

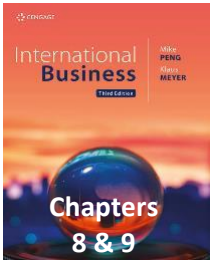
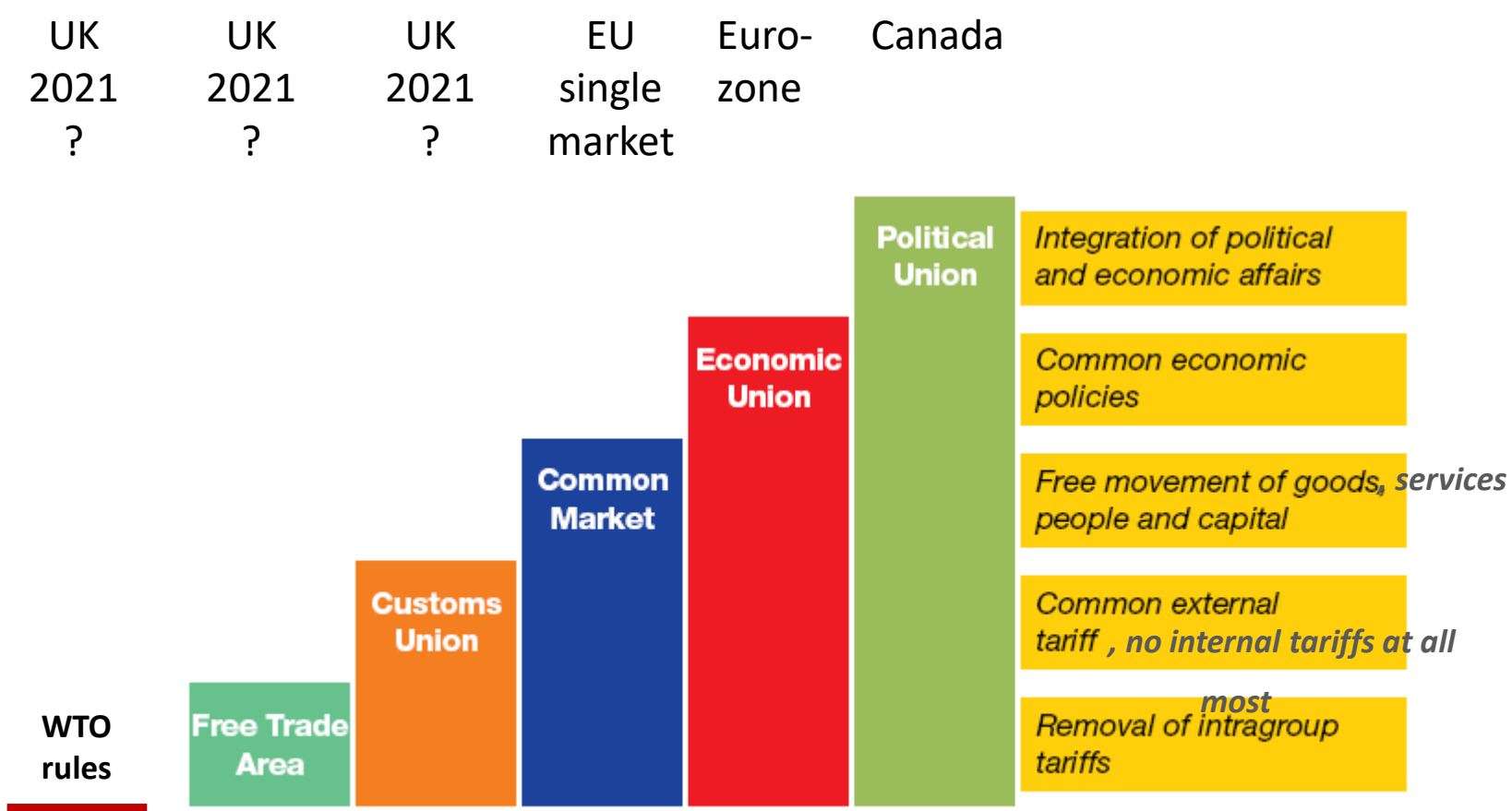
BREXIT: What trade arrangement will the UK and EU have in the future?

