



## Alternative Trading Models After Brexit

The economic impact arising from Brexit will depend, in large part, upon the successful formation of new trading relationships with both the EU and the rest of the world. Whilst the Article 50 process has been completed, and the UK formally withdrawn from the EU, the future relationship has yet to be determined. The political declaration, contained in the withdrawal agreement, indicates the preferred direction of travel. However, until an agreement has been agreed and ratified by all parties, a wide range of potential Brexit options remain viable alternatives. Each of these has its own relative merits and drawbacks. Furthermore, each option will have a significant effect upon the ability of the UK to negotiate trade agreements with other nations and trading blocks and, moreover, will either facilitate or constrain policy solutions to many domestic economic challenges. This chapter, therefore, will seek to outline the range of alternative trading models that could be utilised, together with their likely consequences for the UK economy.

### ALTERNATIVE TRADE ARRANGEMENTS

There have been various alternative trading models which have been advanced in the literature as the basis for UK-EU future economic relations. These include:

1. Membership of the European Economic Area (the Norway model) or, alternatively, a variant of the EEA designated by advocates as 'SIM-lite'
2. Customs union with the EU (the Turkey model)
3. Norway-plus or customs union II
4. Bilateral agreements with the EU (the Swiss model)
5. Concluding an FTA with the EU (the Canadian or South Korean model)
6. Reliance upon World Trade Organization (WTO) rules for trade with the EU (the WTO or Greenland model)
7. Unilateral free trade (the Hong Kong model)

In addition, a number of alternative trade arrangements have been suggested for an independent UK to pursue, including:

1. European Free Trade Association (EFTA)
2. The Commonwealth
3. The Anglosphere
4. Joining the North American Free Trade Agreement (NAFTA)
5. Reviving the proposed Trans-Pacific Partnership (TPP) or joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)

When examining the various options for the UK's future trade relationships, it is important to be clear about the terminology. The 'single market', or more accurately the single internal market (SIM), is more than an internal free trade agreement, where tariff-free trade has been agreed for goods and a limited range of services. It is also more than a customs union, which is what the UK joined in 1973 and involves an FTA being extended by the imposition of a common external tariff, levied on non-members; it may, as in the case of the EU, additionally involve a common external trade policy. Instead, the EU SIM extends trade integration, by adopting harmonisation of trade regulations and guaranteeing the freedom of movement of goods, services, capital and people. These 'four freedoms' form an integral part of the SIM and it would be difficult to negotiate a withdrawal agreement which sought to retain full access to the SIM without acceptance of this core element of the arrangement. Thus, when commentators discuss the option of the UK remaining within the SIM without the need for free movement of labour and possibly also free of EU trade

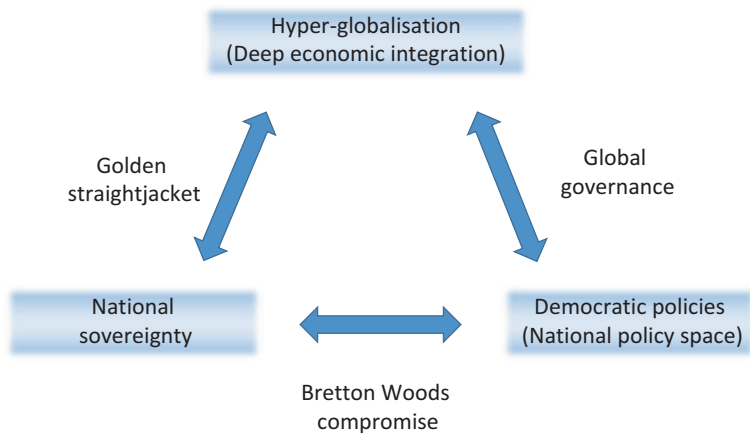
regulation, it is difficult to conceive how this would work. It is certainly possible to negotiate a new trade arrangement with the EU which delivers various degrees of free trade in some if not all sectors, and which does not involve the free movement of labour and/or capital, but this does not constitute full access to the SIM.

When considering options for future trading arrangements between the UK and the EU, it is important to recognise the trade-offs involved. None of the various alternatives is cost free. None provides a ‘free lunch’. All possess potential advantages and disadvantages. Therefore, it is the choice that the negotiating parties make that will determine the type of Brexit impact that will be experienced by the UK and EU member states, and consequently, it will go some way to determine the degree to which Brexit will deliver modest or substantial future economic development opportunities.

The myriad possible options for future trading arrangements with the EU can be a little confusing as they all contain slightly different variants of a standard set of features which, when combined, create a distinctive economic relationship. However, there is an economic theorem which can be used to conceptualise the Brexit options available to voters during the referendum, and moreover the choices facing policy makers in determining which set of economic arrangements the newly independent UK should follow.

Rodrik’s “inescapable trilemma of the world economy” asserts that it is impossible to achieve deep economic integration (hyper-globalisation), national sovereignty and democracy (mass politics) simultaneously (Rodrik 2012; 2000: 180-3) (see Fig. 9.1). Thus, voters and policy makers have to prioritise either: (i) pooling sovereignty and pursuing a form of global federation through continued membership of the EU, even though this limits national sovereignty or self-determination; or (ii) accepting the constraints of the ‘golden straightjacket’ on democracy (Friedman, 1999: 87) by using sovereignty to pursue global integration to the exclusion of other domestic goals, such as occurred during the Gold Standard or perhaps New Labour’s “determined passivity”<sup>1</sup> with respect to globalisation; or alternatively (iii) sacrificing a measure of economic integration in the interests of sovereignty and democracy, such as occurred during the period of the Bretton Woods international monetary system, where limited trade liberalisation was combined with financial regulation and capital controls.

<sup>1</sup><https://www.ft.com/content/63246e18-72b4-11e7-aca6-c6bd07dfla3c>

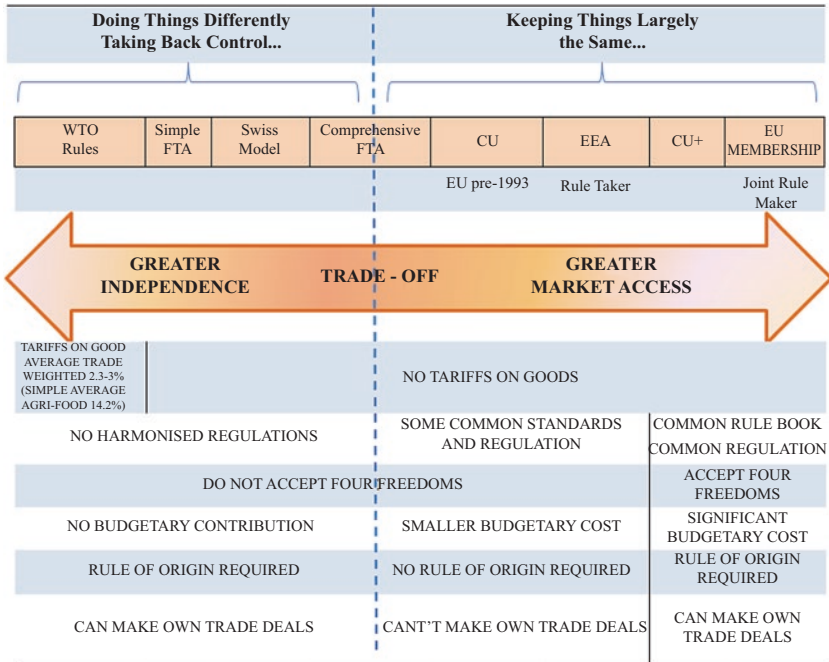


**Fig. 9.1** Rodrik international political economy trilemma. Source: Authors' development of ideas, based on Rodrik (2000: 18) and Palley (2017)

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For Rodrik (2000:182-3), “the essential point is this: once the rules of the game are set by the requirements of the global economy, the ability of mobilized popular groups to access and influence national economic policy-making has to be restricted”. Other theorists prefer to discuss this trade-off in terms of the degree of national policy space which is compatible with different degrees of globalisation or economic integration (Palley 2017: 8). Policy options can be constrained through formal international trade agreements or membership of a supra-national body such as the EU, or through concerns that pursuing certain policies might render the country less competitive (Palley 2017: 16). Indeed, Keynes (1933) himself made a similar argument, when he debated the merits of greater national self-sufficiency and the control of capital to create a sufficient economic policy space to promote national self-determination and full employment.

Viewed in this light, the referendum decision to ‘take back control’ can be understood as one solution to the trilemma trade-off, whilst the vociferous debate that has occurred both within and between political parties, during the past three years, can be perceived as the struggle between alternative competing trilemma outcomes.



**Fig. 9.2** The trade-off between greater independence and greater market access. Source: The Authors

Consideration of the trade-offs involved in the choice of the UK’s favoured form of post-Brexit trade relationship with the EU, and as a result the global economy, can be further illustrated in Fig. 9.2. Given the fact that the UK’s withdrawal from the EU, completed on 31 January 2020, precludes (at least in the short run) the option of pursuing regional (European) governance, the choice remaining to UK policy makers concerns acceptance of rule-taking as a result of EU demands for regulatory harmonisation (the ‘golden straightjacket’) or putting aside certain aspects of deeper economic integration in order to create greater policy space at national level. In essence, this choice is between ‘keeping things largely the same’ between the EU and the UK, by prioritising the maintenance of greater market access, or ‘doing things differently’ by establishing a different model of economic development through creatively utilising the greater flexibility and policy space that derives from a more independent

economic relationship. Viewed in this way, the policy trade-offs become a little clearer.

