

Briefing Paper: 'No Deal' Brexit and Free Trade

Key Findings

- Outside the EU, the UK can sign its own trade deals with non-EU countries while losing the benefits of existing EU FTAs and the internal market. Liam Fox says this will make the UK a **“modern, independent, trading nation”**.¹ Here we summarise expert opinion on the effects of a *No Deal* Brexit on the UK’s **long-term** trade position, **after** the short-term chaos from a No Deal Brexit has subsided.
- The EU has so far not negotiated a free trade agreement (FTA) with the United States. The world’s largest economy with **15% of our trade**, the US is our largest single-country trading partner.
- The EU also does not have FTAs with China, India, Russia, Hong Kong, Taiwan, Australia & New Zealand (though talks should result in one by 2023-25), or the Gulf Cooperation Council (GCC) countries.
- Currently, trade with the EU (**half of UK trade**) is governed by the deepest and most seamless form of liberalised trade possible: an internal market. Under No Deal, trade with EU countries will be subject to maximum friction, or “WTO terms”, meaning:
 - Tariffs: taxes paid by the EU importer of UK products and often passed on in part to consumers;
 - Non-Tariff Barriers (NTBs): frictions from border controls, documentation, and regulation.
- The UK currently benefits from a range of EU-US agreements that reduce NTBs. A new UK-US deal may improve this incrementally but would not replace the benefits lost by leaving the EU internal market². Liberalisation of UK-US trade is **not a counterweight** to frictions created on UK-EU trade.
- Given limited scope to facilitate trade elsewhere, the net effect of No Deal will be **trade barriers** that act as a **permanent drag on UK economic growth of at least 2% and probably a lot more**. Far from being a short-term bump in the road, the economic losses *increase* over time as more effects feed through.
- There is no evidence of this prospect being presented to voters in 2016.

	Internal market (current UK-EU)	Examples of free trade deals (new UK-US)		Current EU-US agreements	Maximum friction (WTO: new UK-EU)
		EU-Canada	EU-Ukraine		
Limits tariffs	Yes	Yes	Yes	Yes	Yes
Removes tariffs	Yes	Yes	Yes	No	No
Eliminates border checks	Yes	No	Partial	No	No
Eliminates tests / inspections	Yes	No	Partial	Sectoral	No
Moves VAT from border	Yes	No	No	No	No
Enables supply chains with multiple seamless crossings	Yes	No	Partial	No	No
Covers services	Yes	Partial	Partial	Very limited	Very limited
Removes NTBs from qualifications and regulations	Yes	No	Partial	Sectoral	No
Regulatory alignment	Yes	No	Partial	Sectoral	No

¹ <https://www.gov.uk/government/speeches/britains-place-in-the-global-trading-system>

² <https://www.ft.com/content/40d74c90-85e5-11e9-97ea-05ac2431f453>

Section 1: Unthinkable damage to UK-EU trade

Current Position On Trade with the EU

- **Tariffs and NTBs:** The EU's internal market eliminates tariffs. More importantly, however, it eliminates most Non-Tariff Barriers on trade among member states.
- **Borderless trade:** Because a product made in one EU country automatically meets the standards of another, goods cross internal EU borders at will without checks, tests, or inspections. Supply chains are integrated and cross-sectoral. In 2014, 61% of UK exports to the EU were in intermediate goods and services³, while most recent figures show that 44% of the value of UK exports comes from imports.⁴
- **Services:** The internal market eliminates many NTBs on services. For example, mutual recognition of qualifications enables UK service providers to serve EU markets.

