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Brexit, Follow-on FTAs, and Global Wine Trade

Kym Anderson and Glyn Wittwer

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University of Adelaide, Adelaide SA 5005 AUSTRALIA
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Contact details:

Wine Economics Research Centre
School of Economics
University of Adelaide
Adelaide SA 5005
AUSTRALIA

Email: kym.anderson@adelaide.edu.au

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Brexit, Follow-on FTAs, and Global Wine Trade[1]

Kym Anderson
University of Adelaide and Australian National University
kym.anderson@adelaide.edu.au
and
Glyn Wittwer
Victoria University, Melbourne
Glyn.Wittwer@vu.edu.au

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Brexit, the UK's planned withdrawal from the European Union (EU), understandably is attracting the attention of wine producers and consumers outside as well as inside the UK, since the UK accounts for a major share of the world's wine imports. The trade-reducing and trade-diverting effects of altering bilateral import tariffs is part of the impact of withdrawing from the EU's Single Market. But it is only a small part of that impact, because the process of exiting the EU, establishing new trading arrangements, and adjusting to altered incentives is inherently uncertain and is expected to spread over many years. That is slowing the growth of UK incomes, and causing the pound to devalue.

Assessing the impact of Brexit on wine markets requires projecting what markets would have looked without Brexit in several years' time and then showing how that projected baseline might change under various scenarios. The obvious ones involve either a 'hard' Brexit in which the UK leaves the EU Single Market, or a softer Brexit involving a replacement trade agreement between the UK and EU27 and then various bilateral FTAs with non-EU trading partners. A recent study has done that using a model of the world's wine markets projected to 2025 (Anderson and Wittwer 2018). Its results are summarized in this article.

The extreme scenario is a 'hard' Brexit. We then consider a 'soft' Brexit to result from negotiating, signing, implementing and responding to, by 2025, a free trade agreement

[1] Forthcoming in *Wine and Viticulture Journal* 33(2), March/April 2018.

(FTA) between the UK and the EU27. In that scenario the fall in the pound and in the UK's real income growth are assumed to be only half as large as in the 'hard' Brexit scenario, because of the FTA being signed well before 2025. An FTA between the UK and the rest of the EU involves removing tariffs on wine (and other goods) in UK-EU27 trade.

Various additional bilateral FTAs are then assumed to be signed sequentially. Just prior to the Brexit decision, the EU announced it would be pursuing other bilateral trade agreements, with Australia and New Zealand as early possibilities (EC 2015). The UK too has signalled that it will be looking to sign FTAs with non-EU trading partners as soon as it has settled a new trade arrangement with EU27 – but that won't be legally possible before the end of the recently offered transition period to 31 December 2020. Again Australia and New Zealand have been mentioned as early possibilities (together they account for one-fifth of the value of UK wine imports), as have Chile and South Africa (whose combined share is one-sixth, with all other non-EU suppliers accounting for just one-eighth of UK wine imports). Each of these FTAs may have some trade-creating effects, but none is likely to have significant positive macroeconomic effects to offset the adverse macro effects of the prolonged uncertainty introduced by Brexit. They will, however, have some trade-diverting effects that may offset each other – just as has happened with recent bilateral FTAs between wine-exporting countries and three Northeast Asian countries (see Anderson and Wittwer 2015).

Impact of a 'hard' Brexit

Following the UK's exit from the EU, we assume under a 'hard' Brexit that the rate of UK economic growth would be only one-third as fast for the period to 2025, the UK pound would be 20% lower in real terms than in the baseline projection, and the UK and EU would apply the EU's external tariff on wine traded between the UK and EU member countries. It is also assumed in this scenario that the UK does not implement any new free trade agreements, particularly with the EU27, Chile and South Africa.

