THE ART OF THE POLITICALLY POSSIBLE

Pragmatism is key to evaluating trade options for post-Brexit Britain, argues **David Martin Jones**

Britain, like Australia, needs a foreign policy geared to its long-term interests in a rapidly changing world no longer en route to a liberal democratic end of history. This has become an urgent task in the wake of the June 23 vote to leave the European Union. Unlike the seemingly interminable process of 'ever closer union', the Brexit referendum was a big bang political event.[1] It requires some guiding principles to govern the process that follows from it and a global strategy to turn uncertainty into opportunity. As new Prime Minister Theresa May's government has come to recognise, policy must not only consider the economic dimension of Brexit, but also how economics and geopolitics are linked in an interconnected but by no means integrated world.

Among the options for a post-Brexit Global Britain that this article evaluates are calls for unilateral free trade and tariff disarmament, engagement with the Asian model of Free Trade Agreements (FTAs), and an Anglospheric alternative of FTAs with states that share liberal market values and common law principles. In terms of national interest and geopolitical strategy the last option seems both more pragmatic and relatively straightforward, at least in principle.

At the same time, the UK needs to extricate itself from the EU. Two contested positions have emerged on how best to do this: hard or soft Brexit. Hard Brexit would involve a clean break. The UK would give up membership of the single market for goods and services but 'take back control' of its budget, laws and borders. Trade with the EU from the outside would occur under World Trade Organisation rules with UK exports subject to tariff and non-tariff barriers.

Soft Brexit would see the UK outside Europe but inside the single market with some tariff-free access. The UK would still be subject to some EU laws and regulations, freedom of labour movement and contributions to the EU budget. This is the trade deal that Norway and Iceland have as members of the European Economic Area but not the EU.

Evidently, the European Commission, in the shape of President Jean Claude Junckers and chief Brexit negotiator Michel Barnier, wishes to punish Britain for questioning the validity of the EU model. This together with the default Eurocratic position that any trade deal has to involve free movement of labour[2]—a deal no Conservative leader could plausibly entertain—means hard Brexit becomes the logical political option even though this could hurt the EU more than the UK.[3] In other words, a hard Brexit would arise from Europe turning its back on Britain rather than vice versa.

Recovering from regional protection

Brexit means the UK can free its economy from the EU's regulatory restrictions and layers

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of bureaucracy that rendered any trade deal an interminable negotiation process. The difficulty of reaching a consensus between 28 states, at different levels of development, on EU trade policy only complicated an already cumbersome decision-making mechanism. A single Belgian province can almost veto a free trade agreement, some seven years in the making, between the EU and Canada (CETA).[4]

Whatever economic advantages the UK enjoyed from access to the single market came with trade-offs. These included an acceptance of a level of protectionism for agriculture, manufacturing and finance that did not necessarily suit the UK. While post-Brexit Britain cannot ignore a market of 500 million people on its doorstep, the UK can—if nothing else—free itself from the encumberances of EU membership.

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Brexit, however, has left a policy vacuum. The immediate aftermath of the referendum witnessed a run on bank and property stocks, a significant drop in the value of the pound and fear of a Brexit-induced recession. Market volatility returned with even greater vigour after Prime Minister May announced her Great Repeal Bill to annul the European Communities Act (1972) and trigger clause 50 of the Lisbon Treaty (to begin negotiations to withdraw from the EU before March 2017) at the annual Conservative Party conference in October.

May declared Brexit announced 'a quiet revolution'. The UK would become 'a sovereign and independent country' again, rejecting 'the ideological templates promoted by the socialist left and the libertarian right', reasserting patriotism and eschewing the transnational cosmopolitanism of the Davosie where 'a citizen of the world is a citizen of nowhere'.

The Economist and *The Financial Times*, the house journals of the Davosie, were not impressed. The sterling's flash crash on October 7 showed, *The Economist* claimed, that financial markets 'had no confidence in a Brexiting Britain'.[5] 'Sterling's slump' signalled a 'waning not a boon', *The Financial Times* editorialised.[6] Both papers considered May's revolution would take Britain in an 'illiberal direction', turning the country into 'a poorer and a meaner place'.[7] Matthew Parris writing in *The Times* called Brexit the 'biggest screw up since Suez. We are heading for national humiliation, nobody's in charge and nobody knows what to do'.[8] The UK Treasury announced that 'Hard Brexit could cost £10 billion in lost taxes'[9] and warned ministers that any trade negotiations with other countries could leave the UK facing 'millions of pounds' in EU fines.

