Brexit: Implications for Trade with Developing Countries[1]

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Summary

- If the UK exits the EU, then under all conceivable scenarios it will need to renegotiate its trade relations with third parties. This is vital for developing countries as almost all of them access the UK market on preferential terms, through a myriad of agreements that have been brokered by the European Commission
- If the UK leaves the EU, these agreements will no longer apply, and quick action will be needed to avert the severe trade disruption that faces some developing countries
- Brexit may offer a silver lining: precisely because new trade arrangements will need to be agreed, it provides an opportunity to restructure and improve the UK's trade relations with developing countries to maximise the positive impact of UK for development

Introduction

The UK government is understandably preoccupied with reconfiguring trade relations with the UK's major trading partners. Equally important for development, the UK needs to think through how to reconfigure trade relations with those developing countries for whom the UK is a major trade partner. For these countries Brexit poses a real risk of substantial trade disruption. It also offers a new opportunity to ensure UK trade works for development.

Brexit puts trade preferences at risk

Preferences that are key for developing country access to the UK market will expire if (when) the UK leaves the EU. At present, nearly all developing countries have preferential access to the UK market under the EU's Generalized System of Preferences (GSP) scheme. By far the most valuable aspect of the EU's GSP scheme is the Everything But Arms programme that has provided duty-free quota-free access to the EU market to all least developed countries (LDCs) since 2001. Two-thirds of all LDCs are in Africa. This scheme has been particularly important for cultivating new revenue streams in some of the world's poorest nations, including Bangladesh and Cambodia, which depend on the scheme to export garments.

Many developing countries also have valuable preferential access to the UK market through EU free trade agreements. At present, the EU has trade agreements with just over 50 countries, most of them developing. These include the Economic Partnership Agreements, which have been concluded with groups of African, Caribbean and Pacific countries.

In the event of a UK exit from the EU the EU's GSP scheme and the EU's free trade agreements will no longer apply. In the absence of a new arrangement developing country exporters will no longer have preferential access to the UK market.

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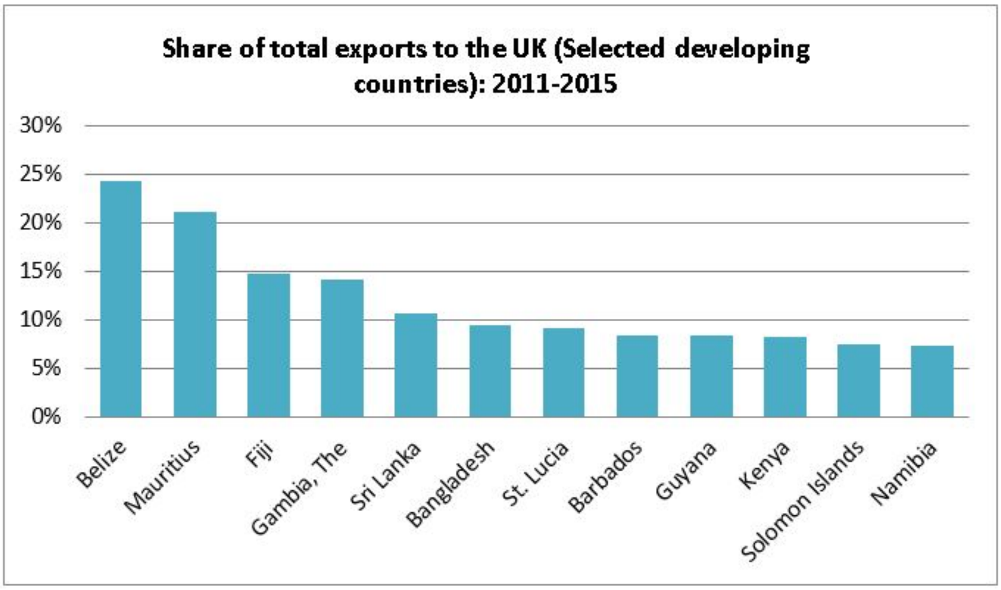
[1]*Note: an adapted version of this piece appeared here:* http://www.ictsd.org/opinion/brexit-opportunity-or-peril-for-trade-with-small-and-poor-developing-economies

Although on average the UK is not a major trading partner for developing countries[2], some small developing countries rely heavily on the UK market (Figure 1). Belize, for instance, sent nearly one quarter of its goods exports to the UK over the past five years. Other countries that rely heavily on the UK for their exports include Mauritius (20%), Fiji (15%), Gambia (14%), Sri Lanka (11%), Bangladesh (10%), and St Lucia (9%).

These countries typically export a narrow range of products that would not be competitive on the UK market in the absence of preferences. Alternatively put, were the UK to exit the EU without a mechanism in place to safeguard existing preferences, garments and textiles factories in Bangladesh, cane sugar producers in Mauritius, Fiji, and Belize, and smallholder banana farmers in St Lucia could go out of business. As these economies are heavily reliant on external trade, the economic impact of any disruption could be substantial. By way of illustration, exports of goods and services as a percentage of GDP in 2013 were 61 for Belize, 49 for Mauritius, and 57 for Fiji.

Figure 1



Source: Author's own calculations, data sources listed below.

