ERG: Thursday 6 July:

"GENERAL DEBATE ON EXITING THE EUROPEAN UNION AND GLOBAL TRADE"

- **The EU has failed to maximise the UK's trading opportunities**
- **There are great new opportunities for UK trade outside of the EU**
- **There is every likelihood of a reciprocal free trade agreement with the EU, however if there is not, the WTO provides a framework to allow trade to continue preventing a "cliff edge"**
- **The UK will not be able to have its own external trade policy unless it leaves the EU's Customs Union and Internal (Single) Market. Opposition to leaving the CU&SM is opposition to all UK trade deals with non EU states.**

1. The EU has failed to maximise the UK's trading opportunities

Failure to liberalise the services sector: The EU's internal market has failed to maximise the benefit to the UK in its area of strength - services. Services make up: "70% of the EU's output, they only make up 20% of the EU's internal trade"[1] It is closer to 80% in the UK.[2]

The services sector includes sectors such as finance, telecommunications, transport and healthcare that are covered by EU internal market legislation. However 40% of EU GDP is not, including areas such as construction, retail, professional services which are dealt with under the Services Directive.

The European Commission brought forward the Services Directive (Services in the Internal Market Directive 2006/123/EC to help liberalise the sector but failed. The EU's own evaluation of the services sector found that:

> *"the Single Market for services is not yet delivering its full potential… The absence of dynamism in intra-EU services trade becomes clear when mirrored against EU's global trade in services. Since 2004, trade in services between the EU and the rest of the world has been growing faster than inside the Single Market. Today only about 8% of European SMEs do business in other Member States."*[3]

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[1] Open Europe Kick Starting Growth; http://openeurope.org.uk/intelligence/economic-policy-and-trade/single-market-in-services/ & HM Government, 'The European Union Single Market – what has been achieved in twenty years?' in 'Twenty years on: The UK and the future of the Single Market', CEPR and HM Government, 2012, p1

[2] FT, 31 march 2016; https://www.ft.com/content/2ce78f36-ed2e-11e5-888e-2eadd5fbc4a4

[3] EC, 2011 "Towards a better functioning Single Market for services – building on the results of the mutual evaluation process of the Services Directive" http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0020:FIN:EN:PDF

Example of the failure of the Internal Market in Services: Regulated professions: The European Commission has found there are 800 different activities "considered to be regulated professions in one or more Member States and are reserved for providers with specific qualifications." "More than 25%" of the regulated professions in the EU are regulated in just one member state, including photographers, barmen, corset makers or chambermaids.[4]

The failure of the EU to liberalise internally has become evident in the EU/USA TTIP negotiations were leaked documents detail the EU areas of non-negotiable restrictions.[5]

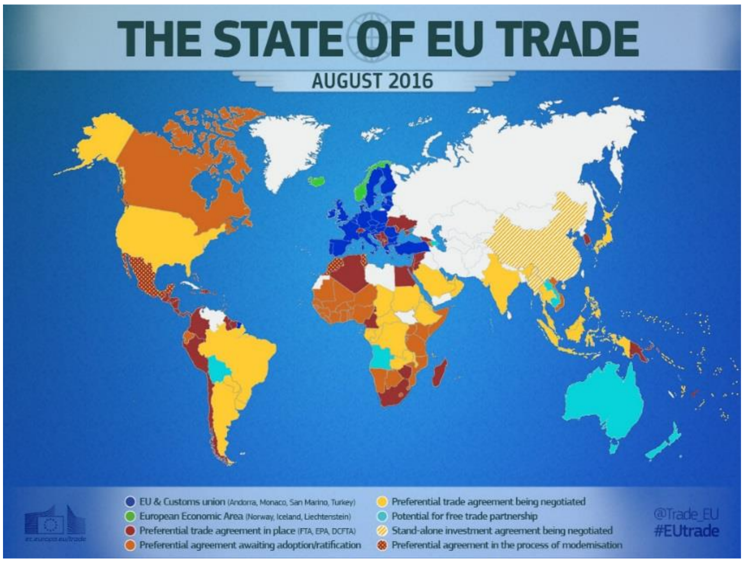
This led German Chancellor Angela Merkel to admit that "We have a Single Market of goods, but not quite a Single Market for services. We still have to work at it."[6]

Failure of the EU to capitalise on external trade deals:

Lack of coverage:

The EU currently has preferential agreements in force with c.27 non EU states and with a number of others awaiting ratification. The EU however does not have agreements with major economies such as China, India the USA or Brazil or with long term UK allies such as Australia and New Zealand.