UK-EU trade after No Deal

UK exports to EU: -50%

GDP: -2.5% to -7%

Jobs / wages: -800k to -1.3m / -5%

- **Tariffs** will be chargeable on UK exports to and imports from the EU. Tariffs vary by sector. The average tariff hence depends on sectoral mix. The CBI currently estimates that tariffs on goods will average **4%**⁵.
- **Non-Tariff Barriers (NTBs):** WTO terms (like most FTAs) do not eliminate most NTBs. For example:
 - UK qualifications to provide services will not be recognised as equivalent;
 - There will be checks, testing, and inspection at the border;
 - The number of required customs declarations will rise dramatically.⁶
- **The results of this are as follows:**
 - NTBs added would cost the same as **tariffs from 5% to over 20%** depending on sector⁷. The average "tariff-equivalent cost" would be **10%**⁸, so UK goods exports will be **14% more costly**.
 - In many goods sectors UK firms will have to supply through an import agent who handles compliance. UK service providers will require⁹ an EU domicile and entity. Many companies that serve the entire EU market are preparing¹⁰ to **transfer their EU operations away from the UK**.
 - Tariffs payable on remaining UK-EU trade will cause a permanent drag on GDP of **0.1%**¹¹;
 - **More important, though, is the loss of export market share** as NTBs erode competitiveness. Exports to the EU are expected to drop by **a half**¹², with a catastrophic **2.1% to 7%**¹³ drag on GDP. Far from being a short-term bump in the road, economic losses get *worse*¹⁴ over time as the UK loses more market access through regulatory divergence, and productivity effects feed through.
 - Loss of Foreign Direct Investment (for example from firm relocations) costs another **0.3%**¹⁵.
 - This is estimated to cost either up to **a million jobs** or up to **5% in average wages**¹⁶.

³ <https://assets.kpmg/content/dam/kpmg/be/pdf/2019/03/TL-brochure-Economic-Outlook-uk-LR.pdf>

⁴ <https://www.instituteforgovernment.org.uk/publications/frictionless-trade-brexite-august-2017>

⁵ <https://www.euronews.com/2018/12/19/how-would-uk-eu-trade-be-affected-by-a-no-deal-brexite>

⁶ *UK trade and the World Trade Organisation, A Brexit briefing for non-specialists*, by Richard Barfield – section 5

⁷ <https://www.parliament.uk/documents/commons-committees/Exiting-the-European-Union/17-19/Cross-Whitehall-briefing/EU-Exit-Analysis-Cross-Whitehall-Briefing.pdf> - section 9 and Barfield section 2

⁸ As previous

⁹ <https://www.pwc.co.uk/the-eu-referendum/beyond-brexite-insights/preparing-for-a-no-deal-brexite-in-financial-services-policy-notes.html>

¹⁰ As previous - "completing these preparations involves shifting business into new EU-based units". See also

<https://www.bbc.co.uk/news/business-47522347> and <https://www.relocatemagazine.com/news/business-hr-manufacturers-shifting-production-to-eu-ahead-of-brexite-dsapsted-0219>

¹¹ <https://www.niesr.ac.uk/sites/default/files/publications/dp462.pdf> - section 4

¹² As note 11, section 2; NIESR update -

<https://www.niesr.ac.uk/sites/default/files/publications/Brexit%20assumptions%20and%20alternative%20scenarios.pdf> - assumes 50-60%

¹³ See note 11; Barfield estimates 2.4% to 3.9% from loss of exports; Cross Whitehall briefing (note 7), page 18, estimates nearly 7% including 3.5% from further later loss of market access as regulations diverge; NIESR update (note 12) estimates 5-6% GDP drag from No Deal overall - including not only trade directly but also productivity and migration (outside the scope of this paper).

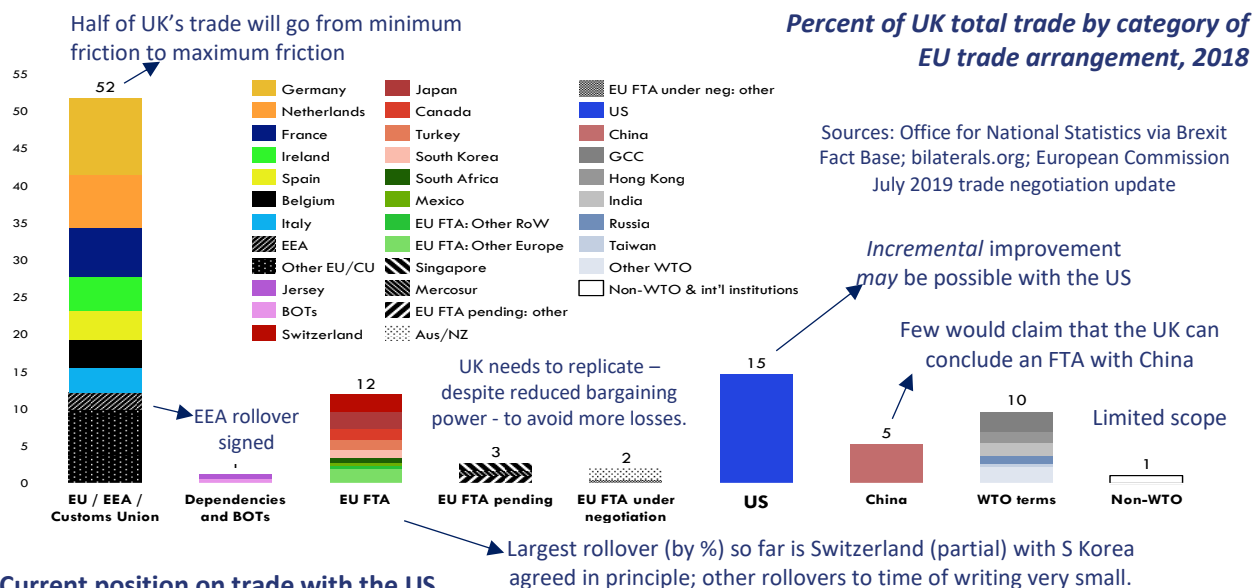
¹⁴ See note 13; NIESR shows increasing divergence from main-case forecast scenario.

