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A trade policy for a brexited Britain

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IEA Discussion Paper No.85

A TRADE POLICY FOR A BREXITED BRITAIN

Kevin Dowd
August 2017

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Summary

- The primary objective of trade policy should be to promote the interests of UK consumers, not producers. The UK's best post-Brexit trade policy should therefore be to trade as freely as possible with the rest of the world.
- Free Trade would bring considerable benefits to the UK. These benefits include lower consumer prices, greater productivity and higher wages. Free trade is also progressive in its impact: the poor benefit proportionately more than those who are better off.
- It is in the interests of UK consumers and UK importers generally to buy as cheaply as possible, which implies that tariffs are a form of self-harm. The UK should therefore commit to a policy of unilateral free trade with the rest of the world, thereby eliminating all barriers to imports, and it should do so regardless of whether other countries impose tariffs on their imports from the UK or not.
- Unilateral free trade should be supplemented by efforts to reach free trade agreements with our major trading partners. The priority should be to seek deals with the United States, Canada, Australia, New Zealand and the EU. The purpose of these deals should be to promote free trade, and it important to avoid deals that focus on other objectives such as regulatory harmonisation.
- In the event that there is no trade deal with the EU, the default position should be that a Brexited Britain would continue to trade

with EU on the same tariff-free basis as it presently does. The UK does not need a trade deal with the EU and the UK should be willing to walk from any bad trade deal.

- The UK bargaining position with the EU on trade issues is then simple. The UK should be willing to seek a trade deal with EU provided that such a deal leads to greater free trade, but it should make it clear that it regards no trade deal as better than a bad one.

Introduction

This paper proposes a future UK trade policy based on free-trade principles. The guiding consideration should be to promote the UK national interest taken as the interest of UK consumers, with interests of producers secondary. Since it is in the UK's interest to buy as cheaply as possible, tariffs and other barriers to imports should be abolished. Such a policy of Unilateral Free Trade (UFT) should then be complemented by efforts to seek Free Trade Agreements (FTAs) with major trading partners, which would reduce barriers to UK exports.

A trade deal with the EU is desirable but is not essential, and the UK should feel free to walk away from any bad deal offered by the EU. Should no deal be reached, the UK would continue to trade with the EU under the umbrella of the World Trade Organization (WTO), of which the EU and UK are members. It would then be up to the EU whether it wished to impose tariffs on imports from the UK, but WTO rules prohibit punitive tariffs against any trading counterparty. And imposing tariffs on imports from the UK would be a major act of self-harm: EU consumers would face higher prices for British goods and the supply chains of EU manufacturers would be disrupted. It is, therefore, in the EU's self-interest to seek free trade with the UK.

This paper first sets out the basic terminology and taxonomy of free trade. It then explains the benefits of free trade, the parallel cases for both unilateral free trade and for seeking free trade agreements with our major trading partners, and the resulting UK negotiating strategy.

Free trade terminology and taxonomy

Free trade means that individuals and companies can import and export goods and services without any government-imposed barriers.¹ Such barriers include tariffs (or taxes on imports), import quotas and discriminatory product standards, government procurement policies or intellectual property (IP) rules.

There are a number of different types of free-trade arrangement. The first distinction between them is that between zero tariffs (ZT) and free trade (FT) or, relatedly, that between tariff policy and trade policy.

Since tariffs apply only to goods while FT applies to both goods and services, it is clear that a ZT policy is necessary for free trade, but not sufficient for it. For example, we might have ZT but also have non-tariff barriers (e.g. trade quotas) or no free trade in services. In such cases, we would have ZT but not full free trade.

Put another way:

free trade = zero tariffs +
zero non-tariff barriers +
zero barriers to trade in services.

The second distinction is that between unilateral free trade and multilateral free trade (MFT). As the names suggest, UFT means that a country applies free-trade policies unilaterally (i.e. it eliminates or reduces barriers to its

¹ One can also imagine free trade arrangements that include free movement of capital, known as a capital union, but for present purposes it is convenient to regard a capital union as a separate issue, the benefits of which are fairly obvious but should be addressed in detail elsewhere.

imports) and MFT means that a group of countries enters into an agreement to eliminate or reduce all barriers to trade between them.

As a general rule, UFT will give a country some of the benefits of free trade but MFT can deliver all such benefits.

There are a number of cases where countries have adopted UFT or near-UFT policies:

- In the UK, tariffs and other protectionist regulations were virtually abolished during the period from 1846 to 1860, and tariffs were only reinstated when the UK switched to a policy of Imperial Preference in 1932.²
- Hong Kong has always had zero tariffs, negligible non-tariff barriers (e.g., it has no quotas or anti-dumping laws) and few barriers to trade in services.
- Singapore operates a policy of almost no tariffs – more than 99 per cent of all imported goods are tariff-free – few non-tariff barriers and few barriers to trade in services.³
- New Zealand has near zero tariffs – the average tariff rate is 1.4 per cent - and few other trade barriers.⁴

These trade policies are widely considered to have been successful.

The third distinction is that between free trade as an ideal and real-world trading arrangements: specifically, the FTAs negotiated under WTO rules.

An FTA would address trade in goods and services and typically cover tariffs and non-tariff barriers, competition and anti-dumping, government procurement policies, IP, barriers to trade in services and dispute resolution.

Many also address barriers to capital mobility or investment.