By contrast, Matt Ridley argued that Brexit represented 'a golden opportunity for a free-trade bonanza',[10] whilst Liam Halligan considered a 'hard Brexit' from Europe the 'best way to fight global protectionism'.[11] Mathias Dopfner, chief executive of German publishing house Axel Springer, said Britain would emerge from Brexit with a 'stronger economy and be better off than other EU countries within five years'.[12]

Prime Minister May wants Britain to be 'the most convincing advocate for free trade' at a time when the United States appears to have abandoned its market-friendly posture. Yet in her Party conference speech, May averred that trade deals will be linked to an industrial strategy that attempts to reconcile a traditional focus on increasing exports with a renewed emphasis on government investment.

The shift in tone and doctrine reflects the thinking of Mrs May's advisory team who have identified trade and industry policy as a crucial area of concern. Channelling an updated version of Joseph Chamberlain, the late 19th century liberal champion of tariff reform—presumably without its protectionist aspects—the government envisages not only negotiating a new relationship with the EU but also moving from a free market philosophy that restrains government to one of economic and social activism. Post-Brexit Conservatives want lower prices, a more reliable supply in energy and an industrial strategy that will promote investment in infrastructure and keep a watch on foreign takeovers that threaten job losses.

This mix of free trade abroad and *dirigiste* aspirations at home—a blend that successive post-war British administrations have failed to achieve—suggests that the new government needs to reflect carefully on the options for responding to the strategic opportunity Brexit opens for a flexible and sovereign market state.

Unilateral free trade

One option, discussed before Brexit and increasingly favoured by hard Brexiteers, is unilateral free trade and tariff disarmament—that is, removing all barriers to imports and abandoning reciprocity in trade deals.

Economists for Brexit, like Patrick Minford and Gerard Lyons, particularly favour this approach and eschew a specific industrial policy. The UK instead would embrace a zero tariff regime under the aegis of the World Trade Organisation (WTO). This would lead to cheaper imports. Minford estimates that embracing global market prices rather than living inside the EU where the overall cost of living is about 8% higher than outside the Union would be worth 'about £40 a week to the average household'. Unilateral tariff disarmament would 'enhance the shift away from manufacturing into service industries, which is where UK growth has largely been concentrated in the decades since 1979'.[13] The government could also cut the company tax rate from 20% to 10%.[14] This would make the UK an even more congenial place to do business for both small start-ups, large multinationals like Google and Amazon and London's financial institutions fearful of losing their European passport rights in a hard Brexit.

Unilateral free trade has benefited small open countries. New Zealand from the 1980s onwards is often held out as a spectacular example, especially in agriculture. Even more so, Singapore is another small country sometimes identified as a model for tariff disarmament. A giant export processing zone and financial services centre, Singapore enables business to enjoy largely tariff-free access to whatever the world has to offer. Export-oriented growth benefits from the relative advantage of cheap imports, offering a competitive edge over those states that impose tariffs.

A zero tariff model could serve as the basis of a Global Free Trade Alliance premised on countries, largely Anglospheric ones, that facilitate open trade, transparent foreign investment and secure property rights.[15] The Alliance would function like a club with membership based on a rules-based system, requiring less negotiation over concessions than conventional free trade agreements.

That said, Singapore is a city state, and despite its consistently high score on annual Economic Freedom Indexes, has a surprising number of state-owned enterprises and a very active Economic Development Board that involves itself in sovereign wealth funds and negotiating a growing number of free trade agreements (FTAs)—32 to date, more than any other state.

Moreover, the 'creative destruction' that unilateral free trade under WTO rules could unleash would have a severe economic downside for traditionally Labour areas like South Wales and the North East that voted Leave but might lose jobs to China and India.[16] Such an outcome would be electoral poison. It explains why May wants to re-examine industrial strategy and the government acting 'as a force for good' in re-balancing the geography of economic growth.

