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A 3D map of Europe is shown against a dark blue background. The map is rendered in a light blue color. The European Union flag (blue with yellow stars) is overlaid on the map, and the United Kingdom flag (red, white, and blue) is overlaid on the map. The letters 'EU' are visible on the map. The background of the entire page is a dark blue color with a pattern of yellow stars and the letters 'EU' in white.

AN ASSESSMENT OF THE ECONOMIC IMPACTS ARISING FOR IRELAND FROM THE POTENTIAL FUTURE TRADING RELATIONSHIP BETWEEN THE EU AND UK

COMMISSIONED BY THE DEPARTMENT OF BUSINESS, ENTERPRISE AND INNOVATION
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EXECUTIVE SUMMARY

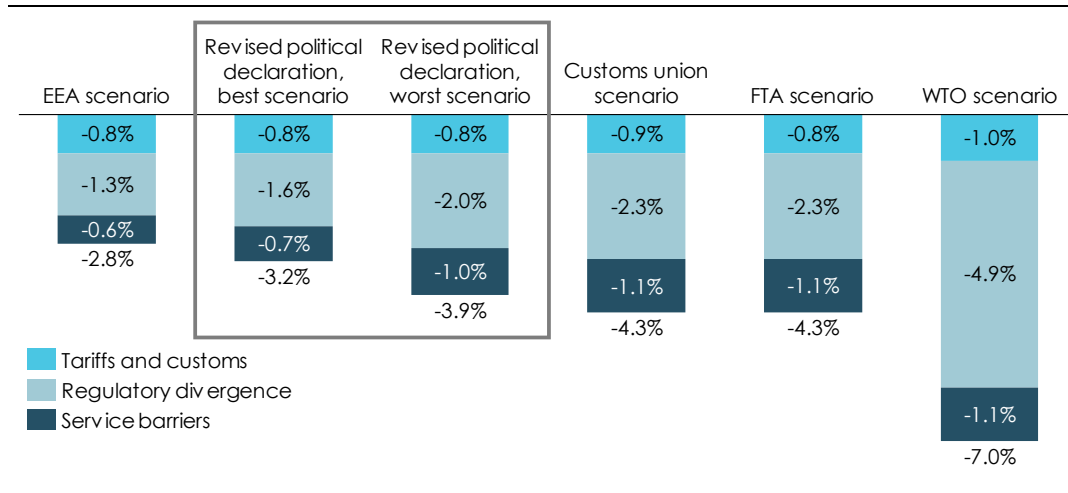
In 2017, the Department of Business, Enterprise and Innovation commissioned Copenhagen Economics to undertake a study to consider the impact of Brexit on Ireland’s trade and economy. This report was published in February 2018 and considered four different Brexit scenarios and the impact of each on the Irish economy. The four scenarios were a European Economic Area (EEA) type scenario, a Customs Union scenario, a Free Trade Agreement (FTA) scenario, and a WTO (No Deal) scenario.

Reflecting more recent developments with the adoption of the Withdrawal Agreement and the Revised Political Declaration (RPD) on the Future Relationship between the EU and the UK, the Department recently undertook further Brexit analysis. DBEI, in conjunction with Copenhagen Economics, has modelled two additional FTA scenarios to take account of the provisions of the RPD.

Overall, the findings suggest that a Brexit outcome based on the RPD is likely to reduce Irish GDP by between 3.2% and 3.9% by 2030 compared with a baseline where the UK remains a member of the EU. This compares to a negative impact of 4.3% for the generic FTA modelled in the previous Copenhagen Economics study.

This latest analysis is intended to inform Ireland’s contribution to the forthcoming negotiations between the EU and the UK.

Figure 1
Impact on Irish GDP in different Brexit scenarios
 Per cent change from 2030 baseline



Note: The figures show the percentage effect of a new EU-UK trade agreement compared to the case where UK had remained a member of the EU. The per cent impact in each scenario should be interpreted as the per cent by which the level of Irish GDP would be lower than in the absence of Brexit in 2030.

Source: Copenhagen Economics based on Copenhagen Economics (2018) and CGE simulations in cooperation with J. Francois

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ACRONYMS AND DEFINITIONS

CGE	Computable General Equilibrium
DBEI	Department of Business, Enterprise and Innovation
EEA	European Economic Area: The EEA comprises the 28 EU member states, as well as three of the four member states of the EFTA (Iceland, Liechtenstein and Norway). Membership provides for the free movement of persons, goods, services and capital within the European Single Market
EFTA	European Free Trade Association: EFTA is a regional trade organization and free trade area consisting of Iceland, Liechtenstein, Norway, and Switzerland. It operates in parallel with the EU, with Iceland, Liechtenstein and Norway being part of the EU Single Market through the EEA agreement. Switzerland's integration with the EU Single Market is regulated through a number of bilateral treaties.
EU	European Union
FTA	Free Trade Agreement: An FTA is an agreement between two or more countries that establishes the free exchange of goods and services among parties. Each party to an FTA retains its own independent trade regime with respect to non-members (unlike the case of a customs union). FTAs are subject to the disciplines and oversight of the WTO
GDP	Gross Domestic Product: The market value of all goods and services produced in a country in a year
GTAP	Global Trade Analysis Project database global data base describing bilateral trade patterns, production, consumption and intermediate use of commodities and services
ICT	Information and Communication Technology
MFN	Most Favoured Nation: MFN is the cornerstone of non-discrimination among WTO members. Any favourable treatment provided by a WTO member to any other country must immediately and unconditionally be provided to all other WTO members
NTB	Non-Tariff Barrier (import quotas, subsidies, customs delays, technical barriers or other obstacles to trade besides tariffs)
PD	The Political Declaration setting out the framework for the future relationship between the European Union and the United Kingdom
R&D	Research & Development
RPD	Revised Political Declaration for the future relationship between the European Union and the United Kingdom, as of October 2019
RWA	Revised Agreement on the Withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community, as of October 2019
Tariff	A duty levied on goods entering a new customs area – sometimes referred to as a customs duty
TRQ	Tariff Rate Quota: A quota within which imports enter a market with a tariff advantage. A TRQ is a volume of imports whose tariff is lower than the tariff charged for imports above the quota
UK	United Kingdom
WA	Agreement on the Withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community