² 'Free trade and protection', UK Parliament, <http://www.parliament.uk/about/living-heritage/transformingsociety/tradeindustry/importexport/overview/freetrade/>

³ 'Trade Regulations, Customs and Standards', US Department of Commerce, <http://2016.export.gov/SINGAPORE/doingbusinessinsingapore/traderegulationscustomsandstandards/index.asp>

⁴ '2017 Index of Economic Freedom, New Zealand', Heritage Foundation, <http://www.heritage.org/index/country/newzealand>

Several countries with UFT or near-UFT trade policies have also entered into FTAs:

- Hong Kong has 4 FTAs with 7 trading partners.
- Singapore has 20 FTAs with 31 trading partners.
- New Zealand has 4 FTAs with 16 trading partners.

They did so because their policymakers believed that such agreements would give them benefits beyond those obtained by their own UFT policies. These benefits include reductions in barriers to their exports, greater exploitation of the efficiencies of comparative advantage, improved competitiveness, higher productivity and higher living standards, as well as geopolitical benefits.

From the perspective of promoting genuine free trade, however, some trade deals are better than others. Historically – one thinks here of the Cobden-Chevalier Treaty of 1860 or the post-war General Agreement on Tariffs and Trade – free-trade deals focused on reducing tariff barriers. But tariffs have come down over the years and non-tariff barriers are now much more important.

Nowadays achieving free trade isn't so much about tariffs or classic bread-and-butter trade policies; it is about regulation and the general degree of economic freedom. Many restrictions to genuine free trade arise from current regulations in areas such as the environment, consumer protection, health and safety, and data security. These regulatory restrictions are pervasive and constitute barriers to free trade that are at least as important as the barriers created from trade policy.

The benefits of free trade

The objective of trade policy

Adam Smith (1981: 660) famously observed that the purpose of economic activity is consumption, and production is merely the means to that end. To quote:

Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumer. The maxim is so perfectly self-evident that it would be absurd to attempt to prove it.⁵

Don Boudreaux puts it this way:

[A]ll economic activity is ultimately justified by how much it enables us to expand our consumption, not by how much it enables us to expand our production. Consumption is the end; production is the means. Of course, production is an essential means; we cannot expand consumption without expanding production. But production is not the ultimate purpose of economic activity. If you disbelieve me, ask yourself how much you'd pay for a sawdust-nail-'n'-cardboard pie that took its well-meaning baker several days to produce. If you answer "nothing," then you get this point.⁶

⁵ For some good overviews of the general benefits of free trade, see, for example, Curtiss, W. M. 'Serving consumers', Foundation for Economic Education, 1 May 1964, <https://fee.org/articles/serving-consumers/> and Federal Reserve Bank of Dallas (2002).

⁶ Boudreaux, D. J., 'The elemental case for free trade', Café Hayek blog, 18 October 2016, <http://cafehayek.com/2016/10/41537.html>

We should work to live, not live to work. Therefore the UK's national interest in this matter is predominantly that of UK consumers, and the interests of producers are subservient. Indeed, most producers would also benefit from zero tariffs: 85 per cent to 90 per cent of the UK economy is in non-protected sectors. Those who benefit from tariffs are a privileged and protected minority who are benefiting at everyone else's expense.⁷ Policies that put the producer first are a modern form of the mercantilism that Smith himself discredited. As he continued:

But in the mercantile system the interest of the consumer is almost constantly sacrificed to that of the producer; and it seems to consider production, and not consumption, as the ultimate end and object of all industry and commerce.

The 'production-first' mindset has been a feature not just of the classical mercantilism of the sixteenth to eighteenth centuries, but of all anti-free-market philosophies. Examples include economic autarky (the promotion of self-sufficiency, as in the economic philosophies underlying Nazism and fascist Japan's 'Greater East Asian Co-Prosperity Sphere'), Communism, central or national economic planning, and the EU's Fortress Europe trade policies (including its Customs Union), which seek to protect EU producers at the expense of EU consumers and taxpayers.

By contrast, the free-trade philosophy is unique in making the consumer interest dominant, and leaving producers to earn their living by competing to serve consumers. The free-market philosophy is that producers exist only to serve consumers, and those producers who fail to perform that task adequately are encouraged by their business failures to re-direct their efforts. This is in much the same way as a restaurant owner might go into another line of business if his or her restaurant fails to attract enough customers to be economically viable.

On the benefits of free trade, let's begin with some elementary home truths from Adam Smith (1981: 456-457) about the benefits of specialisation:

It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to

⁷ An interesting question is whether producers 'disadvantaged' by the removal of tariffs and other protections should be compensated. However, the question is moot because attempts to compensate these producers could be interpreted as export subsidies which are prohibited under WTO anti-dumping rules.

make than to buy. The taylor does not attempt to make his own shoes, but buys them of the shoemaker. The shoemaker does not attempt to make his own clothes, but employs a taylor. The farmer attempts to make neither the one nor the other, but employs those different artificers. ... What is prudence in the conduct of every private family, can scarce be folly in that of a great kingdom.

Sometimes the climate is the main factor:

By means of glasses, hotbeds and hotwalls, very good grapes can be raised in Scotland, and very good wine too can be made of them at about thirty times the expense for which at least equally good can be brought from foreign countries. (ibid.: 458)

Consider jobs. The economy is always changing and markets are always in a state of flux. Typically, a new product comes along, demand for that product increases and the demand for older products falls. There is then increased demand for labour in the new industries and decreased demand for labour in the old ones. Workers in the former lose their jobs, but new jobs are created in the new industries and there is no net loss of jobs. The process is painful for those who lose their jobs, but over time the net effect is beneficial: labour is reallocated towards higher-skilled jobs that are more productive and better paid. This is why our living standards are much higher than those of our grandparents.