Why preferences are at risk and what to do about it

If the UK leaves the EU, a new arrangement will need to be agreed for UK-EU trade relations, and under all scenarios trade relations between the UK and developing countries will need to be reconfigured. Six broad scenarios are possible: the Norway scenario where the UK joins the European Economic Area (EEA) and is part of the EU single market; the Swiss scenario where the UK joins the European Free Trade Area (EFTA) but stays out of the single market and relies on a series of bilateral deals to access the EU; the Turkey scenario where the UK is in a customs union with the EU but is not in the single market or EFTA; the Canada scenario where the UK negotiates access to the EU market based on a new free trade agreement; and the WTO scenario where the UK relies on WTO tariffs to access the EU market as the US does now.

While the debate in the UK is focused on the differences between these various scenarios for the UK economy, they all have similar implications for the structure of UK trade relations with

[2] Over the past five years the UK accounted for just over two per cent of exports of goods from developing countries

developing countries. To see this, it is helpful to examine the Norway model, which from the UK's perspective is the closest to the current status quo.

Under the Norway scenario the UK would be part of the EEA and would stay in the EU single market. The vital difference is that under this and all the other scenarios the UK would manage its own external trade relations. Like Norway, the UK would not be party to the EU's preferential trade agreements with third parties. Norway has its own Generalized System of Preferences, which is modelled on the EU's and includes duty-free quota-free access for least developed countries.

The UK would also need to negotiate its own free trade agreements and economic partnership agreements. If the UK joined EFTA it could negotiate free trade deals together with Norway, Iceland, Switzerland, and Liechtenstein, which have free trade deals covering 38 countries. Alternatively, and more likely, the UK could go it alone to strike its own deals. The UK would also have discretion over the most-favored nation (MFN) tariffs it sets, as it would no longer be party to the EU's common external tariff. The most extreme scenario, advocated by some Brexit supporters, is for the UK to eliminate all tariffs.

To safeguard preferential access for developing countries in the wake of Brexit, two steps will be needed. First, the UK would need to develop its own Generalized System of Preferences. Second, the UK would need to renegotiate free trade agreements and economic partnerships to replace those it has through the EU, including the Economic Partnership Agreements with African, Caribbean and Pacific countries. Any changes to the UK's MFN tariffs will also have implications for developing country preferences. Reductions of these tariffs would create winners and losers among developing countries: while many would welcome increased market access, countries that currently enjoy high margins of preference into the UK market would face preference erosion.

A temporary bridging agreement will be needed

Devising a new GSP scheme and brokering new free trade agreements with developing countries will take time. To ensure trade is not disrupted a creative "bridging arrangement" will be needed. For instance, it may be possible for the UK to simply replicate the EU's GSP schemes for a limited period, pending the development of its own. Similarly, the UK could offer temporary, unilateral preferential access to developing countries that currently have access to the UK market through free trade agreements and economic partnership agreements. While such a move would violate WTO rules, it can be done: the EU has provided such access since 2007 for African, Caribbean and Pacific countries pending the conclusion of Economic Partnership Agreements.

Given how stretched the UK government will be, any solution will need to be relatively simple, and quick to implement. Developing countries have ready allies in the UK for this task, ranging from the UK's Department for International Development, to non-profit groups that have championed fair trade, and British businesses whose supply chains would be disrupted.

Implications of future UK-EU relations

Developing countries also have an interest in the nature of UK-EU trade relations after Brexit. The Norway scenario is the only option that would continue to provide almost seamless access to the EU's single market and under which the UK would mirror most EU regulations. Other scenarios offer varying degrees of integration and alignment of a myriad of rules affecting trade between the UK and the rest of the bloc.

This matters for developing country exporters and investors. If rules and regulations in the UK and EU start to diverge, exporters from developing countries will have to keep abreast of, and comply with, new requirements ranging from rules of origin, to product standards, and labelling. Brexit may then require a reconfiguration of business models by developing country investors that use the UK as a base for smoothly accessing the EU market. Jaguar Land Rover, one of the UK's largest car manufacturers and majority owned by the Indian company Tata Motors, is a case in point.

A silver lining for developing countries?

There may be a silver lining for small developing countries in all of this. The UK has a track record of pushing the EU to open up its markets to developing countries because, unlike for many southern European countries, imports from developing countries don't compete directly with its own producers. Assuming that the UK doesn't declare unilateral free trade, it could take innovative steps to maximise the potential of trade to support the development of the world's smallest and poorest countries.

The UK should develop a generous scheme of preferences for Least Developed Countries, similar to the EU's Everything But Arms Scheme. It should also use the opportunity to design a scheme of preferences that covers all African countries, helping move away from the much-criticised Economic Partnership Agreements, which have proven divisive for regional integration in Africa. Such a scheme could be an improved version of the Africa Opportunity and Growth Act of the United States, providing permanent rather than temporary preferences, with more relaxed rules of origin, fewer conditions, and covering both goods and services. Accompanying these schemes, the UK should continue to provide, and arguably increase, its aid for trade, to support regional integration among developing countries, industrialisation and job creation.

Sources: Trade data is sourced from http://comtrade.un.org/ accessed via Comtrade on 14 July 2016. Exports to GDP data sourced from World Bank national accounts data and OECD national accounts data files accessed on 15 July 2016. Calculations are the authors own. Data was averaged over the most recent five years for which data is available (2011-2015). Where data was missing, it was averaged for the available years. On EFTA's FTAs see here. On Norway's GSP scheme see here.