ECONOMISTS
*for* FREE TRADE

# ACHIEVING ECONOMIC SUCCESS WITH GLOBAL FRE TRADE

## Economists for Free Trade

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Economists for Free Trade (EFT) is a group of leading economists, formerly known as Economists for Brexit (EfB), who believe the UK's optimal Brexit path is outside the Single Market and Customs Union, moving towards an ultimate position of global free trade as a full member of the World Trade Organisation. Becoming a true global leader in free trade – the target that the Prime Minister has set out for the UK - will improve the country's economic position significantly, relative to remaining in the protectionist EU Customs Union/Single Market.

EFT (as EfB) campaigned extensively during the referendum for Brexit, not only on the benefits of global free trade, but also by explaining the economic damage that the Customs Union and Single Market cause the UK. The main effect of the EU Customs Union is to raise prices through protection and business (as opposed to social) regulation, to the benefit of producers at the expense of consumers who pay these higher prices. Whilst there is a place for certain types of unskilled migrant workers, Freedom of Movement primarily benefits major producers at the expense of consumers through taxes levied on the general public to subsidise these individuals – whose incomes are generally too low to tax, but who obtain social benefits. Finally, UK taxpayers must pay for the annual net UK payment that goes directly into the EU budget – about half of a percent of GDP - and is projected to grow in future.

Therefore, the following three core aims are central to EFT's position. They offer distinct economic benefits to the UK:

1. **The pursuit of free trade in a global market with zero trade barriers for goods and services coming into the UK**. Long term analysis by the Cardiff University macroeconomics research group, using their trade and macro models, estimates that this scenario creates an additional GDP gain of 4% and a fall of 8% in consumer prices compared to remaining in the Single Market. Other economic groups who have produced forecasts have almost universally not modelled a free trade policy outcome.

2. **UK-based laws/regulations in place of those from the Single Market**. Currently, 100% of the UK economy must conform to all EU regulations despite only 8% of UK businesses exporting to EU countries, representing only 12% of GDP. Outside the Single Market, these companies will be required to obey EU product standards only for their EU exports. Releasing the economy from the burden of conforming to intrusive Single Market regulations can, if appropriate policy is adopted, lead to an additional 2% increase in GDP (Minford et al, 2015) – making a 6% increase in total from leaving.

3. **Control of unskilled immigration and promotion of skilled immigration**. Each unskilled migrant in the UK costs the taxpayer, on average, around £3,500 (Ashton, MacKinnon and Minford, 2016) per year net as a result of welfare and other support not covered by tax contributions, which should therefore be carefully controlled. Skilled migration, controlled as in other developed countries through a visa system, by contrast is a strong positive contributor to the economy and the exchequer and should be promoted.

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**IMPLEMENTING GLOBAL FREE TRADE**

Broadly speaking, there are two principal routes to achieving global free trade:

1. **Once Article 50 is triggered, the UK leaves the Single Market, takes up its full membership of the WTO and sets zero import trade barriers unilaterally, without seeking concessions from others as a condition of doing so.** This is simple to carry out – both conceptually and in practice - and is the swiftest route to tariff-free trade. Even if other countries do not reciprocate by dropping their barriers, the UK – as a major net importer - will still be better off economically than staying in the Single Market. And, because those benefits will begin accruing immediately through lower prices and higher disposable income, the economy will grow more swiftly than through any other route. However, if other countries do not reciprocate quickly, some of the gain to UK producers will occur further down the track (leaving aside the higher spending power of the domestic market). In any case, we envisage the UK seeking free trade agreements around the world on broader issues of service market access, investment security, property rights, and the further removal of tariffs and non-tariff barriers on goods. This will provide a strong signal that the UK is serious about being a leader in global free trade.

   In relation to tariffs, it is important to put them into context. If the UK leaves the Single Market with no zero tariff agreement on exports to the EU, the cost of EU tariffs on UK exports (excluding agriculture) would be only around £3.5 billion a year (about 0.5% of Government spending). Furthermore, the current lower value of Sterling – which is expected to remain below pre-referendum levels for some time - is likely to more than compensate manufacturers. If this is not sufficient, or if Sterling increases markedly outside the EU, the Government could easily devise industrial strategies that, in effect, could indirectly compensate industry with a small portion of the £10-£11 billion net saving gained from no longer making the annual EU budget contribution.

