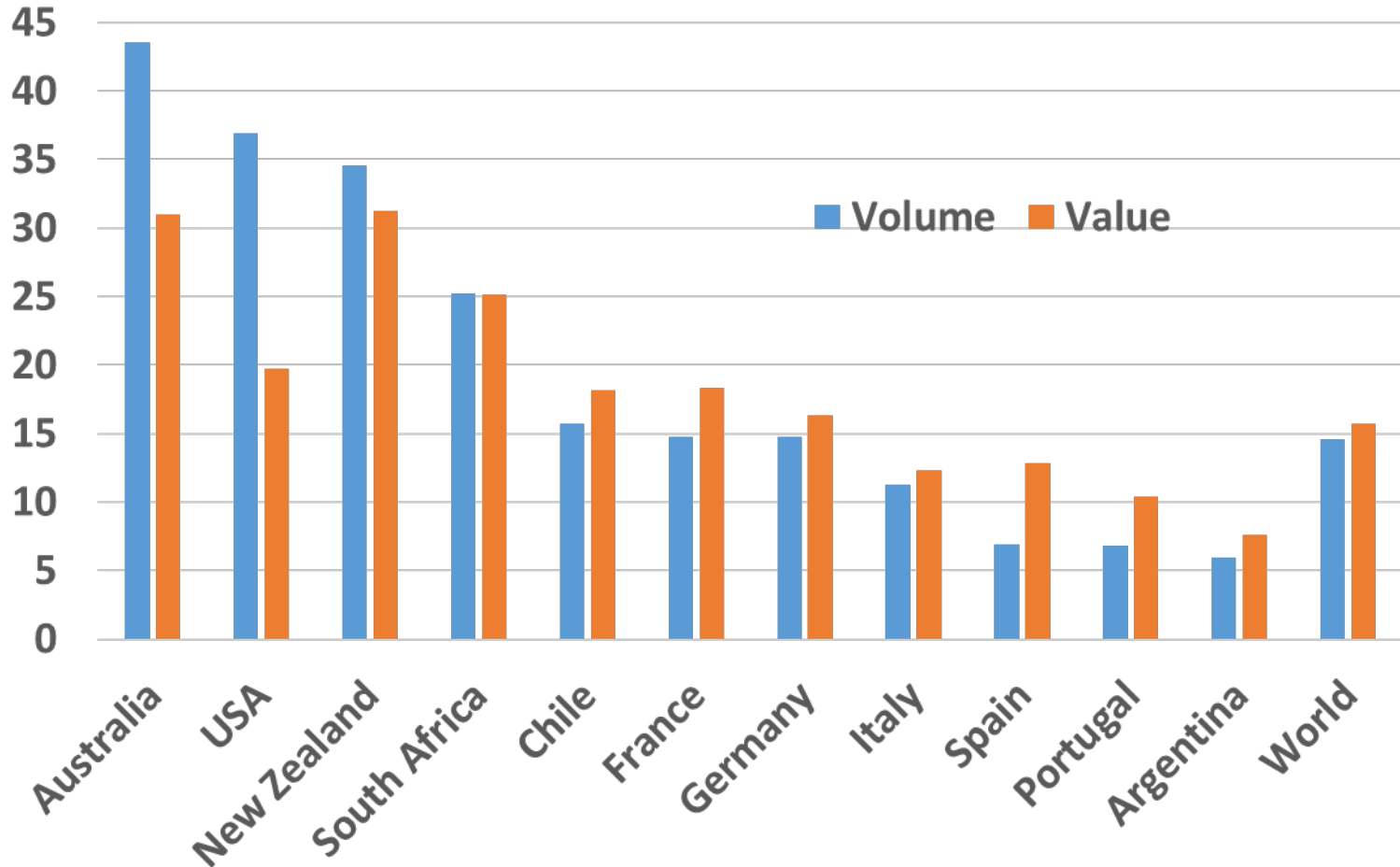


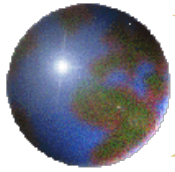
Why focus on wine?