### ACCESS PRIORITISED OVER INDEPENDENCE

The deepest form of relationship, between the UK and the EU, is **full membership**. This was the preferred option for the Liberal Democrats and Scottish National Party, in the December 2019 General Election, and additionally for many advocates of a second referendum on EU membership. The result of that election, and the current government having completed the UK's formal withdrawal from the EU, curtails this option for the foreseeable future. However, given the strength of feeling in certain segments of the UK electorate, it is probable that the option of re-joining the EU, at some future point in time, will remain a feature of the UK's political discourse. For those considering the viability of this option, it should be noted that Article 50(5) states that any former member state would have to re-apply as if it were a new applicant, with no concessions made due to its former membership (Miller et al. 2016: 26). This would involve acceptance of the totality of the accumulated body of legislation and court decisions (*acquis communautaire*) which would apply at the time of re-joining. There would neither be an opt-out from the UK having to join the single currency nor a rebate on the UK budget contributions. Moreover, it is likely that, after a difficult Brexit process, the UK would benefit from less goodwill than previously existed, which would have probable repercussions upon stipulations contained in any accession agreement. This could make re-joining the EU a less attractive proposition than if the UK had remained a member on its original terms.

Outside of full membership, the **European Economic Area (EEA)** would secure greater access to the EU's SIM but would require compliance with EU standards and regulations and the acceptance of the free movement of trade, capital and people (the 'four freedoms'). The EFTA countries (Iceland, Liechtenstein and Norway) which formed the EEA with the EU in 1992, are additionally automatically part of the Schengen border-free travel area, which the UK, as full EU member, has refrained from joining and this would therefore represent an *extension* to the free movement of people than the UK has to date accepted. Acceptance of the 'four freedoms' might additionally prove problematic for certain sections of the electorate. This has not been the case for Norway, for example, who have welcomed the reduction in skill shortages (NOU 2012a, 2012c).

However, it is worth noting that, as an EEA member, Norway has actually accepted more than twice the number of EU migrants per head of population than the UK as a full member of the EU (Booth et al. 2015:53-4). The EEA agreement does not involve participation in the Common Agricultural Policy (CAP) or the Common Fisheries Policy (CFP),<sup>2</sup> and nor does it include common foreign and security policy. Since it does not involve participating in the EU's customs union, EEA nations can operate their own external trade policy, subject to rules of origin regulations for exports into the EU (HoC 2013: 74).

The disadvantages of this option relate primarily to the loss of self-determination that the EEA agreement represents, which would be difficult to reconcile with the referendum result indicating a preference for the UK to take back control over wider aspects of its policy making. It would require the adoption of around two-thirds of the EU's *acquis communautaire*, thus narrowing the freedom of movement that the UK would gain from withdrawal from the EU (Miller et al. 2016: 40). It would involve the acceptance of EU rules and regulations pertaining to competition, goods standards, consumer and environmental protection (NOU 2012c), which may minimise whatever loss of trade opportunities might arise with EU member states due to the UK's withdrawal (CEPR 2013: 43), but at the cost of adversely affecting the probability of negotiating independent trade deals with other nations. Whilst EEA members can participate in preparatory work relating to those laws and regulations pertaining to the SIM, and have a theoretical right of veto over unfavourable new regulations, in practice this has never been exercised because it would prevent all EFTA nations from continuing to trade freely in the SIM (Singham et al. 2017: 27-8). EEA members are, therefore, 'rule takers' and this option has been criticised as offering "integration without representation" (Sejersted and Sverdrup 2012). Furthermore, EEA membership would necessitate the continuation of UK financial contributions as a *quid pro quo* for access to the SIM and/or in contribution towards the less developed EU member states. Norway currently contributes a gross figure of around 0.76% of its GDP to the EU,<sup>3</sup> or around 0.38% (net) (NOU

<sup>2</sup>Supplemental to the EEA agreement, Iceland has negotiated tariff-free access to EU markets for its fishery exports by allowing limited access for EU fishing vessels in Icelandic territorial waters.

<sup>3</sup><http://www.ssb.no/en/nasjonalregnskap-og-konjunkturer/statistikker/knr/kvarta1/2016-05-12?fane=tabell&sort=nummer&tabell=265699>

2012a:784; CBI 2013: 142). Since Norway has a higher GDP per capita, an equivalent figure for the UK might be in the region of 0.22% or £4.4bn per annum. Nevertheless, this still represents a significant reduction in anticipated fiscal savings following Brexit (see Chap. 2).

Trading with the EU through the EEA requires the use of ‘rule of origin’ regulations to prevent tariff-jumping. This is where exporters in a third country seek to evade higher tariffs by exporting first to whichever member of the FTA has the lowest tariffs and, once their products are circulating within that country, re-exporting them (tariff free) to other parties to the agreement, thereby evading the higher part of prevailing national tariffs. Rule of origin regulations place lower limits on the proportion of a good which is to be deemed as originating in the country party to the EEA, and therefore solves the problem, albeit at an additional regulatory (administrative) cost for the exporting firms (Dinnie 2004; Fawcett 2015). Overall, therefore, it is perhaps worth noting that, for Norway, the EEA represents a political compromise and is, as such, a second best solution, given that it limits the policy independence of the state (NOU, 2012b).

There is one final consideration for those advocating the EEA option. EFTA membership is a prerequisite for EEA participation and, as such, has to be ratified by all EU member states in addition to these three EFTA members (Miller et al. 2016:39-40; Piris 2016: 7). Consequently, it is entirely plausible that any attempt made by the UK to join the EEA may be frustrated by a veto, of either an EU member state or, indeed, an EFTA nation which prefers to preserve the current composition of the organisation and does not want the UK to re-join EFTA.

The formation of a **customs union** between the EU and the UK, such as that adopted in 1996 between the EU and Turkey, would represent another Brexit option. This would include free trade in goods but not agriculture, services or procurement. This was the approach favoured by the Labour Party at various points during the last parliament. In many respects, it would revert the trade relationship between the UK and the EU to how it was between 1973 and the advent of the SIM in 1992. The customs union would involve the adoption of the EU’s common external tariff and commercial policy which would, in turn, enable tariff-free trade in goods (services are not typically included) (HoC 2013: 74; Miller et al. 2016: 37). Rule of origin designation would not be required as the common tariff would prevent tariff-jumping (CEPR 2013: 40-1). It is the adoption of the common external tariff being imposed on all imports from



countries not party to the customs union, and the adoption of a common trade policy whereby the EU continues to have sole control over the negotiation of trade agreements with third parties, which distinguishes a customs union from an FTA.

The customs union approach would not require the free movement of labour. However, Turkey was required to accept all aspects of the EU's *acquis communautaire* as part of the arrangement. Thus, whilst some aspects of social, employment, energy and environment policy might be less harmonised than required by full EU membership, there is likely to be a requirement to adopt trade-related regulations determined in Brussels. Customs unions do not typically include agricultural and fisheries support, nor is it likely to impose constraints imposed upon public procurement, although EU negotiators may seek to depart from precedence on this point. Furthermore, Turkey has set a precedent since it participates in EU schemes such as Erasmus and is a net recipient of EU regional and transport funding.<sup>4</sup> Thus, should the UK wish to continue participation in such programmes, there should be no impediment to its so doing.

There are a number of disadvantages with the customs union option. The first relates to its sole focus upon goods and not services, while it is in the latter that the UK has a particular comparative advantage (Ottaviano et al. 2014). This weakness is somewhat alleviated since the SIM has never properly operated where services are concerned and hence the UK will probably not be too badly affected by losing a theoretical advantage which has never been fully realised in any case (Capital Economics 2016:14). Nevertheless, customs unions may be less effective in reducing non-tariff barriers (NTBs) such as health and technical standards, together with those administrative regulations which impose a delay or other costs upon trade, thereby reducing the volume traded (CBI 2013: 16). It is difficult to quantify the magnitude of NTBs (as noted in Chap. 3), although it is generally accepted that they impose a trade cost perhaps twice that of formal tariff barriers, albeit that the combination of multilateral and preferential trade agreements mean that their significance is being steadily reduced over time (De Sousa et al. 2012; UNCTAD 2013: 1, 14-15).

Membership of a customs union would, moreover, require the maintenance of the EU's common external tariff and the UK could not operate its own independent trade policy and it could not strike its own trade deals with other countries (CEPR 2013: 41). One issue which has arisen for

<sup>4</sup><http://ec.europa.eu/enlargement/pdf/turkey/20160122-turkey-factograph.pdf>

Turkey, in relation to EU negotiated trade agreements with third party countries, is that they are asymmetric since Turkey has to allow their goods to enter its market but there is no automatic reciprocal arrangement for Turkish goods. In the case of South Africa and Algeria, subsequent attempts made by Turkey to negotiate reciprocal arrangements were refused.<sup>5</sup> Thus, Turkey has been left in an invidious position of having to grant free access to its own markets but not receiving the same in return. This would hardly represent a sustainable position for the UK.

The UK would be expected to make a financial contribution to EU programmes, although the expectation is that this would be more modest than the EEA option. It is probable that the UK would be expected to accept EU rules pertaining to competition and company takeovers and preclude certain forms of industrial policy, which would, in turn, limit its policy flexibility as an independent nation (Reynolds and Webber, 2019:5).

It is interesting to note that the CBI ( 2013:12, 148) has expressed its concern that the ‘Turkey model’ would be “the worst of the ‘half-way’ alternatives, leaving the UK with very limited EU market access and zero influence over trade deals”. This strong expression of dissatisfaction is a little odd given the CBI’s strong support for the UK’s accession to the ‘Common Market’ in the 1970s, since this was, of course, a customs union. Yet, it is perhaps instructive that, when considering the best alternative model for the UK to pursue in its future trade relationship with the EU after Brexit, the CBI considers customs unions to be inferior to all other options.

The **common market 2.0** or **Norwegian-plus** option provides a hybrid of EEA and customs union approaches. It would combine acceptance of regulatory harmonisation and the ‘four freedoms’, as per the EEA, but it would also involve acceptance of customs union features, such as the EU common external tariff and its continued monopoly on negotiating future trade deals. In doing so, it would provide a resolution to the Northern Ireland ‘backstop’ problem<sup>6</sup> through locking the UK close to the EU, thereby securing more frictionless trade. As such, this is a defensive option, focused upon minimising anticipated economic costs arising from Brexit. Like the EEA, it would lead to the UK being a ‘rule taker’

<sup>5</sup> <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-external-affairs-subcommittee/brexit-customs-arrangements/written/85217.pdf>

<sup>6</sup> <https://ukandeu.ac.uk/norway-or-common-market-2-0-the-problems-are-not-where-they-seem-to-be/>. The backstop is discussed, in more detail, later in this chapter.

and having little influence over the development of the regulations under which its industries operate, whilst, like the customs union approach, it would prevent the UK from negotiating its own future trade deals. Accordingly, this option has been described as a “Hotel California Brexit”, where the UK technically withdraws from the EU but continues to follow its rules as if it were still a member.<sup>7</sup> This does not appear to be an optimum choice. Nevertheless, it does represent a potential solution for the political elite who would prefer to remain an EU member or at least remain as close to this position as possible and yet keep faith with an electorate who do not share this opinion.

