UK IN A CHANGING EUROPE

COVID OR BREXIT?

INTRODUCTION

The world is emerging from the COVID pandemic, with society and the economy opening up again. The immediate impact has been widespread supply and labour shortages, and rising inflation. But for the UK, the issue is not simply that of post-pandemic disruption, but also the early impacts of the decision to leave the European Union, replacing our membership of the Single Market and customs union with a minimal free trade deal. In what follows, we explore the extent to which current problems in the UK economy are down solely to post pandemic disruption or also the result of the altered terms of trade and labour mobility with the EU.

After strong growth in the second quarter, the UK economy has endured a bumpy few months. Warnings from business that supply chains were being disrupted both by global shortages and bottlenecks and by a lack of HGV drivers turned into pictures of empty supermarket shelves and then, as localised disruptions to supply resulted into widespread panic buying, a severe, albeit short-lived, fuel supply crisis. More generally, inflation has risen sharply, driven by increases in energy and commodity prices, and widespread labour and skill shortages have made it harder for businesses to recruit workers to meet rising demand. While talk of a return to the "stagflation" of the 1970s seems somewhat premature, there is no doubt that the UK economy — normally remarkably flexible and responsive to changes in both demand and supply — is encountering constraints not seen for several decades.

The political reaction to these developments has been both revealing and predictable. Judging by Twitter and Facebook, in Remainerville the supermarket shelves are empty, while in Brexitland they remain well-stocked. The government, meanwhile, has segued from claiming that there were no issues to speak of, to claiming that they were nothing to do with Brexit, to arguing that Brexit was driving a necessary albeit painful transformation of the British economy.

Of course, it's more complicated than any these stories imply. The UK, like the rest of the global economy, has been hit by a massive economic shock: the pandemic, lockdowns and other health-related restrictions, and now the reopening of almost all the affected sectors. On top of that, Brexit has radically changed the UK's economic relationship with its largest trading partner. Unpicking these impacts is complex; it is not simply a matter of attributing current difficulties solely or mostly to covid or Brexit. In what follows, we attempt to analyse and explain what we think is going on, and how different factors are interacting.

This analysis covers the short-term — what is happening now. Over the longer term, the impacts of Brexit on the UK economy are likely to be profound, as our earlier analyses have shown. We do not repeat them here — not least because it is far too early to evaluate those longer term impacts. But as we approach what will be a hard winter for many households — some facing both cuts to Universal Credit and higher energy bills — we think it is important to stand back from overly simplistic explanations and understand the mix of factors at work.

FUEL SHORTAGES

UK data: For a succession of days in September/October the average fuel level in British petrol stations was below 20%, compared to the usual average of 43%. The Petrol Retailers Association estimated in late September that up to two thirds of its member outlets were empty. Northern Ireland saw no comparable fuel shortage and was the only part of the UK rated 'green' for its fuel supply by the government throughout the recent shortage. The Petrol Retailers Association attributed this to Northern Ireland's access to the EU single market and close cooperation with the Republic of Ireland.

EU data: The EU has seen no comparable petrol shortages.

Analysis: The absence of fuel at petrol stations has been a phenomenon concentrated in Great Britain. There is no global shortage of petrol; our difficulties seem to relate to supply chain issues, exacerbated by the significant shortage of HGV drivers in the UK, as well as an element of panic buying. While Northern Ireland also has a shortage of HGV drivers, its access to the EU single market and close cooperation with the Republic of Ireland has meant that it has been possible to redistribute fuel within the island of Ireland, ensuring no comparable fuel shortages.

HGV DRIVERS AND SUPPLY SHORTAGES

UK data: The number of qualified HGV drivers fell nearly 15% in the four years prior to the pandemic as many left or retired. Out of 24 European nations, only Luxembourg saw a greater percentage decline. About 40,000 HGV tests were cancelled in the UK during the pandemic. The number of UK citizens employed as large goods vehicle drivers fell by 20,000, or 7%, over the past year, while the number of EU citizens employed as drivers in the UK fell by 12,000, or 30%. The Road Haulage Association says half of the 600,000 registered UK HGV licence holders have left the industry.