Ryan Bourne put it well:

The economy creates and destroys about 4 million jobs a year. [Free trade] might hasten the process, but the economy is changing all the time anyway.⁸

Think of the UK textile industry of 40 years ago facing competition from lower cost imports from India. Over time, the industry shrinks and eventually disappears. The old jobs go and are replaced by others that are

⁸ Personal correspondence. Dan Mitchell and Russ Roberts provide devastating arguments on this subject: see Mitchell, D., 'Capitalism destroys jobs, and that's a good thing', *Foundation for Economic Education*, 22 December 2016, <https://fee.org/articles/capitalism-destroys-jobs-and-thats-a-good-thing/> and Roberts, R., 'The human side of trade', *medium.com*, 11 December 2016, <https://medium.com/@russroberts/the-human-side-of-trade-7b8e024e7536>

better paid. We see the same process at work in manufacturing: faced with low-cost competition, UK workers move into jobs that are more capital- and skill-intensive. In cars or steel, they move out of the cheaper end of the market and focus on cars and steel of higher quality. Yes, low-skilled jobs are lost to poorer countries, but the economy gains more than it loses because workers move up the value chain into higher-paying jobs.

Why protection is bad

Protection is bad is because it interferes with this natural market adjustment process. In particular, and leaving aside its costs to consumers, the long-term effect of using tariffs to protect jobs is to keep workers trapped in uncompetitive low-paying jobs. I am not suggesting that those who advocate such policies intend this result, but it is the result nonetheless.

What is seldom pointed out is that protectionist policies also disadvantage workers in those sectors that are not protected. This is not just because they have to pay higher prices as consumers, but because their employers have to pay higher prices on their imports. These higher costs cut into their employers' profit margins and lead to lower wages and fewer jobs in non-protected sectors. Around 92 per cent of UK workers work in non-protected sectors. Abolishing tariffs would create more jobs in those sectors and easily offset the loss of jobs amongst the 8 per cent of workers whose sectors would lose their tariff protection.

We must also address head-on the argument that any particular industry should be protected to keep current jobs. By this argument, the printing press should have been suppressed to protect the scribing industry, the gaslight industry should have been protected against competition from electric lighting, and the horse-and-buggy industry should have been protected against competition from cars. Instead, these industries were allowed to disappear. Had they been protected, those who worked in them (or their descendants) would still be stuck in their protected jobs and earning correspondingly low wage rates. If it did not make sense to protect those industries, then it makes no sense to protect their contemporary equivalents now.

Consider the plight of the nineteenth century candlemakers highlighted by Frédéric Bastiat's petition for their protection, my version of which goes as follows:

We candlemakers are suffering from the unfair competition of a foreign rival, who floods our domestic markets with his product which he sells at a ridiculously low price. Every day he appears in our country, all our customers desert us and turn to him.

This competitor is the sun.

So can you please order everyone to close all windows, skylights, shutters, curtains, blinds and all other openings, holes, and cracks through which the light of the sun is able to enter houses. This free sunlight is killing our business.

Making it as difficult as possible for people to have access to natural light would greatly stimulate the demand for the artificial light industry and bring many benefits.

There would be greater demand for candles and greater demand for tallow to make candles, which will help agriculture by increasing the demand for livestock and create more manure as a free side product. There would be greater demand for wicks to put into the candles, greater demand for candlesticks to hold the candles, greater demand for matches to light the candles and greater demand for snuffers to put the candles out. You get the picture.⁹

Protecting jobs by tariffs can be enormously costly too. In 1986, a study by Hufbauer, Berliner and Elliot (1986) examined 31 cases of US trade protectionism and found that the average cost of each protected job was over half a million dollars – equivalent to over \$1.1 million in today's dollars. Instead of protecting jobs via protectionism, it would have made more sense to pay each protected worker half a million to accept the job loss and find another job.

US sugar tariffs provide a good example of such costs. As James Bovard writes:

Because American farmers cannot compete with foreign sugar growers, the federal government has maintained

⁹ For the original English language version of the petition, see Bastiat (1845).

an array of sugar import quotas and/or tariffs for most of the last 200 years. The regulatory regime has provided windfalls for generations of politicians and jobs for legions of bureaucrats while destroying more than a hundred thousand private, productive jobs.¹⁰

Protecting a small number of sugar producers costs consumers an estimated \$10 billion a year and represents 'perhaps America's least efficient welfare program'.¹¹ Food manufacturers faced a combination of price supports and import controls that destroyed more than 120,000 jobs in the last 20 years. Nor does the damage stop there. The high cost of sugar led soft drinks manufacturers to replace sugar with high fructose corn syrup, arguably contributing to obesity and a notably higher diabetes rate; and because the US climate is not naturally suitable for sugar production, farmers douse the land with chemicals to stimulate production, which has had a devastating effect on the ecosystem of the Everglades.

The silliness of tariffs

Nor should we forget the simple silliness of real-world tariffs. Forget about economic tariff policies with their grand-sounding protectionist objectives. The reality is that most tariffs make no sense at all. The UK pays over £3 billion a year in import tariffs on 12,651 different categories of goods, including over 1,400 on 'organic chemicals' alone.¹² The tariff schedules themselves are a jungle of extraordinarily complicated but also mindless sets of rules, which must impose huge compliance and administration costs on those who have to bear them. There are 36 different categories of tariff, and most of these are not straightforward percentages but are based on complex formulas. One wonders what sort of mind dreams this stuff up. The process by which they are set is opaque and has little accountability.