2. **The UK does not unilaterally eliminate import barriers but, instead, pursues a free trade path via negotiating Free Trade Agreements (FTAs) with the EU and the ROW.** This is more complicated to do – especially with the EU. We do not know what EU 27 countries can or will agree over Brexit. With the ROW, we do not know which countries might reach an FTA in the short term. Because the UK will continue to maintain import barriers during this period, most of the gains described above will not accrue. Thus, the primary disadvantage of this route is the time it will take – time during which economic benefits will not accrue to the consumer/taxpayer and criticism from those who want to return to the Single Market will be much in evidence. All of this will create uncertainty. More concerning, the UK would (though should not) effectively become a tariff-setting sovereign, so obviously not becoming a global leader in free trade. However, politically, this approach is more orthodox and gradualist than (1) and may appear responsive to protectionist producers - and so may feel easier and 'politically safer to pursue.

**In practice, the Government's strategy is likely to be a hybrid of these two routes comprising, for example, some of the following elements:**

- It is inevitable and right that the Government should try to negotiate free trade with the EU. In practice, this may mean proposing an initial offer to the EU suggesting it would be in both entities' interests to continue the current status quo of free trade. The Government should be clear that reverting to WTO rules and dropping the UK's tariffs and non-tariff barriers to zero is the optimal economic policy post-Brexit.

- If the EU does not agree to the Government's initial proposal, the UK should immediately announce that it will embrace its 'fall-back' position of moving to trade under WTO rules as an independent member post-Brexit and dropping all tariff barriers (but not necessarily all non-tariff barriers). To overcome the economic problems of business uncertainty and delays to Consumer/Voter benefits, the Government should place a strict time limit on its offer to the EU (say, six months) with a clear and publicly-stated up-front position that the UK is content to revert to WTO rules if a 'deal' acceptable to the UK is not agreed on time – even if the EU insists on erecting import tariffs against us.

- Maintaining import barriers (including against the EU) and attempting to achieve the same objective via negotiating FTAs with important like-minded ROW countries is not the preferred approach and a worry is that the Government may place too much weight on the notion that continuing to maintain import tariffs is a good trade-off *pour encourager les autres* in future FTA negotiations. The real focus is probably better placed on reducing non-tariff-barriers (NTBs) and facilitating trade in non-goods sectors. The downside in retaliating against the EU with our own import tariffs - over and above the economic self harm – is that WTO rules then places severe restrictions on the ability to negotiate (and trade) freely with the Rest of the World. It risks the entire Brexit dividend outlined above (6% of GDP or more).

It should also be noted that one of the ill-founded criticisms against the free trade agenda outside the Single Market is that inward investment would be hit. Inward investment itself depends on confidence in the economy, which can be best delivered through tariff-free trade across the world, but also delivering this policy swiftly, placing strict time limits on offers. This will alleviate uncertainty in the economy and offers confidence to investors. Whilst the focus for FDI may change over time towards different industries – depending on which are best suited to the new free trade environment – history has demonstrated it will grow as a whole under a free trade agenda.

## The Post-Brexit Manufacturing Economy – allowing high-value-added manufacturing to thrive

During our membership of the Single Market, manufacturing as a share of UK employment has fallen from around 35% to 8%. Indeed, it is a dangerous fallacy to believe either that the EU has been good for UK manufacturing or that even today's diminished manufacturing status quo would somehow have been preserved in aspic were we to have stayed in the EU. It is furthermore worth noting that this is not a "British problem" relating to free market economics. France, which has had mainly interventionist and socialist policies for the last thirty years, has had an almost identical re-balancing of its economy away from traditional manufacturing.

However, dynamic 21st century industries will benefit significantly if the UK becomes a European haven for free enterprise (just as it did in the 1980s, following trade union and state subsidy reforms). Pre-eminent in this category is high-value-added manufacturing, which will benefit from lower-cost imports into its supply chain, higher domestic consumer spending, and a global trading outlook as opposed to a protectionist Little Europe agenda. Such industries already export substantially to the ROW and, consequently, are competitive in the world market (eg, Jaguar Land Rover). It is no coincidence that the bosses of Dyson, JCB and McLaren were vociferously pro Leave and are pro Free Trade. They know they can compete and want to be set free to do so.

As automation will, in any case, be a factor tending to increase losses of further unskilled manufacturing jobs, it becomes doubly important to encourage high-value-added industry to create more non-automated jobs. If the UK is to grow its manufacturing base, it will not do so by using taxpayers' money to prop up uncompetitive industries. It will do so through education, productivity growth, infrastructure investment, and free trade.

Whilst EFT does not generally support the notion of state support for specific industries, it would be for the UK government to decide if, or how, to respond to the decline of certain industries, where it choose to do so on socio-economic grounds. Post-Brexit, it will be able to do so, free from the EU's restrictions on state aid.

