Why international trade and trade agreements matter

An open international trade and investment system has gone hand in hand with economic growth and offers a means of mutual gain from engagement in trade and investment. Open trade and investment provides a means of promoting economic activity, employment, productivity and knowledge and skills. For the past 40 years the UK has pursued a policy of engagement with world trade and investment through attracting foreign investment (FDI) rather than pursuing national industrial policies. As a result the UK has attracted a large share of inward FDI (second only to the USA in 2013/14) and the UK’s trade dependence (exports and imports of goods and services as a share of GDP) has been on an upward trend to reach 63% in 2012. For mature economies such as the UK an open trade and investment system facilitates engagement with important existing markets, such as the EU and USA, and those with future potential growth, such as emerging markets in Asia.

While industrial policies may be able to shape international competitiveness, the UK was much less successful in these than some other countries in the 1970s and 1980s such as Japan, Korea or Germany, where more consistent and committed support for industry was achieved than in the UK.

International trade and investment is possible without agreements, but there are a number of benefits from agreements that:

- provide the predictability needed for trade investment to take place. The protection of property rights is considered essential for any economic system to function. In the international economic system of the 21st century agreements are needed to provide an equivalent framework for international trade and investment.

- guard against discrimination. The existing multilateral rules preclude for non-discrimination in the shape of the most favoured nation (MFN) and national treatment principles;

- recent trade agreements provide more effective access to markets by a form of positive integration that addresses non-tariff barriers and the trade and investment costs associated with divergent regulatory policies; and

- provide a rules-based system that facilitates trade and investment, while allowing the pursue of legitimate policy objectives (human, animal and plant health, environmental and consumer protection, prudential regulation etc.).

The nature of international markets is such that comprehensive preferential trade and investment agreements now shape trade and investment far beyond tariffs alone. This can be seen as being driven by the desire to ease the trade and investment costs associated with global and/or regional supply chains.
The UK and the WTO

- **the UK is a founding member of the WTO** (from 1995) there is no need to negotiate membership as such, except perhaps of some plurilateral agreements (see below). The UK can benefit from rights and is bound by its obligations under the various agreements of the WTO.

- The UK does however, need to establish its own schedules for tariffs, services and entities covered by the Government Procurement Agreement (GPA). The number of tariff lines that would have to be agreed, if any, on leaving the EU depends on the other WTO members including the EU.

It has been suggested that the UK can simply submit the existing EU CET (Common External Tariff) and a modified GATS (General Agreement on Trade in Services) schedule to the WTO and this would be the basis for trade relations on leaving the EU. This would be sufficient if WTO members are content with this arrangement. It has been suggested (see evidence to House of Lords Select Committee) that the UK would simply table the CET as its own tariff schedule.

There remains a possibility that some WTO members might seek to use the opportunity of the UK leaving the EU to get concessions from the UK and thus better access to the UK market. They may also seek compensation from the EU (for the loss of the UK). Previous reciprocal negotiations were conducted with the EU that included the UK. If this is the case negotiations could take some time and may not start until WTO members know what the relationship between the EU and UK is.

If other WTO members seek to open up negotiations a practical way of dealing with the gap would be for the UK could continue to **trade on the basis of the CET until an agreement is reached.**

Any gap between leaving the EU and agreeing a bilateral relationship with the EU

There are differing views on whether it is possible to negotiate an EU-UK preferential trade agreement (PTA) in parallel with the Art 50 (TFEU) negotiations on the UK exit from the EU. Given good will on both sides parallel negotiations would mean the EU and UK might be ready to conclude an FTA once the UK has left the EU or shortly afterwards. A simple agreement (that covered less issues) might be easier to negotiate.

On leaving the EU it has to be expected that the UK would **leave the customs union.** This means the UK would be **free to negotiate trade agreements** with other countries.

- Leaving the customs union means the **reintroduction of borders**, which in turn means the reintroduction of tariffs, the costs of delays at the border, customs procedures, rules of origin certificates and border controls, such as to ensure imports into the EU comply with EU health and safety requirements. The trade costs of such border measures can range between 5 and 8% of factor gate costs. These could be reduced by trade facilitation measures, but these are likely to take more time to negotiate and implement.
• The average trade weighted, bound tariff facing UK exports of goods to the EU would be 2.9% and that for agricultural products is 22.5%, but there are tariff peaks (40% for animal products, 25% sugar, 14% for textiles and 10% for cars).

• Potentially more significant are the costs of no automatic access to the Single Market. The Single Market means full regulatory mutual recognition. In other words goods and services that are permitted for sale in the UK can be sold throughout the EU market. The UK government has stated it intends to incorporate all EU provisions (the acquis communautaire) into UK law. Leaving the EU raises the expectation of a progressive divergence from these EU provisions on health and safety, environmental protection, consumer safety etc. It will therefore be necessary to manage this process in order to retain the ‘best possible access’ to the Single Market. The costs of complying with such regulatory requirements in the EU has been estimated in the context of the negotiations on the TTIP at an average of 20% for manufactured goods and more for agriculture.

• the WTO rules are largely ineffective against non-tariff barriers or the costs associated with divergent national regulations or standards and would not ensure anything near full access to the Single Market. The EU Single Market is the most effective agreement when it comes to facilitating market access while enabling regulation for legitimate public policy reasons.

