CIVITAS

ISSUE 14
JUNE 2020

ideas for economic growth

WTO vs EU: an assessment of the relative merits of the UK's trade relationships, 1999-2018

Michael Burrage and Phil Radford

A Summary

For the full report, visit: http://www.civitas.org.uk/content/files/aWTOvsEUsummary.pdf

The issue and the comparative assessment

A fundamental issue in the post-referendum debate has been the relative merits of trade as an EU member and under WTO rules. Office for National Statistics (ONS) data released since September 2019 make it possible, for the first time, to compare UK trade conducted within these two trade relationships, in both goods and services, over the two decades from 1999 to 2018. In this report, trade with the 14 other EU members in 1999 is compared with that of the UK's 14 major export markets under WTO rules. The trade conducted by these two groups is of a roughly similar value. In 2018, the EU14 accounted for 45% of UK goods and 36% of its services exports, and the WTO14 for 37% of its goods and 40% of its services exports.

Sub- and near-zero growth

Over the two decades, UK goods exports to eight of the EU14 have fallen rather than grown, though to the EU14 collectively they have grown at a near-zero real compound annual growth rate (CAGR) of 0.56%. By contrast, goods exports have not fallen to any of the WTO14, and collectively have grown at a real compound annual growth rate of 3.38%, which is *six times faster* than exports to the EU14. Hence, it is trade with the WTO14 that has created jobs in the UK over these two decades, not trade with the EU.

Is slow EU GDP growth an explanation?

These differences are unlikely to be the result of the EU and WTO markets growing at different rates, for though the EU14 have certainly had a lower rate of GDP growth over the two decades, UK goods exports failed to keep pace with the GDP growth of 13 of them. The Netherlands is the sole exception, though since many UK exports to the world are routed through Rotterdam and counted as exports to the Netherlands, that is probably an illusion. By contrast, UK goods exports to nine of the WTO14, have surpassed their markedly higher GDP growth rates, and exceeded their collective rate of GDP growth by 0.3 percentage points (ppts).

While there is evidence that large UK firms turned away from the EU over the first 15 years of the Single Market, and in a sense voluntarily voted to leave it without a deal, there is still no plausible explanation for the profoundly counter-intuitive finding that the growth of UK goods exports to 14 diverse and distant WTO markets over these two decades (incurring tariffs, varied non-tariff barriers, and multiple exchange rate fluctuations) should have far surpassed frictionless exporting to 14 EU near neighbours, free from tariffs, quotas and non-tariff barriers, 12 of whom use the same currency.

Why did it happen? Why did no one see it coming?

Successive UK governments, along with the Confederation of British Industry (CBI) and other trade associations, declined to monitor closely the performance of UK exports in the EU. Few, if any, media or academic commentators either noticed or commented on sub-zero and near-zero export growth of goods exports to our EU partners. None felt obliged to try and understand and explain what had gone wrong, or to challenge the optimistic assumptions and expectations about the benefits of EU membership which had always guided UK policy-makers.

Evidence absent from the Brexit debate

Pre- and post-referendum parliamentary and media debate has been dominated by the Treasury's 'scenarios' which contrasted continued economic growth and prosperity for the UK as an EU member with the worst possible post-Brexit option of trade with the EU under WTO rules, which they thought would mean a severe decline of trade, employment, income and productivity. ONS data showing that exports to WTO partners had in fact grown six times faster than those to the EU was never mentioned. Few of the spokespersons of the 93,000 UK firms who currently export around the world under WTO rules, or of the 74,000 who export to both EU and non-EU partners, and have been a part of that remarkable export success story were heard over the many months of bitter debate. Evidence from the United States, Australia, Canada, India, Singapore and other countries who have long traded with the EU under WTO rules was never mentioned. No one ever wondered why their exports to the EU had all grown faster than those of the UK despite all the UK's advantages as a member, and near neighbour, of the EU.

> *There is no sign that the 'clout' of the Commission negotiating agreements on behalf of the EU15 or 28 has benefited UK goods exports over these decades.*

Have EU trade agreements made any difference?

Individual EU agreements with particular countries may have boosted UK goods exports, but the aggregate ONS data shows the real growth rate of UK goods exports of 3.04% to the 88 countries and jurisdictions covered by 70 such agreements was slightly below the 3.41% real growth of exports to the remaining 117 countries of the world with which the UK trades under WTO rules. There is no sign that the 'clout' of the Commission negotiating agreements on behalf of the EU15 or 28 has benefited UK goods exports over these decades.

Towards the trillion pound deficit vs smaller manageable ones

Imports of goods from the EU14 over these decades have grown at a CAGR of 2.64% and the UK has incurred deficits with 12 of them, Greece and Ireland being the two exceptions. Collectively, these deficits totalled, in real terms over the two decades, £740bn. For the EU27, which includes the 13 who joined after 1999, they totalled £869bn, and at their present real CAGR of 12.4% will exceed £1tn by the end of 2020. By contrast, the UK has incurred deficits with only nine of the WTO14, and its cumulative 20-year deficit with them is much smaller, at £215bn, and has been growing at a slower real compound annual growth rate of 4.1%.

