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A Blueprint for UK Trade Policy

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PROMOTING POLICIES THAT LIFT PEOPLE FROM POVERTY TO PROSPERITY

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ABOUT THE SPECIAL TRADE COMMISSION

The Legatum Institute Special Trade Commission (STC) was created in the wake of the British vote to leave the European Union. At this critical historical juncture, the STC aims to present a roadmap for the many trade negotiations which the UK will need to undertake now. It seeks to re-focus the public discussion on Brexit to a positive conversation on opportunities, rather than challenges, while presenting empirical evidence of the dangers of not following an expansive trade negotiating path.

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1. EXECUTIVE SUMMARY

- 1.1 When the British people voted to leave the European Union on June 23rd, 2016, the economic backdrop was not positive. Measures of actual wealth creation had been down since before the financial crisis. Growth in industrial output has been down for over ten years. The elevated growth of the 1990s in developed countries collapsed with the 2001 recession, and then started to increase once more until 2004 when it started to slow. The Global Financial Crisis significantly worsened what was already a deteriorating situation. This was partly because the global trade agenda had been stalled. The only multilateral agreement since the 1995 launch of the World Trade Organization (“WTO”) itself was the WTO Agreement on Trade Facilitation. This agreement which relates simply to ensuring better customs processes to facilitate trade movements took fifteen years to agree in the WTO. The more difficult discussions on services, investment, competition and the like have been stalled since 1997.
- 1.2 Twenty years later, it is fitting that the UK, a new chess piece on the trade policy chessboard will emerge. How effective that piece will be, and precisely what moves it can make will determine the economic future not only of the UK but also the rest of the world. There is an opportunity for this unfrozen moment, or inflection point to be used to create a global economic engine as a result of unblocking the trade agenda and dealing better with barriers inside the border which are the modern impediments to trade. Before we can understand what kind of trade policy the UK should have, it is important to understand the nature and structure of the UK economy. Since 80% of the UK’s GDP is accounted for by services, and because much of its exports are services, it is critical that the UK is able to negotiate on those issues that impede services trade. These are the behind the border barriers, regulatory protection and anti-competitive market distortions that particularly thwart services exports.

WHAT DOES THAT INDEPENDENT TRADE POLICY LOOK LIKE?

- 1.3 The UK’s trade policy should consist of four fundamental pillars. These pillars include:
 - What we can do unilaterally to create a more pro-competitive environment at home and a reduction of tariffs;
 - What we can do bilaterally to sign agreements with other countries;
 - What we can do plurilaterally to gather a group of like-minded countries into a broader Prosperity Zone;
 - What we can do multilaterally including our WTO rectification process, and our liberalizing agenda going forwards.

- 1.4 If the UK can successfully build these four pillars, this represents a significant gain for UK business, and consumers. Furthermore, taken together it could catalyse the creation of a global economic engine, something that the world presently lacks. We have estimated elsewhere that this could inject 2% into Gross World Product year on year. We will now discuss it in more detail now.

UNILATERAL ACTION

- 1.5 The UK should lower its tariffs for industrial goods where they are low (below 4%) already. It should also lower tariffs and quotas for agricultural products that it does not produce, and for products where there are directly competitive or substitutable products. These would in effect be a “Ordinary Working Families” tax cut. Like Canada, the UK should consider reducing intermediate goods tariffs to zero, especially on products like automotive parts. This would make our manufacturing industry much more competitive, and would be done on an MFN basis (i.e. rest of the world).
- 1.6 The UK should also undertake domestic regulatory reform, putting competition firmly at the centre of UK regulatory policy. For example, Australia and New Zealand have incorporated competition agencies into their regulatory promulgation processes through their Productivity Commissions. This would mean better regulation that is more narrowly tailored to the regulatory objectives without damaging trade or the market unnecessarily.

BILATERAL ACTION

- 1.7 The UK will need to negotiate bilateral agreements with a number of countries:
- **Agreement with the EU.** Both the UK and the EU have now stated that they seek a comprehensive free trade agreement (“FTA”) and have publicly talked about the need for a set of interim agreements between the UK’s exit and the negotiation of a full FTA. The UK would need to agree very specific interim measures to minimize disruption to UK and EU firms, in the (non-exhaustive) areas of tariffs, customs, financial services, the digital single market, aviation, immigration and intellectual property.
 - **UK-US FTA.** The UK and the US can develop significant additional gains from mutually liberalized trade, including in the areas of defence trade, financial services and insurance services, access to government procurement markets, and agricultural markets. Both sides should guard against the danger of using this agreement for mutual political gains, and seek a comprehensive FTA. From the UK’s perspective, if the UK will have only one bite at the apple to secure further services liberalization in the agreement, it will not be able to come back to the table and ask for more.
 - **Bilateral agreements with India, Brazil, China and other emerging markets.** The UK can begin talks with emerging markets although agreements may be difficult to negotiate. There is potential for an agreement with India, with the UK being more open on its domestic

settings, particularly with respect to agriculture and business visas, in return for India opening legal services and some financial, medical and educational services. While China is a significant market, any agreement would require meaningful disciplines on trade barriers inside the border, domestic distortions and the activities of China's state owned enterprises. Brazil similarly has internal distortions that would need to be addressed, and any agreement would have to be with the Mercosur Customs Union of which Brazil is a member.

- **Economic Partnership Agreements with developing countries.** The UK should enter into real economic partnership agreements with developing countries, particularly the African, Caribbean and Pacific ("ACP") countries. These should incorporate UK openness on agricultural and other products, such as tropical fruit, sugar, etc., the UK porting over the "Everything But Arms" initiative to support free trade with the least developed economies, structural reform in ACP countries, and reduction of tariffs on imports of advanced manufacturing goods to ACP countries.
- **Negotiations with countries where the UK has agreements through the EU.** The EU has agreements with a number of countries with whom the UK will have to agree an exchange of notes such that both parties will agree to be bound by the terms of the current agreement (with UK regulatory bodies replacing the European bodies, and other technical modifications in terms of schedules) until any new agreements are developed. The UK should also seek to agree higher standards agreements with certain countries, particularly Switzerland, Norway, Iceland, Turkey, Canada, Chile, Mexico, South Korea and Singapore.

PLURILATERAL ACTION

- 1.8 The UK should spearhead a series of deeper commitments in the WTO at a plurilateral level (with open accession, with benefits spread through its most favoured nation ("MFN") status to all members). A critical part of this would be making commitments in both market access and national treatment, but also pushing commitments into the area of domestic regulatory / conditions of competition. Agreements could be in the areas of financial services and digital services, amongst others.
- 1.9 Further, the UK should lead a plurilateral FTA process—a Prosperity Zone—starting with a group of like-minded countries who are all committed to the foundational principles of open trade, competition on the merits, and property rights protection. This could initially include Australia, New Zealand and Singapore.
- 1.10 The UK could use existing regional agreements as a baseline. The Trans-Pacific Partnership ("TPP") is probably the most advanced agreement by any group of countries. Even without formal accession, there are many elements of the agreement that could be carried into future UK FTAs, such as liberal rules of origin with cumulation, strong customs administration and trade facilitation chapter, SPS measures based on sound science, strong rules protecting investment, business facilitation, commitments on financial services, regulatory coherence, and competition policy. The Comprehensive Economic and Trade Agreement ("CETA")

between the EU and Canada is also a useful model with a number of provisions that could be built on in future UK FTAs, including with the EU.

MULTILATERAL ACTION

- 1.11 The multilateral pillar relates primarily to the WTO. As the UK is already a WTO member, it has discoverable schedules that would need to be rectified. There would have to be deconsolidation of UK schedules from within the EU schedules for services.
- 1.12 For goods other than agriculture, the UK will simply replicate the EU Common External Tariff to re-establish independent bindings (WTO terminology for a commitment which represents the highest level of protection allowed—countries can go below their bindings but not above). For agriculture, the process is more complex as there would need to be estimations of the UK's share of import quotas, applicable tariff rate quotas and entitlements to export quotas. These must be considered as a process-driven rectification. However, there is also scope for liberalization in these areas that the UK must negotiate on with other countries.
- 1.13 Deconsolidation of the services schedule will be a non-trivial exercise. A detailed inventory would need to be taken of the UK's current bindings to establish where the UK can further liberalize. Many of these bindings are also out of date and the current state of play is not reflected, which would need to be considered in establishing UK commitments.
- 1.14 The WTO rectification process should be used as a launching pad for FTA negotiations. Any trade deal must include extensive provision for market access and national treatment in services, and mutual recognition of qualifications and licences where relevant. In return, the UK will have to be prepared to make concessions on the Common External Tariff as it currently applies.
- 1.15 The UK should also assert itself as an active member of the WTO, including in the WTO Trade in Services Agreement ("TiSA"), and being a voice for free trade in various WTO councils such as the Technical Barriers to Trade and Sanitary and Phyto-Sanitary Measures councils. The WTO services negotiations have established a Working Party on Domestic Regulation that the UK should be actively involved in to support greater liberalization in a range of services including financial services and digital services.

THREE CARDINAL RULES AND THEIR CONSEQUENCES

- 1.16 In order to achieve this four-pillared trade policy, the UK will have to comply with three cardinal rules, as we exit the EU. It is rather like a spacecraft gently undocking from another spacecraft by changing its configuration so that it can also dock with the rest of the world. The exit from the EU is this initial undocking. First, we must come out of the Customs Union, because we need to be able to negotiate FTAs with other countries. Second, we must come out of the EEA, or European Single market. We need to do this to be able to negotiate services trade deals with other countries, which requires us to put our domestic regulations on the table in a negotiation, something we cannot do from inside the EEA. Finally, we must maintain

open domestic settings. This means that we must be more open than the EU on agriculture, as this is what our other trading partners will need to see, and any industrial strategy we have must be pro-competitive and open. We must also be able to negotiate so-called mode four services deals. In trade terms there are four main modes for the provision of services—consumption abroad, cross-border supply of services, commercial presence and movement of labour (from an office in one state to a branch or subsidiary in another). Many of our trading partners will want to see the UK liberalize in all four modes, and this will require easier pathways to business visas, and the cooperation of the Home Office.