WTO

World Trade Organisation: The WTO is the international organisation dealing with the rules of trade between nations. Its goal is to ensure that trade flows as smoothly, predictably and freely as possible

EU FREE TRADE AGREEMENTS AND BREXIT

In 2016, the United Kingdom decided to withdraw from the European Union. The process of the withdrawal is still ongoing¹ and it is not yet clear what the ultimate relationship between the EU and UK will be – this depends on the outcome of the forthcoming FTA negotiations.² The impact of Brexit on the Irish economy varies depending on what the future relationship will look like.

A previous report by Copenhagen Economics has shown how four different Brexit scenarios may impact the Irish economy. We include those results in this report.³ The four scenarios are an EEA-type scenario, a Customs Union scenario, an FTA scenario, and a WTO (No Deal) scenario.

To those four, we add two new Brexit scenarios based on the *Revised Political Declaration setting out the framework for the future relationship between the European Union and the United Kingdom*.⁴ This document sets out the intent of both the EU and UK to negotiate a comprehensive Free Trade Agreement to replace the current economic relationship. As the future relationship set out in the revised Political Declaration is bespoke, we model one best-case scenario and one worst-case scenario to account for the degree of uncertainty as to how the political text will be implemented in practice.

Finally, we combine the modelling of these six Brexit scenarios with modelling of EU FTAs that are either recently concluded and applied or currently under negotiation.

POSSIBLE BREXIT SCENARIOS BASED ON EXISTING EU TRADE ARRANGEMENTS

In Copenhagen Economics (2018), we analysed the possible impacts of Brexit on the Irish economy. We estimated four different scenarios for the UK's departure and subsequent relationship with the EU based on *existing* trade arrangements between the EU and non-EU countries:

European Economic Area (EEA) agreement: This scenario assumed similar levels of trade costs between the EU and the UK as are currently observed between the EU and two EEA members (Norway and Iceland). The scenario did not assume an agreement that is necessarily 100 per cent identical to the agreement with Norway, but rather an *EEA-like agreement* with similar effects on tariffs and other trade costs. The scenario included duty free trade for most products although with some tariffs on sensitive products within selected agri-food sectors. The scenario also assumed that the UK would commit to a high degree of regulatory alignment with Single Market rules (e.g. including mutual recognition agreements, harmonisation of some standards, etc.). Despite retaining a close integration with the Single Market, the UK would be leaving the EU Customs Union and the Customs Territory of the Community, which makes it necessary to impose border inspections on EU-UK trade by whatever means. UK exporters

¹ As of December 2019.

² The current timetable and most recent Article 50 extension provides for the UK to leave the EU by 31 January 2020, with a transition period up to the end of 2020.

³ Copenhagen Economics (2018a) *Ireland and the impacts of Brexit – Strategic implications for Ireland arising from changing EU-UK trading relations*.

⁴ European Commission (2019), TF50 (2019) 65 – Commission to EU 27.

would be facing higher costs of exporting related to border controls, tariffs and emerging regulatory differences. The EEA scenario also implies an increase in service barriers. Again, we made the scenario operational by imposing a new trade barrier on EU-UK trade in services of similar size as the existing trade barrier between the EU and the EEA countries.

Customs Union (CU): In this scenario, the EU and the UK agree on a traditional customs union agreement. Such an agreement typically removes most tariffs although some tariffs on agri-food products can remain. A Customs Union will require a common external tariff. Consequently, in this scenario the EU and the UK would continue to have a common external trade policy, and the UK would not be able to negotiate its own trade agreements independently of the EU. Just as in the case of the EEA scenario (and the FTA scenario described below), the UK exit from the Customs Territory will imply that border checks on EU-UK trade will be needed, unless a political agreement on their removal can be reached. A standard Customs Union does not cover regulatory convergence for goods or for service trade, and there is a higher risk of regulatory divergence for both goods and services relative to an EEA-like agreement.

Free Trade Agreement (FTA): In this scenario, the EU and the UK agree on a free trade agreement. To make this scenario operational, we used the trade costs of an average EU FTA as mid-point estimate. The scenario includes duty free trade for most products although with some tariffs on sensitive products within selected agri-food sectors. The negotiated tariffs in EU FTAs are generally higher than in the Customs Union or EEA scenarios. The average EU FTA shows very limited ability to ensure regulatory alignment with Single Market rules, and the scenario includes a risk of emerging regulatory divergence between the EU and the UK in both goods and services. Just like the previous scenarios, border measures are imposed. In this scenario, the UK will be free to set its own external trade policy.

