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BREXIT: TALKING TRADE

AN INTERVIEW WITH A DIRECTOR OF THE UK TRADE POLICY PROJECT – DAVID HENIG

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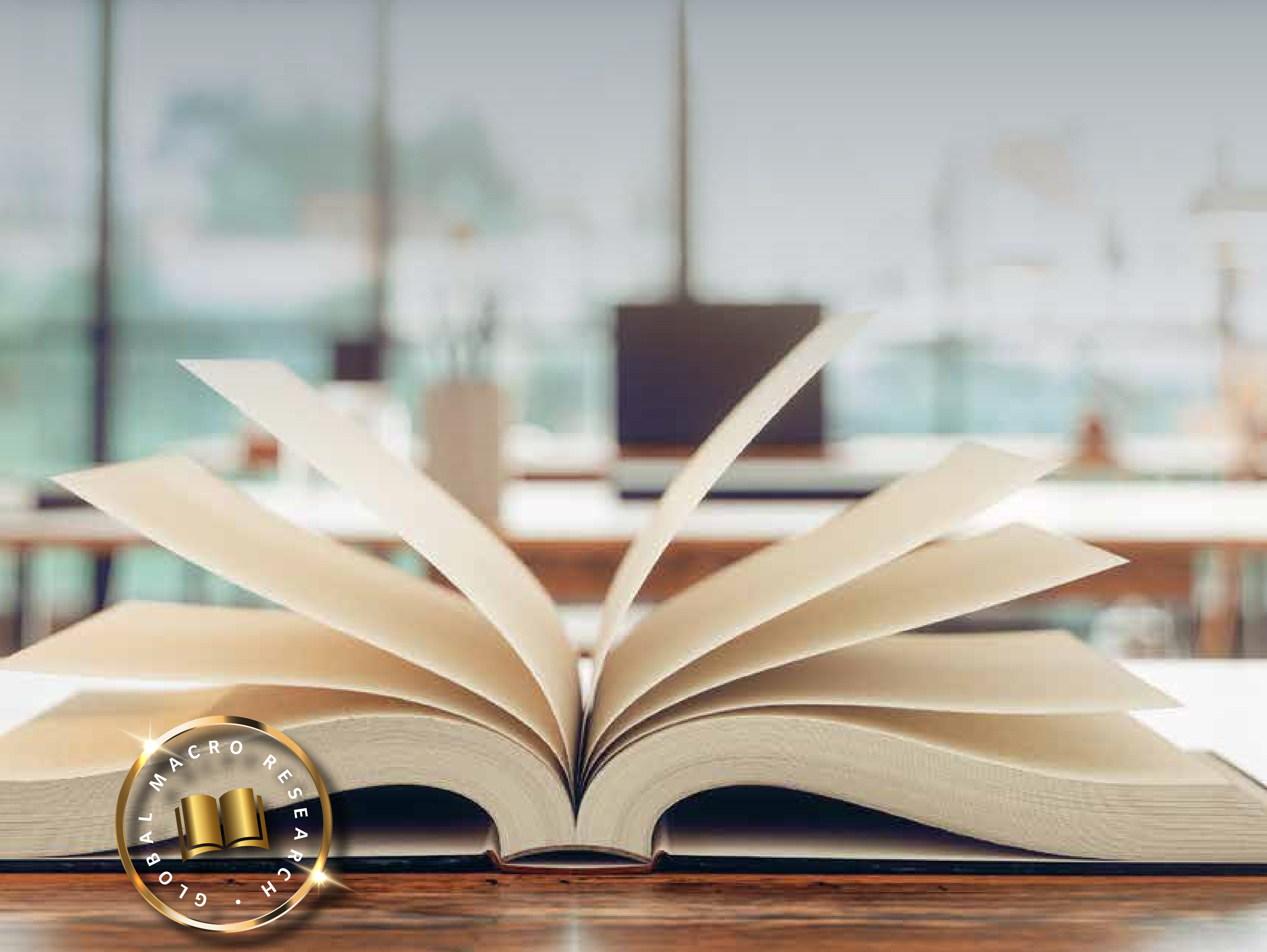

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DAVID HENIG

David Henig is Director of the UK Trade Policy Project. A leading expert on the development of UK Trade Policy post Brexit, in 2017 he co-founded the UK Trade Forum, which brings together UK trade policy experts to debate and analyze these issues.

