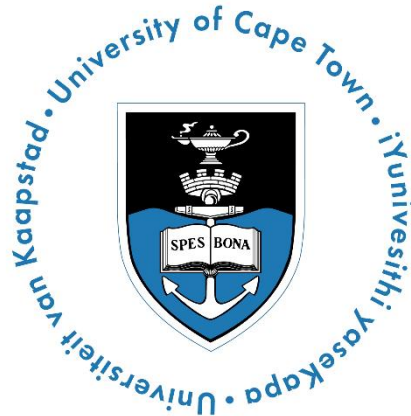


University of Cape Town



Department of Commercial Law  
LLM in International Trade Law

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**BRITISH TRADE POLICY AND BREXIT**

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## LIST OF ABBREVIATIONS:

*The following are the abbreviations used throughout this thesis. They are compiled in the beginning of this thesis for ease of reference.*

AB	Appellate Body
CAP	Common Agricultural Policy
CBI	Centre for the Promotion of Imports
CETA	Comprehensive Economic and Trade Agreement
EC	European Community
ECSC	European Coal and Steel Community
EEA	European Economic Area
EEC	European Economic Community
EFTA	European Free Trade Area
EMS	European Monetary System
EPA	Economic Partnership Agreement
ERM	Exchange Rate Mechanism
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GSP	Generalised System of Preferences
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
ITO	International Trade Organisation
LDC	Least-Developed Country

MFN	Most Favoured Nation
MP	Member of Parliament
NHS	National Health System
NTB	Non-Tariff Barriers
OECD	Organisation for Economic Co-operation and Development
OPEC	Organisation of Petroleum Producing Countries
TTIP	Transatlantic Trade and Investment Partnership
US	United States of America
USSR	Union of Soviet Socialist Republics
UK	United Kingdom
UKIP	United Kingdom Independence Party
VAT	Value Added Tax
WTO	World Trade Organisation
WWI	World War One
WWII	World War Two

## INTRODUCTION:

In June 2016 the United Kingdom of Great Britain and Northern Ireland voted to leave the European Union, also known as ‘Brexit.’ At the time, this was considered an unprecedented decision, with poorly understood reasons and unknown consequences. This paper will attempt to shine a little light on both the decision itself, and what it may mean for Britain’s future. Focusing on trade relationships and policy, this paper will look at the historical emergence and development of British trade policy, Britain’s relationship with the Europe, the decision to leave, and what it may mean for British trade.

This paper will chart a brief history of British trade policy, from its early inception in the 16<sup>th</sup> century as a means of defending the realm, through the entrenchment of mercantilism in the 17<sup>th</sup> and 18<sup>th</sup> century, the nascent free trade of the 19<sup>th</sup>, and its retreat to protectionism in the face of the various crises of the 20<sup>th</sup> century. Looking at the development of British trade policy will provide a useful foundation to examine the evolution of Britain’s three most important relationships, namely those with its Empire, the United States of America, and Europe. Relations with these three blocks were never settled, and they would wax and wane during the centuries as priorities shifted. Thus, seeing how these patterns develop allows us to put the decision to leave the European Union in context, not as some unforeseeable cataclysmic event, but rather as another shift in priorities along the same pattern that had been occurring for centuries. However, this is not to say that the decision to leave the European Union was not an extremely significant event. Britain’s growing relationship with Europe had been the centre point of its diplomacy and development since the 1970’s, and this paper will also look at how this relationship grew during the implementation of the European project. Finally, an attempt will be made to set out the possible future impacts of Brexit by looking at the possible options for subsequent UK-EU relations, as well as how Brexit will affect Britain’s relationships with the rest of the world.

Chapter 1 will look at the early development of British trade policy, starting in around the 16<sup>th</sup> century. Chapter 2 will examine Britain's path towards free trade during the 19<sup>th</sup> century, while Chapter 3 will look at how this was undone by the crises of the 20<sup>th</sup> century. Chapter 4 will look more closely at Britain's relationship with the European project, from the early days of its inception, through its eventual membership, all the way up to the referendum in 2016. Finally, Chapter 5 and Chapter 6 will look at the future prospects for British trade relationships with the European Union and the rest of the world respectively.

# CHAPTER 1: EARLY BRITISH TRADE POLICY AND MERCANTILISM

## Introduction

British trade policy is over five centuries old and, understandably, has undergone many revisions and revolutions over this time. This chapter will look at the earliest concentrated efforts to create a national trade policy, which took the form of mercantilist policies initially implemented in the 16<sup>th</sup> century. This chapter will show that early British trade policy was, arguably, unrecognisable from its modern descendant, with a completely different set of goals and objectives, mostly prioritising the defence of the state. An analysis of the trade policies of the 16<sup>th</sup> to 18<sup>th</sup> centuries shows its development from a weapon of national preservation to a commercial policy focused on protectionism, which is the form it would take for the next several centuries.

## What is Mercantilism?

The essence of the mercantilist idea is that the needs of the state are synonymous with the needs of the nation as a whole.<sup>1</sup> It has often been described as a the economic expression of militant nationalism, and assumed that the government's role was to use any measure necessary to secure a favourable balance of trade (with exports exceeding imports) for the economic benefit of the country.<sup>2</sup> While there is a common complaint that mercantilists mistakenly view a trade surplus as an economic benefit, this tends to ignore the fact that mercantilism was more often a pragmatic attempt to further a nation's strategic goals in other areas such as defence, colonial control, and thwarting the advancement of rival nations.<sup>3</sup> An important feature of early mercantilism was its use as a means to increase the inflow of gold and silver into the

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<sup>1</sup> John V.C. Nye, *War, Wine, and Taxes: Political Economy of Anglo-French Trade, 1689-1900* (2007) pg 23 (Nye)

<sup>2</sup> J. Holland Rose, A. P. Newton, E. A. Benians, *The Cambridge History of the British Empire, Volume 1: The Old Empire, From the Beginnings to 1783*, (1929) pg 561 (Rose et al).

<sup>3</sup> Ibid.

economy (a trade surplus would see other countries sending their coin to the nation in question), which was vital to any nation wishing to pay for an expensive war.<sup>4</sup>

### Early Mercantilism

Mercantilism covers a broad branch of policies, with differing direct goals. A combination of strategic tariffs and redistribution of customs revenue via drawbacks and exemptions allowed for certain industrial interests to be promoted, encouraged import substitution, and modified the terms of trade between domestic exports and foreign imports.<sup>5</sup> Importantly, it was felt by policy makers that protecting employment (especially in the labour-intensive textile industry) was not just important for the economy, but also for the stability of the country.<sup>6</sup> Given that the 17<sup>th</sup> and 18<sup>th</sup> centuries were a period of frequent European wars, mercantilism was often used as a strategic policy in foreign affairs, as the tariffs collected could help fund a government's wars while diminishing the trade of rivals which would reduce their budget and their ability to fund a conflict.<sup>7</sup>

Although commonly thought of as exclusively an economic policy designed to protect domestic merchants at the expense of foreign ones, it should not be ignored that in the 16<sup>th</sup> century mercantilism was also considered a policy for national defence. Policies that favoured local merchants would increase the demand for shipbuilding. The docks that produced these merchant ships could also be used to build warships when they were needed, and the experienced crews that manned them could be conscripted into the navy during times of war.<sup>8</sup> Finally, the self-reliance of mercantilism, especially with regard to the materials required for shipbuilding, was an important strategic goal for national defence as it would prevent any war effort being undermined by enemies cutting off access to vital supplies.<sup>9</sup>

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<sup>4</sup> Rose et al pg 562.

<sup>5</sup> David Ormrod, *The Rise of Commercial Empires: England and the Netherlands in the Age of Mercantilism 1650-1770*, (2003) pg 25 (Ormrod).

<sup>6</sup> Richard Brown, *Society and Economy in Modern Britain 1700-1850*, *Rouledge*, 1991.

<sup>7</sup> Nye pg 23.

<sup>8</sup> Rose et al pg 213.

<sup>9</sup> *Ibid* pg 214.

## The Navigation Acts

The Cambridge History of the British Empire argues that the Navigation Acts of 1650 and 1651 should be judged primarily as a defensive measure as opposed to ones that sought to achieve a purely economic goal.<sup>10</sup> It goes on to argue that whether these policies were successful in and of themselves is impossible to determine as their implementation was soon followed by the Dutch War and the Spanish War, which were far more influential in the development of British sea power.<sup>11</sup> Similarly, the increase in the number of seaman in this period is likely to be due to the needs of the Navy more than as a result of the Acts.<sup>12</sup> As such, it is difficult to determine how successful these Acts were with regard to their goal of boosting England's sea power for the nation's defence; however it could be argued that they indirectly achieved their goal by prompting the First Anglo-Dutch war.<sup>13</sup> The war also saw the development of local shipbuilding industries, especially in colonies such as New England which could provide inputs from their abundant forests, after the Dutch cut off England's access to those supplies in the Baltic which they had previously relied on.<sup>14</sup>

In a move of blatant mercantilism, and to the detriment of the colonies, the 1660 Act prohibited the staple unworked commodities from being shipped anywhere other than England where they would be manufactured into finished products. While this ensured a protected supply of raw materials for English manufacturers, it closed off entire markets to the colonists and severely restricted the legitimate demand for their products. To add to the hardship suffered, the original list was gradually extended to include more and more of the colonies' outputs. Furthermore, the 1663 Act stated that all goods grown, produced or manufactured in Europe had to pass through England before they could be exported to the colonies.<sup>15</sup>

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<sup>10</sup> Ibid pg 217.

<sup>11</sup> M. Oppenheim, *Administration of the Royal Navy*, (1896), pg 307.

<sup>12</sup> Rose et al pg 218.

<sup>13</sup> Ibid.

<sup>14</sup> Rose et al pg 218.

<sup>15</sup> Ibid.

## The Glorious Revolution

In the last thirty-five years of the 17th century, England fought a six-year war with Spain, two separate two-year wars against the Dutch Republic and a prolonged nine-year war with France.<sup>16</sup> The massive expenditure of these wars, as well as the 13 year War of Spanish Succession at the beginning of the 18th century, strained the English budget, and it is a testament to the expanded tax base provided by customs duties, generated from the increased shipping, that these conflicts did not cause complete financial ruin.<sup>17</sup> With William III's accession after the Glorious Revolution, a need for greater revenue combined with low existing customs duties (around 5 per cent) on most goods would see tariffs rise during his reign, with general levels of duties nearly quadrupling between 1690 and 1704.<sup>18</sup> During this time customs revenue would grow in importance to the national budget, and at the height of British mercantilism between 1700 and 1790 these duties would comprise between 20 per cent and 28 per cent of total revenue collected.<sup>19</sup>

In 1696, a new office of Inspector General of Imports and Exports was created and tasked with compiling comprehensive accounts and statistics on English trade.<sup>20</sup> The increased information available to policy makers allowed for the transformation of the English tariff structure from a low-level system with a very general application (around 5 per cent of the value of most goods), to a high level fiscal system which was in practice protective.<sup>21</sup> Indeed, it is only after this that tariffs were used to provide direct protection for specific manufacturing, agricultural, and commercial interests, which were previously primarily protected by non-tariff measures such as the Navigation Acts.<sup>22</sup>

Towards the end of the 17<sup>th</sup> century, France began to replace the Netherlands as England's primary rival, and as such they would become the next target of English

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<sup>16</sup> Ormrod pg 24.

<sup>17</sup> Ibid.

<sup>18</sup> Ralph Davis, 'The Rise of Protection in England, 1689-1786' (1966) *The Economic History Review* Vol. 19, No. 2, pg 306 (Davis).

<sup>19</sup> Ormrod pg 25.

<sup>20</sup> Ibid pg 48.

<sup>21</sup> Davis pg 307.

<sup>22</sup> Ibid pg 308.

protectionism. Prohibitive duties were placed on French goods starting in 1693, however this was conceived less as an economic policy and more a political one aimed at checking the rise of an aggressive power in Europe.<sup>23</sup> Instead of local industries being protected by these measures, duties were raised against things that England did not produce.<sup>24</sup> The policy did have economic impact though, and new industries manufacturing substitutes for French products were developed, such as the London brewing industry which sought to capture the market lost by cheap French wine. By the time peace was established between the two nations nearly 20 years later, these new protected industries could exert enough influence to ensure that the prohibitive duties would remain in place for most of the next century.<sup>25</sup>

### Mercantilism in the 18<sup>th</sup> Century

The increases in tariffs of 1690 to 1700 were generally not intended to give protection to local industries. Instead, they were seen as a method of revenue collection. There was no sign of deliberate industrial protection.<sup>26</sup> However, the rise in power of commercial interest groups would soon mean that tariffs and import prohibitions started to be used as a tool designed to protect local industries from foreign competition.<sup>27</sup> This was compounded by a raising of general tariffs on all ordinary goods from 5 per cent in 1690 to 15 per cent by 1705. This created a tariff wall that acted as real protection for most English industries.<sup>28</sup> The customs reforms in 1722 streamlined some of the more haphazard protectionist measures and simplified the tariff regime while generally leaving high tariffs intact, with a few exceptions for inputs for certain British industries.<sup>29</sup> As the 18<sup>th</sup> century wore on, tariffs would be raised further,<sup>30</sup> while certain industries were successful in lobbying for their raw material inputs to be exempted.<sup>31</sup> There was a solidification of the mercantilist system as an intentional economic policy designed to protect British producers.

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<sup>23</sup> Ibid.

<sup>24</sup> Such as wine, brandy and fine linens.

<sup>25</sup> Davis pg 310.

<sup>26</sup> Ibid.

<sup>27</sup> Such as French wine or Indian textiles.

<sup>28</sup> Davis pg 310.

<sup>29</sup> Davis pg 313.

<sup>30</sup> In 1747 and 1759.

<sup>31</sup> Davis pg 314.

## Conclusion

Early British trade policy was mostly focused on creating a large enough navy to allow Britain to defend itself from her continental neighbours. For nearly two hundred years it was the needs of the navy, not the needs of commerce, which were prioritised when developing legislation in this area. However, by the end of the 17<sup>th</sup> century, commercial interests had managed to wrestle the focus away from the navy and insist that trade policy focus on protecting them from more efficient foreign competitors. They were able to pressure government into giving them high levels of protection (to the detriment of consumers). They jealously guarded what they already had and continuously pushed for more concessions. The next century would see this pattern continue, although by the end of it the policies implemented would reverse course as a new ideology of free trade started to gain ground in the minds of lawmakers and the British public.

## CHAPTER 2: THE RISE OF FREE TRADE IN BRITAIN

### Introduction

British trade policy at the start of the 19<sup>th</sup> century consisted of a range of protective measures created during the mercantilist era, as discussed in the previous chapter. However, a new political and ideological wave during the 1800s would see many of the protectionist barriers to trade broken down, and free trade advanced for the first time. This chapter will look at the clash of protected vested interests against the interests of British citizens and show how a succession of pro-trade leaders would guide Britain to a new trade policy, which represented a clear break from the policies of the past.

### The Reforms of the Early 1800s

In the 1820s, a series of new laws were introduced that started to chip away at the protectionist structures that dominated British trade policy. In 1821, the prohibitive duties on timber from the Baltic nations was lowered, and a year later the Navigation Acts were reviewed by the Board of Trade.<sup>32</sup> Over the next three years several liberal reforms were carried out by the pioneering head of the Board of Trade, William Huskisson, including the removal of the ban on imported silk, the granting of reciprocity agreements to foreign nations, and a general revision of the entire tariff regime.<sup>33</sup>

Huskisson championed the review of the Navigation Acts by pointing out that they had been created to prevent another nation controlling too large a share of naval trade, but were now being used to protect a foreign powers merchant marine. This was the result of the US managing to secure favourable treatment in a peace treaty in 1815, giving it special access to Britain and her colonies, and the Navigation laws were now working to protect the US merchant marine at the expense of third party nations.<sup>34</sup> By granting other nations the same access as the US, Huskisson was able to remove this

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<sup>32</sup> J. Rose, A.P. Newton, E.A. Benians, *Cambridge History of the British Empire: Volume 2, The Growth of the New Empire 1783-1870*, (1940), pg 389 (Rose et al, Volume 2)

<sup>33</sup> *Ibid* pg 390

<sup>34</sup> *Ibid*

advantage and prevent the US merchant marine from becoming too large a force in the cargo trade. European nations were also allowed access to part of the colonial trade, so long as they agreed to reciprocity, which then opened up further markets to British merchants.<sup>35</sup> Foreign and British ships would now be able to enter British ports on the same terms.<sup>36</sup> Huskisson was not, however, a free trade essentialist; dismissing out of hand the US's demand to be given the same preferences granted to British colonies and imposing duties on the Dutch when they refused to reciprocally open the markets of their colonies.<sup>37</sup> Despite the reforms over the 1820s, Huskisson was not able to reform the Corn Laws which underpinned a significant part of the mercantilist system.

