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UK between Integration and Disintegration: Towards Post-Brexit Trade Policy

The paper elaborates on particular challenges and opportunities for the UK, following its experiments with economic integration and disintegration models, including the decision to withdraw from the EU and design its post-Brexit trade policy along with an alternative to membership. In the circumstances, this paper provides analyses on the nature of forthcoming negotiations, the list of issues appearing to be the most sensitive for the UK's prospective foreign trading relations, based on its current participation in the European single market, as well as agreements Britain would need to strike or renegotiate if it leaves the EU customs union.

Key words: *Brexit, United Kingdom, European Union, single market, economic integration, trade policy.*

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Introduction

Economic integration is widely discussed by scholars and researchers worldwide but there is a limited number of papers covering the reverse process, i.e. economic disintegration. In post-Soviet countries it is mainly associated with USSR/CMEA collapse and trends concerning CIS. In fact, there are much more classical examples for this phenomenon. One of them is EFTA which followed gradual disintegration model.

European Free Trade Association (EFTA) originated on the initiative of the United Kingdom and was established in 1960 as an alternative to the continental model of the European Economic Community mostly due to rivalry between Britain and France. Unlike the EEC, the EFTA focused on eliminating tariffs in trade, primarily in manufactured goods, between member states. It did not imply deeper forms of integration. However, this became insufficient for some of its members due course. Britain and Denmark were the first ones to terminate their membership in that trade bloc in order to join the EEC in 1973. In 1986 and 1995 four

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other countries left the EFTA with the same purpose. Nowadays it operates in parallel with the EU but all members participate in the European single market which makes them a part of the European Economic Area.

Such option could be an alternative for membership in the EU for post-Brexit Britain but it was rejected by the UK government. Thus, after decades of integration/disintegration experiments the United Kingdom is now seeking a ‘unique’ model that will confirm its place as “one of the great trading nations in the world” [1].

Both Houses of the UK Parliament will have to confirm the result of the EU membership referendum by voting for the European Union (Notification of Withdrawal) Bill. The first reading took place on 26 January 2017. If the Bill is passed by the European Parliament and is given Royal Assent by Her Majesty The Queen, it will become an Act of Parliament. Only then, Theresa May would notify the European Council in accordance with Article 50(2) of the Treaty on European Union of Britain’s intention to leave the EU.

UK — EU Trade Flows

Post-Brexit UK trade with other European countries will largely depend on a new deal the British government will strike with the EU. Although on 17 January 2017 Theresa May announced her ‘hard’ Brexit plan, it is still unclear which particular model the UK will really follow. The Prime Minister outlined in that speech that Britain will try to pursue an ambitious Free Trade Agreement (FTA) as a priority. That option cannot mean any participation in the EU Single Market.

Both the so called Swiss model covering bilateral agreements and assuming sectoral approach, and the FTA-based model are destructive for Britain’s participation in trans-European supply chains and bilateral trade flows. This is due to growing divergence in trade regulation and additional transaction costs. Crucially, such costs will be distributed among producers and consumers.

Theoretical framework for economic integration shows that trade liberalization leads to significant changes for participating countries, e.g. famous ‘trade creation’ and ‘trade diversion’ concepts developed by Viner within the Customs Union theory [2]. Apart from the production effects, there are consumption-side analyses as well, e.g. Meade’s concept of correlation between trade expansion and welfare in the case of non-zero elasticity demand patterns [3].

According to Centre for European Reform, the UK benefits from the EU membership which has boosted the country’s trade in goods with the EU-27 by 55 per cent, amounting to 130 billion pounds sterling in 2015 [4]. In total, empirical studies suggest that this only has been due to trade with third countries regarding specific sub-sectors like food or clothes production while this is not the case for

other goods. Costs borne by consumers generally increase but they may fall for mentioned protected sub-sectors, respectively.

No matter whether the UK adopts the Swiss model or the FTA approach as an alternative to membership in the EU, it will have a lengthy negotiations period on numerous issues emerging post-Brexit. This includes regulations and standards British companies will be likely to adopt. Otherwise, they will have to adhere to different standards at the same time which incurs additional costs. Other options are unlikely to take place as the EU promotes harmonization instead of recognition.

One of the key achievements in the EU history is the single market with free movement of goods, services, labor force and capital. Under ‘hard Brexit’ conditions, the United Kingdom will not be able to shape the future of the EU internal market. Even now, the single market still has restrictions, e.g. in the services sector. It should be noted that the European Union’s combined commitments on services are not absolutely clear. In fact, they apply to the EU-12 as of 1994 and also further liberalization of telecommunications and financial services is implied. Other member states are bound by individual commitments, and integration with the EU’s ones is still not complete. According to the sixth (current) Director-General of the WTO *Roberto Azevêdo*, this makes Brexit even more complicated because it might be hard for some members to negotiate the Brexit terms with both the UK and the EU if the current status of the EU membership is not fully ascertained [5].