### TRADE-OFF ACCESS FOR INDEPENDENCE AND FLEXIBILITY

The prioritisation of greater policy flexibility and a greater degree of self-determination requires the selection of a looser form of future economic relationship between the UK and the EU. One option would be to seek to negotiate a series of **bilateral agreements** with the EU, covering as many aspects of trade and economic cooperation as is practicable. Switzerland adopted this approach and has successfully negotiated 20 major, and more than 100 lesser, bilateral agreements. The bilateral treaties provide tariff-free trade in goods but are rather more limited in terms of services. Thus, for example, cross-border services are restricted to a maximum of 90 days in a calendar year (Booth et al. 2015:58), whilst financial services (except insurance) are not covered by ‘EU passport’ arrangements, necessitating Swiss banks to establish subsidiaries within EU member states if they wish to operate freely within that market (Keep 2015:12; Miller et al. 2016:40-1).

The advantages of this approach are that only those areas where mutual agreement can be forged are included in the series of treaty’s (CBI 2013: 16). Hence, participation in EU agricultural, energy, foreign, social and employment policies is excluded (Booth et al. 2015: 57). Moreover, Switzerland does not have to accept the importation of legislation and regulations designed in the EU (the *acquis communautaire*), but only has to commit to *equivalent* legislation. Given criticisms of the regulatory burden imposed on UK companies who do not trade with the EU, this might be viewed as a distinct advantage. Furthermore, the ‘Swiss model’ does

<sup>7</sup> <https://www.theguardian.com/commentisfree/2019/apr/01/customs-union-brexite-conundrum-no-deal-cu-peter-mandelson>

not involve any transfer of decision-making to a supra-national authority set up for the purpose of facilitating the trade agreement(s), and it is entitled to negotiate other trade deals with third parties and does not have to impose the EU's common external tariff (CEPR 2013: 45). The bilateral agreements enable cooperation in research and access to public procurement opportunities, although the latter is secured through acceptance of EU rules constraining the use of strategic procurement measures, as were discussed in Chap. 8.

Disadvantages of the bilateral treaty approach include the lack of flexibility that Switzerland has encountered when seeking to extend basic trade in goods into areas where it has a comparative advantage (Booth et al. 2015: 46). Switzerland is also committed to make a financial contribution to EU social and regional programmes in addition to those areas in which the bilateral agreements permit Swiss participation (Miller et al. 2016: 43). If the UK adopted the Swiss model under the same conditions, given the fact that Swiss GDP per capita is approximately 1.5 times the UK rate, UK contributions to the EU might be expected to fall to around £2.1 billion (Thompson and Harari 2013: 26-7).

A more problematic aspect, for Switzerland, concerns the fact that the bilateral agreements stipulate its acceptance of the free movement of labour from the EU (CBI 2013: 145). Given its high GDP per capita and its geographical location towards the centre of the EU landmass, Switzerland has accepted a greater proportion of EU migrants per head of population than the UK. Thus, in 2013, fully 15.6% of the Swiss population had been born in an EU country, whereas the equivalent figure for the UK was 4.2% (Booth et al. 2015: 59-60). A referendum decision for Switzerland to introduce quotas on EU migrants would have breached the free movement of labour clause and the EU threatened to suspend the relevant trade deals until Switzerland set aside the referendum decision and introduced only minor local job preferences.<sup>8</sup> The dissatisfaction with this solution, alongside concerns raised by the EU relating to the Swiss not having to automatically adopt new regulations pertaining to areas covered by the bilateral agreements, raises questions as to the long-term sustainability of this Brexit option (HoC 2013: 76-7). As a result, it may be difficult to persuade the EU to concede a similar approach to the UK (Booth et al. 2015: 73; Miller et al. 2016: 41).

<sup>8</sup><https://www.theguardian.com/world/2016/sep/22/switzerland-votes-for-compromise-to-preserve-relations-with-eu>

A more straightforward option would be for the UK to negotiate a **free trade agreement (FTA)** with the EU. FTAs are the most common form of preferential trade agreements (PTAs) in operation across the globe (CEPR 2013: 16). Prominent examples of countries which have an FTA with the EU include South Africa, Mexico, South Korea and Canada (CETA). Given the enthusiasm with which the EU has begun embarking upon negotiating FTAs with individual countries and groups of nations, it would be slightly surprising if the EU were not interested in doing the same with the UK—a former member state and a large market for EU goods and services (Springford and Tilford 2014: 9).

If successfully negotiated, an FTA would have a number of advantages over the EEA since it is more narrowly focused upon the facilitation of international trade without having to accept additional elements of political and social integration (Milne 2004: 1). Similarly, an FTA has the advantage over a customs union that the UK would be free to determine the level of any tariffs it decided to levy and negotiate preferential trade agreements with other nations. However, FTAs do necessitate the introduction of ‘rules of origin’ regulations to prevent tariff-jumping, which would impose additional administrative costs upon exporters alongside verification procedural costs on importers, which might prove disruptive for those exporters who are part of time sensitive supply chains (CEPR 2013: 36; Miller 2016: 21). Economic studies have identified costs associated with ‘rules of origin’ regulation of between 1% and 8% of the value of traded goods, albeit with most results lying within the lower part of this range (Herin, 1986; USITC 1996; Cadot et al. 2006; Manchin 2006; Brenton 2010; Abreu 2013: 19). Set against this cost, country of origin marking can deliver some economic benefits to exporters, if consumers use it as a proxy for the quality of goods and services (Hui and Zhou 2002). Moreover, it could facilitate a ‘buy British’ campaign, of the type currently forbidden by EU rules but which would be available to policymakers post-Brexit. The evidence is that these campaigns, if designed correctly, can have a positive economic impact, both for UK exporters but also for domestic producers reducing import penetration (Chisik 2003; Dinnie 2008).

An FTA is also unlikely to involve any budgetary contribution to the EU, of the type required from other types of preferential trade deal (Emmerson et al. 2016: 15-16). Certainly, CETA involves no budgetary

contributions in return for market access.<sup>9</sup> It is also possible for FTAs to be expanded to include provisions on areas which usually lie outside of a standard trade agreement, such as the mobility of staff, FDI and other capital movements, intellectual property and so forth (CEPR 2013: 36-39). Whether the UK, having just decided to withdraw from a more comprehensive set of arrangements bundled together within EU membership, desires to move beyond a standard FTA is, however, another question.

The average time for negotiating an FTA is 28 months. The average for the USA is only 18 months, albeit that implementation tends to take a similar additional period.<sup>10</sup> These figures disguise the fact that certain trade deals can be achieved considerably quicker. For example, the FTA negotiated between Jordan and the USA was signed in only 4 months and implemented in 18, whilst an FTA with Australia was signed in 14 months and implemented in less than 2 years. Since the transition arrangement with the EU terminates at the end of 2020, and current UK government policy is not to request an extension beyond that point, this gives negotiators nine months to conclude an FTA with the EU, otherwise trading will revert to WTO rules. This is a short time period and made more difficult by the impact of the COVID-19 virus distracting from future trade negotiations, nevertheless, given the starting position of common standards and regulatory harmonisation, it would be likely that an agreement between the UK and the EU could be concluded more rapidly, *if all parties wished this to be the case* (Singham et al. 2017: 16).

It is not, however, necessarily the ability to negotiate an FTA with the EU that might concern the negotiators, but rather whether the terms that can be negotiated would prove sufficiently favourable to EU and UK economies. Accordingly, there are a number of issues which negotiators should consider.

The first issue that will determine the sustainability of the FTA relates to the breadth of its coverage. It would most likely secure tariff-free trade in goods but not necessarily services. Given the UK's particular competitive advantage in financial, educational and business services, it would be in the UK's interests to secure the maximum inclusion of services in any FTA, whereas the EU might be content to limit any agreement to goods,

<sup>9</sup><https://www.theguardian.com/politics/2016/dec/01/brexit-secretary-suggests-uk-would-consider-paying-for-single-market-access>

<sup>10</sup>Peterson Institute for International Economics, 2016. <https://piie.com/blogs/trade-investment-policy-watch/how-long-does-it-take-conclude-trade-agreement-us>

since this is where it has a large trade surplus. There should be scope for a mutually beneficial agreement, given the juxtaposition of the relative trade strengths, but it may require UK negotiators to display resolution and be willing to accept potential trade according to WTO rules, to secure a favourable deal for the UK. It is worth noting, in this regard, that the FTA negotiated with Canada includes some agricultural goods and a significant proportion of services, although financial services are excluded (Emmerson et al. 2016: 15-16).

A second issue may concern the potential inclusion of “third party MFN provisions” in the FTA. This would ensure that any subsequent preferential trade agreement negotiated with one of the FTA partners would also apply to the other automatically (CEPR 2013: 37). This is a two-edged sword, because it could be used by the UK to ensure that it benefits from any more favourable trade agreements that the EU is able to negotiate with other nations, as a result of its greater bargaining position, or else it could be used by the EU to ensure that the UK could not secure for itself a more favourable trade deal with a third party without the EU having access to the same favourable trade conditions. It might, therefore, be more difficult for the UK to gain a competitive advantage for its exporters over European rivals through negotiating FTAs with fast-growing developing economies, if the EU insisted upon this type of clause in its FTA with the UK (CEPR 2013: 47).