Tariffs were also reduced on the basis that they were redundant, for example those on goods Britain exported, or because they were so high that imports were essentially prohibited or tariffs rendered meaningless by smuggling and illicit trade.<sup>38</sup> Huskisson left a moderate set of tariffs behind after leaving office, however these were soon further reduced by the incoming Prime Minister, Robert Peel, when he took office in 1841. Tariffs were abolished on nearly all raw materials (including coal), while the primary protective tariff remaining after Huskisson's reforms, that on manufactured goods, was reduced from 30 per cent in 1841 to 10 per cent by 1846.<sup>39</sup> The budget shortfall that would have followed these tariff reductions was counteracted by the reintroduction of the income tax, as even in the 19<sup>th</sup> century duties still made up a relatively significant proportion of the national budget.<sup>40</sup>

### The Corn Laws

During the course of the 18<sup>th</sup> century, a combination of population growth and increasing focus on industry resulted in Britain becoming a net wheat importer for the first time.<sup>41</sup> Corn laws introduced in the late 18<sup>th</sup> and early 19<sup>th</sup> centuries regulated

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<sup>35</sup> Ibid

<sup>36</sup> Ernest Woodward, *The Age of Reform, 1815-1870*, (1962), pg 69 (Woodward).

<sup>37</sup> Roes et al, Volume 2, pg 391.

<sup>38</sup> C. P. Kindleberger, 'The Rise of Free Trade in Western Europe, 1820-1875,' (1975) *The Journal of Economic History*, Vol. 35, No. 1 at 26 (Kindleberger).

<sup>39</sup> Rose et al Volume 2, pg 402.

<sup>40</sup> Ibid.

<sup>41</sup> Rose et al Volume 2 pg 233.

prices greatly, and first placed tariffs on imported wheat, before banning imports altogether unless the price of domestic corn reached an extremely high 80 shillings per quarter, to protect domestic producers. At its peak in the 1830's, the equivalent *ad valorem* tariff imbedded in the Corn Laws was approximately 54 per cent.<sup>42</sup> The tariff on corn imported from British colonies was slightly lower than the tariff on foreign wheat, however the colonies were unable to supply enough to have a major effect on the market.<sup>43</sup> In 1814, falling prices saw the government (which was still dominated by the landowning class) take measures aimed at ensuring the 80 shilling price by implementing tariffs on foreign corn.<sup>44</sup> These measures were unpopular among large portions of the population, and their imposition caused riots due to increased food prices which benefited only rich landowners.<sup>45</sup>

As industrialisation created a new wealthy class of manufacturers who were negatively affected by the corn laws, which raised the price of labour, the balance of power began to shift. The policy was suddenly faced with a powerful opposition who had a strong financial interest in repeal. Similarly, the rise in influence of political economists of the 'Manchester School,' who advocated for free trade and liberalisation on more ideological grounds, would also have a major effect in turning the political tide against the corn laws. A combination of the two were able to secure enough support, including the conversion of Prime Minister Peel to the cause of free trade, to ensure that the laws would eventually be repealed.<sup>46</sup>

### Other Steps Towards Free Trade

During this period the British economy moved towards liberalisation and away from the 'zero sum game' approach it had taken previously, when policies deemed in the nation's strategic interest were given priority. The prohibition on the export of machinery, meant to preserve Britain's status as the lead industrial economy and

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<sup>42</sup> Jeffrey G Williamson, 'The Impact of the Corn Laws Just Prior to Repeal,' (1990) *Explorations in Economic History*, Vol.27 No. 2 at 124

<sup>43</sup> Rose et al Volume 2, pg 234

<sup>44</sup> Woodward pg 59

<sup>45</sup> Douglas A. Irwin, 'Political Economy and Peel's Repeal Of The Corn Laws,' (1989) *Economics and Politics*, Vol. 1 No.1 (Irwin)

<sup>46</sup> Irwin pg 41

frustrate the industrialisation ambitions of France and Germany, was removed in the 1830s, while the prohibition on the emigration of skilled tradesmen and artisans was lifted in 1824.<sup>47</sup> Perhaps as importantly, the general liberalisation trend happening during this time meant that demands for protection by powerful industry groups were more often ignored than they had been previously.<sup>48</sup>

### Role of the Colonies

In the early 19<sup>th</sup> century, most of the British colonies still lacked developed markets and financial resources. As such, their value to English industrial interests was mostly as a clearing house for surplus production (so that essential economies of scale could be achieved) rather than vibrant markets that could compete with that of the home or European ones.<sup>49</sup> A lack of capital available to local merchants in the colonies often meant that terms had to be granted which included long lines of credit, or goods consigned to local agents with payment due only after sale. Given that goods sold in the local market did not face extended periods at sea and could be paid for relatively quickly due to abundant capital and financial resources available to British merchants and sellers, most producers operating at a large scale preferred to supply a small portion of their excess production overseas.<sup>50</sup> The era of free trade saw a marked shift in the priorities of British trade, as the rise of other powerful economies (significantly Germany and the United States) created far better opportunities for the export of British goods than the underdeveloped colonial markets could provide. As a result, by 1870 the value of British exports to foreign nations outstripped the value of her exports to her Empire by almost three to one.<sup>51</sup>

### Conclusion

By the end of the 19<sup>th</sup> century, Britain's trade policy was substantially different to what it had been at the start. Barriers to trade which had protected the wealthy elite had been torn down, with a new ideology of free trade taking hold. The corn laws

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<sup>47</sup> Ibid pg 28.

<sup>48</sup> Ibid

<sup>49</sup> Rose et al Volume 2 pg 757.

<sup>50</sup> Ibid.

<sup>51</sup> Ibid pg 779.

were out of date, a relic of the past which was holding back the advancement of the industrial economy by cutting the wealth of the urban working class and increasing wages for producers. However, their removal was not easy, despite the clear benefits to the country, providing a clear illustration of how once vested interests are given protection it can be extremely difficult for the government to remove this protection. The slow but steady removal of barriers liberalised British trade policy and allowed Britain to focus on exporting her new manufactured products to Europe, shifting the economic focus of the nation away from the Empire and towards the continent. However, neither the removal of trade barriers nor the shift of focus towards Europe would survive the crises of the early 20<sup>th</sup> century.

## CHAPTER 3: THE EARLY 20<sup>TH</sup> CENTURY

### Introduction

The 20<sup>th</sup> century was a turning point for Britain. She would start the century at the heart of an Empire spanning the globe, the undisputed world economic powerhouse, and end it as a middle power trying to increase her influence at the periphery of a European Community that she was reluctantly part of. This chapter will look at how the events of the early 20<sup>th</sup> century shaped British economic and trade policy, beginning with the collapse of her nascent free trade ideology through to her embrace of the Imperial Preferences and her troubled negotiation with the US to launch a new world trading order. This chapter will also show how various factors combined to undo the reorientation towards Europe that had been seen in British trade towards the end of the 19<sup>th</sup> century, with the Empire, Dominions, and Commonwealth (collectively referred to as the Empire) once again re-establishing their centrality to British trade.

### Turn of the 20<sup>th</sup> Century

The technological leaps made during the Industrial Revolution led Britain to a period of dominance that had been enjoyed by few economies before or since. However, by the early 20<sup>th</sup> century, this was no longer the case. Britain's decline was relative and had more to do with other nations catching up than to deindustrialisation. The fact remains that Britain had seen her share of manufactured exports decline worldwide, from 40.7 per cent in 1890 to 29.9 per cent in 1913.<sup>52</sup> Rapid industrialisation in Germany and the US elevated these two countries to the status of potential rivals. Furthermore, in the last decade of the 19<sup>th</sup> century, protectionism was revived among the larger European states and the US, often aimed specifically at protecting domestic industries from British exports.<sup>53</sup> In response to this growing wave of protectionism,

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<sup>52</sup> S Saul, 'The Export Economy 1870-1914,' (1965) *Oxford University Press*.

<sup>53</sup> Tim Rooth, 'British Protectionism and the International Economy: Overseas Commercial Policy in the 1930s,' (1995) pg5, (Rooth).

British exporters sought new markets among the less industrialised nations, many of which belonged to Britain's sprawling Empire or were under British influence.<sup>54</sup>

The Empire was an important market for Britain during the first decade and a half of the 20<sup>th</sup> century. By 1913, the Empire was a market for 37.2 per cent of British exports as well as a source of 24.9 per cent per cent of imports, contributing to a slight trade surplus of just under £4 million compared to the £247 million deficit Britain had in trade with the rest of the world.<sup>55</sup> Looking at the composition of this trade, it is clear to see that imperial markets were vital for many of Britain's industrial sectors because these markets imported more than half of the Britain's exports in a several key of sectors.<sup>56</sup>

### After World War I

The first phase of globalisation, which occurred in the late 19<sup>th</sup> and early 20<sup>th</sup> centuries, was largely a result of Britain's leadership of the international economy.<sup>57</sup> After the war, Britain would try and reclaim her former position and recover from the ravages of war. After some recovery in the 1920s, the Great Depression would destroy two of the most important pillars which had underpinned Britain's leadership position, free trade and the gold standard, between September 1931 and March 1932.<sup>58</sup> In this short seven-month period, Britain removed herself from the gold standard and implemented the Import Duties Act,<sup>59</sup> which ensconced their domestic economy in full protectionism for the first time in decades.<sup>60</sup>

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<sup>54</sup> Ibid.

<sup>55</sup> Judith Brown and Roger Louis, 'The Oxford History of the British Empire: Volume IV, the Twentieth Century,' (1999), pg 98, (Brown & Louis).

<sup>56</sup> Ibid pg 99. The sectors in question were clothing, locomotives, railway carriages, motor vehicles, electrical engineering goods, and paper products.

<sup>57</sup> Kevin O'rourke and Jeffrey Williamson, 'When did globalisation begin?,' (2002) *European Review of Economic History*, pg 36.

<sup>58</sup> Rooth pg 2.

<sup>59</sup> The Import Duties Act 1932 (22 & 23 Geo. V c. 8)

<sup>60</sup> Ibid.

The decade after WWI saw relatively good growth in both economic output and exports for the British economy.<sup>61</sup> However, by 1929 (when British exports reached their interwar peak) exports remained significantly lower than their pre-war level.<sup>62</sup> This was not due to a general worldwide decline. Exports of manufactured goods were still increasing over this period.<sup>63</sup> Rather, it was illustrative of the continuing relative decline of Britain as an exporting power, as Britain was now only responsible for 20.4 per cent of the world's share of exports.<sup>64</sup>

Over most of the previous century, Britain had led the world into an era of unprecedented free trade by adopting measures herself and either enticing or compelling less powerful countries to join her system.<sup>65</sup> This was not a policy born of altruism but rather due to the simple fact that it was in Britain's best interests to do so. This policy would allow Britain to take advantage of her technological superiority in order to export high value added goods all over the world while importing food and the raw materials she needed to feed her industrial economy.<sup>66</sup> However, by the 1920s, Britain sent 43.1 per cent of her total exports to the Empire, compared to an average of around 33 per cent in the last decade of the 19<sup>th</sup> century.<sup>67</sup> Recognising her new reliance on her Empire, the British implemented the Trade Facilities Act in 1921 and the Colonial Development Act in 1929 with the aim of stimulating British exports and reducing unemployment.<sup>68</sup> This intervention was desperately needed as Britain's trade weakness was underlined by the fact that her most important colonial markets were all importing a smaller share of their total imports from the Britain compared to before the war.<sup>69</sup>

As the Great Depression and the financial crises that went with it started to spread, the British economy began to take strain and unemployment began to rise. Britain was

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<sup>61</sup> London and Cambridge Economic Services, 'The British Economy Key Statistics 1900-1970,' (1972).

<sup>62</sup> Ibid.

<sup>63</sup> Ibid.

<sup>64</sup> A Maizels, 'Industrial Growth and World Trade,' *University Press Cambridge* (1963).

<sup>65</sup> Stephen Krasner, 'State Power and the Structure of International Trade,' (1976) pg 336.

<sup>66</sup> Rooth pg 2.

<sup>67</sup> Rooth pg 30-31.

<sup>68</sup> G Abbott, 'A re-examination of the 1929 colonial development act,' (1971) *The Economic History Review*.

<sup>69</sup> Rooth pg 33.

unable to devalue the Sterling to compensate because it was still linked to the gold standard. One of the major factors that forced Britain to abandon the gold standard was the failure of British exports to recover to their pre-war levels.<sup>70</sup> This resulted in a balance of payments issue, and it became clear that the shortfall could not be covered by American loans and investments. Therefore, the decision was made to remove Britain from the gold standard, despite the feeling that British exporters needed the currency certainty that the system provided.<sup>71</sup>

### Trade and the Great Depression

The US's reaction to the impact of the Great Depression was to impose the Smoot-Hawley tariff in 1930,<sup>72</sup> which raised the average tariff duty paid on imports by 20 per cent.<sup>73</sup> This was seen as the first step towards a new trend of global protectionism, with several countries raising their tariffs in retaliation. However, full-scale protectionism would not start in earnest until after the financial crisis of 1931.<sup>74</sup> As banks across Europe started to fail in 1931, countries such as Germany, Austria and Hungary imposed capital controls, effectively closing their markets to exports and severely damaging the world trading system as other nations followed suit.<sup>75</sup>

As mentioned above, in February of 1932, Britain implemented the Import Duties Act<sup>76</sup> which imposed a general 10 per cent tariff on most imports alongside some additional restrictions for certain products; however, Imperial Preferences exempted countries in the Empire from these new tariffs.<sup>77</sup> This was, partially, as a result of the electoral resurgence of the Conservatives in parliament a year earlier whom, as long time advocates of protectionism, used their return to power to undo the Labour Party's free trade policy.<sup>78</sup> As with the Smoot-Hawley tariff, other countries retaliated by raising tariffs of their own, further contributing to the collapse of world trade in this

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<sup>70</sup> Ibid

<sup>71</sup> Ibid

<sup>72</sup> The Tariff Act of 1930, ch. 497, 46 Stat. 590, June 17, 1930

<sup>73</sup> Barry Eichengreen and Douglas A. Irwin, 'The Slide to Protectionism in the Great Depression: Who Succumbed and Why?' (2010). *The Journal of Economic History*, Vol. 70, No.4. pg 876 (Eichengreen & Irwin).

<sup>74</sup> Ibid.

<sup>75</sup> Eichengreen & Irwin pg 876.

<sup>76</sup> The Import Duties Act 1932

<sup>77</sup> Eichengreen & Irwin pg 878.

<sup>78</sup> Ibid.

period.<sup>79</sup> The creation of a protectionist regime allowed Britain to adopt one of the longer-lasting examples of imperial policy. The Imperial Preference was a system negotiated at the Ottawa Conference of 1932 that offered the various territories, dependencies, and Dominions of the Empire a range of preferences for their exports to Britain in return for individual commitments to reciprocate by granting Britain preferential access to their markets.<sup>80</sup>

After the creation of the Imperial Preferences, the Empire's share of Britain's exports rose to 41.3 per cent between 1934 to 1938; while imports increased to 41.2 per cent in the same period.<sup>81</sup> Britain's exports fell dramatically in absolute figures between 1913 and 1934 (due to the double crises of WWI and the Great Depression), but the decline in exports to her Empire was only around 15 per cent; while the decline in exports to the rest of the world was twice that.<sup>82</sup> The importance of the Empire in this period is also demonstrated by the realignment of capital flows.<sup>83</sup> By 1936 two-thirds of overseas securities were located in member nations of the Empire; with only one third spread around the rest of the world. This was a complete reversal of the ratio in 1914.<sup>84</sup> Britain leant heavily on its Empire to try to stabilise and rebuild, first after the war and then during the depression. This saw policies aimed specifically at developing the colonies and encouraging imperial trade through the preferences system. These were ways for Britain to secure trade and capital flows in a world which was increasingly turning towards protectionism and financial disaster.

### Trade with the Empire after WWII

There is no doubt that in the decade after WWII, the empire was critical to Britain's economic position; providing it with 45 per cent of its imports in 1948 and 48.3 per cent of its imports in 1954, while purchasing 46.1 per cent and 48.3 per cent of its exports in those years respectively.<sup>85</sup> The empire served as a vital market for Britain's

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<sup>79</sup> Ibid.

<sup>80</sup> Brown & Louis pg 90.

<sup>81</sup> Peter Cain and Anthony Hopkins, 'British Imperialism: Crisis and Deconstruction, 1914-1990,' *British Imperialism Volume 2* (1993).

<sup>82</sup> Brown & Louis pg 102.

<sup>83</sup> Ibid.

<sup>84</sup> Ibid.

<sup>85</sup> Brown & Louis pg 103.

goods while also providing it with essential inputs. As most of the component parts of the empire were part of the Sterling Common Currency Area, the imports did not erode Britain's stores of foreign reserves. However, the exploitation of the imperial markets after the war may have been a double-edged sword for British industry. By 1953, British manufacturing exports to its empire began to decline,<sup>86</sup> which in turn caused the overall decline in the UK's manufacturing exports as producers failed to find alternative markets.<sup>87</sup> This was not a result of the removal of imperial preferences, which largely remained in place, but rather the liberalisation of trade between parts of the empire and outside nations which eroded the relative advantages granted to British manufacturers and placed them on a more level playing field.<sup>88</sup>

British manufacturers were no longer able to compete in markets that they had been comfortably dominating since before WWII once these markets were opened up. Thus, while the existence of these captive markets may have helped the British export economy recover in the decade after the economic disruption of the largest war in history, the competition limiting features may have blunted the competitive edge of its producers, leading to the decline of Britain as a manufacturing power once the protections were removed.<sup>89</sup>

### The GATT negotiations

The end of WWII would also see the rise of, arguably, the most important international trading system that the world had ever seen. Post-war negotiations fundamentally changed the way international trade operated. In 1947, the representatives of 23 nations met in Geneva, Switzerland to negotiate the GATT,<sup>90</sup> a framework for post-war commercial relations whereby governments agreed to a common set of rules for international trading relationships as well as to negotiate tariff reductions with each other.<sup>91</sup>

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<sup>86</sup> Britain went from providing 61.4 per cent of its empires manufacturing imports to 43.3 per cent between 1953 and 1961.

