LEAVE ALLIANCE

Brexit Monograph 5

Trade barriers and Brexit

4 August 2016
(corrected1)

Introduction

An oft' repeated mantra relating to the forthcoming Brexit negotiations is that the EU is bound to offer the UK a favourable deal because we have a substantial trade deficit with the EU and (especially) German manufacturers will want continued access to our markets.

The EU, therefore, will not erect trade barriers against our goods, so the narrative goes, not least because, if they did the UK would retaliate, causing more damage to the EU than its actions would cause UK traders.[1] This option has considerable support within the wider Eurosceptic community, where it is an article of faith that the EU would be willing to trade under these terms, and that it would be advantageous to the UK.[2] The trade imbalance with the EU, it is argued, would preclude any predatory action.[3]

Superficially attractive though these arguments might be – and there can be no dispute that the substantial trade deficit would gives the UK some leverage in trade negotiations - there is a risk that the perceived advantages are being overplayed.

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[1] The outline of this argument is set out by Matthew Elliott, Chief Executive of Vote Leave, in oral evidence to the House of Commons Treasury Committee, on 9 May 2016. http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/the-economic-and-financial-costs-and-benefits-of-uks-eu-membership/oral/33182.pdf

[2] See, for instance, Global Britain, A Global Britain: the Recommended "Brexit" option. Leading the World to Tariff-Free Trade, http://www.globalbritain.co.uk/sites/default/files/GB%20Brexit%20Position%20Paper.pdf

[3] Thus argues the Global Britain, pointing out that the eurozone surplus on goods, services, income and transfers currently stands at €63 billion in 2012. Global Britain Briefing Note 86, http://www.globalbritain.org/BNN/BN86.pdf, accessed 5 December 2013.

Essentially, the core defect in the arguments is the supposition that any barriers which are in place after Brexit, inhibiting the flow of trade, would be erected for that purpose.[4] The reality is that these barriers are already in place, in the manner of walls surrounding "fortress Europe". As a member of the EU, the UK is inside the walls. Leaving the EU (without a comprehensive trade agreement) would place the UK outside those walls – the effect of its own action rather than of any specific action taken by the EU.

This is an important difference of perspective, and one explored in this Monograph. We look at the rules governing the conduct of trade between nations - especially the relevant aspects of the WTO agreements – and related issues, in order to ascertain how Britain would fare if it placed excessive reliance on our trading position, in order to leverage a favourable trade deal.

We also look at the effect of non-tariff barriers, and their effect on the UK's trade with the EU, post-Brexit, and the difficulties in maintaining regulatory convergence – the price for continued trade in goods with the EU.

The UK's trading position

The assertion that the EU would necessarily make concessions to the UK on the basis of the trade imbalance in favour of EU Member States is questioned by the Centre for European Reform (CER). It recognises that the EU buys (nearly) half of the UK's exports while the UK only accounts for around ten percent of EU exports.[5]

However, the ultimate Article 50 settlement is agreed by qualified majority voting, while half of the EU's trade surplus with the UK is accounted for by just two member states: Germany and the Netherlands. Most EU member states do not run substantial trade surpluses with the UK, and some run deficits with it. Those in deficit might seek a settlement which has the effect of blocking (or restricting) UK imports, looking for opportunities to increase intra-community trade without competition from the UK.

This position is most often expressed in terms of the UK having to pay the EU's Common External Tariff, which ranges from a few percent on some goods, to around ten percent on completed vehicles and thirty percent or more on some agricultural produce. Average tariff levels, though, are low, and would have little effect on overall trade. [6]

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[4] This is a frequent refrain, as here the author asks (rhetorically) why the EU "would erect trade barriers which would prevent them from exporting to us", http://getbritainout.org/why-we-can-trade-in-or-out/

[5] Springford, John & Tilford, Simon (2014), The Great British Trade-off. The impact of leaving the EU on the UK's trade and investment, Centre for European Forum, http://www.cer.org.uk/sites/default/files/publications/attachments/pdf/2014/pb_britishtrade_16jan14-8285.pdf

