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Recommendations to UK Government on BREXIT and International Trade Negotiations

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THE PARTNERSHIP TO ENABLE PROSPERITY ("PEP")

We propose a Partnership to Enable Prosperity. Within the overall Partnership, which all countries can embrace, we make specific recommendations for the UK. We also note that the PEP should encompass a broad vision of prosperity and include other non-trade and even non-economic opportunities, where the trade agreements set up the pre-conditions for the creation of wealth but other actions are needed to deliver prosperity in its true and complete form. For the purpose of this memo, we will confine our comments to the international trade aspects of what the UK needs to do as it leaves the EU. If carried out, we believe huge amounts of wealth will be created not only for the UK, but for the world which currently lacks any engine of economic growth. We will divide our recommendations in six broad sections as we note below:

1. UK negotiation with the European Union (UK-EU);
2. UK re-negotiation of World Trade Organisation (WTO) rules;
3. UK negotiation with like-minded group of countries to form Prosperity Zone (the Anti-Distortions Agreement "ADA");
4. UK leading Commonwealth into Free Trade Agreement (CFTA);
5. Grandfathering of certain existing FTAs with fifty countries with whom EU has a deal; new deals for others where it makes sense; and
6. UK improving its own competitiveness by promulgating a pro-competitive regulatory framework to replace EU regulation through the UK Competitiveness and Productivity Act.

UK NEGOTIATION WITH THE EU

We recommend that the UK negotiate as a sovereign nation with the European Union and EFTA. We envisage that there will be a withdrawal agreement, and then an FTA with the EU. This will be different from the so-called EFTA option because the UK will be negotiating a modern FTA with the EU which will include not only the tariff deal but also specific measures that prevent the EU from allowing access but not contestability. Such an agreement would go beyond the CETA and the TTIP in terms of the elimination of Anti-Competitive Market Distortions ("ACMDs").

We discuss and rule out other options as follows.

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EEA Option

The UK could seek to be part of the EEA. Such an arrangement would preclude it from negotiating trade agreements with third countries as it would not be negotiating as a sovereign. An attempt to remain in the EEA in some form would likely come with an immoveable demand for free movement of persons, and a large budgetary contribution. It would be similar to the situation now, except that the UK would become a taker of EEA rules and not a maker of them. This option has a lot of downside and not much upside.

EFTA Option

The UK could join EFTA in order to make sure it had access to the EFTA countries themselves. While the UK could negotiate separate trade deals as an EFTA member (e.g. Switzerland-China FTA and Iceland-China FTA), the downside would be it would be a taker of EEA regulation and not a maker of it because of EFTA's unique relationship with the EEA. It should be noted that many EFTA agreements with third countries are quite basic (Canada-EFTA is goods only, and the Swiss-China deal is very one-sided, as China gets immediate tariff access on 99.7% of goods, while the Swiss have to wait 15 years for access). EFTA agreements tend not to deal with real regulatory barriers and behind the border trade issues like standards which particularly affect the UK.

FTA Plus with the EU

Finally the UK could negotiate an agreement with the EU just as any sovereign does (for example, EU-Mexico, EU-Korea and so forth). Ironically we may be able to get a better deal with the EU than the EFTA countries do through the EEA. This is because EFTA countries have limited services access, and services access would be front and centre of any UK-EU agreement. This agreement would have to include much more than just tariffs on goods, and would have to have comprehensive schedules in services, on domestic regulation, some deal on financial services access for the City of London. Under GATS Article V, no services sector can be excluded from coverage for an FTA to pass muster under Article XXIV of GATT 1947. Given that there will be a financial services deal, it should simply allow maximum coverage (all four modes under GATS with no exemptions to MFN and national treatment). There will also have to a deal that delivers financial services passporting to UK firms, as well as free access to key European markets to UK services providers.

Given the UK's preponderance of services trade, roughly 80% of all exports, the UK is particularly interested in the trade barriers that prevent services access and contestability. Services are disproportionately affected by regulatory barriers. These regulatory barriers are pernicious because they often deal with issues which appear at first blush not to be germane to the commercial interest of the complaining country.

The UK has an opportunity to craft new rules to tackle Anti-Competitive Market Distortions (ACMDs) in the EU agreement. Such rules could be used to deal with the problems that UK industry has suffered from in Port Talbot and other places, and could assist the UK and the EU deal with third country market distortions.

The Canada-EU agreement (CETA) has been proposed as a basis for such a negotiation and we would only note that this and the framework of the TTIP represent the base floor of what is needed. Because of the UK's unique position, it should be able to get an even more comprehensive agreement with the EU than the CETA and the TTIP (both of which look to be in difficulty as of this writing).