- ✦ UK is world's 1st or 2nd largest wine importer
 - ▣ >3 times UK's importance in global goods imports
- ✦ EU provides 60% of world's wine exports
- ✦ UK is one of the largest wine export markets
 - ▣ for EU countries but, even more so, for
 - ▣ New World wine-exporting countries



Importance of UK to wine-exporting countries (% of their total wine exports, 2010-14)

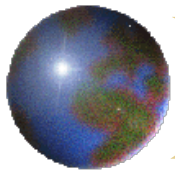




Brexit's effects on wine: initial thoughts

✚ **Conventional wisdom** of customs union theory:

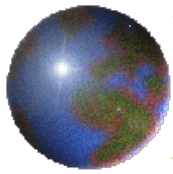
- ✚ a 'hard' Brexit (ie, UK leaving EU Single Market) will **hurt EU27** wine exporters ...
- ✚ ... but **help non-EU vignerons**, who'll face less competition from EU27 in UK wine market



Share of UK wine import volume by source (%):

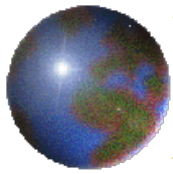
>2/3^{rds} have enjoyed duty free access to UK

| | EU27 | South Africa + Chile | Australia + New Zealand | United States | Others |
|----------------|-------------|-------------------------------------|--|--------------------------|---------------|
| | | | | | |
| | | | | | |
| 1990-95 | 90 | 3 | 5 | 2 | 0 |
| 1996-01 | 68 | 10 | 16 | 6 | 0 |
| 2002-12 | 55 | 15 | 20 | 9 | 1 |
| 2013-14 | 52 | 15 | 21 | 9 | 3 |



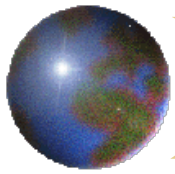
But tariff preference is very small

- ✦ Averages just **13 pence/litre** of wine
- ✦ c.f. excise tax+VAT of approx. **£3/litre**
- ✦ ... and average retail price is around **£6/bottle** off-trade, **>£13** on-trade
 - = > tariff is just **1%-2%** of consumer price



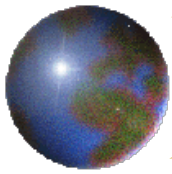
Brexit's effects on wine: initial thoughts

- ❖ **Conventional wisdom** from customs union theory:
 - ❖ a 'hard' Brexit (i.e., UK leaving the EU Single Market) will hurt EU27 wine exporters ...
 - ❖ ... but help non-EU vignerons, who'll face less competition from EU27 in UK wine market
- ❖ However, that's **only part of the likely story**
 - ❖ Outcome **also depends** on extent to which Brexit affects **UK incomes** and **the UK pound** initially ...
 - ❖ ... & then on what & when **new bilateral FTAs** emerge