As compared with the baseline scenario to 2025, in the 'hard' Brexit scenario the consumer price of wine in 2025 is 22% higher in the UK in local currency terms (20% because of real depreciation of the pound, 4% because of the new tariffs on EU, Chilean and South African wines, and -2% because of slower UK income growth). The volume of UK wine consumption is 28% lower: 16% because of slower UK economic growth, 7% because of real depreciation of the pound, and 5% because of the new tariffs. Super-premium still wine sales are the most affected, dropping by two-fifths, while sparkling and commercial wines would drop a bit less than one-quarter. Since the average price rises by more than the fall in the volume sold, the aggregate value of UK sales even in local currency terms would fall in this ‘hard’ Brexit case.

In value terms UK imports are $1.75 billion (or 27%) lower in 2025 because of a ‘hard’ Brexit: $1.13 billion because of lower incomes, $0.38 billion because of the fall in the pound, and just $0.14 billion because of the rise in wine import tariffs (Table 1).

Without Brexit, the UK’s shares of global wine imports are projected to be slightly higher in volume terms in 2025 than in 2010-15, but 2 percentage points lower in value terms thanks to East Asia’s expanding demand for imports of premium wines. With a ‘hard’ Brexit, however, that value share would be a further 2 percentage points lower, and the volume share would be almost 5 points lower. Most of the trade effect of a ‘hard’ Brexit is a large decline in net imports of wine by the UK with very little offsetting positive effect on trade in the rest of the world.

The aggregate effect of a ‘hard’ Brexit on the market shares of various wine-exporting countries in the UK is almost indiscernible. The projected 2025 shares are quite different from the actual 2014 shares for several countries though: they are much smaller in 2025 for South Africa, Australia and New Zealand (and the US in volume terms), and are much larger in volume for Spain and in value for Italy. This is because wine-exporting countries benefit differentially from the varying rates of growth in net import demand for wine in non-UK countries in the no-Brexit baseline over this projection period. The most important projected changes are the increase in the real value of annual wine imports between 2014 and 2025 by China (200% or $3 billion), Other Asia (110% or $2.2 billion) and Africa (270% or $1.6 billion). More than half of Australia’s increase in annual exports from 2014 to 2025 go to Asia, and more than half of South Africa’s increase in exports go to other Africa.

Table 2 reveals that European, Chilean and South African wine exports are lowered by a ‘hard’ Brexit, by 150 ML or US$1.2 billion in the case of the EU, with some of their exports diverted from the UK to EU27 and other markets in competition with New World exporters. While the US, Australia and Argentina sell only a little less into the UK, they sell less also to other countries. For Chile and South Africa, who lose their preferential access to UK (but not to EU27) markets in this Brexit scenario, some of their exports are re-directed from the UK to EU27 countries but again they export less overall. Global wine trade in 2025 would be less under this ‘hard’ Brexit scenario by 240 ML (1.9%) or $1.8 billion (3.5%). The percentage by which wine exporters’ trade shrinks is greater for values than for volumes because of changes in relative prices of different-quality wines. Those differences are shown in the numbers in parentheses in Table 2.

Impact of a 'soft' Brexit involving a UK-EU27 FTA

Suppose instead that the UK were to negotiate a new free trade arrangement with the EU27 and adjust to it by 2025, and that the progress toward that end occurs soon enough for the adverse macroeconomic shocks from the initial impact of uncertainty over the Brexit process to be only half as large as those assumed in our 'hard' scenario outlined above. This would roughly halve most of the macro effects of a 'hard' Brexit, but the FTA would provide only a partial offset to the trade effects because of our assumption of lost economic growth in the initial years of uncertainty.

Table 3 summarizes the wine trade effects for 2025. It suggests the global effects would be only about half as bad as those from a 'hard' Brexit. Nonetheless, the signs are still nearly all negative, including for Australia.

Effects of new bilateral FTAs with non-EU countries

The signing of new trade agreements affecting wine trade will not end with just the UK-EU27 FTA. While President Trump has ruled out the planned Trans-Atlantic Trade and Investment Partnership (TTIP) between the EU and US, the EU has signaled it wants other bilateral FTAs, as has the UK. Meanwhile, in December 2017 an EU-Japan Economic Partnership agreement was finalized, which will see Japan's tariff on wine imports from the EU removed. What would be the cumulative impact of such a sequence of FTAs on the value of wine exports from key countries and globally?

