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Tariffs: Theory and Practice

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Summary

Economic theory suggests that free trade is beneficial to the trading countries, and that tariffs, which are taxes on imported products, reduce economic welfare. Nevertheless, the arguments for and against tariffs are contested, and there is evidence that one of the most common, that of enabling new industries to grow, is supported by some historical episodes.

Tariffs have been employed since 300BCE, and at times have played a key role in countries' economic policies. Today, however, non-tariff barriers to trade are considered to be more significant. These include, for example, safety standards, sanitary checks on food and how products are advertised. Non-tariff barriers are particularly significant for trade in services.

International efforts to regulate trade and reduce tariffs began after World War II, leading to the establishment of the World Trade Organization (WTO) in 1995. WTO members account for 98% of world trade. Trading on 'WTO terms' requires each member to apply equal tariffs to all other members. However, this does not apply if members form a formal trading area, such as the EU, have a bilateral trade agreement, or in certain other circumstances.

As a member of the EU, the UK trades with other members free of tariffs and with efforts to minimise non-tariff barriers, while each member of the EU applies a common tariff to non-members. This will change when the UK leaves, but the UK's position after Brexit will depend on the form of its departure. With a deal, little would change in practice until the end of the implementation period, and somewhat similar arrangements could continue to apply (although for goods only) for longer if the 'backstop' comes into force. In the event of no deal, the UK would move to trading on WTO terms immediately. The Government is attempting to replicate the EU's trade agreements with other countries, which could then be put in place bilaterally to ensure continuity of trade arrangements either after the implementation period or in the event of no deal. Some have been agreed and others are still under negotiation. However, they cover a small percentage of UK trade, and would not include EU countries, which themselves are the partners in around half of UK trade.

The UK has also published its proposed schedule of tariffs to apply to countries where there is no trade agreement in the case of no deal. Overall, these tariffs are slightly lower than apply at present as a member of the EU. However, there would be large changes for some specific goods. The Government has stated that they are intended to balance the interests of consumers and industries.

Chris Smith
27 March 2019

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1. Theory of Free Trade and Tariffs

This section summarises the arguments for and against free trade and tariffs from an economic theory perspective.

1.1 Theoretical Advantages of Free Trade

In his textbook *Principles of Economics*, N Gregory Mankiw states that one of his ten "principles of economics" is that "trade can make everyone better off".[1] He contrasted this with the view that trade was "like a sports contest in which one side wins and the other side loses", which he stated was false. Mankiw outlined the economic theory, known as comparative advantage, which supports his argument.[2] The theory shows that, even if one country can produce all goods more efficiently than another country, both nations still benefit from trading. This is because the more efficient country is better off specialising in the area where it has the greatest efficiency advantage.

This theory of comparative advantage is based on a scenario where there are no tariffs. In other words, it describes 'free trade'.[3]

Other advantages of free trade outlined by Mankiw include that it:

- increases the variety of goods and therefore consumer choice (for example, beers from different countries are actually different products);
- allows lower cost production through economies of scale (by producing for a larger, global market);
- increases competition, to prevent domestic companies exploiting monopoly power in their own markets to overcharge consumers; and
- enhances the transfer of technological advances around the world.[4]

1.2 Definition and Effects of Tariffs

Tariffs are taxes on imported goods.[5] The consequence of a tariff is that goods produced in the local area, whether that be a region, country or free trade area such as the EU, benefit from a price advantage against imported goods, compared to the situation which would exist without the tariff. Tariffs also raise revenue for the government.[6]

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1 N Gregory Mankiw, *Principles of Economics*, 2018, 8th ed, p 8.
2 ibid, pp 52–8.
3 *Encyclopaedia Britannica*, 'Free Trade', accessed 25 March 2019.
4 N Gregory Mankiw, *Principles of Economics*, 2018, 8th ed, pp 176–8.
5 ibid, p 173.
6 World Trade Organization, 'Tariffs', accessed 25 March 2019.

The tariff is paid by the importer of the good, but in practice some or all of the cost may be passed on to consumers in the home country.[7] Tariffs can either be levied per unit of good (for example, per ton of steel), known as a 'unit' or 'specific' tariff, or on the value of the goods (for example, a 20 percent tariff), known as an 'ad valorem' tariff.[8]

Mankiw analysed the theoretical effects of introducing a tariff.[9] He described how it results in a decrease in domestic consumption (because of the higher price of imports), but an increase in domestic production (because of the higher selling price which can now be obtained). The three basic effects in the domestic economy are therefore: (i) to make consumers worse off; (ii) to make producers better off; and (iii) to raise revenue for the government.

Mankiw then sets out a theoretical demonstration of how the combination of these effects, as with any other type of tax, causes an overall loss to society.[10] In other words, the benefits of making producers better off and raising government revenue are more than offset by the degree to which consumers are made worse off. This is because a tax distorts the price system and therefore the incentives to economic agents, which "pushes the allocation of scarce resources away from the optimum".[11]

1.3 Possible Advantages of Tariffs

Despite the disadvantages of tariffs implied by pure theory, arguments are still advanced for their introduction. Mankiw described the following five reasons and discussed their merits and demerits.[12]

Jobs

Because tariffs tend to make producers better off, as outlined above, one argument is that tariffs protect and promote employment levels in the home country. However, Mankiw states that while it is true that under free trade jobs in affected industries may reduce, jobs in other industries would increase.[13] This is because the currency which goes abroad to pay for imported goods in the affected industries can then be used by the overseas country to buy goods from other, exporting sectors. Mankiw recognised,

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[7] Howard Gleckman, 'What is a Tariff and Who Pays It?', Tax Policy Center, 25 September 2018.