A third negotiating issue might relate the EU’s desire to include harmonisation of regulations in any FTA. This may include competition policy, oversight of mergers and acquisitions, health and safety rules, labour market regulation, product standards and technical specifications for goods and services entering its market. These features are not typically included in FTAs, and this includes the trade deals that the EU has negotiated with Canada and South Korea (Reynolds and Webber, 2019: 5). Nevertheless, the EU has made clear its preference to establish a ‘common rule book’ to underpin any such future trade agreement with the UK. This would fatally weaken any attempt to utilise strategic procurement policy or an active industrial policy to regenerate the UK’s industrial capacity.

This raises two rather interesting questions. The first relates to the concern being shown by EU member states that any potential divergence away from EU norms and regulations would prove to be economically successful, otherwise it would not be perceived as an effective competitive threat. This contradicts those economic studies which tend to ignore or marginalise the effectiveness of economic policy autonomy to drive future

UK growth performance. The second question relates to the degree to which it is reasonable for a supra-national organisation to seek to control the ability of a nation state, which has ceased to be part of this bloc, to determine its own economic policy priorities. What for one nation may represent unfair competition and social dumping, may for another be no more than the natural consequence of choosing a different approach to economic development

Public procurement is likely to form a fourth area for discussion. There is a trade-off involved in determining the UK negotiating stance on this issue. UK producers may benefit from having the ability to bid for public contracts across the EU. Yet, as noted in Chap. 8, the size of the UK's market for public procurement dwarfs the amount of EU procurement work won by UK firms, and therefore utilisation of UK procurement expenditure as part of a broader industrial strategy may prove more beneficial.

A final issue concerns whether or not to include investment protection and the associated Investor-State Dispute Settlement (ISDS) into any FTA (Singham et al. 2017: 12). The inclusion of investor protection and ISDS clauses in FTAs is a fairly recent phenomenon, and the stated intention is to prevent unjustified expropriation and unequal treatment by providing foreign investors with the same rights and benefits as local (indigenous) firms (Hufbauer 2016: 197). This sounds to be perfectly reasonable. However, the ISDS provides foreign-owned trans-national corporations (TNCs) a privileged position, able to by-pass local courts and litigate against national governments. It is asymmetric in that it allows foreign firms to litigate against national governments, but it does not provide for governments suing foreign firms for breaches of national law. Critics, such as the US Senator, Warren, describe the ISDS as a threat to national sovereignty<sup>11</sup> whilst Reich (2015) described it as a “Trojan horse in a global race to the bottom, giving big corporations and Wall Street banks a way to eliminate any and all laws and regulations that get in the way of their profit”.<sup>12</sup> The ETUC suggests that this “privileges big multinational

<sup>11</sup> [https://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9\\_story.html](https://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9_story.html)

<sup>12</sup> [https://www.salon.com/2015/01/07/robert\\_reich\\_the\\_trans\\_pacific\\_partnership\\_is\\_a\\_disaster\\_in\\_the\\_making\\_partner/](https://www.salon.com/2015/01/07/robert_reich_the_trans_pacific_partnership_is_a_disaster_in_the_making_partner/)



corporations and can be used to intimidate democratic institutions from acting in the public interest” (ICTU 2016; SETUC 2016).

UNCTAD figures suggest that TNCs win around 60% of the cases taken through ISDS procedures, with the primary beneficiaries being very large corporations and very wealthy individuals (De Zayas 2015: 25). However, even where claims are not successful, the existence of the ISDS can cause “regulatory chill” leading to governments abandoning or modifying measures intended to promote social benefits. In addition, the UN Independent Expert has documented a number of cases where the ISDS process has been used as a means of TNCs evading their breaching of national laws and regulations, most particularly in the case of national health and environmental damage (De Zayas 2015: 10, 13-16). As a result, they recommended the abolition of ISDS approaches in international trade treaties, and its replacement by either the creation of an impartial international investment court, which has to take into account the social impact of its decisions, or a state-to-state dispute settlement along the lines of that operated by the WTO, or alternatively reliance upon domestic dispute settlement (De Zayas 2015: 20-22).

In view of the criticism of the ISDS and investor protection aspects included in some of the more comprehensive FTAs, there is a strong argument for the UK to seek to limit the scope of its preferred FTA with the EU to focus upon trade-related matters. By doing so, the UK would avoid the problems that arise from investor clauses which unduly privilege TNCs and weaken the ability of democratic governments to make laws and set regulations in the best interests of their citizens.

If it were not possible to negotiate a mutually satisfactory FTA, within the timescale allotted, the alternative would be for the UK to revert to trading with the EU according to the rules set down by the WTO, whose membership of 164 nations represents approximately 98% of global trade and GDP.<sup>13</sup> This is typically discussed as the ‘WTO option’ or the no-deal scenario in the literature, although earlier pioneering studies often described it as the ‘Greenland model’ (Burkitt et al. 1996).

The WTO upholds multilateral international trade rules, originating from the General Agreement on Tariffs and Trade (GATT) and General

<sup>13</sup>[https://www.wto.org/english/thewto\\_e/history\\_e/history\\_e.htm](https://www.wto.org/english/thewto_e/history_e/history_e.htm); [https://www.wto.org/english/thewto\\_e/acc\\_e/cbt\\_course\\_e/c1s1p1\\_e.htm](https://www.wto.org/english/thewto_e/acc_e/cbt_course_e/c1s1p1_e.htm)

Agreement on Trade in Services (GATS). The most prominent of these rules concerns ‘Most Favoured Nation’ (MFN) requirements, whereby WTO members are required to offer all other members equal same access to their markets unless a PTA, such as a customs union or FTA, has been separately agreed. This means that, in the case of the UK withdrawing from the EU, the latter cannot impose higher tariffs on imports from the UK than it does on the same goods imported from another WTO member nation with whom the EU does not have a form of PTA. Moreover, whilst PTAs have expanded rapidly over the past three decades, it is unlikely that they account for more than around one-third of total trade, once the share of trade between PTA signatories that attracts little or no MFN duties is taken into consideration (Medvedev 2006: 47-8; WTO 2011: 7). Hence, the majority of international trade occurs within the remit of WTO MFN rules.

The imposition of tariffs would be the largest disadvantage inherent within the ‘WTO model’. When weighted according to the value of UK exports to the EU, these MFN tariffs may only impose an average cost upon UK exports of around 2-3% (WTO 2016: 75; World Bank, 2020), which is a sum easily absorbed by UK exporters as it lies within the monthly fluctuations of a floating currency. However, since the tariff cost would fall disproportionately upon certain industries, such as car production, chemicals, tobacco, clothing, together with food and beverages, it might be advisable for the UK government to seek to use a proportion of budgetary savings arising from Brexit to compensate producers in these sectors. This might occur through a combination of research grants and training subsidies, aiming at enhancing the productivity of these industries whilst simultaneously compensating them for the rise in costs caused by tariffs. This was discussed in more detail in Chap. 3 (see Figs 3.8, 3.9, 3.10 and 3.11 in particular).

A second disadvantage stemming from reliance upon WTO rules relates to the imposition of non-tariff barriers (NTBs), such as administrative, licensing and other regulatory procedures which may delay shipments and add to export costs. As noted in Chap. 3, it is estimated that NTBs may be around twice as significant as tariff costs. Moreover, they could be of particular concern for service exporters, which is where the UK currently has a comparative advantage (and trade surplus), where continued export activity depends upon mutual recognition of professional qualifications and/or permitted access to service professionals to undertake this activity. GATS provisions provide some assistance in this regard, but progress in

multilateral agreements in services was never as advanced as that for trade in goods.

In terms of advantages, the ‘WTO model’ offers the greatest degree of independence from the EU (Booth et al. 2015: 61-2; Minford 2016: 8). The UK would no longer have to implement EU-determined regulations and technical specifications for goods and services across the whole of the UK economy, but only that part which desired to export into the EU SIM. There would be no budgetary cost for trading along WTO lines, unless the UK sought access to specific EU programmes, such as Horizon 2020, for research collaboration, or Erasmus, to facilitate student mobility. The UK would have maximum freedom to negotiate its separate trade agreements with other countries and/or trade blocks, although the CBI (2013: 16) disputes the probable realisation of superior deals than membership of the EU or the EEA could secure. The UK could also resume its seat and vote at the WTO, rather than have to defer to the EU position, given its reserving trade policy to itself (Milne 2004: 42-5). In addition, one further advantage arising from the WTO model is the gain to the public purse arising from tariff revenues (CEPR 2013: 16).

One variant of the WTO option would be for the UK to follow the ‘**Hong Kong model**’ and unilaterally eliminate all tariffs with all nations. Neo-classical international trade theory would predict that the result would be lower prices for imported goods for UK consumers and manufacturers who use inputs from abroad, leading to lower inflation, increased consumer welfare, whilst the lower cost of inputs together with competitive effects arising from the removal of trade protection would increase efficiency and improve the international competitiveness of UK exporters (Minford et al. 2005; Booth et al. 2015: 63, 73; Minford et al. 2015: 116; Economists for Brexit 2016). One estimate suggests that this approach could provide a net benefit for the UK economy of perhaps 0.75% UK GDP by 2030 (Ciuriak et al. 2015: 25-6).

These conclusions are, however, dependent upon the theoretical underpinning of neo-classical theory. For example, it is assumed that factors of production are relatively homogenous and therefore easily interchangeable, whilst wages and prices are sufficiently flexible as to facilitate a relatively rapid movement from one equilibrium situation to another. Thus, the economy will remain at full employment for all of those who are willing to work at the prevailing market wage rate. Say’s Law will prevail, in that supply will create its own demand, and therefore factors will move rapidly to new employment opportunities created by this new demand,

particularly in the services sector (Minford et al. 2015: 17, 73). There may be temporary (frictional) unemployment, but this will not persist into the medium term (Booth et al. 2015: 73-5). None of this is very likely in the real world.