Many of these issues are the issues which the EU has in concept agreed to negotiate with the US in the context of the TTIP.

UK WTO NEGOTIATION

The UK will have to engage in a WTO renegotiation, although it should be noted at the outset that the UK is a WTO member now, and was a founder member of the GATT. The WTO negotiation will consist of an agricultural negotiation in terms of the reallocation of EU agricultural quotas, as well as a review of the services' schedule. In cases where the UK can put forward a better schedule that the EU schedule, it should do so as this would encourage more rapid support from other WTO members. The UK's offer could be more substantial depending on the final landing zone with the EEA.

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ADA/PROSPERITY ZONE

The idea of the Anti-Distortions Agreement ("ADA") would be to assemble a like-minded group of countries who could together agree not only classic international trade provisions in the form of a massive reduction in tariffs, and rules for the better protection of property rights such as rules making regulatory takings (similar to the US constitutional bar on regulatory takings) illegal (a step up from NAFTA's protections against expropriation and actions tantamount to expropriation), but also a reduction of Anti-Competitive Market Distortions (ACMDs).

The ADA would be an agreement among countries who are disposed to the foundational pillars of classical liberalism—property rights protection, open trade at the border, and competition on the merits inside it. These countries could agree among themselves a set of rules that optimised the economic environment inside their borders by reducing barriers between them, distortions and ensuring full protection of property rights. The zone would also include rules that dealt with third country issues, for example distortions in other markets that have a negative impact on firm activity inside the zone. Some of these rules could be drawn from the defensive measures referred to above.

The key elements of the ADA will include optimisation across the dimensions of open trade, competition on the merits and property rights protection. Key provisions will include;

1. Rapid reduction of tariffs to zero among the ADA countries;
2. Provisions to tarifficate identified distortions (ACMDs) within the zone with a mechanism to ensure their reduction;
3. Provisions on how laws and regulations are promulgated in ADA member countries that subjects any new law/regulation to a cost benefit analysis, where the cost is the impact on the market of the law/regulation. The goal would be to ensure that any new laws or regulations are the least distortive possible consistent with the regulatory goal;
4. Upgrading of securities laws in ADA members which require any companies raising money from investors to declare any privileges or benefits which they receive from their government;
5. Strong investor protection provisions that cover not only expropriations, actions tantamount to expropriation and regulatory takings with the potential for investor-state dispute settlement mechanisms in international arbitration; and
6. The empowerment of domestic competition agencies to engage with other government departments on regulations and laws that are ACMDs, giving them the authority to advise governments to remove the offending laws and regulations. This could be set up under a modified version of the UK's Deregulation and Contracting Out Act, 1989.

Potential ADA members include US, Australia, NZ, UK, Canada, Singapore and possibly (depending on precise trade status, Hong Kong).

COMMONWEALTH FREE TRADE ZONE

The UK, unencumbered by the Common Agricultural Policy ("CAP") and the Common Fisheries Policy ("CFP") is in a position to lead discussions towards a Commonwealth Free Trade Zone. The Commonwealth Heads of Government meeting is set for 2018 in London, which would be a perfect time to announce progress on such an initiative.

This would bring development NGOs onside as they have been targeting the damage the CAP and CFP has done to poor agricultural producer countries for many years.

EXISTING EU AGREEMENTS

An inventory should be done of the existing EU FTAs, as in some cases grandfathering of these arrangements would be desirable, but in other cases such as EU-Mexico, and possibly EU-Chile, it may be that the UK can relatively quickly make a better offer which would lead to a better deal for both parties. This is because the EU does not negotiate on agriculture in its trade agreements.

Where the EU is currently involved in an ongoing trade negotiation which has not been ratified into law (such as the CETA, or the India negotiation), the UK should be free to initiate its own negotiation.

UK Competitiveness and Productivity Act

EU law and regulation has filled many gaps in UK law since its inception in 1973. Lord Denning famously said of EU law in 1974:

> "It flows into the estuaries and up the rivers. It cannot be held back, Parliament has decreed that the Treaty is henceforward to be part of our law. It is equal in force to any statute."

It is impossible to extract EU law out of English law as things stand now. However, no parliament can bind its successor and so the UK can, after the UK-EU negotiation is concluded start to change its laws. But in the intervening time there is a massive volume of EU directives and laws that are part of English law. We believe that while harmonisation of all this law will be necessary to ensure there are no gaps in UK law and practice going forward, there could be exceptions where a well-developed economic regulation can replace it. We list below (non-exhaustively) where these might apply.