[8] Amitrajeet Batabyal, 'What is a Tariff? An Economist Explains', The Conversation, 15 March 2018.

[9] N Gregory Mankiw, *Principles of Economics*, 2018, 8th ed, pp 173–5.

[10] ibid, p 174.

[11] ibid.

[12] ibid, pp 178–81.

[13] ibid, pp 178–80.

however, that there could be transitional issues, in that workers in affected industries could face hardship "in the short run".

National Security

Mankiw stated that defenders of an industry threatened by free trade might argue that it is "vital to national security", for example if it is producing a material used in making military equipment.[14] A reliance on imports could risk an interruption of supply, if, for example, a war broke out. Mankiw acknowledges that this argument has some validity, but argued that it could be used "too quickly by producers eager to gain at consumers' expense".

Infant Industries

Mankiw described how new industries might argue for temporary restrictions on imports, to enable them to grow, mature and eventually be able to compete with foreign firms.[15] The same arguments might be advanced by older industries arguing for time to adjust to new conditions. Mankiw notes, however, that economists are "often sceptical about such claims". He argued that to be successful, those proposing 'infant industry' tariffs need to identify which industries will become profitable, and be able to calculate whether the eventual benefits will exceed the initial costs. Moreover, if an industry has the prospect of being successful in the longer run, firms should be willing to bear short-term losses, as is often the case with start-up companies.

It has been suggested that there is often a political element to tariffs introduced for 'infant industry' reasons.[16] For example, when a government is deciding whether to protect industries, and if so which, it may be influenced by powerful industry lobbying groups. Moreover, those who gain from tariff-free trade in the standard economic model are consumers, who do not form lobby groups because they are numerous, diffuse and each individual only has a small gain.[17] Political influence also means that 'infant industry' tariffs can be hard to remove.

Finally, it has also been argued that protection for competition can lead to domestic companies being less efficient, resulting in higher prices whatever the source of the product.[18]

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[14] N Gregory Mankiw, *Principles of Economics*, 2018, 8th ed, p 180.
[15] ibid, pp 180–1.
[16] Ryan Young, '"Infant Industry" Trade Barriers Sound Nice. But Research Shows They Don't Work', Foundation for Economic Education, 30 August 2018.
[17] N Gregory Mankiw, *Principles of Economics*, 2018, 8th ed, p 182.
[18] Howard Gleckman, 'What is a Tariff and Who Pays It?', Tax Policy Center, 25 September 2018.

Unfair Competition

Mankiw summarised the fourth argument against free trade as being that it is "only desirable if all countries play by the same rules".[19] Proponents of this theory suggest that this would not be the case, if, for example, a neighbouring country subsidised an industry which was then able to export to the domestic economy. However, Mankiw suggests that this argument is misguided: if consumers have the opportunity to buy goods at a subsidised price, that is to the domestic economy's benefit, and it is only the taxpayers of the neighbouring country who actually lose out.

Bargaining Strategy

The final argument described by Mankiw is that trade restrictions are useful as bargaining chips, in order to persuade other countries to reduce their own tariffs or restrictions.[20] However, he noted that the problem with this strategy is that if the neighbouring country does not change its policy, the domestic government either continues with its own restrictions (which reduce its own welfare, as in the basic trade theory outlined above), or removes them, with loss of international face and prestige.

1.4 Summary Economic Assessment of Tariffs

The majority of academic economists are opposed to tariffs in principle.[21] However, this is not a unanimous view. For example, Michael Pettis has argued that most economic discussions of tariffs are "more ideological than logical", and that "what matters are the conditions under which trade intervention policies are made".[22] He suggested that the idea that "all countries lose in a trade war" is "logically impossible", and argued that tariffs can have a variety of effects on many economic variables.

2. Brief History of Tariffs

2.1 Early Tariffs

It has been proposed that the first tariff in the world was imposed in India, around 300BCE.[23] The *Encyclopaedia Britannica* suggests that a tariff was first introduced in the UK in 1275, while in the US, the Tariff Act 1789 was the

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[19] N Gregory Mankiw, *Principles of Economics*, 2018, 8th ed, p 181.
[20] ibid.
[21] Tim Worstall, '100% of Economists Asked Said Import Tariffs Were Not a Good Idea', Forbes, 23 December 2016.
[22] Michael Pettis, 'Tariffs and Trade Intervention', Carnegie Endowment for International Peace, 10 July 2018.
[23] C Satapathy, 'Did India Give the World Its First Customs Tariff?', *Economic and Political Weekly*, 20 to 26 February 1999, vol 34 no 4, pp 449–51.

first substantive legislation passed by the first US congress.[24] Indeed, tariffs have historically played a major role in raising government revenue in the US: the Tax Policy Center reported that they represented nearly 90% of federal revenue before the civil war.[25] However, this had fallen to less than a third in 1915 following the introduction of income tax, and to just 1% by 2016.

