

## Post-Brexit trade and development policy

Richard Baldwin, Paul Collier and Anthony Venables

Graduate Institute, Geneva and CEPR; University of Oxford and IGC; University of Oxford IGC and CEPR

### Introduction

Regardless of what one may think of the decision, the British people have voted to leave the EU – a result that throws up historic challenges as well as historic opportunities. EU economic policies, after all, consisted of ‘the good, the bad and the ugly’ and the EU’s trade and development policy was among the worst. Brexit, therefore, should be viewed as an important opportunity for fresh thinking.

This short thought-piece suggests that the time is ripe for the UK government to embrace a new trade and development agenda which demonstrates that post-Brexit Britain is an outward-looking country, ready to play a key role on the world stage. Our proposal walks on two legs.

The first leg consists of pro-development trade and investment policies focused, initially, on Africa and the Caribbean. The second consists of domestic policies, aimed at ensuring that the gains and pains of progress are shared, i.e. that British trade policy is truly in the service of British society, not just in the service of free trade.

#### *Why the focus on developing nations?*

This is easy to answer. Under WTO rules, Britain can offer preferential trade terms to developing nations, without first having to negotiate trade agreements. Offering preferences to, for example, the US or Canada, would require negotiation and ratification of a WTO-consistent Free Trade Agreement – a process that takes years, even in the best of cases. Moreover, most advanced countries will be reluctant to open talks with Britain before the main outlines of its eventual relationships with the EU are clear. Thus, even though such deals will be commercially far more important, they are many years down the road. The same is not true when it comes to developing nations.

Developing nations will be happy to open discussions immediately on the issues that are most pressing to them, namely the level of tariffs that post-Brexit Britain will impose on their exports.<sup>1</sup> This is especially so, given that the EU’s trade policy with respect to Africa is particularly fraught at the moment. The EU strategy rests on coercing developing nations into providing EU exporters with preferences, in exchange for being granted preferential access to the EU market.

The EU’s so-called ‘Economic Partnership Agreements’ (EPAs) have, in reality, been neither partnerships nor agreements. For example, the EPAs for both East and West Africa remain unsigned, despite nine years of negotiations. Now the EU is threatening to put up tariffs against African exports, if the agreements are not signed soon. The British government can rest assured that it will be welcomed by developing nation leaders, if it proposes a different set of trade and development policies.

We should note that we are not alone in these judgements. An excellent eBook edited by Mendez-Parra *et al.* (2016) presents a wealth of specific ideas and analysis, as does the thought-provoking essay by Lande and Matanda (2016).

#### *Why package trade and social policy?*

UK trade policy has been within the purview of Brussels for over four decades, while the main domestic economic policies remained matters for Westminster. Brexit allows Britain a chance to bring the two back together – an outcome that is both natural and important.

Opening any economy to international competition and opportunities creates winners and losers. Maintaining a social consensus for liberal trade policy thus requires the people to embrace a general belief that both the gains and pains of trade will be shared fairly.

<sup>1</sup> Almost any plausible version of Brexit will involve the UK leaving the EU customs union and thus becoming free to provide unilateral tariff preferences to developing nations.

Brexit provides an opportunity to systematically rethink the links between the policies that help share the gains and pains of trade and the policies that promote openness. What we have in mind is a mostly political connection between trade policy and a set of policies that fight economic disenfranchisement arising from all sources (be it robots and technology, or trade and immigration).

The key elements of our proposal are: striving for mutual benefits with developing nations, simplification of trade schemes achieved through generosity, and complementary policies that ensure it all works in the interest of British consumers and workers.

### **Making UK trade policy work better for development**

For over four decades, UK trade policy has been decided jointly with all other EU members. This has not always gone well. Trade policy designed to serve 28 different national interests has, to say the least, not always been in the best interests of British people.

In particular, the EU's trade policy with respect to developing nations has not been particularly pro-development, due to compromises that were made to oblige geostrategic and protectionist interests. For example:

- Continental EU members tend to favour agriculture protectionism – including on tropical goods – since they have significant domestic production to protect.

This has been bad for farmers in poor countries, and bad for British consumers.

- The same is true when it comes to protectionism regarding clothes and other labour-intensive goods which are still produced in some Southern and Eastern EU nations.