WTO Agreement (WTO): If no other solution can be found, trade will be governed by WTO rules and other WTO agreements. In this case, the UK and the EU will impose Most Favoured Nation (MFN) tariffs on each other's goods where these are not bound by other agreements or arrangements. In this scenario, we also assumed that the UK will comply with plurilateral commitments on tariffs in the WTO such as the Information Technology Agreement (ITA)⁵, the Pharmaceutical Agreement⁶ and other similar agreements. These agreements grant duty free trade on a range of listed products between the signatories. This means that MFN tariffs will

⁵ The *Information Technology Agreement* is a plurilateral WTO agreement to eliminate tariffs on certain information and communications technology (ICT) products. The ITA covers a wide range of ICT products, including computers and computer peripheral equipment, electronic components including semiconductors, computer software, telecommunications equipment, semiconductor manufacturing equipment, and computer-based analytical instruments. To date, 82 WTO Members are ITA participants representing 97 per cent of world trade in ICT products.

⁶ The *Pharmaceutical Agreement* is a WTO agreement signed by Canada, the European Union and its 28 Member States, Japan, Norway, Switzerland, the United States, and Macao (China). The agreement was reached during the WTO Uruguay Round negotiations, where the EU and several other major trading partners agreed to reciprocal tariff elimination, a "zero-for-zero initiative", for pharmaceutical products and for chemical intermediates used in the production of pharmaceuticals. The list of items eligible for duty elimination has been updated several times and includes more than 10,000 products.

not apply across the board on EU-UK trade. Furthermore, the EU uses so-called tariff rate quotas (TRQs)⁷ on a range of products⁸ whereby imports from third countries can enter the EU with zero or low tariffs up to a certain quantity for a given time period, and with MFN tariffs only applicable when imports exceed the quota. This implies that the effective import duty on many products is significantly lower than the simple MFN tariff. In the WTO scenario, we assumed that the EU and the UK will continue to use such TRQs both between them and with third countries.⁹

For simplicity, the scenarios are henceforth denoted “EEA”, “Customs Union (CU)”, “FTA” and “WTO”.

THE EU-UK POLITICAL DECLARATION

In November 2018, EU and UK negotiators reached an agreement on a Withdrawal Agreement (WA). The WA set out the terms of the UK’s departure from the EU, including transitional arrangements as well as a protocol on Ireland/Northern Ireland, commonly referred to as the Backstop Plan. The Backstop was only intended to come into force in the event that other solutions to avoid a hard border on the island of Ireland could not be devised as part of the negotiations on the future EU-UK relationship. The WA was accompanied by a Political Declaration (PD) that set out the framework for the future relationship between the EU and the UK over a number of policy areas.

In October 2019, the withdrawal agreement and the political declaration were revised (RWA and RPD) with changes to some sections of the agreement. In essence, in order to deliver on the commitment to avoid a hard border, the RWA integrates Northern Ireland with the EU Single Market to a greater extent than in the WA, while Great Britain is less integrated with the EU Single Market and especially the EU Customs Union in the RWA, compared to the WA. Unlike the previous Backstop, which was intended only as an insurance policy, these arrangements will be implemented immediately after transition and it is intended that they could be in place on a longer-term basis with the democratic support of the Northern Ireland Assembly.

⁷ The EU maintains *tariff rate quotas* (TRQs) for three general types of imports: agricultural products, autonomous MFN quotas, and imports from certain countries pursuant to preferential agreements. In addition, pursuant to a 2012 EU regulation, the EU has established tariff quotas for high-quality beef, applying only to imports from certain countries. Many MFN tariff quotas are allocated on a “first-come, first-served” basis. When the quotas of the application period for the products in question are used up, normal import duties are applied.

⁸ According to the latest WTO Trade Policy Review of the European Union, there were 1,006 categories of TRQs applied on a variety of products as of October 2016. The majority of the TQs were country- or regional-specific TRQs to implement FTA commitments, and about 230 were open to all importers as autonomous quotas. The TRQs open to all importers are mainly applied on fish, agricultural products, chemicals, metals, machinery and equipment. Other TRQs apply bilaterally to certain countries for individual products or to certain sectors such as handicrafts.

⁹ The allocation of the existing EU quotas vis-à-vis third countries is assumed to allow for current quantities from third countries.

The following analysis and modelled impact of Brexit on the Irish economy focuses on the RPD. Specifically, we focus on the articles concerning the Economic Partnership since they contain provisions that are directly related to trade policy. This includes provisions on e.g. goods trade, services trade, financial services, capital movements, personal mobility, global cooperation, level playing field measures etc. The text of the RPD is similar to the PD and notably includes an extended text on Level Playing Field provisions (though, essentially, the text clarifies and strengthens the principle of preferential access to the EU Single Market implying ambitions for comprehensive Level Playing Field provisions, as already set out in the PD).

Based on EU law, fully-fledged negotiations on the future relationship can only take place once the UK has officially left the EU. Hence, a political declaration on the *framework* for the future relationship is as far as the EU and the UK can go at this stage. The RWA (and the RPD) has been approved by the European Council - but it has yet to be approved by the UK Parliament, and then by the European Parliament.