[6] The general duty on motor cars is ten percent. For prevailing rates of duty, see: http://ec.europa.eu/taxation_customs/customs/customs_duties/tariff_aspects/customs_tariff/

Where tariffs might bite, however, is on manufactured goods such as motor vehicles, with a disproportionate effect on Britain's poorest regions.[7] Here, it is argued that, if the EU did impose tariffs, the UK could retaliate by imposing tariffs on vehicles exported from EU Member States.[8]

Sadly, such a straightforward response is not available to the UK. If the UK left the EU without a free trade agreement with the EU, it would acquire in relation to the EU - by virtue of its membership of the WTO - the status of Most Favoured Nation (MFN).

In imposing tariffs on the UK, the EU would be acting in accordance with the rules of the WTO trading system, and especially the rules of equal treatment. It would be obliged to impose the same tariffs under the same conditions as all the other countries that enjoyed MFN status.[9] That would include tariffs on a wide range of industrial goods. The EU would have no choice in the matter. If it failed to obey WTO rules, it might face action from its other trading partners. [10]

On the other hand, it is not at all clear what tariffs the UK could impose. Having been a member of the EU/EEC Customs Union for over four decades, there is no recent tariff history. The pre-entry tariff levels would no longer be relevant and could not be used as a baseline.

Arguably, the UK could adopt the EU schedule of commitments unchanged, as a basis for the national package, which would prevent the UK imposing any tariff higher that that levied by the EU.[11] Alternatively, if it wanted to raise levels above EU bound tariffs, it might have to negotiate a new schedule with the WTO.[12]

This is not as problematical as it might seem. Members are allowed to modify or withdraw concessions from their schedule through negotiation and agreement with other Members. Article XXVIII of the GATT 1994 entitled "Modification of Schedules" is the main provision dealing with the renegotiation of a tariff concession. To date, at least 42 GATT Contracting Parties initiated roughly 300 renegotiations between 1951 and 1994. There have been 39 requests to enter into renegotiations under GATT Article XXVIII since

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[7] Disunited Kingdom: Why 'Brexit' endangers Britain's poorer regions, http://www.cer.org.uk/sites/default/files/publications/attachments/pdf/2015/pw_disunited_js_april15-11076.pdf

[8] John Redwood Blog, 30 June 2016, The EU says no single market without freedom of movement, http://johnredwoodsdiary.com/2016/06/30/the-eu-says-no-single-market-without-freedom-of-move/

[9] WTO website: principles of the trading system, https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm, accessed 8 April 2015.

[10] http://trade.ec.europa.eu/doclib/docs/2012/june/tradoc_149622.jpg, accessed 13 January 2014.

[11] https://www.wto.org/english/tratop_e/schedules_e/goods_schedules_e.htm

[12] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/504216/The_process_for_withdrawing_from_the_EU_print_ready.pdf

the establishment of the WTO in 1995, five of which have been withdrawn, 14 have been concluded and formally certified, and eight have been concluded, but have not been certified for various reasons. The remaining 12 are in principle still on-going.[13]

Whatever tariff levels the UK might be able to impose on the EU, however, WTO anti-discrimination rules would require it to impose the same levels on all its trading partners (other than those with which it had negotiated preferential trade agreements).[14] Thus, if the UK imposed tariffs on the import of goods from EU Member States, it would have to impose the same level of tariffs on similar imports from every other country in the world.

A duty on cars from the EU, therefore, would have to be matched by the same levy on cars from all other trading partners, including Japan and Korea. This cannot even be by-passed by imposing discriminatory domestic taxes, as indicated currently by action being taken against Brazil, where WTO proceedings are being initiated after a special tax was levied on imported cars.[15] Then, on the other hand, if the UK decided to remove tariffs from EU products, it must do the same with all other WTO members.

Asymmetric discrimination

Although WTO rules prevent the UK applying measures which discriminate between EU Member States and other trading partners, the reverse does not always apply. Under certain circumstances, the EU is exempt from WTO anti-discrimination rules and is permitted to discriminate between trading partners.