This reduces opportunities for industrialisation in poor countries, and is bad for British consumers.

- Britain has consistently advocated less protective trade policies, but has been outvoted by other EU members.

A Britain in charge of its own trade policy can do better. The UK now has an opportunity to rethink its trade policy, with respect to developing nations, in such a way that it would demonstrate Britain's global leadership in the trade and development arenas.

#### *Act immediately*

Trade negotiations typically take years, which is too long to wait. Jones (2016) notes that some developing countries rely heavily on the UK market, meaning that uncertainty about the sort of tariffs their exporters will face after Brexit hampers their development prospects. Economic development, after all, requires firms, people and government to invest but, in truth, such investments are bets on the future. Uncertainty over what UK policy towards developing nation exports might be tomorrow, hinders development today.

An immediate political commitment by the British government that is bold, clear, simple and generous will help reduce such negative effects (Rollo 2016). The first step is to set out the guiding principles for British trade policy, with respect to developing nations, at the unilateral, regional and global levels.

#### **Unilateral trade and investment policies**

Unilateral trade policy, with respect to developing nations, is the first target of opportunity for the government. Since it is decided unilaterally, this is an area where Britain can immediately demonstrate its vision.

We suggest British preferential trade policy, with respect to developing nations, be guided by a few basic principles. The trade policies should be:

- Simple in design and generous in nature;
- Respectful and based on mutual advantage, rather than power and mercantilism;
- Based on existing 'global best practice', rather than re-inventions of the wheel; and
- More liberal and more pro-development than EU policy.

Given that distance still has an enormous influence on natural trade flows, Africa and the Caribbean should be the first focus of the new policy initiatives.

Perhaps the most pressing matter is to send clear signals of Britain's intention to lead global free trade from the front.

- To give meaning to intentions, Britain should make an immediate political commitment to maintaining or improving current levels of preferential access for developing nations, for the next ten years.<sup>2</sup>

At the head of the commitment queue should be maintenance of the 'everything but arms' programme, granting duty-free treatment to exports from the least developed nations. Going further, the UK could commit to broadening the range of preference items, so as to include agricultural goods that the EU has, up till now, restricted in order to protect economic interests of import competitors.

As part of this, one bold move would be for the UK government to make a political commitment to, for example, at least double the tariff-rate-quotas allowed to Sub-Saharan African nations for 'sensitive products' like sugar, tropical fruits, cotton, etc.

Pro-development trade policy, however, is more than a matter of tariffs, as Mendez-Parra *et al.* (2016) point out in detail. One set of barriers that hinder developing-nations from exporting to Britain are the so-called 'rules of origin'. While these rules are necessary to prevent tariff cheating (e.g. Chinese shirts being passed off as having been made in, say, Tanzania), excessively strict rules can be used as subtle protectionist devices. Indeed, under EU rules, which currently bind UK practices, these rules of origin are significantly more restrictive than those offered by the US, Australian and Canadian pro-development trade programmes (Crowther *et al.* 2016).

Britain should commit to using simple, generous, best-practice rules of origin – for example, following the Australian and Canadian practice of setting 25% of local value-added as the qualification threshold for duty-free treatment.

America's pro-development policy, known as the African Growth and Opportunity Act (AGOA), should be another source of inspiration, as Britain moves away from the EU's approach. In particular, it does not demand that African nations lower their tariffs to American goods in the way that the EU's current policy does. Further, it applies not only to EBA-eligible low-income countries but also to others such as Kenya, which often have a better prospect of industrialisation.

Britain could extend the same offer of market access to countries such as Kenya as it does to those eligible for EBA. To foster regional production cooperation and intra-African trade, exporters should be able to cumulate value added in any eligible nation in reaching the 25% threshold.

#### *The question of a WTO waiver*

Since the first principle of the global trade system is non-discrimination, granting tariff preferences brings any government straight into the difficult terrain of WTO rules. The way to deal with this is to immediately start discussions with other WTO members on a 'waiver' of the type that the US won for its pro-development, tariff-preference (AGOA). Indeed, were Britain simply to make exactly the same countries eligible for its market access package as are eligible for AGOA, it would be adopting a category of countries already granted a waiver by the WTO for US preferences, and this could minimize the risk that a waiver for its own preferences might be blocked.