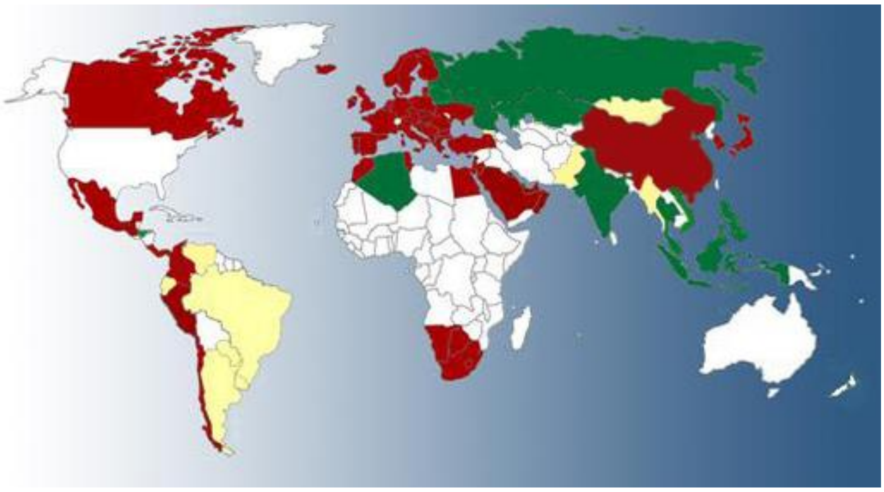
Map of EU trade agreements in force, in negotiation or awaiting ratification:



A comparison of the EU's trade agreements with other smaller states however shows that this is not particularly impressive.

Map of Swiss trade agreements:

[4] European Commission, 'Towards a better functioning Single Market for services – building on the results of the mutual evaluation process of the Services Directive', 27 January 2011, p7;http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0020:FIN:EN:PDF
[5] Green Peace leaked TTIP document https://ttip-leaks.org/ttip/
[6] 18 February 2013



Michael Burrage, in his 2016 Civitas paper “How the trade benefits of EU membership have been miss-sold” analysed the EU’s trade agreements in comparison with a number of smaller states an made the following two claims:

- *“The EC has therefore opened services markets of just $4.8tn to UK exporters, whereas the Swiss have opened markets of $35tn, the Singaporeans of $37.2tn, the Koreans of $40tn and Chileans of $55.4tn.”*
- *“90 per cent of the agreements of these four smaller, independent countries include services, whereas only 68 per cent of the EC’s trade agreements do so.”*[7]

Prioritising the wrong elements:

The EU has traditionally argued its weight in negotiations allow it to secure better access for its members goods & services (although this does not explain the lack of access to the USA & China).

The draw back to this is that the UK’s competing interests are played off against others in a common negotiating hand.

The EU has to negotiate with the interests of the EU28 in mind, and the EU28’s interests often diverge from those of the UK. For instance the EU retains high tariffs on the import of textiles and agricultural products increasing the cost to consumers, at the behest of lobbying from other member states when these sectors are comparatively small in the UK. These tariffs will make EU trade agreements more difficult to achieve.