<sup>87</sup> Brown and Louis pg 105.

<sup>88</sup> Ibid.

<sup>89</sup> Ibid.

<sup>90</sup> General Agreement on Tariffs and Trade, 61 Stat. pt. 5, T.I.A.S. 1700 55 U.N.T.S. 194 (1947), (the GATT)

<sup>91</sup> Douglas Irwin, Petros Mavroidis, and Alan Sykes, 'The Genesis of the GATT,' (2007), pg 1, (Irwin et al).

Negotiations on the future of the world economic system had begun years before with talks between the US and Britain during the war. The US was already determined to undo the Imperial Preference system. Then US Secretary of State, Cordell Hull, had called the system 'the greatest injury, in a commercial way, that has been inflicted on this country since I have been in public life.'<sup>92</sup> John Maynard Keynes, representing the British Treasury, reacted with dismay at the idea that the US was attempting to undo the Imperial Preference system. He refused to allow the US to attach it as a condition for much needed assistance, and declined to make any commitments on Britain's behalf to agree to such conditions.<sup>93</sup> Over the next several years of negotiations, it was an issue that would arise continuously, straining UK-US relations and threatening to kill the idea of a new multilateral trading system before it could be properly developed.

Years of intense negotiations brought the US and UK views on issues such as the elimination of quantitative restrictions (import quotas); the advantages of a multilateral as opposed to bilateral approach, and the centrality of the MFN clause closer together.<sup>94</sup> In 1944, other countries were invited to join the Bretton Woods conference to discuss an international economic structure after the war.<sup>95</sup> The conference established the international monetary regime of adjustable exchange rates, and established two pillars of the post-war international economic system in the IMF<sup>96</sup> and the World Bank.<sup>97</sup> However, the issue of the Imperial Preferences still loomed over the UK-US negotiations on a new trading system to match the newly launched monetary system and, as talks dragged on into 1945, the war ended and there was a new President in the US and a new Labour government in the Britain.<sup>98</sup>

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<sup>92</sup> Armand Van Dormael, 'Bretton Woods: Birth of a Monetary System,' (1978)

<sup>93</sup> Irwin et al pg 22.

<sup>94</sup> Ibid pg 32-34.

<sup>95</sup> Ibid pg 65.

<sup>96</sup> To deal with balance of payments issues.

<sup>97</sup> For reconstruction and development assistance in Irwin et al pg 65.

<sup>98</sup> Irwin et al pg 82.

The Labour government was not as attached to the idea of the Empire as their Conservative predecessors had been, but they had to face the same political realities as Churchill's government.<sup>99</sup> After the surrender of Japan, US President, Harry Truman, cancelled the Lend-Lease program that had been supporting Britain. Britain had no way to pay for much needed food and materials and thus had no choice but to negotiate with America for a loan, which would place them in a vulnerable position with regard to the trade negotiations that were still ongoing.<sup>100</sup> The US attempted to use the threat of withholding financial assistance to force Britain to dismantle its Imperial Preference system, but this was rejected by British negotiators who believed that the two negotiations should not be combined and that talks about preferences should include reciprocal tariff reduction obligations for the Americans.<sup>101</sup> The American negotiators eventually retreated and agreed that the removal of preferences should not be a condition for financial assistance.<sup>102</sup>

By 1946, a two-track system of trade negotiations was developing. The first undertaken by the invitation only 'core-group' of nations selected by the US and the Britain to negotiate tariff reductions; while the second comprised of negotiations at the UN with the aim of creating an ITO.<sup>103</sup> That year, nations belonging to the 'core-group' met to compile the first draft version of the GATT by drawing on some of the provisions set out in the ITO negotiations. However, a wide set of issues were left out based on the understanding that these would be covered in more depth in the ITO.<sup>104</sup> In 1947, a conference was organised in Geneva to further negotiate the ITO and allow the core countries to continue their negotiations of the GATT, which was expected to be an interim measure to fill the gap before the launch of the ITO, and to prevent the tariff concessions already negotiated from being unravelled before the ITO could take effect.<sup>105</sup>

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<sup>99</sup> Richard Toye, 'The Labour Party's External Economic Policy in the 1940's,' (2000) *The Historical Journal* Vol. 10, No. 3

<sup>100</sup> Irwin et al pg 100.

<sup>101</sup> Ibid.

<sup>102</sup> Ibid pg 103.

<sup>103</sup> Irwin et al pg 110.

<sup>104</sup> Ibid at pg 120

<sup>105</sup> Richard Toye, 'The Atlee Government, the Imperial Preference System, and the Creation of the GATT,' (2003). *English Historical Review* Vol. 118, No. 478., pg 22.

The 1947 conference was marred by yet another disagreement between Britain and the US regarding the Imperial Preferences. Britain refused to dismantle it and demanded that the US drop its tariff walls, while the US offered only restricted tariff concessions and demanded the end of the preferences.<sup>106</sup> The acrimony between the two nations grew to the point that a senior trade negotiator for the US warned that there was a serious risk that the entire trade program could be at risk.<sup>107</sup> Concerned that the remains of her Empire was the only thing keeping Britain relevant in the post-war world given the ruinous state of her economy, the British feared that undoing the preferences would see the decline of the Empire hastened, and thus refused to be moved on the issue.<sup>108</sup>

Although the US had made the removal of the preferences a key part of their foreign policy for years, they had other strategic goals to consider, namely the rebuilding of the European (and British) economy so as to prevent the spread of the USSR's influence. They were well aware that the breakdown of trade negotiations could place their fragile reconstruction efforts at risk.<sup>109</sup> As a result, compromises were agreed to after months of negotiations that left the Imperial Preferences largely intact, much to the disappointment of several lead American negotiators.<sup>110</sup> This allowed the nations to finalise the GATT which, despite its supposed temporary nature, would become the cornerstone of international trade for the next five decades after the collapse of the ITO in 1948.<sup>111</sup>

## Conclusion

The early 20th century saw war, depression, and destruction on a scale that the world had not seen before. The budding globalisation that had started in the 19<sup>th</sup> century virtually collapsed under the weight three disastrous crises in the space of just over 30

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<sup>106</sup> Ibid pg 26.

<sup>107</sup> Irwin et al 134.

<sup>108</sup> Ibid pg 136.

<sup>109</sup> Ibid pg 139.

<sup>110</sup> Richard Toye, 'The Churchill Syndrome: Reputational Entrepreneurship and the Rhetoric of Foreign Policy since 1945,' (2008) *The British Journal of Politics and International Relations*.

<sup>111</sup> Daniel Drache, 'The Short but Amazingly Significant Life of the ITO,' (2000).

years, as did Britain's status as a superpower. Britain had relied on its Empire to overcome the challenges that the early 1900's presented, and to rebuild after each. The ties that bound together the centre and the periphery were strengthened by the shared experience of war and increased commercial links in the form of investment and trade. Early in the 20<sup>th</sup> century Britain had been locked out of European markets by protectionism, and this had not been reversed by 1950, which was understandable given the damage caused to the economies of Western Europe. Britain stood apart from the nations of Europe, however the next few decades would once again force a transformation of this relationship, with various factors undermining Britain's ability to differentiate itself from the continent and remain aloof of its internal affairs. With regard to the US, the first five decades of the century had illustrated what a pivotal ally it could be, intervening both during wartime with arms and supplies, and during peace with trade and aid. However, the US had also shown that it was willing to put its own interests ahead of Britain's, threatening Britain's imperial links during the GATT negotiations, nearly collapsing the whole process. Although the US was held at bay, the lesson was clear that Britain could not rely on them to be a benign ally. Good relations were important, but Britain would have to continue to defend her interests, and her Empire. The tensions between the three (Europe, the US, and the Empire) had been made clear during this half century, as had Britain's relative stake in each. However, the next few decades of the 20th century would completely alter the importance of each and lead to a significant realignment in Britain's policy towards all three.

## CHAPTER 4: BRITAIN AND THE EARLY EU

### Introduction

As described in the previous chapter, the first five years of the 20th century had been disastrous for Europe. By the end of WWII most of Europe's economies were in ruins, and the few empires that remained were starting to collapse. From this carnage a new project of European Unity started to emerge, in the hopes of preventing another destructive war. As this project was new and relatively unique, it was largely uncertain what this community would look like, or what membership of it would entail. This chapter will look at the evolution of the European project from its inception as the ECSC to its modern successor the EU, and investigate how Britain went from being an aloof outsider to a reluctant member, before her scepticism started to put her membership in serious doubt. This time period would also see a dramatic change in how Britain treated her Empire, which would start to dwindle in both size and importance from the 1960s, going from the central focus of British foreign policy to a secondary issue that acted as an impediment to her newly prioritised European relations. There would also be a change in relationship with the US, as Britain struggled to accept her diminished place in the world while maintaining her vital strategic relationship with the one remaining democratic superpower.

### After WWII:

Britain had a very different experience of the war compared to continental Europe and emerged having learnt different lessons. The war had helped to bolster the British national identity as well as her links with her Empire, which were seen as crucial to Britain's survival.<sup>112</sup> Much of Britain's foreign policy was still focused on relations with her Empire and the US, and her relationship with the European nations (or a 'United Europe') was seen as just one of three interlinking circles of British interest.<sup>113</sup> Britain was well aware of her diminished power on the world stage, and

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<sup>112</sup> Grzegorz Ronek, 'Britain's Membership in The European Communities and The European Union,' (2013) pg 221. (Ronek)

<sup>113</sup> Winston Churchill, 'Winston Churchill's 9 October 1948 Speech to the 69th Annual Conservative Party Conference published in the Report of the Proceedings' (1948).

her leaders were also aware of the rising power of the USSR which, after the war, exercised *de facto* control over most of Eastern Europe. The only capitalist nation with the strength to stand up to the USSR was the US, which had spent the pre-war years in isolation. Therefore, much of the Britain's foreign policy centred on ensuring that the US took its leading place on the world stage, rather than retreat back into isolation.<sup>114</sup> On the other hand, protecting ties with the Commonwealth was an economic imperative, as around 40 per cent of Britain's exports and re-exports were sent to Commonwealth nations.<sup>115</sup>

### European Coal and Steel Community

The first major step towards creating a new united Europe was taken in 1950 with the creation of the Schuman Plan, an ambitious effort to pool German and French coal and steel production under the authority of a supranational body, which would act as the foundation of the efforts to create the new federation.<sup>116</sup> This new creation held little appeal for Britain, which was more or less self-sufficient in both products; exported little of each to Europe, and enjoyed preferential access to the economies of its Commonwealth.<sup>117</sup>

Access to the still devastated economies of Europe was not as much of an incentive for Britain, which had survived the war in much better condition than its continental neighbours. The French were determined to create an alternative to the superpowers of the US and the USSR by uniting Western Europe under their influence. The omission of Britain was an unexpected benefit as it allowed France to act as the *de facto* leader of the new block.<sup>118</sup> Britain staying out of the block ensured that it would be controlled by France, and that Germany (or at least West Germany) would be securely aligned with French interests.<sup>119</sup> Secure in their special relationship with the US and their longstanding commitment to the Commonwealth, the British had little

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<sup>114</sup> Stephen George, 'An Awkward Partner: Britain in the European Community' (1994) pg 14 (George).

<sup>115</sup> Kenneth Morgan, 'Labour in Power, 1945-1951' (1984) pg 391-392.

<sup>116</sup> J. Pinder, 'European Community: The Building of a Union,' (1995) pg 1.

<sup>117</sup> Ronek pg 222.

<sup>118</sup> George pg 19.

<sup>119</sup> Roy Jenkins, 'Britain and the EEC,' (1982) pg 21 (Jenkins).

appetite to be involved with a new force that would disrupt these crucial links.<sup>120</sup> The outcome of the Schuman Plan was the Treaty of Paris (signed in 1951) which launched the ECSC and included France, Germany, Italy and the three Benelux states, but not Britain which had declined to participate.<sup>121</sup>

### The European Economic Community

In 1957 the treaty of Rome established the EEC, which was made up of the same nations as the ECSC, and greatly enhanced integration efforts. This treaty was a road map for the abolition of customs duties between the member nations; the creation of a common external tariff and of a free movement zone for capital and labour, and, eventually, provided for the progressive integration of agriculture, trade, transport and competition policy with the goal of an 'ever closer union.'<sup>122</sup> Britain joining the new EEC was out of the question. Prime Minister Harold Macmillan refused to agree to any proposal that would prevent Britain from enjoying a preferential trading relationship with her Commonwealth, which the adoption of a common external tariff would undoubtedly do.<sup>123</sup>

After it became clear that there were too many fundamental differences between Britain and the EEC to allow for a possible compromise, Britain set about creating its own trade block by negotiating the EFTA with Austria, Denmark, Norway, Portugal, Sweden, and Switzerland.<sup>124</sup> The EFTA was supposed to act as an alternative to the EEC and provide Britain with more bargaining power when negotiating with the EEC. However, it largely failed in this task. The results of EFTA were muted, while the economies of the EEC flourished over the first few years of its existence to the extent that the program of tariff reduction was accelerated and all of the EEC, except Belgium, enjoyed higher rates of economic growth than Britain.<sup>125</sup>

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<sup>120</sup> Ibid.

<sup>121</sup> CVCE, 'The Schuman Plan and Franco-British relations' available at [https://www.cvce.eu/content/publication/2009/8/26/b6864066-9e1a-47d3-ab29-f7aabe8f88fe/publishable\\_en.pdf](https://www.cvce.eu/content/publication/2009/8/26/b6864066-9e1a-47d3-ab29-f7aabe8f88fe/publishable_en.pdf), accessed on 26 January 2019.

<sup>122</sup> Ronek pg 223.

<sup>123</sup> Jenkins pg 25.

<sup>124</sup> J. Ramsden, 'The Oxford Companion to Twentieth Century of British Politics,' (2005) pg 345.

<sup>125</sup> M. Dedman, 'The Origins and Development of the European Union 1945–95,' (1995) pg 278–286.

### Britain's Path to Joining the EEC

The decolonial project had advanced rapidly after the war ended. By the early 1960s, it was becoming apparent that the economic interests of Britain and those of her former colonies (especially those in the developing world) were diverging.<sup>126</sup> The newly independent nations in Africa and Asia had no intention of sacrificing their economic wellbeing for British interests, and instead wanted to move forward with their development agenda at their own pace.<sup>127</sup>

The Suez crisis in 1956, a joint military intervention by Britain and France in Egypt after the nationalisation of the Suez Canal by the Egyptian President, Gamal Abdel Nasser, was a cataclysmic event for British foreign policy. The crisis would have ramifications in all three of the circles and would lead to a reevaluation of Britain's status in the world economy. Britain's retreat in the face of US disapproval did little to quell French concerns that Britain was simply a US agent attempting to frustrate European integration and the creation of a Western power block that could challenge the US's unquestioned hegemony.<sup>128</sup> The deterioration of Franco-British relations was made clear in 1958 when de Gaulle vetoed a British proposal for a European free trade area on the grounds that it did not suit French interests (as it excluded agriculture) and would derail the progress of the EEC.

As the 1960s dawned, the ties between Britain and the Commonwealth were continuing to fray. The Asian Commonwealth states, driven by India, had started to shift away from British influence and the traditional core of the Commonwealth, namely, Canada, New Zealand, and Australia, were beginning to fall under the influence of the US. It was, furthermore, becoming clear that Britain was not economically strong enough to act as the main market for all of the Commonwealth's needs.<sup>129</sup> South Africa, despite Britain's reluctance, was forced to depart from the Commonwealth due to intense pressure from the African and Asian member states.

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<sup>126</sup> Jenkins pg 27.

<sup>127</sup> Jenkins pg 27.

<sup>128</sup> Ibid.

<sup>129</sup> John Darwin, 'The Empire Project: The Rise and Fall of the British World System, 1830-1970' (2009) pg 588 (Darwin).

This delivered a fatal blow to the notion that Britain could exercise international influence disproportionate to her size due to her unquestioned leadership of a Commonwealth block.<sup>130</sup> Britain's Empire was starting to collapse under the weight of decolonial nationalism and the waning relative economic strength of Britain itself.

No longer able to guarantee the support of the US, Britain could ill-afford to be shut out by another block, this time French-dominated Europe.<sup>131</sup> With the other two circles crumbling, it was clear that Britain needed to reprioritise and increase its reliance on the third.