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The alternative world of free trade agreements

In contrast to unilateral tariff disarmament, the more dynamic economies in the global trading order, especially those in the Asia Pacific, have developed an elaborate regime of bilateral, trilateral and multilateral FTAs. To enter this world the UK would first need to establish its own relationship with the WTO (as distinct from the relationships it has agreed through the EU since 1995).

Having established its independent status within the WTO, the UK would need to negotiate high quality FTAs with a range of potential trade partners that could invest in the UK as well as facilitate a trade pivot to Asia, or a recalibrated Anglosphere, or both. We can assume an evolving UK interest in negotiating FTAs with states in East, South and South East Asia, and with Commonwealth countries such as Australia and New Zealand as well as the US, before leaving the Union. In this context, as we shall see, after repealing the 1972 European Act and triggering article 50 of the Lisbon Treaty, the UK's most prudent option would be to line up trade agreements with countries like Australia, Canada and New Zealand that already share a common language, law and liberal worldview.

Unlike the European single market, FTAs entail no loss of sovereignty nor require free movement of labour or a universal regulatory regime. They do, however, facilitate investment and enhance agricultural, service and manufacturing complementarities.

The noodle bowl of Asian FTAs

East and South East Asia has maintained growth rates across the region in excess of 5% over the last decade. Foreign direct investment, openness to global production networks, and bilateral, trilateral and multilateral FTAs have been crucial to this growth. This pattern of agreements, which evolved with the rise of China in the aftermath of the Asian Financial Crisis in 1997, increasingly links the economies of the Asia Pacific with the United States and India.

The more dynamic and export-oriented economies in the region have negotiated a range of agreements covering goods, services, manufacturing, agriculture and economic collaboration. South Korea has 15 FTAs, Japan 24 and China 23. The overall effect is a 'noodle bowl' of overlapping and cross-cutting agreements.

FTAs require careful negotiation and take years. Australia began negotiating an FTA with China in 2005 and only concluded the agreement in 2015. While South Korea and China have expressed interest in FTAs with the UK, they would need careful sector-by-sector negotiation. Unfortunately, the UK civil service has few experienced trade negotiators. Canada, which took some seven years to negotiate CETA, has 300. Hence the potential advantage in negotiating with countries like Australia with which the UK already shares cultural similarities and geopolitical interests.

The geopolitics of free trade agreements

The noodle bowl of Asian FTAs throws geopolitics into sharp focus. China considers the Association of Southeast Asian Nations (ASEAN)-led Regional Comprehensive Economic Partnership (RCEP) — which amalgamates all ASEAN's FTAs with regional partners into a coherent whole—integral to its bold 'Belt and Road' initiative. This seeks to improve connectivity by building land transportation corridors linking China to Europe and South Asia as well as with Southeast Asia whilst its Maritime Silk Road promotes port development to enhance sea-borne trade links.

Reflecting and informing this partnership is China's Asian Infrastructure Investment Bank (AIIB). The Bank involves 50 primarily Asian members but includes the UK and Australia. The AIIB could prove a significant boon to the integration of Southeast Asia as a single market facilitating a free flow of goods and services, and the UK could find itself participating in China's regional growth strategy.

This scenario has geopolitical trade-offs, however. Xi Jinping's dream is to integrate the smaller ASEAN economies into a Sinocentric regional production network. In fact, China's proactive economic diplomacy in Southeast Asia serves a broader strategy that imbricates its neighbours in a web of incentives that increase their dependence and raises the ante for calling China over 'either territorial or economic disputes'.[17] The new Duterte regime in the Philippines quickly realised the stakes involved in taking China to the (non-binding) UN tribunal on the law of the sea over China's historic claim to 90% of the South China Sea and has backpeddled from the tribunal's findings as well as its formerly close ties with the US. Beijing also sharply rebuked Australia and Singapore for daring to say they respected the tribunal's decision.