This exemption is not specific to the EU but applies to all WTO members which enter into Regional Trade Agreement (RTAs), of which the EU's Customs Union is one example. By virtue of these agreements, members grant more favourable conditions to their trade with other parties then they do to other WTO members' trade. This departs from the guiding principle of non-discrimination defined in Article I of GATT, Article II of GATS, and elsewhere but, through the application of a complex of rules, the RTAs are exempted from the principle.[16,17]

In relation to tariffs, this means that, where the EU has entered into preferential trade agreements with other parties, it may apply lower tariffs to their goods – or even eliminate them altogether – while still applying the full rates to MFN partners. As a result, the EU now applies the full MFN tariff to only nine of its trading partners.[18] The UK leaving the EU would make it ten.

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[13] https://www.wto.org/english/tratop_e/schedules_e/goods_schedules_table_e.htm
[14] https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm
[15] European Commission, EU requests WTO consultations over Brazil's discriminatory taxes, 19 December 2013, http://europa.eu/rapid/press-release_IP-13-1272_en.htm, accessed 20 December 2013.
[16] https://www.wto.org/english/tratop_e/region_e/regrul_e.htm
[17] https://www.wto.org/english/tratop_e/region_e/scope_rta_e.htm
[18] https://www.wto.org/english/thewto_e/10anniv_e/future_wto_chap2_e.pdf

Crucially, the exemptions which apply to tariffs also apply to non-tariff barriers, the effect of which (see later sections) can be more severe than tariff discrimination.

Non-tariff barriers

Although much of the discourse on post-Brexit trade with the EU has focused on tariffs, the far greater problems presented by the need to trade with the EU are the so-called Non-Tariff Measures (NTMs) or Technical Barriers to Trade (TBTs). These have become far more important than tariffs.[19,20] Their significance is discussed at length by the United Nations Conference on Trade and Development (UNCTAD), which puts the issue in perspective. Traditional trade policies such as tariffs and quotas no longer have a significant impact on restricting market access, it says:

> Tariffs on international trade are generally low, as they have been progressively liberalized, first under the auspices of the General Agreement on Tariffs and Trade (GATT)/World Trade Organization (WTO) and subsequently in the context of regional and bilateral preferential trade agreements. The decreasing importance of tariffs for market access also results from special and differential treatment schemes, such as the UNCTAD generalized tariff preferences, and the various preferential schemes granted to most needed countries. The fact that tariff liberalization alone has generally proven unsuccessful in providing genuine market access has drawn further attention to non-tariff measures (NTMs) as major determinants in restricting market access.[21]

This is something readily acknowledged by the British government. These measures, it says, often stem from domestic regulations enacted primarily to achieve valid domestic goals. Therefore, unlike tariffs they cannot be removed simply.[22] Furthermore, they are a growing problem. In 1995, the WTO received 386 formal notifications of TBTs. By 2013, this had risen to 2,137.[23] Overall, they are estimated to add more than 20 percent to the costs of international trade, compared with the average costs of tariffs in the order of 2-3 percent.[24]

In terms of the EU (and the EEC before it), it was the 1957 Treaty of Rome, starting off the Common Market, which dealt with tariffs and quotas. Originally

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[19] The WTO Agreements Series: Technical Barriers to Trade, http://www.wto.org/english/res_e/publications_e/tbttotrade_e.pdf, accessed 18 November 2014,
[20] Anon (2005), Looking Beyond Tariffs - The Role of Non-Tariff Barriers in World Trade, OECD, http://www.keepeek.com/Digital-Asset-Management/oecd/trade/looking-beyond-tariffs_9789264014626-en#page18, accessed 29 December 2013.
[21] http://unctad.org/en/PublicationsLibrary/ditctab20121_en.pdf
[22] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32467/12-533-regulatory-cooperation.pdf
[23] WTO, World Trade Report 2014, http://www.wto.org/english/res_e/booksp_e/anrep_e/anrep14_e.pdf
[24] Anon, Non-Tariff Measures in EU-US Trade and Investment – An Economic Analysis, ECORYS Nederland BV, 11 December 2009, http://trade.ec.europa.eu/doclib/docs/2009/december/tradoc_145613.pdf

it was assumed that "non-tariff barriers" were of limited importance compared with actual duties. But during the recession of the 1970s they multiplied as each Member State endeavoured to protect what it thought was its short term interests - not only against third countries but against fellow Member States.