The British government opened talks with the EEC in 1961.<sup>132</sup> Proponents believed that the European market could jumpstart Britain's flagging economy and European capital flows would strengthen the City of London's position as the global financial centre. Furthermore, Britain's new position at the centre of Europe would boost its declining status on the world stage.<sup>133</sup> By this time it was becoming clearer that part of Britain's economic stagnation was due to its patterns of trade and its orientation towards the Commonwealth, rather than Western Europe, at a time when the fastest growing trade in the world was between industrialised states.<sup>134</sup>

Negotiations to join the EEC were arduous, as the British were determined to safeguard key Commonwealth interests much as they had during the GATT negotiations. Sticking points included British agriculture, which was very different to its heavily protected French counterpart; Britain's new EFTA partners, which couldn't suddenly be left in the lurch, and the Commonwealth, which had its own system of preferences at odds with the EEC trading system.<sup>135</sup> However, after a frustrating year of diplomatic deadlock, French President Charles De Gaulle vetoed Britain's entry.<sup>136</sup> De Gaulle believed that Britain was not sufficiently committed to

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<sup>130</sup> George pg 32.

<sup>131</sup> Darwin pg 637.

<sup>132</sup> Darwin pg 637.

<sup>133</sup> Ibid.

<sup>134</sup> George pg 28.

<sup>135</sup> George pg 25.

<sup>136</sup> Darwin pg 637.

Europe as it was still too attached to the Commonwealth and to its 'special relationship' with America.<sup>137</sup> However, the main reason for the veto may well have been that the entry of Britain into the ECC threatened De Gaulle's idea of a French dominated European block.<sup>138</sup>

As the 1960s wore on, Britain's position did not improve. This would add to Britain's increased isolation from her trade partners in all of the three circles due to economic uncertainty that was largely caused by the strain placed on the pound from 1965 onwards.<sup>139</sup> The Labour government was unwilling to devalue the currency despite its glaring weakness.<sup>140</sup> They feared that its devaluation would damage London's status as a financial centre and cause overseas-users of British currency (the Sterling Area) to abandon the currency. The Government also refused to decrease public expenditure, instead searching for alternatives to revive the stalling economy.<sup>141</sup> Joining the EEC was seen as a viable alternative, and negotiations began again in 1967. Britain's previous attempts to join the EEC played out again as De Gaulle vetoed the application, believing that the British were not ready to join the EEC as his view had not changed since their last application.<sup>142</sup> It was clear that there was no avenue for Britain to deepen its ties with the continent as long as De Gaulle remained in power in France.

After over a decade as President, De Gaulle resigned from office in 1969 after a failed referendum on constitutional reforms.<sup>143</sup> His successor, Georges Pompidou, wasted little time in calling for a summit of the newly merged EC to discuss negotiations for Britain's entry, and the new British Prime Minister, Edward Heath, was happy to oblige.<sup>144</sup>

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<sup>137</sup> George pg 345

<sup>138</sup> George pg 345.

<sup>139</sup> Darwin pg 640.

<sup>140</sup> Ibid

<sup>141</sup> Darwin pg 641.

<sup>142</sup> George pg 38.

<sup>143</sup> Ibid.

<sup>144</sup> George pg 38.

Negotiations continued from where they left off, and issues such as access for Commonwealth countries; the CAP and Britain's contribution to the budget became sticking points that were eventually overcome.<sup>145</sup> This was despite the French government spearheading a new EC funding agreement, which earmarked duties received from the import of food and industrial goods to be two of the primary sources of funding.<sup>146</sup> This system put Britain at a disadvantage, as it imported far more food and industrial goods from outside the EC than the other members. Moreover, the EC budget was mostly allocated to the CAP which did not benefit Britain that much due to her much smaller and more efficient agricultural sector.<sup>147</sup> Regardless, Britain pressed on with its application and accepted compromises, hoping to renegotiate them at a later date. The Treaty of Rome was signed by Britain in 1972 and Britain entered the EC on the 1<sup>st</sup> of January 1973.<sup>148</sup> After decades of imperial decline, Britain had accepted its position in Europe, albeit reluctantly and somewhat awkwardly. However, any hope that acceding to the EC would finally tie Britain fundamentally to its long underappreciated third circle of foreign relations was somewhat misplaced.

### Early EEC membership and the Thatcher Years

The ink was barely dry on Britain's accession to the EC when the newly installed Labour government demanded a renegotiation of its entry conditions and a referendum on Britain's membership.<sup>149</sup> After a slight change in the budget contribution formula was agreed, the government backed a vote to remain in the EC and the referendum of 1975 resulted in a 67.2 per cent majority in favour of doing so.<sup>150</sup> The result was a massive endorsement of the Britain's new European focus however, Britain's uneasy position in the EC and its disagreement on fundamental issues was a sign of things to come.

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<sup>145</sup> George pg 50-52.

<sup>146</sup> George pg 53.

<sup>147</sup> Ibid.

<sup>148</sup> Peter Wilding, 'What Next? Britain's Future in Europe' (2017). pg 37.

<sup>149</sup> D. Butler and U. Kitzinger, 'The 1975 Referendum' (1996) pg 341.

<sup>150</sup> Ibid.

Britain's late arrival into the EEC meant that she missed the period of high economic growth that was experienced by the original six members in the first years after its creation. Instead, Britain joined just before unfavourable world economic conditions sent large parts of the developed world into a recession.<sup>151</sup> As a result, the British did not have the same positive connotations of membership that the other members had. This, combined with the fact that they had no hand in shaping the foundation of the community, meant that there was never the same sense of belonging that the other states enjoyed.<sup>152</sup> The turmoil of the 1970's would delay any chance of improving the EC and deepening Britain's connection with it as the oil crisis caused by OPEC's drastic increasing of prices plunged much of the developed world into economic chaos.<sup>153</sup> Rather, the remainder of the decade entrenched Britain's status as an 'awkward partner' in the EC. Disputes over fisheries; disagreements over agricultural support prices, and a flat out refusal to join the new EMS<sup>154</sup> firmly placed Britain as an outsider within the EC.<sup>155</sup>

The CAP had been a source of British ire since its creation. Already an entrenched feature of the EEC before Britain's accession, it was heavily weighted against British interests, but accepted by her negotiators as the price that needed to be paid for admission. In the early years of Britain's membership, the CAP constituted around 80 per cent of the EC's budget. The formula for this budget meant that Britain was one of the largest contributors; despite having one of the lowest GDP per capita of the member states and not receiving anywhere near the amount of CAP subsidies that went to France and other nations.<sup>156</sup> Ironically, one of the reasons that Britain was the largest net contributor in the EC was that, by 1980, she still had large trade links with the Commonwealth. Tariffs from this Commonwealth trade went towards the EC budget, leaving Britain at a disadvantage because of her lower than average trade levels with the rest of the EC (43 per cent to an average of 50.8 per cent).<sup>157</sup> It was in this context that a new Conservative Prime Minister, Margret Thatcher, would arrive

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<sup>151</sup> George pg 6.

<sup>152</sup> Ibid

<sup>153</sup> George pg 74.

<sup>154</sup> A framework to link the currencies of the EC at set rates.

<sup>155</sup> George pg 126-130.

<sup>156</sup> Jenkins pg 32.

<sup>157</sup> George pg 132. Intra-EC trade did not affect the budget contribution, as it was duty free

on the European stage and demand, once more, that the rules of the EC be changed to better suit British interests.

The Thatcher government would act to reverse the steady decline of Britain, both in the political and economic sphere. However, before any improvements could be made with regard to Britain's position in the EC, the issue of the budget needed to be dealt with. The 1980s would also see a renewal of the special relationship between Britain and the US as its two leaders, Reagan and Thatcher, shared an ideology and general outlook.<sup>158</sup> This allowed Britain to strengthen ties with one of her three circles with little extra effort required, solidifying her one flank and allowing her to focus efforts on reshaping the European circle to better suit her needs. An EC budgetary crisis in 1981 provided Britain with an opening to demand a fairer budget allocation. They proceeded to frustrate a range of measures<sup>159</sup> in an attempt to achieve their goals.<sup>160</sup> This inflamed the other members of the EC, and isolated Britain in the organisation. The fractures started to show in the EC and precipitated a 'relaunch' of the organisation in an attempt to deal with the multitude of issues which had arisen.<sup>161</sup> The budgetary issue was, eventually, resolved in the 1984 Fontainebleau agreement which allowed Britain a rebate of 66 per cent of the difference between their VAT contribution to the budget and her receipt there from.<sup>162</sup> However, the tense negotiations left Britain isolated in Europe. Britain was permanently opposed to greater increases in the power of Brussels and the ever-closer union. In contrast the French, led by President Mitterrand, who was supported by other members, proposed a new treaty of European Union in order to bind members together and to increase the power of the central decision-making institutions.<sup>163</sup>

After the settlement of the budgetary issue, Thatcher's government set out a series of policy objectives that it believed the EC needed. Britain insisted that the EC needed to

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<sup>158</sup> George pg 143.

<sup>159</sup> Including an increase in the VAT contribution to the EC and the agreement to set agricultural prices.

<sup>160</sup> George pg 150.

<sup>161</sup> Ibid

<sup>162</sup> George Ibid pg 156.

<sup>163</sup> Bulletin of the European Communities, 5-1984, point 3.4.1. This included establishing majority voting in the Council of Ministers as well as create a two speed Europe if not all member states wished to follow this new route at the same time

cut out wasteful spending and start trimming the excesses of the budget. Furthermore, Britain supported the creation of a true single market for free trade and free enterprise via deregulation, and opposed centralised legislation and a single currency. They would argue for the pursuit of an outward looking global project rather than the building of an inward focused bureaucratic super-state.<sup>164</sup>

There is no doubt that Britain wanted a closer Europe. They pushed for the reduction of barriers between markets; a common foreign policy, and a coordinated defence policy.<sup>165</sup> However, her reluctance to cede national sovereignty to a centralised European power structure, centred around the European Parliament in Brussels, put it at odds with its fellow member states. Moreover, the President of the European Commission, Jacques Delors, was a staunch supporter of the idea of a federal Europe.<sup>166</sup> The Thatcher government argued for practical achievements, such as the improvement of the single market, while Delors demanded institutional reform in order to give greater power to the central European institutions.<sup>167</sup> Although Thatcher achieved her goal of bolstering the single market, which would arguably become the biggest achievement of the EC to date, Britain was on the losing side in debates over budget reform; increased CAP spending; increased powers for the European Parliament; the move towards a monetary union by strengthening the EMS, and an unquestionable march towards an even more united Europe.<sup>168</sup>

The abovementioned losses enhanced Thatcher's opposition towards Europe, and led to her famous speech in Bruges where she stated that 'we have not successfully rolled back the frontiers of the state in Britain, only to see them re-imposed at a European level with a European super-state exercising a new dominance from Brussels.'<sup>169</sup> This railing against federalisation and centralisation in Europe was accompanied by a staunch refusal to support the monetary union despite its support by key elements in

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<sup>164</sup> Wilding pg 40-41.

<sup>165</sup> George pg 178.

<sup>166</sup> Ibid

<sup>167</sup> George pg 179.

<sup>168</sup> George pg 179

<sup>169</sup> Margaret Thatcher Foundation, 'Speech to the College of Europe,' available at <https://www.margaretthatcher.org/document/107332>, accessed on 29 January 2019.

her own party. Her refusal to support party policy led to the resignations of key Conservative officeholders and precipitated Thatcher's fall from power in 1990.<sup>170</sup>

Thatcher's successor, fellow Conservative John Major, would continue Britain's reluctant approach to the European project by negotiating opt-outs to both the Social Charter and the monetary union when signing the Maastricht Treaty that established the EU in 1992.<sup>171</sup> However, the pressure facing the pound would force Major to remove it from the European ERM, thus effectively ending any chance of Britain joining the currency union.<sup>172</sup> However, in 1997, the election of a new Labour government provided Britain with an opportunity to set its relationship with Europe on a new course.

### Britain under Blair

Blair's Labour government made it clear from the outset that they wished to take Britain's 'rightful' place as one of the leaders of the newly formed EU. There was a belief that only through influence in Europe would Britain be able to exert global influence. However, the recipe for doing so was the same as had been attempted in the Thatcher years, with a focus on leadership in the single market, common foreign policy, and defence.<sup>173</sup> The Labour government was willing to embrace supranationalism to a point. Commitments were made to allow the electorate to have a say in key sovereignty matters (such as pledging that a referendum had to be held before Britain would participate in the single currency).<sup>174</sup> The Blair government would attempt a balanced approach by pledging to take tackle issues that Britain had fought for since its admission (such as reform of CAP and the retention of the national veto) while moving towards a leadership role in Europe by pushing for EU expansion and signing the social chapter (one of the opt-outs negotiated by the Major government).<sup>175</sup>

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<sup>170</sup> Iain Begg, 'Margaret Thatcher maintained a difficult relationship with Europe, but she was far from a figurehead for Euroscepticism,' (2013) available at <http://blogs.lse.ac.uk/europpblog/2013/04/17/margaret-thatcher-relationship-with-europe-euroscepticism-figurehead-iain-begg/>, accessed on 29 January 2019.

<sup>171</sup> Ronek pg 233.

<sup>172</sup> Wilding pg 57.

<sup>173</sup> Wilding pg 57.

<sup>174</sup> Simon Bulmer, 'New Labour, New European Policy? Blair, Brown and Utilitarian Supranationalism,' (2008) (Bulmer).

<sup>175</sup> Labour Party, 'New Labour: Because Britain Deserves Better,' (1997).

It appears that the British presidency of the Council of the European Union in 1998 was generally well received by other member states.<sup>176</sup> While key EU programs were accelerated under the British presidency, Britain's absence from the most important policy program of the time, the launch of the common currency, largely undermined Blair's attempt to appear as a true European leader.<sup>177</sup> Despite this, Blair was able to achieve some success, such as the St Malo declaration to set the agenda for a common European security and defence policy, and the Lisbon European Council strategy to transform the EU into a more dynamic knowledge based economy.<sup>178</sup>

All Blair's good work would, unfortunately, be undone when the US invasion of Iraq split the EU and once more returned Britain to the periphery. A split occurred between those who supported the US, led by Britain, and those who believed the EU should stay separate from the US's foreign policy adventures, led by France and Germany.<sup>179</sup> This split undermined Britain's relationship with the two other EU leaders after it became clear that Britain would side with the US and join the Iraq war.<sup>180</sup> Britain's status in Europe was further diminished when it was announced in 2003 that Britain would not join the Euro.<sup>181</sup>

Under the shadow of the Iraq war, Britain was no longer able to advance her European agenda. A lack of domestic support for the war made the Blair government more defensive in its EU policy.<sup>182</sup> The Labour party's majority was cut by 100 seats when Blair failed to repeat his electoral success in the 2005 general elections and there was increased pressure on him to step down, which he did in favour of Gordon Brown in 2006.<sup>183</sup> Brown's term would be short; dragged down by the weight of the Iraq war and a growing Euroscepticism.<sup>184</sup> The 2010 general election would see the

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<sup>176</sup> Peter Ludlow, 'The UK Presidency: A View from Brussels' (1998). *Journal of Common Market Studies*, Vol. 31, No. 2.

<sup>177</sup> Bulmer pg 602.

<sup>178</sup> Ibid.

<sup>179</sup> Wilding pg 58.

<sup>180</sup> Ibid

<sup>181</sup> Bulmer pg 222.

<sup>182</sup> Wilding pg 58.

<sup>183</sup> Wilding pg 60

<sup>184</sup> Ibid

end of Britain's renaissance in Europe with the return of the growingly anti-Europe Conservative party under David Cameron.

### Cameron and Brexit

In the years since they had last been in power, the Conservative party had grown more Eurosceptic, creating divides in the party.<sup>185</sup> The election of David Cameron did little to mend the growing problem. These divides made it practically impossible for the new government to take any sort of strategic initiative regarding Europe. Thus, Britain no longer contributed in a meaningful way to discussions on the EU's policy. The French foreign minister, Laurent Fabius, complained about the Britain's 'non-diplomacy' in Europe due to her lack of a coherent policy.<sup>186</sup> In 2011, the Cameron government's status in Europe was severely weakened by a defeat over an EU fiscal compact.<sup>187</sup> Cameron's defensive measure was defeated by a French-German coalition with widespread support which left Britain isolated and friendless in the EU.<sup>188</sup> This sums up Cameron's record in the EU.

Cameron's domestic concerns limited his foreign policy options considerably and, as such, the Prime Minister felt that he needed to shore up his domestic support before he could pursue a more effective strategy in the EU. To do this, Cameron floated the idea of a referendum on Britain's membership in the EU, in an attempt to maintain control of his own party as Eurosceptic backbenchers grew even more rebellious.<sup>189</sup> While not a Eurosceptic himself, Cameron worried about the divisions in his own party and the surging support for UKIP, which threatened to undermine the Conservatives electoral support.<sup>190</sup> Thus, Cameron was willing to gamble on the referendum. He hoped a victory would heal his own party's divisions so it could unite behind his leadership while undercutting the rise of UKIP and removing its electoral

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<sup>185</sup> Ibid

<sup>186</sup> Wilding pg 61.

<sup>187</sup> Charles Grant, 'Britain on the edge of Europe,' (2011) available at <https://www.opendemocracy.net/ourkingdom/charles-grant/Britain-on-edge-of-europe>, accessed on 29 January.

<sup>188</sup> Ibid.

<sup>189</sup> Charles Grant, 'Cameron's Optimistic, Risky And Ambiguous Strategy,' (2013) available at <https://www.cer.eu/insights/camerons-optimistic-risky-and-ambiguous-strategy>, accessed on 29 January 2019.