Our approach to estimate impacts of the Revised Political Declaration

Unlike the four Brexit scenarios that were modelled in Copenhagen Economics (2018), the EU does not have an existing arrangement with a third country that can be appropriately used as a template for the RPD scenario. The modelling of the EEA scenario was based on the current trade costs between the EU and Norway/Iceland, the CU scenario was based on the current trade costs between the EU and Turkey, and the FTA scenario was based on a weighted average of the current trade costs between the EU and all third countries with whom the EU has a FTA in place. Regarding the RPD, no such trade agreement exists today where we can observe actual trade costs between the EU and the third country and use them as a template for the modelling.

Instead, we assess the content of the articles as they are written in the RPD and base our modelling on how they compare to the four Brexit scenarios that are modelled and made operational based on actual, observable trade costs. Notably, the provisions of the RPD aim to establish an “*ambitious, wide-ranging and balanced economic partnership*”¹⁰ grounded in the fact that the EU and the UK have been closely economically integrated for more than 45 years.

In practice, the 45 years of close economic relationship has led to integrated and complex supply chains that have been formed and developed under the free movement of goods, services, persons and capital – the four freedoms of the EU Single Market. On the one hand, there is an incentive for agreeing on an *ambitious* and *wide-ranging* relationship so as to minimise the disturbance to those supply chains by increased trade costs as a result of Brexit.

On the other hand, the EU has repeatedly stated that it is not possible to leave the EU while retaining all the benefits that EU membership creates. The EU’s chief negotiator Michel Barnier has stated that “*the internal market is an integrated ecosystem and the four freedoms, including the freedom of movement, are indivisible and inextricably linked*”.¹¹ Hence, the partnership also needs to be *balanced*.

¹⁰ §17 RPD.

¹¹ Statement by Michel Barnier at the plenary session of the European Parliament on the Article 50 negotiations with the United Kingdom, Strasbourg, 13 March 2018.

In other words, while the RPD aims to minimise the increase in trade costs resulting from Brexit, it does acknowledge that there is a constraint regarding how low this cost minimisation can go.¹² Consequently, the level of integration set out in the RPD is likely to be somewhere between the EEA scenario (which includes, *inter alia*, freedom of services provision, establishment and movement of persons) and the CU and FTA scenarios over the relevant parameters used in our modelling.

Additionally, since the RPD is indeed a declaration for which there is no precedent, there is an element of ambiguity on some of the relevant parameters that we model. For those parameters, we have made an assessment of the wording in the RPD to establish the possible range of the actual outcome, in relation to the EEA scenario and the CU and FTA scenarios.

Therefore, we report two results of our modelling of the RPD scenario: One best-case scenario where trade costs are as low as possible given the wording of the RPD, and one worst-case scenario where trade costs are as high as possible given the wording of the RPD.¹³ We prefer to report results for these two sub-scenarios over reporting one average result since an average result would imply an uncertain assumption about whether a best-case or worst-case outcome is more likely than the other.

Modelling of the Revised Political Declaration

Our modelling of how Brexit will impact Ireland's GDP through increased trade costs is done over five parameters: Tariffs on agri-food products, tariffs on manufactured products, customs procedure costs, regulatory divergence for goods and barriers to services trade. This section presents our analysis of the RPD in more detail over the five trade cost parameters.¹⁴ An overview figure of the trade cost estimates for the five parameters across all six scenarios can be found in Figure 2.

¹² In that regard it is also relevant that the jurisdiction of the Court of Justice of the European Union (CJEU) will cease over the UK, which could lead to uncertainties about how e.g. market rules will be interpreted in the UK and the EU, respectively. Such uncertainties could lead to higher trade costs. The RPD does however set out an aim to ensure consistent interpretation (para. 128 RPD) and dispute settlement mechanisms and referral procedures (para. 129-132 RPD) to counteract this issue. The actual outcome on regulatory uncertainty is nonetheless uncertain.

¹³ One could estimate best and worst case estimates also for the EEA, CU, FTA and WTO scenarios, since the actual trade costs between Ireland and the UK may differ from those observed between Ireland and other non-EU countries, in any scenario. However, the level of uncertainty about the actual outcome is higher in the RPD scenario since there are no actual, observable trade costs to guide as to the most likely outcome.

¹⁴ We treat the RPD as being adopted as a whole by the EU and the UK. Our analysis and modelling of the five trade cost parameters therefore assumes that all necessary flanking policies that are required for the outcomes to be realised will be put in place, as envisioned in the RPD (e.g. the provisions on level playing field, §77 RPD). In addition, we do not make any prejudgements as to how realistic or likely the RPD scenario is relative to the other Brexit scenarios.

Figure 2
Overview of trade barriers in the six different Brexit scenarios

Effect on five main categories of trade barriers

	EEA scenario	Revised political declaration, best-case scenario	Revised political declaration, worst-case scenario	Customs Union scenario	FTA agreement scenario	No agreement (WTO terms)
Tariffs on agri-food products	Low	None	None	Low	Medium	Highest ¹
Tariffs on manufactured goods	None	None	None	None	None	Highest ¹
Customs procedures	Yes	Yes ²	Yes ²	Yes ²	Yes	Yes
Regulatory divergence on goods	Lowest	Low	Medium	High	High	Highest
Service barriers	Lowest	Low	Medium	Highest	Highest	Highest

Note: 1) The analysis assumes that the UK replicates the EU's current external tariffs and arrangement of tariff rate quotas (TRQs) in key agriculture sectors, e.g. beef and dairy.

