The Tacitus Lecture 2017

The World is Our Oyster? Britain's Future Trade Relationships

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When it comes to trade these days, the world hardly seems to be anyone's oyster. Perhaps it is a Chinese oyster – one which President Trump is finding hard to swallow.

We have reached a crossroads in attitudes to trade in Western societies. The orthodoxy of the post-Cold War period, when globalisation became an article of faith, has been reopened, and with it the international economic system we created and have come to take for granted.

Remarkably, the disruption has come not from the world's most disadvantaged, nor from countries people here label as protectionist, but within the two rich countries that have been the most vocal champions of open trade in a rules-based multilateral system: the United States and the United Kingdom. We now have an American President who says "protection will lead to great prosperity and strength", while Britain is leaving the European Union.

When I took on this lecture, I expected a relatively straightforward review of how Britain should set about reorganising its trade relationships, as best it could, after Brexit. Tacitus would understand that. He wrote a biography of his father in law Agricola, the Roman governor of Britain, who knew a thing or two about relations between these islands and the European super-state. But since the election of Donald Trump, the question of how we will create new opportunities for British trade around the world must be considered in a changing and more worrying international context.

How Did We Get Here?

It's easy to be wise after the event, but 2016 was a year of shocks that should have shocked us less. The signs of discontent have been there for some time. Our problem has been reading them correctly and being willing to react.

I first worked on trade in the European Commission in the mid-1990s. Those were the heady days of globalisation, when we had completed the Uruguay Round and just created the WTO. Multilateral liberalisation stimulated competitiveness and innovation. Global trade grew, consumers benefitted, and around the world standards of living were rising, democracy was spreading and poverty was in retreat.

Shortly before the Millennium, popular opinion began to turn. It started among the activist fringe at the Seattle anti-WTO riots of 1999 and then spread wider. The downsides of globalisation have become evident, while we have grown more blasé about its benefits.

When I went back to Brussels in 2004, the Doha Round of global WTO negotiations was already becoming a saga of missed deadlines. We lowered our sights to plurilateral agreements – what you might call more extreme trade among consenting adults; or regional agreements on the NAFTA model; or bilateral agreements between countries. These are easier to negotiate and evaluate, but they were a retreat from the goal of multilateral liberalisation.

Nevertheless, growth of global GDP and trade remained strong, giving political and business leaders every incentive to press ahead. As the global race accelerated, the response was too often imprudent deregulation and a blind eye to unethical risk, notably in financial services.

The 2008 financial crisis was the watershed, and the most important historical event since 1989. Not only because it wrought economic and financial havoc, but because it undid the credibility of elites, notably in the US and UK. We seemed to sleep-walk into it; many believe those most responsible escaped the consequences; policies of austerity have brought a decade of disappointed economic expectations and lower investment in social services and infrastructure; and society now seems more unequal.

It is hardly surprising that the idea took hold that global trade does not after all work for the solid, salaried middle class in richer countries, or for people squeezed out of secure work by outsourcing or cheaper foreign labour. As the process of globalisation has accelerated, driven by technological change, this has fed frustration, grievance and hostility to immigrants – and here we are, with Brexit, President Trump, and Marine LePen breathing down our necks. It did not have to go this way. The problem was not globalisation itself, so much as our inability to manage it.

What will come next? Some argue that we are now facing a phase of active de-globalisation. Whether that happens depends on policy makers. Trade is done by businesses, but the policy and regulatory context governments provide is hugely influential. The toothpaste of global trade, finance and investment will only go back into the tube if it is forced back by policy choices. This will depend above all on the new US administration, and here the evidence so far is most disturbing. It will also depend on the behaviour of China, which has too often twisted the rules of open trade, and on the future voice and cohesion of Europe.

What Does Brexit Mean?

This is not an easy context in which to leave the EU and strike out alone as "Global Britain". Our decision to leave heralds the biggest change for many decades in our international economic and political relationships.

During the post-Cold War period, as well as being a vocal national champion of open trade, the UK has pursued many of its international economic policies through the EU.

The EU single market, which is by far the world's most successful example of international trade liberalisation and regulatory cooperation, was our brainchild. No other economic or free trade area comes near it for ease of cross border activity or removal of non-tariff barriers. It is far from perfect: for example, in coverage of services. But almost half of British trade in goods and services now takes place in this space with minimal border controls or regulatory divergence. The Government's recent White Paper shows that trade has grown more rapidly as a proportion of UK GDP since we joined the EU than before.