Even though Britain cannot change its tariffs until it leaves the EU customs union, it can start waiver talks before Brexit is settled, since the UK is an independent member of the WTO. Moreover, while it is true that the intricacies of WTO law could prove a hurdle, the moral imperative of this British proposal should help to clear the path. With most of the WTO's 164 members – the vast majority of whom are developing countries – good intentions can go a long way towards smoothing out legal wrinkles.

Specifically, Britain should immediately launch a political initiative at the WTO aimed at securing a waiver for its eventual preferential tariff policy.

This can and should happen, even before the UK has managed to extract itself from commitments it made at the WTO as an EU member. Whilst this ordering might not conform to strict legal theory, the difference between theory and practice is different in practice than it is in theory (as the saying goes).

#### *Beyond tariffs*

The world has long experience with trade and development policies. The UK should therefore rely on existing best practices. Although the EU's EPAs policies have met with a great deal of criticism, one that does seem to work well is the EPA with the Caribbean Forum (Keane 2016). This could be a model for the UK's own bilateral agreements with developing nations, especially when it comes to beyond-tariffs issues.

<sup>2</sup> Such an announcement would not presume UK membership of the EU customs union. If the UK stays in the Customs Union, tariffs will not rise. If it leaves the Customs Union (as we believe it should), Britain would be committing to not raise tariffs against developing-nation exports.

It covers services, investment and e-commerce, and is more ambitious on services than the EU's existing commitments in the General Agreement on Trade in Services (GATS). As such, it offers what can be thought of as the equivalent of tariff preferences, but for services instead of goods.

Investment is another important, beyond-tariffs issue that needs to be addressed. In the world of 21st century international commerce, trade and investment are thoroughly intertwined – the government free-trade initiative thus needs an investment component.

Currently Britain has over one hundred so-called Bilateral Investment Treaties (BITs), most of them with developing nations. Moreover, since investment policy was a matter for national prerogative for EU members up until the 2009 Lisbon Treaty, all of Britain's BITs were negotiated by Britain. Nevertheless, the key part of the UK's new leadership in the trade arena should include a rethinking of its investment treaties from a pro-development perspective. As Gelb (2016) points out, new issues have come to the fore with the rise of global value chains. One of his specific recommendations is that the UK government work towards a more open and transparent dispute settlement mechanism.

While unilateral trade policy is ripe for rapid progress, fostering development will require new trade agreements. We thus turn to ideas for what the UK's new trade policy should look like in terms of bilateral, or regional agreements with developing nations.

### Regional trade and investment policies

Trade in today's world can be thought of as factories crossing borders, not just goods crossing borders. This makes trade policy about much more than just trade. In other words, it is not enough for Britain to simply lower its tariffs and hope that development will follow. The government should add specific commitments on reinforcing aid/technical-assistance programmes aimed at boosting the export capacities of its developing-nation partners — this is best done in a trade agreement (Evenett 2016). The examples that Evenett (2016) provides include:

- Improving Sub-Saharan African transport infrastructure (both within the region and with rest of world),
- Helping governments to reduce hindrances arising from local market power and red tape, and

- Supporting the development of supply-side capabilities in developing countries, to meet the standards of western buyers.

Whilst not necessarily tied to trade agreements, issues surrounding so-called Aid-for-Trade (A4T) packages almost always arise in discussions on trade and development. Since these have always been under national control (the EU has only a small development aid budget at its disposal), there is much less need for us to comment on this aspect, beyond a call for coherence between the British government's new trade and investment policies, and its A4T policies.

### *Avoid the bespoke deal 'trap'*

When it comes to advancing a pro-development trade policy, 'particularism' is a trap to be avoided. There is a tendency to see each developing nation as a special case, requiring its own set of rules and exceptions. This, however, runs two sets of risks, since, first, it tends to delay initiatives – often by years – and, second, it usually leads the more powerful nation – Britain in this case – to slip into a paternalist mind set.

To avoid 'particularism' and speed implementation, Britain should seek to negotiate simple, generous arrangements that are applied as equally as possible across all developing nations.