In October, the EU increased eight tariffs on imported oranges fivefold – from 3.2 per cent to 16 per cent. Why? Because Spanish producers of

¹⁰ Bovard, J., 'Why Americans pay triple the world price for sugar', Foundation for Economic Education blog, 9 March 2017, <https://fee.org/articles/why-americans-pay-triple-the-world-price-for-sugar/>

¹¹ Bovard, op. cit.

¹² Dan Lewis provides a good guide to the tariff jungle. See, for example, Lewis, D., 'The UK's golden opportunity to axe 12, 561 tariffs and save £3bn: Do we really need the 15% tariff on unicycles inflicted on us by the EU Customs Union?', Reaction, 19 October 2016, <https://reaction.life/uks-golden-opportunity-axe-12561-tariffs-save-3bn/>

citrus fruits objected to competition from South Africa, so questions were raised by Spanish MEPs and the tariffs were quietly raised. Net result: UK consumers have to pay more so that Spanish producers face less competition, and the revenue raised goes to Brussels.

Then consider coffee. There are at least eight different schedules imposed on coffee imports which one might imagine must protect the EU coffee industry – except that this industry does not exist. This is a tariff to protect a non-existent industry.

Then there are the high tariffs on clothes and footwear – the tariff on sports footwear, for example, is 16.9% – which account for 37 per cent of total tariff revenue. These tariffs constitute a regressive tax, affecting the poor more than the rich. They destroy retail jobs in the UK and destroy jobs in the countries that export these commodities – often poor countries that the UK and other EU countries are trying to help via foreign aid. There is also no obvious reason why this particular industry should pay higher tariffs than others, and it is not even as if there is a significant domestic industry left to protect.

There are plenty of other tariffs that make as little sense. These include: a 4.7 per cent tariff on umbrellas; a tariff of 1.7 per cent on swords, cutlasses, bayonets and scabbards; a 4.2 per cent tariff on suborbital and spacecraft launch vehicles, which protects a market that does not exist; and a 15 per cent tariff on unicycles (one wonders which clown set that).

The manufacturing shibboleth

Many politicians and political commentators are obsessed with manufacturing, and therefore with protecting it. But manufacturing is much less important than it used to be. We should be wary of arguments to protect manufacturing jobs which assume they have some special significance that jobs in other sectors lack. Consider the evidence:

In 2015, UK the manufacturing sector employed 2.5 million people.¹³ As of 2013, its annual output was £150.7 billion or 10 per cent of total national

¹³ Chu, B., 'The charts that show George Osborne's March of the Makers has gone nowhere', Independent, 11 May 2016, <http://www.independent.co.uk/news/business/news/the-charts-that-show-george-osbornes-march-of-the-makers-has-gone-nowhere-a7023851.html>

output.¹⁴ However, this sector has been in long-term relative decline and attempts to reverse that decline have failed. Indeed, manufacturing output is still lower than it was at its 2008 peak. Recent figures suggest that it won't be long before there are more people employed in the hospitality sector (which now employs 2.2 million people) than in manufacturing: the 'march of the makers' will soon be surpassed by the march of the waiters.¹⁵

Such statistics sometimes evoke shock from those accustomed to thinking of economic activity primarily in terms of workers making 'stuff', as if to suggest that even to cite such evidence is to attack manufacturing. But the fall in manufacturing output simply reflects decreased demand for its products, and the fall in manufacturing employment primarily reflects a combination of higher manufacturing productivity and a shift in demand away from manufacturing jobs towards jobs in the service sector. Comparable 'decline of manufacturing' trends are to be seen across the developed world and governments' attempts to reverse it have failed. George Osborne failed to reverse it and it is a safe bet that Donald Trump won't reverse it either.

Consider the auto industry. In 2014, this industry contributed £12 billion to total output, which is 8 per cent of manufacturing output and 0.8 per cent of total output.¹⁶ In terms of gross value-added, this industry contributes 3 per cent of UK exports. It is protected by a 10 per cent import tariff but this tariff yields little revenue because the UK actually imports few cars from outside the EU. Imported vehicles contribute only 5.2 per cent of tariff revenue.

Then there is the steel industry. In 2015, this industry contributed £1.2 billion to total output, which is 0.7 per cent of manufacturing output and 0.07 per cent of total output.¹⁷ Imports of iron and steel products account for only 1.5 per cent of tariff revenue, which is below the 2.6 per cent of tariff revenue accounted for by 'edible fruits and nuts; peel of citrus fruits or melons'.

¹⁴ See: 'Manufacturing: statistics and policy', House of Commons Library, 6 August 2015, <http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN01942>

¹⁵ Peck, T., 'UK hospitality sector set to overtake manufacturing in the 'march of the waiters'', Independent, 29 October 2016, <http://www.independent.co.uk/news/uk/politics/hospitality-manufacturing-sector-jobs-decline-march-of-the-makers-waiters-a7385806.html>

¹⁶ See: 'Motor industry: statistics and policy', House of Commons Library, 5 October 2015, <http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN00611>

¹⁷ See: 'Steel industry: statistics and policy', House of Commons Library, 28 October 2016, <http://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7317>

So as far as relative importance is concerned, the take-home message is simple: total output is ten times manufacturing output, which is ten times car output, which is ten times steel output, more or less. These figures should give everyone pause for thought about the relative (un)importance of these once pivotal sectors.

And as regards the impact of Brexit on manufacturing, the more credible projections suggest that Brexit will boost manufacturing because of the overall positive impact of lower tariffs (see Minford and Miller 2017). However, there is still no reason to believe that even Brexit will reverse the longer-term decline in manufacturing employment.

