LSE LAW POLICY BRIEFING SERIES

BREXIT SPECIAL 4

Trade after Brexit

Prof. Damian Chalmers

POLICY BRIEFING 23 | 2017

LSE Law

Trade after Brexit

Leaving the European Union has been characterised as potentially one of the **greatest protectionist acts** in the United Kingdom's history. The European Union has intimated that any trading relationship must offer the United Kingdom significantly **worse terms of trade** than it currently enjoys. Alongside this, the United Kingdom has no ambition to be either part of the **customs union or the single market**. This would put it on the periphery of European trade. Only a few States from the former Soviet Union would enjoy worse terms than it.

The negotiating positions are less hard-line than might appear. It is quite possible for significant trade integration to remain between the United Kingdom and the European Union. The negotiating positions of the two involve a spectrum of alternatives which range from a very loose free trade agreement, on the one hand, to an 'EEA-lite', on the other, which secures full free movement of companies, goods, services and capital and significant liberalisation of free movement of persons.

The challenge is with this spectrum, however. Its breadth allows for very divergent negotiating positions. The United Kingdom might wish high levels of financial service integration, while the European Union might indicate that the price is a very liberal regime for movement of persons. Alternately, the price for protecting the position of the highly British pharmaceuticals industry might be set as giving generous access to the British market for EU farmers. There are real issues of commensurability here. The domestic constituencies within both the European Union and the United Kingdom pushing for different measures will also be fluid, diverse and, most likely, rumbustious.

It is highly implausible, therefore, that the United Kingdom will secure a trade deal with the European Union before Brexit. This is all the more so because (a) the European Union will insist that the substance of the formal Article 50 TEU negotiations on things like residence rights of EU citizens and financial liabilities will need to be agreed before trade negotiations can get going (b) there is no reason for the European Union to rush negotiations as the United Kingdom suffers more from disorderly Brexit than it. It strengthens its negotiating position by dallying during 2017 and maybe early 2018, and (c) the mood music surrounding the negotiations is terrible. Negative and volatile press commentary may well constrain on what can be negotiated.

And if there is no deal?

If there is no deal, relations between the European Union and the United Kingdom will be governed by WTO law. Each must offer the same terms to the other that it offers to all WTO States with whom it does not have a free trade or customs union agreement. United Kingdom exporters will be required to pay the same customs duties as United States' exporters. Assessments as to whether these comply with EU regulations sufficiently to warrant market access will have to be on the same basis as assessments of US or Japanese exporters

This already binds the United Kingdom more than is realised. If negotiations go south with the European Union, it can punish the latter by imposing punitive tariffs on sensitive EU exports to the British market. However, if it does this, these tariffs will also have to be imposed on exports from Japan, Korea, the United States etc. And this would not be a promising start to the much vaunted trade negotiations with those States.

Furthermore, British business is used to a certain level of competition from non-EU businesses on the British market. This has, hitherto, been determined by the levels of customs duties set by the European Union and the commercial policy instruments deployed by it (e.g. anti-dumping duties or countervailing measures). If British officials come in and remake the wheel by setting new duties or abolishing these instruments, this may well have unexpected and unwelcome effects on British jobs and businesses. It is more likely that the same levels of duty and identical instruments will be maintained, albeit with 'Made in the United Kingdom' label stuck over them.

Yet, how will WTO rules affect EU-UK trade from EU membership?

There is an assertion that it will hurt the European Union more than the United Kingdom as it runs a big trade surplus with the United Kingdom. However, things are a little more complicated than that. The European Union runs a huge trade surplus in goods with the United Kingdom whilst the United Kingdom runs a significant surplus in trade in services with the European Union. These surpluses fluctuate, but United Kingdom's surplus in trade in services is generally about two thirds that of the European Union's surplus in goods.

The sting in the tale is that WTO law requires considerable liberalisation in trade in goods but this is not the case with services. In other words, a good part of the European Union's surplus might be protected but that might not be the case with the United Kingdom's surplus in services.

Tariffs on most goods entering the EU are **low** and the growth of international standardisation, particularly since 2000, has meant that goods conforming with these standards experience few non-tariff barriers. The largest sectors where tariffs are high are automobiles and agriculture. In both these sectors, the United Kingdom imports more from the European Union than it exports. In addition, there are some sectors, such as automobiles and **pharmaceuticals**, where it is insufficient that the good comply with EU standards. The type of good must also have been tested for safety through authorised procedures (i.e. a new drug going through regulatory tests). British authorisation processes will not be recognised by the European Union after Brexit, and therefore may have to go through the EU's own authorisation procedures.