Bilateral EU27-Australia and EU27-New Zealand FTA agreements boost ANZ global wine trade by US$30 million, offsetting one-third of ANZ losses due to a 'soft' Brexit and the UK-EU27 FTA (column 1 of Table 4).

When new bilateral FTA agreements are then implemented between the UK and four Southern Hemisphere exporters, ANZ and global wine exports expand a little further, benefitting not only Australia and New Zealand but also Chile and South Africa but at the expense of exporters in the EU27 and the US (column 2 of Table 4).

The new EU-Japan Economic Partnership agreement further boosts global wine exports, but in this case virtually all of that benefit is enjoyed by EU27 exporters while other wine exports lose a little from this new preferential arrangement (column 3 of Table 4).

All of these prospective FTAs, even including the UK-EU27 FTA, raise the value of world wine trade in 2025 by less than 0.5% compared with the original baseline projection for 2025. This is because the gross trade creation of each FTA is reduced by considerable trade diversion, whereby one exporter's gain is largely at the expense of other exporting countries. Together those FTAs are insufficient to offset the decline in Australia's and the world's wine exports due to even a 'soft' Brexit, let alone a 'hard' Brexit.

To see how close those FTAs get the world to free international trade in wine, we also ran a scenario in which all import tariffs on wine are removed multilaterally. The results of that scenario are reported in the final two columns of Table 4. Clearly the gains are far greater, and far more evenly spread among wine exporters, when all tariffs are removed simultaneously rather than just a few being removed preferentially. The value of world wine trade would be 7% greater in 2025 with all wine tariffs eliminated, similar to the percentage increase for Australia.

Conclusion

Brexit will be costly to many participants in UK wine bottling, transporting, storing, wholesaling and retailing businesses, in addition to restaurants and pubs. Very little of the impact is because of higher import tariffs; most important is the slower growth in UK real incomes relative to what they would have been if the UK vote in June 2016 had been to remain in the Single Market, and the adverse impact of that on the value of the pound.

There will continue to be great uncertainly for some years over the possible policy outcomes to flow from Brexit, and of their consequent impacts on UK household disposable incomes, foreign exchange rates, and bilateral wine tariffs. The net effect of Brexit on the welfare of the world's consumers and producers of wine as a whole are likely to be negative while ever that uncertainty persists. Fortunately market growth prospects elsewhere are bright for Australian vignerons, especially in Asia. Figure 1 shows our model's projections to 2025 of increases in Australian wine exports to various markets without and with a 'hard' Brexit. The US$25 million loss in Australia's sales to the UK because of Brexit is very small compared with the huge projected growth in its sales to China and other Asian wine markets.

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Table 1: Difference in 2025 projected volume and value of wine imports by the United Kingdom and the rest of the world as a consequence of the initial Brexit shock (ML and 2014US$ million, 'hard' scenario)

	Volume (ML)				Value (US$ million)			
	NP + CP[a]	Super Pr[b]	Sparkling	TOTAL	NP + CP[a]	Super Pr[b]	Sparkling	TOTAL
Change in UK imports due to:								
Lower incomes	-198	-20	-29	-247	-644	-253	-234	-1131
Lower pound	-70	-10	-14	-93	-248	-127	-102	-476
Higher tariffs	-71	-1	-16	-87	-110	-8	-24	-143
TOTAL	**-339**	**-31**	**-58**	**-427**	**-1001**	**-388**	**-360**	**-1750**
% diff. from base	*23*	*32*	*33*	*25*	*24*	*32*	*32*	*27*
% of total cuts	*79*	*7*	*14*	*100*	*57*	*22*	*21*	*100*
Change in:								
Rest of world's net imports	143	21	25	189	230	143	-181	192
WORLD TRADE	**-195**	**-10**	**-34**	**-239**	**-763**	**-246**	**-543**	**-1552**

[a] Non-premium plus Commercial Premium still wines [b] Super-premium still wines

Source: Authors' model results.