As for Britain, one of the papers published by the UK Department for Business, Innovation and Skills before the referendum demonstrates that further liberalization in this sector might increase the country’s GDP by seven per cent [6].

The ‘hard’ Brexit approach implies ‘A Truly Global Britain’, specifically some conditions like new comprehensive trade agreements worldwide and establishing own tariff schedules at the World Trade Organization instead of being bound by the EU Customs Union’s Common External Tariff as well as not being part of the EU Common Commercial Policy. For this reason, the UK will seek a new customs agreement with the EU. However, whatever agreements Britain strikes, in the case of a ‘hard’ Brexit, it will no longer enjoy the advantages of the single market, e.g. economies of scale. The empirical evidence shows that there is a correlation between productivity and foreign trade. Thus, productivity of British companies is likely to be under pressure because new deals in Europe and globally cannot provide the same benefits as the single market does.

The single market also contributes to competitiveness. One of the factors for that is an opportunity to take part in supply chains which are quite often subject to regional concentration. Within the UK merchandise trade structure, intermediate goods account for approximately half of the imports [7]. Obviously, the United Kingdom’s production and foreign trade are dependent on supply chains across Europe.

Although leaving the EU is not beneficial for its member states and Britain at least in terms of foreign trade, it is worth mentioning that generally the significance of trade with the EU as a whole for Britain is much higher than vice versa. Nonetheless, almost all member states have continuously boosted their production and productivity due to the growing British consumers demand. As a consequence, Britain records substantial negative net balances of trade with those partners.

While the share of the UK in the Union’s economy was about 16 per cent in 2016 and about half of British exports are to the member states (Fig. 1, Table below), the UK accounts for ten per cent of the EU-27 exports [8].

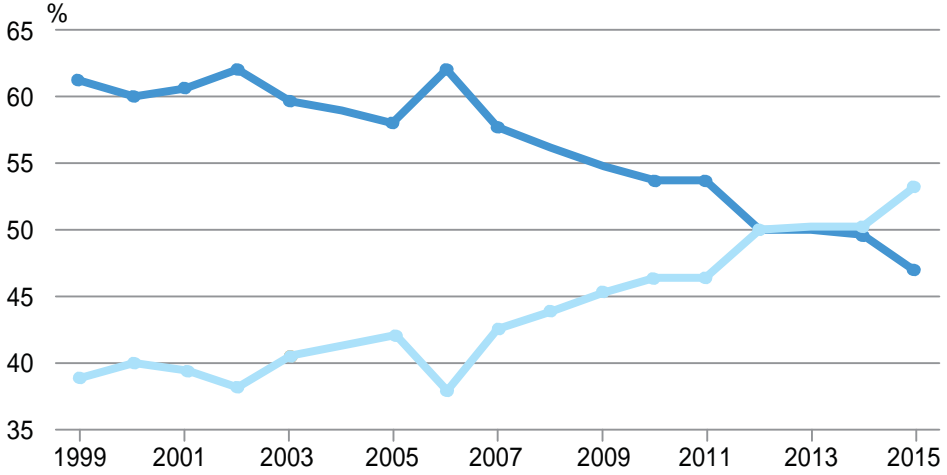


Fig. 1. UK goods exports to the EU and non-EU areas, % of total UK goods exports in current prices in 1999–2015:
 ● EU; ● non-EU

Source: [9].