In the field of services, there is only so-called positive list liberalisation under WTO law. WTO members indicate the services sectors in which they wish to liberalise. In this regard, EU commitments in a number of services sectors, notably financial services, are **extremely restricted** with a requirement for many insurance and banking services being that they can only be offered by somebody established within the European Union. Even in so-called liberalised sectors, such as architecture or engineering, there may be further problems as the EU will no longer be committed to recognising British professional qualifications.

There is a further challenge. Much international trade today is made up of intra-industry value chains. Parts will come from States A, B and C, will be assembled in State D, and will supplied by capital from State E. Since 2000, there is evidence that the average number of parties in these networks have halved from about 15-20 to about 5-20 and they have become more regionally compact. The reason was that the chains were too unwieldy and were exposed to too much risk if something went wrong in one State or there was too much costs or hassle moving parts between States. The increased costs and complications of trade between the United Kingdom and the European Union post Brexit is likely to see some change in these chains. British producers more able to source supplies or services within the United Kingdom might turn to these rather than EU counterparts. The opposite will, of course, be true for EU producers. The party most likely to lose from this is the United Kingdom for the simple reason that it is a smaller and less diverse market than the European Union. EU producers will have alternatives if their value chain is disrupted, whereas British producers may not.

Trade with the rest of the world

But this will not matter, it is claimed, because Brexit allows the United Kingdom to move around nimbly securing trade deals with the rest of the world so that it sits at the epicentre of world trade.

The reality is that the United Kingdom will lose access to many non-EU markets at the moment of Brexit. It will exit all the free trade arrangements that the European Union has made with non EU States. These markets will likely include, by 2019, Mexico, Turkey, Korea, Colombia, Ukraine, South Africa, Canada, Morocco and the EFTA States. Furthermore, no agreements with any EU State can be signed until after Brexit. Even if they are signed on the day after Brexit, some time will be needed for their ratification by national parliaments. There will, thus, be a period, therefore, when the UK is on the periphery of all major markets.

It would appear relatively easy for the United Kingdom to replicate the free trade agreements currently in force between the EU and non EU States. There is a template and both parties may have a strong interest in continuity. Even here, there may be glitches. There are some, notably those with Turkey, Norway and Iceland, which cannot be replicated because they involve too high a level of integration. If the UK does not want a customs union with the EU, it is unlikely to want one with Turkey, and it did not leave the EU single market to re-enter it through a single market with Norway and Iceland. There is also the possibility that non-EU States who felt that they were railroaded into less than optimal free trade arrangements with the EU because of its economic strength may wish to renegotiate when it comes to replicating these agreements with the United Kingdom.

Agreement is likely to be even more difficult with significant trading partners (i.e. United States, China, Japan, India and Mercosur) who do not currently have free trade arrangements with the European Union.

A central advantage of a free trade arrangement between, say, State A and B is that it grants goods from State B a competitive advantage over goods from State C on State A's market, with the same being true for State A's goods on the market of State of B. In determining what they will offer the United Kingdom, other States will wish to know the relative position of their industry and service providers vis-à-vis their main foreign competitors on British markets, EU providers. The latter will often be their biggest competition, and the free trade arrangement may not be worth much if a more generous deal is subsequently made with the EU. The United Kingdom will not be able to provide those assurances until it has made a final deal with the EU.

The other more generic reason is that the bigger trade partner the harder it is to secure a trade deal. There are more constituencies which have to be negotiated and more has to be offered in return. Whilst deals with the likes of Singapore and New Zealand may appear relatively unproblematic, the United Kingdom has already begun to realise how challenging it will be to make a deal with **India**. There has also been some unrealistic assumptions about what the United Kingdom has to offer. There has, thus, been talk of creating a free trade area with the **whole of Africa**. In fact, the European Union has been trying to do this through three Economic Partnership Agreements. It has foundered because WTO rules require African States to grant wide-ranging access to their markets for this to take place. Simple market access being provided by the EU is insufficient. With many nascent industries, they have been **wary** about this. This wariness is unlikely to change simply because the request is coming from Whitehall rather than Brussels.

So, yes it will be cold outside the European Union. Which is why the odds on a transitional deal will increase during the second half of 2018.

Prof. Damian Chalmers
(Department of Law,
London School of Economics
and Political Science)

DAMIAN CHALMERS

Damian Chalmers is Professor at the LSE as well as the National University of Singapore. He is also Professor of European Union Law and UK in a Changing Europe ESRC Senior Fellow. His visiting positions include being a Jean Monnet Fellow at the European University Institute (2003–2004) and Visiting Professorships at the College of Europe and the Instituto de Empresa.

BREXIT
SPECIAL 4

LONDON | MARCH 2017

THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

Department of Law
The London School of Economics
and Political Science
Houghton Street
London WC2A 2AE