The EU is also unique in operating as a single entity in trade negotiation, leveraging a market of 500 million people in the WTO, in regional negotiations, and in bilateral deals with Korea, Canada or Japan.

It is argued, with some reason, that despite its internal openness the EU is externally protectionist, notably in agriculture. But, as someone who was often in the room, I can attest that the lack of multilateral trade successes since the Uruguay Round is no more down to EU protection than to that of the US, India or Brazil.

It is also a fair criticism that EU negotiation of bilateral deals is ponderous. But the EU does have in place over 20 Free Trade Agreements covering 50 countries. The US has 14 FTAs with 20 countries, and China also has 14. Just as America is pulling out of the Trans Pacific Partnership and threatening tariffs on China and Mexico, the EU is closing in on a new agreement with Japan.

It is true that leaving the EU will allow the UK to pursue a nimbler and more nationally focused international trade policy. Global Britain is a laudable goal. But it is ironic that we start by withdrawing from the world's most sophisticated regime for free trade in by far our largest market. It's a bold case of “reculer pour mieux sauter”.

A New Trade Strategy

To be more than an optimistic slogan, Global Britain needs to rest on a clear, evidence based strategy. And once we have the strategy, we will need a consistent plan to deliver it which is a marked improvement on our chop and change efforts at trade promotion in recent years.

First, it is important to understand the changing nature of trade. There is still a tendency in political debate to talk in terms of finished products being sent from one neatly separate nation state to another. But in modern supply chains part finished goods cross borders many times on their journey to completion. Does President Trump know that 40% of the content of Mexican exports to the US originates in the US?

Much trade is not about physical goods. Services rose from 25% to 44% of UK exports between 1995 and 2015. Trade policy increasingly focuses not on tariffs or customs controls, but on mutual recognition of product standards or human qualifications, protection of intellectual property rights, rules governing investment, copyright law, or data protection. These are the infrastructure of a modern trading system between advanced economies.

We also need to work out where our future comparative advantages lie and the markets which best suit them. Our weight in services may require us to pioneer new forms of trade agreement since coverage is inadequate in the current generation. We may wish to concentrate on markets for our creative industries and technology. Our domestic strengths should guide our external trade priorities.

And we need to think imaginatively about how trade rules, regulation and taxation will cope with the speed and borderless nature of the internet economy. As far back as 2013 60% of all cross-border flows in services were digital and global e-commerce sales amounted to 2% of global GDP.

Finally, our strategy should not be opportunistic or reactive, but based in principles. Brexit makes it even more important for the UK to have an international trade system with rules ensuring non-discrimination, fair competition and enforcement. Alone, we will be less equipped to cope in a trade environment driven by the bilateral and power based instincts of the new US administration and China, or indeed the sheer trading weight of the future EU.

That is why we should remain a strong supporter of the WTO, and resist any temptation to short-circuit rules to score quick successes. The first act of our new strategy will be to establish the UK as a national member of the WTO outside the EU. The Government intends to replicate the EU's WTO commitments for trade in goods and services. This will need to be endorsed by all WTO members. It should not be unduly difficult, but there will be issues to resolve, for example over commitments the EU and UK have made on agricultural tariff rate quotas.

Which Market Priorities for the New Strategy?

The journey can only start from where we stand today.

In 2015, 44% of total UK exports of goods and services went to the EU, and 53% of total UK imports came from the EU. The EU is the biggest market for all major sectors of the UK economy.

The 50 countries with which the EU currently has FTAs accounted in 2015 for 13% of our trade. That rises to 25% if you include countries with which the EU is currently negotiating. This means that almost 60% of our trade will be directly affected when we leave the EU.

In the same year, 20% of total UK exports of goods and services went to the US, and 11% of our imports came from the US, amounting to around 16% of our total trade.

8% of UK exports went to all the BRICS countries – Brazil, Russia, India, China, South Africa – combined. 11% of our imports came from the BRICS.

The Commonwealth accounted for 9.5% of our exports and 8% of our imports. Of that Australia received 1.6% of our exports and provided 0.8% of our imports. New Zealand accounted for 0.2% of both exports and imports.