There have been widespread anecdotal reports of shortages of specific goods in shops, especially supermarkets. The UK is clearly not suffering from generalised shortages of food or other essentials. However, a recent ONS survey found that 17% of respondents were not able to buy an essential food item, and only 57% reported that everything they needed was available to buy, suggesting that there are indeed significant difficulties in supplying some items.

EU data: Key economies such as Germany and France saw less than 5% shrinkage in the HGV driver workforce in the four years prior to the pandemic, while Italy and the Netherlands actually saw an increase: more than % in the case of Italy. Romania, a traditional source of HGV drivers for the UK, saw an increase of more than 30%; it is thought that many repatriated from the UK. There are still reported shortages of HGV drivers in European countries, as in the US, but the shortfall in the UK appears considerably worse. While there appear to be far fewer reports of goods shortages in EU supermarkets, we cannot draw firm conclusions about this without good comparable data.

Analysis: Brexit has reduced the attractiveness of HGV work in the UK not just because of changes to immigration policy but also because of new border controls and other restrictions. It is clearly not the only cause — Covid delayed HGV training schedules, while drivers complain that the UK has underinvested in facilities for lorry drivers such as toilets and washing facilities, and the tax position of some drivers has changed — but Brexit has aggravated an already existing problem, hence the UK is more severely affected than any other European country. It is also worth noting that the UK hasn't yet introduced border checks on goods imported from the EU (whereas the EU has done so for goods going the other way). These checks will introduce further administrative burdens on supply chains and may exacerbate issues related to the HGV driver shortage.

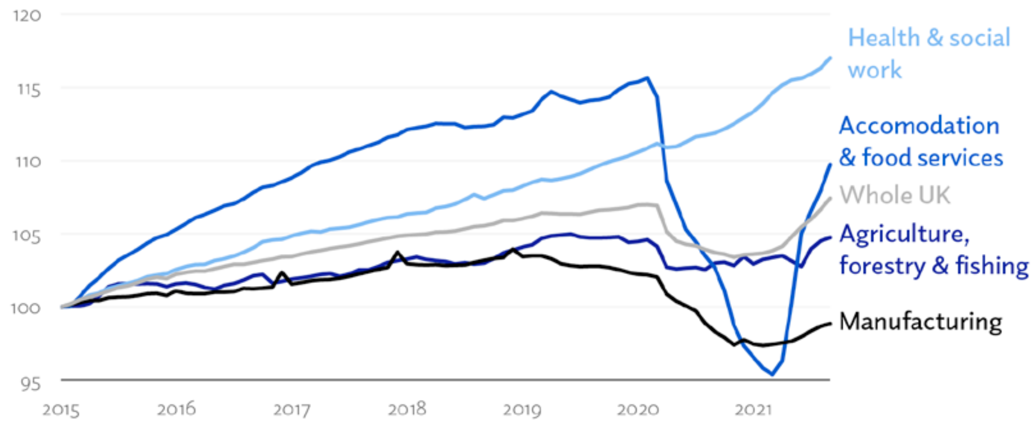
LABOUR SHORTAGES

UK data: Across the UK, there are more than 1.1 million job vacancies — a record — as the economy reopens after Covid. That's equivalent to 3.7 vacancies for every 100 employee jobs — which is also a record.

The biggest increases in vacancies since the start of the pandemic have been in construction (65%), manufacturing (64%), administrative and support services

Fewer people working in manufacturing and accomodation and food services since the pandemic

Change in number of payrolled UK employees (seasonally adjusted) in selected industries. January 2015=100.



Source: ONS, Earnings and employment from Pay As You Earn Real Time Information, UK: October 2021.

(63%) and accommodation and food services (59%). Over the past quarter by far the biggest increase in vacancies has been in transport and storage (56%). Meanwhile, unemployment remains very low, at 4.5%.

