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

Kym Anderson and Glyn Wittwer

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

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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)
Conventional wisdom of customs union theory:

- a ‘hard’ Brexit (ie, UK leaving EU Single Market) will **hurt EU27** wine exporters …

- … but **help non-EU vigneron**s, who’ll face less competition from EU27 in UK wine market
Share of UK wine import volume by source (%):
>2/3\textsuperscript{rd}s have enjoyed duty free access to UK

<table>
<thead>
<tr>
<th>Year</th>
<th>EU27</th>
<th>South Africa + Chile</th>
<th>Australia + New Zealand</th>
<th>United States</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-95</td>
<td>90</td>
<td>3</td>
<td>5</td>
<td>2</td>
<td>0</td>
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<tr>
<td>1996-01</td>
<td>68</td>
<td>10</td>
<td>16</td>
<td>6</td>
<td>0</td>
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<tr>
<td>2002-12</td>
<td>55</td>
<td>15</td>
<td>20</td>
<td>9</td>
<td>1</td>
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<tr>
<td>2013-14</td>
<td>52</td>
<td>15</td>
<td>21</td>
<td>9</td>
<td>3</td>
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</table>
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 vigneron, 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

USD per 1 GBP

EUR per 1 GBP

Nominal effective exchange rate

23 June 2016 - Referendum
UK real income growth (% pa)

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

- Real GDP
- Real household disposable income
- Real average weekly earnings excluding bonuses

<table>
<thead>
<tr>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
<th>Q1</th>
<th>Q2</th>
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<td>2015</td>
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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 4/5ths would enjoy duty-free access

<table>
<thead>
<tr>
<th></th>
<th>EU27</th>
<th>South Africa &amp; Chile</th>
<th>Australia &amp; New Zealand</th>
<th>United States</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Volume:</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>2013-14</td>
<td>52</td>
<td>+ 15 = 67</td>
<td>21</td>
<td>9</td>
<td>3</td>
</tr>
<tr>
<td>2025</td>
<td>63</td>
<td>+ 16 = 79</td>
<td>13</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td><strong>Value:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2025</td>
<td>67</td>
<td>+ 11 = 79</td>
<td>14</td>
<td>5</td>
<td>3</td>
</tr>
</tbody>
</table>
Model of world’s wine markets

- 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
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 2/3rds (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 $\frac{1}{4}$th 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 \( \frac{1}{4} \)th 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**

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

- We use this Scenario 2 to examine additional effects by 2025 of signing a UK-EU27 FTA
  - …the assumed reason for Brexit becoming ‘Soft’
Under ‘Soft Brexit’, a UK-EU27 FTA is estimated to restore about $\frac{3}{4}$ of UK and global wine market losses (relative to ‘Soft Brexit’ without such an FTA)
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)

<table>
<thead>
<tr>
<th>Extra FTAs: Exporter:</th>
<th>EU27-ANZ</th>
<th>+ UK-NW&lt;sup&gt;a&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU27</td>
<td>38</td>
<td>16</td>
</tr>
<tr>
<td>ANZ</td>
<td>12</td>
<td>-16</td>
</tr>
<tr>
<td>SA + Chile</td>
<td>-1</td>
<td>28</td>
</tr>
<tr>
<td>USA</td>
<td>-1</td>
<td>-7</td>
</tr>
<tr>
<td>ROW</td>
<td>-1</td>
<td>2</td>
</tr>
<tr>
<td>WORLD</td>
<td>47</td>
<td>23</td>
</tr>
</tbody>
</table>

<sup>a</sup> 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)

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

*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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Model is revised and updated from:


Initial results are detailed in:


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**

<table>
<thead>
<tr>
<th></th>
<th>UK</th>
<th>RoW</th>
<th>WORLD</th>
<th>(%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU27</td>
<td>-692</td>
<td>-114</td>
<td>-806</td>
<td>-2</td>
</tr>
<tr>
<td>Chile</td>
<td>-128</td>
<td>36</td>
<td>-92</td>
<td>-4</td>
</tr>
<tr>
<td>South Africa</td>
<td>-83</td>
<td>23</td>
<td>-60</td>
<td>-5</td>
</tr>
<tr>
<td>USA</td>
<td>-23</td>
<td>-27</td>
<td>-50</td>
<td>-2</td>
</tr>
<tr>
<td>Australia</td>
<td>19</td>
<td>-52</td>
<td>-33</td>
<td>-1</td>
</tr>
<tr>
<td>Argentina</td>
<td>-3</td>
<td>-25</td>
<td>-28</td>
<td>-3</td>
</tr>
<tr>
<td>New Zealand</td>
<td>-80</td>
<td>34</td>
<td>-46</td>
<td>-2</td>
</tr>
<tr>
<td>WORLD</td>
<td>-990</td>
<td>-32</td>
<td>-1022</td>
<td>-2.0</td>
</tr>
</tbody>
</table>
Increase in value of Australian wine exports, 2014 to 2025, without & with Brexit, FTAs & global free trade (in 2014 US$m)