The experience of the recent financial crisis should have demonstrated to all but the most enthusiastic adherents to economic orthodoxy, that disequilibrium can persist for more than a short transitional period and that the economy can find itself in a demand deficient position, where individuals who want to work find it difficult to do so, and that firms that cease to trade often leads to capital scrapping rather than reallocation. Should structural reorganisation not occur rapidly, through price flexibility, it will likely do so through quantity effects, such as impacting upon output and/or employment. Unemployed workers would need to retrain before being able to find alternative employment, whilst any resulting economic downturn would likely result in depressed demand, investment and employment. The creation of depressed areas in certain regions of the country may take a long time to reverse. Moreover, to the extent that the net negative effects were concentrated upon manufacturing industry, this would have a disproportionate effect upon productivity growth and negatively impact the trade balance. This would contradict the conclusion reached in Chap. 8 of this book that the greater freedoms offered by Brexit should be utilised in order to strengthen not weaken the UK manufacturing sector.

The ‘Hong Kong’ option would, moreover, reduce the probability of the UK being able to negotiate advantageous trade access to other nations. If a country has already secured tariff-free access to the UK market as a result of the unilateral liberalisation approach, there would be little advantage for it to provide a similar benefit to UK exporters. As noted earlier in this chapter, Turkey has discovered this weakness in the asymmetric nature of its customs union with the EU, and it would be likely that the UK would find itself in a similar position. Thus, unilateral liberalisation is unlikely to produce benefits for UK exporters.

### OTHER BESPOKE SOLUTIONS

The option to re-join **EFTA** is typically discussed alongside a supplementary application for membership of the **EEA**. However, there is nothing to prevent the UK from eschewing the latter and instead participating in **EFTA** as one element in a post-EU strategy. **EFTA** is a much smaller entity

than the EU, having only four member nations—Iceland, Liechtenstein, Norway and Switzerland—and representing a total GDP of €0.9bn.<sup>14</sup> UK membership could be attractive to other EFTA members, who would otherwise lose tariff-free trade with the UK market. Set against this, the UK would become far the largest single member of EFTA and this would change the dynamic of the organisation, which some current members may find unsettling.

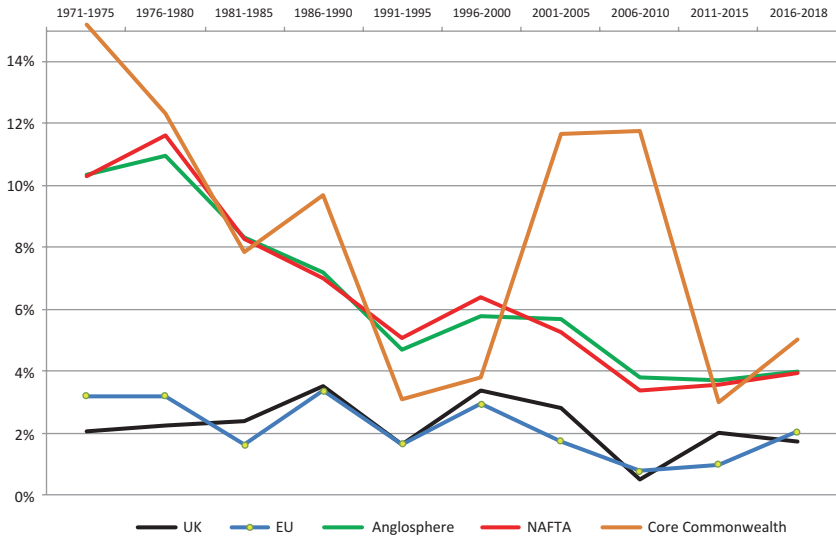
Whilst potentially attractive as part of any post-Brexit global trading realignment, EFTA membership in isolation is simply too small to replace any significant amount of lost trade with the EU should negotiations fail to agree some form of free trade agreement. Hence, whilst not necessarily agreeing with Piris (2016: 7-8) that, due to the advent of the EEA, the EFTA has become “an empty shell”, it is certainly true that, as currently constituted, it is too small to represent more than part of any future trade strategy developed by the UK.

A more promising source of future trade opportunities, neglected during the UK’s focus upon regional European trade, concerns the 54 nation **Commonwealth**.<sup>15</sup> These markets formed a significant proportion of UK trade before EU accession; the application of the EU’s Common External Tariff (CET) and the ending of the ‘imperial preference’ system which formerly prioritised trade between the UK and Commonwealth countries, caused trade displacement in favour of the EU internal market. Whilst Commonwealth nations have often been viewed as part of the UK’s trading past, it is noteworthy that the growth rates of core Commonwealth nations have exceeded that of the EU for the whole of the period since 1971 (Fig. 9.3). Moreover, the entire Commonwealth represents around 15% of global GDP, which is larger than the Eurozone and, mainly due to the high growth rates recorded by India, is predicted to overtake the EU by the end of the decade.<sup>16</sup> Consequently, there is a good argument to be made for an independent UK to have a greater focus upon exploring potential trade opportunities within this group of nations, with which it has historic ties and pre-existing layers of cooperation.

<sup>14</sup> <http://www.efta.int/statistics/efta-in-figures>

<sup>15</sup> Perhaps this should be more accurately 53 member nations, since Fiji is currently suspended.

<sup>16</sup> <http://www.telegraph.co.uk/news/newstoppers/eureferendum/12193101/Brexit-will-allow-Britain-to-embrace-the-Commonwealth.html>; [http://www.worldeconomics.com/papers/Commonwealth\\_Growth\\_Monitor\\_0e53b963-bce5-4ba1-9cab-333cedaab048.paper](http://www.worldeconomics.com/papers/Commonwealth_Growth_Monitor_0e53b963-bce5-4ba1-9cab-333cedaab048.paper)



**Fig. 9.3** Annual average growth rates (GDP), selected areas and countries. Notes: The EU here consists of the EU(15) member countries. The core Commonwealth area includes here the top six countries by GDP in the Commonwealth (excluding the UK) amounting to about two-thirds of the total Commonwealth GDP. The Anglosphere includes the USA, Canada, Australia and New Zealand. Source: Authors' calculations based on UNCTAD (2020) and OECD (2019)

Given that there are already FTAs in place between the EU and 18 Commonwealth nations, with a further 14 awaiting ratification,<sup>17</sup> it is possible that gains from closer trading ties between an independent UK and many Commonwealth nations might be limited.<sup>18</sup> Nevertheless, it would be churlish to fail to recognise the fact that membership of a regional trade bloc tends to cause exporters to focus upon regional trade opportunities, particularly when encouraged to do so by a common external tariff that makes the forging of complex supply chains a little more complex and

<sup>17</sup><http://eulawanalysis.blogspot.co.uk/2015/11/the-eu-or-commonwealth-dilemma-for-uk.html>

<sup>18</sup><http://blogs.lse.ac.uk/brexitvote/2015/12/10/the-commonwealth-and-the-eu-lets-do-trade-with-both/>; <http://www.economist.com/blogs/bagehot/2011/10/britain-and-eu-3>

expensive than would otherwise be the case. Withdrawal from the EU will therefore focus attention upon trade opportunities outside Europe, and the Commonwealth nations with shared history, language and cultural ties would seem like a good starting point (Algan and Cahus 2010; Guiso et al. 2009).

Similar arguments have been used to promote the potential of what has been termed an ‘**Anglosphere**’ might provide the basis for economic and political partnership for an independent UK (Nesbit 2001; Bennett 2004). When considered as a bloc, the Anglosphere (USA, Britain, Ireland, Canada, Australia and New Zealand) has more than one quarter of the world’s GDP, and this advantage is amplified if considering GDP per capita measured according to purchasing power parity (Kotkin and Parulekar 2011: 29-30). These nations share a common language, operate according to common law, together with shared cultural and historical ties, all of which has been found to be conducive to trade (Algan and Cahus 2010; Guiso et al. 2009). Moreover, the growth performance of Anglosphere countries has been considerably superior to that of the EU for the past half century (see Fig. 9.3).

Taking into account these potential advantages, it has been reported that a number of leading political figures, in the UK, Australia and Canada, have stated an interest in this concept (Miller et al. 2016: 46). Whilst both the new President of the USA and the New Zealand Prime Minister have expressed their interest in negotiating a free trade agreement with the UK shortly after the Brexit withdrawal process has been completed.<sup>19</sup> This has led a former Conservative MEP, Daniel Hannan, to argue that, when comparing EU membership to the perceived advantages of the Anglosphere argued that “far from hitching our wagon to a powerful locomotive, we shackled ourselves to a corpse”. However, it should be noted that, whilst countries may share elements of culture, they do not necessarily have shared interests. Nor is the Anglosphere concept a new proposal, having been first proposed in imperial terms in 1911, when it received only scant support (Harries 2001). Nevertheless, like the Commonwealth option, the cultural and other ties between Anglosphere nations may facilitate closer trade arrangements and other forms of economic cooperation between sovereign nations.

<sup>19</sup><http://www.bbc.co.uk/news/uk-politics-38608716>; <http://www.telegraph.co.uk/news/2017/01/27/congress-pushes-donald-trump-form-bilateral-trade-deal-uk/>

A perhaps more immediately practical option, considered by the US Senate Finance Committee, is whether an independent UK could join **NAFTA**, which currently operates between the USA, Canada and Mexico. Like the Anglosphere, the NAFTA countries have recorded far better growth rates than the EU for the time period included in Fig. 9.3. This option has been discussed by sections of the US Congress and the US International Trade Commission (USITC) completed a report on the likely impact that UK participation in NAFTA may have upon the economies of all four nations. Conducted in 2000, but based upon trade data drawn from 1995, the report suggested that there would be significant trade effects, with UK exports to Canada rising by approximately 24% and the USA by 12.5%, with similar although smaller rises in imports from NAFTA nations, leading to an improvement in the UK's trade balance. This would not, by itself, be sufficient to compensate for a probable reduction of UK exports to the EU, albeit that due to imports into the UK would fall faster than exports, resulting in the UK's trade deficit with the EU being reduced and its overall trade balance improved (USITC 2000: 4-13-14). The impact on FDI would likely reduce the output of US-owned manufacturing affiliates in the UK by 0.56%, which is a significantly smaller effect than many more recent predictions (USITC 2000: 4-19). Overall, in terms of macroeconomic effects, the report suggests that prices may decline slightly in the UK, whilst the modelling predicted insubstantial changes in national GDP, ranging from -0.02% for the UK to a zero change for the USA (USITC 2000: 4-16-17).