Klaus Meyer

March 2020



Multilateral trade agreements can take different forms and depth



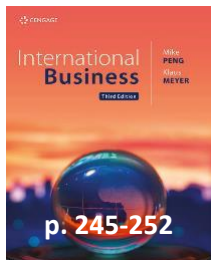
The World Trade Organisation (WTO) has been created to eliminate trade barriers.

How does it work?



A rules-based system for international trade

- **principle of non-discrimination** (“**most favored nation** principle”): cannot discriminate tariffs between different trading partners, unless it is a FTA.
- Formal process to **handle disputes** constructively
- Periodical **trade policy reviews** for member countries



Predecessor:

General Agreement on Tariffs and Trade (GATT)
created in 1948 under US leadership.



“most favored nation principle”

- ➔ member countries are not permitted to discriminate between member countries when setting their tariffs and other trade barriers
- ➔ if tariff for a product category is lower vis-à-vis one other country, then the lower tariff applies to all other countries that are WTO members

“Member countries” includes all major countries around the world

Exception:

Free Trade Areas that have been notified to the WTO.

Implications:

Countries can't bilaterally agree higher/lower tariffs that would discriminate against third countries

How does the WTO (try to) settle dispute between nations regarding trade barriers?



- **Countries submit formal complaint to the “Dispute Settlement Mechanism”**
 - Mandatory bilateral consultations
 - Panel of experts to investigate & hear both parties & issue report
 - Formal ruling by WTO (normally follows panel report)
- **WTO does not have its own enforcement capability**
 - a WTO ruling is a recommendation not an order; it has no power over sovereign nations
- **A country that won a dispute (usually) is permitted to charge retaliatory tariffs**
 - Hurts the ‘winner’ too
 - Little effect in case of small countries
- **A country that has lost a dispute case can:**
 - change its laws or practices to be in compliance
 - defy the ruling by doing nothing and be willing to suffer trade retaliation

How do Free Trade Agreements (FTAs) work?

(bilateral or multi-country)

Designed around the preferences of the participating nations!

Tariffs are eliminated for many product categories

- But excluding sensitive sectors
 - typically agricultural products are not included
- Local content requirements apply
 - “need to have x% content from exporting country to be tariff free”
 - Not cumulative across FTAs

Normally not much **Regulatory alignment**

- May (!) include investor protection & commitment to ISDS processes
- Politically often too sensitive
- De facto, barriers for service trade remain



How does the EU Common Market work?

(EU single market)

The core principle

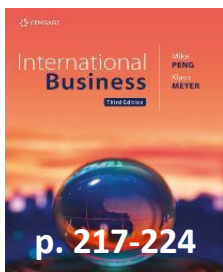
- **free movements of goods, capital, people and services**

The Principles of **Harmonization**

- Principle of **“mutual recognition”**
 - Products recognized as legal in one country may be sold throughout the EU
- **Harmonized sectors**
 - Sectors for which the EU has created common rules
- **Subsidiarity** principle
 - The EU takes action only if it is more effective than actions taken at lower levels



European leaders in 1988



Harmonization in the EU Common Market impact many aspects of the economy.

Examples



Rules for recognition of professional qualifications → free movement of people

Rules for public procurement → common market in services & construction

Liberalization of services → free movement of people providing services
→ alignment of regulation of services

Bank regulation → free flow of capital

No subsidizing your own firms → competition policy

Regulatory alignment

(absence of non-tariff barriers)

low



Border crossings:
Documentation required to demonstrate that goods meet **regulatory standards** of destination country

high



Border crossings:

- **Tariffs** due
- **Invoices** satisfying customs as basis to calculate tariffs
- **Country-of-origin** documentation

low

high

Tariffs

Regulatory alignment

low

Customs Union

WTO Rules

Free Trade Area

high

Single market

low

high

Tariffs

For EU imports e.g.
10% on cars
2.5%-4.7% on car components

*NB: tariffs can **not** discriminate between WTO members unless within a FTA registered by WTO*