The EU provides 54% of our direct inward investment: France over 8%; Germany over 6%; The Netherlands over 17%. Almost 32% of FDI into the UK comes from America. The BRICS, excluding of course Hong Kong, account for 1.6% of our inward FDI.

Of our outward FDI almost 43% goes to the EU, 23% to the US and 5% to the BRICS.

I apologise for this raft of statistics. We can debate the precise figures, but they tell a clear story. Whatever our longer-term goal, the EU and the US together constitute over 60% of our export market and will remain at the heart of our trading relationships. Certainly, the ratios may change over time, not least as a consequence of Brexit. Trade with the EU has fallen from 55% of our total in 1999 to 44% today. But significant structural change will not happen rapidly, and there will be a floor.

There is strong evidence that trade flows are influenced by geographical proximity. Switzerland has about one third of the population of Canada, but imports twice as much from the UK. It is our third largest trade partner outside the EU, after the US and China. Over 70% of UK agricultural exports go to the EU, where it is easier and cheaper to get them fresh to market. By any calculation, the trade strategy for Global Britain has to start with Europe and America.

One: The EU

Brexit was a political choice. Our aim now should be the best possible economic relationship with the EU that is consistent with our wider Brexit objectives. The course we have taken since the Prime Minister's speech of 17 January makes this difficult. None of the possible forms of Brexit could have given us the same access and influence in the EU market that we currently have. A relationship based in a Free Trade

Agreement, which is the aim the Prime Minister set, will significantly reduce both.

The Government has decided to prioritise other goals over our economic relations with the EU. This is fine, provided either people are prepared to pay the price in more expensive goods, less inward investment and lower growth, or we can quite rapidly find compensating alternative markets.

There is also a risk, if the Article 50 exit negotiation does not go smoothly, that our future trade relationship will be negotiated not from the starting point of the status quo – integrated membership of a common market and regulatory space - but from outside, almost like any other third country. We should do our utmost to minimise this risk by avoiding gratuitous political friction and prioritising a smooth transition to new arrangements.

I believe it is right now to press ahead if we can with negotiations on both our exit and preparing our new relationship. We need to ground the speculation and political positioning of recent months in hard negotiating reality, which may come as a salutary reality check to politicians on both sides.

British Ministers correctly point out that the EU has a strong economic interest in minimising the damage with the UK, the market for 16% of EU exports with which they have a big trade surplus. They are less quick to note that in neither our vote to leave the EU, nor the choice of the form Brexit should take, has UK economic interest overridden other considerations. Politics and emotion do not stop at Dover.

As in all negotiations, both sides will pursue their interests as they perceive them. Two priorities on the EU side are to preserve the unity of the 27, which is now at significant risk, and to ensure that the UK does not gain advantage from leaving. To assert that if you leave a club and stop paying the subscriptions you cannot enjoy the benefits of membership, is hardly vindictive.

The Government is right that the options are not simple or binary. Negotiations will cover many issues: tariffs and other barriers for trade in goods, market access and regulatory equivalence for provision of services, mutual recognition of product standards, dispute settlement and more.

Take the customs union. Leaving it would imply additional tariff costs on goods. The average EU tariff is 5.3%, and in sectors like automotive and agriculture it is higher. We should aim for, and we have a good chance of achieving, an FTA agreement to reduce most tariffs to zero or near zero. But this would have to be enshrined in such an agreement. Under WTO rules we cannot unilaterally offer a zero-tariff to the EU unless we also offer it to all other countries - the trade equivalent of unilateral disarmament.

Tariffs are anyway not the critical issue, especially given the fall of sterling. Some analysts calculate that the added Brexit cost of so called non-tariff barriers could be between 5 to 10%. They mean new costs of customs checks, inspections, regulatory compliance, more intrusive paperwork or delays in distribution. It will be a high priority to minimise these. Even so, where trade with Europe is concerned, rather than reducing red tape Brexit seems certain to increase it, and the number of public officials required to police it. There are 34 EU regulatory agencies that we will either need to stay within or replicate.

It is not yet clear how the Government will approach this complex negotiation. The White Paper mentions sectoral agreements, and obviously there are high priorities such as financial services and automotive exports. The EU may resist this approach as an attempt at cherry picking. Classic best practice in trade negotiations is to create a wide canvass which allows trade-offs between different sectors and interests. If we address each sector separately we could weaken our hand.