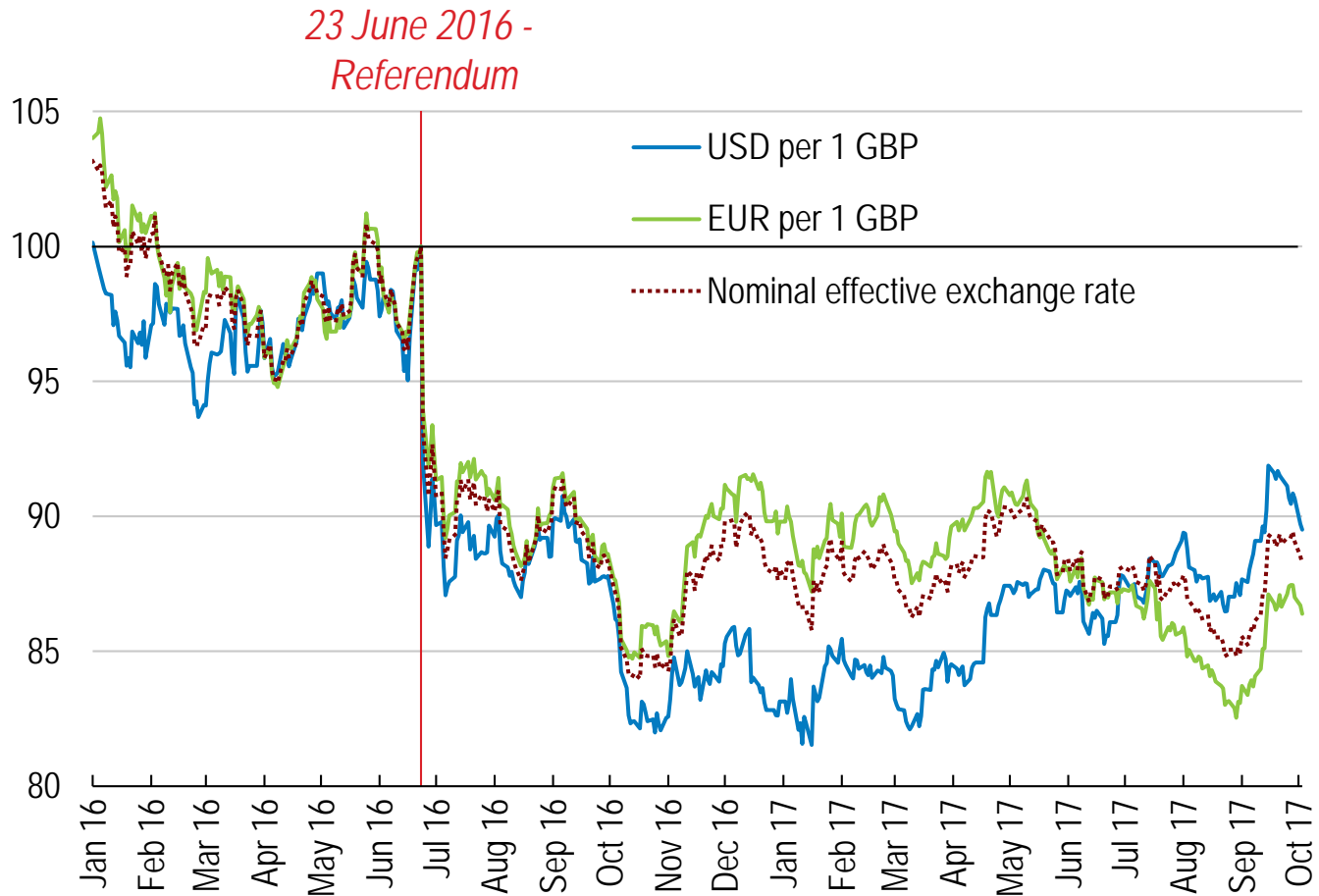


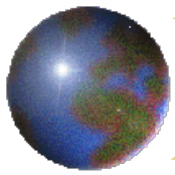
What initial effects matter for wine?

- ✦ Brexit will alter some bilateral import tariffs, but:
- ✦ ... it is also **devaluing the pound**
 - which **raises the pound price of wine** in the UK
- ✦ ... **and**, unless UK adopts great macroeconomic policies, **UK income growth rate will fall**
 - which will **reduce growth in UK demand for wine**