- 1.17 The application of these three rules entails consequences and business disruption which both sides should seek to minimize which we discuss below.

LEAVING THE CUSTOMS UNION

- 1.18 This entails tariff disruption because without agreement, both the UK and EU would fall back to the Common External Tariff. This disruption is minimized if both sides agree a zero for zero tariff deal which is fully WTO compatible as long as it is for a fixed period and in contemplation of a FTA (which is now clear from both the Article 50 letter and the European Council response). Second, there is potential disruption because of more difficult customs clearance. However other countries' experience teaches us that you do not need to be in a Customs Union to have good customs clearance. The US-Canada border clears \$1.5bn worth of trade every day as a result of electronic mechanisms, trusted operator programs (such as Authorized Economic Operator or "AEO"), pre-clearance and other electronic mechanisms. The Australia-New Zealand border, and closer to home, the Norway-Sweden border are also examples of frictionless trade outside of a Customs Union. Third, standards and product regulation could lead to friction at the border. These are mitigated by mutual recognition agreements on standards, and product regulation which should be easy for both sides in the interim period because the UK will have transposed all EU regulation into its law as a result of the Great Repeal Bill.

LEAVING THE EEA

- 1.19 Leaving the EEA presents problems in services trade in particular which has relied on a single regulatory system. There will need to be interim measures on financial services, such as the Dual Regulatory Coordination ("DRC") system proposed in a joint Legatum Institute/CMS paper¹ which allows mutual recognition of home state supervision while clarifying the prudential carve-out for financial services and moving both systems towards more pro-competitive, consumer welfare enhancing ones. Similarly, there will need to be interim measures in aviation, life sciences, digital and other services sectors. Ultimately, the FTA must deal with these areas and provide solutions that manage the inevitable divergence which is true for all FTAs between sovereign nations.

¹ Legatum Institute, CMS, "A New UK-EU Relationship in Financial Services" available at <http://www.cms-lawnow.com/regzone/articles/2017/march/cms-li-brexite-and-financial-services> and <http://www.li.com/activities/publications>

OPEN DOMESTIC SETTINGS

1.20 While the Article 50 letter satisfies the first two rules above, it does not address the third. This is because for the Article 50 mechanism to be initiated, the third rule does not need to be addressed. However now that we are beyond Article 50 initiation, we will need to be clear about our domestic settings in order to “dock” with other countries in the form of FTAs, and to re-integrate into the global trading system (the multilateral pillar). This means being more open on agriculture. This does not mean immediately moving to free trade in agriculture. We can lower tariffs and quotas for products we do not produce (provided we do not produce directly competitive and substitutable products), move our direct payments from land based (“BPS”) to fully decoupled direct payments which recognize that some things farmers do are not agriculture but contribute to a £30bn tourism industry, are valuable and should be recognized. We should also be more open (or at least WTO compliant) in terms of our regulatory system. Merely complying with WTO rules in the regulatory space in agriculture would be a step up from where we are now. As our country embarks on an industrial strategy, we must make sure that that strategy does not raise barriers to other countries or other firms. We must make sure that that strategy is based on competition on the merits, and does not unduly favour incumbents and monopolists who extract rents from consumers and make prices higher and supply more constrained. Finally, we must be able in our negotiations to be flexible on other countries’ demands in services for liberalization across all modes of supply, including the easy granting of temporary business visas and other ways for businesses to be able to manage operations in other countries. As we go forward with our WTO rectification and with our negotiations with other countries, we will need to communicate this newfound openness with our trading partners. Every action we take will be interpreted by them as a signal, and great care needs to go into the crafting of our language as we go forward. While we tend in this country to live in a Brexit bubble, other countries are watching and trying to comprehend what kind of country they will be dealing with on the global stage. We cannot afford to be unclear or send mixed messages.

WHAT COULD THIS TRADE POLICY MEAN FOR THE UK AND THE WORLD?

1.21 Wealth is created, and people are lifted out of poverty when trade is open, markets are competitive, and property rights are protected. The goal of any nation’s trade policy should be to deliver this for its people at home, to make sure that its exporters do not face barriers abroad along any of these dimensions, and to ensure that supply chains that it manages or has a role in are as efficient as possible. By doing this, trade policy can deliver a win-win situation where the lot of all people in all countries is lifted. To be sure, there will be specific losses where the move to this new setting means some producer loses a benefit he currently has as a result of distortions, and we will need policies to help manage these transitions. However, the consumer gains as a result of this open trade policy should not be underestimated because they directly benefit the poorest among us the most.

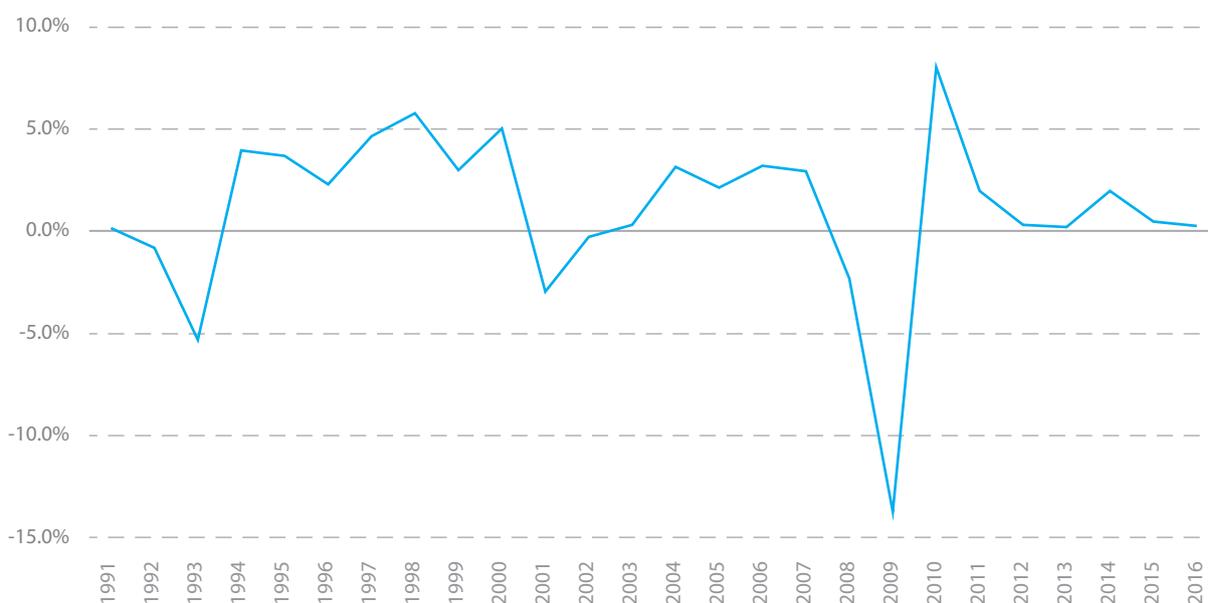
- 1.22 The UK's trade policy could deliver significant economic gains for the UK as well as for other countries. By reducing barriers, both at the border and behind, there could be greater levels of trade, including in services, which in turn would support wealth creation. With open trade and competition, businesses could optimise their production processes and increase efficiency. Over the longer time period, there could be industrial restructuring as economies focus on the production of goods and services in which they have a comparative advantage. By leading on bilateral and plurilateral agreements, the UK could promote the reduction of distortions in other markets as well. The result of this will be more supply and lower prices, critical for the poorest section of our societies.
- 1.23 We stand at a pivotal moment, an inflection point in our country's history. When the history of this time is written, our children and their children will weigh us in the balance, and ask whether we did our part to turn this moment of uncertainty into one of hope and prosperity, or whether we drifted along, constrained by fear with much darker consequences. We are now embarking on a process with the EU who are our partners and colleagues in a mutual endeavour to agree a partnership that will create wealth for all of our people. It is our people who cannot wait, and for whom we must deliver. We are embarking on a process with the rest of the world which could improve the lives of billions of people, currently mired in poverty and hopelessness. They cannot wait either. They are counting on us and we must not fail them.

2. THE CONTEXT OF THE BREXIT VOTE

Below: Figure 1: Index of Industrial Production: Advanced Economies (growth rate)

Source: IMF (2017)

2.1 The global economy has been stalled for over a decade. Growth in measures of economic output and wealth creation such as industrial output has fallen significantly since before the Global Financial Crisis. As illustrated in Figure 1, there was relatively strong growth in the IMF's index of industrial production for advanced economies in the mid- to late 1990s. Output fell in the wake of the 2001 recession, following which rates of growth were more subdued. This situation has worsened since the financial crisis, with little or no growth in industrial output in recent years. In the five years preceding the crisis, the average annual growth rate for advanced economies in the IMF's index of industrial production was 2.4%, compared to an average annual growth rate of 0.9% after 2010.²



² IMF (2017), "Prices, Production, Labor and Population", available at <http://data.imf.org/?sk=6AC22EA7-E792-4687-B7F8-C2DF114D9FDC&slid=1439776194766>, accessed March 30, 2017.