Two: The US

On the timing of new trade agreements outside Europe there are three important requirements. First, we cannot start formal negotiations before we have left the EU and its external trade policy. If we try, we will be challenged in the WTO and sour the Brexit negotiation. Second, we cannot negotiate seriously until we know the nature of our future relationship with the EU, for example our new customs arrangement. Third, no other country is going to make an agreement until they know what our future relationship with the EU will be, because this may affect the value of the deal for them and create other complications. So our new deals with the EU and with other countries cannot be viewed in isolation; they will be connecting vases.

Priority number two must be the US. It is our biggest single trade partner and our great ally. A small percentage increase in trade will deliver big economic benefits, and geography and language are favourable.

However, what matters is not getting a deal, but what it contains. You can get a bad trade agreement quickly. Good ones, that really serve your interests, are harder and take longer. There has so far been little focus on the content of what either party actually wants.

For the UK, the answer is not really tariff reductions on goods, but improved market access for services and investment, greater mutual recognition of standards, qualifications and regulation, more access to public procurement, an agreement on data protection. These are politically sensitive issues on the US side and some are regulated at state rather than federal level.

They are also sensitive here, as we know from the upsurge of opposition to the EU/US TTIP negotiations. TTIP offers a starting platform for a UK/US negotiation, but also some cautionary lessons. The US will have other access goals in our market, for example for hormone treated beef and genetically modified foods, of which British public acceptance is far from assured. In other key areas like financial services, the US may see access to the EU market, no longer available via the UK, as a more important objective.

I first worked on the precursor of TTIP in the 1990s in Brussels and that taught me that the US does not do charity in trade negotiations. Incoming Commerce Secretary Ross has said “When you start out with your adversary understanding that he or she is going to have to make concessions, that’s a pretty good background to begin.” However much political good will there may be, the UK will be the weaker party and the smaller market. Finding the balance of advantage is the challenge: we need a good plan.

Three: EU FTAs

A third early priority should be new arrangements with the group of 50 countries with which the EU has FTAs. Together they account for 13% of current UK trade, of which 70% is with just four countries: Norway, Switzerland, Korea and Turkey.

When we leave the EU, we will cease to have privileged trade access to these markets unless by mutual agreement we continue the terms of the EU FTA or negotiate new deals. Trade would not stop, but it would cost more and the UK would be at a competitive disadvantage against EU countries. Our aim should be to preserve current arrangements, and over time to improve them. Negotiating this will require the EU to be involved, because what we do will affect the EU agreements. The EU will in future be offering access to a smaller market unless, for example, the UK continues to receive its agreed quota of agricultural products.

South Korea is a good example. It is the most ambitious EU FTA until the recent one with Canada. It eliminated 97% of tariffs and broke new ground in coverage of services. In its first five years, EU exports to Korea rose by 55%, and the UK benefitted more than most EU countries. Global Britain will need to maintain participation in this agreement or to negotiate equivalent or better market access. The same goes for Canada and Japan.

Four: The BRICS

Some economists and politicians argue that any European trade disadvantages from Brexit will be outweighed by the gains we stand to make in newer, more dynamic markets like the BRICS - Brazil, Russia, South Africa, and especially China and India.

We will have welcome and promising new opportunities to pursue British FTAs with these countries. Strengthening our trade and political relations with them is an excellent policy, which we have been pursuing for some years and should take further. It must be a high priority of our new trade strategy as they turn further outward on the world. The BRICS collectively account for 8% of our exports and this will certainly grow.

But it is important to understand the scale of the shift in the structure of our trade that is implied by some of the airier aspirations. If we were to lose 5% of our trade with the EU, we would need a 25% increase in our trade with the BRICS, or with the Commonwealth, to recoup that loss before any new gains were made.

Our recent record in these markets is mixed. UK exports to India as a percentage of India's total import market fell from 5.2% in 2005 to 2.4% in 2015. That was not directly the consequence of EU membership, since we lost market share to Germany, France and Italy. In China, we have done better: our export share rose from 1.2% to 1.4% over the same decade, in a growing market. Germany's market share is over 5%, including 23% in cars.