Rising vacancies reflect falls in the number of older workers in the labour market, but also a significant reduction in the number of EU-origin workers. The number of EU-origin workers on company payrolls (which omits the self-employed) fell by about 200,000 in 2020. While the exodus of EU workers in 2020 was primarily driven by the pandemic, their failure to return (or to be replaced by new migrants) is likely to be driven by Brexit.

EU data: EU member states have suffered similar labour shortages to the UK, particularly in agriculture. France had a shortage of 200,000 seasonal workers up to the end of May, Spain 70-80,000 and Italy 250,000. Workers who would normally come from eastern Europe and north Africa were disrupted by Covid. The labour shortage issues are not confined to agriculture. Earlier in the year the overall eurozone workforce was 2.6 million below pre-pandemic levels.

Analysis: Labour shortages have been seen in many countries as economies rebound from the pandemic. Job vacancies are at a record high in the US. Shortages in retail, hospitality and other sectors are largely the result of the post-Covid reopening, not Brexit. However, Britain seems to have suffered from EU workers' unwillingness to come back after returning to their home countries during the pandemic, and Brexit may have affected their decision.

WAGES

UK data: Average earnings grew 2.7%, adjusted for inflation, in the year to August 2021. That yearly growth rate rate has dropped from 5.1% the month before, reflecting the volatility in earnings growth data largely due to the effects of the bounceback from the pandemic. Compared with 2019, real wages — or spending power — have grown by slightly under 4.3% over two years, a roughly 2% annual rate that is not exceptional by historical standards. As shortages have grown in the past three months and global energy prices have risen, pushing up inflation, real wages in the UK have stayed roughly flat.

Wages in the accomodation and food industry have fallen since the start of the pandemic

Real UK median monthly pay (seasonally adjusted) from PAYE RTI in selected industries.

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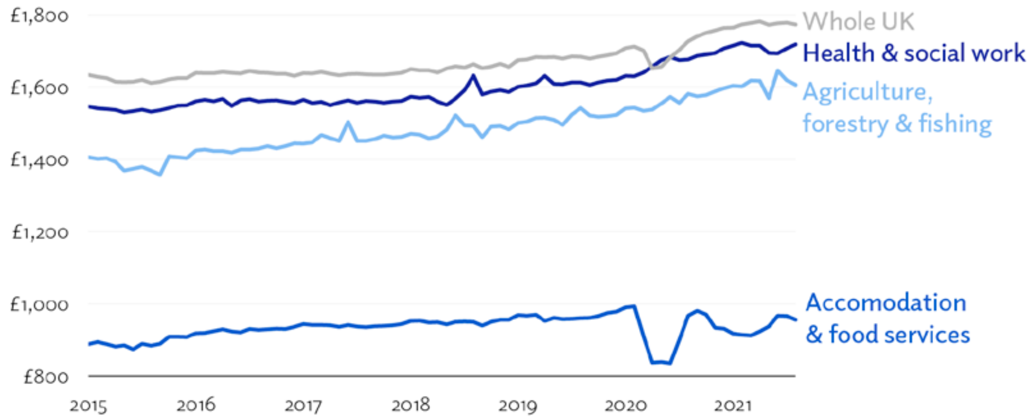

Source: ONS, Earnings and employment from Pay As You Earn Real Time Information, UK: October 2021. Deflated by CPI.

EU data: The pace of wage growth in the EU has been about 2% a year for the past two years. Over that period, inflation in the Eurozone was typically close to zero. That, in effect, means that real wage growth in the Eurozone was broadly similar to that in the UK, at 2%. Eurozone inflation has picked up sharply in recent months — 3% in August and expected to rise to 3.4% in September — reducing real wage growth, as it has in the UK. Similar patterns have been seen in other parts of the developed world as they put the worst of the Covid crisis behind them.