He joined the European Centre for International Political Economy (ECIPE) in 2018, having worked on trade and investment issues for the UK government for a number of years. He was heavily engaged on the Transatlantic Trade and Investment Partnership (TTIP) throughout the three and a half years of negotiations, working with both sets of negotiators to develop ways forward, particularly on regulatory coherence, technical barriers to trade (TBT), and sustainable development. He also travelled extensively through the EU making the case for TTIP with Member State Governments and stakeholders. After the UK referendum vote, he helped establish the new Department for International Trade, engaging in many of the UK's first working groups with non-EU countries, and setting out options for engagement with the US. Prior to TTIP, he was involved with investment policy, the Organization for Economic Co-operation and Development (OECD) and international rules-based system, and business policy towards China.

David started his career before government in consulting and business development, having graduated from Oxford University. He is bringing all of this experience together in a project examining and evaluating the UK's performance in preparing for and delivering effective trade policy.

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Against a backdrop of trade disputes and uncertainty around how the future rules for global trade will evolve, the UK is about to forge a new path in the world, with its own independent trade policy. Gareth Colesmith, Head of our Global Macro Research Group, speaks to David Henig, international trade expert, to discuss the choices and potential pitfalls the UK may face as it embarks upon this journey.

SECTION 1: PREPARATIONS AND PRACTICALITIES OF A NO-DEAL BREXIT

TRADING ON WORLD TRADE ORGANIZATION (WTO) RULES

GARETH: Let's start by focusing on no-deal, as that is the scenario that potentially has the greatest impact in the short term. We hear a lot of discussion about the UK moving to trade on WTO rules in a no-deal scenario, but something that is rarely discussed are the problems that the WTO itself is facing. There is considerable pressure being put on the WTO from the US administration, which is, amongst other things, blocking the appointment of judges to the Dispute Resolution Board. What are your thoughts on the future of the WTO and is this really a stable platform for the UK to use as a base for trade until it signs more free trade agreements?

DAVID: That is definitely a concern and the WTO is in quite a worrying place at the moment. There are three arms of the WTO: there are the basic rules for trade; the ongoing negotiations; and the appeals body. The appeals body is in trouble, with the US blocking the appointment of judges. No new negotiations have happened at a multi-lateral level since the Doha round[1] was declared dead a few years ago.

So the biggest problem now is around the core rules. There is speculation that the US-Japan trade deal that has been negotiated is not in line with WTO rules as it doesn't cover enough of the trade undertaken between the two countries to be considered a preferential trade deal. The US has also threatened WTO 'most favored nation' status where a country imposes tariffs on all WTO countries at the same rate unless reduced in a preferential agreement. Once these basic rules start to break down and countries start to flout the rules with impunity then clearly it raises questions about the stability of the whole platform.

I don't think the WTO will collapse; there are too many countries that have an interest in it continuing, including China, the EU and many mid-tier countries such as Canada. But the UK will want to get a set of free trade agreements in place as soon as possible in case there are problems with the WTO in the future.

FREE TRADE AGREEMENTS – PRIORITIES AND PRACTICALITIES

GARETH: Is it realistic to expect these negotiations to be done quickly? Free trade agreements normally take quite a long time to negotiate – can they be accelerated?

DAVID: It will take time – and they will need to have a clear idea of what they want to achieve, but I see no reason why most UK trade agreements should take longer than a couple of years, particularly for trade with other mid-tier countries. Most of them won't be terribly controversial, except for maybe a deal with the US.

GARETH: If we do see no-deal, the EU has announced a series of temporary mitigation measures in certain sectors in order to keep planes flying, to allow trucks to still carry goods and for financial services to continue functioning. These measures have varying timeframes, lasting between 6 months and 2 years. Do they make a difference and is it possible that they get extended further?

DAVID: To answer the second part of that question first – can they get extended further? I'm sure they could.