Britain in trade in 2015

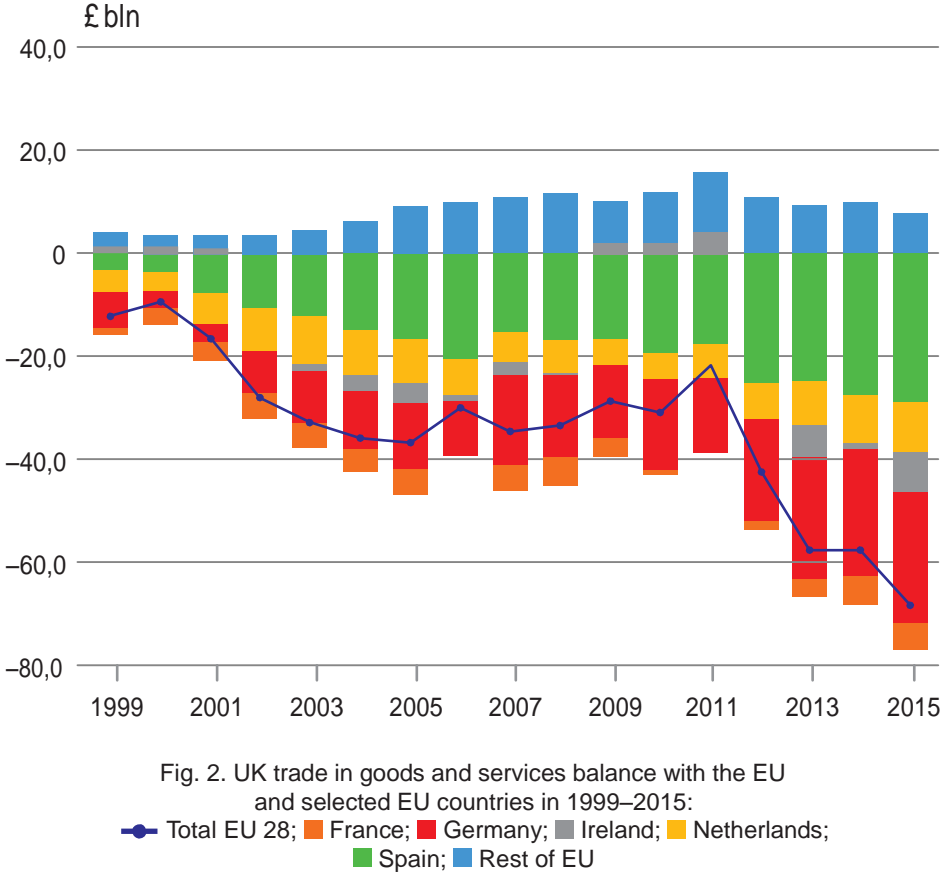
	Exports		Imports	
	£ billions	Share	£ billions	Share
EU countries	2220	44%	291	53%
Rest of the world	288	56%	258	47%
Total	510	100%	549	100%

Source: [7].

Similar to bilateral trade deficits, the overall UK trade balance against 27 members as a whole is also negative.

Just several countries, especially Germany, run positive trade balances against the UK. However, in terms of share of surplus in national GDP, some countries, notably Belgium, Poland, the Netherlands run that trade surplus at more than one per cent [9].

Besides, the UK has run both bilateral trade deficits and surpluses against the Netherlands during last 20 years because of the so-called ‘Rotterdam effect’¹. Just a few members report trade deficits with the UK, mainly Ireland as a traditional importer of British goods. At the same time, a significant number of Irish companies’ export into British supply chains. Dynamics for the UK trade balances are shown in Fig. 2.



Source: [9].

British firms are more integrated into supply chains worldwide than those of many other EU members. As for services, Britain’s financial and business services always play a great role in regional and global supply chains. The same trend is observed regarding exports of chemical and mining products to other countries.

¹ Dutch and Belgian trade flows are often overestimated due to the so-called ‘Rotterdam effect’ (or quasi-transit trade) meaning that goods bound for other EU countries that arrive in Dutch or Belgian ports should be recorded as extra-EU imports by the Netherlands. This in turn increases the intra-EU flows from the Netherlands to other member states.

Post-Brexit Trade Policy

If the United Kingdom adopts one of the alternatives to membership mentioned in the last section, then the government would be able to establish its own trade policy outlines. However, most principles are likely to remain the same as they are set within the EU common trade policy framework. Post-hard-Brexit conditions would not provide as much leverage in foreign trade as the UK currently experiences. This also relates to Britain's participation in the WTO dispute resolution system. Though some disputes are technical, other cases may take on political dimensions. Even if an FTA with the EU is reached, Britain alone would not be so powerful, compared to be a part of the EU united front as a member of the single market.

The European Union as a whole has also gained lots of experience in trade liberalization with external partners. There are three major types of agreements:

- Customs Unions establishing a common external tariff and eliminating customs duties in bilateral trade flows;
- Association Agreements, Stabilization Agreements, (Deep and Comprehensive) Free Trade Agreements or Economic Partnership Agreements reducing or eliminating customs tariffs in bilateral trade;
- Partnership and Cooperation Agreements establishing just basic principles of liberalization of economic relations.

Apart from trade agreements in place, the EU has not yet applied several finalized agreements, namely those with Canada, East African Countries, Singapore, Vietnam and West Africa. Essentially, there is a list of ongoing negotiations with different countries or blocs across the globe, notably with the United States and Japan. Moreover, there are negotiations regarding an investment agreement with China and the Trade in Services Agreement (TiSA). Thus, the European Union is one of key players in the global network of current and prospective agreements.

According to some concepts, regionalism in trade is opposed to multilateral cooperation within the WTO system. Recently this discourse has shifted to Multilateralism—Plurilateralism approach [10, p. 142]. However, whatever flexibility is granted to the UK by 'hard' Brexit provisions in terms of concluding own agreements, it should be highlighted that negotiations are becoming mostly regional or bilateral, so it is the EU that provides leverage to Britain in trade disputes or striking trade deals. Given the circumstances, this is especially significant in trade in services due to regulatory barriers which exist even within the EU single market.