The national treatment and MFN provisions of the WTO have proved largely ineffective in dealing with non-tariff and regulatory costs. This is why many countries have reverted to PTAs. **UK exporters would therefore face a considerable competitive disadvantage vis-à-vis their competitors if they had to rely on WTO rules.**

• the GATS agreement of 1995 (even with the two sector annexes in telecommunications and financial services of 1997) codified the existing level of unilateral liberalization of the parties, and does not offer the sort of access offered by the SEM or the other PTAs. UK services suppliers would therefore face a competitive disadvantage vis-à-vis their main competitors under WTO rules;

• the Trade in Services Agreement (TiSA)(a plurilateral agreement) currently under negotiation may offer an opportunity for the UK to match the access for services under the advanced PTAs. But the UK cannot sign or negotiate this agreement while a member of the EU. TiSA has been criticized as undermining multilateralism.

**Tariff rate quotas**

• it has been suggested that the EU and UK could divide the tariff rate quotas proportionately on the basis of the UK’s share of total EU GDP. The EU is likely to seek to retain as much of the existing EU export quotas as possible and as small a share of the import quotas as possible.

The UK may argue that it has a legal right to a proportionate share of the export quotas, but this will form part of the general Brexit negotiations. If the UK wishes to progress negotiations on a PTA with the EU it may have to make concessions.
WTO members with quotas for exports to the EU, such as for agricultural products, may be interested in using the opportunity to increase their quotas, if the UK wishes to smooth the adoption of its schedules in the WTO it may have to make concessions to these exporting countries.

It should be recalled than many of the tariff quotas have not been fulfilled.

Agricultural subsidies

- The Agreement on Agriculture under the WTO sets ceilings for agricultural support based on an aggregate measure of support. In recent years the reform of the CAP has meant the EU has been within the existing ceilings.

- The most logical approach to subsidies would be for the UK to assume a share of the ceiling that matches current subsidies paid to UK agriculture. The main negotiation may be with the EU, as some EU Member States are likely to argue for the retention of the whole ‘allowance’ for the EU.

The greatest growth in agricultural support/subsidies in the WTO has been in the emerging economies that now match the EU in terms of subsidies as a share in production costs. These countries are reaching the existing ceilings under the AoA, so any precedent to increase EU/UK ceilings would be opposed.

State Aid

- WTO rules on state subsidies are considerably weaker than those in the EU.

State subsidies that are provided on a selective basis to specific firms or sectors are prohibited under the Subsidies and Countervailing Duty Agreement of the WTO. If such a subsidy is provided the importing WTO member can apply countervailing duties on the subsidized imports, but only after they have shown that subsidies have been provided and that these have resulted in injury to the industry in the importing country.

- the EU rules on subsidies are more effective in limiting subsidies that distort competition. Subsidies that promote research and development or regional development and other horizontal measures are permitted under EU policy.

Procurement rules

- there is a plurilateral Government Procurement Agreement under the WTO that has been signed by OECD countries and a (very few) developing countries.

The WTO rules provide for transparency (of laws, implementing regulations, contract award procedures and calls for tender). These apply to all members and are also the general norm in all PTAs currently being negotiated.

The GPA has a schedule of covered entities that like tariffs and other liberalization measures is based on reciprocity. The UK has a schedule of covered entities as part of the EU schedule.
The UK did not sign the most recent revision of the GPA so there has been some discussion as to whether the UK would need to negotiate membership. Other signatories to the GPA may wish to renegotiate coverage because the EU market will be smaller (the UK accounts for 25% of the EU procurement market). These countries may also offer the UK a reduced coverage to correspond to the smaller size of the UK procurement market compared to that of the EU. Again this will depend very much on the position adopted by the other signatories to the GPA.

A third element in the GPA (which is also included in the EU procurement provisions) is bid challenge in cases of alleged discrimination in favour of a local supplier that is prohibited by the rules.

It should be recalled that national entities can procure from abroad or which ever company they wish without any rules. The rules oblige them to offer national treatment.

**Dispute settlement**

- the WTO has state-state dispute settlement, there are independent panels and the possibility of review by a quasi judicial Appellate Body.

WTO dispute settlement has been seen as a success and has helped contain protectionist measures. The parties are expected to seek an agreed solution before a formal panel procedure is initiated. Losing parties can appeal. Enforcement is by means of ‘compensation’ meaning adjudicated retaliation in the form of restrictions to trade.

WTO dispute settlement is however slow. Protectionist measures, or measure that are inconsistent with WTO rules, can remain in place for some years before the Panel has reported and any appeal has been heard. This may be relevant if the UK schedules were for example challenged.

More important than formal dispute settlement however, are the many specialist committees and peer review mechanisms that implement both multilateral and preferential trade and investment agreements. Without consistent work in these agreements would amount to little more than the paper they are written on.

**A free trade model**

- a unilateral free trade policy would reduce costs for UK consumers. It would also reduce input costs for some UK producers and suppliers. But it would mean the UK would give up the negotiating coinage it will need to negotiate PTAs and gain access to markets such as those of the emerging powers (India, China, etc.) on tariffs. The nature of international trade and investment means that access is also needed to other markets.

The UK pursued a policy of unilateral free trade in the 19th century (until 1932), which even then was not followed by others. The international trade and investment system has, since the US Reciprocal Trade Agreements Act of 1934, been firmly based on
reciprocity and shows no signs of changing, least of all in countries such as China and India.

While a unilateral free trade policy would mean the UK will be able to continue to trade and invest, it will be a competitive disadvantage compared to its current international competitors in the OECD and risks being excluded from those markets where most growth is occurring namely China and the other emerging markets.

In terms of non-tariff and regulatory barriers to trade and investment it is unclear what unilateral free trade would mean. If it means reducing costs through deregulation it would be important to know which health, safety, employment, environmental, consumer or prudential regulations will be affected. Deregulation is likely to make it difficult if not impossible to reach equivalence or mutual recognition agreements with the EU and other major markets.

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