In terms of the impact, this is pretty basic stuff in terms of air and freight transport. It won't stop passport queues and customs checks, but it will stop the UK being completely cut off. Financial services are more substantial. This is an area where the UK does have power over the EU in talks, as the EU doesn't have a clear answer as to what it is going to do on that front. I think the EU would struggle to stop co-operating on financial services anytime soon because of the relative size of the UK versus EU markets. That is obviously a very important area for UK GDP, so it makes a difference to the UK.

[1] The Doha Development Round or Doha Development Agenda was a round of trade negotiations that started in November 2001 with the objective of reducing trade barriers globally and to reform global trade. These negotiations broke down in 2008 and attempts to revive talks have repeatedly failed.

GARETH: Once it leaves the EU, the UK would obviously lose a number of free trade agreements that it currently has with other countries via its EU membership. We've negotiated standstill/status quo agreements with 44 countries, but there are another 71 countries representing around a quarter of UK exports where we haven't negotiated standstill agreements yet. Is that going to have a big impact as we fall back onto WTO rules for trade with those countries?

DAVID: For my own analysis, I've focused on 24 trading partners with whom we trade more than £10bn per annum (combined imports plus exports). We currently have preferential arrangements with 16 of those countries (including 10 EU countries) and 15 of those 16 would be affected by a no-deal Brexit and face trade disruption. That number includes Norway and Switzerland, as although we have carried over deals, they are very limited – by no means the full-trade relationship. South Korea is the only country unaffected.

Of those 15, Canada and Japan are both countries that have only recently agreed free trade agreements, so there will probably not be a significant impact from switching back to WTO terms for those two countries.

Apart from losing preferential access to the EU, another major impact is going to come from the EU neighborhood agreements, so countries like Ukraine and countries in North Africa. Turkey is another major deal that we would lose and which we can't roll over because Turkey is in a customs union with the EU. The agreements that we have agreed to roll over are largely small countries in places like Central and South America which are not particularly economically significant.

GARETH: So is a deal with the EU is in some ways a prerequisite to a deal with some of these other countries?

DAVID: If we take the Ukraine agreement as an example. There is a lot of regulatory alignment between the EU and Ukraine. If the UK doesn't have a deal with the EU and doesn't want to agree to that regulatory alignment, it's going to take a lot longer to replicate a deal with Ukraine. Turkey we can't replicate at all. Then there are some countries that we simply aren't on good terms with , or don't like the original EU agreements – Algeria and Egypt are two examples.

So there is quite a big program to achieve everything the UK will need, but ultimately it is going to be the European deals that have the greatest economic cost.

GARETH: Can these negotiations happen in parallel? Can we do them all at the same time or does it have to be sequential in terms of negotiating bandwidth?

DAVID: A very careful choice will be needed of where to allocate resources. So if we start doing a deal with the US and Japan, and at the same time try to arrange agreements with Australia and New Zealand, that's probably all the bandwidth gone. It's not actually down to numbers of negotiators; you can hire as many negotiators as you want. It is actually the cross-government processes in the agreements and the size of teams within domestic departments. Those teams are probably going to struggle with doing more than two or three trade agreements at one time.

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SECTION 2:
THE IRISH BORDER AND THE CLIFF EDGE

THE IRISH BORDER

GARETH: If we shift focus to the UK's efforts to agree a deal: current UK policy is obviously focused on trying to negotiate the withdrawal agreement with the Irish backstop stripped out. The EU seems adamant that it can't be removed or that we need to replace it with something that is equivalent. Do you think that this is going to get resolved? Is an infrastructure-free border possible in reality?

DAVID: That is going to be very difficult. In reality, there isn't one outside of the EU. I would say that there are three things that a border does: it handles people; it handles different goods regulations; and it handles VAT and customs (the money-raising part).

At the moment, people can move freely via the common travel area between the UK and the Republic of Ireland, and that will remain, so won't be a problem. Regulations are dealt with via the single market and in the Irish backstop in the withdrawal agreement by Northern Ireland maintaining those regulations.

Then you've got the customs issue, which is currently dealt with by a customs union between the UK and the EU.

If you take out the backstop and the customs union, keeping the current situation without a border is phenomenally complicated. A border is the only place where the goods, the drivers and the paperwork all come together. Once you move away from having a border, you either need to have pretty much identical systems on both sides, as currently happens, or you need to have lots of measures in place to keep declarations away from the border. The problem is that it requires a lot of surveillance, which is politically sensitive in Ireland.

