



Free Trade Bulletin

No. 68 • July 19, 2016

After Brexit: Charting a Course for the United Kingdom's Trade Policy

by Simon Lester

Introduction

Last month's vote by the United Kingdom to leave the European Union gives control over trade policy back to British officials, who are now faced with the difficult task of creating new domestic institutions and formulating trade and other international economic policies.

Some of their immediate work is obvious. The UK must negotiate a new economic relationship with Europe, both with the EU and with non-EU countries. The UK's relationship with the EU could be along the lines of what Norway or Switzerland currently have with the EU, or it could be something less extensive, such as the trade agreement Canada and the EU have been negotiating. As to trade with the non-EU part of Europe, it makes sense for the UK to negotiate a free trade agreement with the European Free Trade Association (EFTA) (it could even consider becoming part of EFTA). In addition, the UK will need to make a decision on whether to be part of the EU customs union, which will have a significant impact on how much control it has over its trade policy.

The UK must also restructure its relationship with its trading partners at the World Trade Organization (WTO). It was an original member of the General Agreement on Tariffs and Trade (GATT) and remains a member of the WTO in its own right. However, as it subsumed its trade policy to that of the EU over the years, the EU took over negotiations on its behalf, and the UK's WTO membership is now intertwined with that of the EU. The job of the UK trade negotiators is to disentangle themselves, and establish the UK as a fully independent member of the WTO.¹

Beyond Europe and existing international institutions, the possibilities for UK trade policy are more open ended, with a great deal of discretion on future directions. Two big questions are: (1) How free-trade oriented will the UK be?

And (2) how will the UK approach trade negotiations with countries outside Europe? This paper evaluates the UK's options, and makes recommendations for how it should proceed.

Will Brexit Be about Free Trade or Protectionism?

The motivations for the UK leaving the EU were complex and varied, and many issues played a role. In the area of trade policy, it is difficult to discern a single view among those supporting Brexit. Some Leave proponents have hinted at protectionism, whereas others were strong free traders.

On the protectionist side, UK Independence Party (UKIP) leader Nigel Farage noted that leaving the EU would offer greater protection against China's dumping of steel. He also complained about EU procurement laws, stating: "Whether we are building a warship or whatever it is, under EU rules we have to tender this out to German companies and French companies as well."² On the free trade side, by contrast, economist Patrick Minford, a member of the Economists for Brexit group, argued for cutting import tariffs to zero immediately after the vote.³

So how will this conflict between supporters of the vote to leave the EU be resolved? There is a tradition of free trade within the UK. The repeal of the Corn Laws in 1846 is still held out as one of the great examples of unilateral free trade. In today's political climate, pure free trade of this sort is difficult to achieve. Nonetheless, hopefully the post-EU leaders of the UK will draw on the views of their ancestors, and try to keep the UK as a champion of free trade. When there are choices to be made as to whether to be protectionist or not, the UK should err on the side of openness and liberalization.

Negotiating New Trade Treaties

These days, however, free trade is largely an international issue. Governments negotiate mutual reductions in trade barriers, with international agreements to enforce their commitments.

Simon Lester is a trade policy analyst with Cato's Herbert A. Stiefel Center for Trade Policy Studies

But there are many models for these negotiations, with different countries taking different views about what a trade agreement should involve. The UK has a blank slate in front of it and thus has many options available.⁴ The two most important questions for future UK trade agreements are: (1) With whom should the UK negotiate? And (2) what should it negotiate about?

Whom to Negotiate With

As noted, the UK will be negotiating a new relationship with the EU and with other European neighbors. This is not in doubt. There are questions, though, about how the UK should select other trade negotiating partners.

To maximize the value of its initial trade negotiations, the UK should think about several factors: (1) Which countries have the most to offer in terms of a substantial economic relationship; (2) with which countries would the negotiations be the smoothest; and (3) which countries would involve the least external controversy in a trade negotiation.

To achieve the greatest economic gains, the UK should look for fairly large economies as negotiating partners, so as to maximize the impact of its initial negotiations.

To ensure a speedy and smooth negotiation, the UK should look for countries with whom it shares cultural ties and/or political values. Trade negotiations often get bogged down in various disagreements. Having a good overall relationship can help minimize this.

And to minimize controversy, the UK should avoid, at least for its initial trade negotiations, trade agreements with large developing countries, whose cheap labor is seen by some as a threat. This is a political reality, rather than a rational economic assessment.

With this guidance in mind, and weighing and balancing all of these factors, the best candidates for the initial trade negotiations would be Australia, Canada, New Zealand, and the United States; and perhaps developed countries such as South Korea and Japan. These countries maximize the potential value of an international economic agreement; the agreements could be done relatively quickly, and they would minimize any controversy. Of these countries, Australia and New Zealand are likely to be the ones most open to fully liberalized trade. Some of the others might resist full liberalization, but the size of their markets makes them important nonetheless.