The UK should adopt unilateral free trade

There are two complementary routes to free trade. The first is to implement Unilateral Free Trade (UFT): to set tariffs to zero and minimise non-tariff barriers to imports. The case for UFT follows immediately from the premise that the objective of trade policy should be to promote the consumer interest. As Sir Robert Peel concisely put it in a Commons Debate in 1843:

I am bound to say that it is our interest to buy cheap, whether other countries will buy cheap or no.¹⁸

UFT is good for the UK economy because:

- Consumers benefit from lower consumer prices.
- Most producers benefit from lower import prices which reduce their costs.
- UFT will encourage greater efficiency, greater productivity, higher living standards, a more dynamic economy and improved competitiveness, especially in sectors that are currently protected.
- UK workers will move up the value chain and their incomes will increase.
- UFT has long since been adopted successfully by Hong Kong and Singapore.¹⁹

It is also useful to have some idea of the magnitudes of the benefits of Brexit. The work of Patrick Minford suggests that consumer prices would fall by about 8 per cent, food prices would fall about 20 per cent and GDP would rise by about 4 per cent.²⁰

¹⁸ Reported in *The Examiner*, 23 September 1843.

¹⁹ See also: Leach, G., 'Option Zero: Why Britain should embrace unilateral free trade post-Brexit', *City AM*, 25 August 2016, <http://www.cityam.com/248187/option-zero-why-britain-should-embrace-unilateral-free>

²⁰ See, for example, Minford (2016) and Minford and Miller (2017).

The fall in food prices would also benefit the poor disproportionately and one can argue that the Left in particular should be receptive to this point.²¹ Indeed, in the early 20th century, the Labour Party supported free trade for this reason.

One might add that amongst the many benefits of such a policy is the potential for the UK to become a super-Singapore or super-Dubai. As Professor Tim Congdon has pointed out, once the entire UK becomes a free port, if companies are confident that the UK would never impose tariffs or other import restrictions, then the UK could become the ideal warehousing centre in the Europe/Middle East/Africa (EMEA) part of the world. The UK would become the place to go to buy imports of all kinds at the lowest possible prices in the world and then ship them elsewhere in the EMEA region. The inward investment and associated benefits would be phenomenal.²²

Virtually all new trade created because of liberalisation since the 1990s has come from unilateral forms of liberalisation. A good example is the successful policy of Mart Laar and the Estonian government after independence: 'liberalise first, then negotiate'.

On the benefits of UFT, there was an instructive exchange between Sir Desmond Swayne MP and Professor Patrick Minford at a meeting of the Commons International Trade Committee on 29 November 2016 last year:

Q78 Sir Desmond Swayne: Why haven't the rest cottoned on to [these] advantages that you advocate? What is stopping them?

Professor Minford: As a matter of fact, if you look at the trends in world tariffs, they have all come down massively in the last 30 years. I think that is due to supply chains putting pressure on Governments to get into the supply chain by cutting their tariffs. Although there have been no big Doha rounds and so forth - they have all stalled on all sorts of issues - if you look at the progress of world

²¹ To illustrate, a recent study suggested that the bottom 10 per cent of the population spent almost 24 per cent of their income on food (and indeed, were struggling to achieve basic nutritional standards) whereas the top 10 per cent spent only 4.2 per cent of their income on food. Zero tariffs on food would therefore really help the poor (CEBR 2013).

²² For a good discussion of how a free port policy could create large numbers of jobs and revitalise some of the poorer parts of the UK see Sunak (2016).

trade in terms of protectionism it has come down a lot. It has been countries surrendering their tariffs, initially on imports but then it gradually catches on, so I think there is quite a lot of this going on.

The basic answer to your question is an intellectual one. I think people find it hard to get their minds around unilateral free trade because they don't understand that tariffs are self-damage. They think it is good for your industry to have tariffs, because you are protecting your guys and then you do trade deals that get protection down and penetrate other markets in return for you giving them rewards in yours. This sort of thinking dies hard.²³

UFT precludes 'tit for tat' policies

It is sometimes suggested that international trade negotiations should be approached in terms of some bargaining game. Participants should not make unconditional 'concessions' unless they get something in return. Otherwise they are likely to get an inferior deal, or so it is said.

This way of thinking is not helpful for a number of reasons. First, it is predicated on the mistaken premise that the main consideration of trade policy should be to promote producer interests. Once one accepts that consumer interests should be paramount, however, then the nature of the policy problem is revealed to be quite different. It is how to recognise, confront and ultimately overcome powerful producer interests whose primary concern is to persuade the state to impose protectionist measures in their favour, at everyone else's expense.

Sir Robert Peel had a good answer for the tit-for-tatters of his time, the 'reciprocitarians', as they were then called. As he told the Commons when announcing the repeal of the Corn Laws in 1846:

If other countries choose to buy in the dearest market, such an option on their part constitutes no reason why we should not be permitted to buy in the cheapest. I trust the

²³ House of Commons International Trade Committee, 'Oral evidence: UK trade options beyond 2019', HC 817-I, 29 November 2016.

Government ... will not resume the policy which they and we have felt most inconvenient, namely the haggling with foreign countries about reciprocal concessions, instead of taking that independent course which we believe to be conducive to our own interests.²⁴

Another problem is that thinking of trade in terms of negotiating games feeds into a prevailing misconception that trade is a zero-sum game, in which one party can gain only at the expense of the other: it suggests that we have two antagonists trying to get the better of each other as in a game of chess. Yet a zero-sum game is exactly what trade is not. Trade is about all parties benefiting, not one party benefiting at the expense of the other.