Also, realising the new opportunities is likely to take time. It took Australia ten years to agree an FTA with China, and the US eight years with Colombia. India needed six years to get a deal with ASEAN. Reaching the sunny uplands will require a hike.

Finally, businesses need to know the risks. Those who complain about red tape in the EU may overlook the bureaucratic or political hurdles to trade in other markets. These can include onerous customs and labelling requirements, language barriers, legal uncertainty and discriminatory taxation, not to mention corruption.

Five: The Commonwealth

If the BRICS are a high priority, but not a panacea, so is the Commonwealth. I do not subscribe to the view that the Commonwealth offers an equivalent vehicle to the EU for projecting UK influence in the world, but we should definitely be looking to strengthen Commonwealth trade and other links.

Australia and New Zealand are keen for trade deals. The problem is that between them they account for less than 2% of our exports. When Australia made an FTA with the US, their trade grew about 70% over a decade, but academics suggest much of this was diversion of trade from other Australian partners. For the UK, early FTAs with Australia and New Zealand are desirable in political terms, but secondary in economic terms. Should they be a priority for deploying limited trade negotiating resources?

Another little remarked fact is that thirty-two Commonwealth countries, mainly in Africa and the Caribbean, are covered by EU FTAs or have tariff free access to our markets. This raises two issues. First, until we negotiate new agreements with them we risk being in the odd position of having worse trading terms with these Commonwealth countries than the EU. Second, these EU trade agreements are vital for their development goals. The UK will no longer be able to champion their access to the EU market as we have in the past. We have a moral responsibility to address the concerns of these countries, which illustrate how Brexit may have unforeseen repercussions well beyond Europe.

Conclusion: Attitude, Policy, Capacity

These are some of the opportunities, priorities and challenges ahead for Britain's future trade relationships. Whatever any of us may think about the choice to leave the EU, and the way the Government is putting it into practice, our task now is to look forward and pursue new opportunity, with rigour and realism. Success will start at home and be built on three foundations: our attitude, policies and capacity.

On attitude, in a worsening international context, I believe Britain must remain a positive force for sustainable growth, international cooperation, tolerance and respect. Fair trade, conducted in a rules-based international system, is an essential pillar of international security and prosperity. Withdrawal into narrow nationalism, protection or xenophobia is the route to economic loss and insecurity.

This calls for leadership. We will only restore faith in open trade if people believe it serves their interest. Making this case is harder than peddling simplistic short term answers - or indeed untruths - that store up future distress. The failure of successive leaders to make the case for Europe, until it was far too late, was one of the reasons for the referendum result.

Government also needs to understand business attitudes. Large companies will adjust to find new ways to operate in international markets. But their decisions will be driven by commercial considerations of profit and shareholder interest, not patriotism or national identity. And they cannot wait too long to know what the future holds: they need to make contingency plans and decisions well in advance. Smaller businesses have fewer options and may find operating in international markets more complex. British SMEs already have a low propensity to export, so the government will need to redouble its support and encouragement.

On policies, our trade strategy for a Global Britain should be rooted in a credible, sustained domestic strategy for a strong, inclusive and competitive economy. The Government's proposal for a new Industrial Strategy is welcome. We need a sustained effort to give people education, skills, opportunities and the confidence to believe that they have a stake and can compete in a high quality, high technology, knowledge economy. We also need social and investment policies that convince people that our economically successful society will respect and protect the weak.

This will be achieved neither through a low tax, low regulation sweat shop economy, nor through heavy state intervention or protection. Either model will invite damaging international retaliation.

Third, capacity. The agenda is huge and complex. Even focussing on the very highest priorities will be an enormous task for Parliament, ministers and civil servants, and will test our system to the limit. We shall need more high quality resources at home and abroad to meet the challenge. And as we prioritise, we must make sure that important considerations, like the concerns of friends in Africa or the Caribbean, do not fall through the cracks.

If the world is to be our oyster, we need to find the pearl of new, successful international trade relationships. The grit that grows the pearl will be our own determination and enterprise. But we must also respect other people and countries, and keep in mind the wider purpose of improving the lives of people at home and abroad. We should learn from experience, but not see the future solely through the prism of the past. We need to be open to new ways of thinking, managing change and achieving results. Perhaps then we can look forward to Whitstable oysters once more dominating international markets – as in the days of Tacitus, when they were exported live to the tables of Rome.

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