There is also a lack of trust between the Republic of Ireland, the EU and the UK regarding solutions. Some kind of guarantee could work while everyone works on the specifics, but that is not a cost the UK seems prepared to accept. That leaves me pessimistic that the joint efforts that would be required to make this a success can occur. Even if they did, I could easily imagine it taking ten years to agree a solution to such a difficult problem.

GARETH: Ten years is a long time, particularly given the deadline is the end of October. In practice then, what happens in Ireland? The EU needs them to maintain the integrity of the single market, so do we see border controls imposed, or do you expect the border to shift to a less politically sensitive place like the Irish sea?

DAVID: I think we'll see a light-touch approach from both sides. So the Irish will put up some border posts, but inside Ireland where they will start to ask lorries and vans to check in and do light-touch checks. The UK are suggesting that they will accept an open border, but I think in practice the UK will start making more checks at Irish sea ports, but just won't say that is what they are doing. So, in practice, we will shift towards a Northern Ireland specific solution but it may take a lot of confusion before we get to that point.

UK MITIGATION EFFORTS AND PLANNING

GARETH: Looking at some of the mitigation announcements the UK has made recently, there is an £8m project to establish a number of pop-up customs advice centers and things to try and reduce delays. There are also plans to park lorries in different parts of Kent, if necessary. Are these things going to make a significant difference or is this just public relations?

DAVID: For most of our goods, the import and export is managed by large organizations, and large organizations will generally get themselves well organized, so I'm in two minds as to the real impact of these measures. There will definitely be queues, as even two minute checks would generate them, but if sufficient measures are in place it could make the difference between three hour queues and three day queues. I do genuinely see a lot of activity going on in government departments to raise awareness. This could turn out to be crucial for the key Dover-Calais port route and may mean that any transition to having to have checks will not be as bad as it might have been.

GARETH: So do you see Operation Yellowhammer – the leaks that were released – are they genuinely a worst-case scenario rather than a base case?

DAVID: I think they are what they say they are – they are planning assumptions. I'm sure that there are many other documents that actually tell them what the worst case scenario is, as there are many things that aren't covered. For example, we don't know what happens if there are announcements from manufacturers that they are ceasing production. We don't know what happens if there is a much bigger slide in sterling, or what happens if a large number of UK citizens living in Europe return to the UK. Presumably one reason behind the announcement that healthcare will be paid for another six months is to mitigate against that. The scenarios the Bank of England released a few months ago provided a real worst case scenario for what might happen, which was a contraction of up to 8% of GDP in one year. They've revised that back to 5.5% now, but that would still be a heavy hit in one year.

GARETH: Does that impact – on whatever scale – only happen in a no-deal scenario? Or does the resolution of a deal to pass the withdrawal agreement simply shift the impact to the end of 2020 when the transition period comes to an end? The transition period could obviously be extended, but you are then into an EU funding cycle with a whole set of extra questions there.

DAVID: I think that once there is a deal, there carries on being a deal. If there was a deal, given that trade talks take so long to reach conclusion, I find it impossible to say that after 14 months they would just give up and go straight into the backstop for example, if there was a backstop there. So I think it can be extended and delayed. So deal or no-deal now is the clear decision point. I think that if there is a deal now, you don't face such abrupt decision points in the future and things become easier. This is the cliff edge, not later.

SECTION 3:
THE LONGER-TERM JOURNEY

THE IMPORTANCE OF PRODUCT STANDARDS AND TECHNICAL DETAIL

GARETH: Thinking about some of the longer-term issues, in terms of the product, labor and environmental standards that we are currently signed up to as part of the EU, the UK government is talking about potentially lowering some of those standards to get a trade benefit. Is the concept of Singapore-on-Thames a realistic goal?

DAVID: I struggle with it as any developed market governments find it difficult to deregulate. The concept is also predicated on the idea that deregulation is good for economics and that is what businesses are pushing for. This isn't necessarily the case. It's important to consider all of the environmental talk at the moment, for example, with the UN general assembly and the protests around that. So it's very hard to see the UK deregulating environmental standards in the current environment. Perhaps they could do a little bit on labor, but the UK already has a pretty deregulated labor market.