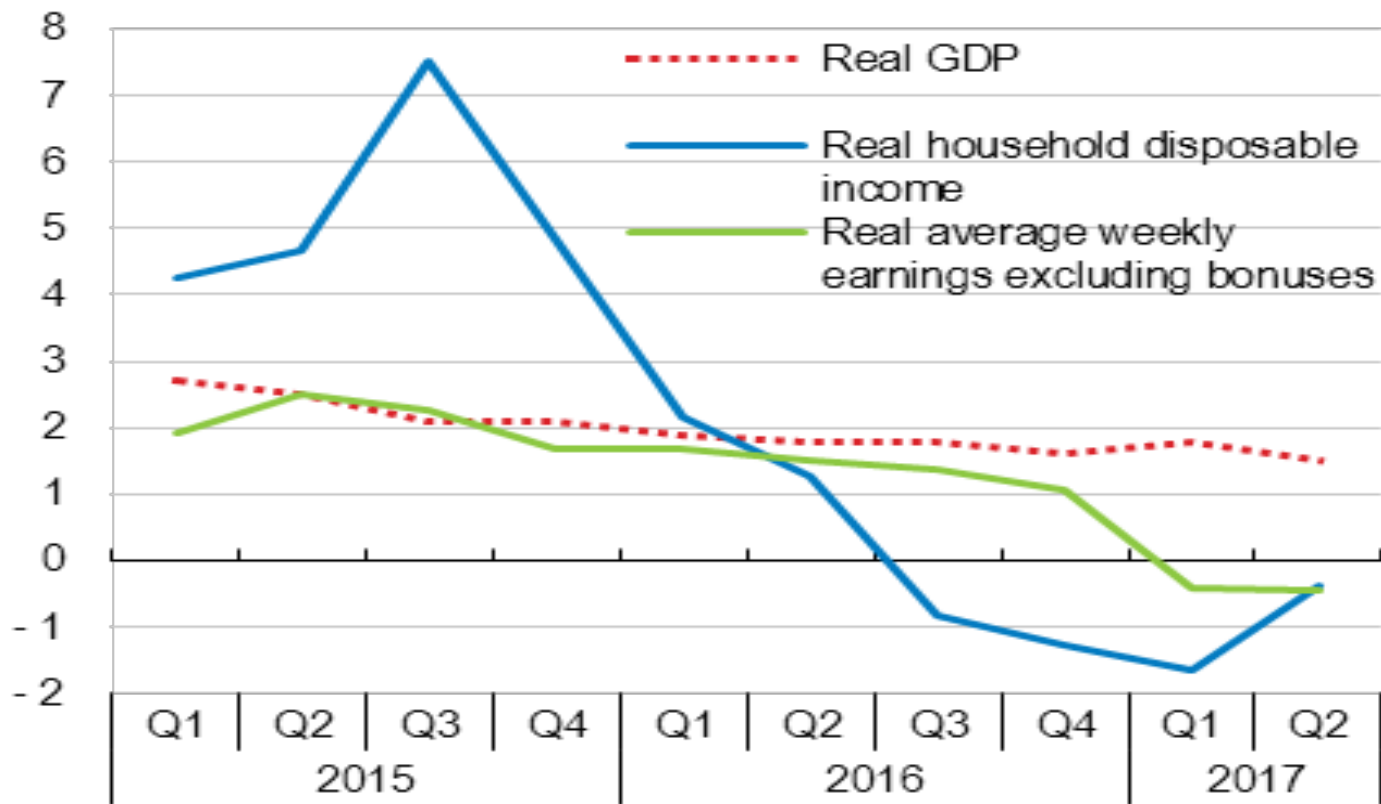
Pound devaluation: 15% since referendum

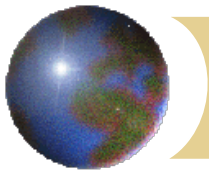




UK real income growth (% pa)

A. Real GDP and household income growth
Year-on-year percentage change

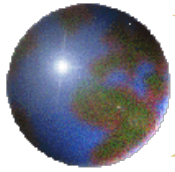




UK real GDP impact by 2017-18

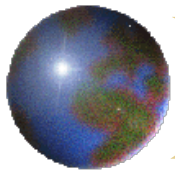
✚ By third quarter of 2017, economic cost of Brexit vote **already 1.3% of GDP**, and could be **3x that by end-2018**

▣ See “The Economic Consequences of the Brexit Vote”, by B. Born, G.J. Müller, M. Schularick and P. Sedláček, CEPR DP 12454, November 2017



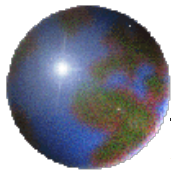
What will be initial effects of Brexit?

- ✚ ... on UK wine prices, consumption, production, imports and exports
- ✚ ... on EU27 wine exports, and
- ✚ ... on wine exports of other countries?