China's Belt and Road model, moreover, sits at variance with the US proposal for a Trans-Pacific Partnership (TPP), a key feature of the US pivot to Asia under the Obama presidency and one that underpins its view that the Asia Pacific—not Europe—is the region of most consequence in the world. In 2015 this partnership (which looks like becoming a victim of US electoral politics) involved 12 countries, but only four from ASEAN together with New Zealand, Australia, Japan and Canada and three South American states.[18]

Whilst former Australian Trade Minister Craig Emerson once asserted that this meant two pathways to the same destination, the reality is more complex.[19] China promotes and belongs to the former and not the latter, the US vice versa. The ASEAN-led RCEP actually brings under one umbrella the various bi- and tri-lateral preferential trade deals concluded between ASEAN and a number of regional states like Australia and India. The TPP, by contrast, envisages a more comprehensive and rule-binding trade agreement, which a number of ASEAN states as well as China resist. In fact, belonging to both groups looks like hedging. In this context the UK would face dilemmas not dissimilar to Australia in addressing the shifting geopolitical dynamics.

Bilateral trade with China

At the same time, China's growing global reach coupled with the US' relative indifference has implications for investment and development in the UK. Prior to Brexit, Sino-UK relations had entered a 'golden era' with bilateral trade worth $75 billion in 2015. London accounts for two-thirds of renminbi payments outside mainland China and Hong Kong. China viewed the UK as a gateway to Europe. Difficulties (subsequently resolved) over the new nuclear power station at Hinckley Point to be built by France's EDF and the China General Nuclear Power Group, however, accentuated the economic stakes and political risks Brexit might entail for enhanced bilateral trading and investment with China.

This in part reflects the fact that the corporate animals that emerged from reform in the 1990s of loss-making state enterprises of the Mao and Deng era were curious corporate beasts at the same time commercial and linked to the party state.[20] The split personalities of powerful, reconstituted state enterprises—like the China Development Bank, Chinalco and CNOOC—have raised questions of security and national interest through their investment strategies in the US and Australia as well. The May government's concern over the Hinckley Point reactor and Chinese control of vital infrastructure evokes a familiar dilemma where liberal market states engage with the state-led Chinese model. Moreover, the clumsy handling of the project highlighted the lack of any mechanism in the UK for adjudicating whether such investments are in the national interest.

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The Anglospheric alternative

Given the geopolitical complexity of dealing with China, it might be better in the short term for the UK to focus on FTAs with developed economies in the Commonwealth and with the US. These states share both liberal market values and common law principles (to varying degrees). Special Administrative Regions like Hong Kong and sovereign Commonwealth states like Canada, Malaysia, India, Singapore, Australia and New Zealand followed constitutional and economic practices bequeathed by the UK. Unlike the UK, however, they did not abandon sovereignty for a utopian project of 'ever closer union'.

By 2015, states following some version of Anglo liberal market values, coupled with rule of law and property rights, enjoyed both high standards of living and were amongst the more attractive places in the world to live. City states like Singapore had a per capita GDP (US$53,000) significantly higher than the UK and most European states.[21]

The UK's lack of skilled trade negotiators, combined with poor planning and decision-making over infrastructure, currently inhibits investment and development. Nevertheless an enhanced and high quality framework of FTAs with both like-minded liberal democracies in the European Economic Area and with the US, Australia, New Zealand and Canada could offer the basis for a Global Free Trade Alliance where the 'free' in free trade is more than notional.

Ultimately a more geo-strategically oriented framework of FTAs could lead to ambitious schemes such as James C. Bennett's *Canzuk* or even *Canzukus*. This would add military co-operation, liberalised migration rules and other co-operative measures to free trade with Canada, Australia, New Zealand and, in time, Singapore and perhaps India (the difficulties of making trade deals with India notwithstanding).

This revamped Western alliance could also involve the United States. As with Canada and Australia, the US and the UK share common law and liberal market values. This could afford the basis, in conjunction with Commonwealth countries, not only for evolving economic linkages but also geopolitical ones, in terms of a shared language (English) and a political culture based on sovereign institutions and the rule of law.