2) Unless a political agreement can be reached to avoid customs procedures.

Source: Copenhagen Economics

Tariffs on agri-food products

The RPD is the scenario with the lowest trade costs regarding tariffs on agri-food products. As stated in §22 RPD, it is envisioned that there should be “...no tariffs, fees, charges or quantitative restrictions across all sectors...”. The EEA, the CU, and the FTA scenarios all imply tariffs on selected agri-food products such as beef, dairy and processed foods, although they are relatively low, on average. As the wording in the RPD leaves no wiggle-room in this regard – no tariffs means no tariffs – there is no difference between the best-case and the worst-case scenarios on this parameter.¹⁵

Tariffs on manufactured goods

As is the case for agri-food products, both the best-case and worst-case scenarios imply no tariffs on manufactured goods. On this parameter, the RPD scenarios are on par with the EEA, the CU and the FTA scenarios. In sum, the RPD provides for the lowest possible tariff regime between Ireland and the UK of all scenarios.

Customs procedures

The provisions related to customs procedures in the RPD mean that trade costs will increase compared to the current situation where the UK is an EU member. However, the RPD provides for a significant reduction of trade costs compared to the FTA scenario and the WTO scenario.

¹⁵ The no-tariff outcome is dependent on the EU and the UK agreeing on relevant flanking policies on e.g. agricultural and SPS policy.

The EU's customs territory comprises the EU Member States. As such, EEA countries are not part of it, nor is Turkey despite being in a customs union with the EU, and neither will the UK be once it leaves the EU. Hence, goods trade between EU and non-EU countries is subject to customs procedures. The fact that tariffs will be zero for all products does not alter this, since the purpose of the customs territory is not limited to collecting tariffs and other fees but also to ensure the integrity and proper functioning of the EU and the UK markets.

The RPD states that both the EU and the UK shall put in place ambitious customs arrangements that make use of all available regulatory and technological means to facilitate as smooth a trade flow as possible, such as trusted trader programmes and administrative cooperation.¹⁶ There will be “*appropriate and modern accompanying rules of origin*”¹⁷ when goods are traded between the EU and the UK.

All in all, our assessment is that the trade costs arising from the customs procedures set out in the RPD will be similar to those in the EEA scenario in the best-case scenario. This is because of the mutual aims of the EU and the UK to do everything possible to make customs procedures as lenient as possible. In the worst-case scenario, we conclude that there is a risk of increased checks and controls due to the possibility of either the EU and the UK perceiving increased risks with goods that are traded from one party to the other. We therefore model the worst-case scenario as increased customs costs compared to the EEA scenario, but a lower customs costs compared to the CU and FTA scenarios.

Compared to the FTA scenario, the RPD implies significantly lower trade costs since FTAs allow for reduced or zero tariffs, but no reductions in customs procedure costs. In fact, in order to utilise the tariff reductions offered by an FTA, traders must prepare and submit additional documentation compared to trading on non-preferential terms (e.g. to prove compliance with the FTA's Rules of Origin). Thus, in a way, FTAs can lead to some further customs formalities. It is therefore necessary that the tariff reduction is large enough to offset the extra administrative cost for the trader to find it worthwhile to utilise the FTA (i.e. that the benefits outweigh any costs that may arise). It also underlines the need for the policy system to minimise such formalities as much as possible in order to maximise the potential of FTAs.

Regulatory divergence for goods

The RPD provides a foundation for far-reaching cooperation over several regulatory areas between the EU and the UK, with a specific focus on technical barriers to trade (TBT) and sanitary and phytosanitary (SPS) measures. The RPD states that the EU and the UK have a “*particularly important trading and investment relationship*”.¹⁸ This suggests that the relatively general provisions on regulatory cooperation are intended to go well beyond that of a CU or FTA scenario.

The fact that the EU and the UK for more than four decades have developed their regulatory environments for products in as close cooperation as possible should provide for a significant reduction in trade costs compared to the CU and FTA scenarios. This will be further facilitated by the envisioned cooperation between UK authorities and the EU agencies for e.g. medicines, chemicals, and

¹⁶ § 24 RPD.

¹⁷ § 22 RPD.

¹⁸ § 16 RPD.

aviation safety. The UK authorities have extensive experience of working with the EU agencies, which should make for efficient regulatory cooperation.

However, the fact that the UK leaves the EU Single Market and will not be as directly bound by EU regulations and directives means that trade costs are likely to be higher than in the EEA scenario. An important point to note in this regard is that the trade cost increase may not only stem from the UK adopting rules that differ from the EU's, but also stem from *actual* regulatory divergence, e.g. driven by different interpretations and rulings by UK courts and authorities than in the EU, even though the UK and EU regulations are identical on paper.

Furthermore, trade costs may also increase due to *perceived* regulatory divergence, since firms can no longer rely on the right to free movement of goods. Even though the RPD sets out procedures for ensuring consistent interpretation of common rules, those procedures may prove onerous and inefficient.

The EEA scenario provides more regulatory certainty than the RPD, since it has well-established mechanisms to ensure that common product rules are implemented correctly across the Single Market. The fact that the EEA scenario implies membership of the Single Market means a heightened certainty for firms that product rules would be applied and interpreted uniformly in the UK as in Ireland. The EEA countries are *rule-takers*, since they are bound by Single Market rules but they do not partake in the drafting and adoption of them.