Anti-Dumping and Countervailing Duties

The UK will need to revise its anti-dumping/countervailing duty laws when it transitions out of the EU. This presents the UK with an opportunity to have a more pro-competitive law that actually protects its domestic producers from market distortions in other markets, and is not simply a price-based mechanism that discriminates against efficient producers in other markets.

The original justification for anti-dumping law was to prevent anticompetitive predation by foreign producers, many anti-dumping laws as currently designed and applied instead diminish competition in industries affected by AD tariffs and reduce economic welfare. Modification of AD laws to incorporate more of an antitrust predatory pricing standard would strengthen the national economy and benefit consumers while precluding any truly predatory dumping designed to destroy domestic industries and monopolise industrial sectors.

In addition to dealing with predatory activity, the new UK AD/CVD law should deal with market distortions in other countries where producers receive an artificial cost advantage which does not arise through their own merits.

Competition

The new UK Government should focus on simpler, clearer rules in competition policy enforcement, particularly as regards single firm conduct. It should seek to avoid second-guessing innovative and novel contractual arrangements by high tech firms, which may be key to leapfrog innovation and economic growth. European rules on collective dominance and abuse of dominance should be avoided and more economics based market power test should be used instead. There is a lot of new thinking in this area such as decision theory which could inform the UK's new legislation in this area.

SPS/TBT

There are many examples of EU regulation that go well beyond what is necessary to promote the regulatory goal. Examples include REACH type chemicals regulation, regulations on Flourinated 67 Greenhouse Gases, the Renewable Energy Directive; Transport Fuel Directive; Trucks (Maximum Authorized Dimensions Directive) to name just a few. It will be necessary for the UK to categorically reject the precautionary principle as a basis for UK regulatory promulgation.

Standards

The UK should embrace voluntary standard setting, and allow private standard setting organisations to be involved in the standard setting process.

Clearly for SPS/TBT and standards, if UK manufacturers wish to access the EU market they will have to produce products that satisfy EU requirements (subject to whatever is agreed in the UK-EU agreement itself to ensure

these standards are not barriers against UK exports). This will be a matter for manufacturers to decide based on where their commercial opportunities lie.

REGULATORY PROMULGATION PROCESS

The UK can embrace a regulatory promulgation process where competition on the merits is the organising principle for regulatory reform. The test should be what the impact of the regulatory proposal is on the market as well as on consumer welfare. Regulation should only be undertaken in ways that minimise the market impact, consistent with the regulatory goal. This would be a better regulatory promulgation process than any other country has (most countries, if they do this at all focus on business compliance cost). This should apply to all regulations and legislation.

Aviation/Maritime Regulatory Reform

There are a couple of key reforms that are necessary in both the aviation and maritime sectors. In aviation, pro-competitive landing slot allocation, and open skies (or equivalent degrees of air freedom) would lead to more revenue derived from airport operations. In maritime, the elimination of flag carrier rules, crew member nationality requirements and equity caps would lead to a better port offering. The UK has a fairly open maritime situation, but has does have anti-competitive slot allocation at its airports.

Financial Services Regulation

The UK should maintain an open financial services market. At the outset, the UK should implement MIFID 2/MIFIR fully. After the negotiation, the pursuit of alternative financial services regulation for example the elimination of deposit insurance, and the embracing of less restrictive capital adequacy rules should be considered, having regard to the potential losses from MIFIR changes (which could lead to loss of equivalence and therefore any passporting previously agreed) set against the gains in other agreements, and the gains to the UK of offering a more competitive financial services offering to the largest savings pools which will be found in Asia in the future.

CONCLUSION

This proposal requires an understanding of trade policy, trade negotiations and domestic regulatory policy which are intertwined in the 21st century. The UK stands to gain a significant amount, but it has a narrow window of opportunity to put in places systems that will allow the above to be achieved. A timid approach could lead to a very negative situation because EU negotiations in a vacuum are likely to lead to a bad outcome for the UK—we have much to lose and not much to gain. An approach which treats all larger markets as if similar agreements can be achieved with them (for example assuming we can get similar deals from China and the US) will likely fail and could expose UK industry to substantial pressure (i.e. increasing exposure to China imports without properly dealing with China's market distortions).

If on the other hand, we advance along the paths outlined above at the same time, we believe that the future is bright. A mountain must be climbed, to be sure, but at the mountain top, the much vaunted sunny uplands of prosperity and peace can certainly be attained.