Conclusion

Post-referendum UK has opened a Pandora's box that requires careful handling if Brexit is to fashion a positive global event rather than an extended damage limitation exercise. Examining the options for unilateral free trade and free trade agreements suggests that some version of the developing Asian FTA model offers the UK an environment in which to embrace global market prices rather than the regulatory-intense environment of Europe. In this context, the fact that English is the language of international trade and business—and that the UK can draw upon its Anglospheric connections with the US, Canada, India, Singapore, Australia and New Zealand—means that the UK already enjoys a comparative advantage in dealing on a global rather than a regional basis.

Endnotes

1 Brendan Simms argues that the European Union suffered from being more concerned, after Maastricht, with the process of union rather than union itself. See Brendan Simms, *Britain's Europe* (London: Penguin, 2016), 229.

2 Switzerland—which is not a member of the EU or EEA but enjoys special access to the single market—faces similar EU intransigence over free movement. See 'Swiss Climbdown Over Free Movement May Deal Blow to UK Hopes', *The Guardian* (22 September 2016).

3 Michael Savage 'Hard Brexit Would Cost the EU £8billion a Year More Than Britain' *The Times* (24 October 2016).

4 http://www.bbc.co.uk/news/world-europe-37657187. Although the EU and Canada ratified the CETA Treaty on 30th October, 38 national parliaments need to ratify it before it comes into full force. See https://www.theguardian.com/business/2016/oct/30/eu-canada-sign-ceta-free-trade-deal-trudeau-juncker

5 http://www.economist.com/news/finance-and-economics/21708673-pounds-weakness-vote-no-confidence-brexiting-britain-why-sterling

6 'Sterling's Slump signals a warning not a boon'. *The Financial Times* 15 October 2016

7 http://www.economist.com/news/britain/21708223-britains-new-prime-minister-signals-new-illiberal-direction-country?cid1=cust/ddn

8 Matthew Parris, 'We're Heading for the Biggest Crisis Since Suez', *The Times* (15 October 2016).

9 Sam Coates and Oliver Wright, 'Hard Brexit Could Cost £10bn in Lost Taxes', *The Times* (27 September 2016); Henry Zeffman and Bruno Waterfield, 'Trade Talks Could Land Britain with Big Fine from EU, *The Times* (19 September 2016).

10 Matt Ridley, 'Golden Opportunity for a Free Trade Bonanza', *The Times* (3 October 2016).

11 Liam Halligan, 'Hard Brexit is the Best Way to Fight Global Protectionism', *The Daily Telegraph* (2 October 2016).

12 Quoted in Oliver Wright, 'Brexit Will Boost Britain: German Business Chief', *The Times* (27 September 2016).

13 Patrick Minford, 'Evaluating European Trading Arrangements', in Patrick Minford and J. R. Shackleton (eds) *Breaking Up Is Hard To Do, Britain and Europe's Dysfunctional Relationship* (London: Institute of Economic Affairs, 2016), 140.

14 Chancellor George Osborne proposed reducing the tax to 15% before the referendum Corporate tax rates in Germany are 30% and 33% in France. See Tim Shipman, 'Threat of UK Tax Cut Staves Off Hostile EU', *The Sunday Times* (23 October 2016).

15 John C. Hulsman, 'Reviving the Age of Drake: How a Global Free Trade Alliance Can Transform the UK', in Ralph Buckle et al, *Brexit: Directions for Britain Outside the EU* (London: Institute of Economic Affairs, 2015), 146-160.

16 Even the new minister for Brexit, David Davies, considers such a 'brutal Brexit' would send the UK economy 'over the cliff'. See Shipman, 'Threat of UK Tax Cut' (note 14).

17 Bonnie Glaser and Deep Lal cited in Benjamin Schreer, 'Should Asia be Afraid?: China's Strategy in the South China Sea Emerges', *The National Interest* (20 August 2014), 2.

18 The four ASEAN states are Singapore, Brunei, Malaysia and Vietnam. The three South American states are Mexico, Peru and Chile.

19 See trademinister.gov.au/releases/2012/ce_mr_121120.html

20 See Richard McGregor, *The Party: The Secret World of China's Communist Rulers* (London: Penguin, 2012), 53

21 According to the World Bank, see http://data.worldbank.org/indicator/NY.GDP.PCAP.CD