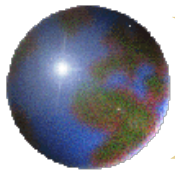
Model of world's wine markets

- ✦ Revision & update of model in Wittwer, Berger & Anderson (*Economic Modelling*, 2003) and Anderson & Wittwer (*China Economic Review*, 2015)
- ✦ Model's baseline is 2014
- ✦ Model is **projected from 2014 to 2025** assuming no Brexit, to get a baseline view of markets in 2025
 - ✦ Very significant, because of **Asia's growing importance**



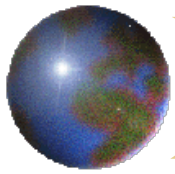
Baseline shares of UK wine imports (%): by 2025, w'out Brexit 4/5^{ths} would enjoy duty-free access

| | EU27 | South Africa & Chile | Australia & New Zealand | United States | Others |
|-----------------------|-------------|---------------------------------|------------------------------------|----------------------|---------------|
| <u>Volume:</u> | | | | | |
| 2013-14 | 52 | + 15 = 67 | 21 | 9 | 3 |
| 2025 | 63 | + 16 = 79 | 13 | 5 | 3 |
| <u>Value:</u> | | | | | |
| 2025 | 67 | + 11 = 79 | 14 | 5 | 3 |



Model of world's wine markets

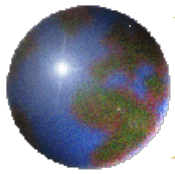
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- ✦ Model's baseline is 2014
- ✦ Model is **projected from 2014 to 2025** assuming no Brexit, to get a baseline view of markets in 2025
 - ✦ Very important, because of **Asia's growing importance**
- ✦ **Brexit is then imposed**, assuming UK leaves customs union & adopts EU tariff schedules at WTO
 - ✦ ... including on wine imports from EU27
 - ✦ ... and EU27 imposes its common external tariffs on UK wine exports & re-exports too



Assumptions about Brexit by 2025

✚ Two alternative initial Brexit scenarios:

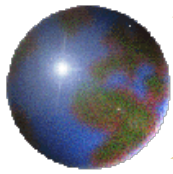
1. UK **adopts EU's tariff structure** which raises tariffs on EU (and Chilean and South African) wine, lowers **UK income growth rate** to 2025 by 2/3^{rds} (0.9% instead of 2.6%/yr) & causes 20% **real depreciation of £** ('**Hard Brexit**')
2. As with Scenario 1 but macro impacts on growth and pound are only half as large by 2025 ('**Soft Brexit**') because of assumed signing of FTAs well before 2025



Scenario 1 ('Hard Brexit'): effects on UK wine consumption

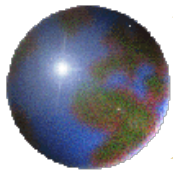
- ✦ Wine consumer prices in UK (in pounds) would be 24% higher on average:
 - ✦ 4% because of *altered tariffs*
 - ✦ 22% because of *pound depreciation*
 - ✦ -2% because of *lower income growth*

- ✦ Wine consumption volume in UK would be 28% lower:
 - ✦ 5% because of *altered tariffs*
 - ✦ 7% because of *pound depreciation*
 - ✦ 16% because of *lower income growth*



Scenario 1: effects on UK wine imports

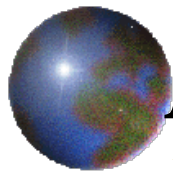
- ✚ UK wine imports in 2025 would be **1/4th lower**
 - ✚ by US\$1.75 billion:
 - \$0.15 billion because of *altered tariffs*
 - \$0.5 billion because of *pound depreciation*
 - \$1.1 billion because of *lower income growth*



Scenario 1: effects on UK wine imports

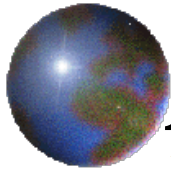
- ✚ UK wine imports in 2025 would be **1/4th lower**
 - ✚ by US\$1.75 billion:
 - \$0.15 billion because of *altered tariffs*
 - \$0.5 billion because of *pound depreciation*
 - \$1.1 billion because of *lower income growth*

- ✚ **UK share of global wine imports** in 2025 are 2% less by value, 5% less by volume
 - ✚ and **global wine trade** would be 3% less in 2025 than it would have been without this Brexit shock, with **all wine countries exporting less** (not just EU)