In his White Paper on completing the internal market, published in June 1985, Jacques Delors set out the position:

> Member States also increasingly sought to protect national markets and industries through the use of public funds to aid and maintain non-viable companies. The provision in the EEC Treaty that restrictions on the freedom to provide services should "be progressively abolished during the transitional period" not only failed to be implemented during the transitional period, but over important areas failed to be implemented at all. Disgracefully, that remains the case. [25]

The main focus of the Single European Act of 1987 therefore was to address the technical barriers which had built up over time, and which had the potential to proliferate, prejudicing one of the core concepts of the Community, the free movement of goods. To deal with the problem of non-tariff barriers, the (then) EC developed the "new approach" to technical harmonisation and standards, which was to become a key factor in the expansion of the Single Market, triggering an explosion of regulatory and allied measures.[26]

As a member of the EU, the UK is part of a common (harmonised) regulatory system and has already incurred many of the costs arising from securing technical harmonisation over a wide range of economic activities, including those borne in making the structural changes to governance and administrative systems needed to ensure regulatory compliance. Thus the UK has already paid the price for achieving a high degree of regulatory convergence with the EU. As long as the convergence dynamic is maintained, regulatory barriers will have little effect on trade between the UK and EU Member States.

However, as discussed at length in Brexit Monograph 2, in seeking to gain access to Union markets, there is an additional and substantial barrier.[27] This is the need to demonstrate conformity with EU regulatory requirements, by means of approved mechanisms of conformity assessment. This creates an ongoing requirement which cannot be satisfied solely by regulatory convergence. And it is not an issue that can be ignored. The UNCTAD document referred to above provides evidence of how strict rules on conformity assessment can reduce cross-border trade.[28]

In Brexit Monograph 2 we point out that the EU has complex and sophisticated requirements for securing conformity assessment, which are imposed on the

[25] http://aei.pitt.edu/1113/1/internal_market_wp_COM_85_310.pdf
[26] http://aei.pitt.edu/3661/1/3661.pdf
[27] http://www.eureferendum.com/documents/BrexitMonograph002.pdf
[28] *Op cit*, http://unctad.org/en/PublicationsLibrary/ditctab20121_en.pdf

internal market, and on potential importers – with additional, discriminatory requirements for WTO members with which there are no specific agreements on conformity assessment.

Without complying with these requirements, access to the Union market for UK exporters would be considerably more difficult and costly than at present, to the extent that trade would be severely handicapped. Nevertheless, the unintended discriminatory effect would be permitted by the exemption for RTAs which, by the same token, would rule out retaliation. And even without this, the UK could not seek to exclude Union products by imposing its own regime. The WTO Agreement on Technical Barriers to Trade (the TBT Agreement), to which the UK and the EU are parties, specifically excludes the use of conformity assessment schemes as barriers to trade (Article 5.1.2).[29]

On this basis, the UK could be obliged to conform with the EU scheme in order to gain access to its market, but could not retaliate by imposing more onerous conditions on EU Member States for the purpose excluding Union goods.

Rather, the TBT agreement encourages Members to enter into negotiations for the conclusion of agreements for the mutual recognition of results of each others conformity assessment procedures.[30] Such negotiations would have to be an essential part of any Article 50 settlement, if the UK decided to work outside the EEA framework, the Agreement on which incorporates recognition on conformity assessment.

Maintaining regulatory convergence

Although the degree of regulatory convergence with the EU at the point at which the UK leaves the EU will be high, without purposeful intervention on the part of UK regulators, the two systems will inevitably start to diverge.