The USITC study is interesting partly because it was one of the first studies to seek to model the economic effect of UK withdrawal from the EU, and its prediction of an insubstantial impact on the UK economy of only -0.02% GDP is in sharp contrast to more recent studies outlined in Chap. 1. Moreover, it is probable that the results of its analysis would be more favourable to the UK, if the exercise was repeated in 2020, because the share of UK exports taken by the EU is significantly lower now than it was in the mid-1990s, whilst the average trade-weighted MFN tariff levied by the EU has fallen from a little over 6% in 1995 to around 2–3% today (Thompson and Harari 2013:7; WTO 2016: 75; World Bank, 2020). Hence, whilst it would be unwise to base current economic policy upon one study, conducted using data from two decades previously, the USITC predictions do provide a tantalising piece of evidence that UK withdrawal from the EU, and subsequent membership of NAFTA or alternatively a broader Anglosphere, might provide an interesting option for an



independent UK. At the very least, it would be worth UK policy makers examining this option in more detail.

Another option for the UK to consider would be to follow the advice of US Trade Representative Michael Froman<sup>20</sup> to join the **CPTPP**. This is an FTA negotiated between the following countries in the Asia-Pacific region, namely: Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam. The CPTPP emerged from the previous Obama administrations attempt to create a TPP, but which was vetoed when President Trump took office.<sup>21</sup> With USA involvement, the TPP would have created a trade bloc of 800 million people and representing around 40% of global GDP and around one-third of world trade.<sup>22</sup> In the absence of the USA, once fully implemented, the CPTPP will include 495 million people and represent around 13.5% of global GDP. This is slightly larger in population terms than the EU (447 million people), represents a similar share of global GDP to that of the EU and is larger than the Eurozone. If the UK joined, the trade bloc would have a larger GDP than the EU.

The TPP, from which the CPTPP evolved once the USA withdrew from the arrangement, was criticised for its anticipated effect upon employment and wages in the USA,<sup>23</sup> whilst concerns were raised that market access rules might enable the penetration of national public services by TNCs and Investor-State Dispute Settlement (ISDS) clauses might undermine national policy sovereignty (Backer 2014: 54-5).<sup>24</sup> The CPTPP agreement suspended 22 provisions relating to ‘investor agreement’ and ‘investor authorisation’ from the former TPP approach, which has narrowed the scope of the ISDS, providing additional protection for national health services in their efforts to secure the best price for drugs and safeguards for national governments being able to regulate in the national

<sup>20</sup> <http://www.express.co.uk/news/uk/687484/Obama-admin-Brexit-Britain-not-back-queue-trade-deal>

<sup>21</sup> <https://www.cfr.org/backgrounder/what-trans-pacific-partnership-tp;https://www.politico.com/story/2019/01/23/trans-pacific-trade-pact-2017-1116638>

<sup>22</sup> <https://www.bbc.co.uk/news/business-32498715>

<sup>23</sup> <http://www.independent.co.uk/voices/ttip-american-ttp-trade-deal-bernie-sanders-hillary-clinton-donald-trump-barack-obama-looks-set-for-a7194336.html>

<sup>24</sup> [http://inthesetimes.com/article/18695/TPP\\_Free-Trade\\_Globalization\\_Obama;https://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9\\_story.html](http://inthesetimes.com/article/18695/TPP_Free-Trade_Globalization_Obama;https://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9_story.html)

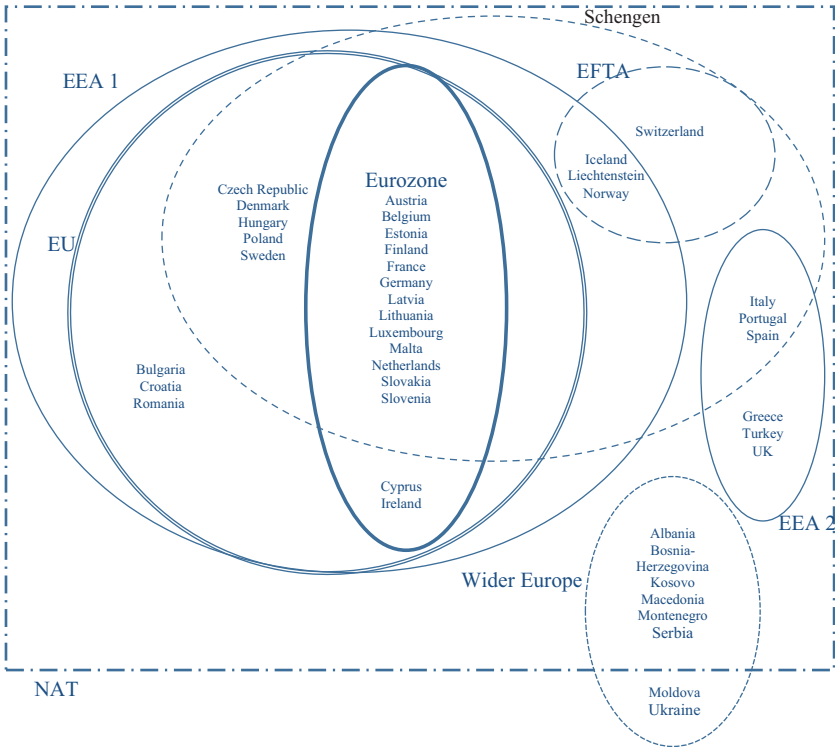
interest.<sup>25</sup> Clauses concerning public procurement were also delayed for a period of time. However, the rest of the investment chapter remains unaltered in the CPTPP (Yu 2018: 2). Therefore, UK trade experts would need to assure themselves that the additional safeguards built into the agreement are sufficient to safeguard UK interests, otherwise participation would remain problematical.

A different type of settlement, which would depend upon a significant shift in the adherence to ‘the project’ by leading members of the EU, would be to accept the existence of a ‘**variable geometry Europe**’, whereby different nation states participate to a varying degree in the various aspects of economic integration pursued by the EU (see Fig. 9.4). To a certain extent, this would be to formally recognise differences which currently exist, with certain long-standing EU member states reluctant to participate in the single currency or the Schengen agreement, whilst others would be content to have a looser association rather than implement the full *acquis communautaire* (HoC 2013: 78-9; Booth et al. 2015: 64). It might provide the basis of a new settlement, between the EU and the UK, but would additionally solve certain tensions persisting within the EU, between participants in the Eurozone and other members (Chopin 2013: 9). It might additionally facilitate a more general realignment between core membership and those seeking looser alignment, such as EFTA members, Switzerland and possibly the UK (van Hulst 2011; Chopin 2016). Nevertheless, it is unlikely to occur. Previous suggestions to introduce a two-speed EU, including those made by former UK Prime Minister Major, did not attract sufficient support across other EU member states. If the opportunity for such realignment existed, during the recent Euro crisis, this now seems to have passed, and one supporter of this variable geometry framework considers that it is unlikely to receive serious consideration unless the UK makes a success out of its independence from the EU (Owen 2016: 2).

## CHEQUERS AND THE JOHNSON WITHDRAWAL AGREEMENT

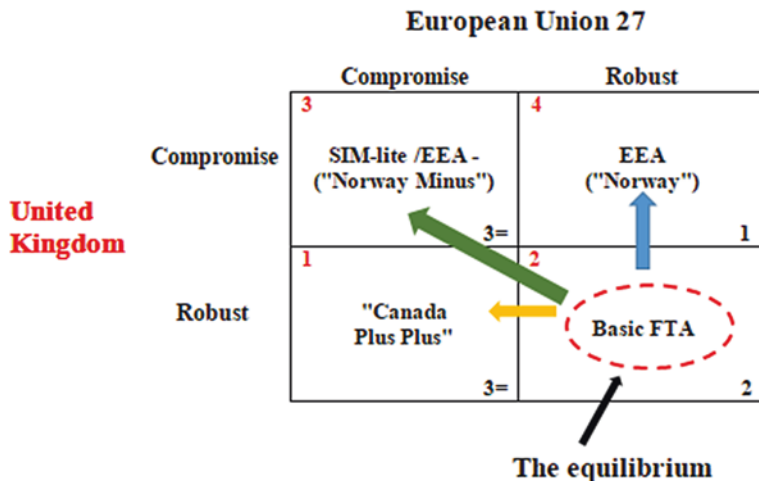
Having outlined the main generic Brexit options available to UK policy makers, it is perhaps easier to understand the motivations and choices made by successive UK governments in their development of the two

<sup>25</sup> <https://www.mfat.govt.nz/en/trade/free-trade-agreements/free-trade-agreements-in-force/cptpp/understanding-cptpp/tpp-and-cptpp-the-differences-explained>



**Fig. 9.4** An illustration of the highly complex variable geometry Europe and the potential for a new realignment between Eurozone-Core and SIM-lite-Periphery groupings. Source: Authors’ drawing, based on Owen (2016:2-3)

versions of the withdrawal agreement set before Parliament. To distinguish between the two, former Prime Minister May’s proposals are discussed as the Chequers Plan, following the dramatic events which occurred during the cabinet discussions that took place at the Prime Minister’s countryside retreat and the subsequent resignations. It is the Chequers Plan that suffered three of the largest parliamentary defeats in UK history. The replace of May with Prime Minister Johnson, led to the renegotiation of the withdrawal agreement with the EU, the December 2019 General Election victory and the implementation of the revised withdrawal



**Fig. 9.5** Game theory potential bargaining solution. Source: Authors' revised version of material drawn from the academic blog, available via: <https://blogs.lse.ac.uk/brexit/2018/07/16/two-years-after-the-vote-there-is-little-certainty-where-the-uk-eu-relationship-is-heading/>

agreement, culminating in the UK withdrawing from the EU on 31 January 2020. This is described as the Johnson Plan.

### *Chequers*

The Chequers proposals sought to reconcile a challenging if not contradictory set of negotiating criteria, or 'red lines', imposed upon the process by UK and EU authorities. The UK government sought to end freedom of movement of labour, whilst the EU sought to protect the integrity of the SIM, which for them included the four freedoms as a key foundation. The UK sought to regain the ability to negotiate trade deals with third parties, which was incompatible with remaining within the customs union. These 'red lines' are relatively easy to resolve, through the negotiation of an FTA. Indeed, prior to the Chequers meeting, the Department for Exiting the EU had been in the process of developing a 'Canada-Plus-Plus' FTA proposal.