- 2.2 The global trade agenda has also stalled. Prior to agreement of the Trade Facilitation Agreement (“TFA”), it had been 22 years since the last negotiated multilateral agreement (the WTO agreement itself, including GATT 1994 and GATS, as well as agreements on intellectual property (“TRIPs”) and trade-related investment (“TRIMs”)). The TFA is nothing to crow about. While trade facilitation is an important issue, this agreement should have been agreed long ago (it was 15 years in the making), and the fact that an agreement that is so obviously in the interests of all parties (who can possibly oppose trade facilitation other than customs officials seeking to preserve the status quo?) took so long to bring to a conclusion shows how broken the WTO trade-negotiating machinery is. As a direct result of this, global trade flows are growing at their slowest rate since the Global Financial Crisis in 2009 and the early 1980s before that.³ They are losing pace with general GDP growth, suggesting that spending—in particular, government spending—and loose monetary policy are contributing more to global growth than actual wealth creation: clearly an unsustainable position.
- 2.3 It is in this context, in terms of the global economy and global trade, that the British people voted on June 23, 2016 to leave the EU. Either Brexit will arrest the negative global trends which were in place before it or it will accelerate and worsen them. The blueprint for UK trade policy laid out in this document sets out a course of action which will not only arrest the slow-down in growth but will catalyse a significant increase in positive wealth creation.

³ WTO (2017), “Trade and Tariff Data”, available at https://www.wto.org/english/res_e/statis_e/merch_trade_stat_e.htm, accessed March 30, 2017.

3. WHAT DOES AN INDEPENDENT TRADE POLICY FOR THE UK MEAN?

- 3.1 The UK will shortly be in a position to maintain its own trade policy; it will need to develop its plans so that immediately after Brexit it is in a position to have its own policy.
- 3.2 This will require visualising what that policy will look like. The goal of a good trade policy depends on the nature of a country's economy and that country's future potential for growth. The UK's economy is heavily services-based (nearly 80% of GDP is services).⁴ Some of these services are not tradeable (i.e. hairdressers, etc.), but most are major services that are exported. For example, the UK is the second-largest exporter of financial services in the world, with \$84.7 billion of exports in 2015,⁵ and the second-largest exporter of services generally, with \$345 billion of exports in commercial services in 2015.⁶ The UK is also one of the biggest sites for foreign direct investment ("FDI"), receiving £1,034.3 billion in inward FDI in 2014 and the largest percentage (63.7%) of inward FDI as a share of GDP among the G7 countries (UK, Canada, France, Germany, Italy, US, Japan).⁷ The UK does have advanced manufacturing capability, and some agricultural and fisheries production, but these are not mainstays of the economy.
- 3.3 The UK is therefore an economy which is capable of maintaining relatively open domestic settings. This means it has comparatively low levels of defensive baggage in trade terms. In other words, while the UK has very significant offensive interests in lowering the barriers to its services trade, it is not constrained by having to promote protection of a large number of domestic interests. This is not to say it has no defensive interests. British farmers will seek some protection from foreign production, but it is likely to be much less than the protection afforded by the Common Agricultural Policy ("CAP"). Similarly, most UK protective tariffs with respect to manufacturing have been lowered to nuisance levels (less than 4%) in most cases. There are some exceptions, such as cars, electronic equipment, clothing and footwear. UK industry and agriculture have demonstrated concerns about distortions and behind-the-border barriers in other markets that give competitor firms an artificial cost reduction and therefore an edge over their UK competitors. British steel firms and UK producers of dairy, lamb, beef, and other products will be concerned about the import of these products from competitors made cheaper by subsidy or other domestic distortion. Our trade policy will have to deal with this reality.
- 3.4 A sensible UK trade policy will therefore have to include a range of trade agreements with countries where the UK is able to push elimination of behind-the-border barriers, regulatory reform in other countries, and improvement in market conditions for its services providers. The first step is to make sure that, as the UK exits the EU, it does not do anything that unwittingly takes some of its trade policy options off the table.

⁴ ONS (2017), "Gross Domestic Product, Preliminary Estimate: Oct to Dec 2016".

⁵ WTO (2016), "World Trade Statistical Review".

⁶ *Ibid.*

⁷ ONS (2016), "International Perspective on UK Foreign Direct Investment: 2014".

4. OVERCOMING BARRIERS TO A SUCCESSFUL UK TRADE POLICY

- 4.1 The UK cannot be in the Customs Union, otherwise it would be unable to negotiate trade agreements with other countries. It should be noted that:
- The UK can leave the Customs Union without incurring significant customs clearance and tariff losses (as we describe in detail in *Brexit, Movement of Goods and the Supply Chain*).⁸
 - Leaving the Customs Union will allow the UK to negotiate FTAs with other countries.
 - As the UK leaves the Customs Union, it will be important to ensure that the disruption caused by potential tariff increases and customs clearance is minimised. This can be accomplished in an FTA with the EU, and in specific interim measures that are outlined in summary in this paper (and in detail in *Brexit, Movement of Goods and the Supply Chain*).⁹
- 4.2 The UK cannot be in the European Economic Area (“EEA”) because services agreements are agreements on domestic regulation, and the UK will not be able to negotiate high-standards services agreements unless it can put its domestic regulation on the table. It should be noted that:
- Outside the EEA, the UK will be able to negotiate services agreements on domestic regulatory issues, by being able to put its domestic regulatory issues on the table so that countries will be willing to negotiate with it.
 - Leaving the EEA means that there may be disruptions in a number of sectors which will have to be managed. As is the case with the Customs Union, we will need to manage these through the end-state FTA and suitable interim measures in the interregnum period between exit and initiation of an FTA. These interim measures are dealt with specifically in a number of papers that we have produced.¹⁰ In many cases, these disruptions can be turned to advantage by agreeing with the EU a set of measures that actually contribute to further liberalising trade. Our DRC proposal set forth elsewhere is an example.¹¹ Under DRC, home state supervision acceptance can be withdrawn if the supervisor does not maintain prudential regulation and supervision to a level to satisfy the reasonable prudential goals of the host state. This has the advantage of ensuring maximum recognition while facilitating the overall direction of travel towards greater competition. Managing these sometimes conflicting forces will be very important. Managed properly, this could lead to a greater level of liberalisation between the UK and EU member states than that which currently exists.
- 4.3 In order to obtain the trade liberalisation gains from its trading partners that are necessary for a successful outcome, the UK will have to have open domestic settings. Domestic settings relate to a country’s laws and regulations that are either liberalising and open, or protectionist and closed. For example, a country that moved from a higher to a lower level of production subsidies in agriculture would be a country that was moving to more open domestic settings.

⁸ Legatum Institute (2017), *Brexit, Movement of Goods and the Supply Chain*, available at <http://www.li.com/activities/publications>

⁹ *Ibid.*

¹⁰ *Ibid.* See also Legatum Institute, *CMS A New UK–EU Relationship in Financial Services* available at <http://www.cms-lawnow.com/regzone/articles/2017/march/cms-li-brexit-and-financial-services> and <http://www.li.com/activities/publications>

¹¹ Legatum Institute, *CMS A New UK–EU Relationship in Financial Services* available at <http://www.cms-lawnow.com/regzone/articles/2017/march/cms-li-brexit-and-financial-services> and <http://www.li.com/activities/publications>

Similarly, a country that opened up a services sector to greater foreign participation would also be moving to a more open domestic setting. Clearly, countries that have more open domestic settings will find it easier to negotiate trade agreements. In order to negotiate the agreements that constitute a trade policy that generates the significant gains that the UK needs, it must maintain open and positive domestic settings. These include its settings on immigration and on agriculture, as well as any setting changes as a result of industrial strategy proposals:

- Immigration—the UK's domestic settings should be such that it is in a position to negotiate mode 4 services deals with trading partners. This requires a needs-based immigration policy that solves the needs of a competitive UK economy (to be explored in our forthcoming paper "Industrial Strategy").
- Agriculture—Clearly agriculture is one of the most difficult issues in any trade negotiation; it is vital that the UK maintains openness here, consistent with protecting the interests of British farmers (to be explored in our forthcoming paper *Opportunities and Challenges for British Agriculture Post-Brexit*).¹⁰
- Industrial strategy—It is important that the UK's industrial strategy is open and competitive and minimises economic distortions (recommendations to be outlined in our forthcoming paper *Industrial Strategy*).

5. CORE ELEMENTS OF SUCCESSFUL UK TRADE POLICY; TOWARDS A FREE AND PROSPEROUS BRITAIN

- 5.1 This paper assumes an end state for the Brexit negotiations which is based on four pillars discussed below.

WHAT CAN WE DO UNILATERALLY?

- 5.2 The UK should lower its tariffs for industrial goods where tariffs are quite low (below 4%). It should also lower tariffs and quotas for agricultural products it does not produce and for products where there are no directly competitive or substitutable products. This reduction of tariffs can be packaged as an “Working Families” tax cut.
- 5.3 The UK should embrace domestic regulatory reform. This reform would put competition firmly at the centre of UK regulatory policy. Australia and New Zealand, by way of example, have incorporated competition agencies into their regulatory promulgation processes. The idea of this is to ensure that pro-competitive regulation is more likely, as competition agencies can weigh the impact of regulation on markets and competition, and then legislators can be better placed to determine whether any harm to consumer welfare is worth suffering to satisfy the regulatory goal. This does not mean no regulation or a regulatory race to the bottom; it means better regulation that is more narrowly tailored to the regulatory objectives without damaging trade or the market unnecessarily.

WHAT CAN WE DO BILATERALLY?

- 5.4 The UK will need to negotiate bilateral agreements with a number of countries as follows.

Agreement with the EU

- 5.5 The EU agreement is likely to be achieved in two parts:
- **A Final Comprehensive FTA**
 - Given the interconnectedness of supply chains in Europe, and the stated aims of the parties, it is likely that the final EU–UK agreement will be an ambitious and comprehensive agreement, and will provide for broader co-operation on non-trade matters such as security.
 - **Interim arrangements**
 - As it is unlikely that a final FTA will have been agreed in full by the end of the two-year negotiation period prescribed under Article 50 of the Treaty on European Union, it will be necessary to agree interim measures.