2.2 Tariffs in the Twentieth Century

In 1929, the US introduced a major protectionist policy known as the 'Smoot-Hawley Tariff'.[26] An article summarising the period stated that economists disagree on "how much economic damage" it did, but "virtually none argues that protectionism and tariffs made things better".[27] Subsequently, the growth in global prosperity following the Second World War has been ascribed, at least in part, to trade liberalisation.[28] However, the same article suggested that there are counter-examples: for example, the rapid growth rates of Japan, South Korea and Taiwan took place under a regime of protection for the industries which formed the basis of their success.[29] Economists Alan Milward and George Brennan have also argued that non-tariff protection played a significant role in the development of some industries following the Second World War.[30]

2.3 World Trade Organization

In 1948, the General Agreement on Tariffs and Trade (GATT) was introduced, governed by a body of the same name, establishing rules which covered much of global trade in the post-war era.[31] In 1995 the governing body was replaced with the World Trade Organization (WTO).[32] The WTO currently has 164 members, accounting for 98% of world trade. It covers goods and services, the latter through the General Agreement on Trade in Services (GATS).[33]

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[24] *Encyclopaedia Britannica*, 'Tariff', accessed 25 March 2019; and Jeremy Byellin, 'Today in 1789: The First Session of the First US Congress Ends', Thomson Reuters Legal Solutions Blog, 29 September 2016.

[25] Howard Gleckman, 'What is a Tariff and Who Pays It?', Tax Policy Center, 25 September 2018.

[26] Ben Chu, 'How We Can Learn from the History of Protectionism', *Independent*, 6 June 2018.

[27] ibid.

[28] ibid.

[29] ibid.

[30] Alan Milward and George Brennan, *Britain's Place in the World: A Historical Enquiry into Import Controls 1945–60*, 1996.

[31] World Trade Organization, 'The GATT Years: From Havana to Marrakesh', accessed 25 March 2019.

[32] World Trade Organization, 'What is the World Trade Organization?', accessed 25 March 2019.

[33] World Trade Organization, 'WTO in Brief'; and 'The General Agreement on Trade in Services (GATS): Objectives, Coverage and Disciplines', accessed 25 March 2019.

The UK is a member both in its own right and as an EU member state.[34] However, the WTO has stated that "the European Commission […] speaks for all EU member states at almost all WTO meetings".[35]

WTO terms require that each member, whether an individual nation or a trading bloc such as the EU, publishes a list of tariffs that apply to other countries (their 'WTO schedules').[36] A key element of the WTO system is that these tariffs should apply to all countries, known as 'trade without discrimination', and often described as 'most favoured nation' terms (MFN). The WTO described this as follows:

> Under the WTO agreements, countries cannot normally discriminate between their trading partners. Grant someone a special favour (such as a lower customs duty rate for one of their products) and you have to do the same for all other WTO members.[37]

However, there are exceptions to the MFN rule.[38] First, two countries, or a group of countries such as the EU, may sign a formal free trade agreement, providing more favourable terms to each other than to countries outside the agreement. Second, member states can provide developing nations with more favourable terms. Third, duties on imports may be imposed as an "anti-dumping" measure if they are being sold at "unfairly low prices".[39]

Under the GATT and WTO, global tariffs have reduced. For example, in 2009, the Organisation for Economic Co-operation and Development (OECD) stated that on industrial goods, "tariffs have fallen from around 40% at the end of World War II to a tenth of that today".[40]

2.4 US-China Trade War

In 2018, President Donald Trump began imposing tariffs on imports of some goods, particularly, but not exclusively, targeting imports from China.[41] These have resulted in complaints to the WTO by China and other affected

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[34] World Trade Organization, 'United Kingdom and the WTO', accessed 25 March 2019.

[35] World Trade Organization, 'The European Union and the WTO', accessed 25 March 2019.

[36] Chris Morris, 'Brexit: What is the "No Deal" WTO Option?', BBC News, 4 February 2019. Each WTO member's tariff structure can be analysed and compared with other members on the WTO's website (World Trade Organization, 'Get Tariff Data', accessed 25 March 2019).

[37] World Trade Organization, 'Principles of the Trading System', accessed 25 March 2019.

[38] ibid.

[39] World Trade Organization, 'Anti-dumping, Subsidies, Safeguards: Contingencies, etc', accessed 25 March 2019.

[40] Organisation for International Co-operation and Development, *Protectionism? Tariffs and Other Barriers to Trade*, 27 July 2009, p 5.

[41] House of Commons Library, *World Trade in 2018: The US and the WTO*, 18 December 2018, pp 16–18.

countries, on the grounds that they breach WTO rules.[42] The tariffs have also attracted retaliatory measures from China and others.

In December 2018, an agreement was reached between the US and China not to impose further tariffs for 90 days, and to hold talks.[43] Although the 90-day period has passed, talks are ongoing.[44]

When he announced the tariffs, President Trump said that "when a country (USA) is losing many billions of dollars on trade with virtually every country it does business with, trade wars are good, and easy to win".[45] It is noteworthy that at various times, the Trump administration has advanced all five arguments for tariffs outlined in section 1.3 above.[46] However, economist Paul Krugman has criticised both the use of tariffs and the particular approach taken by the US, saying that "trade wars are not good or easy to win even if you know what you are trying to accomplish […] What's notable about the Trump tariffs, however, is that they are so self-destructive".[47]

3. Other Barriers to Trade

3.1 Non-tariff Barriers

While tariffs have previously been important instruments of economic policy, today it is believed that 'non-tariff barriers' (NTBs) are more significant in their effects.[48] NTBs include any measures other than tariffs which act to restrict imports and international trade. Examples include product standards, safety regulations, sanitary checks on food and animals, rules dictating how products can be advertised, 'rules of origin' requirements for proof of which country a good was produced in and quotas, which limit the quantity of a good which can be imported.[49]

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[42] House of Commons Library, *World Trade in 2018: The US and the WTO*, 18 December 2018, p 19.

[43] BBC News, 'US-China Trade War: Deal Agreed to Suspend New Trade Tariffs', 2 December 2018.