The final EU ‘red line’ proved to be more difficult to reconcile. This is related to the EU’s desire to avoid the (re-)imposition of a hard border, between its member state the Republic of Ireland and Northern Ireland. Whilst the Belfast (Good Friday) Agreement<sup>26</sup> does not actually commit the UK to maintaining an open border—the only related clause concerning the removal of security installations—it is probably accurate to conclude that the reintroduction of border infrastructure could become a security target and thereby destabilise the peace process (Phinnemore and Hayward 2017: 26, 34, 47).

Borders manage the flow of goods and people. Since a common travel area has existed since 1922 between the Republic of Ireland and the UK, the flow of people was a lesser concern for UK negotiators, as passport control could always be exercised upon arrival onto the British mainland. Customs duties could always be collected by the relevant parties to the agreement, as part of a customs partnership arrangement. However, the EU’s concern over the integrity of the SIM focused attention upon how the passage of goods across the Irish-Northern Irish border could be facilitated. If the UK were to diverge from EU rules and regulations, checks would need to be imposed to ensure that goods entering the SIM through this route complied with EU standards. The EU’s conclusion, therefore, was that the only solutions would involve the UK or Northern Ireland remaining in a customs union (or EEA or customs union-plus) arrangement with the EU, or via the UK’s voluntary acceptance of regulatory harmonisation with EU rules, standards and regulations. This meant that, either the whole of the UK was required to follow EU rules (i.e. become a rule-taker) or Northern Ireland would have to do so alone, which would necessitate different parts of the UK being subject to different laws and regulations. Complaints lodged by the UK that this created a democratic deficit were dismissed and in December 2017, the UK negotiating team reluctantly agreed to the proposal.<sup>27</sup>

The resulting Chequers Plan and subsequent White Paper (HMG 2018b), therefore, was composed of elements of the EEA, FTA and customs union options. It sought to maintain frictionless trade in goods with the EU (section 1.2.1.15), whilst ending freedom of movement of labour (section 1.1.7c), thereby moving outside the SIM, and regaining an

<sup>26</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/136652/agreement.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/136652/agreement.pdf)

<sup>27</sup> <https://www.politico.eu/article/how-uk-lost-brexiteu-negotiation/>

independent trade policy (sections 1.1.7h, 1.8.155), which necessitated leaving the customs union. The Chequers Plan also sought to maintain the UK's regulatory autonomy *in services*, whilst accepting regulatory harmonisation with the EU ('a common rule book') for goods and agricultural products (sections 1.1.7a, 1.2.11, 1.2.3.25-28, 1.2.4.35, 1.3.48-9).<sup>28</sup> It further accepted non-regression of labour standards (section 1.6.1.123), both to neuter internal criticism from the UK trade unions and Labour opposition, but additionally to mollify EU negotiators concerned over the UK gaining a competitive advantage through a 'race to the bottom' in social policy and labour standards.

The Protocol on the Republic of Ireland and Northern Ireland comprised around one-third of the content of the Withdrawal Agreement, thereby indicating its importance and complexity. The 'backstop' solution it contained committed the UK as a whole to acceptance of a customs union with the EU, covering all goods (except for fish), which would come into force unless the two negotiating parties could reach a mutually satisfactory alternative arrangement (Article 2). It would require the whole of the UK to accept 'level playing field' restrictions, including continued acceptance of EU competition, procurement and state aid rules (sections 1.1.7f, 1.6.106-108, 1.6.1.109-111), alongside commitments to maintain high standards in the areas of labour and social policy. Northern Ireland would additionally be subject to EU regulations in agriculture, VAT, the environment and customs (Articles 10:4, 11-12, Annex 4:4 and Annex 8) (Reynolds and Webber, 2019: 1-3).

The Chequers Plan sought to evade the necessity of invoking the backstop through the introduction of what it described as a "facilitated customs arrangement", whereby the UK would apply EU tariffs for goods whose ultimate destination would be the SIM and UK tariffs for those destined for the UK market (sections 1.2.12, 1.2.1.14, 18). The intention was that this would remove need for customs checks as if a combined customs territory was in operation (HMG 2018a). This type of revenue sharing is complex, but the experience of the MERCOSUR trade bloc indicates how it can be operated.<sup>29</sup>

<sup>28</sup> <https://www.gov.uk/government/speeches/sos-dominic-raab-statement-on-the-future-relationship-between-the-united-kingdom-and-the-european-union-12-july-2018>; [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/723460/CHEQUERS\\_STATEMENT\\_-\\_FINAL.PDF](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/723460/CHEQUERS_STATEMENT_-_FINAL.PDF)

<sup>29</sup> [https://www.instituteforgovernment.org.uk/sites/default/files/publications/IfG\\_Brexit\\_customs\\_WEB\\_0.pdf](https://www.instituteforgovernment.org.uk/sites/default/files/publications/IfG_Brexit_customs_WEB_0.pdf)

Technological solutions (often described as ‘max-fac’ or ‘smart borders’) were proposed in the Chequers Plan as a means of avoiding customs checks taking place at the point of border crossing, through the use of Authorised Economic Operator (‘trusted trader’) arrangements (sections 1.2.1.16-17) (HMG, 2017: 7). Trusted traders can make use of advance electronic cargo information and pre-declaration, customs duties paid on account (subsequently audited), whilst risk targeting can identify items for inspection to be carried out by X-ray and other non-invasive equipment or by mobile customs teams up to a designated distance from the border (Karlsson 2017: 41; HMG 2018c: 8-9; WCO 2018: 2, 4).<sup>30</sup> RFID tags and GPS can be used to track registered commercial vehicles, whilst automatic number plate recognition can facilitate passenger vehicles (Karlsson 2017: 25-6). These approaches have been trialled along the US-Canada border and in its most advanced form along the Swedish-Norwegian border (Karlsson 2017: 22, 24, 29). In the latter case, most goods are cleared through the border within 3–9 minutes (Karlsson 2017: 30).

The smart borders proposals were dismissed by the EU negotiators as “magical thinking”,<sup>31</sup> which is a little disappointing given the support for the approach as a potential solution to the Irish border issue in a report produced by the European Parliament’s Policy Department for Citizens’ Rights and Constitutional Affairs (Karlsson 2017). It is certainly the case that the introduction of smart borders would require considerable investment in technological solutions, whilst the trusted trader scheme would have to be considerably extended.<sup>32</sup> One complication to any extension of trade-related infrastructure stems from the UK having privatised its ports, and consequently the government has no direct control over capacity and equipment (Owen et al. 2017: 16). Moreover, the current Customs Handling of Import and Export Freight (CHIEF)<sup>33</sup> system is scheduled to be replaced by a new Customs Declaration Service (CDS), in part to extend capacity, towards the end of 2020 which coincides with the end of

<sup>30</sup> <http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/safe-framework-of-standards.PDF?la=en>

<sup>31</sup> <https://www.theguardian.com/uk-news/2017/aug/25/uk-accused-of-magical-thinking-over-brexit-plan-for-irish-border>

<sup>32</sup> <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-external-affairs-subcommittee/brexit-customs-arrangements/written/83040.pdf>

<sup>33</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/209612/Customs\\_Handling\\_of\\_Import\\_and\\_Export\\_Freight\\_CHIEF\\_.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/209612/Customs_Handling_of_Import_and_Export_Freight_CHIEF_.pdf)

the transition period and is, in any case, a “demanding” timetable according to the National Audit Office.<sup>34</sup>

There has, moreover, been a degree of controversy over the potential cost that may be involved in the extension of customs declarations that may accompany any new trading system. One suggestion is that an additional 180,000 traders will need to make customs declarations, which could cost in the region of £4bn per annum (Owen et al. 2017: 4). More troubling, the head of the HMRC, Thompson, suggested that the cost of additional customs declarations could be as high as £17–20bn per annum,<sup>35</sup> although this claim was later criticised by Gudgin and Mills whose own estimate for customs costs was a significantly smaller £2bn per annum.<sup>36</sup>

### *Johnson Revision*

The failure of former Prime Minister May to secure parliamentary approval for her version of the Withdrawal Agreement led to a change in Prime Minister and a renegotiation of certain elements of the Chequers proposals.<sup>37</sup> These changes were agreed in October 2019 and constituted a revised Withdrawal agreement (HMG 2019c). Most of the content of the withdrawal agreement remains identical to that of the previous iteration. However, the primary strategic choice made by the Johnson government was to accept Northern Ireland remaining subject to EU harmonised rules and regulations, for goods and agricultural produce (Articles 5–10), in order to remove backstop provisions and enable the rest of the UK to diverge. Notwithstanding this regulatory alignment with the EU, the revised withdrawal agreement made it clear that Northern Ireland remains part of the UK’s single customs territory (Article 4), and can benefit from the UK’s independent trade policy (Article 5).<sup>38</sup> One important caveat concerns the EU’s acceptance that this arrangement is subject to the ongoing consent, expressed through a majority vote of the Northern Ireland Legislative Assembly, reaffirmed every four years (Article 18) (HMG 2019a).

<sup>34</sup> <https://www.nao.org.uk/report/the-customs-declaration-service-a-progress-update/>

<sup>35</sup> <https://www.ft.com/content/fbdc5d58-5e97-11e8-9334-2218e7146b04>

<sup>36</sup> <https://briefingsforbrexit.com/customs-costs-post-brexit-long-version/>

<sup>37</sup> <https://www.politico.eu/article/how-uk-lost-brexit-eu-negotiation/>

<sup>38</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/840230/Revised\\_Protocol\\_to\\_the\\_Withdrawal\\_Agreement.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/840230/Revised_Protocol_to_the_Withdrawal_Agreement.pdf)



The political declaration expressed the intention of the UK and EU negotiating a comprehensive and balanced FTA, which would be based upon regulatory autonomy (HMG 2019b). At the same time, however, Clause XIV.77 introduces the notion that, because of the UK's "geographic proximity and economic independence", any future relationship should be based upon "open and fair competition, encompassing robust commitments to ensure a level playing field", particularly in the areas of state aid, competition, social and employment standards, environmental measures and taxation (HMG 2019b: 14-15). Given other statements made by EU negotiators and the leaders of both France and Germany, over their concerns that the greater policy freedoms secured by Brexit will enable the UK to become a competitive rival to the EU, it would seem that this single paragraph may foreshadow the forthcoming negotiations between the UK and the EU over their future relationship, with the UK seeking to widen its policy space following independence and the EU seeking to continue to constrain the ability of the UK to use this greater flexibility to improve its competitive position.