Additionally, this even-handed, non-reciprocal approach will reduce the chance that British policy, like the EU's EPA policy, obstructs African efforts to set up their own free-trade zones. One of the heaviest criticisms of the EU's trade and development policy (which is also Britain's policy for now) concerns its disruptive impact on African attempts at within-Africa trade-integration. It is a story of unintended consequences, but it provides important lessons about why the government needs to consider regional factors and eschew particularism.

Both the EU and the US launched new trade and development programmes at the turn of this century. The US offered lower tariffs, without requiring African countries to reciprocate. However, it did ask that any preferences granted to other developed nations also be extended to the US. The EU, by contrast, demanded reciprocity. Now the EU is threatening to put up tariffs against African exports, if the agreements are not signed soon. Worse still, some of the least developed nations, such as Lesotho, whose exports rely heavily on AGOA preferences, could find their duty-free access to the US reduced or rescinded, since their EPA commitments say they should discriminate in favour of EU exports. The best way to avoid such problems and help African-wide trade integration is to make Britain's tariff preferences truly unilateral.

The final pillar, that is now wide open for a bold British initiative, concerns the global stage.

### **A bold, global initiative: Updating trade and development policy to match 21st century realities**

Today's world trade governance 'space' is a vacuum waiting to be filled. For various domestic reasons, world leaders in North America, on the Continent and in large emerging economies are deeply reluctant to present bold visions for global commerce. Yet the nature of international commerce has changed radically in recent years, in particular with the Global Value Chain (GVC) revolution. A rethink is needed to update trade and development policy to match 21st century realities. The door is wide open for Britain to return to its centuries-old leadership of global free trade. (Next year is the 200th anniversary of Ricardo's famous tome.)

While the opportunity is clear, rapid progress is unlikely in most areas. An important exception concerns the trade and development sphere. The trade and development agenda has stagnated at the WTO, along with the Doha Round. As a result, current thinking and policy is based on a very 20th century view of exports and export barriers. For example, the 'Special and Differential Treatment', which has been part of the DNA of the GATT/WTO since the beginning, is conceptualised almost entirely in terms of tariffs, longer phase-in periods, and technical assistance.

- Britain should lead the push for rethinking trade policy at the global level (specifically at the WTO, G20, World Bank, and regional development banks).

This new initiative could give an impetus to ideas that were caught up in the Doha deadlock. It could also seek to add new dimensions to the discussion relating to the changed nature of international commerce and the GVC revolution.

Recent work at the World Bank on 'making global value chains work for development' have brought to the fore the more complicated nature of international commerce (Taglioni and Winkler 2016). This is not just true for the rapidly industrialising nations in East Asia, it is even the case for least developed nations. Global value chains are now important in many agriculture exports (coffee, tea, nuts, etc.) – not just in the classic manufacturing sectors such as autos and aircraft. Across the world, importing-to-export is a much more dominant fact (with important policy implications for tariff preferences, rules of origin and rules of cumulation). Likewise, investment, firm-specific flows of know-how, and availability of world class infrastructure services, ranging from air cargo and telecoms to trade financing and

pre-shipment inspection, play far more important roles than they did just a decade ago.

In the global value chain world, 'special and differential treatment' could (and probably should) mean much more than tariff preferences. Things like local-content restrictions, and other forms of cluster-level industrial policy measures could help developing nations get more good jobs in international production networks. Furthermore, GVCs often involve massive power asymmetries with the multinational companies being able to play off developing nations against each other.

Britain should put its weight behind a WTO-level initiative to develop codes of conduct that enable developing countries to participate in and benefit from GVCs.

### **Making UK trade policy work better for the British society**

Trade liberalisation creates winners and losers – it always has and always will. As Pascal Lamy, ex-Head of the WTO, puts it:

*"Opening trade creates efficiencies. It works because it is painful. It is painful because it works."*

But globalisation in recent years seems to be affecting societies with a finer degree of resolution; it is not just sunrise and sunset sectors anymore. Because globalisation is now driven more by advances in communications and information technology, it is more individual, more sudden, more unpredictable, and more uncontrollable (Baldwin 2016). In short, no matter what job you have and no matter what sector you work in, you cannot really be sure that your job won't be the next to suffer from, or benefit from, openness.