These interim measures will be specific in nature and designed to minimise the disruption to UK and EU businesses as the process unfolds. Interim measures are needed in the following (non-exhaustive) areas:

- **Tariffs**—In order to minimise disruptions caused by an increase in tariffs, it will be necessary to agree a zero-for-zero tariff deal between both parties for a reasonable but limited period of time. Under WTO rules, this is allowed provided it is of a reasonable duration and in anticipation of an FTA (see WTO Article XXIV and our paper *Brexit, Movement of Goods and the Supply Chain*).¹²
- **Customs**—A transitional arrangement to facilitate customs clearance may be needed for a limited period of time to ensure that customs IT systems and personnel are ready and businesses have been able to adapt to rules of origin and other formalities as required (see our paper *Brexit, Movement of Goods and the Supply Chain*).¹³
- **Financial services**—The UK will be looking for mechanisms for continued mutual recognition of regulation for financial services. We have proposed a DRC model, in which both sides would accept home state supervision and could withdraw that recognition if measures were taken that were not necessary to satisfy prudential concerns, or imposed competitive damage in the market. This could function on an interim basis, as the parties start from a position of harmonisation, but could ultimately be carried into the FTA as a financial services chapter (see our papers on financial services).¹⁴
- **Digital single market**—The key interim measures here would be to ensure minimal disruptions with the EU. The UK should seek, for example, ‘white-listing’ for data protection purposes, mutual recognition of broadcasting licences, and cost-based interconnection for telecommunications operators connecting to EU networks.
- **Aviation ‘Open Skies’**—It is in both sides’ interest to maintain open access to aviation markets. The UK may also wish to retain some oversight or influence over European security standards.
- **Immigration**—The UK should clarify early on the status of EU citizens residing in the UK, and seek the same support for British citizens in the EU. Both sides have indicated that this will be a priority.
- **Intellectual property**—Intellectual property rights protection is highly integrated across the EU and measures will be required for continuity. Future cooperation in this field is likely.

UK-US FTA

5.6 There are many areas where the UK and US can develop significant additional gains from mutually liberalised trade, and we outline these in our forthcoming paper on the ground to be covered in any UK/US FTA. They include:

- **Government Procurement**—The UK could benefit from better access to US government procurement markets. States undertaking procurements are mandated under ‘Buy American’ laws to give preference to US-produced materials, subject to certain waivers where domestically sourced products are more expensive or in favour of countries where the US has reciprocal benefits under the WTO Government Procurement Agreement (“GPA”) or an

¹² Legatum Institute (2017), *Brexit, Movement of Goods and the Supply Chain*, available at <http://www.li.com/activities/publications>

¹³ *Ibid.*

¹⁴ Legatum Institute, *CMS A New UK-EU Relationship in Financial Services*; Legatum Institute (2016), “Financial Services Briefing”, available at <http://www.cms-lawnow.com/regzone/articles/2017/march/cms-li-brexit-and-financial-services> and <http://www.li.com/activities/publications>

FTA. The UK would look to benefit from waivers for its exporters though an FTA. A significant amount of public procurement is operated at municipal levels (and therefore not covered by the GPA, even though much of it is funded by the federal government). The UK could also raise this in the context of an FTA.

- **Defence trade**—The UK has major interests in improving its access to, and relationship with, the US defence base. The UK has the ability to be part of the US defence base for the purposes of ITAR (International Traffic in Arms Regulations)—so no export licences would be needed for the export of defence articles to the UK—and also for the purposes of government procurement in the defence sector.
- **Financial services and insurance services**—The UK and US could collaborate more and the UK could have better access to the US market for financial services.
- **Agriculture**—The US would seek improved access to UK agricultural markets. The US will want access for beef, sheep meat, pork, poultry, oilseeds, dairy, and bulk commodities. It would also be interested in an improved regulatory environment in the UK. We have treated potential regulatory improvements in the areas of the precise application of the precautionary principle, as well as due process in the implementation of specific provisions for certain products (to be explored further in our forthcoming papers on agriculture and fisheries).

BILATERAL AGREEMENTS WITH INDIA, BRAZIL, CHINA, AND OTHER EMERGING MARKETS

- 5.7 At the same time, the UK can begin talks with emerging markets, which are important trading partners but not yet ready, because of their internal distortions, to be candidates for the Prosperity Zone of like-minded countries which are committed to open trade, competition on the merits, and property rights protection (on which see section 5.17 below). Agreements with these countries will be difficult to negotiate, but it is necessary to initiate the process, as none of these relationships is conducted in isolation—they all have an impact on each other.

India

- 5.8 In the case of India, there is a potential agreement that can be done. If the UK is more open on its domestic settings, particularly with respect to agriculture and business visas in the context of mode 4 services, then it is likely that we will see India opening in legal services, some financial services, some medical and educational services, and perhaps even the Scotch whisky tax.

China

- 5.9 China represents a significant amount of UK trade and is therefore a very important market. However, we would counsel against a China deal unless it includes meaningful disciplines on trade barriers inside the border, domestic distortions, and the activities of China's state-owned enterprises.

Brazil

5.10 Brazil is another significant emerging market, but one that is fraught with internal distortions, including tax distortions. Any agreement must also deal with Brazil's internal distortions. As Brazil negotiates through the Mercosur customs union, any UK agreement would have to be with the customs union.

Economic partnership agreements ("EPAs") with developing countries

5.11 The UK should enter into real EPAs with developing countries, particularly the ACP countries. These EPAs should incorporate the following elements:

- The UK will be more open to the agricultural and other products of these countries.
- Many developing countries benefit from Generalized System of Preferences ("GSPs") and other preference programmes. For the least developed, the UK should transpose the EU's 'Everything But Arms' ("EBA") initiative, which will lead to free trade with the least developed countries in a way that cannot be removed. For the other developing countries, the UK should be careful not to simply replicate the preference programmes that exist. This creates an "Alice through the Looking Glass" situation where developing countries ask a developed country to keep its tariffs high (with the consequence that consumers in the UK pay higher prices so that developing countries' state-owned companies can maintain a preference). GSPs are discussed in further detail at 4.45–4.50.

UK's openness to agricultural products produced in ACP countries

5.12 Many of the products produced by ACP countries are not produced by UK farmers. Here the UK can lower tariffs and quotas in the selected areas, and also end the practice of tariff escalation in which processed products further up the value chain attract higher tariffs.

Structural and regulatory reform in ACP countries

5.13 Many of the least developed countries want to engage in serious structural and regulatory reform but are prevented from doing so by their own vested interest elites who benefit from the distortions in place. An EPA would give the government of a given country the external benefits necessary to convince its people to back regulatory reform.

Reduction of tariffs on imports of advanced manufactured goods to ACP countries

5.14 Many developing countries maintain high tariffs on advanced manufacturing goods. These are only in place for revenue reasons. There is no domestic production for these goods. Removal of these tariffs would be essential to ensuring better access for UK advanced manufacturing in areas such as (for example) medical devices and other life sciences products.

WHAT CAN WE DO PLURILATERALLY?

- 5.15 The UK should embrace a series of plurilateral agreements both at the services level and in FTAs, in terms of the general services agreement and the built-in agenda of the WTO of deepening commitments in various services sectors.

Deepening commitments in WTO

- 5.16 The UK should spearhead a series of deeper commitments in the WTO at a plurilateral level (with open accession and benefits spread through MFN status to all members). These deeper commitments would be initiated by countries that are committed to the core principles of open trade, competition on the merits, and property rights protection. A critical part of this would be making commitments in both market access and national treatment, but also pushing commitments into the area of domestic regulatory/conditions of competition. We would envisage agreements in the areas of financial, digital, and other services.
- 5.17 The UK should lead a plurilateral FTA process, starting with a like-minded group of countries. Initially, this would include Australia, New Zealand, and Singapore. It is important to ensure that as we move towards a plurilateral agreement, we do not include the agricultural subsidisers too early in the process. We have advocated a Prosperity Zone of like-minded countries which are all committed to the foundational principles of open trade, competition on the merits, and property rights protection. These countries are more likely to be able to strike FTAs that will deepen liberalisation, deal with domestic regulatory barriers, and knock down a host of domestic distortions currently untouched by trade agreements.

Existing regional agreements as a baseline for UK trade policy: The Trans-Pacific Partnership (“TPP”)

- 5.18 The TPP is probably the most advanced trade agreement that has been agreed by any group of countries. It is a high-standards, platform agreement that attempts to make progress on the most difficult aspects of international trade—especially behind-the-border barriers, regulatory protection, the impact of state-owned business on trade, and distortions more generally.
- 5.19 Although the new US administration has rejected the TPP and it will not now proceed in its current form with the parties who negotiated it, it still provides a useful starting point for a discussion of a high-standards agreement that could underpin the Prosperity Zone. In addition, if enough members of the TPP opt to keep the agreement, even without US participation, then the UK could look to accede to the TPP. This could be a quick win for the UK. However, at time of writing, the chances of the TPP proceeding with the parties that agreed it are thought to be quite low.
- 5.20 The process for such accession would be to agree schedules with the TPP countries of the UK’s tariffs and quotas, and for the UK to accept the disciplines of the TPP.