[44] BBC News, 'Trade War: US-China to Resume Face-to-face Talks Next Week, Reports Say', 20 March 2019.

[45] BBC News, 'Trump Steel Tariffs: Trade Wars are Good, Says Trump', 2 March 2019.

[46] For the 'national security' argument, Ben Chu, 'How We Can Learn from the History of Protectionism', *Independent*, 6 June 2018; for the 'jobs' and 'infant industry' arguments, Jacob Pramuk, 'Trump Thinks His Tariffs are Saving the US Steel Industry', CNBC, 16 August 2018; for the 'unfair competition' argument, Heather Long, 'How China Doesn't Play Fair on Trade', CNN Business, 12 July 2016; and for the 'bargaining chip' argument, James Lake, 'Trump Was Dealt a Winning Hand on Trade—His Hardball Negotiating Tactics are Squandering It', The Conversation, 29 November 2018.

[47] Paul Krugman, 'How to Lose a Trade War', *New York Times* (£), 7 July 2018.

[48] Institute for Government, 'Non-tariff Barriers', accessed 25 March 2019.

[49] ibid; and Chris Morris, 'Brexit: What is the "No Deal" WTO Option?', BBC News, 4 February 2019.

One study suggested that NTBs contributed "more than twice as much as tariffs to overall market access trade restrictiveness".[50] The Institute for Government has reported that, prior to the (suspended) discussions on the proposed US-EU Transatlantic Trade and Investment Partnership (TTIP), the US maintained a 1.25% tariff on imports of cars, but its NTBs in the sector added 26 to 27% to the cost of selling cars in the US.[51] However, the OECD noted that, unlike tariffs, NTBs may not be easy to measure or analyse and are not subject to comprehensive reporting requirements.[52]

3.2 Services Trade and Tariffs and Non-tariff Barriers

In general, tariffs apply only to goods and not services, while services are much more likely to be restricted by NTBs.[53] In the UK, services account for 80% of the value created by the economy, and it has therefore been argued that non-tariff barriers should be the most important objective of UK trade policy.[54]

4. Tariffs in the UK

4.1 UK as a Member of the EU

Currently, as a member of the EU, the UK participates in the EU's trade policy. This includes the single market for both goods and services within the EU. The single market removes barriers to trade and harmonises or unifies national rules at the EU level.[55]

The EU's trade policy towards non-members is described as an "exclusive responsibility of the EU, rather than the national governments of member countries".[56] The European Commission states that "by acting together as one, EU countries benefit from increased negotiating power when making trade deals with other countries".[57]

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[50] Institute for Government, 'Non-tariff Barriers', accessed 25 March 2019.

[51] ibid. For more information on TTIP, see European Parliament, 'TTIP Chapter on State-to-state Dispute Settlement', 20 November 2018.

[52] Organisation for Economic Co-operation and Development, *Protectionism? Tariffs and Other Barriers to Trade*, accessed 25 March 2019, pp 62–3.

[53] House of Lords European Union Committee, *Brexit: Trade in Non-financial Services*, 25 March 2017, HL Paper 135 of session 2016–17, p 17.

[54] Swati Dhingra and Josh de Lyon, 'The Brexit White Paper: What It Must Address—Trade, Regulation and Non-tariff Barriers', UK in a Changing Europe, 16 July 2018.

[55] Catherine Barnard, 'How the EU Works: What is the Single Market?', Full Fact, 8 March 2016. The same article describes how the free movement of goods and services are two of the EU's 'four freedoms': the others being the free movement of people and capital.

[56] European Commission, 'What is Trade Policy?', 23 November 2018.

[57] ibid.

The Commission explains that the main trade regime between the EU and non-member states was the WTO 'most favoured nation' regime (see section 2.3).[58] This applies tariffs and NTBs which, for any particular good or service, are common to all countries which have not reached a particular agreement (such as a free trade agreement) with the EU (subject to the exceptions outlined in section 2.3) The tariffs are set by the EU's common commercial policy and its common customs policy.[59] Once inside the EU's own customs union, goods and services can move tariff free between member states.[60]

4.2 EU Tariff Regime

According to the WTO, the trade-weighted average EU tariff in 2018 was 8.7% for agricultural goods and 2.8% for non-agricultural goods.[61] In some sectors, however, tariffs are much higher: on average 10% for cars, and 36% for dairy products, for example.[62]

The EU has a wide range of trade agreements. According to its website, it has 36 agreements in place, 48 agreements partly in place, 25 agreements pending ratification, and 21 being negotiated.[63] As a result, EU members, including the UK, trade with only 24 countries and territories under WTO rules alone. These include the US, China, Russia, Brazil, Argentina, Australia, New Zealand and Saudi Arabia. Even for these countries, there are trade agreements with the EU in areas other than tariffs.[64]

As well as eliminating tariff barriers between members, the EU has worked to minimise non-tariff barriers.[65] This is achieved through the principles of 'mutual recognition', whereby each member state's product standards are accepted by all the others, or 'equivalence', whereby a 'host' member state assesses the regulatory regime of the product provider's 'home' state and deems it acceptable.[66]

Overall, the UK Trade Policy Observatory (UKTPO) has presented the

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[58] Eurostat, 'International Trade in Goods—Tariffs', May to June 2017.

[59] EUR-Lex, 'Common Commercial Policy', accessed 25 March 2019; and European Commission, 'What is the Common Customs Tariff?', accessed 25 March 2019.

[60] European Commission, 'EU Customs Union', accessed 25 March 2019.

[61] World Trade Organization, *World Tariff Profiles 2018*, p 79.