¹⁵ Per note 11

¹⁶ Barfield pages 55-56 - methodology agreed with former member of Monetary Policy Committee – while NIESR (note 11) assumes that labour market effects are channelled through wage reductions rather than unemployment; in a third scenario, both wages and employment could fall, but by less than these estimates, which each ignore the other effect.

Section 2: limited benefits at best to non-EU trade

Current trade position



Current position on trade with the US

- Although there is no FTA, the EU and US have over 100 sectoral level agreements limiting NTBs¹⁷. An example is the Open Skies Agreement. While rounds of WTO talks have minimised tariffs, the US and EU have established the Transatlantic Economic Council to discuss and reduce NTBs¹⁸.

UK-US trade after No Deal

GDP: +0.2%

- Distance means that any liberalisation of trade with the US will have a **smaller effect than even an equivalent restriction** on trade with the EU¹⁹.
- However, liberalisation of trade with the US will not be as extensive as new frictions created with the EU. A UK-US deal would be a **free trade agreement not an internal market**²⁰:
 - It would hence make limited impact on NTBs compared to status quo²¹.
 - It would eliminate most tariffs, but these already average only 3%²².
- The government hence estimates the GDP impact of a UK-US FTA – even if it is reached despite Congress' objections²³ over the UK's disregard for the Good Friday Agreement – at around only **+0.2%**²⁴.

Trade with other countries under No Deal

GDP: +0.1% to +0.4%

- China represents 5% of UK trade. The price of a deal would be UK silence²⁵ on human rights - as with the Gulf Cooperation Council²⁶ (GCC) countries (2%) – and risks to the UK's alliances²⁷ and sovereignty²⁸.
- Other countries with which we trade on EU terms include Russia – inconsistent²⁹ in living up even to its WTO obligations – and India, which will prioritise an EU deal³⁰. Estimates of GDP upside max out at 0.4%³¹ including Australia and New Zealand – with which the EU has opened talks – China, India, and the GCC.

¹⁷ <https://www.independent.co.uk/news/business/analysis-and-features/world-trade-organisation-rules-mean-brexit-no-deal-tariffs-checks-a8752811.html>

¹⁸ <https://researchbriefings.files.parliament.uk/documents/LLN-2018-0012/LLN-2018-0012.pdf>

¹⁹ Alan Winters, UK Trade Policy Observatory, quoted <https://www.ft.com/content/40d74c90-85e5-11e9-97ea-05ac2431f453>

²⁰ <https://www.ft.com/content/40d74c90-85e5-11e9-97ea-05ac2431f453> - see Sam Lowe, Centre for European Reform

²¹ https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/working_papers/USUK%20FTA%20516%20FINAL.pdf suggests that the US' greater bargaining power could even leave the UK in a worse position on NTBs than the status quo with the EU's sectoral agreements

²² https://ec.europa.eu/trade/policy/countries-and-regions/countries/united-states/index_en.htm

²³ <https://www.theguardian.com/politics/2019/aug/14/no-chance-of-us-uk-deal-if-northern-ireland-peace-at-risk-pelosi>

²⁴ <https://www.parliament.uk/documents/commons-committees/Exiting-the-European-Union/17-19/Cross-Whitehall-briefing/EU-Exit-Analysis-Cross-Whitehall-Briefing.pdf>

²⁵ <https://blogs.lse.ac.uk/europpblog/2015/05/05/what-the-eu-could-learn-from-switzerlands-free-trade-agreement-with-china/> - comparing Switzerland with Norway; and <https://theconversation.com/why-there-wont-be-a-progressive-canada-china-trade-deal-88450>