<sup>190</sup> Ibid.

threat.<sup>191</sup> If a vote to remain could be secured, Cameron would have a mandate to project greater influence at the EU and reform it in Britain's favour.

In 2013, Cameron promised an in/out referendum on Britain's EU membership if the Conservatives were to win the next general election.<sup>192</sup> The Prime Minister stated that he would renegotiate the relationship with the EU and present the electorate with the choice of either remaining under the new terms or leaving the union.<sup>193</sup> In 2015, the Conservatives would defy the pre-election polls and win an outright majority in the general election, clearing the way for the Prime Minister to follow through with this promise.<sup>194</sup> The date for the referendum was set for the 23<sup>rd</sup> of June 2016, a day that would be a defining moment for Britain's relationship with the Europe.

### Conclusion:

British political commentator, Hugo Young, summed up the situation succinctly when he remarked that the fundamental difference between Britain and the rest of the European community was that, while the community saw the creation of the EC/EU and entry thereto as a victory, Britain saw it as a type of defeat; a last resort that she had resisted for as long as she could.<sup>195</sup> Had Britain been able to keep her superpower status after the war, or been able to consolidate her position at the head of a united Empire, there is every chance that Britain may never have become a member of the EU. As it was, economic forces largely forced their hand. Britain's entry into the EC was a drawn out and torturous affair, with many political divides (both domestic and international) which were only partially healed once membership was finally achieved. In many ways, Britain's membership in Europe would proceed on much the same lines. Successive governments took hard lines against European integration efforts, citing a lack of domestic support, distrust of supranationalism, or an unfair foundation that was against British interests. Britain's efforts in the community were not entirely without success, with the creation of the single market still one of the resounding triumphs of the EU, which was no doubt at least partially due to Britain's

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<sup>191</sup> Ronek pg 238.

<sup>192</sup> BBC, 'David Cameron promises in/out referendum on EU,' (2013) available at <https://www.bbc.com/news/uk-politics-21148282>, accessed on 29 January 2019.

<sup>193</sup> Ibid.

<sup>194</sup> BBC, 'Election Results: Conservatives Win a Majority,' (2015) available at <https://www.bbc.com/news/election-2015-32633099>, accessed on 29 January 2019.

<sup>195</sup> Hugo Young, 'This Blessed Plot: Britain and Europe from Churchill to Blair,' (1998).

support of the project. However, there were more defeats than successes, and more bridges burnt than built. By the time the Conservative party returned to power in 2010, a wave of Euroscepticism was building in Britain, no doubt partially caused by the self-imposed isolation in Europe. By the end of the first decade of the twenty first century, Britain's membership of the EU would be in the balance, and the people of the UK would have to decide whether they wanted to remain part of the block in which they felt they had few friends and less allies, or try and go it on their own. By the slimmest of margins, they would choose the latter.

## CHAPTER 5: POST-BREXIT UK-EU ECONOMIC RELATIONS

### Introduction

The refrain that 'we are leaving the EU, not Europe,' is one that has been used by several high-profile members of the British government on many occasions since the referendum, including Prime Minister Theresa May,<sup>196</sup> and former Foreign Secretary, Boris Johnson.<sup>197</sup> While this statement could be considered to be more about geographic reality than political strategy, the fact remains that once Britain leaves the EU it will have to have some form of a relationship with the remaining member states. The exact form of this relationship has yet to be decided, and regardless of the intentions of politicians on both sides the final relationship will involve compromise. Negotiations on the post-Brexit relationship between Britain and the EU are currently ongoing. As such, it will be beneficial to look at several suggested models for a post-Brexit relationship, analysing the strengths and weaknesses of each and the possibility of their adoption as the basis of future UK-EU trade relations. This chapter will look at four of the more likely frameworks for a final agreement, namely a customs union, membership of the EEA, a FTA, and a no deal situation. The last of these options will be discussed in more depth, given the severe economic consequences that it poses and the fact that negotiations have been inconclusive so far, meaning that this potentially dire option is more likely than many had initially presumed.

### A Customs Union based on the EU's Relationship with Turkey

A customs union is one of the closer relationships available for post-Brexit UK-EU relations. Customs unions require the free circulation of goods between members, fully liberalizing trade in the goods agreed upon by the parties involved.<sup>198</sup> There is some policy space allowed by the members in choosing which goods are covered by

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<sup>196</sup> Theresa May 'We have voted to leave the EU, but not Europe' (2017), available at <https://www.gov.uk/government/speeches/we-have-voted-to-leave-the-eu-but-not-europe-article-by-theresa-may>, accessed on 4 October 2018.

<sup>197</sup> BBC 'Boris Johnson: 'We are leaving the EU, not Europe'' (2016), available at <https://www.bbc.co.uk/news/av/uk-politics-37641405/boris-johnson-we-are-leaving-the-eu-not-europe>, accessed on 4 October 2018.

<sup>198</sup> Peter Van den Bossche and Werner Zdouc, 'The Law and Policy of the World Trade Organization,' 4th ed (2017) pg 680-682 (Bossche and Zdouc).

the agreement (for example, the EU-Turkey Customs Union excludes agricultural goods).<sup>199</sup> However, once members have agreed on which goods will be included in the customs union, the policy space is largely done away with and it is required that the members adopt full liberalisation, a common trade policy, and a common external tariff.<sup>200</sup> As goods covered under the union can flow freely between member states, the regulations for these goods must be harmonised. Moreover, the union does not differentiate between goods produced by members and those imported from third parties and thus, members must have a common external tariff and a common trade policy (including rules of origin).<sup>201</sup> A customs union requires significant policy coordination between member states.

The major benefit of this solution is that it would minimise the disruption of UK-EU trade by allowing most (if not all) goods from Britain to enter the EU without paying EU tariffs; or worrying about complying with administrative hurdles such as rules of origin certification. This is a major benefit as most of the barriers on manufactured goods implemented by the EU tend to be NTBs such as safety requirements and rules of origin, rather than traditional tariffs. Most importantly, staying in the customs union would be the only solution that does not disrupt the supply chains of British businesses that operate on a ‘just in time basis’<sup>202</sup> importing large amounts of their inputs from the EU, as it requires less border friction than the other options. Much of Britain’s automotive industry (a major export sector for the economy) operates in this manner, and this trading arrangement would minimise the potential disruption that they face and remove the potential benefits of relocating their operations to the continent after Brexit.<sup>203</sup>

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<sup>199</sup> The European Commission ‘Countries and Regions: Turkey’ available at <http://ec.europa.eu/trade/policy/countries-and-regions/countries/turkey/>, accessed on 4 October 2018.

<sup>200</sup> Van den Bossche and Zdouc, pg 680-685.

<sup>201</sup> Piet Eeckhout ‘Future trade relations between the EU and the UK: Options after Brexit’ (2018) pg 9 (Eeckhout).

<sup>202</sup> A production strategy where components are used as soon as they arrive with virtually none stored on site.

<sup>203</sup> Lisa O’Carroll and Gwyn Topham, ‘Brexit uncertainty puts thousands of jobs at risk, car industry warns,’ (2018), available at <https://www.theguardian.com/politics/2018/jun/26/brexit-uncertainty-putting-860000-jobs-at-risk-warns-car-industry>, accessed on 19 January 2019.

The agreement between the EU and Turkey essentially places Turkey in the position of having to copy EU trade policy. However, it is not automatically a party to any free trade agreements negotiated by the EU with third party nations.<sup>204</sup> The nature of a customs union is such that goods imported from third party nations to the EU can be deflected to Turkey under the access granted by the customs union. This is a problem for Turkey, as customs unions do not distinguish between goods produced in the member countries and goods produced in a third-party nation imported into the customs union under the common tariff. This creates a problem of non-reciprocal market access to the markets of third-party nations as they are not an EU member state, and thus are not granted benefits under EU trade deals.<sup>205</sup> This leaves Turkey in a poor negotiating position when it tries to negotiate its own market access with these third-party nations in separate bilateral negotiations. There will be little incentive for such nations to grant Turkey market access in a separate deal given that they already enjoy access to the Turkish market via the customs union with the EU, leaving Turkey with little to offer to secure reciprocal market access. An example of the struggle that Turkey faces in negotiating free trade agreements was provided in 2011 when an invitation to negotiate an FTA with South Africa, which enjoys *de facto* access to the Turkish market via its EPA with the EU, was politely declined by the South African government even as they stressed their desire for stronger diplomatic and economic ties.<sup>206</sup>

One of the biggest issues raised in the run up to the referendum by those in favour of Brexit was that Britain does not control its own trade policy. Entering into a customs union with the EU would retain this arrangement, as Britain would still not be able to develop its own trade policy. Furthermore, Britain's ability to negotiate its own bilateral agreements with non-EU nations would be severely restricted. This model would prevent Britain from being able to create its own independent trade policy, while requiring it to adopt EU regulations without having any say in their creation, and as a result this type of arrangement may be politically difficult.

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<sup>204</sup> Eeckhout pg 8.

<sup>205</sup> Eeckhout pg 9.

<sup>206</sup> Jimmy Manyi 'Statement of cabinet meeting November 10 2011' 10 November 2011, available at <http://www.politicsweb.co.za/opinion/statement-of-cabinet-meeting-november-10-2011-2>, accessed on 23 October 2018.

Joining the European Economic Area: Based on the EU's relationship with Norway

The EEA is a Pan-European single market that includes all members of the EU along with three members of the EFTA, namely Norway, Lichtenstein and Iceland.<sup>207</sup>

Members of the EEA are part of a single market and must, therefore, allow for the free movement of goods, services, people and capital between EEA members, while also adopting and implementing EU rules governing the single market.<sup>208</sup> While membership of the EEA requires relatively integrated economic relations, it does not match the deep integration required by EU members. Nations are not required to participate in the monetary union, common foreign or security policy, or the common agricultural policy.<sup>209</sup> It does, however, require at least partial participation in the EU legal system with regard to policies that govern the single market in areas such as competition policy, government procurement and consumer protection.<sup>210</sup> As result, it would require Britain to partially adhere to certain parts of the EU system, while allowing Britain to create her own independent trade policy and negotiate trade agreements with third party nations.

As it is not a customs union, there is not a complete harmonization between members, and thus trade between EU members of the EEA and non-EU members is not completely frictionless. Border controls, of some form, will be required to ensure that measures such as rules of origin are properly enforced, and to prevent goods from non-EEA nations being re-exported under the EEA.<sup>211</sup> This would create problems for businesses operating in Britain with large European supply chains as it would increase the time it takes for their imports from the continent to arrive.<sup>212</sup> It would also create problems for those that import from supply chains outside the EU and then export the finished product to the EU. In order to take advantage of the access provided by this arrangement, importers would have to meet the rules of origin set by the EU, and they

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<sup>207</sup> EFTA, 'The Basic Features of the EEA Agreement,' (2018), available at <https://www.efta.int/eea/eea-agreement/eea-basic-features#1>.

<sup>208</sup> European Parliament, 'Fact Sheets on the European Union: The Internal Market,' (2018) available at <http://www.europarl.europa.eu/factsheets/en/sheet/33/the-internal-market-general-principles>, accessed on 19 January 2019.

<sup>209</sup> Eeckhout pg 9.

<sup>210</sup> Ibid

<sup>211</sup> Dhingra, Swati, and Thomas Sampson, 'Life after BREXIT: What are the UK's options outside the European Union?' (2016) (Dhingra and Sampson).

<sup>212</sup> Especially problematic for those operating on a 'just-in-time' basis.

would not be able to do so if the majority of their inputs originated from third-party nations.

Under the current structure of the EEA, members who are not part of the EU need to contribute towards the EU budget in order to secure access to the single market.<sup>213</sup> This may result in a significant financial contribution being required by Britain as she would have to effectively purchase her way back into the market she is leaving. For example, Norway's per capita contribution to the EU budget in 2011 was only 17 per cent lower than Britain's contribution for the same year, indicating that Britain is unlikely to be able to drastically reduce her financial commitments to the EU if she chooses this option.<sup>214</sup>

The EEA option combines significant market access with a degree of independence. This combination could make it politically attractive. Given the deep economic links that have developed between Britain and the EU over the past several decades, continued access to the single market and the free flow of capital provided by the EEA will make this option attractive to the private sector, which is growing increasingly concerned over disruptions to business operations caused by Brexit. However, this option would also require the free movement of people (along with capital, goods and services). This policy has been widely rejected by many of those in favour of Brexit. Britain would also be required to submit to rules and regulations governing the single market issued by Brussels, without having any representation in the bodies creating these rules. Given that two of the major arguments in favour of Brexit during the referendum campaign were to take back control of borders and regain sovereignty from Brussels, the EEA model may prove politically impossible for British government to implement, despite its economic advantages.

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<sup>213</sup> Dhingra and Sampson pg 38.

<sup>214</sup> Ibid

### A Comprehensive Free Trade Area based on the EU's Relationship with Canada

WTO law allows for FTAs to be negotiated between countries in order to allow those country's producers preferential access to their partner nations markets on terms that would otherwise violate the MFN clause of the GATT.<sup>215</sup> Such agreements have proliferated over the past two decades, and offered partner nations a way to liberalise trade between themselves without requiring the larger scale integration projects of a customs or monetary union. The primary requirement of a FTA is that the nations involved liberalise 'substantially all trade' between them, as well as ensuring that trade with non-member nations is 'no more restrictive' than it was before the creation of the FTA.<sup>216</sup> So long as these requirements are met, a FTA can be infinitely customisable depending on the will of the parties, and as such this option provides a very flexible framework for future UK-EU relations.

CETA, signed between the EU and Canada, has been hailed as 'the most ambitious trade agreement the EU had ever concluded.'<sup>217</sup> CETA eliminates 98 per cent of all tariffs on goods; opens up government procurement bidding processes; protects geographical indicators, and offers improved protection for intellectual property rights.<sup>218</sup> It has been talked about as a possible basis for a future UK-EU FTA. While CETA is impressively comprehensive, the market access offered to Canada under the agreement is nowhere near as comprehensive as what Britain currently enjoys as part of the EU, as it still has numerous regulations that importers must comply with to access the EU market. Like most FTAs, CETA offers little in the way of liberalization of services. This would be extremely problematic for Britain as a services-based economy and the second largest exporter of services in the world.<sup>219</sup> Given the importance of the City of London to the European financial sector, it is likely that any FTA between Britain and the EU would have to include liberalization of trade in

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<sup>215</sup> Van Bossche and Zdouc pg 671.

<sup>216</sup> Article XXIV of the GATT 1994.

<sup>217</sup> Jamie Robertson 'What is a 'Canada-style' trade deal?' 25 September 2018, available at <https://www.bbc.co.uk/news/business-45633592> accessed on 21 October 2018.

<sup>218</sup> Ibid.

<sup>219</sup> United Kingdom Trade Profile, WTO, available at <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Country=GB&Language=S>, accessed 21 October 2018.

financial services, at least to some degree, or risk the widespread disruption of the European financial system.

The independence offered by a FTA to Britain would likely make it politically desirable to a government promising to take back sovereignty. An FTA would allow Britain complete control over her borders, as it would not have to include the free movement of people, and it would also not require Britain to be subject to EU regulations emanating from Brussels. As FTAs are flexible in nature, they provide a range of possibilities for the parties to define their future relationship, and both Britain and the EU would be able to protect sensitive sectors in return for offering greater market access in other areas. As long as the final agreement conformed to WTO rules, the parties could design the agreement to avoid any red lines and ensure that acceptable solutions are found to all issues.

Such an agreement would not be without its flaws. Physical barriers would have to be re-imposed at the borders between Britain and the EU to ensure compliance with the rules and regulations stipulated in the final agreement, including rules of origin.<sup>220</sup> Even the most streamlined of such barriers will be a shift from the current status of frictionless trade between the EU and Britain, which would result in a disruption of trade flows. Furthermore, an FTA would allow the EU to levy tariffs on certain goods originating from Britain (and vice versa) because such agreements do not have to eliminate all tariffs in the way that the current EU agreement requires.<sup>221</sup> The imposition of tariffs and physical barriers on the borders could have a negative effect on British exports to the EU. It is possible that investors will prefer to set up production in, or move production to, an EU member state rather than Britain in order to ensure better market access to the significantly larger block. Britain would lose a major competitive advantage, as her frictionless access is what currently makes her an attractive location for investors to manufacture for the EU market.

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<sup>220</sup> Van Bossche and Zdouc pg 685-687.

<sup>221</sup> Ibid

The EU will be aware that this presents a challenge for Britain and will be unwilling to grant access to the single market that is too beneficial. Allowing Britain to cherry pick its obligations would likely bolster the anti-EU sentiments in member states such as Italy, where Eurosceptic political parties are starting to garner more support. If Britain is granted access to the single market on terms that are seen as too generous, while avoiding the other obligations of EU membership, then critics of the EU project would be emboldened to argue for the same treatment for their countries, which could destroy years of work by the EU to form a closer political union as the block regresses to a mere free trade area.