[62] ibid; and Chris Morris, 'Brexit: What is the "No Deal" WTO Option?', BBC News, 4 February 2019.

[63] European Commission, 'Negotiations and Agreements', accessed 25 March 2019.

[64] Alex Forsyth, 'Reality Check: Does theUK Trade With the "Rest of the World" on WTO Rules?', BBC News, 6 November 2017.

[65] Stephen Byrne and Jonathan Rice, 'The Impact of Non-tariff Barriers on EU Goods Trade After Brexit', Centre for Economic Policy Research Vox Policy Portal, 19 June 2018.

[66] Andy Tarrant et al, 'Equivalence, Mutual Recognition in Financial Services and the UK Negotiating Position', UK Trade Policy Observatory, January 2019.

following summary of why a large proportion of UK trade is carried out with no tariffs:

> There are zero tariffs on imports from the EU (which accounts for about 54% of UK imports), largely zero tariffs on imports from all the countries the EU has free trade agreements with (accounting for another 15% of UK imports); and largely zero tariffs on UK imports from those developing countries which the EU offers preferential access to under the generalised system of preferences. There are around 24 countries with whom the UK trades on most favoured nation terms […] These countries account for around 25% of UK imports, of which around 40% is in products already facing zero tariffs.[67]

5. UK Options on Leaving the EU

5.1 Withdrawal Agreement

Implementation Period

If the UK leaves the EU on the basis of the withdrawal agreement, it will continue to operate the EU's tariff regime for the implementation period.[68] This period runs until 31 December 2020, but can be extended for a further one or two years.[69] The implementation period will be used to negotiate the future relationship between the UK and the EU, including on issues relating to trade.[70] In the political declaration issued alongside the withdrawal agreement, the UK and the EU stated that the aim was to have a "free trade area in goods that provides for no tariffs or quotas".[71]

However, the House of Lords European Union Committee has suggested that it is "unlikely" that a free trade agreement between the UK and the EU can be concluded during the implementation period.[72] Similarly, the organisation UK in a Changing Europe has argued that trade agreements yielding any significant economic benefit typically take around seven years to

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[67] Michael Gasiorek et al, 'What Should We Make of the UK's "No Deal" Tariffs?', UK Trade Policy Observatory, 14 March 2019.

[68] Fabienne Vermeeren et al, 'Brexit: Trade in Goods Under the Draft Withdrawal Agreement Endorsed on 25 November 2018 by the UK and the EU', White and Case, 28 November 2018.

[69] Department for Exiting the European Union, *Agreement on the Withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Agency Community*, 11 March 2019, pp 91 and 96.

[70] European Commission, 'Brexit Negotiations: What is in the Withdrawal Agreement', 14 November 2018.

[71] Department for Exiting the European Union, *Explainer for the Political Declaration Setting Out the Framework for the Future Relationship Between the United Kingdom and the European Union*, 25 November 2018, p 3.

[72] House of Lords European Union Committee, *Brexit: Trade in Goods*, 14 March 2017, HL Paper 129 of session 2016–17, p 31.

agree and implement.[73] Should an agreement not be reached in the implementation period, the provisions on the protocol on Ireland/Northern Ireland (the 'backstop') would apply.[74] These are discussed further in the following section.

In relation to services, the political declaration stated that the aim was to deliver "ambitious arrangements for services and investment that go well beyond WTO commitments".[75] However, the UKTPO has argued that this will "fall far short of the access (in both directions) that the single market for services provides", and that "the lack of attention paid to services sectors by the Government is both staggering and potentially economically costly".[76] It argued that being outside the single market will "dramatically" increase the barriers to services trade with the European Economic Area. Likewise, the OECD has suggested that, on average, EU barriers to services trade with non-members are four times higher than those between members.[77]

During the implementation period the UK can also negotiate, sign and ratify other free trade agreements, but it cannot implement them until after the implementation period, unless the remaining EU states agree.[78]

Backstop

The withdrawal agreement contains provisions for a 'backstop' at the end of the implementation period. This would ensure that there is no hard border between the Republic of Ireland and Northern Ireland in the event that an agreement on the future relationship between the UK and EU is not in place at that date.[79]

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[73] UK in a Changing Europe, *Cost of No Deal Revisited*, September 2018, p 16.

[74] Department for Exiting the European Union, *Agreement on the Withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Agency Community*, 11 March 2019, pp 139–52.

[75] Department for Exiting the European Union, *Explainer for the Political Declaration Setting Out the Framework for the Future Relationship Between the United Kingdom and the European Union*, 25 November 2018, p 3

[76] L Alan Winters, 'What About the Remaining 80 Percent—Services? The "Customs Union" and "Unilateral Free Trade" Share the Same Flaw', UK Trade Policy Observatory, 5 July 2018; and 'Not Fit for Service: The Future UK-EU Trading Relationship', 14 February 2019.

[77] Chris Giles, 'A Goods-only Brexit Deal Puts UK Services Sector Jobs at Risk', *Financial Times* (£), 5 July 2018.

[78] ibid.

[79] Department for Exiting the European Union, *Explainer for the Agreement on the Withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union*, 14 November 2018, p 39. For more information on the backstop, see John Curtis, 'The Backstop Explained', House of Commons Library Blog, 12 December 2018, and on its interactions with the Northern Ireland Executive and Assembly, North-South co-operation bodies etc see Department for Exiting the European Union, *UK Government Commitments to Northern Ireland and Its Integral Place in the United Kingdom*, 9 January 2019.