Regulatory alignment

low

Customs Union

WTO Rules

Free Trade Area

“Boris’ Deal”

“Theresa’s Deal”

Single market

high

low

high

Tariffs

For EU imports e.g.
10% on cars
2.5%-4.7% on car components

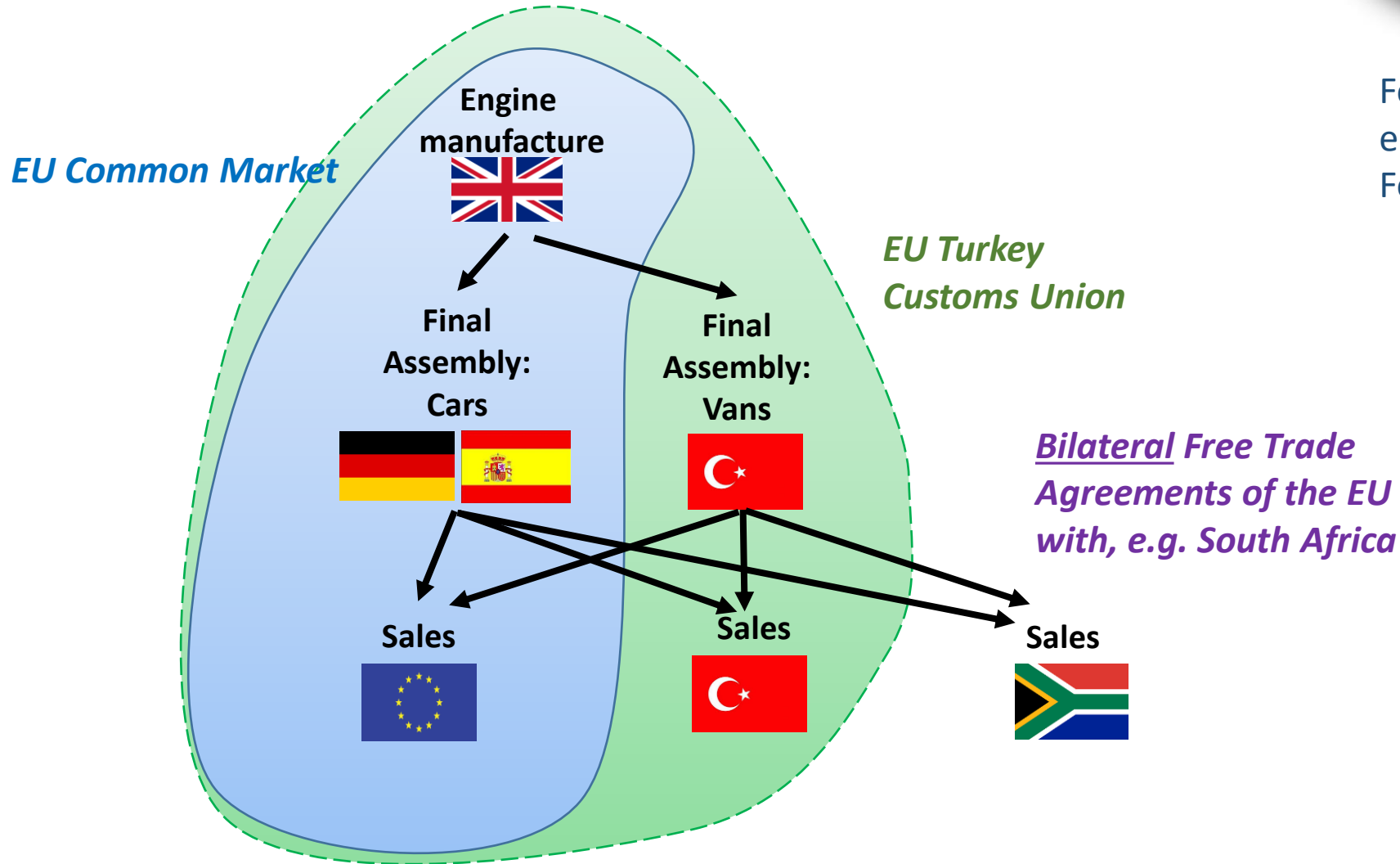
Note: tariffs can **not** discriminate between WTO members unless within a FTA registered by WTO

How do Free Trade Agreements (FTAs) work?