An example of a trade-off is that EU’s negotiation with Singapore. Singapore is a major financial services market with zero tariff rates meaning that all negotiations would be on the subject of non-tariff barriers. In the final stages of the negotiation issues related to financial services and geographical indications remained outstanding.[8] For the UK, financial services are of key importance whereas for other EU states the protection of goods by geographical name (i.e. Australian

[7] Civitas, Michael Burrage, 2016: “How the trade benefits of EU membership have been miss-sold”; http://www.civitas.org.uk/content/files/mythandparadox.pdf

[8] European FOREIGN AFFAIRS COUNCIL - TRADE ISSUES Friday 16 March in Brussels; http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/EN/foraff/128948.pdf

Champagne sold in Singapore) were of more importance. In this case the EU ended up with less access to the financial centre than the USA.[9]

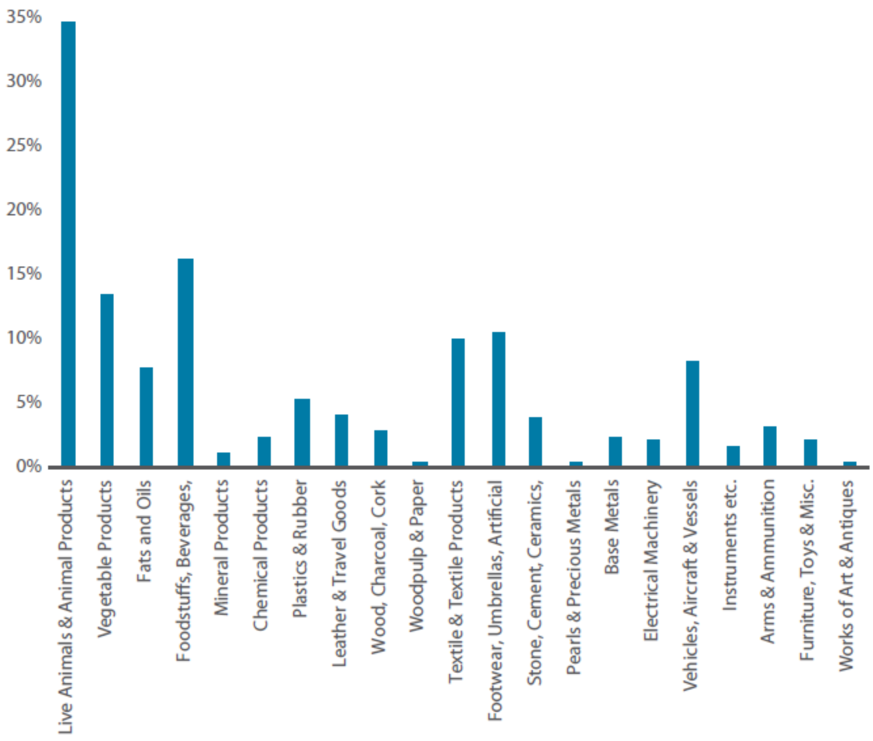
In the future it may also be argued that the EU's inclusion of Greek & Cypriot banking may have dragged on its ability to secure a favourable deal.

2. There are great new opportunities for UK trade outside of the EU

Since Brexit the UK 6 of the G20 have indicated a willingness to discuss trade with the UK.[10] These are China, India, Mexico, South Korea, Singapore and Australia. Other notable states where trade agreements may be possible include the USA.

In these trade discussions the UK will be able to reduce its own tariffs and so help consumers while potentially securing better preferential access as a result of not having defensive interests.

Figure 30.ix: Effective tariff rates on UK exports by category in the 'Worst Case Scenario'



Source: see Annex B

[11]