As regards trade and tariffs, the arrangements for the backstop period are technically different to those for the implementation period, although in some respects their effect would be similar.[80] Under the backstop, the EU and UK would form a 'single customs territory': this is not equivalent to a customs union, having more "formalities".[81] The UK would be required to align or harmonise certain aspects of its policy, including tariffs, with that of the EU. However, it would be free to enter into trade agreements with other countries, providing that they do not contain tariffs lower than the EU's tariff. It would also have to obtain the permission of the EU to implement certain other aspects of trade policy, such as quotas.[82] These backstop arrangements have been criticised by some who believe that they unduly limit the UK's freedom to operate an independent trade policy.[83]

The backstop arrangements do not cover trade in services.[84]

5.2 No Deal

If the UK leaves the EU with no deal, the default position would be that it would move to trading on WTO terms with all other countries, including the EU, immediately.[85] This would mean that exporters may face new or higher tariffs and other trade barriers.[86] However, the Government has stated that "highly automated, risk based and intelligence targeted customs controls" would be introduced, to ensure that delays and burdens for "legitimate trade" were minimised.[87] It has published a series of guidance notes for businesses, including specifically on tariffs.[88]

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[80] Fabienne Vermeeren et al, 'Brexit: Trade in Goods Under the Draft Withdrawal Agreement Endorsed on 25 November 2018 by the UK and the EU', White and Case, 28 November 2018. For a more detailed explanation on the mechanics of the single customs territory under the backstop, see Attorney General's Office, 'Letter to Prime Minister', 13 November 2018, p 2. The Attorney General's advice was later updated following the publication of further documents relating to the withdrawal agreement (Attorney General's Office, 'Letter to Prime Minister', 12 March 2019).

[81] ibid.

[82] ibid.

[83] *Telegraph* (£), 'MPs Must Reject the PM's Wretched Deal and Deliver a Proper Brexit, or Face Political Disaster', 9 December 2018.

[84] Aarti Shankar et al, 'The Proposed UK-EU Brexit Deal: An Explainer', Open Europe, 2 December 2018.

[85] Department for International Trade, 'Existing Trade Agreements if the UK Leaves the EU Without a Deal', 21 February 2019.

[86] Callum Jones and Bruno Waterfield, 'Brexit: Canada Trade Deal Close but Just Days Left for Dozens More', *Times* (£), 20 March 2019.

[87] HM Revenue and Customs, 'Trading With the EU if there is No Brexit Deal', 23 August 2018.

[88] For example, Department for International Trade et al, 'Classifying Your Goods in the UK Trade Tariff if there is No Brexit Deal', 23 August 2018.

5.3 Trade Continuity Agreements

The Government has stated that its priority is to "avoid disruption to our global trading relationships as we leave the European Union".[89]

If the UK leaves the EU under the withdrawal agreement, the UK will be treated as a member state for the purposes of international agreements (including trade agreements) with third countries during the implementation period.[90] In a letter to Lord Purvis of Tweed (Liberal Democrat), Baroness Fairhead, Minister of State for Trade and Export Promotion, explained that:

> At the March European Council, we agreed with the EU that the UK is to be treated as a member state for the purposes of international agreements for the duration of the implementation period. The EU will notify the other parties of this approach. After this notification, partner countries will be able to confirm their clear agreement to the continued application of international agreements.[91]

In her letter the minister stated that a number of countries had made public statements endorsing this approach.[92] However, Baroness Fairhead also stated that "some are understandably waiting for the notification to be issued before they respond".

However, at the end of the implementation period, or if the UK leaves with no deal, the UK will no longer be party to trade agreements between the EU and third countries. Therefore, the UK is seeking to replicate these agreements as bilateral agreements between the UK and the respective country or trading bloc.[93] Baroness Fairhead stated in her letter that in the event of a no-deal scenario "with no transitional arrangements, the Government will seek to bring into force bilateral agreements with partner countries from exit day, rather than following the implementation period".[94]

While the Government has stated that trade continuity agreements were its "priority", it has acknowledged that not all may be in place if there is a no deal exit on 12 April 2019.[95] In relation to these, it said that it was "exploring a range of options to ensure continuity of effect for trade

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[89] Department for International Trade, 'An Update on Existing Trade Agreements if the UK Leaves the EU Without a Deal', 21 February 2019.
[90] Department for International Trade, 'Letter to Lord Purvis of Tweed', 13 September 2018.
[91] ibid.
[92] These countries are listed in the annex to the letter.
[93] Department for International Trade, 'An Update on Existing Trade Agreements if the UK Leaves the EU Without a Deal', 21 February 2019.
[94] Department for International Trade, 'Letter to Lord Purvis of Tweed', 13 September 2018.
[95] Department for International Trade, 'Existing Trade Agreements if the UK Leaves the EU Without a Deal', 21 February 2019.

agreements if an agreement has not been ratified and brought into force in time for exit day". A recent information note explained that these might include 'memoranda of understanding' and/or 'diplomatic notes'.[96] The Department for International Trade stated in the note that although such agreements are not legally binding, they create a "strong political commitment". Such arrangements would apply until the relevant free trade agreement could be brought into effect, and would be time limited.

Status of Current Continuity Agreements

The Department for International Trade's website provides a list of those EU trade agreements for which the UK has signed continuity agreements, and the status of discussions for those which have not yet been agreed.[97] As of 26 March 2019, it suggested that eight trade agreements have been signed.[98] These were reported to cover £43 billion out of the £117 billion of UK trade which takes place with countries having a trade deal with the EU.[99] The £117 billion represented 11% of total UK trade.[100] This would suggest that the eight continuity agreements which have so far been signed represent around 4% of all UK trade.