Effects of 'Hard Brexit' on wine export values (US\$m): SAfr & Chile lose most

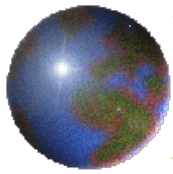
| | UK | RoW | WORLD | (%) |
|---------------------|--------------|-------------|--------------|--------------|
| EU27 | -1182 | -217 | -1399 | (-4) |
| Chile | -170 | 31 | -139 | (-11) |
| South Africa | -106 | 20 | -86 | (-7) |
| USA | -75 | -39 | -114 | (-5) |
| Australia | -25 | -59 | -84 | (-3) |
| Argentina | -16 | -38 | -54 | (-5) |
| New Zealand | -162 | 71 | -91 | (-4) |
| WORLD | -1752 | -16 | -1768 | (-3) |



Alternative assumptions about Brexit

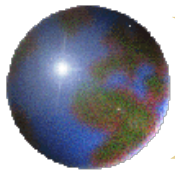
Subsequent FTA scenarios:

-  'Soft Brexit' plus **UK-EU27 FTA**
-  plus also **EU27 FTAs with Aust. & New Zealand**
-  plus also **UK FTAs with Aust., NZ, Chile & SAfrica**



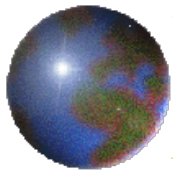
Assumptions about 'Soft Brexit' by 2025

- ✚ 'Soft Brexit' plus UK-EU27 FTA scenario:
 - ✚ Assumes UK pound is only 10% less, and real UK incomes are only 9% less, than they would have been in 2025 in absence of Brexit
 - '**lost years**' are because of current uncertainties, pending decision on future UK-EU27 trade agreement



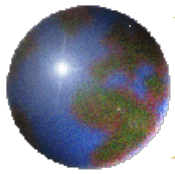
Scenario 2 ('Soft Brexit') pre-FTAs

- ✦ Effects on wine **consumer prices** in UK, and on volume of wine **consumption** in UK, would be about half as large as in 'Hard Brexit' case
 - ✦ Both about 12-14% less in 2025 than they would have been without Brexit
 - ... assuming UK-E27 & other FTAs not yet signed



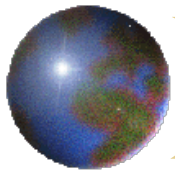
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 - ✦ Both about 12-14% less in 2025 than they would have been without Brexit
 - ... assuming UK-E27 & other FTAs not yet signed
- ✦ We use this Scenario 2 to examine additional effects by 2025 of signing a UK-EU27 FTA
 - ✦ ... the assumed reason for Brexit becoming 'Soft'



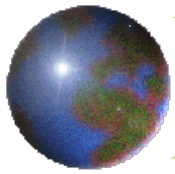
'Soft Brexit' plus UK-EU27 FTA scenario

- ✚ Under 'Soft Brexit', a UK-EU27 FTA is estimated to restore about **3/4^{ths}** of UK and global wine market losses (relative to 'Soft Brexit' without such an FTA)



UK-EU27 FTA plus 2 other FTA scenarios

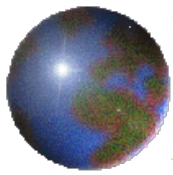
- ✚ Starting with 'Soft Brexit' including a UK-EU27 FTA:
 - ✚ we add **EU bilateral FTAs with Aust and NZ**
 - ✚ then also add **UK FTAs with ANZ, Chile & Sth Africa**



Impact of adding sequentially two extra FTAs on world wine trade in 2025 (2014 US\$m)

| <i>Extra FTAs:</i> <i>Exporter:</i> | EU27-ANZ | + UK-NW^a | | |
|--|-----------------|----------------------------|--|--|
| EU27 | 38 | 16 | | |
| ANZ | 12 | -16 | | |
| SA + Chile | -1 | 28 | | |
| USA | -1 | -7 | | |
| ROW | -1 | 2 | | |
| WORLD | 47 | 23 | | |

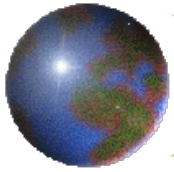
^a NW includes Aust, NZ, Chile and South Africa



Impact of multilateral free trade in wine on world wine trade in 2025 (in 2014 US\$m)