## FUTURE TRADE RELATIONSHIPS

Looking forward to the negotiations to be held regarding the form of future economic relationship between the UK and the EU, the experience gleaned from the past few years would suggest that this may be a difficult and not straightforward process. The EU has been particularly effective in setting the agenda and controlling the negotiations process through sequencing and channelling negotiations through a single conduit (Ries et al. 2017: 38).<sup>39</sup> This approach is unlikely to change given the success achieved to date. In addition, the former Greek finance minister, Varoufakis, has suggested that the EU bureaucracy will wish to frustrate the negotiation of a mutually beneficial agreement in order to protect the stability of the European project.<sup>40</sup> Thus, the forthcoming negotiations between the UK and the EU over the framework of the future trade relationship may be difficult.

<sup>39</sup><https://www.politico.eu/article/how-uk-lost-brexiteu-negotiation/>; <https://www.theguardian.com/politics/2017/jun/19/uk-caves-in-to-eu-demand-to-agree-divorce-bill-before-trade-talks>

<sup>40</sup><https://www.newstatesman.com/politics/brexit/2018/11/yanis-varoufakis-eu-declared-war-and-theresa-may-played-along>

Consideration of the economic ‘game theory’ approach suggests that there may be a bargaining solution which would meet the preferences of both sides. Whilst the EU would prefer an EEA-style agreement, to ensure a ‘common rule book’ and secure the integrity of the SIM, and the UK would prefer a comprehensive FTA to include financial and business services, unless one or more parties to the negotiations are prepared to make major concessions, the likely equilibrium position that both parties would accept would be a simple form of FTA,<sup>41</sup> a solution certain commentators have dubbed ‘Canada minus’ (UK&EU 2019: 4-5). This option would deliver an FTA without the UK having to become a rule-taker and being subject to EU-imposed constraints (Menon et al. 2018: 8). It has the advantage of being straightforward to negotiate, given that it would not include clauses concerning investor protection, social, labour and environmental policies, which is important given the fact that the transition period terminates at the end of 2020. It would provide the basis for continued free trade in goods, following the end of the transition period, and could be extended by mutual agreement to include elements of services in the future. Mutual agreements relating to professional qualifications are already in place and this should be straightforward to roll over into the new arrangement.

Note to editors: if needing to have the figure above as a stand-alone image, then please use the version below:

The one potential roadblock in reaching this mutually acceptable solution concerns the stated intention of EU negotiators to force the UK to agree to ‘level playing field’ provisions, intended to prevent what the EU considers to be the “undercutting of EU standards to gain competitive advantage” (UK&EU 2019: 5). This could simply be the EU’s ‘robust’ negotiating stance. Yet, even if it is not, it is unlikely that the current UK administration would accede to this position, as it would negate the policy flexibility that Brexit delivers. In effect, they would be accepting the ‘golden straightjacket’ option described in the Rodrik trilemma. Or, in Varoufakis’ prose, it would mean accepting a ‘Hotel California Brexit’ where the UK “could check out but never leave”.<sup>42</sup> Thus, it is probable that this will be the end result of the negotiations between the UK and the

<sup>41</sup> <https://blogs.lse.ac.uk/brexit/2018/07/16/two-years-after-the-vote-there-is-little-certainty-where-the-uk-eu-relationship-is-heading/>

<sup>42</sup> <https://www.newstatesman.com/politics/brexit/2018/11/yanis-varoufakis-eu-declared-war-and-theresa-may-played-along>

EU, with the option of trade according to WTO rules if negotiators miscalculate.

Of course, the completion of the UK's withdrawal from the EU signifies its ability to seek new trading relationships with other nations and trade blocs. The Change Britain organisation has reported that 14 nations, including China, Brazil, India, Argentina and Australia, have publically stated their interest in negotiating an FTA with the UK once the Brexit process has been completed. Were these agreements successfully completed, this would represent a potential marketplace for UK exports of around £16.8 trillion,<sup>43</sup> which is considerably larger than the GDP of the EU(27). Moreover, the Trump administration has emphasised its willingness to negotiate an FTA with the UK and has even set out its own preferred set of negotiating priorities (USTR 2019). Certain of the more unpalatable aspects of the US negotiating position—that is, food safety rules, investor protection, access to public health systems and control over exchange rates—would be negated if the UK were to advocate a simpler, more basic form of FTA. This would still deliver some benefits in terms of expanded trade opportunities, but would avoid the more troublesome aspects that might be contained within a more comprehensive agreement.

Interestingly, those studies which have sought to estimate the economic impact of FTA agreements, between the UK and other nations, have indicated how effective this independent trade policy might be in offsetting the impact arising from potential trade losses with the EU. For example, one study predicts that the negotiation of FTAs with Anglosphere countries could increase trade between themselves and the UK by around 12%, whilst similar arrangements with BRIICS countries (Brazil, Russia, India, Indonesia, China and South Africa) could increase bilateral trade by 19%. This would result in a boost to total UK trade of around 4.8% (Ebell, 2017). This would imply only a 0.2% gain to UK GDP (Hantzsche et al., 2018: 23). By contrast, another study suggested that an FTA between the UK and the USA would offset half of any predicted economic cost arising from the worst-case Brexit scenario (Ries et al. 2017: 57-9). Adding in other NAFTA countries would further reduce any Brexit cost to negligible levels (USITC 2000: 4-16-17). Extending trade opportunities to include leading Commonwealth countries, or other members of the Anglosphere, or alternatively considering participation in the CPTPP, would provide a

<sup>43</sup> <http://www.telegraph.co.uk/news/2016/10/29/hard-brexit-could-help-secure-trade-deals-worth-double%2D%2DDeu-agree/>

further economic boost to the UK economy. This is irrespective of whether the UK and the EU can negotiate an FTA. If this was added into the calculations, the predicted effect would be a net *gain* for the UK economy over and above former EU membership (Ries et al. 2017: 57-9, 67).

It is difficult, as highlighted in Chap. 1, to make precise predictions concerning the potential economic impact arising from Brexit. Partly that is because such calculations do not take place in a vacuum. The world is constantly changing. The advent of the COVID-19 virus, as this book was in the finishing stages of completion, demonstrates this only too clearly. Thus, whilst the EU SIM is likely to remain the largest single consumer of UK exports for the foreseeable future, its importance seems likely to decline over time due to a combination of faster growing areas of the global economy and the income elasticity of trade (Milne 2004; CBI 2013: 27; Business for Britain 2015: 30-2, 697; ONS 2016). Thus, a reorientation of trade relationships with more focus upon global (rather than regional) opportunities, could deliver greater long-term benefits. Similarly, Brexit offers the opportunity for the UK to recalibrate its economic stance away from attempts to secure regional governance through the EU and policy makers must determine whether to opt for a ‘golden straightjacket’ for of Brexit, trading rule-taking and policy constraints against greater SIM market access, or preferring to pursue greater national self-determination and using the greater policy space to transform its productive sector. The choice will determine not only the success or failure of the Brexit project, but additionally the life chances for UK citizens for decades to come.

## CONCLUSION

This book has evaluated the existing evidence relating to the economic impact that is likely to arise from Brexit. It has noted the methodological flaws of many of the more prominent studies on which policy makers and other economic actors reply, reaching the conclusion that the magnitude of their predicted negative consequences are most likely exaggerated. These studies do, however, highlight the areas that are disproportionately prone to negative consequences, such as in trade with the EU and in relation to investment being deferred due to the uncertainty caused by the Brexit process. However, other factors are too often either ignored or marginalised, such as the potential to expand trade and investment with the rest of the (non-EU) world and the potential for government policy to

ameliorate negative, and magnify positive, effects. What is needed is for policy makers and other economic actors to base their decision making on a broader range of economic evidence. It is hoped that this book plays a small part in this endeavour.

The choice of future economic relationship, between the UK and the EU, will play a critical role in determining whether Brexit will ultimately be viewed as a success or failed experiment. There is a trade-off between greater trade access into the EU SIM, which may deliver short-term benefits, and securing a greater degree of policy flexibility, which may deliver longer-term gains. Judgements concerning the merits of either option will be, at least in part, determined by perceptions concerning the significance of economic problems facing the UK and the potential for economic policy intervention to provide a solution. If the UK economy is viewed as essentially sound, and/or policy interventions are viewed as having only weak effects, then there would appear to be little to gain by more independent action and therefore continued market access is the overwhelming priority. EEA or customs union membership would therefore appear to be the most preferable Brexit options.

If, however, the UK economy is viewed as suffering from a number of longstanding problems, not least the very large trade deficit and productivity weaknesses, then a more independent stance would appear more advantageous. If, in addition, the evidence is accepted that active forms of economic policy can have significant impact upon the economy—and the reader needs to look no further than the stabilisation achieved amidst the recent financial crisis or indeed the action of the Bank of England to reduce uncertainty immediately after the European referendum—then the most obvious Brexit option would be to seek to negotiate an FTA, including as greater portion of services as possible. Should this not prove to be possible, then it would be preferable for trade to revert to WTO rules rather than accept a form of trade agreement which unduly restricted the policy flexibility for the now independent UK. This would provide sufficient policy flexibility to reduce uncertainty through the stimulation of aggregate demand, utilise an active industrial and procurement policy to strengthen the UK's productive base, whilst targeting national regulation upon the needs of the domestic economy and maintaining a competitive exchange rate to facilitate international competitiveness. Given the evidence presented in this book, this independent option would appear to offer the greater potential.

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