Table 2: Difference in 2025 bilateral wine import volumes and values from key exporters by the UK and rest of the world (RoW) as a result of initial Brexit shock (ML and 2014US$m)[a]

(a) 'hard' Brexit scenario

	Volume (ML)				Value (2014US$m)			
	UK	RoW	WORLD	(%)	UK	RoW	WORLD	(%)
EU27	-287	136	-150	(-1.7)	-1187	-5	-1192	(-3.1)
Chile	-59	35	-25	(-3.0)	-169	31	-138	(-4.8)
Sth. Africa	-53	35	-18	(-3.2)	-105	20	-85	(-6.7)
USA	-7	-6	-13	(-2.4)	-75	-40	-115	(-5.0)
Australia	-4	-3	-7	(-0.9)	-25	-65	-90	(-3.0)
Argentina	-3	-9	-12	(-4.8)	-16	-39	-55	(-5.2)
NewZealand	-11	9	-2	(-0.9)	-162	71	-91	(-4.3)
Others	-2	-10	-12	(-0.2)	-11	-52	-63	(-4.4)
WORLD	**-427**	**187**	**-240**	**(-1.9)**	**-1750**	**-79**	**-1829**	**(-3.5)**

(b) 'soft' Brexit scenario

	Volume (ML)				Value (2014US$m)			
	UK	RoW	WORLD	(%)	UK	RoW	WORLD	(%)
EU27	-178	82	-96	(-1.2)	-692	-43	-736	(-1.9)
Chile	-46	28	-18	(-2.4)	-128	36	-91	(-3.2)
Sth. Africa	-43	29	-14	(-4.2)	-82	23	-59	(-4.7)
USA	1	-6	-5	(-1.1)	-23	-28	-51	(-2.2)
Australia	5	-10	-5	(-0.6)	19	-56	-38	(-1.3)
Argentina	0	-6	-6	(-2.6)	-3	-25	-29	(-2.7)
NewZealand	-5	4	-1	(-0.6)	-80	34	-46	(-2.2)
Others	0	-9	-9	(-0.1)	-1	-33	-34	(-2.4)
WORLD	**-266**	**112**	**-154**	**(-1.3)**	**-991**	**-92**	**-1083**	**(-2.1)**

[a] Numbers in parentheses are the percentage difference between the Brexit and baseline scenarios for 2025 projected wine import volumes or values by source.

Source: Authors' model results.

Table 3: Difference in 2025 bilateral wine import volumes and values from key exporters by the UK and rest of the world (RoW) as a result of the ‘soft’ Brexit shock and implementing a UK-EU27 FTA (ML and 2014US$ million)

	Volume (ML)			Value (2014US$m)		
	UK	RoW	WORLD	UK	RoW	WORLD
EU27	-111	44	-67	-523	-101	-625
Chile	-54	35	-19	-155	58	-96
Sth. Africa	-48	34	-14	-96	34	-62
USA	-3	-4	-6	-39	-22	-61
Australia	-2	-4	-5	-7	-37	-45
Argentina	-2	-5	-6	-9	-21	-31
NewZealand	-6	5	-1	-87	38	-48
Others	-2	-7	-9	-7	-25	-32
WORLD	**-226**	**99**	**-127**	**-922**	**-76**	**-999**

Source: Authors’ model results.