### A 'No Deal' Brexit and a Reversion to WTO Rules

Britain, along with the EU member states, is a member of the WTO and will incur all of the obligations (and receive all of the benefits) of a WTO member once it leaves the EU.<sup>222</sup> Should no trade agreement be concluded between Britain and the EU governing their future relationship, then trade between the two would have to be conducted under WTO rules.<sup>223</sup> This has been referred to as a 'hard landing' or a 'hard Brexit' which would have significant economic effects on both sides.<sup>224</sup> A no deal scenario is considered to be the worst possible outcome to Brexit. Despite this, there are still those that champion the idea of a no deal Brexit claiming, despite mounting evidence to the contrary, that it is in fact the best option available to Britain.<sup>225</sup>

Without any deal, trade between the EU and Britain, conducted solely on WTO terms, would face significantly more barriers than those currently in place. Producers would face full MFN tariffs when exporting, as WTO rules prohibit favourable treatment outside of WTO compliant agreements.<sup>226</sup> Although the tariffs on most industrial goods are relatively low, there are still tariff peaks on certain products and large

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<sup>222</sup> Dhingra and Sampson pg 6

<sup>223</sup> Eeckhout pg 25.

<sup>224</sup> Ibid.

<sup>225</sup> Gordon Rayner, 'Jacob Rees-Mogg: No-deal Brexit will boost UK economy by £1.1 trillion over 15 years,' available at <https://www.telegraph.co.uk/news/2018/09/10/jacob-rees-mogg-no-deal-brex-it-will-boost-uk-economy-11-trillion/>, accessed on 17 January 2019.

<sup>226</sup> Article 1 of the GATT, also known as the Most Favoured Nation clause.

tariffs on agricultural goods.<sup>227</sup> Producers with complex supply chains between the EU and Britain will face delays and increased costs as the imposition of barriers at the border increases trade friction; while those who import will face increased administrative costs as they are forced to navigate new customs procedures. Trade in services, which is only slightly regulated by current WTO rules, will face severe disruptions, as issues such as lack of mutual recognition will compound the loss of market access that was previously provided under single market membership.<sup>228</sup>

The effects of a no deal Brexit would be felt in both the long term and the short term by the British economy. Economic forecasts of a no deal scenario are varied in their magnitude, but many predict either decreased economic growth or an outright recession in the short term.<sup>229</sup>

In the short term, the largest disruptions of a no deal Brexit would result from regulatory issues that would see an instant and significant increase in friction at the border between the EU and Britain. Without deals that govern the areas in question, a no deal scenario may see aircrafts grounded; foodstuffs refused access at the border for not meeting health and safety standards; and a gridlock at ports and crossings as tariffs and regulations suddenly have to be applied.<sup>230</sup> Many crossings and borders remain unprepared to deal with the significant backlog that performing customs checks would create. Large delays on the border are almost inevitable for both sides.<sup>231</sup> This would be extremely disruptive to any producer with a cross border supply chain.<sup>232</sup>

Almost as soon as the referendum result was announced in favour of Brexit, the pound began to devalue. This trend has continued throughout the Brexit negotiating

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<sup>227</sup> WTO, 'European Union Tariff Profile' available at <http://stat.wto.org/TariffProfile/WSDBTariffPFView.aspx?Language=E&Country=E28>.

<sup>228</sup> Eeckhout pg 25.

<sup>229</sup> Cat Contiguglia, 'How no-deal Brexit would hit UK economy,' available at: <https://www.politico.eu/article/how-no-deal-brex-it-would-hit-uk-economy/>, accessed on 16 January 2019.

<sup>230</sup> Barnard et al, 'Cost of No Deal Revisited,' (2018) pg 9 (Barnard et al).

<sup>231</sup> Barnard et al pg 14.

<sup>232</sup> Barnard et al pg 15.

process.<sup>233</sup> A no deal Brexit would likely see another sharp devaluation. The uncertainty of a no deal situation would create a fall in both business and consumer spending, which combined with the relocation of business to the continent and the disruption of supply chains for British businesses, would place downward pressure on economic growth.<sup>234</sup> Businesses and consumers would face higher prices (driven by inflation and a weaker currency), creating disruptions and a slowdown of economic activity. Government policy could be used to counteract this by increasing government spending that would be financed by borrowing in an attempt to stabilize the economy in the short run.

British exporters would be among the hardest hit by a no deal Brexit as they would lose their duty-free access to the single market as well as the access provided by non-EU nations in trade agreements signed with the EU. Over and above the regulatory and trade facilitation issues described above, British producers will have to pay tariffs on goods they export to the EU for the first time in several decades. The general effect of tariffs will probably be lower than the effect of NTBs, as the EU's average tariffs for manufactured goods are relatively low. The applied trade weighted average duty applied on non-agricultural goods was 2.8 per cent, indicating that exports tariffs will not be a significant hurdle in most sectors.<sup>235</sup> However, there are tariff peaks in key sectors that could be problematic for British exporters.<sup>236</sup> An example of how high tariffs may disrupt British agricultural exports can be seen in the tariffs that will face beef and lamb products, two of the largest agricultural exports to the EU, with over 90 per cent of each heading to the EU market.<sup>237</sup> It is calculated that, in the event of a no deal Brexit and a switch to MFN tariffs without a quota, these products will face an effective *ad valorem* tariff rate of between 37 per cent and 72 per cent for sheep<sup>238</sup> and between 48 per cent and 160 per cent for beef.<sup>239</sup> Such significant price increases

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<sup>233</sup> Katie Allen, Jill Treanor and Simon Goodley, 'Pound slumps to 31-year low following Brexit vote,' available at <https://www.theguardian.com/business/2016/jun/23/british-pound-given-boost-by-projected-remain-win-in-eu-referendum>, accessed 18 January 2019.

<sup>234</sup> Barnard et al pg 10.

<sup>235</sup> WTO trade statistics database, European Union, available at <http://data.wto.org/> accessed 18 January 2019.

<sup>236</sup> Agricultural tariffs, which have a trade weighted average duty of 8.7 per cent, are high for certain products that are important to the UK.

<sup>237</sup> Agriculture and Horticulture Development Board, 'What might Brexit mean for UK trade in beef and lamb products?' (2016).

<sup>238</sup> Depending on the cut of meat in question.

<sup>239</sup> Depending on the cut. Op cit note 34.

would likely force exporters of these products out of their largest market, causing untold damage to the sector.

Moreover, the disruption would not be limited only to farmers. Certain industries are also in line to face new tariffs which would distort trade, albeit not to the same extent. The automotive industry, which is responsible for 12 per cent of Britain's exports,<sup>240</sup> has raised the alarm on a no deal Brexit. The industry cautions that implementing the 10 per cent WTO MFN tariff to access an EU market that takes around 45 per cent of its exports of finished cars<sup>241</sup> would be a red line for the industry and severely impact it in terms of prices, output, and jobs.<sup>242</sup>

Once Britain leaves the EU, it will no longer have preferential market access to dozens of countries with EU trade agreements because it will no longer qualify as a party of those agreements. Although replicating these trade agreements will be one of the primary goals of Britain post Brexit, none of the partner countries have officially agreed to do so yet. Billions of pounds worth of trade will be disrupted if Britain loses its preferential access to countries such as Turkey (\$5.45 billion worth of exports in 2016), South Korea (\$5.37 billion worth of exports), and South Africa (\$2.24 billion worth of exports).<sup>243</sup> Furthermore, Britain would lose future negotiated access to the large economies of Japan and Canada, as both are party to deals in the process of being implemented.

The success of City of London as a financial centre over the last few decades has undoubtedly been bolstered by its status as the go-to financial hub for much of the European Union. Financial services are offered seamlessly across the continent because of the EU passport rules. The 'EU passport' is a mechanism that allows

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<sup>240</sup> OEC, 'UK Trade Profile,' (2016) available at <https://atlas.media.mit.edu/en/profile/country/gbr/>, accessed 18 January 2019 (UK Trade Profile).

<sup>241</sup> OEC, 'Where does the United Kingdom export Cars to?,' (2016) available at [https://atlas.media.mit.edu/en/visualize/tree\\_map/hs92/export/gbr/show/8703/2016/](https://atlas.media.mit.edu/en/visualize/tree_map/hs92/export/gbr/show/8703/2016/), accessed on 18 January 2019.

<sup>242</sup> Graham Ruddick, 'Car firms tell May post-Brexit tariffs are 'red line' issue that threatens jobs,' (2017) available at <https://www.theguardian.com/business/2017/jan/26/uk-car-industry-tariffs-red-line-issue-jobs-brexit-smmt>, accessed on 18 January 2019.

<sup>243</sup> UK Trade Profile.

financial service providers based and certified to do business in one EU (or EEA) member state to ply their trade across the single market without requiring separate certifications from each country.<sup>244</sup> If British based firms were to lose their passport rights upon a no deal Brexit, they would be faced with the choice of either relocating part of their operations to another single market member state and applying for new passport rights, or to forgo selling their products across the single market.

There is major concern that trillions of pounds worth of contracts between British and EU banks will become legally uncertain as there is a possibility of them becoming void in the event of a no deal Brexit.<sup>245</sup> Most at risk would be the market for derivatives contracts, which protect banks and businesses from interest rate rises and is overwhelmingly centred in the City of London.<sup>246</sup> The Bank of England estimates that around £29 trillion worth of derivatives contracts would be affected by a no deal Brexit, including 90 per cent of euro-denominated interest rate swaps.<sup>247</sup> Without some form of agreement in place to allow for the smooth continuation of these contracts post Brexit, the European and British financial system may be at risk of complete turmoil, an outcome that would be disastrous to an EU that is still recovering from the last financial crisis and a Britain suffering the various negative consequences of a no deal Brexit.

While the above paragraphs have focussed on the short-term effects of a no deal Brexit, the long-term effects are potentially far more severe and lasting in their economic impact. In its 2016 economic analysis, using the gravity modelling approach, the British Treasury forecast the long-run economic impact of leaving the EU on WTO terms to be an estimated 7.5 per cent loss of GDP over 15 years.<sup>248</sup> This

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<sup>244</sup> Andrew Walker, 'What is an EU 'bank passport'?', (2016) available at <https://www.bbc.com/news/business-36630606>, accessed on 18 January 2019.

<sup>245</sup> Phillip Inman, 'Brexit: bank contracts worth trillions at risk, says finance watchdog,' available at <https://www.theguardian.com/politics/2018/jun/27/brexit-bank-contracts-worth-trillions-at-risk-says-finance-watchdog>, accessed on 18 January 2019.

<sup>246</sup> Simon Tilford, 'A No-Deal Brexit Will Destroy the British Economy,' available at <https://foreignpolicy.com/2018/10/02/a-no-deal-brexit-will-destroy-the-british-economy/>, accessed on 18 January 2019.

<sup>247</sup> Ibid.

<sup>248</sup> HM Government, 'HM Treasury analysis: the long-term economic impact of EU membership and the alternatives,' (2016) pg 7 (HM Treasury Report).

does not necessarily mean that they predict Britain's current GDP to shrink by 7.5 per cent over the next 15-years, but rather that they forecast the economy to be 7.5 per cent smaller than what it would have been if Britain had remained in the EU over the same period.<sup>249</sup>

Of the three scenarios modelled against the baseline of remaining in the EU, the WTO option was the most negative. By contrast, leaving the EU with a negotiated bilateral agreement would see a 6.2 per cent reduction of GDP from the baseline value; while leaving the EU but remaining in the EEA would see considerably less economic damage, with only a 3.8 per cent reduction from the baseline.<sup>250</sup> The impact of a no deal Brexit is estimated to mean an annual loss of GDP of £5,200 per household, providing an indication of how the economic impact of Brexit will negatively affect the average household.<sup>251</sup> Areas such as North-East England, Scotland, and Wales are predicted to experience far greater economic losses than London and South-West England.<sup>252</sup>

Beyond the macroeconomic damage of a smaller long-term GDP, other long-term forecasts of a no deal Brexit are also a cause for concern for the British government. The Treasury report predicted that, even after taking into account the reduced contribution paid to the EU every year, the government would suffer a £45 billion per year gap in its budget as a result of lower tax receipts when compared to the baseline of continued EU membership.<sup>253</sup> This would likely have to be funded by higher taxes, lower public spending, or increased government borrowing. Given the pro-Brexit campaign's calls to fund the NHS with the money that Britain sends to the EU every year, it is somewhat contradictory to find that the net effect on the government's budget is predicted to equal a loss of around 44 per cent of the NHS's entire budget every year after 15 years.<sup>254</sup>

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<sup>249</sup> HM

<sup>250</sup> Ibid.

<sup>251</sup> Ibid.

<sup>252</sup> BBC, 'Brexit: Official forecasts suggest economies throughout UK will be hit,' available at <https://www.bbc.com/news/uk-politics-42977967>, accessed on 17 January 2019.

<sup>253</sup> HM Treasury Report pg 8.

<sup>254</sup> Ibid pg 144.

The damage to the economy predicted by the Treasury report comes from several sources namely, a decrease in trade flows, FDI, and productivity. The report estimates that, given Britain significant trade with the EU and the barriers that would come into force after a no deal Brexit, trade with the EU would be between 17 per cent and 24 per cent less than the baseline.<sup>255</sup> This is extremely concerning considering the increasingly important role that trade plays in the overall British economy.<sup>256</sup> FDI has undoubtedly been boosted by Britain's EU membership and it has become the top destination for inward FDI in Europe. However, a no deal Brexit would see this flow slow to a trickle as FDI is predicted to decrease by 22 per cent on the baseline level.<sup>257</sup> Finally, productivity would decrease by between 3.7 per cent and 7.7 per cent on the baseline level, indicating a loss of competitiveness that Britain can ill afford.<sup>258</sup>

The fall-back of a no deal Brexit, as described above, is that Britain would be able to rely on WTO rules and use those to achieve a level of access to the markets of both the EU and other WTO member states. Several politicians in favour of Brexit have talked up this option as the best one for Britain, arguing that the WTO provides enough certainty to be the basis of a successful trade policy going forward.<sup>259</sup> One of the flaws with this argument is that it ignores the current state of the WTO and the pressures it is currently facing which decreases the amount of certainty it can provide as a contingency option for Britain.

The President of the US, Donald Trump, an advocate of protectionist policies and fierce critic of the WTO, has threatened on multiple occasions to withdraw the world's largest economy from the global trading body. In an interview with Bloomberg, he stated that the WTO puts the US at a disadvantage and that if the 'unfair treatment' of his country did not stop, he would withdraw from the

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<sup>255</sup> Ibid pg 128.

<sup>256</sup> Ibid pg 19. Trade as a share of GDP has risen from under 40 per cent in 1990 to above 60 per cent in 2016.

<sup>257</sup> Ibid pg 131.

<sup>258</sup> Ibid

<sup>259</sup> Priti Patel, 'Britain should have no fear in pursuing a WTO Brexit,' (2018), available at <https://www.ft.com/content/82902f9e-f4a4-11e8-938a-543765795f99>.

organisation.<sup>260</sup> Without the US, there is also the concern that others may follow suit and withdraw thus, leading to the collapse of the WTO and the rules-based system it governs. Even if the US does remain in the WTO, their frustration with the AB, and its blocking the appointment of new members to hear the cases brought by states to the WTO's highest decision-making body, limits the current effectiveness of, arguably, the organisation's most important element.<sup>261</sup> The AB requires three of its members to constitute a panel to hear an appeal case brought by a WTO member disputing the original panel's decision. As it stands, the AB only has three such members left.<sup>262</sup> AB members may not hear a case involving their own nation,<sup>263</sup> and with two member's terms expiring at the end of 2019, the AB will not be able to hear any cases at all unless the current impasse is solved.<sup>264</sup> This would, essentially, render the WTO's rules non-binding in practice as nations that lose panel decisions would appeal to the frozen AB, which would not be able to rule on the case and the decision in question would not be able to be adopted.

In such a situation, Britain would thus not be able to rely on the WTO settlement system. Furthermore, as it is no longer a member it would not be able to use the internal EU mechanisms it previously had access to. Britain, as the weaker power when compared to the economic might of the EU, would be in a vulnerable position if the WTO system that keeps the EU in check fails. Britain would be exposed to unilateral actions from the EU if trade relations turned sour in the event of an acrimonious no deal Brexit.

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<sup>260</sup> John Micklethwait, Margaret Talev, and Jennifer Jacobs, 'Trump Threatens to Pull U.S. Out of WTO If It Doesn't 'Shape Up'', (2018), available at <https://www.bloomberg.com/news/articles/2018-08-30/trump-says-he-will-pull-u-s-out-of-wto-if-they-don-t-shape-up>, accessed on 19 January 2019.

<sup>261</sup> Tom Miles, 'U.S. blocks WTO judge reappointment as dispute settlement crisis looms,' (2018), available at <https://www.reuters.com/article/us-usa-trade-wto/u-s-blocks-wto-judge-reappointment-as-dispute-settlement-crisis-looms-idUSKCN1LC19Q>, accessed on 18 January 2019

<sup>262</sup> WTO, 'Appellate Body Members,' (2019) available at [https://www.wto.org/english/tratop\\_e/dispu\\_e/ab\\_members\\_descrp\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/ab_members_descrp_e.htm), accessed on 19 January 2019.