Analysis: So far, wage developments in the UK and EU (and US) do not appear to be radically dissimilar — a post-pandemic bounceback, now being eroded by rising inflation. So there is no obvious "Brexit effect" overall, although there is some anecdotal evidence of higher wages in some (not all) sub-sectors, such as HGV drivers, that have been most adversely affected by Brexit-related shortages, However, overall, the prime minister's assertion that "wages are rising" is not supported by the most recent data.

AGRICULTURAL WORKERS

UK data: Research by the National Farmers Union has found that 500,000 of the four million people who work in the food supply chain have left the sector during the coronavirus pandemic.

In 2018 British workers made up only 1% of the required number with the majority of seasonal workers arriving from Eastern Europe, according to estimates from the National Farmers Union. By contrast, the summer of 2020 saw British workers make up a slightly increased 5% to 11% of the 70,000 workers required that season under the government's now-scrapped Pick for Britain campaign. There has also been an increase in non-EU foreign nationals entering these roles. Following the Seasonal Agriculture Workers' Pilot's cap increase from 2,500 work visas in 2019 to 10,000 work visas in 2020, 7,236 visas were granted to seasonal workers in 2020 with 87% of those being Ukrainian nationals. This represented a 192% increase on 2019. Despite this, shortages have risen further: in July this year, 34% of seasonal farmworker roles were unfilled, the highest since the National Farmers Union kept records.

There have been particular issues with abattoir workers, with up to 120,000 pigs are currently at risk of being culled; this number is likely to increase by approximately 12,000 pigs per week. Culling has now begun on some farms. The government is currently offering 1,000 temporary visas for butchers, however, the National Farmers Union have urged them to relax visa rules requiring foreign vets and butchers to speak English to allow 15,000 workers in to the country to address the culling crisis.

EU data: German pork suppliers have been significantly disrupted after outbreaks of African Swine Fever saw China ban German exports. Before they were hit by the outbreak, German pork exports doubled in the first six months of 2020, according to the Federal Statistics Office. Germany and China are now in negotiations to remove the ban.

Analysis: The immediate shocks of the culling crisis, carbon dioxide shortages and a drastic decrease in workforce numbers come as a result of supply chain disruption and travel barriers/concerns caused due to Covid. However, issues of produce surplus and labour shortages in agriculture have been around for a number of years. The decrease in EU seasonal workers in the UK has been happening since Brexit and accelerated/exacerbated by Covid.

HEALTH AND SOCIAL CARE WORKERS

UK data: Vacancies across NHS England are at their highest level since December 2019, reaching almost 94,000 full-time equivalent roles at the end of June 2021 — a 13% increase in the same period the year before. Shortages in nursing and mental health are most acute. The NHS has suffered from chronic workforce shortages (regularly over 100,000 prior to the pandemic). The proportion of the NHS England workforce known to be EU nationals has fallen from 5.6% in June 2017 to 5.4% in March 2021 — with the fall particularly acute among nurses (9.8% to 8.7%). The proportion of new nurses who were EU/EEA nationals has fallen from 19% in 2015/16 to 6.1% today. These figures may be somewhat distorted by far fewer staff not reporting their nationality in recent years.

EU data: Nursing professionals was the most prevalent shortage occupation in a 2020 EU report, cited by 21 out of 30 countries/regions, with mental healthcare workers and GPs mentioned by 12 out of 30. Seven said that the nursing shortage was a of a high magnitude. The WHO has previously estimated there will be a shortage of 4 million healthcare workers in the EU by 2030 (although this included the UK as an EU member at the time).

Analysis: The pandemic put unprecedented pressure on the NHS in terms of both the need for workers (which brought the level of staff shortages down), and the demands being put upon workers (which may be contributing to the level of shortages now rising back up). Fundamentally, staff shortages have long been a chronic issue for the NHS (and indeed, for many EU countries), which may now be exacerbated by staff suffering from pandemic-related ill health. Brexit hasn't helped either, as fewer EU/EEA nationals are being retained and recruited — especially in nursing, where shortages are especially acute — compounding existing staffing problems.