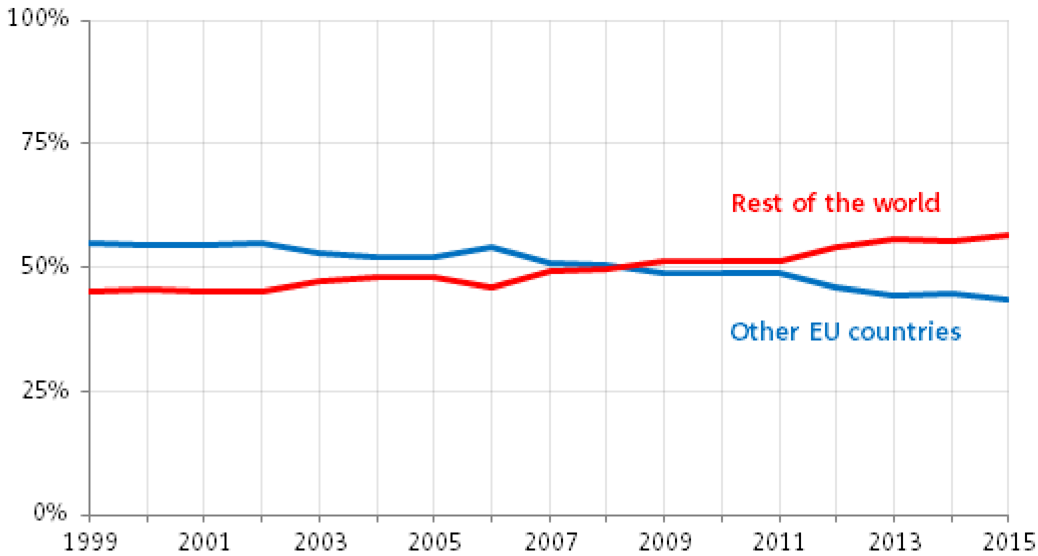
[9] Open Europe, Trading Places; https://docs.google.com/viewerng/viewer?url=http://openeurope.org.uk/wp-content/uploads/2014/10/trading_places_Is_EU_membership_still_the_best_option_for-_UK_trade_and_what_are_the_alternatives.pdf
[10] Guardian; https://www.theguardian.com/world/2016/sep/05/five-countries-at-g20-keen-on-uk-trade-talks-says-theresa-may
[11] P.777 Change or Go 2016; http://2mbg6fgb1kl380gtk22pbxgw.wpengine.netdna-cdn.com/wp-content/uploads/2016/11/ChangeorGo.pdf

Reducing UK food prices to world prices has been calculated as saving the UK household £361 and in textiles a further £146.[12]

In the long term the economic growth rates of the markets outside of the EU are likely to be.[13]

3. There is every likelihood of a reciprocal free trade agreement with the EU, however if there is not, the WTO provides a framework to allow trade to continue preventing a "cliff Edge".

The UK's exports to the EU are declining as a proportion of the whole, due to the Eurozone crisis, diversification and higher growth in other regions.



[14]

Article 50 gives the UK a two year negotiating period to secure a deal with the EU. There will be a number of areas that need agreeing including the Article 50 withdrawal agreement and a preferential trade agreement.

The White Paper sets out the aim:

> *"We will forge a new strategic partnership with the EU, including a wide ranging, bold and ambitious free trade agreement, and will seek a mutually beneficial new customs agreement with the EU."*[15]

There is no reason to suppose this cannot be agreed, given the EU/UK agreement starts from the basis of 100% alignment and the EU has agreed comprehensive trade agreements with complex economies such as Canada and South Korea that take tariffs close to zero and include elements of financial services.

<u>Nomenclature of a deal:</u>

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[12] Ibid P.827

[13] See for instance, PwC "The World in 2050". https://www.pwc.com/gx/en/issues/the-economy/assets/world-in-2050-february-2015.pdf

[14] ONS Goods & Services exports %

[15] UK Gov, 2 February 2017: https://www.gov.uk/government/publications/the-united-kingdoms-exit-from-and-new-partnership-with-the-european-union-white-paper

Much of the commentary concerning the deal or lack thereof has been confused by inaccurate use of the terms used to describe the various types of trade agreements.

- **Membership of the EU**
- **A Customs Union with the EU: Turkey and the microstates**
- **Membership of the Internal Market: Probably the EEA but potentially the Swiss bilateral agreement as well**
- **Preferential access to the Internal Market: South Korea**
- **Access to the Internal Market (+ mutual recognition agreements): The USA on Most Favoured Nation Terms (MFN)**
- **No agreements on anything…. North Korea**[16]

In addition to the main "deal" there are numerous multilateral and bilateral agreements that are vital but not controversial on everything from air traffic control to data security.

