

# Playing the game without a say in the rules: how Britain would trade outside the EU

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*Pro-Brexit campaigners are keen to cut tariffs. But tariffs only play a small role in international trade, says **Steve Woolcock**. Much more costly are the non-tariff barriers, such as border controls, customs and food standards and regulations, and these are shaped by preferential agreements such as the EU's single market or TTIP. Were Britain to leave the EU, it would still have to obey the regulations of its trading partners – which are very unlikely to abandon them as a result of Brexit – and would no longer have a say in drawing them up.*



Trade and investment policy has featured as one of the central issues in the Brexit debate. But some of the contributions do not always seem to recognise the nature of today's international trade and investment system. This is shaped not by 'free trade' or multilateral agreements such as the WTO, but by preferential agreements between the 'big beasts' (the EU, USA, Japan, China) of the trading system. These preferential agreements are primarily designed to facilitate trade and investment by reducing the trade costs associated with non-tariff measures, such as standards and regulations, and border controls and customs procedures.



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In the Brexit debate there continues to be reference to tariffs, but these play only a small and diminishing role in trade, except in relation to some emerging markets, such as India and Brazil. Average bound tariffs across the developed OECD economies are about 3%. In comparison the trade costs associated with non-tariff barriers are in the order of 20%. This is the figure for the USA. In other words the costs of compliance with regulatory requirements and standards in the US market are equivalent to a 20% tariff. The figure can be higher, such as in transport equipment (23%) or much higher as in food products (60%) or lower as in electrical goods (16%). The equivalent figures for the EU are about the about the same. The normal precaution in terms of the difficulties measuring such barriers should be taken, but there is little doubt that trade costs associated with non-tariff barriers are far more important than tariffs.

The aim of trade agreements is to reduce these trade costs, while ensuring that the legitimate public policy objectives pursued by regulation are safeguarded. This is more challenging than removing barriers at the border, such as tariffs, so it is more easily pursued in preferential agreements. In this the EU is further advanced than the rest of the world. EU 'regulations' are therefore about facilitating trade and investment and reducing trade costs, not restricting it or increasing costs. Nor is the EU becoming a regulatory super state, but simply one example of policies that are being pursued by all economies through preferential agreements such as the Transpacific Partnership (TPP) or the Transatlantic Trade and Investment Partnership (TTIP) and many others. It has been estimated that 80% or more of the economic benefits of TTIP will come from reducing addressing non-tariff barriers.

Another feature of the trading system is that, for better or worse, production and investment are increasingly global and set to become more so with e-commerce opening up international markets for smaller companies supplying products and services. To remain competitive in such markets the trade costs associated with non-tariff barriers are important.

## **The implications of a Brexit**

### **Higher trade costs**

The question for the UK outside the EU is therefore not so much about tariffs. The UK is a member of the World Trade Organisation (WTO) so the EU and other WTO members are bound to the existing (most favoured nation – MFN) tariff rates. If the UK were not part of the EU customs union it would therefore face an average tariff exporting to the EU of about 3%. Tariffs in a few sectors would be higher and perhaps much higher.

The main difficulty with Brexit is with the non-tariff barriers. If – as has been suggested – the UK opted out of the Single European Market, UK based companies would have no guaranteed access to the EU market and could face barriers equivalent to an average of 20%. This would not happen 'overnight', but if the UK keeps the same standards and regulations it has today there would be no trade rationale for leaving the EU or the Single Market.

One immediate cost would be the costs of border controls. These include customs clearance, border checks (for example to ensure that food products do indeed comply with EU standards), and rules of origin costs (to prove that the goods entering the EU from the UK are UK goods and not transshipments from China or elsewhere). These costs can easily amount to 5% of factory gate prices. The reduction of these costs was of course one reason for creating the single market in the first place.

Companies based in the UK would face similar trade costs in the USA and other major markets. If the UK were outside the EU, companies based in the UK would not benefit from reductions in these costs resulting from the TTIP and other EU preferential agreements. With global markets and global supply chains companies can switch investment and activity between locations easier than in the past. In order to remain competitive firms will therefore, over time, move investment to locations that benefit from lower trade costs.

### **More of a rule taker than rule maker**

The aim of trade and investment agreements is to reduce the trade costs associated with non-tariff measures and border controls etc. These agreements shape the rules, or the international 'regulations' designed to facilitate trade. This is no easy task and it takes time and effort. Hence the detail and complexity of recent preferential trade agreements.

An explicit aim of the recent preferential initiatives, such as TPP, TTIP and other, is to shape international trade and investment rules, in other words the 'regulations' for international trade and investment. Outside the EU, the UK would therefore be excluded from the fora that are currently shaping the rules of trade, but would be obliged to follow the standards and norms adopted if it wished to ensure that companies based in the UK could, in the long term, compete effectively in the global economy and global supply chains.

## The ability to negotiate its own trade agreements

One of the benefits of leaving the EU is seen to be freeing the UK to negotiate its own agreements more quickly than the EU. This may be possible, but depends on the UK's trading partners being ready to negotiate and on the UK having the capacity to do so. The EU has over 40 preferential agreements and is negotiating with the USA, Japan, India, Australia and New Zealand, Brazil and China (on investment) and others. The position of current US administration suggests that all the UK's trading partners may not be rushing to the negotiating table.

The historical evidence suggests that small countries, such as the EFTA countries, can negotiate agreements quicker than the EU, but generally at the expense of good agreements. For example, EFTA negotiated a free trade agreement with Canada before the EU did, but this was a much shallower agreement. In other words it was mostly about tariffs and did not address many of non-tariff measures that the later EU–Canada agreement does. Nor did the EFTA–Canada agreement do anything to modernise investment policy, in which the EU–Canada agreement has provided a lead.

It is worth stressing that all significant progress in trade and investment negotiations since 1994 has come through preferential trade agreements. To stand aside from these agreements – as has been suggested by some proponents of Brexit – therefore means that UK exporters would be trading largely on the basis of WTO rules that are now 20 years old and date from the end of the Uruguay Round of the GATT.

### A 'free trade' agenda?

Outside the EU the UK would be free to pursue a free trade agenda. It could reduce tariffs further, a modest advance. But unilateral liberalisation is very unlikely to be reciprocated by other countries. The current trading system, unlike that of the 19th century when the UK had more influence, is based firmly on reciprocal market access. A free trade agenda that means reducing non-tariff barriers would threaten to undermine health and safety, food safety, environmental protection and undermine social and labour market policies. Even if there were political support for such a policy in the UK, which seems unlikely and for most people undesirable, the UK's trading partners are not about to reduce their 'regulations'.

*This post represents the views of the author and not those of the BrexitVote blog, nor the LSE.*

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