TRADE SHORTFALL

UK data: Trade with the EU rose sharply just before the turn of the year as UK businesses stockpiled goods in anticipation of Brexit disruption. It then fell back more sharply before recovering slowly through the spring. These transitional impacts should have worked through by now. UK exports to the EU are back to pre-Covid levels but imports are down 10%. Exports to the rest of the world are down by about 10%. Trade between Northern Ireland the Republic has increased dramatically as a result of the Protocol: with data from the spring showing Northern Irish exports to the Republic up 52% in a year, with imports the other way rising 28%.

EU data: In contrast to the disruption to trade with the UK, EU trade data shows exports to the rest of the world have increased. In July, EU goods exports to the rest of the world recorded an 11.4% increase year on year. They are now higher for all its key trading partners — the US, China, Switzerland, Russia — except the UK. In the second quarter of 2021, the value of the EU's exports of goods to countries outside the EU was slightly above the level it had been in the first quarter of 2019.

Analysis: Overall, UK trade performance has been weak, especially in exports outside the EU, where it has lost market share. This is worrying given that Brexit was supposed to boost trade with regions outside Europe. How much of this is due to Brexit is unclear. The data is noisy and unreliable, and will probably be revised. We still have little data on the services sector, which makes up around 40% of UK exports to the EU.

RISING PRICES

UK data: Inflation hit 3% in August, rising 0.9% on the month — the largest increase since the Consumer Prices Index began in 2006. Part of that was due to the drop in prices a year earlier with the Eat Out To Help Out scheme but the largest rise was in transport as fuel prices rocketed. UK fuel prices have risen faster this year than in all but one country in the EU 27. The Czech Republic has seen prices rise by 20p a litre, 1p more than in the UK.

EU data: As in the UK, inflation in the euro area hit 3 % in August and is expected to rise to 3.4 % in September. Trends in the past two years between the UK and Europe have been broadly similar. Energy, food and industrial goods prices were the main contributors. Fuel prices have risen sharply this year but less than in the UK. In Germany and France, the rise in the price per litre of unleaded was considerably less than the UK, at 16p and 11p respectively.

Analysis: It is hard to say exactly what is driving inflation, although rising global energy prices are clearly a key factor. However, the fact that UK and EU trends are similar — as in other parts of the world — suggests it is not primarily related to Brexit. Global shortages due to pandemic-related supply bottlenecks are the main cause of most price rises, although fuel has risen somewhat more in the UK than elsewhere.

CONCLUSION

Covid was a massive shock to the global economy and it hit the UK harder than most. It is not surprising the recovery has been bumpy.

Wages have bounced back but so have prices, with inflation at its highest for a decade in many countries. Labour shortages, supply chain disruptions and sharp rises in energy prices are also present in the EU and US. Brexit cannot be blamed.

But the HGV shortage is more acute here than elsewhere, while its impacts — fuel shortages, problems with supermarket deliveries — seem unique and have been exacerbated by Brexit.

Brexit-specific effects, resulting from new barriers to trade and labour mobility, are also clear. And while the impact of the pandemic will fade relatively quickly, that of Brexit will not. In some areas, such as trade and migration, it may even grow over time. There is no evidence that labour shortages will lead to a high-wage, high-skill economy; reducing labour supply does not boost productivity, the main driver of real wages. Reduced migration from Brexit may raise some wages but spending power could be eroded by higher inflation.

In addition, Brexit so far has signally failed to boost our exports to non-EU countries.

The overall picture is one of short-term disruptions, mostly due to the pandemic, that are common to most countries.

However, on top of this, the UK faces structural adjustments that are down to Brexit and are likely, over the medium to long-term, to make the UK somewhat poorer.

This does not bode well for Boris Johnson's vision of a "high-wage, high-productivity" economy.

The UK in a Changing Europe promotes rigorous, high-quality and independent research into the complex and ever changing relationship between the UK and the EU. It is funded by the Economic and Social Research Council and based at King's College London.

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