Then there is the difficulty it would cause for trade agreements, as you have to sign up to level playing-field commitments, especially in large deals with the US or with the EU. Companies that export to the EU are also going to want to keep product standards as closely aligned as possible – the Brussels effect. The one area where we could see change is perhaps moving towards the US in terms of food standards. Given all of this, I don't see the Singapore model as a realistic one.

GARETH: In terms of the product standards, there are some countries that have managed to reach free trade agreements both with the EU and the US – Canada for example. Is that model something that is realistic for the UK, where you ultimately end up with a clear free trade agreement with both? The UK would have its own product standards for its domestic market, but exports only need to meet the product standards of the countries that are being exported to?

DAVID: That is increasingly tricky, as the US and EU now compete in one or two areas. Geographical indications[2] for food would be one example; something the EU insists upon and the US insists against. On industrial standards, the EU's model is that they have a single standard and the US model is that they have multiple standards, and again, the two don't quite fit together. Until recently, that wasn't so much of a problem; it could be overcome because the US weren't quite so insistent on pushing back on some of these issues. The EU is also likely to demand greater alignment from the UK because we are in the neighborhood with their regulations and that could make a UK-US trade deal very difficult.

GARETH: Ok, so this is the whole issue around Melton Mowbray pork pies in that you either have protection for that product within the EU or you don't, and anyone can create their own version of a Melton Mowbray pork pie.

DAVID: Yes, that's a geographical indication that is protected within the EU. But it's also chlorinated chickens coming in from the US to the UK, which is currently not allowed in the EU. It is hormone-treated beef. The standards side is a slightly obscure area of trade policy – but essentially the US and EU have conflicting models of standardization. If the UK still wants to be in the European standardization model, because of course it's not just the EU that is within that model, then a US trade deal would be difficult alongside that.

[2] A geographical indication is a distinctive sign used to identify a product to link its quality, reputation or other characteristics to its geographical origin.

GARETH: So coming back to the Irish border, if you do have this type of product coming into the UK, then you do need checks on the Irish border, or indeed any other border between the UK and the EU, to ensure that these products don't get into the EU.

DAVID: Yes, and that is one reason the Irish government have been lobbying quite strongly in the US to highlight the potential problems that a US trade deal could create for the Irish border. That is why we have seen the Speaker of the House, Nancy Pelosi, and other political figures in the US making comments about the Irish border.

One point to note is that Trump does not regard trade deals in the same way as other politicians. A trade deal does not have to be a full trade deal. He could claim a great trade deal that doesn't cover any of these things and is in fact completely different. There has been a lot of debate in the UK regarding the introduction of a digital tax, for example, impacting US technology companies. If Trump were able to strike an agreement that covered issues such as that then he could claim that was a great deal. So although a standard trade deal with the US may prove difficult, a non-standard one could be easier.

