

Free Trade Agreements aren't the solution

says Anthony Scholefield, who argues that the UK should decide what sort of trading regime it wants before thinking about FTAs

The EU-sceptic cause had to start from a very weak position in the 1990s. Politicians were claiming absurd benefits for EU membership and all parties proposed further integration. Business as represented by the CBI was in favour of EU integration and membership of the euro. The idea of modifying or withdrawing from the EU had been branded by Margaret Thatcher as one of the 'extreme' policies of Michael Foot's Labour Party. The electorate was carefully kept out of any influence on, or knowledge of, moves to EU integration.

All of these handicaps have now been thrown off. British public opinion has woken up to the cost, bureaucracy and lack of benefit to the British people. The idea of modification or withdrawal from the EU is no longer treated as extreme, 'nationalistic' or 'racist'. The CBI has lost business support because of its euro enthusiasm and the City will not back the euro. The benefits of electoral success by UKIP and, to a lesser extent the Tory Party, are that any overt move to further political and economic integration is unlikely. That, of course, is why the pro-EU forces, heavily entrenched in Parliament and the EU organs, are now going about their work furtively.

This necessary emphasis on demolition work by EU-sceptics has meant that not enough serious attention has been paid to a post-EU Britain. Richard North correctly advised the Tory Party that, to be taken seriously, 'we need to paint a picture in very clear detail of what sort of Europe we want'. Among these details, more effort must be made to analyse the economic effects of withdrawal and the various options available. In recent months more data and interesting proposals have been put forward both by Ian Milne of *eurofacts/Global Britain* and Patrick Minford and his associates at the Cardiff Business School; and on 20th October last *Open Europe*

published similar proposals.

How to replace membership of the EU customs union?

How do genuinely eurosceptic politicians propose to replace the EU customs union membership?

Daniel Hannan MEP recently called for Britain's membership to be replaced by 'bilateral free trade agreements'. UKIP's 2004 Manifesto called for 'Full withdrawal from the European Union in favour of a Free Trade Agreement similar to those enjoyed by other non-EU states, including Switzerland, Norway, Iceland and Mexico'. The Veritas Manifesto for the 2005 election also called for 'a Free Trade Agreement with the EU similar to the ones Norway and Switzerland have'. All these proposals appear broadly the same.

Clearly the idea of free trade agreements now has traction at least among those who are minded to consider withdrawal or new forms of association with the EU. The main advantage of Free Trade Agreements - which, incidentally, are not favoured by the WTO which seeks free world trade - is that they enable politicians to argue that the electorate would not be 'isolated' in the post-EU world. For whatever reason most EU-sceptics are not prepared to jump immediately to unilateral free trade from a customs union security blanket.

There are certain difficulties with the idea of bilateral free trade agreements. Patrick Minford puts a powerful case against them. Ian Milne is sceptical of trade agreements in the modern world of low tariffs and WTO arrangements.

If we divide trade into sectors such as services, industrial goods, public procurement and defence procurement, agriculture and fisheries, it is worth pointing out that services are already virtually freely traded. It is notable that UKIP promises substantial financial support for agriculture and it is likely

that this policy would attract support from other EU come-outers. It would, of course, be possible to combine this with imports at world prices but would require effective state determination of the quantum and prices of agricultural production. There have been considerable pressures not to go down the free trade route in public procurement and defence procurement as well. So, in practice, it is likely that any Free Trade Agreement (FTA) would revolve around industrial goods, like most other FTAs. In order to simplify the arguments the rest of this article only considers industrial goods

How would an FTA actually work?

To begin with it should be noted that an FTA is partly a contradiction in terms. While an FTA may allow the two parties free trade in each other's home markets, it also assumes a measure of discrimination against goods purchased from a country not party to the agreement.

The analysis of an FTA's advantages depends on what sort of trading regime an independent Britain chooses to have. To call for an FTA prior to this basic decision is to put the cart before the horse.

Broadly, Britain would have three choices.

First, it could declare for unilateral free trade, as favoured by Patrick Minford. Second, it could retain the tariffs and protective trade regime of the EU as presently constituted, with the regime administered by Whitehall and the proceeds of tariffs going to the UK Treasury instead of Brussels. Third, it could introduce a modified controlled trade regime with fewer restrictions than presently organized by Brussels but administered by Whitehall.