<sup>263</sup> Cases involving the US, India, and China may not be heard by the AB any longer as the three remaining judges are from those nations

<sup>264</sup> Tom Miles, 'U.S. blocks WTO judge reappointment as dispute settlement crisis looms,' (2018), available at <https://www.reuters.com/article/us-usa-trade-wto/u-s-blocks-wto-judge-reappointment-as-dispute-settlement-crisis-looms-idUSKCN1LC19Q>, accessed on 18 January 2019

## Conclusion

When the referendum result of 2016 gave a clear, albeit slim, mandate for Britain to leave the EU, it did not provide any framework for how this should be done or what the future of UK-EU relations should look like. Over two and a half years later, there is still no definitive answer to this question. The potential frameworks for a future relationship as set out above tend to follow one singular pattern. The more market access they offer, the less independence they provide, meaning that there is a clear trade-off between obtaining economic benefits (or at least limiting economic damage) and reclaiming sovereignty which would allow Britain to implement its own policies and regulations. It is likely that the final arrangement will fall somewhere between the extremes discussed above, taking the form of either a trade agreement or membership of the EEA, each of which would have its own benefits and drawbacks. One possibility that cannot be ruled out, at least in the short term, is an agreement to delay Brexit. Given the fact that the date on which Britain is scheduled to leave the EU is rapidly approaching, with no deal yet agreed, it is possible that both sides would prefer to delay in order to give them more time to find a solution. While this does not fundamentally change anything in the long-term, it could create uncertainty for years to come.

## CHAPTER 6: POST-BREXIT RELATIONSHIPS BETWEEN BRITAIN AND NON-EU NATIONS

### Introduction

While Britain's future relationship with the EU may be the most important, and therefore the highest negotiating priority, it cannot be overlooked that there are over 150 other sovereign nations in the world which Britain will be dealing with independently for the first time in decades after Brexit. Trade relationships are largely dealt with at EU-level, with the EU Commission responsible for negotiating trade deals, implementing short-term protections such as antidumping, and maintaining current agreements.<sup>265</sup> After Brexit, the responsibility for all of this will once again revert to the British government, which will have to be prepared to undertake this new administrative burden. This chapter will give an overview of the administrative and political challenges that Britain will have to face as it creates an independent trade policy and takes control of its trading relationship with the rest of the world outside of the EU.

### Britain and Currently Existing EU Trade Deals Post-Brexit

The EU has been remarkably proactive in negotiating trade agreements with the rest of the world. Thus, member states are now able to enjoy the benefits of 40 separate agreements, which include around 70 different countries.<sup>266</sup> Further, EU member states can also enjoy the benefits of being party to nearly 759 EU treaties, with 168 different countries, in various areas including aviation and customs.<sup>267</sup>

The British government has made delivering certainty for British businesses and consumers one of the key aims in its white paper on future trade policy, and, at the

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<sup>265</sup> European Commission, 'Policy Making,' (2018) available at <http://ec.europa.eu/trade/policy/policy-making/>, accessed on 21 January 2019

<sup>266</sup> House of Commons International Trade Committee, 'Continuing application of EU trade agreements after Brexit: First Report of Session 2017–19,' (2018). (House of Commons Report).

<sup>267</sup> Ibid.

same time, committed itself to upholding its development obligations by ensuring that developing countries continue to enjoy current tariff preferences.<sup>268</sup> In order to do this, the government indicated that it will seek to ensure that all current trade and investment agreements, including both EU-third country FTAs and EU preferential arrangements, are continued in some form.<sup>269</sup> To this end, existing EU agreements would have to be replicated, which would require some negotiation with the third countries involved. Given the complexities of these negotiations, the current Brexit deadline of March 2019 seems an unrealistic target for the replication of all the EU-third party agreements.

There has been an indication by Britain that it wishes to use current agreements as a starting point and simply interpret the relevant terms, such as ‘European Union’ or ‘EU member state’ to include Britain as an independent state. This would allow a relatively smooth transition and require little in the way of new negotiation; saving time and creating certainty for all parties involved. However, it is not clear how many third-party states would agree to this.<sup>270</sup> Furthermore, changing the meaning of terms in treaties that the EU itself is a party to would require the consent of the EU.

A significant hurdle for Britain is that the EU enters into these agreements with the specific aim of improving the terms of competition for EU exporters in foreign markets, and to encourage further foreign investment. It is, therefore, extremely unlikely that the EU would be willing to allow Britain to benefit under agreements that they negotiated (which would divert benefits that could otherwise accrue to its member states) without requiring some concessions from Britain or attaching conditions. As a result, it is probable that both the EU and the third-party nations will demand concessions and reciprocation. Thus, Britain will not be able to simply change the definition of ‘EU member state’ to include themselves.

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<sup>268</sup> UK Department for International Trade, ‘Trade White Paper: Preparing for our future UK trade policy,’ (2017) pg 28 (The White Paper).

<sup>269</sup> Ibid.

<sup>270</sup> Op cit note 1.

Should Britain remain in the EU customs union after Brexit, then it will be bound to continue applying the EU's common external tariff as per its WTO commitments as well as preferences granted to third party nations.<sup>271</sup> This would simplify the negotiation process with the EU, as there would be no major change to the current relationship (at least as far as goods are concerned), and ensure that Britain remained committed to its development goals. However, as stated above, such an arrangement would render Britain unable to pursue her own independent trade policy and strike her own deals with third party nations, as the power to do so would remain vested with the European Commission.<sup>272</sup> Given that remaining in the customs union indefinitely will prevent the creation of an independent trade policy, the rest of this chapter will assume that Britain chooses one of the other options discussed above that will allow Britain to negotiate independently once she leaves the union.

### The Possibilities of a New Post-Brexit British Trade Regime

The notion that a post-Brexit Britain would be able to pursue her own independent trade policy was one advocated by those in favour of leaving the union. Their argument rested on the idea that an independent Britain would be able to pursue an independent trade policy for the first time in decades, without being constrained by EU interests and bureaucracy. To those in favour, the contrast between 'free trade Britain' and 'protectionist EU' was stark. After the referendum, the British government appeared to advocate this when it stated its aim was to 'seek opportunities to pursue an ever more ambitious free trade agenda.'<sup>273</sup> This stance was however moderated in the same white paper, whereby it was confirmed that other less comprehensive, agreements would also be considered as a possibility in certain, appropriate situations. The British government argued that FTAs are only one way of achieving the above aim and it will be drawing on best practices from the EU and elsewhere.<sup>274</sup>

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<sup>271</sup> Emily Lydgate, Jim Rollo and Rorden Wilkinson, 'The UK Trade Landscape After Brexit,' UK Trade Policy Observatory (2016) pg 3 (Lydgate et al).

<sup>272</sup> Ibid.

<sup>273</sup> The White Paper pg 28.

<sup>274</sup> Ibid pg 29.

The attitude mentioned above is evident in quotes from influential government ministers. In 2018, Liam Fox, the Secretary for International Trade, stated that Brexit would allow Britain to once again become an independent global trading nation, free from the restrictions of Brussels, and highlighted that an independent trade policy would allow Britain to target increased exports in sectors where she has a competitive advantage such as financial services.<sup>275</sup> David Davis, the first Secretary of State for Exiting the EU, published an article a week before he was appointed arguing that leaving the EU would allow Britain to take control of her trade policy again, allowing Britain the opportunity to ‘maximise returns from free trade.’<sup>276</sup> Davis also argued that single countries had greater flexibility, and thus could negotiate new deals faster than large blocks. He hinted that many nations such as the US, Australia, China, and India would welcome the opportunity to negotiate a trade agreement with Britain once it left the EU.<sup>277</sup>

It seems that reality is proving very different to the vision of easy agreements advocated by pro-Brexit supporters. There has been little progress made on the conclusion of trade agreements in the two years since the referendum. Most nations are awaiting the conclusion of UK-EU negotiations before beginning their own. As it stands, one of the most attractive aspects of Britain’s economy to foreign investors, is the access that she has to the EU single market. However, it is uncertain whether this will be the case going forward. Until this question is settled, and Britain is able to formalise its relationship with the common market, it will be difficult for negotiators (both British and third-party nations) to determine what their demands should be for investment chapters in any treaties, or what benefits market access will grant in relation to the EU single market.<sup>278</sup>

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<sup>275</sup> Liam Fox, ‘Brexit is a golden opportunity for us to regain our power over international trade,’ 28 March 2018, available at <https://www.independent.co.uk/voices/brexit-uk-international-trade-power-regain-liam-fox-eu-deals-a8277576.html>, accessed on 21 October 2018.

<sup>276</sup> David Davis, ‘David Davis: Trade deals. Tax cuts. And taking time before triggering Article 50. A Brexit economic strategy for Britain,’ available at <https://www.conservativehome.com/platform/2016/07/david-davis-trade-deals-tax-cuts-and-taking-time-before-triggering-article-50-a-brexit-economic-strategy-for-Britain.html> accessed on 21 October 2018.

<sup>277</sup> Ibid.

<sup>278</sup> Shayerah Ilias Akhtar, ‘U.S.-UK Free Trade Agreement: Prospects and Issues for Congress,’ Congressional Research Service Report (2017).

The extent to which Britain will adopt EU regulations, such as those on agricultural goods, will also be a major issue to any third-party nations wishing to negotiate with Britain as it may frustrate the market access that they receive. Standards on agricultural goods have been an issue that has frustrated negotiations between the EU and the US for many years. Any future deal between Britain and the US will be considerably impacted by whether or not Britain continues to accept and apply EU regulations in this sector.<sup>279</sup> There is also Britain's concern that granting concessions to third-party nations on regulations, standards, or tariffs may hinder negotiations with the EU and make a beneficial deal harder to obtain.<sup>280</sup> As a result, it is likely Britain will need to make further progress in its negotiations with the EU before it can have sufficient certainty to start negotiating with third party nations.

#### Creating a WTO Schedule for Britain from Present EU Commitments

Once Britain leaves the EU, it will have to renegotiate certain core aspects of her WTO rights and obligations. Most importantly, her schedule of concessions set out under Article II of the GATT<sup>281</sup> and Article XX of the GATS.<sup>282</sup> Britain's schedule of concessions is extremely important. It sets out the terms of trade with all WTO member states with which she does not have a separate WTO compliant agreement (such as a FTA). While some have suggested that Britain would have to enter negotiations as a new member, the generally accepted view is that Britain would only be continuing her membership and would simply have to separate her share of EU agricultural subsidies; tariff rate quotas currently allocated to or by the EU, and other similar issues, rather than negotiate a full accession agreement.<sup>283</sup> Britain's membership in the WTO, and the associated rights and obligations that come with that membership, are not contingent on her status as a EU member. Rather, Britain possess all of the rights and obligations of an original WTO member, which have been

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<sup>279</sup> The Economist, 'The elusive art of the deal: The promised post-Brexit trade deal with America may never materialise' available at <https://www.economist.com/Britain/2018/04/05/the-promised-post-brexit-trade-deal-with-america-may-never-materialise> accessed 21 October 2018.

<sup>280</sup> Ibid.

<sup>281</sup> GATT, 61 Stat. pt. 5, T.I.A.S. 1700 55 U.N.T.S. 194 (1947), (the GATT).

<sup>282</sup> GATS, 1869 U.N.T.S. 183, 33 I.L.M. 1167, (1994), (GATS)).

<sup>283</sup> Lorand Bartels, 'The UK's status in the WTO after Brexit,' (2016) available at: <https://ssrn.com/abstract=2841747>, accessed on 12 January 2019.

exercised by the EU on behalf of Britain since the creation of the WTO, and it will exercise these rights independently once it leaves the EU.<sup>284</sup>

Britain and the EU began negotiations to untangle their WTO-relations shortly after the referendum with both sides aiming to conclude a deal in order to present it the WTO before Britain officially left the EU. For the majority of tariff lines, little negotiation was needed because Britain duplicated the EU's current tariff schedule without changing the maximum tariff on any product line.<sup>285</sup> Tariff rate-quotas and agricultural subsidies were slightly more complex issues, which would need to be divided between Britain and the EU. Britain and the EU have an incentive to work together to ensure that this process is completed quickly and without many objections. Britain wants to be able to certify her schedule and start negotiating new trade agreements as soon as she leaves the EU, which will be made easier by a smooth rectification of the existing schedule. The EU, on the other hand, is vulnerable to demands from other WTO members to renegotiate their existing schedules of concessions as the exit of one of the unions largest economies suddenly makes those concessions less valuable.<sup>286</sup>

In July 2018, Britain submitted her proposed new schedule, which were a result of her talks with the EU, to all WTO members. This gave them three months to object before it is considered approved under the WTO's rules for rectification of schedules.<sup>287</sup> After several WTO members objected, Britain opted to pursue a modification of her WTO commitments as provided for under Article XXVIII of the GATT. Britain entered into talks with the objecting nations to allay their concerns and allow for the schedule to be certified.<sup>288</sup> The countries in question were largely concerned with the

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<sup>284</sup> Ibid pg 7.

<sup>285</sup> Dmitry Grozoubinski, 'Objections to the UK's WTO Schedule: What do they mean?,' (2018) available at <https://www.explaintrade.com/blogs/2018/8/11/why-there-are-objections-to-the-uks-wto-schedule-and-why-you-shouldnt-care>, accessed on 14 January 2019.

<sup>286</sup> Lydgate pg 6.

<sup>287</sup> WTO, 'United Kingdom submits draft schedule to the WTO outlining post-Brexit goods commitments,' (2018), available at [https://www.wto.org/english/news\\_e/news18\\_e/mark\\_24jul18\\_e.htm](https://www.wto.org/english/news_e/news18_e/mark_24jul18_e.htm), accessed on 14 January 2019.

<sup>288</sup> Bryce Baschuk, 'U.K. Suffers Brexit Trade Setback Over Copy-and-Paste WTO Terms,' available at <https://www.bloomberg.com/news/articles/2018-10-25/u-k-suffers-brexit-trade-setback-over-copy-and-paste-wto-terms>, accessed on 14 January 2019.

proposed division of agricultural quotas between the EU and Britain that would amount to an impairment of a current concession under WTO law. Exporters would lose their current flexibility to switch their exports between Britain and the EU depending on which has the highest price for the goods in question. However, this is not fatal to Britain's WTO membership, nor will it have a meaningful impact on the ability of Britain to trade under WTO law. Using the proposed schedule, Britain will be able to trade on an uncertified schedule while she negotiates under Article XXVIII of the GATT for final certification.

### The Problem of Lack of Negotiating Capacity

Trade negotiations are often long, drawn out, and complex processes that sees both sides attempting to extract favourable results without offering too many concessions of their own. In essence, trade negotiators have to negotiate with foreign governments, who they must extract concessions from, as well as with vested domestic interests, which may be harmed by increased imports. Often, those domestic interests become 'losers' in a particular trade deal and will have to be compensated in some manner to ensure that there is minimal disruption to the economy. As international trade has become more interconnected and complex, the deals that govern it have had to adapt and increase their complexity in response. Trade deals negotiated today include far more technical detail than those negotiated in previous decades, from rules on services and government procurement to sanitary and phytosanitary measures, which regulate food, animal, and plant health measures in trade.

Furthermore, the sheer scope of the challenge facing Britain as she prepares to launch her independent trade policy after Brexit is intimidating. The Directorate General for Trade of the European Commission has suggested that there are 148 potential sets of negotiations facing Britain based on the classification of current EU bilateral and regional trade relationships.<sup>289</sup> Over half (92) of these are unilateral agreements granted to least developed and developing countries under the WTO's GSP which will

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<sup>289</sup> European Commission, 'Overview of FTA and Other Trade Negotiations,' (2016) [http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc\\_118238.pdf](http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf) accessed 20 October 2018.

not require much negotiation to replicate. The remainder will still represent a significant undertaking for any single nation. This does not include the negotiations that will have to be undertaken with the EU in order to determine the long-term trading relationship between the two; or agreements with third-party nations that are currently under negotiations by the EU Commission, with whom Britain may wish to continue negotiating on her own once she has left the union.

In order to minimise disruption after Brexit and successfully implement her new independent trade policy, Britain will need a significant number of negotiators and other trade officials. However, Britain does not possess either of these in sufficient numbers as, for the past few decades, all of her trade negotiations have been conducted by the Directorate-General for Trade in Brussels. As a result, there are few people in the British civil service with any experience in negotiating specific trade agreements with non-EU nations.<sup>290</sup> This is not to say there is no negotiating capacity at all. Various departments such as the Department for International Development, Department for Environment, Food & Rural Affairs, and the Treasury, will have staff with negotiating experience in their specific fields. Furthermore, the Department for International Trade will have experience negotiating on EU trade agreements.<sup>291</sup> However, Britain lacks sufficient personnel with knowledge and experience in the language and practice of international trade law; the negotiation of trade deals, and their potential impact.

The dearth of skills becomes clearer when the size of the negotiating apparatus that Britain will need is estimated. In a 2016 report, the British Trade Policy Observatory estimated that Britain would need around 700 negotiation-capable staff for front-line negotiations, as well as hundreds more working on policy analysis to support them.<sup>292</sup> This estimate was based on the number of staff working at the EU Directorate-General for Trade, which currently does the job that needs to be taken over by the UK government, and was then doubled because of the large number of new agreements that will need to be negotiated, and the existing relationships that will need to be

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<sup>290</sup> Lydgate et al pg 8.

<sup>291</sup> Lydgate et al pg 8Ibid.