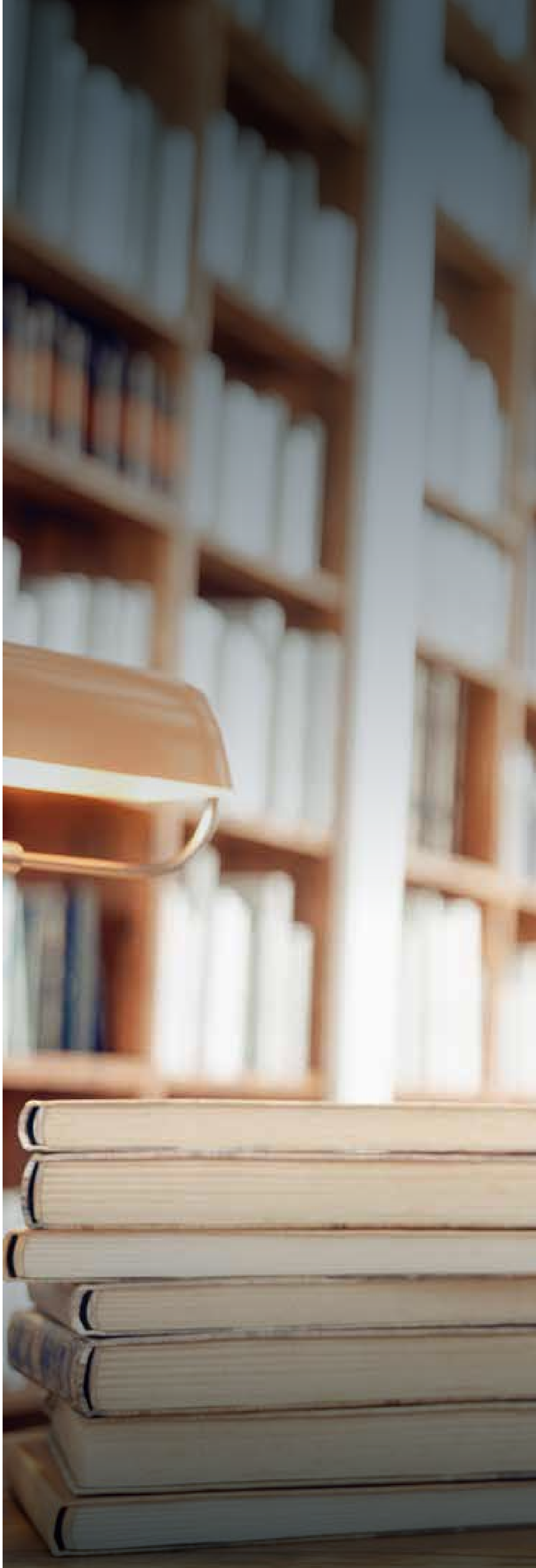
GARETH: Do you see much chance of the EU striking its own trade deal with the US, which would presumably then make a UK deal easier?

DAVID: Unfortunately, at the moment I don't. The politics just isn't right and there isn't the political will anymore to make that happen. But regulatory talks are still ongoing and making little bits of progress. Traditionally, we see a big push for a US-EU trade deal every 20 years and I fear we won't see another one for another 10 years.

GARETH: Assuming that the Conservatives continue in power in the UK, and it reaches a point where they have to choose between a trade deal with the EU or the US, which do you think they would choose?

DAVID: I think they would definitely choose the US deal; I'm just not convinced that they would be able to pass it.

One problem the UK is going to face is simply time. The Trade Promotion Authority legislation in the US that allows the President to expedite trade agreements runs out on 1 July 2021, and after that it's likely impossible to do a deal until they put in place new legislation, which will take time. If the UK remains in the EU into 2020, which seems likely, we're just going to run out of time realistically for a US trade deal to happen.



A BROADER VIEW OF THE POLITICS OF TRADE

GARETH: Looking beyond goods, are financial services and other service sectors that the UK has a strong position in something that could be included in future deals with either the US or the EU?

DAVID: You could argue that the US market is already relatively open for financial services companies, with the exception of insurance. Insurance is mostly an issue handled at state level, or the regulations are handled at state level, and that is nothing that a trade deal is going to change. What the UK may want is financial services regulatory dialogue. That may not be something that the US department of trade would be able to give them, but the US Treasury may.

But the same is true for the EU, many of the financial regulations and equivalence regimes actually kick in at a member-state level rather than being EU wide. If you don't get financial passporting you fall back to individual country regulations. I would have thought that, for their own interests, the EU will want a financial services dialogue, and so we will probably be able to get that relatively quickly. Those dialogues don't require a full deal. The size of our financial services sector means that others are going to want to deal with us. But financial services is probably the only area where that is the case.

GARETH: Thinking further afield, let's discuss how Brexit affects trade relations globally. Obviously, the UK has been one of the countries that has really driven the single market within the EU and the push for free trade and free-trade agreements outside of the EU. How do you see future EU trade policy evolving after Brexit?

DAVID: I actually think this is one of the biggest impacts of Brexit. The UK has, as you say, been a large member, strongly pushing for free trade agreements, pushing for continued deepening of the single market. Without the UK, there is no large member state that is going to consistently push that line. Germany tends to be cautious and France tends to have a more defensive view on both of those issues. It will be harder for the smaller, more pro-trade countries like Sweden or the Netherlands to push this agenda.