²⁶ <https://www.bilaterals.org/?eu-gcc>

²⁷ <https://blogs.spectator.co.uk/2019/04/the-myth-of-the-great-british-brexit-trade-policy/>

²⁸ <https://www.cnas.org/publications/reports/beltandroad>

²⁹ https://ec.europa.eu/trade/policy/countries-and-regions/countries/russia/index_en.htm

³⁰ <https://www.politico.eu/article/india-no-rush-to-do-bilateral-trade-deal-with-post-brexit-britain-commonwealth-eu-customs-union-external-tariffs> and <https://www.politico.eu/article/brexit-eu-hopes-for-india-trade-deal-talks/> - talks had been suspended due to India's lack of ambition

³¹ As note 23

Section 3: Verdict on the effect of No Deal on trade

- No Deal advocates like to claim that their agenda will lead to a free trade renaissance. Indeed, Tim Martin of Wetherspoons held a “free trade tour³²” to promote it, accusing Prime Minister May of being against free trade.
- However, the effect of No Deal is that **net trade frictions created** will result in a **permanent drag on GDP growth of at least 2%** even in the most optimistic scenario, in which:
 - The UK concludes a bilateral FTA with the US;
 - The UK replicates all of the EU’s current FTAs on similar terms despite its reduced bargaining power as a smaller market than the entire EU;
 - The UK concludes FTAs with other countries such as China, India, and the GCC that - for reasons other than EU protectionism or EU internal politics - have proven difficult even for the EU.
- We can only conclude that:
 - Preconceptions have caused No-Dealers to **massively inflate** the amount of low-hanging fruit in free trade opportunities around the world that the EU has deliberately chosen not to pick;
 - They have similarly **underestimated** the freedom of trade guaranteed by the internal market that people and firms in the UK take for granted every day.

Dan Price, former trade advisor to George W Bush:

“The prospect (for the UK) of trade agreements with entities other than the EU... is dwarfed by the significance of maintaining frictionless trade with the EU”

How does this compare to what was promised in 2016?

“The OECD states that ‘trade with the EU and other countries would initially revert to a WTO MFN-basis’. This is a highly flawed assumption that not even the IN campaign contemplates as a realistic possibility.”

Matthew Elliot, Chief Executive of Vote Leave, April 2016

- Vote Leave Chief Executive Mathew Elliot rubbished³³ the idea that UK-EU trade would be conducted on WTO terms after Brexit.
- Michael Gove stated³⁴ on 8th May 2016 that the UK would leave the internal market. David Cameron echoed³⁵ this. Boris Johnson agreed³⁶ in an interview on 5th June 2016. However, he³⁷ and Gove³⁸ promised a free trade deal. Dominic Raab in April 2016 said that “it’s certainly not in the EU’s interest to erect trade barriers.³⁹”

- Daniel Hannan in a 2015 interview was unclear⁴⁰ on whether the UK would stay in the “single market” or “free market”. Either way he was not suggesting maximum friction.
- Boris Johnson told⁴¹ the House of Commons that “we are not preparing for No Deal because we are going to get a great deal”.
- Michael Gove, when leading the Department for the Environment Food and Rural Affairs, said “We didn’t vote to leave without a deal. That wasn’t the message of the campaign I led⁴²”.

A No-Deal Brexit will create far more trade barriers than it could possibly eliminate – with massive economic costs – and was never presented as an option in 2016.

Free-market Conservatives and democrats of all stripes should be doing their utmost to prevent it.

³² <https://www.theneweuropean.co.uk/top-stories/brex-factor-wetherspoons-tim-martin-1-5855204>

³³ <https://www.theguardian.com/politics/2019/jul/29/what-vote-leave-leaders-really-said-about-no-deal-brexit>

³⁴ <http://news.bbc.co.uk/1/shared/bsp/hi/pdfs/08051604.pdf#page=6>

³⁵ <http://news.bbc.co.uk/1/shared/bsp/hi/pdfs/12061602.pdf#page=9>

³⁶ <http://news.bbc.co.uk/1/shared/bsp/hi/pdfs/05061602.pdf#page=5>

³⁷ As 32

³⁸ http://www.voteleavetakecontrol.org/michael_gove_the_facts_of_life_say_leave.html

³⁹ As 32

⁴⁰ <https://www.youtube.com/watch?v=zzykce4oxll&feature=youtu.be&t=308>

⁴¹ As 32

⁴² <https://www.independent.co.uk/news/uk/politics/boris-johnson-dominic-cummings-brexit-unelected-no-10-philip-hammond-a9056676.html>