All in all, our assessment is that the trade costs arising from regulatory divergence in the best case will be marginally higher in the RPD scenario than in the EEA scenario. In the worst case, trade costs of regulatory divergence will be only marginally lower than in a CU or FTA scenario.

Barriers to services trade

When it comes to services trade and establishment rules, it is worth noting that the RPD states that the EU and the UK should liberalise their markets towards each other well beyond their respective WTO commitments. Since the EU's FTAs in general do not achieve much (if any) liberalisation of services trade beyond the WTO commitments, the RPD is likely to reduce trade costs significantly compared to the FTA scenario. Since customs unions only concern goods trade, the same applies for the CU scenario.

The RPD also has specific provisions on financial services, data flows, and e-commerce, but the wording is not as assertive as it is on services trade in general. Hence, it is less certain what the actual outcome will be.

In a similar way as the reasoning on regulatory divergence for goods, the RPD is not likely to achieve levels of liberalisation that are on par with the EEA scenario. Even though the RPD goes relatively far in providing for open services markets, firms cannot rely on the Treaty-based right to free movement and the right to establishment as they can in the EEA scenario.

Accordingly, the trade cost increases on services trade may stem from actual as well as perceived barriers. However, one should not forget that the free movement of services within the Single Market is not as integrated and deeply implemented as the free movement of goods.¹⁹

¹⁹ Copenhagen Economics (2018b) *Making EU trade in services work for all*.

All in all, our assessment is that the trade costs for services will be marginally higher in the best-case RPD scenario than in the EEA scenario. In the worst case, we expect trade costs to be marginally lower than in the FTA (and CU) scenario, given the clear wording of liberalising beyond WTO commitments.

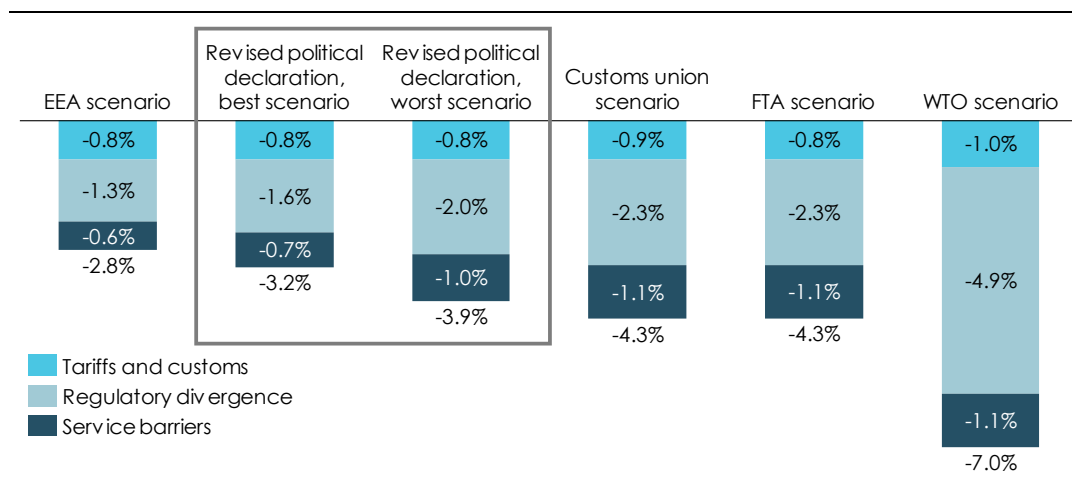
Summary of trade costs in the best-case and worst-case RPD scenarios

Overall, the RPD is likely to lead to trade cost increases in the best-case scenario that are slightly higher than in the EEA scenario, and slightly lower than the CU and FTA scenarios in the worst case. The risk of costly customs procedures and, especially, the risk of regulatory divergence for products and increased uncertainty regarding services trade outweigh the fact that tariff costs are likely to be lower in the RPD scenarios than in all other scenarios. In particular, since tariffs are relatively low in the EEA, CU, and FTA scenarios, the absolute difference in trade costs is limited.

THE GDP IMPACT OF THE REVISED POLITICAL DECLARATION SCENARIOS FOR IRELAND

When we estimate the best-case and worst-case RPD scenarios, we find that the impact of Brexit in 2030 is likely to lead to Irish GDP being between 3.2 and 3.9 per cent lower than if the UK would remain a member of the EU. This means that the impact of the RPD is more negative than if the future relationship would be an EEA-type agreement, but less negative than if the EU and UK opts for a customs union or an FTA-type agreement. See Figure 3 for an overview of the results.

Figure 3
Impact on Irish GDP in different Brexit scenarios
 Per cent change from 2030 baseline



Note: The figures show the percentage effect of a new EU-UK trade agreement compared to the case where UK had remained a member of the EU. The per cent impact in each scenario should be interpreted as the per cent by which the level of Irish GDP would be lower than in the absence of Brexit in 2030.

Source: Copenhagen Economics based on Copenhagen Economics (2018) and CGE simulations in cooperation with J. Francois

Furthermore, it becomes clear that the zero-tariff regime also for agri-food products in the RPD does little to alter the impact of Brexit on Irish GDP. This is due to the fact that while tariffs are not

zero in e.g. the EEA scenario, their impact on total trade costs are relatively low compared to the trade costs of regulatory divergence. Thus, the added value of the zero-tariff regime for all products in the RPD is limited.