The British government should recognise that globalisation is acting in new ways and that this requires new domestic policy responses. Specifically, since it is much harder to identify who will win and who lose, and since it is basically impossible to determine precise causes (globalisation, demographics, immigration, robots, technology, climate change, etc.), a new social compact needs to accompany Britain's new trade policy. Education, infrastructure, regional, technological, and industrial policies all need to be more nuanced, nimbler, and more tightly focused on helping losers adjust. The key is to focus on helping workers adapt; to protect workers and communities, not particular jobs and sectors.

## Brexit: Reconnecting trade policy and domestic policy

British trade policy was largely run by the EU for four decades but UK social policy remained national. The result is today's general approach of dealing with social policy and trade policy separately. Brexit allows Britain a chance to bring the two back together.

This is important and natural. After all, everyone knows that trade policy creates winners and losers and that maintaining a social consensus for liberal trade policy requires some sharing out of the gains and pains of trade. Rethinking UK trade policy as a whole provides an opportunity to systematically rethink the links between policies that help share the gains and pains of trade and the policies that promote openness.

Now the UK has an opportunity to propose a policy package that is pro-openness and anti-exclusion at the same time. The anti-exclusion policies should be viewed very broadly – everything from secondary education in languages to benefits schemes. The idea is not to link each and every trade agreement to a particular package of benefits but, rather, to create a political linkage – above all in the eyes of the electorate – between Britain's leadership of a liberal global trade system and domestic policies that ensure a just sharing of the burdens and benefits. In a phrase, the key is to commit to a trade policy that is in the service of society, not just in the service of free trade. As part of this, the government could commit itself to undertaking studies that look at the distributional impact of trade agreements by region, skill groups, disadvantaged groups etc.

### Concluding remarks

This essay argues that Britain faces a unique window of opportunity for demonstrating that it is a confident, outward-looking country, ready to play a key role on the world stage. Today's world trade governance space is a vacuum waiting to be filled. For various domestic reasons, world leaders in North America, on the Continent and in large, emerging economies are deeply reluctant to present bold visions for global commerce. The door is thus wide open for Britain to return to its centuries-old leadership of global free trade.

To seize this opportunity, the government should embrace a new approach to trade and development, and it should push the issue to the top of the global policy agenda. Simultaneously, it should embrace complementary domestic policies, recognising how important it is that citizens feel there is a fair sharing of the gains and pains of international openness.

The package, we believe, could be thought of as trade policy in the service of society, not just in the service of free trade.

While the British government faces massive complexities in its trade-policy dealings with the EU and other advanced economies, it could, almost instantly, launch bold trade-policy initiatives with respect to developing nations. Moreover, failing to do so will cause actual harm by creating uncertainty over what UK policy towards developing nation exports will be after Brexit.

This year is the 200th anniversary of free trade's touchstone tome – David Ricardo's *On the Principles of Political Economy and Taxation*. What better time to launch a new phase of British world trade leadership?

### References

- Baldwin, Richard (2016), *The Great Convergence: Information Technology and the New Globalisation*, Harvard University Press, November.
- Crowther, Barbara, Liz May and Matt Grady (2016), *Keeping the UK open for business post-Brexit*, in Mendez-Parra et al.(eds) 2016
- Evenett, Simon (2016), *Beyond tariff preferences and trade deals*, in Mendez-Parra et al.(eds) 2016
- Gelb, Stephen (2016), *Foreign investment and UK trade policy post-Brexit*, In Mendez-Parra et al.(eds) 2016.
- Jones, Emily (2016), *Brexit: Opportunity or peril for trade with developing countries?*, In Mendez-Parra et al. (eds) 2016.
- Keane, Jodie (2016) *Brexit and trade in services: securing future gains*, In Mendez-Parra et al. (eds) 2016.
- Lamy, Pascal (2015), *The New World of Trade*, Jan Tumlir Lecture, ECIPE, March 2015, <http://ecipe.org/events/jan-tumlir-lecture-new-shape-world-trade-entail-global-trade-policy/>
- Lande, Stephen and Dennis Matanda (2016), *Africa: Economic Partnership Agreements - A Case of Unfortunate Timing?*, Manchester Trade Limited (Washington, DC).
- McDonald, Steve, Stephen Lande, and Dennis Matanda (2013), *Why Economic Partnership Agreements Undermine Africa's Regional Integration*, May 2013, <https://www.wilsoncenter.org/publication/why-economic-partnership-agreements-undermine-africas-regional-integration#sthash.tPWD3MNx.dpuf>