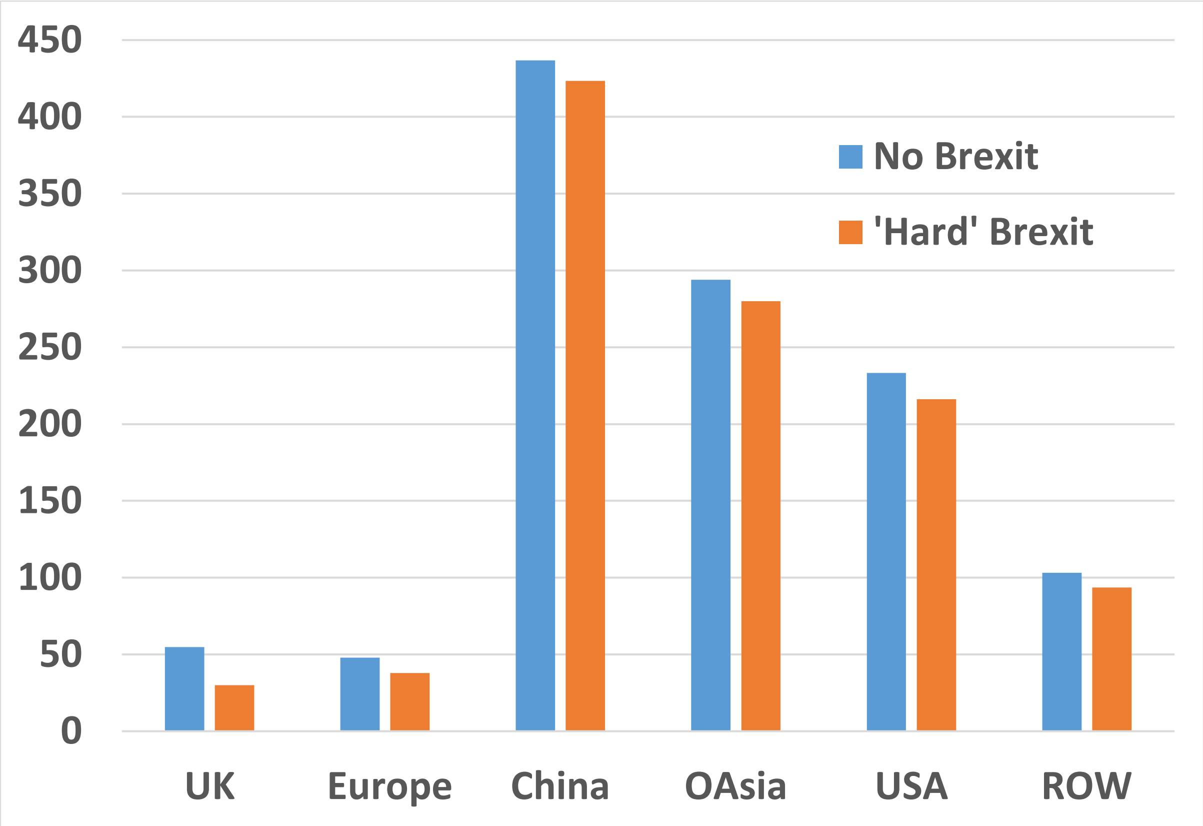
Table 4: Cumulative impacts of additional FTAs, and of multilateral free trade in wine, on the value of national and global total wine exports in 2025 (difference relative to 'soft' Brexit with UK-EU27 FTA, in 2014 US$ million)

Extra FTAs: ***Exporter:***	EU27-ANZ FTA	EU27-ANZ FTA + UK-NW[a] FTA	EU27-ANZ FTA + UK-NW[a] FTA + EU27-Jap FTA	Global free wine trade	*(% above 2025 base)*
EU27	122	105	188	2137	*6%*
Australia + NZ	30	45	44	368	*8%*
Chile + S. Africa	-10	16	12	379	*10%*
USA	-11	-18	-24	219	*10%*
Rest of world	-1	3	3	451	*13%*
WORLD	**131**	**150**	**222**	**3553**	***7%***

[a] 'NW' includes Australia, NZ, Chile and South Africa

Source: Authors' model results.

Figure 1: Increase in the value of Australian wine exports, 2014 to 2025, without and with a 'hard' Brexit (2014 US$ million)



Source: Authors' model results.