After an elapse of some years, significant differences may develop, which will militate against any continued mutual recognition of conformity assessment.[31] Recognition is at its most effective if there is close alignment of regulation. And lack of alignment may become especially severe if the UK undertakes a systematic programme of deregulation, negating the effect of agreements on conformity assessment.

The need to maintain convergence is often downplayed, on the basis on an argument that over 90 percent of the British economy is not involved in exports to the EU. Those firms which trade with the EU will thus conform to EU standards, those which trade with other countries will conform to their standards, and those which trade only domestically can take advantage of more relaxed standards. [32] By this means, it is argued, the UK could be relieved from

[29] *Op cit*. WTO Agreement on Technical Barriers to Trade http://www.wto.org/english/docs_e/legal_e/17-tbt_e.htm
[30] *Ibid* (Article 6.3).
[31] Op cit, http://unctad.org/en/PublicationsLibrary/ditctab20121_en.pdf
[32] Bruges Group, The Single Market and British Withdrawal, February 2011,

a massive regulatory burden and benefit from huge savings in regulatory costs.[33]

However, this goes entirely against the grain of globalisation, where traders and manufacturers prefer working to global rather than national, or even regional standards. In what is described as the "Brussels effect", export-oriented EU firms seek consistent and predictable regulatory frameworks. Multiple regulatory regimes create problems in having to work to different manufacturing standards, and increase inventories. The additional costs involved often outweigh the advantages of working on a local level to a more relaxed regulatory regime.

Thus it is argued that, while uniform regulations have abolished obstacles for doing business within the Single Market - it is more complicated and costly to comply with multiple, sometimes conflicting regulations than with a harmonised regulatory scheme. Once all European firms have incurred the adjustment costs of conforming to common European standards, they have preferred that those standards are institutionalised globally. Hence, to level the playing field and ensure the competitiveness of European firms, EU corporations have sought to export these standards to third countries.[34]

Thus, as trade has globalised, so has regulation. And when it comes to the choice of standard, firms opt for the most demanding, simply because it is cheaper and more efficient to work to a single standard.

This is encouraged by the WTO TBT Agreement and the parallel Agreement on Sanitary and Phytosanitary Measures (the SPS Agreement).[35,36] These require national authorities to replace their own standards with international standards where they exist. They work in parallel with the Vienna and Dresden Agreements, which allow European technical standards, respectively for general products and electrical goods, to be subordinate to standards produced by their global equivalents, the International Standards Organisation (ISO) and the International Electrotechnical Commission (IEC).[37,38]

For the UK to demonstrate continued regulatory convergence, it will need to commit to full conformity with these international agreements, heavily restricting its own independent rule-making capability.

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/278491/Bruges_Group_SingleMarketAndWithdrawal.pdf, accessed 29 May 2014.

[33] Minford, Patrick (2013), Balance of Competences Review – Setting Business Free: Into the Global Economy. Hampden Trust and The Freedom Association, p.12.

[34] http://scholarlycommons.law.northwestern.edu/cgi/viewcontent.cgi?article=1081&context=nulr

[35] http://www.wto.org/english/docs_e/legal_e/17-tbt_e.htm, accessed 29 December 2013.

[36] https://www.wto.org/english/docs_e/legal_e/15-sps.pdf, accessed 9 November 2015

[37] Agreement on technical co-operation between ISO And CEN (Vienna Agreement), http://boss.cen.eu/ref/Vienna_Agreement.pdf, accessed 25 April 2014.

[38] https://www.cenelec.eu/aboutcenelec/whoweare/globalpartners/iec.html, accessed 19 April 2016

However, it is unlikely that the EU will accept informal assurances that conformity is being maintained. While this is the case with the Swiss bilateral agreements, without any provision for Switzerland's automatic adoption of new legislation in areas covered by its agreements, and without any dispute settlement mechanism, the current system is considered to create "legal uncertainty".[39]

As such, the Council of the European Union has dismissed the arrangements as failing to ensure "the necessary homogeneity in the parts of the internal market and of the EU policies in which Switzerland participates".[40] The general and consistent view, therefore, is that the Swiss option is unlikely to be repeated.[41] In any agreement with the UK, the EU is likely to be looking for a dynamic arrangement which can ensure that UK regulation is constantly updated to ensure continued convergence.[42]

In terms of the WTO regime, a two-tier regulatory framework also confronts the spirit if not letter of the WTO agreements on "national treatment".[43] This is the principle of treating foreign and locally produced goods equally. Essentially, regulation that applies to domestic products must also apply to imports, which means that relaxations must apply to both classes of goods and services.