The major driver of the negative impact is regulatory divergence for goods. Even in the best-case scenario, where we assume that the EU and the UK achieve an ambitious regulatory cooperation set out in the RPD, the impact from regulatory divergence on Irish GDP is almost 25 per cent more negative than in an EEA scenario. In the worst case, the impact of regulatory divergence is more than 50 per cent for negative than in the EEA scenario.

The barriers to services trade that are likely to arise in both RPD scenarios further decrease Irish GDP compared to if the UK would remain a member of the EU, with 16 per cent in the best case and 67 per cent in the worst case. However, the magnitude of the impact of the service barriers are lower than those from regulatory divergence on goods.

Overall, the RPD will likely lead Ireland's GDP in 2030 to be 3.2 to 3.9 per cent lower than in the 2030 baseline scenario. Hence, the EEA scenario, with a 2.8 per cent lower GDP compared to baseline, is the preferable outcome from an economic point of view. However, as stated earlier in this chapter, an EEA-type agreement requires the UK to accept, *inter alia*, continued free movement of persons.

Insofar as this makes an EEA-type agreement politically impossible to agree, our estimates suggest that the RPD, even in the worst-case scenario, is the best available option compared to a CU or FTA scenario. In the best-case scenario, the RPD reduces the negative impact on Irish GDP in 2030 by 25 per cent compared to the FTA scenario. In the worst-case scenario, the RPD reduces the negative impact by 10 per cent.

The major drivers behind this relative benefit of the RPD is that it provides for reduced regulatory divergence for goods trade and, to a lesser extent, reduced occurrence of barriers to services trade.

THE COMBINED IMPACT OF EU FTAs AND BREXIT

As a last exercise, we combine the modelling of the six Brexit scenarios with modelling of EU FTAs that are either recently concluded and applied or currently under negotiation. The objective is two-fold.

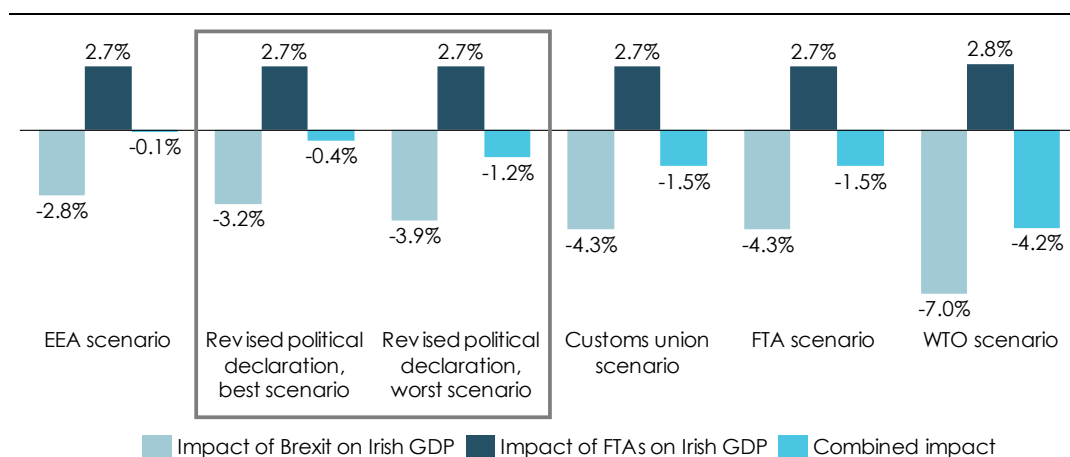
First, it will shed some light on the interplay between the growth-enhancing impacts of the FTAs and the growth-dampening impacts of Brexit. This gives an understanding of the size of the effects and the extent to which the FTAs are able to offset the detrimental impacts of Brexit.

Second, we get an understanding of whether the different Brexit scenarios affect the impacts of the FTAs on Irish GDP. For example, if trade costs rise sharply between Ireland and the UK as they would in e.g. the WTO scenario, Irish firms may intensify their trade with the FTA partners. If trade costs between Ireland and the UK rise to a lesser extent, e.g. in the EEA or the best-case RPD scenario, Irish firms may to a greater extent continue to focus their trade with the UK.

In other words, we estimate long-term cumulative impacts in 2030 of recent and prospective FTAs for each of the six different Brexit scenarios, cf. Figure 4. The results are based on a scenario where

recent and prospective FTAs are fully implemented regarding their ambitions for reducing tariff and non-tariff barriers.

Figure 4
The impact of Brexit on Irish GDP with and without recent/prospective FTAs
 Per cent change from baseline in 2030



Note: The figure shows the impact of Brexit on Irish GDP in 2030 under six different Brexit scenarios, with and without recent/prospective FTAs in place. The impact of the recent/prospective FTAs is the combined impact, in the ambitious scenario in 2030.

Source: Copenhagen Economics based on Copenhagen Economics (2018) and CGE simulations in cooperation with J. Francois

We find that the FTAs can almost fully net out the negative impact of Brexit on the Irish economy in the EEA scenario. Irish GDP is expected to be 0.1 per cent lower in 2030 than would have been the case if neither Brexit nor the recent/prospective FTAs were implemented. The FTAs will also offset most of the negative impact of Brexit in the best-case RPD scenario, albeit not as much as in the EEA scenario – the net impact on Irish GDP in 2030 is -0.4 per cent, compared to baseline.