<sup>292</sup> Ibid.

renegotiated or managed once Britain takes full responsibility for her own trade policy. As the report states, ‘the need to engage with a large, high-stakes and high-tempo agenda implies that a competent body of 700 may not be excessive.’<sup>293</sup>

In order to meet the demand for new negotiators, Britain will have to invest time and resources into the training and development of new negotiators and will also have to look at other options to find suitable candidates with experience. This could include approaching former British trade policy officials; absorbing British nationals currently working on trade policy in Brussels into the civil service and approaching non-EU foreign nationals from countries such as Australia, New Zealand and Canada with experience in negotiating these types of agreements.<sup>294</sup> Although this last option brings potential conflicts of interest, it is likely the only way that Britain will be able to build negotiating capacity that includes much needed experience. This approach was used in 2017 when Britain hired Crawford Falconer, former representative to the WTO of New Zealand, as chief trade negotiating advisor to manage Britain’s free trade deals with non-EU nations once the Britain leaves the EU.<sup>295</sup> It is probable that once Britain has left the EU and starts negotiations with non-EU nations in earnest, more foreign experts will be sought to improve the negotiating capacity of Britain during what will be a particularly frenetic time for trade negotiations.

### Peace Clauses

One of the temporary solutions which could be used by Britain to limit the disruption of Brexit on her trading relationships is a ‘peace clause.’ This clause would extend the current terms of trade between Britain and a trading partner for a period of time after Brexit and could stay in effect for a reasonable period of time until a permanent agreement is reached on a future trading arrangement.<sup>296</sup> Using peace clauses could minimize the impact of Brexit on Britain’s current trade relationships, providing some much-needed certainty for businesses and investors, while the strategic

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<sup>293</sup> Lydgate et al pg 5.

<sup>294</sup> Ibid

<sup>295</sup> Tim Wallace, ‘UK hires top New Zealand trade negotiator to head post-Brexit deals,’ (2017) available at <https://www.telegraph.co.uk/business/2017/06/16/uk-hires-top-new-zealand-trade-negotiator-head-post-brexit-deals/>, accessed on 21 December 2018.

<sup>296</sup> Lydgate et al pg 5.

negotiation of agreements could conserve Britain's limited negotiating capacity while still allowing her to design a new independent trade policy that best suits her economic interests.

### Negotiating Preferences for Least Developed Countries and Developing Countries

The post-Brexit trading relationship between Britain and the poorest developing countries has largely been absent from the current Brexit debate. As it stands, much of Britain's trade with these nations is governed under the EU's GSP and various EPAs.<sup>297</sup> If Brexit were to interrupt the access of these nations to Britain's market, some of the poorest nations will be forced to pay costly additional duties. If Britain were to replicate the EU's current MFN tariff schedule without changes, then losing GSP and EPA access to Britain's market will cost LDC's around £323 million annually in tariffs.<sup>298</sup>

Given the potential impact that the removal of tariff preferences from LDC's and poorer developing countries could have on those economies, it should be a key goal of Britain to provide reassurances and ensure that these preferences are maintained at least at current levels. As GSP's are granted unilaterally under WTO rules, it would be relatively simple for Britain to start with the current EU GSP as a base and then refine it if need be. As described above, peace clauses could be used to roll over current EU EPAs while giving both Britain and the partner nation time to renegotiate.

If Britain is serious about her development objectives, then giving these nations assurances as soon as possible should be made a priority to ensure that the negative effect on their economies from the uncertainty surrounding Brexit is kept to a minimum. It should not require that much time or negotiation to replicate the GSP. Once certainty is provided for in the short-term, Britain can develop and implement her own development agenda, which could be a key part of her re-emergence as an

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<sup>297</sup> Bilateral treaties negotiated between the EU and least developed or developing nations which offer more concessions to the partner nations than what is expected in return.

<sup>298</sup> Max Mendez-Parra, Dirk Willem te Velde and Jane Kennan, 'Post-Brexit trade policy and Development: Current developments; new directions?' (2017). *International Economic Development Group*, pg 2.

independent power on the world stage. Should Britain wish to develop an effective development policy then she could implement several changes to increase the effectiveness of her new GSP and EPAs. These could include simplifying the rules of origin she applies in these agreements, as this is currently a major issue preventing exports from LDCs, as well as simplifying the tariff schedules these nations face (including removing nuisance tariffs) and ensure mutual recognition in her negotiations with the EU so that poor countries do not have their value chains disrupted by having to comply with different regulations for goods exported to the EU and Britain.<sup>299</sup>

### Services

As the second largest exporter of services in the world,<sup>300</sup> any effective British trade policy will have to place the facilitation of exports from the services sector at the forefront of its strategic goals. While discussion over goods often dominates debates about trade policy, focusing on this at the expense of services will divert attention away from the most dynamic growth area of British trade, an area where Britain clearly has a comparative advantage and specialises in.<sup>301</sup> It is vitally important for the stability of the British economy that the needs of the services sector be prioritised when negotiating new trade deals. Already the uncertainty around Brexit has caused many British based service providers to relocate to the EU, and a failure to negotiate agreements that ensure that service providers have market access could exacerbate the flight of service providers.<sup>302</sup>

It is difficult to determine the impact that Brexit will have on Britain's services industry because of the difficulty in measuring the services trade through the multiple modes of supply (which includes certain flows of capital and goods).<sup>303</sup> The barriers in this sector are nearly all regulatory and thus difficult to track and assess the impact

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<sup>299</sup> Ibid pg 1.

<sup>300</sup> Op cit note 285.

<sup>301</sup> Lydgate et al pg 4-5.

<sup>302</sup> Huw Jones, 'Britain expects 5,000 financial services jobs to leave by Brexit Day,' available at <https://www.reuters.com/article/us-Britain-eu-banks/Britain-expects-5000-financial-services-jobs-to-leave-by-brex-it-day-idUSKCN1MK11S>, accessed on 27 December 2018.

<sup>303</sup> Ingo Borchert, 'Services Trade in the UK: What is at Stake?' UK Trade Policy Observatory (2016) pg 2 (Borchert).

thereof. There is seldom one singular policy maker for a services sector, with regulatory power most often spread across multiple ministries or departments.<sup>304</sup> An example of just how difficult it can be to characterise services trade is shown by the recent development of the idea of 'mode 5' services trade, an addition to the GATS accepted four modes of services trade. 'Mode 5' refers to what is sometimes called 'servicification,' which refers to situations where firms use external service providers (as opposed to doing the work in house) to support their primary economic activity (usually manufacturing).<sup>305</sup> These types of activities would include producers, such as car manufacturers, outsourcing their accounting, design, marketing, or strategic planning operations to domestic service providers rather than doing them internally. Once the final good is exported, a substantial share of the value added will have come from these domestic service providers. As such there is an argument that it should be recorded as trade in services, rather than trade in merchandise.<sup>306</sup>

Research on the EU-27's goods exported in 2009 estimated that nearly 35 per cent of their gross merchandise exports (valued at over €300 billion) represented services inputs.<sup>307</sup> Given that the British economy is one of the most services-based in the EU, with a growing share of manufacturing value added coming from high-skilled labour, it is likely that 'Mode 5' services trade is extremely prevalent in Britain's exports, meaning that services exports in reality make up a greater share than what is currently reported.<sup>308</sup> Indeed, a WTO report showed that domestic services made up 21.3 per cent of the value added for British manufacturing exports which, combined with the fact that services already make up around 44 per cent of Britain's total exports,<sup>309</sup> underpins the importance of the services sector to Britain's overall export performance.

Despite the increase in the competencies of the EU Commission over the past decade via the Treaty of Lisbon and other agreements, the EU still only provides a framework

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<sup>304</sup> Borchert pg 4

<sup>305</sup> Borchert pg 4.

<sup>306</sup> Lucian Cernat and Zornitsa Kutlina-Dimitrova, 'Thinking in a Box: A 'Mode 5' Approach to Service Trade,' (2014).

<sup>307</sup> Borchert pg 4.

<sup>308</sup> Ibid.

<sup>309</sup> Ibid.

of rules for each of the four modes of service supplies under GATS.<sup>310</sup> Thus, each member state decides its own market access and national treatment rules (including both applied policies and GATS commitments).<sup>311</sup> Under WTO law, Britain would be allowed a minimum level of services market access under the EU's GATS schedule of commitments, which is a guaranteed binding agreement in the absence of any other arrangement. However, the problem with this is that most GATS commitments are not very comprehensive with regard to market access and national treatment, therefore trading under these conditions would not be ideal for Britain. Countries are free to apply more liberalized rules than what is set out in their schedules, and many do so, yet there is nothing stopping them from reverting back to the minimum access set out in their schedules and therefore there is uncertainty for exporters to contend with.

Furthermore, should Britain exit without a deal that specifically deals with services access, she would be reverting to a less opportune position than what she currently enjoys as an EU member. Given the variation in regulations between individual service sectors, and the variation in applied regulations between member countries, it is difficult to gauge the precise magnitude of the effect that this change will have. If Britain wants better access than that granted under the EU's current MFN regulations then she will have to conclude a comprehensive agreement under Article II:1 of the GATS, or any preferential access granted outside of such an agreement would then immediately have to be extended to all other WTO members under GATS Article V.

## Conclusion

The threat of losing preferential access to EU trade partners all over the world after Brexit will undoubtedly be on the mind of many British based exporters, creating huge uncertainty in the economy. As a result, it is likely that continuing these relationships will be the priority of the British government, taking precedence over the creation of a new trade strategy and commitments to development. However, in order to negotiate and maintain these new trading relationships (and eventually execute an overall trade strategy) Britain will have to build up her negotiating

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<sup>310</sup> Ibid pg 5.

<sup>311</sup> Ibid.

capacity. Peace clauses may be a viable short-term solution, but eventually they will have to be replaced with final agreements, which will likely require negotiations. Likewise, the negotiations regarding Britain's finalised WTO schedule should be prioritised to ensure certainty, meaning that negotiations with the nations that objected should be high on the list of priorities. Once these two issues are resolved, Britain can set about creating an independent trade policy that is strategically crafted to suit her relatively unique competitive advantage. In this regard, the services sector should form the central focus of any trade strategy moving forward. If Britain is able to secure an agreement with the EU that allows her to create her own regulations and negotiate access to other markets without requiring EU approval, then extending services access beyond what is currently provided for in the GATS should be one of the most important negotiating points for Britain in any bilateral or multilateral negotiations she undertakes as an independent actor once more.

## CONCLUSION

Early British trade policy was used as a tool for the defence of the realm; a method to augment Britain's naval power; fund foreign wars or frustrate the ambitions of her continental rivals. However, the system soon developed into a protective policy that operated in favour of vested interests, similar to many trade policies throughout history, and many still operating today. Over a brief period in the 19<sup>th</sup> century, it can be said that Britain truly embraced free trade, systematically dismantling the protections that operated in favour of inefficient commercial interests or the landowning elite. This brief period is, however, the sum total of Britain's historical commitment to free trade.

After the dual shocks of WWI and the Great Depression, Britain would once more retreat behind protectionist barriers, much like the rest of the world. The system developed by Britain at this time, the Imperial Preferences, would go beyond the standard protectionism of the age by developing a British dominated block sheltered from competition by the rest of the world. The Preferences gave the Empire access to British markets, but also ensured that British goods would receive special treatment in return. This was a boon for British producers, and undoubtedly aided Britain's recovery after WWII. However, it puts claims that Britain always had an affinity for free trade into sharp contrast. Instead Britain was ensconced at the centre of a highly protectionist system that, arguably, had a detrimental effect on its industrial competitiveness in the long run, leading to her decline as a manufacturing power.

Britain's commitment to her Empire would threaten to undermine her other trade relationships. It nearly caused the breakdown of GATT negotiations, straining relations with the US to the degree that negotiators feared the new world trading order may collapse before it had a chance to be implemented. Later, it would be one of the key factors in Britain first choosing not to join the European project, and then being blocked from entering by France because British leaders were singularly unwilling to dismantle the benefits that the Empire gave them, both in terms of trade and in global standing. The lessons of the 1950s and 1960s showed that the old Empire could no

longer be utilised in the way it used to be to boost British standing in the world, and as a result joining the rest of Europe in a common project was given a higher priority. This approach of joining the European project resigned in defeat at the loss of both economic power and international influence marked a severe contrast between Britain and the other European nations, who approached the project more enthusiastically and ambitiously.

Britain's time in the EU and its predecessors was a turbulent one. Her membership was marred by constant battles over expenditure; centralisation of power in Brussels; the ambition of the European project, and many other issues. The highlight of this period was Britain's contribution to the creation of the single market, but most of Britain's policies regarding Europe faced only frustration and defeat. Britain's stance left it isolated and friendless in Europe. It is not unlikely that the constant string of defeats during her four and a half decades of membership were a contributing factor to the indifference towards Europe felt by many in Britain. This ambivalence towards Europe was combined with her 'special relationship' with the US (another source of European ire) and her affinity for a more global foreign and trade policy, a remnant of her imperial days. Therefore, in hindsight, the decision to leave the EU may not have been as surprising as many originally thought. While not inevitable, and certainly avoidable, it was always a possibility that Britain may once again reprioritise her international relationships as she had many times over her history and decide that Europe no longer warranted prioritisation to the degree it enjoyed. Over the last century Britain repeatedly chose either its Empire, or the US, over Europe. It is perhaps not that unexpected that Britain would wish to do so again, and that Brexit was the only way to accomplish this.

However, the world that Britain left upon its entry into the ECC in 1973 is not the same one that it will be returning to today. The Commonwealth, the last remnant of Britain's imperial tradition, is not comparable to the Empire of old. There is little in the way of common feeling binding together the loose collection of states, nor are Commonwealth countries politically or economically dominated by British interests. This is not to say that pursuing a Commonwealth strategy will not be beneficial to

Britain. The nations share a common language and similarities in legal systems, which make them potentially valuable economies for Britain to expand into. Countries such as Canada and Australia are advanced economies that could make good potential allies, especially if a future relationship could go beyond trade in order to take advantage of shared global outlooks. Other Commonwealth nations, such as India, Pakistan, and Nigeria, are large developing economies which can provide British goods and services with lucrative markets as they continue to grow. Closer ties with the Commonwealth could be augmented by continuing to develop the 'special relationship' with the US, although at the moment the US does not look like the most reliable partner.

However, as much as future strategies should focus on developing the other two circles, it cannot be ignored that over the past four decades the European circle has grown to dominate British policy. Its new importance will not, and cannot, be undone by Brexit. Britain is leaving the EU, it is not leaving Europe. The interconnectedness of the two economies, from global value chains crossing borders to banks selling financial services across the EU, means that a clean break is impossible without disastrous consequences. Britain needs Europe in a way that it never has before. As a result, preventing a no deal Brexit must be the top priority for governments on both sides of the English Channel. While British participation in the EU customs union may be the least economically damaging option, it is unlikely to be politically acceptable to either side. As such, it is likely that a FTA or membership of the EEA will be the form that the final agreement will take. This will allow for a balance between policy independence and limited economic instability. It will require a substantial transition period to negotiate either of these two agreements and will likely have to include a peace clause to ensure that Britain retains the stability of EU membership until a permanent future agreement is reached. Any final arrangement will decrease the access that Britain currently enjoys into the EU, its largest trading partner, and thus will have economic consequences. These have been discussed in depth above and will not be repeated here. If they are to be mitigated, British negotiators will need to ensure that they approach negotiations with the EU with a firm strategic plan that prioritises services and key industries, or the damage to the British economy will only be exacerbated.

The silver lining of Brexit, from a trade perspective, is that once Britain is free of the EU and has cleared the initial backlog that will arise from rolling over existing EU trade agreements, Britain will be able to design its own trade policy for the first time in nearly 50 years. A strategic framework that prioritises the services sector, combined with a commitment to freer trade, should be the ultimate goal of British trade policy in the coming decades. While leaving the EU does diminish the bargaining power available to Britain, it will also be leaving behind the numerous vested interests which have frustrated and collapsed trade negotiations in the past. An independent Britain no longer needs to worry about the demands of farmers in Belgium or wine makers in Italy, making negotiations simpler as there are fewer red lines to defend.

That being said, there is no guarantee that Britain will turn towards free trade. The referendum offered a confused mix of protectionism, demanding protection of British workers from European immigrants competing for their jobs, and free trade rhetoric, promising that an independent Britain will be able to negotiate more and better deals with likeminded nations. Many believe that the referendum result itself was a backlash against globalisation, similar to the rise of the Northern League in Italy or President Trump's election in the US. As a result, it may be difficult for the government to use Brexit as a mandate to embrace free trade in the same way that was done in the 19<sup>th</sup> century. However, incremental steps towards this ideal may be viable, supplemented with targeted programs to aid those who are harmed by these policies in order to reduce the dangers of another backlash.

Brexit was one of the most significant events of the last decade, and undoubtedly will cause economic damage to Britain. Given the understandable reluctance by politicians to be viewed as anti-democratic, it is very unlikely that it is a course that will be changed. Therefore, in the short term, Britain must make every effort to minimise the damage and negotiate an amicable withdrawal from the EU, one that safeguards the future of Britain's relationship with Europe. Once Brexit is completed, Britain will have a blank slate to design and implement its own trade policy and will face two choices: either to retreat to the protectionism that defined it in the 20<sup>th</sup> century, or

adapt the liberalised ideals of the 19<sup>th</sup> century to the modern world and its services dominated economy. Without a doubt, it is in its best interests to choose the latter.

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