ECONOMISTS FOR FREE TRADE

Why the Supposed 'worst possible option' – a World Trade Deal Trading Under WTO rules - is the UK's Best Next Step

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In the Treasury's predictions that formed the centrepiece of its pre-referendum Project Fear, trading with the EU as a most favoured nation under WTO rules emerged as the worst possible post-Brexit option for the UK They predicted that UK GDP in 2030 would be lowest if it chose this option, rather better if it continued as a member of the EEA or left with a bilateral trade agreement, and highest of all if it remained an EU member. It never occurred to them that the UK might sensibly trade under WTO rules for a limited period post-Brexit while it put in place FTAs and selectively established unilateral free trade is selected areas in order to become the world leader in free trade that it aspires to be. The Treasury has nothing to say about what would happen if it chose that course of action.

The Treasury's calculations were highly speculative, and have been discredited on numerous counts. They rested on a flawed pseudo gravity model, made numerous questionable assumptions, misrepresented cited sources and found it difficult to reconcile the Treasury's earlier research that had come to entirely different conclusions - which they simply 'forgot' to mention. It might fairly be described as a discreditable and dishonest work. Moreover, the Treasury saw no reason to publish its work nor to answer its critics. It has continued to contribute to the Brexit debate as if they were indeed able to see the future, usually repeating the message that leaving without a deal and trading under WTO rules is the UK's worst option.[1]

In January 2018 'a cross-departmental briefing' by government economists was leaked to a website in which this option was portrayed as Armageddon with projections very similar to the Treasury's earlier predictions. This effort sensibly adopted a different model, but still could not resist making wild assumptions and ignoring readily-available research so that trading under WTO rules remained the worst option.

The majority of voters in the referendum evidently took all these civil service predictions with a pinch of salt, but they nonetheless remain of great importance, first of all because one imagines that the lead negotiator and much of the negotiating team who are drawn from the Treasury must continue to worry about the worst possible option that their colleagues have predicted. Indeed, some of the terribly clever ploys they have included in the Chequers Agreement to convince leave voters that the HMG was intending to leave, such as referring the EU rule book as 'a common rule' book, and redefining the jurisdiction of the CJEU so that the UK would somehow escape it, appear to have been expressly devised to avoid the worst possible option of leaving without a deal.

[1] This Leaked Government Brexit Analysis Says The UK Will Be Worse Off In Every Scenario January 29, 2018, at 9:30 p.m BuzzFeed News January 29, 2018, at 9:30 p.m EU Exit Analysis – Cross Whitehall Briefing

These predictions are also important because they have been the primary source of empirical evidence for the divers branches of the Remain campaign who have done little research on their own account and have cited Treasury and government economists research to justify their dismissal of trade under WTO rules as 'crashing out of the EU' or falling off 'a cliff edge', or facing 'chaos' or 'Armageddon. '

Martin Howe, QC observed that, 'they have all evidently decided, for their own reasons, to ignore the rules-based international trading system that has emerged under the auspices of the WTO/GATT over the past half-century. They also forget to mention that the greater part of UK trade is currently conducted according to these rules rather than those of the EU, and they do not appear to have given rise to chaos or Armageddon.'

On the contrary, UK goods exporters exporting to the rest of the world have, over many years, outperformed exporters enjoying the benefits of frictionless trade with the EU. One study using IMF-DOTS data shows that UK goods exports to 111 countries under WTO rules over the 23 years 1993-2015 (that is 23 years working in the worst possible option) grew at a CAGR of 2.88%, which was three times faster than those exporting to the EU15 (0.91%), and also growing much faster than those exporting to 62 countries that had some kind of trade agreement with the EU (1.82%). One imagines that exporters who have been working in the worst possible option for 23 years must therefore have considerable expertise available among UK forwarding, freight and logistics agents to help those who have never exported to anywhere other than the EU.

The bad image of trading under WTO rules derives almost entirely on the supposed adverse economic consequences identified by the civil service forecasts, and not its political consequences. If one was to examine instead the political consequences of leaving without a deal, and trading under WTO terms over the transition period, it might well be considered a good option, even the very best. Mrs May could deliver exactly what she promised at Lancaster House, and stay well behind all her red lines without the least difficulty. There would be no quarrel about the sequencing of negotiations, no reason for UK negotiators to be supplicants on their knees, since they would finally have some leverage. They would have no reason to make concessions or further payments to the EU, other than for past commitments and for participation in selected future activities. And Mrs May domestic political strife would be limited to those who want to reverse the referendum, a far less daunting task. The government could then concentrate on making free trade agreements with the EU and others over the transition period.