Minford points out the benefits for the UK of declaring unilateral free trade. These are that the UK would now buy all its goods at world prices.

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FTAs are not what Britain needs

Not only would EU manufacturers, who sell far more industrial goods to Britain than vice versa (a net deficit of £20 billion p.a. for the UK), be forced to compete with manufacturers outside the EU, which would reduce prices, but also the hidden price rises through actual and threatened anti-dumping and other restrictive mechanisms of the EU, which do not necessarily show up in the trade figures, would be got rid of. In other words, declaring free trade in industrial goods would be similar in its effects to leaving the CAP.

The second advantage is the general economic point that free trade corrects misallocation of resources in the UK, a basic point in economic theory.

Preferential Access

Minford concludes that if Britain declared unilateral free trade there would then be no possibility of an FTA. Why? *"This is to miss the point of a customs union in which there is horse-trading between the producers of different countries paid for by the consumers; if a country refuses to trade by penalizing its consumers, it has nothing to offer"*. He adds, *"Were the UK to be outside and let its consumers receive world prices, continental EU countries would be mad to let UK producers have access to their markets at preferential customs union prices; this would amount to asking their own producers to transfer profits to UK firms with no quid pro quo"*.

So if it is impossible to have an FTA in the event of Britain declaring unilateral free trade, what is the relevance of an FTA under the other scenarios?

The Other Scenarios

The two other scenarios are that

Britain retains the Brussels' industrial goods regime either wholly or partly under pressure from commercial interests. It should be noted that if Britain administered its own trade regime from Whitehall it would make three undoubted gains. First, all duties would accrue to Britain not Brussels. Second, it could eliminate dumping and even more the threat of dumping rules, voluntary restraints and all the rest of the Brussels panoply which push up prices. These are the equivalent of the effects of the CAP in pushing up costs to the consumer when buying food. The third effect is more subtle. Basically, the wider the area of a customs union the larger number of producers and special interests which are created, all of whom press for anti-dumping duties, tariffs and trade restrictions. At present UK consumers may pay higher prices for goods in which there is little or no UK production because we are in a customs union with EU countries that do have producers keen to protect their own markets. By contracting the size of the EU customs union to the UK, the number of special interests pressing for protection is substantially reduced.

Should an FTA then be concluded with the rest of the EU? Of course, FTAs come in different shapes with different trade products covered in different ways.

The main point to note is that Britain has a long-term structural deficit in industrial goods with the rest of the EU of about £20 billion p.a. A fairly negotiated FTA in industrial goods would entrench this surplus which, insofar as it relates to goods which could be obtained more cheaply elsewhere, transfers wealth from UK consumers to EU manufacturers. EU manufacturers would be able to export industrial goods to the UK and get the same prices as UK manufacturers but

better prices than countries without an FTA. Of course, Britain would do the same with the rest of the EU but the structural surplus which is in favour of the EU could well increase as EU countries (such as France) maintain their industrial base by protectionism.

No Sense

It therefore makes no sense for Britain to have an FTA with the rest of the EU on withdrawal under any of the scenarios outlined above. We should, however, be mindful that Switzerland has a similar economic profile vis-à-vis the EU as the UK. It has a permanent deficit in its EU trade which reached (visibles) in 2003, 12.5 billion euros, but it has an FTA. Our analysis shows that Switzerland would be economically better off without this FTA. It is impossible to say how much of the EU surplus would disappear if Switzerland opted for unilateral free trade but there is at present a transfer of wealth from Switzerland to the EU under the FTA regime.

The reasons for Switzerland agreeing to an FTA and for British eurosceptics to advocate an FTA for the UK are undoubtedly political. To withdraw from the EU without an FTA is considered in some quarters to be a step too far. An FTA might offer a political "comfort blanket" to that part of the electorate that feels the UK would be "isolated" but it is expensive and not economically justified. The analysis also shows the necessity of deciding what sort of trading regime there would be in post-EU Britain before making decisions about Free Trade Agreements.

Straight from the horse's mouth

"Europe has been built in a St. Simonian way from the beginning; this was Monnet's approach. The people weren't ready to agree to integration,

so you had to get on without telling them too much about what was happening".- Pascal Lamy, Chef de Cabinet to Commission President

Jacques Delors, July 1992, in G. Ross, *"Jacques Delors and European Integration"*, Policy Press, Oxford and Cambridge, 1994.