For the remaining Brexit scenarios, the FTAs are not able to reduce the total impact on Irish GDP below one per cent – Irish GDP in 2030 would be 1.2 per cent to 4.2 per cent lower in 2030 compared to baseline.

It is also clear that the different Brexit scenarios only have a marginal effect on the potential impact of EU FTAs on Irish GDP. The FTA impact ranges from 2.7 to 2.8 per cent across all types of Brexit. This is due to the fact that the impact is modelled as the cumulative impact that arise when recent/prospective EU FTAs are in place simultaneously. Irish producers will direct their resources towards selling in the markets where they can find the largest value. The small difference across different Brexit scenarios shows that the attractiveness for Irish producers of the FTA partner markets is not strongly related to the attractiveness of the UK market.

The intuition is therefore that Irish trade with the FTA partners is not dependent on the trade costs between Ireland and the UK. The FTAs are a boon to the Irish economy in and of themselves, and the positive FTA impact on Irish GDP is only to a very limited extent driven by the relative attractiveness of the FTA markets vis-à-vis the UK market.

For Irish trade, the FTA markets and the UK market appear to be complements, not substitutes. While there is a strong demand for Irish products and services in the FTA markets, as shown by the positive impact on Irish GDP from the EU FTAs, this demand is likely *different* from UK demand for Irish products, as shown by the lack of a clear correlation between the (negative) Brexit impact and the (positive) FTA impact. The geographic and cultural proximity between Ireland and the UK, and the fact that both Ireland and the UK have been part of the EU for more than 40 years, has enabled Irish firms to develop and adapt their production and export patterns to focus on UK preferences and demand.

While EU FTAs reduce trade costs between Ireland and the FTA markets, and Brexit increases trade costs between Ireland and the UK, neither the FTAs nor Brexit will change the geographic or cultural distance between Ireland and its trading partners. The negative impact of distance on international trade is one of the strongest empirical results in the international trade literature.²⁰ Hence, the competitiveness of Irish exporters in faraway markets, thanks to trade cost reductions achieved under the EU FTAs, is not likely to be significantly related to the increased trade costs with Ireland's closest and largest export market, the UK.

One may, for example, consider the EU-Japan FTA: Japan is a large market in itself and also a central gateway market to the Asia-Pacific region.²¹ The trade liberalisation achieved with the EU-Japan FTA thus offers improved access for Irish firms to enter the Japanese and, furthermore, the broader Asia-Pacific market. Thus, the Japanese and the UK market can only to a limited extent be seen as substitutes, as they are likely to offer drastically different export opportunities. It is, in that regard, beneficial and important that efforts to promote Irish-Japanese trade are undertaken.

Concluding remarks

The United Kingdom's withdrawal from the European Union is expected to affect the Irish economy negatively. The revised Political Declaration sets out the framework for future cooperation between the UK and the EU. We estimate that a future UK-EU trading relationship based on the revised Political Declaration is likely to impact the Irish economy more negatively than an EEA-type Brexit scenario, but less negatively than an FTA or a WTO scenario.

EU FTAs are not likely to mitigate fully the negative economic impact of Brexit for the Irish economy, although they have the potential to offset the negative impact to a significant extent. However, the analysis also shows that the impact on the Irish economy from the FTAs is not significantly impacted by which Brexit outcome the EU and the UK agrees to, suggesting that the FTA markets are complements to the UK market for Irish firms, rather than substitutes.

²⁰ Disdier, A-C, and Head, K., 2008, *The Puzzling Persistence of the Distance Effect on Bilateral Trade*, Review of Economics and Statistics, 90:1, p. 37-48.

²¹ RTE, 14 October 2019, *50 Irish companies in Japan on trade mission*, available at: <https://www.rte.ie/news/business/2019/10/14/1083235-japan-trade-mission/>.

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APPENDIX A

TECHNICAL APPENDIX

In order to quantify the impacts of Brexit and the recent/prospective EU FTAs on the Irish economy, we use a Computable General Equilibrium (CGE) model (see short description below).²² Key inputs to the model are the expected increase in trade costs between the EU and the UK, and the reduction in trade costs between the EU and FTA partner countries. These trade costs include tariffs, TRQs and non-tariff barriers.

Computable General Equilibrium (CGE)

In the CGE model the entire economy is classified into production and consumption sectors. These sectors are then modelled collectively. Production sectors are explicitly linked together in value-added chains from primary goods, through higher stages of processing, to the final assembly of consumption goods for households and governments. These links span borders as well as industries.

The link between sectors is both direct, such as with the input of steel into the production of transport equipment, and indirect, as with the link between chemicals and agriculture through the production of fertilizers and pesticides. Sectors are also linked through their competition for resources (the primary factors of capital, labour, and land).

The model uses new trade data from the GTAP10 database, which among others includes global trade flows on a sectoral level for goods and services.

Note that Irish CSO trade statistics deviate in several ways from GTAP data. For example, the CSO data report services exports based on ownership and include exports from Irish affiliates based outside of Ireland. As GTAP data provides a better picture of the economic activity in Ireland, we use this data to model the impact of FTAs.

The model does not take into account any future unknown changes that may occur, for example unknown changes exchange rates etc.

²² For full description, see Copenhagen Economics (2018a)