Services have grown at a faster rate

Unlike the sharp contrast between goods exports to the EU14 and WTO14, the real rates of growth of UK services exports to the two groups were almost identical 4.79% and 4.77%, respectively. Indeed, those to the EU14 were slightly *more likely* to keep pace with the GDP of their partners than those to the WTO14, which raises the possibility that EU membership has been of some marginal benefit to services exports. However, Eurostat data over the nine years 2010 to 2018 showing services imports to the EU from the United States and numerous other countries have grown faster than those of the UK, throws doubt on the idea that UK services exports have benefited from EU membership. Moreover, since UK services exports to the EU14 have grown only 0.02 ppts faster than those to the globally dispersed WTO14 over two decades, it is difficult to believe they have benefited greatly from the Single Market in services.

Have trade agreements made a difference to services exports?

UK services exports to 27 of the 38 countries with which the EU had, by 2019, negotiated services agreements grew at a real compound annual growth rate 5.19% which is slightly higher than the 4.98% rate of real growth to 154 countries which have no such agreement with the EU. This might indicate a marginal benefit from these agreements. However, the remaining 11 jurisdictions of the 38 included in EU agreements are all overseas British jurisdictions, and exports to them grew at a real compound annual growth rate of 7.17%. It seems unlikely that this was due to the intervention of EU negotiators.

Deficits that can be offset and those that can't

Over the 20 years, the UK has incurred a total deficit of £740bn on its trade in goods with the EU14. This was partially offset by the surpluses earned on its services exports to nine of the EU14, which over 20 years totalled £282bn, reducing the overall UK deficit with the EU14 to £460bn, and to the EU27 to £602bn. The surpluses earned on services exports to the WTO14 were well over twice as large, and over 20 years totalled £768bn. They therefore offset the UK's smaller deficit of £215bn on goods with these countries completely, and left a surplus over the 20 years of £553bn.

> *The UK trade relationship with the WTO14 has, we conclude, been a success, has paid its way, and created new jobs over the past two decades. Trade with the EU, by the contrast, must be counted a failure.*

A final verdict

The UK trade relationship with the WTO14 has, we conclude, been a success, has paid its way, and created new jobs over the past two decades. Trade with the EU, by the contrast, must be counted a failure. Near-zero real rate of growth of goods exports has created no new jobs in the UK and has resulted in large, growing, and probably unsustainable, trade deficits. Although services exports to the EU have grown at a much faster rate, they can hardly be rated a success since, despite the advantages of membership and proximity, they have not grown significantly faster than exports to WTO trading partners.

Conclusion: implications for negotiations and future trade policy

The evidence presented above suggests that future UK trade policy should be built on the proven success of trade under WTO rules, and wherever possible negotiating well-targeted agreements to improve trade with existing WTO partners.

Equally clearly, it follows from the evidence that future UK trade policy should not be based on an agreement with the EU which tries to stay close to the existing trade relationship, by a so-called level playing field or other commitments, since that would only perpetuate the problem of sub- and near-zero export growth and an ever mounting deficit. These problems are best addressed via the trade agreements with WTO partners, rather than directly in bilateral negotiations with the EU.

The problems of crashing out to trading under WTO terms have been greatly exaggerated in pre- and post-referendum debates. There is, however, one certain major problem in the transition to trade with the EU under WTO rules for an identifiable minority of UK exporters whose businesses developed under, and still depend on, the protection of the EU common external tariff (CET). The overnight imposition of CET on their exports to the EU and/or freer UK trade with WTO partners will threaten their survival, especially those with limited non-EU or domestic UK markets.

These vulnerable businesses, the threats they face, and their alternative options can, however, be identified in advance, by means of a sector and sub-sector trade performance database, which will inform decisions about an appropriate response in specific cases. The design and construction of such a database is properly the business of government, and most obviously of the Department for International Trade, since it will also be its major beneficiary. Apart from dealing with the problems of transition to trading under WTO rules, such a database will also provide the empirical research foundation of trade negotiations, trade promotion, and of an accountable trade policy, into the indefinite future.

Michael Burrage is a senior research fellow at Civitas, and the author of the report *It's Quite OK to Walk Away: A review of the UK's Brexit options with the help of seven international databases* (Civitas, 2017). He is also a member of Economists for Free Trade.

Phil Radford is a Sydney-based writer who specialises in trade and security in the Asia-Pacific region. He was a contributor to the Australian Strategic Policy Institute from 2013–2017 and to Brexit Central in 2019. He is the author of *nothingtofear.co.uk*

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