It is these standard but vital agreements that keep trade flowing and come closest to being the "cliff edge" that has concerned some quarters of UK business.

The WTO (Most Favoured Nation trade terms)

What would happen if the UK left without a "main deal" under WTO Most Favoured Nation Terms (MFN)?

The UK is a member of the WTO and its forerunner GATTS. If the UK was not able to secure a preferential trade deal within the 2 years it could rely on Most Favoured Nation Terms (MFN). This is the WTO norm whereby states have to offer each other their best trade terms, outside of the context of a Free Trade Agreement or Customs Union.

The Legatum Institute in their paper "Brexit: WTO Process and Negotiations of FTAs" has described the WTO as follows:

> ***"WTO rules are not something you "fall back on" in the absence of a better bi-lateral agreement. They are the foundation for and structure around which all international trade is carried on. Bi-lateral and platform trade deals (such as FTAs and customs unions) build on this structure. WTO rules still apply, both to cover aspects of trade that are not dealt with in the trade deal and to regulate the parties' trade with countries that they do not have a trade deal with."***[17]

The WTO and EU tariffs:
In the case of the EU, UK Companies that export to the EU would have to pay the EU's common external tariff and EU companies would have to pay the UK's new schedule of tariffs lodged at the WTO. The UK could unilaterally remove its import tariffs, however under the MFN system it would have to do this for all states and not just the EU.

[16] For more information on 42 different types of EU relationship see Dr Rotherham here: http://www.theredcell.co.uk/uploads/9/6/4/0/96409902/42.pdf

[17] Legatum Institute special trade commission; February 2017; http://www.li.com/activities/publications/brexit-world-trade-organisation-process-and-negotiation-of-free-trade-agreements

No "Cliff Edge": We will maintain cooperation via the WTO and simple bilateral agreements

- States such as the USA export to the EU under the EU's MFN tariff schedules.[18]
- The absence of a preferential trade deal will not mean the absence of all agreements.

WTO or multilateral agreements:

The UK will be able to cooperate with the EU on matters such as customs, standards and secure non-discrimination in the services trade without a preferential trade agreement. Under the WTO there are a series of multilateral agreement on the following:

- Customs cooperation
- GATS & the soon to come into force TISA on services
- International standards including aviation safety
- Government procurement

Standard bilateral UK/EU agreements separate to or in conjunction with a free trade agreement

On a technical level the EU and UK will have to agree the following.

- Data: Agreements on data sharing to allow technology companies to pass details across EU borders.
- Aviation: Both on air traffic control & open skies for landing slots.
- Mutual recognition to allow goods to keep flowing. This is a standard agreement to which Australia and the USDA have agreements despite not having preferential trade agreements.[19]

How to keep an integrated supply chain going?

Companies with supply chains crossing EU borders can, under a MFN scenario, mitigate for the cost of tariffs in a number of ways:

- Invest in a UK supply chain, as has been announced by by Toyota.[20]
- Use WTO agreed Rules of Origin for components
- Introduce inward and outward processing relief. The introduction of this scheme (already used by the EU has been mooted by Lord Bridges of Headley MBE, Parliamentary Under-Secretary of State, Department for Exiting (See Appendix A)

An explanation of it is here:

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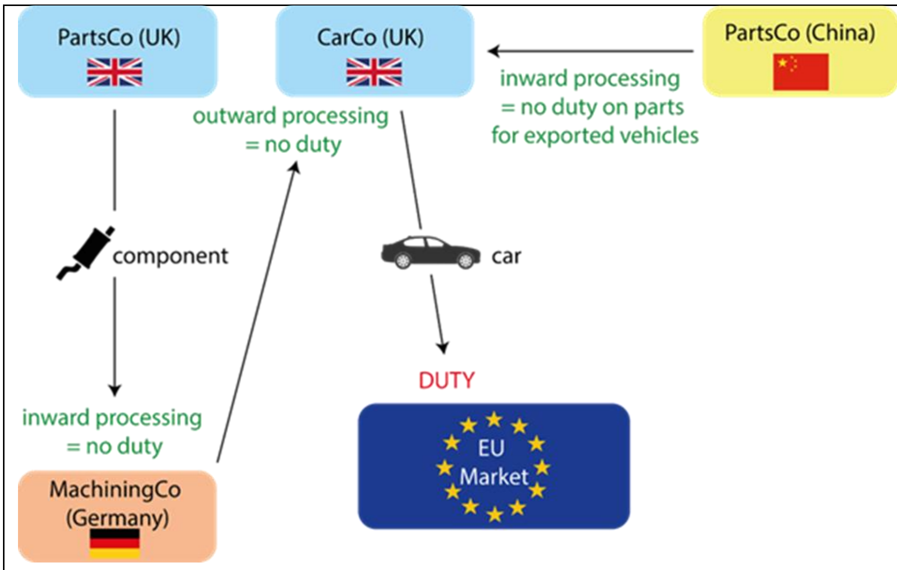
[18] For an explanation of how the UK files a new schedule at the WTO, please see evidence of Richard Eglin of White & Case to the House of Lords EU Committee September 2016; http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-external-affairs-subcommittee/brexit-future-trade-between-the-uk-and-the-eu/oral/37864.html

[19] See the Australian Mutual Recognition agreement for instance; https://industry.gov.au/industry/IndustryInitiatives/TradePolicies/TechnicalBarrierstoTrade/Pages/ECAustMRA.aspx

[20] 16 March, UK Gov: Toyata investment announcement; https://www.gov.uk/government/news/government-welcomes-240-million-strategic-toyota-investment



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Tariff mitigation

In addition the government could seek to introduce schemes to off set the cost of tariffs to exporters using the revenue collected on imports. Some potential ideas have been set out by Will Norton in a paper for Civitas.[22] The paper observed that:

> *"UK exports to the EU-27 could expect to suffer tariff costs in the region of £5.2 billion, but the corresponding exports from the EU-27 to the UK would face costs in the region of £12.9 billion."*

Of these funds the UK could, while not contravening WTO rule against export subsidies, direct them to export dependant sectors of the economy thus mitigating the impact of the cost of exporting.

Appendix A

Box 3: Inward Processing Relief

Inward Processing Relief is an EU scheme that improves export competitiveness, similar to schemes that in other countries may be termed 'duty drawback'. It permits relief from the payment of import duties and other charges for certain goods brought into the EU, in order to enable those goods to be used for manufacturing, processing or repair before they are then exported from that territory.[232]

[21] Legatum Institute, Supply Chains; http://www.li.com/activities/publications/special-trade-commission-brexit-movement-of-goods-and-the-supply-chain

[22] Will Norton, Civitas, Jan 2017 "Mitigating the impact of tariffs on UK-EU trade"; http://www.civitas.org.uk/publications/mitigating-the-impact-of-tariffs-on-uk-eu-trade/

Inward processing or duty drawback is permitted under WTO law, as long as the relief is granted on a MFN basis, and the relief is not larger than the tariff due on the imported goods (if it were larger it would constitute an illegal export subsidy).233

The World Customs Organisation has noted that the rules of origin (see Chapter 5) within many FTAs prohibit the use of such duty drawback systems (so-called 'no-drawback' provisions).234 'No-drawback' ('no-inward-processing') provisions are routinely included within EU FTAs. For example, the EU-Canada Economic and Trade Agreement (CETA) limits the use of duty drawback.235 However, we note that the EU-Korea FTA does not limit duty drawback to the same extent.236 Whether the FTA between the UK and the EU will contain a no-drawback provision will be subject to negotiation.

118.Lord Bridges of Headley MBE, Parliamentary Under-Secretary of State, Department for Exiting the EU, told us that the Government was considering the issue of Inward Processing Relief. Such a scheme was another way to "mitigate tariffs", and was "something that is there or will be there".[23]

[23] House of Lords EU Committee 14 March 2017; http://www.parliament.uk/business/committees/committees-a-z/lords-select/eu-select-committee-/publications/