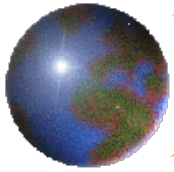
| <i>Extra FTAs: Exporter:</i> | EU27-ANZ | + UK-NW ^a | Global free wine trade | (% above 2025 base) |
|----------------------------------|-----------|----------------------|---------------------------|------------------------|
| EU27 | 12 | -16 | 2065 | 16% |
| ANZ | 38 | 16 | 368 | 17% |
| SA + Chile | -1 | 28 | 379 | 36% |
| USA | -1 | -7 | 219 | 56% |
| ROW | <u>-1</u> | <u>2</u> | <u>522</u> | <u>52%</u> |
| WORLD | <u>47</u> | <u>23</u> | <u>3553</u> | <u>20%</u> |

^a NW includes Aust, NZ, Chile and South Africa



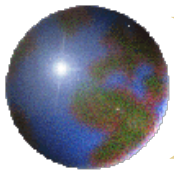
Conclusions

- ✚ **'Hard Brexit' reduces global welfare**
 - ✚ **UK wine consumers** and most **non-UK wine producers** would lose, compared with no Brexit
 - ✚ **Non-UK consumers** would be slightly better off, but not enough to offset losses to others, hence a **global loss** overall



Conclusions

- ✚ 'Hard Brexit' reduces global welfare
 - ✚ UK wine consumers and most non-UK wine producers would lose, compared with no Brexit
 - ✚ Non-UK consumers would be slightly better off, but not enough to offset losses to others, hence a **global loss** overall
- ✚ Even 'Soft Brexit' with UK-EU27 FTA involves initial losses due to years of uncertainty over future deals
 - ✚ & its effects on non-EU producers could be +ve or -ve, depending on mix of subsequent bilateral FTAs
 - ✚ & are trivial compared with moving to global free trade in wine



Thanks!

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✦ Glyn.Wittwer@vu.edu.au

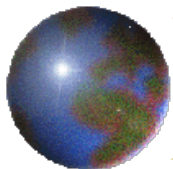
✦ Model is revised and updated from:

- ✦ Anderson, K. & G. Wittwer, "Modeling Global Wine Markets to 2018: Exchange Rates, Taste Changes, and China's Import Growth", *Journal of Wine Economics* 8(2): 131-58, 2013; and
- ✦ Anderson, K. & G. Wittwer, "Asia's Evolving Role in Global Wine Markets", *China Economic Review* 35: 1-14, 2015

✦ Initial results are detailed in:

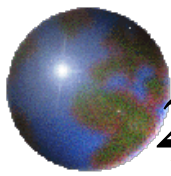
- ✦ Anderson, K. & G. Wittwer, "The UK and Global Wine Markets by 2025, and Implications of Brexit", Working Paper 0217, Wine Economics Research Centre, University of Adelaide, rev. July 2017 (forthcoming in *Journal of Wine Economics* 12(3), Dec 2017)
- ✦ Anderson, K. & G. Wittwer, "Will Brexit Harm UK and Global Wine Markets?", Wine Brief 16, Wine Economics Research Centre, University of Adelaide, May 2017
- ✦ Anderson, K. & G. Wittwer, "How Will Brexit Affect Australia's Wine Exports?", Wine Brief 17, Wine Economics Research Centre, University of Adelaide, June 2017
- ✦ Anderson, K. & G. Wittwer, "Impact of a 'Softer' Brexit on Wine", Wine Brief 18, July 2017

✦ See www.adelaide.edu/au/wine-econ



Scenario 2: Effects on wine export values (US\$m) if Brexit's UK income slowdown and pound depreciation are only half as large

| | UK | RoW | WORLD | (%) |
|---------------------|-------------|-------------|--------------|---------------|
| EU27 | -692 | -114 | -806 | (-2) |
| Chile | -128 | 36 | -92 | (-4) |
| South Africa | -83 | 23 | -60 | (-5) |
| USA | -23 | -27 | -50 | (-2) |
| Australia | 19 | -52 | -33 | (-1) |
| Argentina | -3 | -25 | -28 | (-3) |
| New Zealand | -80 | 34 | -46 | (-2) |
| WORLD | -990 | -32 | -1022 | (-2.0) |



Increase in value of Australian wine exports, 2014 to 2025, without & with Brexit, FTAs & global free trade (in 2014 US\$m)