A final problem is that the trade 'bargaining game' can and often does go wrong. Let's suppose that we enter into a negotiating game to encourage the other party to reduce their import barriers. Let's suppose then that agreement is difficult to reach. This will be because some special interest producer group is mounting a lobbying effort to maintain its protectionist privileges. You then have a situation where the trade negotiations could go on for a long time or stall completely, and throughout this period our consumers and most of our producers would be paying higher prices for their imports than necessary.

²⁴ Parliamentary Debates, House of Commons, London, 29 June 1846.

The UK should seek free trade agreements with its major trading partners

The second, complementary, approach to achieving free trade is for the UK to seek FTAs – especially with its major trading partners.

The principle of continuity and future trade with the EU

Before addressing this issue, however, it is important to clarify the international legal context. Of particular concern are widespread fears about future trading arrangements with the EU, especially if no agreements are reached. Will the UK have access to the EU market without a trade agreement? Such fears are overstated.

The key principle here is that of continuity, which has long been recognised in international treaty law. When a country secedes or disengages from a broader union, there is a presumption that its relationships otherwise remain the same unless explicitly changed (see Howe 2016: 36-37).

For example, when Czechoslovakia split into the separate states of the Czech Republic and Slovakia on 1 January 1993, both successor states continued to honour the treaty obligations of the former state of Czechoslovakia, and other states and international bodies accepted the succession as being effective, where necessary agreeing new machinery for the separate representation of the two new states.

So when the UK leaves the EU, there is a presumption that its trade and treaty relationships with all other entities, including the EU, will remain substantially the same, unless there is agreement to the contrary or the UK or one of its trading partners decides to change its own trade policy.

An implication of this principle is that the UK does not have to agree to any post-Brexit trade treaty with the EU. If there is no agreement, the default is not that trade will stop until the EU deigns to give its approval. Instead, the default is that trading arrangements will remain substantially the same. I say substantially, not formally. Formally, post-Brexit, the UK would not be trading with the EU as a member state of the EU; instead, it would be trading with the EU as an independent state under the umbrella of WTO rules.²⁵ But if there is no trade agreement with the EU, then, unless the EU explicitly imposes tariffs, the UK would continue to trade with the EU on tariff-free terms.

This continuity or rolling-over principle should also apply to the UK's trading relationships with the 38 countries that have signed trade agreements with the EU: those FTAs would remain in force unless any of those countries objected, which they would have no reason to do.

The EU would be within its rights to impose tariffs on imports from the UK. However, the EU's choices of tariff policy are limited by WTO rules. In particular, the Most Favoured Nation rules prohibit any WTO member imposing punitive tariffs intended to discriminate against any other member: the only choices available to the EU on tariffs are to impose zero tariffs on imports from the UK or to impose tariffs based on the same tariff schedules that it imposes on imports from other countries with which it does not have an FTA.²⁶

So if the EU did impose punitive tariffs on the UK, it would also have to impose the same punitive tariff schedules on these latter countries too. Such a protectionist lurch would then run into all sorts of problems, not least from disaffected trading partners, some of whom (e.g. the US) would be minded to retaliate. The EU would then have a major trade war on its hands. The EU pursuing a punitive tariff policy specifically towards the UK is, thus, a non-starter.

However, the EU imposing any tariffs on imports from the UK would be ill-advised, not (I hope) because the UK would retaliate, but because it would be an exercise in self-harm. If it is in the UK's own best interest not to impose tariffs on its imports, then it is also in the EU's self-interest to refrain from imposing tariffs on its imports. The same arguments apply.

²⁵ Note also that there is no question of the UK automatically leaving the WTO on 'Brexit Day' and then having to re-apply for membership, because the UK is already a member – indeed, a founding member – under Article XI(1) of the WTO agreement.

²⁶ See: https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm

Higher tariffs hurt its own importers including, most importantly, its own consumers. The imposition by the EU of tariffs on its imports from the UK would also cause problems for EU manufacturers dependent on existing EU-UK supply chains, as supply chains are highly sensitive to tariffs.²⁷

In sum, if the EU were to attend to its own self-interest, then it would refrain from imposing tariffs on the UK and either let existing trading arrangements continue or seek to negotiate a future FTA with the UK.

What are the UK's post-Brexit trade policy options?

On March 29th 2017 the UK invoked Article 50 of the Treaty on European Union to start formal negotiations on leaving the EU. Under this Treaty the UK is obliged to continue with current trade arrangements (both with the EU and those the EU has agreed with the rest of the world) until exit actually happens, which is likely to be in March 2019.

However, the UK government is wise to enter into trade discussions in advance of Brexit. As Martin Howe QC explains:

To negotiate a good agreement with the EU, one which serves Britain's interests, it is essential that the UK pursues a twin-track policy. While seeking to negotiate a trade agreement with the EU ... it must simultaneously prepare for and be in a position to execute an external trade policy without an agreement with the EU if necessary. This is ... because having no alternative plan in the event of no agreement, is a recipe for disaster. The UK would [otherwise] find itself obliged to agree to whatever terms are offered (Howe 2016: 7)

Is there a case for joining EFTA? Yes, but the situation is not as it might appear. The case is not that joining EFTA would be necessary to continue trading with EFTA member states on existing terms, because the UK would continue to trade on such terms anyway.