With regard to developing countries, one possible exception to their initial exclusion would be a North Atlantic trade agreement that included Mexico in addition to Canada and the United States. But as a general matter, if the UK wants to complete trade agreements quickly and without controversy, large developing countries may have to wait a bit. China and India, for example, offer great possibilities. Unfortunately, negotiations with these countries will lead to objections from a range of groups.⁵

What to Negotiate About

Perhaps the most important question for the UK in deciding on a new trade agreement policy is what to negotiate about. Ongoing trade negotiations such as the

Trans Pacific Partnership (TPP), the Comprehensive Economic and Trade Agreement (CETA) between Canada and the EU, and the Transatlantic Trade and Investment Partnership (TTIP) have dragged on for years. The UK should try to avoid a process that takes five years or more. A quick agreement done in one or two years would be preferable.

To achieve this, the UK should consider a streamlined approach to negotiating trade agreements that focuses on core trade liberalization issues and leaves out the more complex and controversial regulatory and governance issues that have led to delays in other trade negotiations.

To get a sense of this, consider various chapters in the CETA. There are chapters on technical barriers to trade and sanitary and phytosanitary measures, which mostly duplicate what already exists at the WTO. There is a chapter on investment, even though investment barriers between Canada and the EU are limited. And the investor state dispute settlement mechanism engenders great controversy, without clear evidence that it actually encourages investment. There is a competition policy chapter that achieves very little. There is a chapter on intellectual property, even though the benefits of intellectual property protections that go further than what already exists are questionable, and including such chapters in trade agreements has been controversial. And there are chapters on sustainable development, labor, and the environment that stray far beyond trade liberalization.

Instead of the broad global economic governance agreements that have become the norm in the trade negotiating world, the UK should negotiate trade agreements that focus on trade liberalization. They should cover tariff reductions, services liberalization, and opening procurement markets. There should also be a placeholder for negotiating future mutual recognition agreements for trade in specific goods and services.

With regard to tariffs, the UK should be bold and propose zero tariffs on all products. Trade negotiations can get bogged down in balancing out the demands from each side for continued tariff protection and in determining how long phase-out periods should be. However, the simplest and most beneficial tariff policy is to remove all tariffs as quickly as possible. Certain trading partners may resist, but UK trade negotiators should take zero tariffs as the starting point. If the UK is willing to eliminate all of its tariffs, it sends the right message about its seriousness in the negotiations and will, hopefully, lead to trading partners reciprocating with zero tariffs of their own.

Services are traded differently than goods, and the barriers tend to be regulatory in nature. That makes services negotiations inherently more controversial than simple tariff lowering. With services trade, the UK should focus on particular areas that are less sensitive. As an example of a controversial sector, the TTIP negotiations have been undermined by concerns that the UK's National Health Service could be subject to challenge by U.S. healthcare companies. The UK should make clear at the outset that regulations and policies such as this are not going to be covered by a trade negotiation (although domestic reform of the National Health Service would be

welcome). It needs to establish general principles and specific rules that leave no doubt about this.

A cross-cutting area, which covers both trade in goods and services, is government procurement. Many trade agreements in the past have been successful in opening procurement markets to competition from foreign providers. The UK should also push hard in these negotiations to open its market and those of its trading partners.

Beyond these core issues, there is the potential for mutual recognition of domestic regulations related to product standards and services qualifications, under which goods and services that satisfy the regulations of one country are deemed to satisfy those of other countries as well. But trying to negotiate these issues comprehensively has proved extremely controversial in the TTIP context, and is unlikely to have greater success in UK trade negotiations. Instead, the agreements should merely refer to the possibility of future discussions on specific products and services, and leave this issue for a later date.

By keeping trade negotiations simple and focused in the ways described above, the UK can push quickly for significant trade liberalization, without the process getting bogged down, either during the negotiations or subsequently with the domestic ratification.

A Chance to Remedy Trade Remedies

One final area where the UK has an opportunity to be bold is trade remedies, which covers antidumping, countervailing duties, and safeguards. Ideally, the UK would use these measures in a very limited manner, or even not at all, as part of its domestic trade regime. But practically speaking, these trade measures are a core part of today's trade policy world, and it is unlikely the UK will abandon them.