However, for manufacturers servicing a global market, the greater need is for uniform regulation. Taking advantage of reduced standards in any one country is not always possible – any savings being absorbed by the cost of variations in manufacture, and in inventory costs. Therefore, a regime that undermines the international regulatory system can be a form of discrimination against imported products, even if it is not necessarily actionable.[44]

Furthermore, WTO members "must not apply internal taxes or other internal charges, laws, regulations and requirements affecting imported or domestic

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[39] HoC, Foreign Affairs Committee, The future of the European Union: UK Government policy. First Report of Session 2013–14. Volume I, p.76 *et seq*, http://www.publications.parliament.uk/pa/cm201314/cmselect/cmfaff/87/87.pdf, accessed 19 December 2013.

[40] Council conclusions on EU relations with EFTA countries, 3060th GENERAL AFFAIRS Council meeting, Brussels, 14 December 2010. http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/118458.pdf

[41] See also Appendix 4: text of the press release following the Swiss Referendum of 9 February 2014. Note specifically, the reminder that: In the Council Conclusions on relations with EFTA countries of December 2012, Member States reiterated the position already taken in 2008 and 2010 that the present system of "bilateral" agreements had "clearly reached its limits and needs to be reconsidered".

[42] http://www.efta.int/sites/default/files/publications/bulletins/EFTA-Bulletin-2012.pdf

[43] https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm, accessed 26 October 2015.

[44] See, for instance, here: https://www.wto.org/english/res_e/booksp_e/gatt_ai_e/art3_e.pdf, accessed 26 October 2015.

products so as to afford protection to domestic production".[45] If the relaxations in regulations are framed in such a way that only domestic enterprises could take advantage of them, then they could be considered "hidden barriers to trade" and thus become actionable under the WTO disputes procedures.

Conclusions

Drawing together several complex issues, we have confronted the problems that might arise for the UK after leaving the EU, in terms of barriers to trade, and explored the measures the UK might adopt to mitigate their effects.

What emerges is that the global trading system is heavily biased against the single nation trading without the benefit of regional trade agreements. This would be the position of the UK in the immediate aftermath of Brexit if it failed to conclude a satisfactory (or any) exit agreement. Exporters would find that the EU was permitted to discriminate against them, while there is no prospect of retaliatory measures. This has significant implications for the Brexit negotiation strategy, limiting the leverage which the UK can apply.

Much the same applies to tariff barriers, and non-tariff barriers, the latter almost certainly having a more serious effect on EU-UK trade after Brexit. It is likely that the EU's specific requirements on conformity assessment will considerably complicate UK traders' attempts to sell into the Union market, while international rules will prevent any retaliatory action.

Minimising trade barriers, however, raises more than questions to be settled during Brexit negotiations. Maintaining ongoing regulatory convergence is essential, which will require strict adherence to international agreements and the provision of a mechanism to assure our trading partners that convergence is being maintained. This may limit the UK's scope for deregulation.

Overall, in order to minimise barriers to trade, with our EU partners, it will be necessary – at least in the short term – to maintain a close alignment with current Single Market rules, currently and in the immediate future. This would tend further to support the idea that the UK's best interests are served by continued participation in the EEA, for the time being.

Nevertheless, this should not be seen as the final resolution of long-standing issues with global implications. Barriers to trade are as significant at the global level as they are in the European markets, if not more so. Therefore, a longer-term objective might be to look at global solutions rather than to focus on EU relationships. What can be resolved in global forums can also ease trade at regional levels.

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[45] http://www.meti.go.jp/english/report/downloadfiles/gCT0002e.pdf, accessed 26 October 2015.