5.21 Even without formal accession, there are many key elements of the TPP we recommend should be carried into future UK FTAs, including with the EU:

- Liberal rules of origin with cumulation—Cumulation rules should be deployed within the Prosperity Zone so that as the provisions make the overall zone better for supply chains, efficiencies can be developed.
- Strong customs administration and trade facilitation chapter—This should provide for, among other things:
 - prohibition on excessive penalties;
 - co-operation between customs authorities;
 - special provisions for express shipments and business facilitation measures;
 - provisions for risk management and release of goods;
 - transitional safeguard mechanism (eventually to be replaced by anti-competitive market distortion (“ACMD”) mechanism).
- Sanitary and phytosanitary (“SPS”) measures—These should be based on sound science and should not be unjustified barriers to trade. Historically within the EU this has not been the case, and a strong framework will be required. Headings will include:
 - transparency provisions;
 - equivalence recognition of SPS measures; and
 - risk-management objective not to be more trade-restrictive than is necessary to achieve the regulatory goal.
- Technical barriers to trade (“TBTs”):
 - transparency provisions—consider sector-specific measures;
 - standards-setting bodies to have full stakeholder participation; bottom-up consultations;
 - a move away from government-mandated standards systems towards self-regulating and private standard-setting; and
 - liberal conformity-assessment procedures.
- Investment—There should be strong rules protecting investment on a negative list basis, with annexes for any non-conforming measures. Provisions should include:
 - investor/state dispute resolution;
 - measures to deal with state-owned enterprises;
 - prohibition of measures which are not technologically neutral;
 - provisions to deal with forced localisation, local content rules, etc.; and
 - application to sub-federal entities.
- Competitiveness and business facilitation—To achieve supply-chain development, enhancing efficiencies.
- Financial services—Useful sector-specific commitments in areas such as back-office functions, portfolio management for collective investment schemes, and electronic payment card services.

- Regulatory coherence—A very important provision in any UK FTA. It should be based on impact assessment where impact on competition is considered (by the UK’s Competition and Markets Authority (“CMA”) and the partner country’s competition agency); again, it should be aimed at regulation that causes as little distortion to markets as possible while remaining consistent with the regulatory goal.

5.22 The following elements of the TPP, in particular, will need to be modified to reflect the UK’s negotiating objectives:

- Measures dealing with labour
 - The measures agreed under the TPP may not be universally applicable. The TPP requires compliance with fundamental labour rights recognised by the International Labour Organization and effective enforcement of labour laws. Many of the specific plans for particular countries in the TPP would not be necessary with a like-minded group. UK FTAs need not necessarily cover labour issues to the same extent as the TPP.
 - As regards an FTA with the EU, the recent opinion delivered by the advocate general in respect of the EU–Singapore FTA suggests that the labour provisions in that FTA are a matter of shared competence as they are not immediately and directly linked to trade such that they would fall within the common commercial policy. A UK FTA with the EU could exclude provisions on labour standards (given that both parties clearly meet whatever minimum commitments and international standards are generally included in FTAs) in order to avoid a “mixity” problem that would require ratification at member-state level. More helpfully, mutual recognition of qualifications was considered by the advocate general to fall within the common commercial policy. The judgement on this case is expected in May 2017.
- Environment
 - Generally, environmental provisions that relate to enforcement of the territory’s own laws are adequate. Environmental provisions that call for ending fisheries subsidies would also be appropriate.
 - The environmental chapters of UK FTAs should require that environmental rules are not used as disguised barriers to trade and are the least trade- and market-distortive possible consistent with the regulatory goal (which goes much further than the TPP and other trade agreements).
 - Note that environmental measures would make a UK–EU agreement a mixed agreement and therefore an environmental side letter might be a better approach.

An alternative to TPP accession: The P4 Agreement

5.23 Given that the US has withdrawn from the TPP, the ratification process for the remaining countries will have to change, as the current process requires ratification by at least six countries that account for more than 85% of the GDP of all signatories.¹⁵ If the TPP proves difficult to ratify, the UK may wish to look at a different mechanism to engage in a like-minded group of plurilateral partners. One possibility is that the UK could accede to the P4 (Pacific four) trade agreement, an existing agreement (a precursor to the TPP) which includes

¹⁵ Text of the Trans-Pacific Partnership, Chapter 30, available at <https://www.tpp.mfat.govt.nz/text>.

Singapore, New Zealand, Brunei, and Chile. Under Article 20.6, P4 is open to other states to accede. The idea of the P4 + 1 would be to use this as a platform agreement to which others could accede.

- 5.24 P4 provides for import duty-free trade for all goods and agriculture, but Chile has special provisions for certain agricultural products and also reserves the right to have a special safeguard mechanism for its agriculture which is triggered at a particular level of imports. In principle, therefore, subject to agreement, the UK could maintain its agricultural settings for certain products, such as lamb, beef, and dairy among others.
- 5.25 Rules of origin in the P4 agreement are liberal and allow for accumulation. As new members are added, cumulation rules allow global supply chains to be made more efficient. Article 4.11 allows transit through non-Parties, as long as they do not undergo operations in these non-Parties. Article 4.12 allows outward processing to be applied in certain circumstances, in contrast to other agreements (such as CETA) which make it illegal (P4 includes a list of products to which outward processing may be applied).
- 5.26 P4 contains extensive customs co-operation provisions, and customs facilitation that the UK could feasibly accept.
- 5.27 P4 contains equivalence measures for SPS and TBT measures, as well as conformity-assessment procedures.
- 5.28 P4 contains strong intellectual property provisions. The only geographical indications ("GIs") are listed for Chile. To the extent that the UK wishes to list GIs, it should be possible to do so.
- 5.29 Article 12.10 of the P4 provides disciplines on domestic regulation. Measures relating to qualification requirements and procedures, technical standards, and licensing requirements should not be more burdensome than necessary to ensure the quality of the service.

Other useful models for the UK in the prosecution of its trade policy: CETA

- 5.30 CETA is considered by the European Commission to set "a new global standard for future trade agreements". CETA includes a number of useful provisions that could usefully be built on in the UK's FTA with the EU, and some that should be avoided. In any event, it is a useful indication of the EU's positions and what is achievable. Points to note include:
 - CETA includes a restriction on the application of duty drawback, deferral and suspension programmes conditional on export, where the relevant export benefits from preferential tariff treatment between the EU and Canada. The UK should not look to include this rule in its FTAs as it is distortive and could be particularly adverse for the UK in the period where it does not have FTAs with many countries and manufacturers would be particularly reliant on duty reliefs.
 - CETA has a different approach to SPS than that taken under the TPP. An equivalence mechanism is used rather than the TPP requirement that measures should be based on sound science and should not be unjustified barriers to trade. This is because of the defensive interests in

agriculture of both Canada and the EU. The equivalence mechanism allows parties to accept one another's SPS measure if it gives equivalent levels of protection. The UK will face pressure from the EU to adopt this approach, which should be resisted. The TPP approach is to be preferred, but this in turn is likely to be strongly resisted by the EU.

- Both CETA and the TPP include provisions against export subsidies for agricultural products. In practice, this does not go very far, as most export subsidies are "red box" illegal anyway—the real issue is domestic supports and other subsidies for those products. Neither the TPP nor CETA go far enough in restraining those.
- The parties to CETA are to respond to consultations by endeavouring to remove the adverse effects of subsidies for non-agricultural goods, and are to use best endeavours to do so for fisheries and agriculture. The UK may wish to strengthen this, particularly in the context of agriculture and fisheries, although it should be noted that resistance to stronger disciplines in agriculture and fisheries will probably have come from both the EU and Canada.
- With respect to customs and trade facilitation, TPP customs measures are more robust and include, for example, provisions on express delivery, which the UK should look to replicate in its FTAs.
- CETA has audio-visual/cultural industries exemptions that may be eliminated to some extent (subject to the UK's retained obligations under, for example, the European Convention on Transfrontier Television) in the UK's FTAs, although they will remain a priority for partners like Canada and the EU.
- CETA requires parties to work towards setting up a multilateral investment tribunal, whereas the TPP has a more general process for arbitration of investment disputes. Investor protection and investor-state dispute resolution have been controversial matters in both CETA and the TPP; UK policymakers will need to develop and engage publicly on the UK's position in this area as it will be of particular interest to Parliament and interest groups.
- CETA provides for a process towards mutual recognition of professional qualifications. This kind of provision will be very helpful in fully addressing services in the UK's FTAs. The FTA with the EU should look to go further and retain the mutual recognition of qualifications that already exists.
- The financial services section under CETA is significant progress compared to the parties' respective commitments under GATS. It includes provision for the cross-border supply of financial services on an unsolicited basis but retains the broad prudential carve-out and does not provide for recognition of prudential supervision or licensing between the parties. CETA does not include the useful specific commitments in respect of certain services that were agreed in the TPP.
- In respect of intellectual property rights, CETA (like the TPP) affirms the parties' commitments to the Doha Declaration in respect of compulsory licensing of pharmaceutical patents in certain circumstances. While fully understanding the health issues in developing countries, the UK should be looking for agreements that require strict compliance with Article 31 of TRIPS, which regulates such compulsory licensing, notwithstanding the Doha Declaration, in order to protect the interests of the UK life sciences sector.

- The Regulatory Cooperation chapter in CETA is prescriptively looking towards harmonisation driven by the regulatory goals of protection of human, animal, and plant health and is less concerned with building markets based on competition, which is the goal of the Regulatory Coherence chapter in the TPP. The position in the UK–EU FTA will be different as the two sides are already highly integrated and harmonised, so the agreement will need to be focused not so much on harmonisation as on managing co-operation in the progress of future regulation and any eventual divergence.
- CETA goes further than most trade agreements in allowing temporary access of workers, movement of key personnel, and so forth on easy terms and for short periods.

WHAT CAN BE DONE MULTILATERALLY?

- 5.31 The multilateral pillar relates primarily to the UK's obligations and actions within the WTO. It includes the UK's rectification of its schedules, as it is already a WTO member and has discoverable schedules. It also includes the UK asserting itself as an active member of the WTO and, specifically, asserting itself in the WTO Trade in Services Agreement ("TiSA"). The UK should also be a voice for free trade in various WTO councils such as the Technical Barriers to Trade and Sanitary and Phyto-Sanitary Measures councils. The multilateral pillar reinforces the bilateral and plurilateral pillars as much of the negotiation of our tariff-rate quotas ("TRQs") will be dependent on what else we can offer in terms of greater liberalisation in trade agreements in those agricultural sectors where the UK has a productive sector.
- 5.32 The WTO services negotiations have established a Working Party on Domestic Regulation. The progress in the Domestic Regulation working group should be enhanced so that conditions of competition can be factored into the discussions. This is only likely with a like-minded group of countries:
- The UK should gather a group of like-minded countries to agree plurilaterally within the services built-in agenda for greater liberalisation in a range of services sectors, including digital services and financial services.
 - This group should develop text for Reference Papers on Competition Safeguards in a number of these sectors along the lines of the GATS Annex on Telecommunications and the Reference Paper on Competition Safeguards that followed it. This was the original intention of the WTO members at the time of the Tele-communications Annex in 1997. Countries unilaterally sign up to the Reference Paper, and some 90 countries have already agreed to this.