However, the adverse economic consequences of trading as a most favoured nation under WTO rules painted by the Treasury might well trump any helpful political consequences, and it is therefore of some importance to decide whether that evidence is credible and trustworthy.

Fortunately, there is an alternative, simpler, and more reliable, way of assessing what the economic consequences of trading under WTO rules might be, which does not require prior assessment of the reliability of a particular model or any questionable assumptions, and that is by examining the past record of countries that have been trading with the EU under these or GATT rules over the Common and Single Market decades. Instead, therefore, of predicting, as the Treasury and government economists sought to do, *what might perhaps happen* to the UK, given certain assumptions, over the next 15 years if it were to trade with the EU under WTO rules, we can

report *what has in fact happened* to those countries that have been doing so for the past 15 years and more, whom the UK would join, if it decided to leave the EU without a deal.

One advantage of this method is that draws on authoritative international databases, such as UNComtrade, UNCTAD, OECD, IMF-DOTS, ITC, and the World Bank, which are readily accessible to everyone, including Treasury and other civil service mandarins. They might have used one or other of them to check the plausibility of their own predictions about trading under WTO rules, and allowed ministers and the rest of us to see what 'chaos' and 'Armageddon' has been like for other countries, and how they coped with all the tariffs and non-tariff barriers that we as paying members did not have to put up with. They didn't.

A first look at IMF-DOTS data of goods exports to the 12 founder members of the EU Single Market over the 23 years 1993-2015 given in the table below categorises the 22 largest value exporters to the EU 12 over these years by their trade relationship with the EU; 15 were trading as most favoured nations under WTO rules, (and GATT until 1995); seven under some kind of bilateral agreement, twelve were founder members' exporting to the other eleven founder members. The UK figure is also given separately to see how well we performed relative to disadvantaged non-members trading under WTO rules.

Real Growth of Goods Exports to the 12 Founder Members of the Single Market 1993-2015
In 4 Trade Relationships
(In 1993US$)

Partner Country	% Real Growth from 1993 to 2015	Value of Exports ($bn 2015)
15 MFN/WTO	135	829.5
7 Bilateral	107	191.7
12 EU members	70	1585.9
UK	25	176.8

Source: IMF DOTS, data.imf.org

The 15 MFN/WTO countries include China and India, and so it is perhaps no great surprise that they should record the highest growth despite all the tariff and non-tariff barriers. However, they also include U.S. whose growth of 68% is close to that of the EU members to each other and is considerably greater than that of the UK whose trade with the Single Market despite having paid substantial sums for frictionless trade over these years.

The Single Market was intended to increase the 'intensity' of trade amongst its members and the impression that it has done that prompts much Remain anxiety about leaving it. In the event, as the figures show, it is the exports of non-members from the worst possible option, that has intensified most. Several countries trading under WTO rules have therefore been the major beneficiaries of the Single Market. The UK has benefited from it less than all of the countries covered by the table, apart from Japan.

This sends a rather different message to the UK negotiators than that they might have got from their Treasury and civil service colleagues, namely, UK goods exports have benefited very little from the Single Market, so do not concede too much, or indeed anything at all, to maintain some form of membership of it. Those trading under WTO rules have fared much better, and the UK might do the same once it is out.

This result is entirely consistent with the recent research of Clarke, Goodwin & Whiteley, among others, who found no evidence that EU membership had boosted UK economic growth. It is not readily reconciled with the HMT predictions of the loss of GDP growth by 2030 should the UK leave without a deal, and trade with the EU under WTO rules, which replicates the great myth that the UK has benefited economically from EU membership.

A second look at the IMF-DOT tables compares the growth and growth rates of goods exports to the 12 founder members of the Single Market over the two decades 1993-2015 with those of the Common Market 1973-1992 of 30 nations categorised by their trade relationship with the EU.

Real Growth of Goods Exports to the Founder Members of the Single Market by 30 Nations, Categorized According to their Trade Relationship with the EU

(In 1973 US dollars)

Exports of goods by	1973 to 1992 (Common Market)		1993 to 2015 (Single Market)	
	% Real Growth	% CAGR	% Real Growth	% CAGR
14 MFN/GATT/WTO	119	4.22	52	1.93
2 EEA	184	5.65	133	3.91
2 Bilateral	180	5.57	117	3.58
12 EU	125	4.37	64	2.28
UK	205	6.04	25	1.00

The two EEA countries are Iceland and Norway, the two with bilateral agreements are Switzerland and Turkey, and the 14 MFN (most favoured nations) trading under WTO rules are Bangladesh, Brazil, Canada, Hong Kong, India, Indonesia, Japan, Korea, Malaysia, Nigeria, Saudi Arabia, Singapore, Thailand and the U.S. Source: IMF DOTS, data.imf.org

The first notable finding is the sharp contrast between the high growth rate of UK goods exports to other members of the EU 12 during the Common Market and the low rate during the Single Market, especially as HMT claimed it was the other way around to support their view 'that the trade benefits from EU membership increase over time' . However, they came to this conclusion after failing to recognise the impact of EU enlargement, or the sharp differences in growth of eastern and western EU countries, and by assuming that the UK would approximate the EU mean. It obviously doesn't, and their predictions are accordingly wholly untrustworthy.