GARETH: You don't see them banding together in this new Hanseatic League?

DAVID: Historically, smaller member states have always felt they need to choose their battles very carefully and I think that will continue to be the case. This grouping will give them some opportunities to do more, but it's still very different than being a large member state, which tend to speak up whenever they like.

I think what we are more likely to see is the European Commission focusing on enforcing existing trade agreements – a more muscular trade policy than we've seen before. Europe first, which is kind of the opposite message to the one the UK used to send, so the agenda will likely slow down. It is possible that they will get agreements with New Zealand and Australia. It is possible but far from certain that the Mercosur agreement (between the EU and South America) is ratified. The Singapore and Vietnam agreements that have already been completed should be ratified and implemented. But there won't be any further significant push forward on deepening the single market or pushing forward on trade liberalization.

GARETH: President Trump has been quite a vocal critic of the Europeans and the EU in particular, but is focusing for the moment on China. Do you think there is a reasonable risk that he does at some point shift his gaze to the EU? Would the UK be able to sidestep that assuming that we've left by that point?

DAVID: I don't think anyone should feel safe from President Trump's activities. Mexico negotiated the USCMA with him, but that didn't stop him threatening further tariffs. The EU certainly don't feel safe; the Boeing-Airbus dispute is likely to lead to the US imposing a lot of retaliatory tariffs against the EU and we're not quite sure what that means for the UK, even under no-deal. I doubt that we will be unaffected by it. Then there are still threats to the car industry of tariffs, and steel and aluminum tariffs in place. Everyone is trying to navigate around Trump's actions and essentially hope to survive it without major impact.

One point that could be in the EU's favor is the upcoming US election. There is relatively broad support in the US for taking action against China, but I suspect that there isn't such broad support for taking action against the EU. That will matter for Trump in the run up to an election.

GARETH: Yes, the bipartisan support for taking action against China is evident and that's been the case for some time – Obama was trying to contain China with the TTIP proposals – it's merely a difference in method. Do you see that the US-China struggle for supremacy as what matters most for the world? Do we see a breakup of the world into different trading blocs ultimately?

DAVID: To a degree, the regions are already phenomenally important.

I think the real problem with the US-China situation is that no one quite knows how it comes to any sort of resolution. China clearly does do some of the things that it is accused of, but they would argue that others stretch the system as well. I think the worry is that this is just going to drag on. If Trump remains in office, it drags on as a really high profile issue with lots of things happening. If someone else is in office, it is perhaps less dramatic but the tension is still there; it doesn't go away.

So China-US tensions are likely going to be a drag on trade growth and investment for some years to come, until we work out how the system can evolve and we're still some way away from that.

GARETH: A very unsettled environment to be experimenting with independent trade policy for the UK, I guess.

DAVID: It's an uncomfortable environment for anyone undertaking long-term investment. There is a backlash against globalization, and Trump, Brexit and some of the events in Europe are all linked to that. But under the surface, globalization continues on new fronts. All of the large countries are arguing about old issues, but there is the rise of services, the rise of data and the fact that we don't really have rules and regulations around any of these issues. There is definitely an opportunity, as well as a risk.

GARETH: So the UK does have an opportunity given its strengths in data, services and financial technology, but it isn't linked to Brexit, it is linked to the changing nature of globalization?

DAVID: Data could benefit from Brexit, the UK is clearly more relaxed on data protection and on data flows than the EU and Germany. I wonder if the optimum strategy for the UK is not to be too hung up on goods, but to be really aggressive on services. To find deals where countries are prepared to remove services barriers, because it seems to me that's where the UK is valued around the world – as a leading provider of services. That is a growth area. So, could we make ourselves a leader in things like autonomous vehicles and data within cars, putting in place a sensible regulatory framework that other countries will then want to replicate?

Then there could be more trade with emerging economies that have huge tech savvy populations like Indonesia or Mexico. No one seems to be prioritizing sectoral opportunities at the moment. When we go back to the referendum, people were talking about deals with emerging economies; they were talking about the UK as a service economy, not like Europe. It seems like we have lost that narrative and it now feels we are looking backwards. We need to get back to a forward-looking narrative.

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