The car industry is often cited as one of the more 'at risk' industries outside the Single Market. However, much of the growth in demand for cars is already coming from developing countries outside of the EU and with no FTA with the EU, and falls in Sterling offer a support to exports. Furthermore, once outside the Single Market, a drop in tariffs for imported parts will create a more competitive supply chain, enabling the industry to compete on a global basis at lower prices.

### The Post-Brexit Financial Services Economy - The UK as a World Financial Centre

There is much misunderstanding of the prospects for Financial Services after Brexit. Some Remainers suggest that the City (ie, the UK's financial services sector) could be hit by large-scale relocation of banks and other financial houses to the Continent as large amounts of EU business is lost. This is quite wrong. These concerns have neglected to take into account the limited degree to which passporting matters; do not see the nature of potential EU protectionism in perspective; under appreciates the City's strong position in the global financial services market, and have ignored the advantages of the City's enhanced freedoms outside the EU.

- **The world's number 1 financial centre -** The City has competed strongly in highly competitive world markets at least since Big Bang in 1986, becoming the world's no 1 financial centre by most accounts. The EU has not affected this; what it has done since 2007 in its efforts at a 'single market in services' is to introduce new regulations and to dilute the national protective barriers against imported services in other EU countries via 'passporting' which allows firms to sell directly to people or firms in EU countries without directly satisfying national regulations.

- **Better UK-based regulation -** The City will continue to rely on world markets after Brexit and it will have the new advantage of UK-based regulation by the Bank in place of the erratic and often hostile regulation from the EU. Leaving the EU brings definite advantages to the City, namely the end of the bonus cap and the short selling ban and potentially avoiding the Financial Transactions Tax. Accordingly, EU exit may also expand some financial services business and jobs in London. As the country's largest traded service sector the City exemplifies the UK's comparative advantage in traded services as a skill-intensive activity for a country well-endowed with skilled workers. With protection removed from other sectors it will attract resources from them in the long run and expand further.

- **Negligible effect of passporting -** The EU knows that its economic interest is served by free trade with the City as its most efficient supplier of financial services; therefore it is likely to opt for 'equivalence' for the UK which is the substitute for passporting for countries outside the single market. Only about 9% of the City's total business is directly dependent on passporting. If the EU for some reason decides to act against its own economic interests by engaging in protectionism against the UK, the City has nothing to fear: the business affected is likely to be small and even in the short run is unlikely to cause any significant losses. Given London's enormous strengths which banks and other financial institutions will continue to prize, they will actively seek to minimize any moves away from London. In the long run this protectionism will have no effect on world prices for financial services, so the City can divert output to the world market as necessary and at no long run cost.

We conclude that the UK's financial services industry - rather than concentrating on maintaining a relatively narrow regulatory feature (passporting) - should instead embrace a post-Brexit future as a World Financial Centre establishing its own financial regulatory regime attuned to the requirements of global financial markets. (For further details EFB evidence to International Trade committee of H of C; also Barney Reynolds, A Blueprint for Brexit, Politeia, Jan 2017)

**Agriculture- the need to abandon the CAP and related agricultural protectionism**

It is absolutely essential that whatever other decisions are taken, the UK government withdraws totally and unconditionally from the CAP and all its associated tariffs on agricultural products through which nowadays the CAP mainly raises farmers' prices.

The CAP involves the government in contributing to EU farm subsidies, only a small part of which returns to UK farmers; this money forms part of our EU budget contribution. However, the key damage to the UK economy from the CAP comes from the massive raising in farmers' prices (by some 20% according to our and OECD estimates). The knock-on effect on the economy comes through land prices and consumer prices, which both have large indirect effects both on the structure of the economy and on consumer welfare.

We have calculated through our world trade model that any policy retaining the CAP causes substantial damage to the economy, even if unaccompanied by UK tariffs on manufactured imports. This is because it greatly distorts the shape of the economy through a huge rise in land prices, forced up by agricultural demand; this rise in land prices also means that on its own the CAP raises consumer prices by around 8%. The importance of eliminating CAP is underscored by this finding, as CAP alone has about the same unfavourable impact on prices as we estimate is caused by all projected EU protection if we kept the status quo.

Given this damage to our economy from the CAP, support that HMG gives to farmers must be channelled directly to them on social and environmental grounds. The effects of such direct support can be economically neutral and of quite limited budgetary cost if they are untied to the size of farms but linked instead to particular goals such as preserving the rural environment and enabling farmers carrying out such goals to reach sustainable incomes.

**ENDS**

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