By value of trade, the most significant of these was with Switzerland, ensuring that there will be no additional goods tariffs between the two countries in the event of a no deal Brexit.[101] However, the House of Lords European Union Committee noted that trade in services accounts for 52% of UK-Swiss trade, and that, apart from in specific areas, this will continue on a WTO basis.[102] The committee also stated that, in fact, the continuity agreement "differs significantly" from the precursor agreement to which the UK is party as an EU member state. For example, the UK will not be able to export products marked as organic to Switzerland.[103]

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[96] Department for International Trade, *Continuing the UK's Existing Trade Relationships as We Leave the EU*, 26 March 2019.

[97] Department for International Trade, 'Signed UK Trade Agreements Transitioned from the EU', 14 March 2019; and 'Existing Trade Agreements if the UK Leaves the EU Without a Deal', 22 March 2019.

[98] Department for International Trade, 'Signed UK Trade Agreements Transitioned From the EU', 22 March 2019; and 'An Update on Existing Trade Agreements if the UK Leaves the EU Without a Deal', 21 February 2019.

[99] Richard Partington, 'UK Secures Post-Brexit Trade Deal With Group of Caribbean Countries', *Guardian*, 22 March 2019.

[100] Department for International Trade, 'An Update on Existing Trade Agreements if the UK Leaves the EU Without a Deal', 21 February 2019.

[101] Department for International Trade, 'UK and Switzerland Sign Trade Continuity Agreement', 11 February 2019.

[102] House of Lords European Union Committee, *Scrutiny of International Agreements: Treaties Considered on 12 March 2019*, 13 March 2019, HL Paper 315 of session 2017–19, pp 8–9.

[103] ibid, pp 7 and 9. For more details on parliamentary scrutiny of continuity agreements and other replacement treaties in the context of Brexit, see House of Commons Library, *Brexit: Parliamentary Scrutiny of UK Replacement Treaties*, 22 March 2019.

Where continuity agreements have not yet been signed, the status of the vast majority is described as "engagement ongoing", but in some cases, including Japan, Turkey and Algeria, it is noted that the agreement will not, or it is unlikely that it will, be transitioned by exit day.[104] On 20 March 2019, the *Times* reported that a trade agreement with Canada was expected to be sealed "within days".[105]

Three 'mutual recognition' agreements have also been signed, with the United States, Australia and New Zealand: the Government stated that these ensure that businesses do not face "additional bureaucracy", and allow them to "continue trading as freely as they do today after we leave the European Union".[106]

Estimates of the Effect of WTO Trading on UK Economy

The UK Government has estimated that an exit on the basis on no deal and trading on WTO terms would lead to a reduction in UK GDP of between 6.3% and 9.0% over next 15 years, assuming the application of existing tariffs by both the UK and the EU.[107] This has been described as being "broadly in line with estimates made by other credible external organisations".[108] The Government's estimates did not account for any short-term disruptions which, it suggested, would be likely to have additional short and long-term economic impacts. The Government argued that because of the complexity of the issue, the data was presented as ranges and should be interpreted with care. It published a further analysis of the implications of no deal for business and trade in February 2019.[109]

An alternative model by the group Economists for Free Trade predicts much more positive outcomes from a scenario in which the UK left the EU with no deal and immediately eliminated all tariffs and non-tariff barriers.[110] However, this model was criticised by the *Financial Times* as being unrealistic, for example because the assumption of no non-tariff barriers implies, for instance, no sanitary standards for imported food, no emissions standards for cars and no safety standards for toys.

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[104] Department for International Trade, 'Existing Trade Agreements if the UK Leaves the EU Without a Deal', 22 March 2019.

[105] Callum Jones and Bruno Waterfield, 'Brexit: Canada Trade Deal Close but Just Days Left for Dozens More', *Times* (£), 20 March 2019.

[106] Department for International Trade, 'An Update on Existing Trade Agreements if the UK Leaves the EU Without a Deal', 21 February 2019.

[107] UK Government, *EU Exit: Long-term Economic Analysis*, November 2018, Cm 9742, pp 6 and 20.

[108] UK in a Changing Europe, *Cost of No Deal Revisited*, September 2018, p 12.

[109] Department for Exiting the European Union, Implications for Business and Trade of a No Deal Exit on 29 March 2019, 26 February 2019.

[110] Chris Giles, 'The Latest Pro-Brexit Analysis Has Got its Sums Badly Wrong', *Financial Times* (£), 21 February 2018.

GATT Article 24

The chairman of the pro-Brexit European Research Group of Conservative MPs, Jacob Rees-Mogg (Conservative MP for North East Somerset) has argued that a provision contained in article 24 of the WTO's GATT would permit the UK to continue to trade with the EU as now (ie tariff free) for up to ten years after leaving, if negotiations on a future free trade agreement are ongoing.[111] However, the Government has stated that this is a "misunderstanding" of the rules.[112] The provisions of GATT XXIV have been cited by some MPs as a way of trying to maintain current trading arrangements between the UK and the EU, without a negotiated withdrawal agreement, whilst a future relationship is negotiated. For example, the 'Plan B' part of the 'Malthouse compromise' would have sought to use GATT XXIV as part of a "transitional standstill period".[113]

The website Full Fact also concluded that it is "very unlikely" that the UK would be able to use this provision, as it would not meet the condition to have a "plan and schedule" in place for the form of a final trade deal.[114]