Instead, the main consideration is geopolitics. The UK used to be a member of EFTA before it entered the Common Market, and if it re-joined EFTA

²⁷ Wells, P., written evidence (FTG0013) – House of Lords: Future trade evidence, automotive sector, 11 November 2016.

it would be by far the biggest member. From a geopolitical perspective, the UK re-joining EFTA would reinvigorate a northern European trading bloc that could provide a counterweight and even an alternative to the EU. This concept would be reminiscent of King Cnut's Anglo-Scandinavian empire of a thousand years ago and would attract considerable support in Scandinavia, the Netherlands and Switzerland, and even in Ireland, France or Germany were new governments to come to power.

There is no reasonable case for joining the EEA, however. Membership of the EEA implies membership of the Single Market and, as such, would entail submission to Single Market requirements²⁸ and its stifling regulations and anti-free-trade 'Fortress Europe' mentality. To paraphrase a comment made by a senior Bulgarian central banker in 1992, the Brussels bureaucracy has the same aims and methods as the Comintern without the Comintern's sensitivity to local needs.²⁹

We should keep in mind that the Single Market terminology is misleading and the Single Market regulatory regime highly undesirable. To quote Daniel Hannan:

Most people understand "single market" to mean something like "free trade zone". In fact, in the EU context, it means "single regulatory regime". Membership of the single market doesn't mean the right to buy and sell there (pretty much the entire world can do that); it means accepting EU jurisdiction over your domestic technical standards...

Only six per cent of British companies do any business at all with the rest of the EU; yet 100 per cent of our firms must apply 100 per cent of EU regulations. Our aim should be to exempt the 94 per cent ... from EU directives and regulations.³⁰

²⁸ For example, free movement of people and the need to make support payments to the EU.

²⁹ Quoted from Hutchinson, M., 'The real danger is staying in', The Bear's Lair, 18 January 2016, <http://www.tbwns.com/2016/01/18/the-bears-lair-brexit-the-real-danger-is-staying-in/>

³⁰ Hannan, D., 'Repeat after me. Single market membership and single market access are not the same thing', ConservativeHome, 1 September 2016, <http://www.conservativehome.com/thecolumnists/2016/09/daniel-hannan-repeat-after-me-single-market-membership-and-single-market-access-are-not-the-same-thing.html>

Richard Patient, the former chairman of London Business for Britain, agrees:

In truth, the single market was always a misnomer. It should have been called the Single Protectionist Zone or the Single Regulatory Regime. The single market was never about opening up markets. It was always about imposing rigid common, anti-competitive standards.³¹

The main consideration with the Single Market is not whether the UK should be accept all the restrictive pre-conditions of membership, but to ensure that the UK has the maximum freedom to trade with the countries in the Single Market.

An estimated 194 countries and territories successfully trade in the Single Market without being members of it.³² Some of these countries are not even members of the WTO. For example, the Holy See has access to the Single Market but only has Observer status in the WTO, and North Korea has no WTO status but still has access to it, albeit limited access due to international sanctions. Indeed, all European countries except Belarus and Russia already have tariff-free access to the Single Market. It is preposterous to suggest that a Brexited Britain would be 'cut off' from the Single Market or even face a tariff barrier on its exports to it.

The EEA option was also never politically realistic. One of the preconditions for EEA membership is free movement of people within the EEA region, and the government has made it clear that free movement will not be acceptable to the UK post Brexit. For its part, the EU has always insisted that free movement is not negotiable either. In any case, the EEA option is now moot as the UK has made it clear that it will be seeking a hard Brexit outside the Single Market.³³

31 Patient, R., 'The single market was never about opening up markets, but imposing rigid anti-competitive standards', BrexitCentral, 16 September 2016, <http://brexitcentral.com/richard-patient-single-market-never-opening-markets-imposing-rigid-anti-competitive-standards/>

32 Lord Stoddart of Swindon, '194 countries and territories trade in the EU's single market without being a member of it', BrexitCentral, 14 December 2016, <http://brexitcentral.com/lord-stoddart-swindon-194-countries-territories-trade-eus-single-market-without-member/>

33 For more on the downsides of the Single Market, see Howe (2016) and Minford (2016).

Then there are gains from replacing EU Single Market regulations with less onerous regulations, the benefits from the UK walking out of the Common Agricultural and Common Fisheries Policies,³⁴ and the benefits of the City being free from the burdens of EU financial regulations.³⁵

The UK should certainly enter discussions with countries outside the EU and EFTA. However, we need to appreciate that the recent record of trade agreements is not auspicious. In fact, multilateral trade deals have achieved little trade liberalisation in over two decades.

The problem is that removing trade barriers is no longer the focus of the 'big' recent trade deals. For example, the Trans-Pacific Partnership (TPP) does not even mention trade in its title and focuses instead on regulatory harmonisation (e.g. of environmental and labour standards) and the woolly notion of 'partnership'. As Iain Murray explains:

The Trans-Pacific Partnership is an example of why free trade came to have such a bad reputation with the American public. Rather than a simple agreement to lower tariffs for mutual benefit, it morphed into a massive international regulatory regime over 5,000 pages long. It was weighed down by numerous non-trade provisions aimed at appeasing non-trade special interests. To be sure, there may be worthy environmental and labor issues worth addressing through international agreements, but these should be considered in separate treaties and have no business being part of trade negotiations.

Instead, the TPP went down the road of regulatory harmonization, a good-faith effort to tackle non-tariff barriers to trade that became hostage to special interests. Moreover, the complexity of the regulations meant that there needed to be an investor-state dispute resolution process, whereby companies that had invested in a country on the basis of the agreement could sue the country for redress of grievances if the regulations weren't properly applied. The presence of these processes led to accusations that the TPP was "corporatist" and that it was anti-democratic, putting corporate interest above national legislation.³⁶

34 See, for example, Rickard (2016).

35 For more on the benefits to the City specifically, see Congdon (2014), Economists for Brexit (2016), Reynolds (2016) and Blake (2017).