The second is the modest difference between growth and growth rate of the EU12's exports to each other, and that of the 14 most favoured nations trading under GATT/WTO rules. The difference increased during the Single Market years, but once again, the most favoured nations

cannot be said to have performed as miserably as HM Treasury keeps telling us they will. China was excluded because there were no returns for it in 1973. Had it been included, the growth and growth rate of 15 MFN/WTO would have comfortably exceeded that of the EU 12's exports to each other. The claim that it is worst possible option would then have been still more embarrassing,

In fact, over the entire period as whole, the growth and growth rates of the goods exports of 14 MFN/WTO, and of the 12 EU members to each other are virtually identical, so the idea that the 14 were suffering great disadvantages by trading under WTO rules is implausible.

The best performers of all are the EEA members and the two countries with bilateral agreements with the EU. The datelines of the comparison mean that we cannot include more countries, and with only two of each, it would be foolish to draw firm conclusions. However, although the EEA is ruled out as a Brexit option because it requires freedom of movement and effectively entails subjection to the CJEU, the evidence hints that there would be benefits, at some point in the future, of a bilateral agreement. That is hardly controversial, but probably cannot be obtained until the UK has left and is negotiating in the presence or promise of CET on EU exports to the UK.

There are no tariffs on services exports but numerous non-tariff barriers that the WTO is struggling to document and, by negotiation, to reduce. However, it is frequently assumed that there is a sharp contrast between exporting services to the EU as a member and exporting to them as a non-member, so that if the UK were to leave without a deal, it would have to trade as a non-member and therefore suffer all the disadvantages of doing so . The Treasury and government economists predictions, rightly or wrongly, almost certainly wrongly merged goods and services to give a combined figure of the economic benefits of continued membership in 2030 and the disadvantages of leaving without a deal. So we must also ask whether the evidence indicates leaving without a deal is the 'worst possible option' for services, just as it was, or rather the civil servants thought it would be, for goods.

The data on services is much more limited, discontinuous, and irregular than that on goods. However, it was possible to compare exports to 27 EU members, by the other 26 with the exports of 27 non-members to them over the years 2004 to 2012. The CAGR of the non-members exports over those years was 3.7%, while that of members to each other was 3.2%. Hence, the advantages that members may have enjoyed and the disadvantages that non-members may have suffered had no observable impact on the rate of growth of their services exports to the EU over these nine years. The disadvantaged non-members performed slightly better.

Another study of services exports to the EU over the five years 2010 to 2014 found that the growth of 23 non-members (six of which benefited from a services element in a trade agreement with the EU) was faster than the growth of services exports of the EU 28 to each other, and of the UK to the other 27. Neither the EU nor the UK outperformed non-members over the years, so it is difficult to conclude, as the civil servants did, that the 17 of them without any agreement whatever that they are 'the worst possible option' either for trade with the EU or for economic growth

These two studies suggest that there is no services equivalent to 'crashing out', of 'falling over a cliff', of 'chaos' and Armageddon. There is no 'worst possible option' for services. But then the image that such a thing exists in goods is a figment of dishonest, incompetent and shamelessly

partisan predictions made by the Treasury who have taken advantage of the official status they enjoy to publicize their views, while remaining anonymous and unaccountable.

No doubt many companies will find it inconvenient and possibly somewhat more costly to change their procedures for exporting to the EU from the present frictionless ones to the rather more cumbersome ones that other companies have to use when exporting to the rest of the world. But, to add perspective, more than half our exports are under MFN/WTO rules and Switzerland as a non-EU member reports that the border costs to its traders is only 0.1% of the goods' value. It is also understandable that such companies prefer their trade costs to be paid by the UK taxpayer in the form of the annual payments to the EU rather than paying them directly themselves.

Their influential voices are therefore often added to those of the civil servants. However, the export data shows that exporting as a most favoured nation under WTO rules has been combined with rates of export growth equal to or exceeding that of EU members. It is therefore implausible to describe it as 'the worst possible option' for post-Brexit trade with the EU. It is a perfectly acceptable option, and given its beneficial political consequences might well be the option that will ensure a successful Brexit.