Mendez-Parra, Maximiliano, Dirk Willem te Velde and L. Alan Winters (2016). *The impact of the UK's post-Brexit trade policy on development*, ODI Briefing paper, London. <https://www.odi.org/sites/odi.org.uk/files/resource-documents/10852.pdf>

Rollo, Jim (2016), *A new UK trade policy towards developing countries: what sort of transition?*, In Mendez-Parra *et al.* (eds) 2016.

Taglioni, Daria and Deborah Winkler (2016), *Making Global Value Chains Work for Development*, World Bank book, <https://openknowledge.worldbank.org/handle/10986/24426>

**Richard Baldwin** has been Professor of International Economics at the Graduate Institute in Geneva since 1991 and Editor-in-Chief of *VoxEU.org* since he founded it in 2007. He has been President of CEPR since 2016. He was a Visiting Research Professor at the University of Oxford (2012-2015), Visiting Professor at MIT Economics Department (Fall 2002-03), and an Associate Professor at Columbia University Business School (1989-1991, Assistant Professor 1986-1989).

He has served as Managing Editor of *Economic Policy* (2000 to 2005), Policy Director of CEPR (2006-2014) and Programme Director of CEPR's International Trade programme (1991 to 2001). Before moving to Switzerland in 1991, he was a Senior Staff Economist for the President's Council of Economic Advisors in the Bush White House (1990-1991), following trade matters such as the Uruguay Round and NAFTA negotiations, as well as numerous US-Japan trade conflicts.

He has been an adviser and Consultant to many international organisations and governments. He did his PhD in economics at MIT with Paul Krugman and has published a half-dozen articles with him. Before that he earned an MSc at LSE (1980-81), and a BA at UW-Madison (1976-1980). The author of numerous books and articles, his research interests include international trade, WTO, globalisation, regionalism, global value chains, and European integration

**Sir Paul Collier**, CBE, is a Professor of Economics and Public Policy at the Blavatnik School of Government at the University of Oxford, Professorial Fellow of St. Antony's College, and a Director of the International Growth Centre. From 1998 to 2003 he was the Director of the Development Research Group of the World Bank, and was the founding Director of the Centre for the Study of African Economies, in the Department of Economics at Oxford University, 1993-8 and 2003-12. He is the author of several books, including *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*, published in 2007, and his most recent book, entitled *Exodus: Immigration and Multiculturalism in the 21st Century*, published in 2013. His research covers growth in African economies, and the political economy of fragile states.

**Tony Venables** is Professor of Economics at Oxford University where he directs a programme of research on urbanisation in developing countries and the Oxford Centre for the Analysis of Resource Rich Economies. He is a Fellow of the Econometric Society, the Regional Science Association, and the British Academy, and a member of the steering group of International Growth Centre. Former positions include chief economist at the UK Department for International Development, professor at the London School of Economics, research manager of the trade group in the World Bank, and advisor to the UK Treasury. He has published extensively in the areas of international trade and spatial economics, including work on trade and imperfect competition, economic integration, multinational firms, economic geography, and natural resources. Publications include *The spatial economy; cities, regions and international trade*, with M. Fujita and P. Krugman (MIT press, 1999), and *Multinationals in the World Economy* with G. Barba Navaretti (Princeton 2004).

The **Centre for Economic Policy Research**, founded in 1983, is a network of over 800 researchers based mainly in universities throughout Europe, who collaborate through the Centre in research and its dissemination. The Centre's goal is to promote research excellence and policy relevance in European economics. Because it draws on such a large network of researchers, CEPR is able to produce a wide range of research which not only addresses key policy issues, but also reflects a broad spectrum of individual viewpoints and perspectives. CEPR has made key contributions to a wide range of European and global policy issues for almost three decades. CEPR research may include views on policy, but the Executive Committee of the Centre does not give prior review to its publications, and the Centre takes no institutional policy positions. The opinions expressed in this paper are those of the author and not necessarily those of the Centre for Economic Policy Research.