Post-Brexit UK trade policy remains a wish list

About half of UK's trade and investment is with the EU and, as a member of the single market, the UK implements similar standards for products and services as the EU. Furthermore, as a member of the customs union, the UK operates a common external tariff, and goods and services can move seamlessly with no customs or compliance checks. How the UK exits the EU will, therefore, have profound impacts on trade, investment and economic growth in the UK, write ***Nikhil Datta*** *and* ***Swati Dhingra (LSE's Centre for Economic Performance).***

The government white papers have made clear the intention of the UK to establish its own trading schedules (import tariffs and quotas) at the World Trade Organisation, replicating the existing EU tariffs as much as possible.

Such a move would inevitably mean that the UK leaves the EU's customs union, which in turn means goods from the UK exported to the EU, and *vice versa*, would face 'rules of origin' checks at the border. These checks ensure the goods are produced in the exporting country, and are not simply being re-routed from another country that is subject to higher tariffs.

But the problem with these checks is that they are time-consuming, and estimated to cost about 8% of the value of the good. It is these sorts of issues which ranked Norway (a member of the single market but not the customs union) as the most problematic trading partner for Swedish businesses in a survey by the Swedish National Board of trade: one of the most common complaints of trading with Norway was the "incredibly cumbersome" customs handling and rules. Other procedures, such as custom searches and filling declarations and risks of delays at ports, are concerns voiced by stakeholders.

The latter of these is of particular importance to industries relying on fresh produce or operating just-in-time production lines such as the automotive industry. Major disruption to their production lines could occur if customs procedures are not as smooth as they have been previously. It is, therefore, promising that in both the white paper and the future partnership paper the government has given attention to the future customs arrangement between the UK and the EU, and has proposed two possible arrangements.

One – a "highly streamlined customs arrangement" – would seek the implementation of a technological solution for fast movements through roll-on, roll-off ports, and would attempt to negotiate a waiver for declarations. The other – a new customs partnership agreement – would involve mimicking the EU customs arrangement specifically for goods to be consumed in the EU. However, the former would most likely require a large amount of infrastructure spending, while not mitigating all costs, and the latter would need some form of enforcement mechanism.

Unfortunately, little information has been offered on the detail and implementation of such arrangements. Given these have not been attempted before, it is such details which are arguably the most important. However, it is almost certain that, outside the customs union, HMRC will need to expand to ensure it has both the personnel and the infrastructure to handle the increased workload.

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Deep trade deals, which increase trade volumes, go beyond tariffs and customs issues. They aim to reduce the divergences in standards and regulation between countries so that businesses face lower costs of compliance and operation across borders. This is what turns a free trade area into one large single market. By following a common standard, or at least having mutual recognition of standards, products do not need to be certified to mark that they meet domestic requirements.

It would be hoped the UK could make a mutual recognition agreement with the EU, covering items such as electrical goods and machinery, similar to those struck with countries such as Australia and Canada. The larger issue, however, concerns the services sector, which makes up 80% of the UK economy. For example, the loss of financial passporting rights (which allow UK based financial institutions to do business across the EU) could have major implications for the financial sector. Even if some sort of regulatory equivalence was recognised, this is unlikely to cover commercial banking or primary insurance, as not all EU financial regulations currently offer the possibility of equivalence.

Access to the single EU aviation market could be disrupted because current rules require headquarters to be located within the EU. This is the main factor behind EasyJet setting up their Austrian HQ. Estimates suggest that non-tariff barriers in services have an *ad valorem* equivalent of 8.5% to 47.3% between the EU and US. Outside of the EU, the UK could face a proportion of these costs, and that proportion would rise as standards diverge between the two areas.

Out of the EU, the UK might find it easier to strike bilateral agreements with new trade partners, because it would no longer face the constraints imposed by 27 other members. As a smaller economy though, the UK would also lose bargaining power, which matters significantly in trade negotiations. This was Switzerland's experience when striking its trade deal with China (a proposed FTA partner for the UK): as noted by the Lalive Report, the "FTA is more favourable to Chinese exports". A survey by the Swiss Chamber of Commerce further noted that "the FTA is not very attractive", while the Swiss Embassy has noted that service exports from Switzerland to China haven't grown as a result of the FTA.

Another difficulty that the UK will face when negotiating with its large trade partners – the US, China and India – is that its regulatory framework is substantively different from these countries. Thus striking deep deals, which achieve regulatory harmonisation without compromising domestic standards, would be difficult in future negotiations with these non-EU trade partners. The goals set out in the Department for International Trade's most recent policy paper are ambitious. As negotiating deep trade deals can be a lengthy process, this is a long-term strategy for trade policy and is unlikely to cushion immediate drops in trade volumes under plausible scenarios, like a no-deal Brexit in which tariffs would apply right away.

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The goal outlined by the government to achieve a transition agreement, which will maintain current market access and customs arrangements with the EU, is therefore a step in the right direction. It will avoid a cliff edge in eighteen months, and buy the government time to negotiate its future terms with the EU. Ultimately though, a transition arrangement will need to give way to a new arrangement with the EU. The government papers give no details of the specific set of policies that will be put in place to achieve the stated ambition of frictionless trade with the EU. Without these workable details, UK trade policy remains a wish list.

This post represents the views of the authors and not those of the Brexit blog, nor of the LSE. It first appeared on the UKinEU blog.

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