36 Murray, I., 'Free Traders Shouldn't Mourn the Loss of the TPP', Foundation for Economic Education blog, 26 January 2017, <https://fee.org/articles/free-traders-shouldnt-mourn-the-loss-of-the-tpp/>

The Transatlantic Trade and Investment Partnership (TTIP) is similar. My point is that the purpose of trade agreements should be to promote free trade, not to achieve other objectives. Both these trade deals are highly flawed and their demise – President Trump has withdrawn the United States from the TPP and few now expect the TTIP to go ahead either – is mourned by few, even amongst free traders.

The UK should seek trade agreements that promote free trade and complement domestic policies of unilateral free trade. However, the government should bear in mind the benefit/cost balance of trade discussions. They can be protracted and distracting processes that ultimately deliver little gain – an especially high risk given the UK's lack of experienced trade negotiators.³⁷

These considerations suggest that the UK should have clear priorities in seeking future FTAs. The obvious priorities would be Britain's major trading partners, especially the US. Recent statements from President Trump suggest that the US would be keen to pursue such an arrangement with the UK and this willingness provides a major opportunity that should be enthusiastically pursued.³⁸

There is also a strong case for seeking a trade deal with Anglosphere countries³⁹ with which the UK has much in common. An example would be a CANZUKTA trading deal with Australia, Canada and New Zealand.⁴⁰

Even without CANZUKTA, the UK should invite Canada to revise the recently approved Canada-EU Comprehensive Economic and Trade Agreement (CETA). The focus would be to get rid of the protectionist elements in CETA, such as those relating to Canadian exports of agricultural products. Such an agreement could be reached quickly: the two sides need merely take the CETA as a template and delete all the provisions that were inserted to placate EU interest groups.

³⁷ The severe shortage of experienced UK negotiators is a major constraint on the UK's capacity to manage more than a limited number of simultaneous trade negotiations. This constraint arises because the UK has not entered into such discussions in its own capacity since joining the then Common Market in 1973. Accordingly, it would be wise for the UK to accept offers by Australia and New Zealand to second some of their trade negotiators to the UK whilst the UK builds up its capacity in this area.

³⁸ See, for example, Murray, I., 'How a US-UK free trade deal could revolutionise world trade', BrexitCentral, 22 December 2016, <http://brexitcentral.com/iain-murray-us-uk-free-trade-deal-revolutionise-world-trade/>

³⁹ See, for example, Leach (2016) and Singham (2016).

⁴⁰ See, for example, Lilico, A., 'CETA is dead? Long live CUKTA. How Canada can save the best of CETA with a U.K. trade deal', Financial Post, 21 October 2016, <http://business.financialpost.com/fp-comment/forget-europe-canada-can-use-ceta-to-get-a-far-more-harmonious-deal-with-a-post-brex-it-u-k> or <http://www.canzuk.co.uk>

A final priority would be a market-friendly Global Free Trade Agreement with like-minded countries.⁴¹ The key elements of such an agreement would be minimal trade barriers, strong property rights, reduced regulation, openness to foreign investment and greater freedom of movement. There would also be a shift away from regulatory harmonisation (as in the TPP and TTIP) towards the use of 'mutual recognition agreements' that acknowledge differences between different countries' regulatory systems rather than attempt to steamroll over them. To quote Iain Murray again:⁴²

[H]armonization can lead to conformity and stagnation – resulting in superior alternatives not being explored. Rather, policymakers should look to competition among regulatory regimes. This “discovery process” is a better way to reduce transaction costs and thus increase voluntary wealth creation.

Providing companies with a choice of regulatory regimes often works better than a single uniform regulatory structure or a harmonized system. Centralized regulators can suffer from limited information and pressures from special interest groups. Dispersed regulatory structures can satisfy different preferences, try varied approaches to regulating, gain information about what works and what doesn't, and provide feedback to learn more about the cost effectiveness of specific rules. Regulatory competition provides these benefits.

A good example of regulatory competition through mutual recognition is the Australia-New Zealand single economic market based around the Trans-Tasman Mutual Recognition Agreement, whereby goods legally sold in one country can be sold in the other regardless of different sale-related regulatory requirements between the two countries.

⁴¹ See Hulsman, J., 'A Global Free Trade Alliance should be Britain's stunning post-Brexit future', City AM, 22 August 2016, <http://www.cityam.com/247909/global-free-trade-alliance-should-britains-stunning-post>

⁴² Murray, I., 'Trump Moves on Trade: TPP and NAFTA', 23 January 2017, CEI blog, <https://cei.org/blog/trump-moves-trade-tp-and-nafta>

A negotiating strategy

The UK's trade policy 'negotiating strategy' vis à vis the EU is then quite simple:

- It emphasises that 24 months after invoking Article 50, the UK will leave the EU with or without any agreements.
- It emphasises that the UK does not need EU permission to select its own trade policy post-Brexit. The EU has no veto over the UK.
- It emphasises that if there is no agreement with the EU on trade, come 'Brexit Day' the UK will pursue its own trade policies in its own best interests, regardless of any demands or threats from the EU.
- It emphasises that the UK is willing to commit to zero barriers on imports from the EU and to provide reasonable assurance to EU citizens resident in the UK. The EU should be invited to make comparable commitments in everyone's interest.
- It emphasises that the UK is always willing to enter into constructive discussions with the EU about how to move towards freer trade between the UK and whatever is left of the EU post-Brexit.

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