6. UK's Published No Deal Tariffs

As outlined above, if the UK leaves the EU with no deal, the UK would move to trading on WTO terms with all other countries (except those for whom continuity agreements had been signed), including the EU. To trade on WTO terms requires a schedule of tariffs, and these were published by the Government on 13 March 2019.[115] The proposed regime was described as temporary, applying for twelve months "while a full consultation and review on a permanent approach to tariffs is undertaken". The Government said that its aim was to "minimise costs to business and consumers while protecting vulnerable industries", and the Trade Policy Minister, George Hollingbery, stated that it represented a "modest liberalisation" of tariffs compared to the current regime, derived from the EU.[116]

The Government also clarified that the tariffs would not apply to goods crossing from the Republic of Ireland into Northern Ireland.[117]

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[111] BBC Politics, 10 May 2019, extract available at Jim Cornelius, 'Twitter Account', 12 May 2018.
[112] Department for Exiting the European Union, *Implications for Business and Trade of a No Deal Exit on 29 March 2019*, 26 February 2019, p 4.
[113] Conservative Home, 'The Malthouse Compromise: An Official Explainer in Full', 3 February 2019.
[114] Full Fact, 'Does WTO Article 24 Allow Us to Have Tariff-free Trade with the EU?', 15 March 2019. For a more detailed discussion of the issues around article 24, see House of Commons Library, 'No Deal Brexit and WTO: Article 24 Explained', 4 February 2019.
[115] HM Treasury et al, 'Temporary Tariff Regime for No Deal Brexit Published', 13 March 2019.
[116] ibid.
[117] ibid.

6.1 Coverage

The Government stated that, under the proposed regime, 87% of total imports to the UK by value would be free of tariffs.[118] The remaining 13% would include meat and some dairy products, finished vehicles (but not car parts), ceramics, fertiliser and fuel. There would also be some preferential arrangements for developing countries, as permitted under WTO rules (as described in section 2.3).

6.2 Commentaries

Analysing the package, the UKTPO suggested the 87% of imports by value which would be free of tariffs is an increase from approximately 82% under the current regime.[119] It further stated that 95% of all product types would have a zero tariff, an increase from 26% under the current regime, and that the average tariff would fall from 7.7% under the EU regime (or 22% excluding zero tariffs) to 0.7% (or 15% excluding zero tariffs).[120] Of the 5% of product types where tariffs would continue to exist, slightly over half of tariffs would remain at the existing EU level, while the remainder would see some reduction.

Overall, the UKTPO echoed the Government in saying that the proposals represented "not a very large liberalisation". However, it also analysed the implications for particular products, in which there were some larger changes. For example, for those dairy products where tariffs would be eliminated, the average tariff under the EU regime was 72%. The UKTPO argued that this "could result in a substantial increase in imports from new partner countries and competitive pressure on UK products".[121] The UKTPO also cautioned that even though the proposed regime is temporary, it could have permanent effects on domestic producers in sectors exposed to increased competition.

On the other hand, the Office for Budget Responsibility suggested that the effects of tariffs would be "completely swamped in all likelihood" by the much bigger effects of movements in the exchange rate in the event of a no deal exit.[122] It also suggested that the "dominant effect" would be from the tariffs imposed on cars.

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[118] HM Treasury et al, 'Temporary Tariff Regime for No Deal Brexit Published', 13 March 2019.

[119] Michael Gasiorek et al, 'What Should We Make of the UK's "No Deal" Tariffs?', UK Trade Policy Observatory, 14 March 2019.

[120] ibid. For a discussion of product types, and how the definition of these can alter the statistics presented, see Julia Magntorn Garrett and L Alan Winters, 'Tariff Woes', UK Trade Policy Observatory, 12 March 2019.

[121] ibid.

[122] House of Commons Treasury Committee, *Oral Evidence: Spring Statement 2019, HC 2056*, 19 March 2019, Q37.

The Institute for Government (IfG) also analysed the proposed tariffs. It stated that they represented a "difficult trade-off between a desire to maintain minimal tariffs on UK-EU trade […] but maintaining tariffs on imports of goods from elsewhere to protect vulnerable industries in the UK".[123] It summarised the regime by saying that tariffs have been maintained on sensitive agricultural products, and "some selected industrial goods like finished vehicles", but dropped most other tariffs to zero. The IfG raised concerns about the process of deciding on the tariffs, for example the speed with which they were decided and the lack of consultation prior to their publication.

The Government has recognised that farming is a "sensitive sector" for the tariff regime, and stated that it would continue to benefit from financial support from the UK Government once it no longer receives funds from the EU's common agricultural policy.[124]

6.3 Legislative Process

The proposed tariffs would be introduced by virtue of powers in the Taxation (Cross-border Trade) Act 2018 and would be made by statutory instrument.[125] The Act specifies that the procedure for passing the statutory instrument would be the 'made affirmative' procedure. However, this has been criticised by both the House of Lords Constitution Committee and the House of Lords Delegated Powers and Regulatory Reform Committee as being a process which should only be used in urgent cases.[126]

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123 Alex Stojanovic, 'The UK's Independent Trade Policy Falls at the First Hurdle', Institute for Government, 13 March 2019.

124 HL *Hansard*, 19 March 2019, col 1366.

125 House of Commons Library, *Brexit: Trade Tariffs if there is No Deal*, 13 March 2019, pp 4–5.

126 House of Lords Constitution Committee, *Taxation (Cross-border Trade) Bill*, 23 February 2018, HL Paper 80 of session 2017–19, p 2; and House of Lords Delegated Powers and Regulatory Reform Committee, *Taxation (Cross-border Trade) Bill*, 17 January 2018, HL Paper 65 of session 2017–19, pp 2–3.