Surely, not trade in goods and services only will be affected should Britain leave the EU. Other matters regulated by the WTO e.g. trade-related aspects of intellectual property rights also depend on the Brexit deal because Britain takes advantage of the economic bloc's weight whilst striking new deals on numerous matters.

Pursuant to a 'hard' Brexit plan, current EU trade arrangements and ongoing negotiations may not be transferred to Britain by default. Actually, the UK would have to

negotiate its departure from the EU as well as trade agreements with its non-EU countries and blocs at the same time. A question arises whether it is possible at all bearing in mind the provisional two-year period according to the Treaty on European Union. As a consequence, it is likely that whilst discussing and voting on a motion regarding Brexit negotiations, Members of the European Parliament will adhere to their current views. Specifically, they might propose conditions that negotiations on time-limited transitional arrangements taking future relations plans into account cannot take place unless the progress towards the UK's withdrawal agreement has been made. Alternatively, a condition on a deal on future UK-EU relations might be made, e.g. that an agreement cannot be reached until Britain has withdrawn from the EU. MEPs have already highlighted they would insist that the UK should meet all financial obligations to the EU despite Britain's contribution to the EU project and institutions.

Besides, the European Union might also be affected by Brexit because the UK contributes to its attractiveness as a trade partner and FDI destination. Although European countries account for about half of world services exports, the share of Britain constitutes six per cent which is larger than individual shares of other EU countries. Furthermore, the UK is the world's second biggest services exporter after the United States [11, p. 70].

Despite some protectionist measures which gained momentum due to crises, the European Union has a progressive and open trade policy partly shaped by Britain. In 2014 the European Commission proposed a new trade and investment strategy called 'Trade for all: Towards a more responsible trade and investment policy' which highlighted effective and transparent trade. On 29 March 2017 the EU Commissioner for Trade Cecilia Malmström addressed European Economic and Social Committee with speech 'A progressive trade policy in a protectionist age' to discuss CETA, TTIP and other agreements negotiated.

In recent years, the European Union's key ambitions regarding foreign trade have been the Transatlantic Trade and Investment Partnership (EU—US) and the Economic Partnership (EU—Japan) while both have not been so prioritized in those countries' trade agendas. However, after D. Trump's decision to abandon the Trans-Pacific Partnership the situation appears to be changing.

Britain's contribution to liberalization of international trade and European foreign economic affairs should not be underestimated. It has advocated the WTO Doha Development Agenda, called for acceleration of TTIP negotiations and proposed trade arrangements in addition to an investment agreement with China.

As for the EU-27 economy, its total GDP is expected to decline by about 15 per cent if Britain leaves the single market [12]. In terms of foreign trade, the share of the EU without Britain is likely to be at the level of around 14 per cent in the world's total while the share of Britain alone would reach about four per cent [Ibid].

It is still too early to say which trade policy instruments Britain will actively use in the future. But surely it will employ trade remedies at a larger scale than it does

now. The European Commission currently handles trade remedies and several UK industries may seek import protection through such measures after Brexit. The UK will set up its own national investigating authority for trade remedies [13]. But it is important to remember that a huge number of domestic consumers and companies depend on imported intermediate goods from outside the EU and would be put at a disadvantage by such contingent trade protection measures.

Conclusion

To sum up, due to complexity of negotiations and related issues it might take much more than two years to negotiate the withdrawal from the European Union, future agreements with this bloc and non-EU countries as well.

Thus, there is nothing certain regarding Britain's withdrawal from the European Union including a model it will adopt as an alternative to membership. This lengthy period might affect investors, financial markets, currencies, employment, trade balance, ongoing and prospective negotiations, and lots of other issues. If it happens that the UK should ensure greater and fair competition, there is much at stake hence adjustment measures are to be designed in advance.

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Великобритания в процессах интеграции и дезинтеграции: торговая политика после выхода из ЕС

Рассмотрены вызовы и возможности для Великобритании, которые появились вследствие ее экспериментов в сфере экономической интеграции и дезинтеграции, включая решение о прекращении членства в ЕС и поиске модели, альтернативной членству в ЕС, наряду с выработкой новой торговой политики. Представлен анализ природы предстоящих переговоров, наиболее чувствительных для будущих внешнеторговых связей страны проблем с учетом текущего участия в едином внутреннем рынке, а также соглашений, которые будет необходимо заключить или пересмотреть в случае выхода Великобритании из Таможенного союза ЕС.

Ключевые слова: *брексит, Соединенное Королевство, Европейский Союз, единый внутренний рынок, экономическая интеграция, торговая политика.*

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