The Role of the World Trade Organization

Since the WTO and the UK's role in it are such critical parts of the whole process, we need to examine how the WTO works. Much has been made of falling back on WTO rules if the UK leaves the EU without a comprehensive FTA.

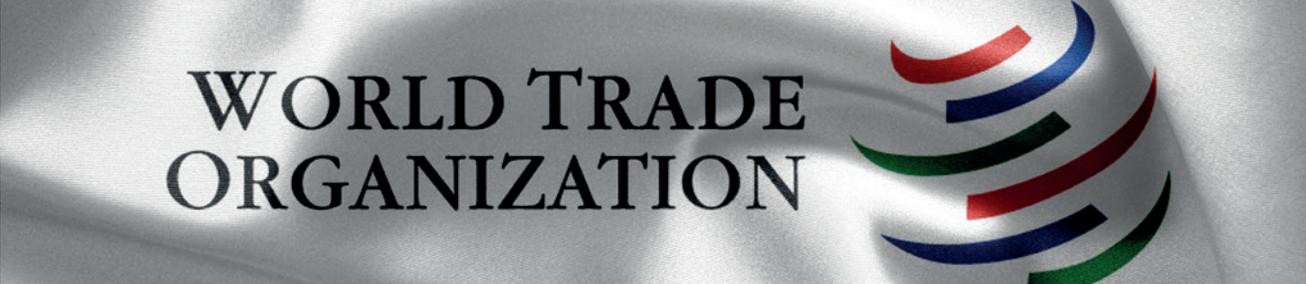
Despite the rhetoric, it is important to note that WTO rules are not something you "fall back on" in the absence of a better bilateral agreement. They are the foundation of all international trade and the structure around which it is carried on. Bilateral and platform trade deals (such as FTAs and customs unions) build on this structure. WTO rules still apply, both to cover aspects of trade that are not dealt with in the trade deal and to regulate the parties' trade with countries with which they do not have a trade deal.

WTO rules comprise a suite of agreements between members. There is a body of cases arising out of dispute settlement and a continuous process of trade policy reviews. The most important agreements for current purposes come under the umbrella of the WTO Agreement, which was the conclusion of the Uruguay Round in 1994. It includes the General Agreement on Tariffs and Trade ("GATT"), the General Agreement on Trade in Services ("GATS"), and the Agreement on Trade-related Aspects of Intellectual Property Rights ("TRIPS"). Sector-specific agreements and annexes sit under GATT, including the Agriculture Agreement, and each country has specific "schedules of commitments" under GATT

and GATS. Other WTO agreements include subsidies and countervailing measures, trade facilitation, government procurement, and dispute settlement.

GATT comprises general terms on non-discrimination in trade in goods between WTO members. The so-called MFN principle means that a preference or advantage made available to one member, such as a lower tariff or higher quota, must be extended to all, unless it qualifies for an exception such as being part of an FTA or customs union covering substantially all trade, or support for developing countries. Discrimination between imported and domestically produced goods is also prohibited, once the imported goods have entered a market. This is the principle of "national treatment".

WTO members are required to publish the tariffs and quotas that they apply to imports of goods from other WTO members in their schedules of commitments. These are legally binding commitments that set out the rates of duty that a country (or in the case of the EU, each member state) will apply to all goods and, in the case of agriculture, quantitative restrictions (quotas) on amounts of goods that can be imported from each country, TRQs whereby a higher tariff is applied after a certain quantity of imports has been reached, and limits on subsidies that can be paid to farmers. In WTO parlance, these commitments on tariffs, quotas, and TRQs are known as "bindings", and the permitted agricultural subsidies are the "aggregate measure of support" ("AMS").



WORLD TRADE
ORGANIZATION

WTO Rectification process

- 5.33 The multilateral pillar consists of what can be done at the multilateral level, both in terms of our WTO rectification—the process whereby the UK discovers its WTO schedules—and in the context of a positive forward-facing trade policy agenda in the WTO.
- 5.34 As part of the Brexit process, the UK will have to rectify its WTO schedules. The starting point for this discussion is that the UK is already a WTO member and has schedules that are currently contained within the EU's schedules, so that the UK's share of import quotas, applicable TRQs, and entitlements to export quotas need to be calculated or discovered. It is important that all the apportionments and separations of the bindings of the UK and the EU respectively are presented to WTO members as process-driven rectification rather than substantive changes to the commitments and concessions of both UK and EU. This is because substantive changes to schedules must go through a process of being negotiated with affected supplier countries, which may include making compensatory adjustments. However, under the Procedures for Modification and Rectification of Schedules of Tariff Concessions under GATT, a certification process was agreed in order to expedite "rectifications of a purely formal character". This means that "amendments or rearrangements which do not alter the scope of a concession ... in national customs tariffs in respect of bound items ... and other rectifications of a purely formal character" will be certified if the text is submitted to the Director General and the other WTO members, and no member objects within three months that either the text does not reflect the changes or the change is not a permitted purely formal rectification.
- 5.35 Similar Procedures for the Certification of Rectifications or Improvements to Schedules of Specific Commitments apply to rectification of GATS schedules, covering "new commitments, improvements to existing ones, or rectifications or changes of a purely technical character that do not alter the scope or the substance of the existing commitments".
- 5.36 This is why the calculations applied in discovering and rectifying the UK's schedules need to be transparent and communicated collaboratively so that WTO members can be assured that the scope of their concessions from the EU and the UK is not being substantively altered. Even if there are objections to certification in this way, trading can and does continue under uncertified schedules while the matter is resolved.
- 5.37 The schedules to be attended to are as follows.

Goods and Agriculture

- 5.38 The EU's Common External Tariff ("CET") on industrial goods and agricultural products and its import quotas in agriculture will be the UK's goods and agriculture schedule. For goods other than agricultural products, simply replicating the CET will be a straightforward step to re-establish independent bindings, and the government has already initiated this. For agriculture, quotas apply and are overlaid with TRQs, so the separation of the UK's bindings is more complex. However, there is a lot of scope for liberalisation in the EU's tariffs and quotas in agriculture, and perhaps in other areas. The UK's position should be to seek to negotiate

reductions in the CET rates in the context of an FTA on a country-by-country basis. Many of the countries we would seek to negotiate FTAs with (including prospective Prosperity Zone countries) value agricultural access highly. Furthermore, if the UK is unable to negotiate FTAs with these countries, they will increase pressure on the UK in the context of the WTO process and may raise objection to the proposed rectified schedules. For example, New Zealand will press for a higher lamb TRQ (so that it can import more at lower tariffs), unless the UK can credibly say that better access is on offer in the FTA. Not being able to conclude such FTAs spring-boarding off the WTO rectification process will complicate the WTO process. Specific points to note:

- **Agricultural import quotas**

The UK will have to agree with the EU what its share of the EU's quota and associated TRQ is for each agricultural tariff line. This may be determined in a number of ways. We can look at the import levels of the particular product as a fraction of the total EU import levels, in order to determine a reasonable share of the quota. We have looked at this issue in a few key sectors, such as lamb, poultry, and beef. There are a number of countries which will want to see increased access in these areas, and since the EU is also a significant exporter to the UK in these areas, it will also want to secure a quota from the UK. In the absence of agreement on retaining zero tariffs with the UK, the EU member states will want quotas for imports of agricultural products into the UK.

It is important that the conversations regarding TRQs are conducted in a holistic fashion, having regard not only to the TRQ itself but also to the possibility of further and deeper liberalisation, a very limited amount of agreed production subsidy, if any, and industry co-operation where UK industry can be better integrated into global supply chains.

- **Aggregate measure of support ("AMS")**

The UK has the right to a share of the European agreed AMS. As this is a WTO right, the UK should claim a reasonable share, and as long as its methodology is robust, it is likely that its suggested AMS level will be accepted by other WTO members. The EU does not spend anywhere near its bound AMS of €60 billion. It spends only around €7 billion a year on so-called amber box support, which are the kinds of subsidy that count towards AMS. The UK does not rely on amber box subsidies in any event, utilising only some £38 million for its two voluntary coupled support ("VCS") programmes in beef and sheep in Scotland. The rest of the UK's subsidies and supports fall into green and blue box types of support which do not count towards the AMS limits. This gives the UK tremendous flexibility when it comes to its AMS binding.

Agreeing no or a very limited amount of AMS will send a very strong signal to WTO members that the UK's domestic settings are open.

- **UK share of EU share of third-country quotas**

When the UK leaves the EU, if a zero-for-zero tariff deal with the EU is not agreed, then it will need quotas for access to the European market in agriculture. The UK currently exports most of its lamb to other EU countries;¹⁶ it would need to agree a quota with the EU for lamb. In the

case of beef, nearly 95%¹⁷ (by weight) of the UK's beef exports are to the EU and around 5% to other countries; the UK will need quotas for the EU and for these other export markets. In the case of poultry, over 25% of UK exports is to other countries beyond the EU;¹⁸ it will therefore need a poultry quota for the EU and these other countries (particularly China, US, Hong Kong, and the Cote d'Ivoire). The largest importers of dairy products are China, Russian Federation, Mexico, Saudi Arabia, Malaysia, and the UAE. The UK will need to ensure it has access for its dairy exports into these markets. Roughly one quarter of UK exports of wheat are to countries outside the EU,¹⁹ so the UK will have to negotiate access with these countries as well as with the EU. In fruits and vegetables, the UK is primarily an importer.