The Case of FORD



Ford produces over 1.5 million car engines every year in the UK.
Ford does not build cars in the UK.



How do Free Trade Agreements (FTAs) work?

The case of FORD



Exports of engines to EU & Turkey are subject to new trade regime

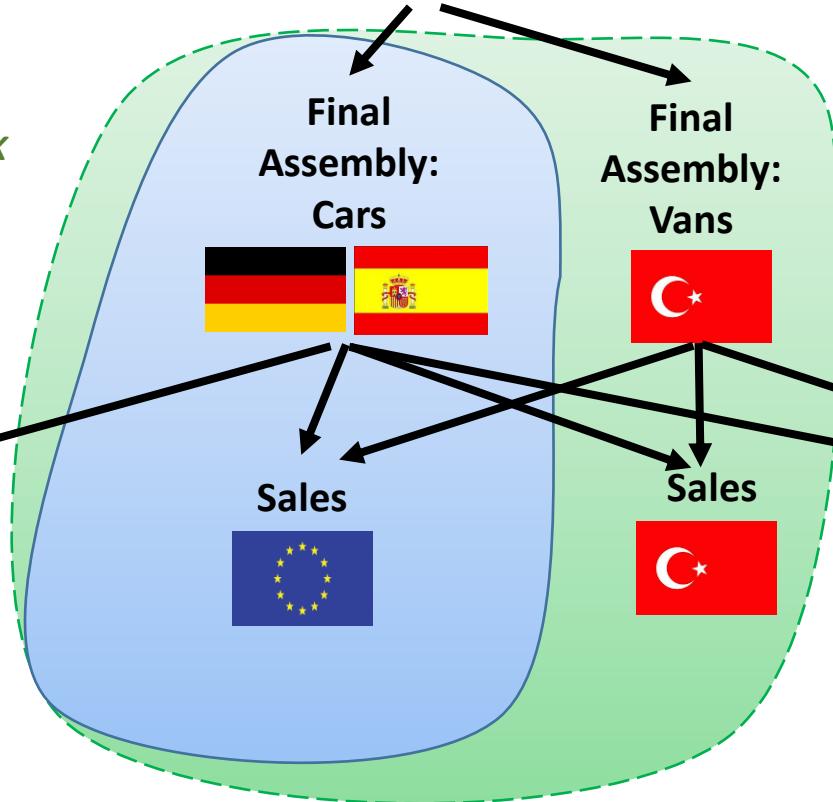
- Tariffs of 4.7% unless FTA is agreed
- Documentation needed that EU standards are met

Engine manufacture

Exports of cars to UK are subject to new trade regime

- Tariffs of ??? unless FTA
- Documentation needed?

Sales



UK value added no longer counts as EU content for car exports; which has to be (typically) 60% to qualify for tariff free under FTA.

Possible Future Trade Arrangements for the UK and the EU

	EU Single Market	European Economic Area	European Free Trade Area	Customs Union	Free Trade Agreement	WTO rules
example	27 members	Norway, Iceland	Switzerland	Turkey	Canada, Singapore	USA
Internal tariffs?	no	no	no	no	Mostly abolished	Yes
Common external tariffs?	yes	no	no	yes	no	no
Free movement of non-agricultural goods?	yes	Yes but rules of origins apply	Yes but rules of origins apply	Yes if complying with host regulation	Yes for most goods if complying with host regulation, and rules of origins apply.	No
Free trade in services	yes	Some services, not financial services	no	no	Some services, usually not financial services	no
Regulatory compliance	yes	yes	Yes (some opt outs)	yes	normally no	No
Border controls for goods transports	no	Yes, to check country of origin	Yes, to check country of origin	Yes, to check regulatory compliance (but not country of origin)	Yes, to check country of origin & regulatory compliance	Yes
Free trade agreements with 3rd countries	no	yes	yes	limited	yes	yes