However, what is possible is that, for its trade relations with close trading partners, the UK might consider a mutual decision not to apply trade remedies. There is precedent for this in various free trade agreements, such as the Australia-New Zealand Closer Economic Relations agreement, in which Australia and New Zealand agreed not to apply antidumping duties against each other.⁶ Antidumping laws are a particular problem in trade relations, and have been criticized for their lack of economic justification.⁷ The negotiation of new UK trade agreements provides an opportunity for reform, as allegations of "dumping" often focus on competition with cheap labor in developing countries. With trading partners who are at similar development levels, it may be possible to escape the usual arguments about fear of low-priced products.

With regard to the potential trading partners mentioned above, the United States is the least likely to agree to such a proposal. However, as noted, Australia and New Zealand have already agreed to this between themselves. And Japan was traditionally only a limited user of trade remedies (although it has increased its use in recent years). Thus, there is a chance that if the UK proposed the elimination of one or more trade remedies, some of these countries might agree.

Conclusion

The UK faces some difficult tasks in terms of formulating a new trade policy. First of all, it needs to hire trade

negotiators. While there are some UK government officials who have expertise in this area, this type of work has been largely farmed out to European officials for decades. The UK needs to start from scratch to a great extent, which could slow down its progress.

But it will put a team in place eventually, and that team will be faced with many difficult choices. In this short paper, I have tried to kick off the debate by suggesting some general ideas for how the UK might approach the negotiation of trade treaties in a manner that draws on its tradition of free trade. In the coming months and years, after the UK sorts out its trade relationship with the EU and takes back competence over trade policy,⁸ the specific details will continue to be fleshed out.

Notes

1. For some discussions of this process, see Alan Matthews, "WTO Dimensions of a UK 'Brexit' and Agricultural Trade," *CAP Reform*, January 5, 2016, <http://capreform.eu/wto-dimensions-of-a-uk-brexite-and-agricultural-trade/>; Peter Ungphakorn, "Nothing Simple about UK Regaining WTO Status Post-Brexit," *Trade β Blog*, June 7, 2016, <https://tradebetablog.wordpress.com/2016/06/07/uk-wto-brexite/>, and Katrin Fernekeß, Solveiga Palevičienė and Manu Thadikkaran, "The Future of the United Kingdom in Europe: Exit Scenarios and Their Implications on Trade Relations," Graduate Institute Geneva's Centre for Trade and Economic Integration, January 7, 2014, http://graduateinstitute.ch/files/live/sites/iheid/files/sites/ctei/shared/CTEI/Law%20Clinic/Memoranda%202013/Group%20A_The%20Future%20of%20the%20United%20Kingdom%20in%20Europe.pdf.
2. Greg Heffer, "Farage: Remaining in the EU Is a Death Sentence for Britain's Steel Industry," *Daily Express*, March 31, 2016, <http://www.express.co.uk/news/politics/657124/Tata-steel-crisis-Nigel-Farage-Brexit-EU-referendum-David-Cameron>; and UK Independence Party, "Farage Calls on Welsh First Minister to Defy the EU to Save Welsh Steel ahead of Major Debate in Cardiff," http://www.ukip.org/farage_calls_on_welsh_first_minister_to_defy_the_eu_to_save_welsh_steel_ahead_of_major_debate_in_cardiff.
3. Phillip Inman, "What Would British Business Be Like after Brexit?" *Guardian*, June 18, 2016, <https://www.theguardian.com/business/2016/jun/18/british-business-after-brexit>.
4. With certain trade arrangements between the UK and EU, such as a customs union, the UK's options for agreements with other countries would be constrained.
5. One of the goals expressed by some of the Leave campaigners was to take protective action against Chinese steel imports: "Mr Farage said leaving the EU would . . . offer greater protection against China's dumping of cheap steel on international markets." Heffer, "Farage: Remaining in the EU Is a Death Sentence for Britain's Steel Industry."
6. See Tania Voon, "Eliminating Trade Remedies from the WTO: Lessons from Regional Trade Agreements," *International and Comparative Law Quarterly* 59 (July 2010):625. See also, Sweden, Kommerskollegium "Eliminating Anti-Dumping Measures in Regional Trade Agreements: The European Union Example," 2013, http://www.kommers.se/Documents/dokumentarkiv/publikationer/2013/rapporter/report-eliminating-anti-dumping-measures_webb.pdf.
7. See, e.g., Daniel Ikenson, "Protection Made to Order: Domestic

Industry's Capture and Reconfiguration of U.S. Antidumping Policy," Cato Institute Trade Policy Analysis no. 44 (December 2010).
8. There are questions about when it can actually start negotiating trade agreements. See, Simon Lester, "When Can the UK

Negotiate Its Own Trade Agreements?" *International Economic Law and Policy Blog, World Trade Law*, June 27, 2016, <http://worldtradelaw.typepad.com/ielpblog/2016/06/when-can-the-uk-negotiate-its-own-trade-agreements.html>.