Services

5.39 The EU's schedule of commitments under GATS is already broken down on a member-state basis, so identifying the UK's bindings will be relatively straightforward. However, deconsolidation of the EU services schedules will be a non-trivial exercise. It is self-evident from analysis of the EU services schedule of commitments that there is much scope for the UK to update and further open-access commitments in services. Once again, this can be communicated to other WTO members in the context of potential FTAs in the future. While the legal deconsolidation process should be kept separate from future offers, the UK should certainly telegraph these to members.

¹⁶ DEFRA (2016), "Agriculture in the United Kingdom", available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/557993/AUK-2015-05oct16.pdf.

¹⁷ Average over 2011 to 2015.

¹⁸ Average over 2011 to 2015.

¹⁹ AHDB (2017), "Cereals and Oilseeds: Export Statistics".

Services in the WTO

WTO commitments on services are divided into four "modes of supply":

1. Cross-border supply from one country to another.
2. Consumption abroad where the customer travels abroad to receive a service.
3. Commercial presence, which means the establishment of a branch or office in a country.
4. Presence of natural persons.

Each sector where a country has accepted a binding commitment can have different conditions and limitations attached to each of the modes of supply. Generally, in the EU schedules mode 2 is unrestricted for most services and mode 4 is subject to "horizontal" restrictions, so all sectors are subject to limits on the provision of services by sending people into a country, even for short periods of time, unless specifically provided otherwise.

GATS schedules of commitments work on a "positive list" basis so countries have bindings only in sectors that are specifically identified. The sectors fall into 12 broad categories:

1. Business
2. Communication
3. Construction and Engineering
4. Distribution
5. Education
6. Environment
7. Financial
8. Health
9. Tourism and Travel
10. Recreation, Cultural, and Sporting
11. Transport
12. "Other".

Beneath these sector headings is a multiplicity of subsectors (which are drawn from the UN's Central Product Classification), and each of these subsectors must also be positively opted into for a country to accept a binding. In the case of the EU's schedule, each member state can also add its own conditions, or opt out of a binding, in a sector or mode of supply.



5.40 All the categories specified in the GATS schedules of commitments (except “Other”; see box) are covered in the EU services schedule. A detailed inventory will need to be taken of the UK’s bindings against the sectors and subsectors listed in the UN’s Central Product Classification to establish where the UK would be able to give further commitments and relax the conditions and limitations that it currently reserves. An audit of the commitments of EU member states will also be required to establish what additional access the UK needs through its FTA with the EU. Many of the bindings are out of date (for example, there are still references to deutschmarks and drachma) so the current state of play with respect to market access and national treatment in many sectors is not accurately reflected and the consolidated position following the most recent accessions to the EU has not yet been formalised.

Using the WTO Rectification Process as a Launching Pad for FTA negotiations

5.41 While the UK’s initial opening position should be to replicate the EU’s schedules as much as possible, it should also make it clear to key trading partners that there is plenty of scope to liberalise the position under these schedules, which can be achieved through the negotiation of FTAs.

What does the UK need from its trade deals?

5.42 Some 80% of the UK’s GDP is services, and around 44% of its exports are services (although the ONS notes that due to the ways in which services are provided and paid for, trade in services is hard to measure).²⁰ Any trade deal, therefore, must include extensive provision for market access and national treatment in services, and mutual recognition of qualifications and licences where relevant. In order to achieve this, the UK will have to be prepared to make significant “concessions” in WTO language. Most of these concessions must come in areas where the CET is relatively high. This is primarily in agriculture. The UK will have to communicate to major supplier countries in certain sectors that it is willing to negotiate a trade agreement in order that the trading partner can take advantage of the increased liberalisation available under the UK’s WTO schedules.

Specific areas of potential liberalisation

5.43 Within agriculture, there are many areas of potential liberalisation. In all areas where the UK has no production and there is no directly competitive or substitutable product (as revealed by a cross-elasticity study), the UK does not need to maintain a tariff or a quota. While the CET is the declared schedule, the UK should communicate this flexibility to countries that seek to export agricultural products that the UK does not produce.

Protection for UK farmers against distortions in other markets

5.44 While agricultural tariffs and quotas can be lowered in an FTA negotiation or dispensed with altogether, we will need to recognise the reality that, if the UK is devoid of all border barriers, then its farmers will be exposed to products flooding the UK market whose costs

²⁰ <https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/methodologies/uktrade>

have been artificially reduced as a result of subsidy or other less direct methods of economic distortion (what we have described elsewhere as anti-competitive market distortions, or ACMDs). This will be particularly important because the UK will be next to one of the world's biggest agricultural subsidisers. Mechanisms are available to protect UK producers from such distortions and to provide financial support to farmers in more efficient ways than are currently possible under the Common Agricultural Policy.

ACPs and other preference beneficiaries

- 5.45 As referred to above at 5.11, many developing countries benefit from trade preferences into the EU. If the UK drops tariffs and quotas in products that it does not produce but these countries do, they will be concerned about so-called "preference erosion" as they become exposed to competition with larger developing country producers. The UK will have to provide ACP countries with some measure of comfort that their industries will not be damaged, as happened when the smaller textile producer countries were decimated when the global textile quotas (the Multi-Fibre Agreement) were removed in 2004 and China's production supplanted many of these countries' exports. In that case, an attempt was made to minimise disruption by giving some of the affected countries a special safeguard which was linked to proof of market disruption. The mechanism capped exports of textiles to 6% above the imports from the year previously, but could not be in place for more than six months.
- 5.46 GSP beneficiaries should be protected from loss of access to markets or preference erosion if that preference erosion comes as a result of distortions in other markets. In order to accommodate this, ACP countries must be given some form of safeguard mechanism that would enable them to return to their preference (tariff or quota or some combination) if distortion in the country of export, causation, and damage to their industry can be proved.
- 5.47 If, as a result of greater openness of the UK agricultural market, it is flooded with products from major producers who benefit from subsidies or whose costs are artificially reduced by distortion, then it will be important to provide a mechanism that not only protects UK farmers who are adversely affected, but also protects ACP country farmers who will lose market share into the UK market through no fault of their own. If preferences are to be eroded, some mechanism must be developed which ACP countries can use to ensure that they do not lose critical market share because of another country's distortions. However, at the same time, moving away from the preference system is a necessary part of a forward-looking, market-based agricultural system in the UK. We note that some market share will inevitably be lost to countries that are major agricultural producers of products that do not benefit from distortions and subsidies. While this could adversely affect the ACP producers, the reduction of food prices that could result from this market opening would be very important to UK consumers and would be particularly important for poorer consumers. As we develop policy, we must be careful not to transfer wealth from poor UK consumers to rich developing country agri-producers who have benefited from a protected position.

- 5.48 One of the major problems of the preference system is that it locks in selling patterns that are not based on commercial and innovative factors, but rather result from the protection of the preference. In many ways, this is the soft bigotry of low expectations. Instead, we must develop incentives for producers in these markets to rise up the value chain, producing better products more efficiently and cheaply and fully utilising their workforce. The preference system is the welfare state of the trade world: better mechanisms exist to lift the poor out of poverty.
- 5.49 There are other ways that the UK can and should provide support to the ACP countries. We suggest that the Department for International Development (“DFID”) and the Foreign and Commonwealth Office (“FCO”) create a fund which can provide bridging loans for producers who have specific one-time needs to improve the efficiency of their production methods. These funds should be carefully administered so that they do not become like subsidy payments, but actually enable producers in these markets to become more efficient and competitive. Funds could also be provided for technical assistance to ensure that key inputs of these producers are made as cheap as possible. In developing countries, energy costs tend to be very high, as a result of various inefficiencies in the way in which the power generation and transmission markets operate. It may be that in other markets buying and selling practices put farmers in a price squeeze (such as the C4²¹ cotton farmers who have to buy cotton seed from monopoly French parastatal sellers, and have to sell cotton to the same parastatals, who then use their monopsony power to lower the price of the end product). These measures will be necessary to assist developing countries in much needed structural reform. As such, they represent a win-win for all sides, and the UK’s active engagement in them will enhance its soft power.
- 5.50 Many of the countries that benefit from GSP programmes are concerned about preference erosion and have been lobbying the British government to ensure that the MFN rate is maintained to protect the preference. The reality is that it may be impossible for the UK to resist a unilateral reduction in tariffs in agriculture and other products if the Europeans do not co-operate on interim arrangements on tariffs as the UK leaves the EU (the zero-for-zero offer). Lack of co-operation in this area could lead to considerable food price inflation which will require the UK to unilaterally lower tariffs in precisely the products that ACP countries and GSP beneficiaries typically produce (food and textiles/clothing). This will lead to preference erosion. The only solution for ACP countries is to lobby the EU to co-operate with the UK on interim measures so that the EU and UK agree a zero-for-zero tariff deal on exit. ACP countries should not make the mistake of lobbying the UK only.

Services liberalisation

- 5.51 The UK also has a relatively open market in terms of services. As noted above, there is significant headroom in the EU services schedule for the UK. This means that the UK can agree a more liberal set of services obligations in the context of an FTA negotiation, while retaining its parts of the EU services schedule as a binding. Any further liberalisation beyond these WTO bindings may be accomplished in the context of FTAs with other countries or in the context of a wider platform agreement.

²¹ Mali, Benin, Burkina Faso, and Chad.

- 5.52 The UK's initial WTO rectification process will include accepting that part of the EU services schedule which is relevant to the UK as the UK's services schedule. The UK, as noted above, can then offer countries a more liberalised services schedule in the context of FTAs with them. The starting point is the EU services schedule, so it is useful to know how much headroom is in the schedule—in other words, where the UK could provide a more liberalising offer to its trading partners.
- 5.53 There are key subsectors—for example, audio-visual services—that are not in the schedule at all, therefore no EU member state has any binding in them. There are other cases where the sector is included but is subject to significant limitations and qualifications—most notably, financial services, or legal services (subsector of category 1, "Business"), which are included but only for advising on the service provider's home law and public international law. Both of these examples, because of their highly regulated nature, also depend on mutual recognition of qualifications and licences, and this too can be included in FTAs. For Prosperity Zone candidate countries that have common law-based legal systems and are compliant with global financial standards such as Basel III, this would be a viable offer from the UK.
- 5.54 For sectors that benefit from wide access and national treatment (such as IT implementation and consultancy services) in modes 1 to 3, mode 4 is still strictly controlled. Mode 4 services access will be a key offensive interest for all potential FTA partners, and will also be necessary for the UK economy to thrive in sectors where the presence of specialists is required, and to cover service provision where there are not enough UK-based workers to fulfil a need. Mode 4 services access is closely linked to immigration policy, and it will be critical for the government to have a strategy in place that enables it to make commitments to interested countries that could unlock huge reciprocal benefits for UK businesses.
- 5.55 There are many areas where the EU services schedule is not liberalising of trade and can be improved upon by the UK. In addition, a group of 23 parties (one of which is the EU, so in total 50 countries are represented) has been negotiating an agreement that would further liberalise trade and investment in services: TiSA. TiSA builds on GATS but would advance the position under GATS significantly. It aims to open up markets and improve rules in areas such as licensing, financial services, telecoms, e-commerce, maritime transport, and professionals moving abroad temporarily to provide services. Negotiations have been underway for several years. As an independent party to the TiSA negotiations, the UK would be in a position to contribute to and influence their progress in a positive direction.

Negotiations with Countries where the UK has agreements through the EU

- 5.56 The EU has agreements with a number of countries with which the UK will have to agree an exchange of notes such that both parties agree to be bound by the terms of the agreements until such time as new agreements are developed; this will be subject to agreement on the new regulatory bodies which will enforce the subject matter of any agreement in the UK and carry out necessary activities on standards and regulations.

5.57 The full list of countries with which the EU has FTAs is set out in Appendix A: EU FTAs.

5.58 In addition, there are a number of deals which have been finalised but not yet applied. These include:

- East African Countries (“EAC”)—Interim Economic Partnership Agreement, end of negotiations, October 16, 2014
- Ecuador—Trade agreement, legal revision ended, February 17, 2015
- Singapore—Free Trade Agreement, initialled on October 17, 2014
- Vietnam—Free Trade Agreement, negotiations concluded on February 1, 2016
- West Africa—Economic Partnership Agreement, initialling, July 10, 2014.

5.59 Of all these agreements, it is a priority for the UK to continue to benefit from those made with the following 29 countries or regions:

Bosnia	Russian Federation	Algeria	Morocco	Colombia	South Africa
Georgia	Serbia	Egypt	Tunisia	Peru	South Korea
Iceland	Switzerland	Israel	Canada	Ghana	Singapore
Moldova	Turkey	Jordan	Central America	Kazakhstan	Ecuador
Norway	Ukraine	Lebanon	Chile	Mexico	

5.60 Of these, we believe that the UK would need, and could agree, much higher standards agreements with the following countries:

Switzerland	Turkey	Mexico
Norway	Canada	South Korea
Iceland	Chile	Singapore

- 5.61 As for the other countries, it will suffice, for the time being, to have an exchange of notes identifying the UK regulatory bodies which replace the European bodies, and setting out an agreement between the UK and the third country to abide by agreements on standards and technical barriers to trade. These issues will need to be resolved in the context of the Great Repeal Bill in any event. The EU will have agreed with these third countries rules on technical standards and technical barriers which the UK will have to honour at least initially, until other arrangements are agreed.
- 5.62 The UK must prioritise the countries with which it needs to have agreements, and that list is set out above. These countries must be approached to ascertain whether they will agree to be bound by the terms of these agreements. All of the EU FTAs set up technical committees between the parties which the UK would have to stand up (such as the technical committees on TBT/SPS measures, intellectual property, and other areas which are required under the terms of the EU–Mexico agreement).

6. CONCLUSION

Soon there will be a new piece on the chessboard of trade policy. The UK's trade policy could deliver significant economic gains for other countries as well as for the UK. It could unlock the stalled global trade agenda. It could catalyse the global economic engine the world so badly needs. Leadership is called for, and the world expects a country like the UK to lead. Adopting the policies and goals outlined in this paper could make significant progress towards these gains.

APPENDIX A: EU FTAS

- » Albania—Stabilisation and Association Agreement, May 22, 2006
- » Algeria—Association Agreement, September 1, 2005
- » Armenia—Partnership and Co-operation Agreement, entered into force on September 9, 1999
- » Azerbaijan—Partnership and Co-operation Agreement, entered into force on September 17, 1999
- » Cameroon—Interim Economic Partnership Agreement, signed on February 28, 2009
- » Canada—Comprehensive Economic and Trade Agreement ("CETA"), signed on October 30, 2016
- » CARIFORUM States—Economic Partnership Agreement, provisionally applied
- » Central America—Association Agreement with a strong trade component, signed on June 29, 2012
- » Chile—Association Agreement and Additional Protocol, March 1, 2005
- » Colombia and Peru—Trade Agreement, signed on July 26, 2012
- » Egypt—Association Agreement, June 1, 2004
- » Faroe Islands—Agreement, January 1, 1997
- » Georgia—Association Agreement, July 1, 2016
- » Ghana—Stepping-stone Economic Partnership Agreement provisionally applied, December 15, 2016
- » Herzegovina—Stabilisation and Association Agreement, June 1, 2015
- » Iceland—Agreement, April 1, 1973
- » Iraq—Partnership and Co-operation Agreement, signed on May 11, 2012
- » Israel—Association Agreement, June 1, 2000
- » Cote d'Ivoire—Economic Partnership Agreement provisionally applied, September 3, 2016
- » Jordan—Association Agreement, May 1, 2002
- » Kazakhstan—Enhanced Partnership and Co-operation Agreement, April 30, 2016
- » Kosovo—Stabilisation and Association Agreement, April 1, 2016
- » Lebanon—Interim Agreement, March 1, 2003
- » Madagascar, Mauritius, the Seychelles, and Zimbabwe—Economic Partnership Agreement signed in August 2009

- » Mexico—Economic Partnership, Political Co-ordination and Co-operation Agreement, July 1, 2000
- » Moldova—Association Agreement, July 1, 2016
- » Montenegro—Stabilisation and Association Agreement, April 29, 2010
- » Morocco—Association Agreement, March 1, 2000
- » Norway—Agreement, July 1, 1973
- » Palestinian Authority—Association Agreement, July 1, 1997
- » Papua New Guinea and Fiji—Interim Partnership Agreement ratified by Papua New Guinea in May 2011
- » Russian Federation —Partnership and Co-operation Agreement, December 1, 1997
- » San Marino—Customs Union, December 1, 1992
- » Serbia—Stabilisation and Association Agreement, September 1, 2013
- » South Africa—Interim Trade, Development, and Co-operation Agreement, January 1, 2000
- » South Korea—Free Trade Agreement, signed on October 6, 2010, entered into force on December 13, 2015
- » Southern African Development Community (“SADC”)—Economic Partnership Agreement provisionally applied, signed on October 10, 2016
- » Switzerland—Agreement, January 1, 1973
- » Syria—Co-operation Agreement, July 1, 1977
- » The Former Yugoslav Republic of Macedonia—Stabilisation and Association Agreement, April 1, 2004
- » Tunisia—Association Agreement, March 1, 1998
- » Turkey—Customs Union, December 30, 1995
- » Ukraine—Deep and Comprehensive Free Trade Agreement, January 1, 2016; Association Agreement, May 29, 2014

ABOUT THE LEGATUM INSTITUTE SPECIAL TRADE COMMISSION

The Legatum Institute Special Trade Commission (STC) was created in the wake of the British vote to leave the European Union. At this critical historical juncture, the STC aims to present a roadmap for the many trade negotiations which the UK will need to undertake now. It seeks to re-focus the public discussion on Brexit to a positive conversation on opportunities, rather than challenges, while presenting empirical evidence of the dangers of not following an expansive trade negotiating path.

The STC draws upon the talent of experienced former trade negotiators from the US, Canada, Mexico, Australia, New Zealand, and Singapore, among other nations.

In the coming few months, the STC will host a number of public briefings that offer advice to key stakeholders on EU negotiations.

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All commissioners will serve the Commission in an individual capacity.

MISSION STATEMENT

The purpose of the Legatum Institute Special Trade Commission (STC) is to understand and guide the process that the UK and other governments are engaged in as a result of the Brexit referendum.

The Commission will provide the academic firepower to enable a successful process that includes:

1. The UK's relationship with Europe;
2. The relationship with the countries that more holistically embrace open trade, competition on the merits as an organising economic principle, and property rights protection;
3. The bilaterals with other key trading partners;
4. The relationship with the Commonwealth and developing countries; and
5. The underpinning WTO relationship.

The STC's combined expertise and experience, spread over two hundred years and hundreds of trade agreements puts it in a unique position to be a trusted and independent advisor to the series of post-Brexit processes that could and should lead to the creation of a global economic engine.

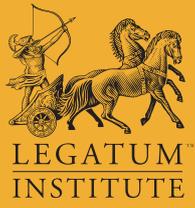
This realises the Legatum Institute's theory of change which is ultimately driven by the need to lift the global poor out of poverty and to create jobs, hope and opportunity for the world's people through the application of property rights protection and open trade systems that are characterised by competition on the merits as the organising economic principle.

The STC's role is to help shepherd governments, stakeholders and others towards increased global prosperity which is available if the inflection point in history that the Brexit vote represents is capitalised on.

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