

Possible Options and Constraints Impacting the United Kingdom's Farm Trade Policy Following its Exit from the European Union ('Brexit')

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This submission covers only one aspect of the Sub-Committee's enquiry: the possible options and constraints that might impact the UK's future trade policies for agricultural commodities and food and drink products following its exit from the EU ('Brexit'). A central theme is the rights and obligations the UK will enjoy as a Member of the World Trade Organization (WTO). Readers should bear in mind that the author is an agricultural economist, and not a trade lawyer, and treat his conclusions with care.

Background

The EU encompasses both a *Customs Union* (defined by WTO rules) and a *Single Market* (an EU concept). The Customs Union covers trade in *all* products (including agricultural commodities and food and drink), with a common external tariff. Within the Single Market either a common set of regulatory provisions, or the principle of mutual recognition, largely apply (covering food safety, pesticide residues, etc.). Consequently products can circulate freely within the EU (Swinbank, 2017: Annex). The UK's Government has said that in leaving the EU the UK will also leave the Customs Union and Single Market (but see below).

The EU's common agricultural policy (CAP) has changed significantly over past decades, initially prompted by the Uruguay Round of multilateral trade negotiations in which Australia and the Cairns Group played a part (Daugbjerg & Swinbank, 2009; Kenyon & Lee, 2006). A succession of policy reforms have reduced many support prices in nominal terms, and inflation has further eroded their value in real terms. Farms however are eligible for direct income support (currently the tax-payer funded Basic Payment Scheme and its 'Greening' component, etc.), which the EU declares to be so-called 'green box' measures and thus exempt from reduction commitments (WTO, 2017). Export subsidies (refunds) are about to disappear.

However, one aspect of the 'old' CAP survives. Despite these changes to the CAP's domestic policy provisions, its import taxes are largely those established after the modest tariff reductions achieved in the Uruguay Round. Thus the EU's most-favoured nation (MFN) bound tariffs on a number of agricultural products (e.g. sugar, dairy, beef, lamb) are obscenely high —often prohibitively so. Some examples are given in Table 1. These high tariffs differentiate trade in agricultural commodities and food and drink products from the trade policy concerns of other sectors of the economy, and complicates enormously any consideration of the UK's future trade arrangements post-Brexit, as discussed below.

Table 1: The EU's MFN Tariff Bindings on Selected Products

| | MFN tariff, per tonne |
|--------------------------------|--------------------------|
| Beef carcass, fresh or chilled | 12.8% <i>plus</i> €1,768 |
| Lamb carcass, fresh or chilled | 12.8% <i>plus</i> €1,713 |
| Butter | €1,896 |
| White sugar | €419 |

Not all of the EU's agricultural tariffs are high, however. Many are much more modest. On sparkling wine —of export interest to Australia— the MFN tariff is bound at €32 per hectolitre for instance; and oilseeds pay no import duty.

The Organisation for Economic Co-operation and Development's PSE (Producer Support Estimate) calculations for the period 2013-15 indicates that 19% of EU farmers' gross farm receipts were dependent upon transfers from consumers and taxpayers, and suggests that 24% of this took the form of market price support (OECD, 2016: 86). In the main, it is the EU's high import tariffs on agricultural products that generate this market price support.

Brexit: Its Uncertain Timing and Outcome

The UK Government plans to invoke Article 50 of the *Treaty on European Union* by the end of March 2017. Unless the timeframe is extended by the unanimous agreement of the other EU member states (EU27), the UK will leave the EU and probably its Customs Union, and the Single Market, two years later (i.e. March 2019). Article 50 is primarily concerned with the withdrawal of a Member State. It seems doubtful that the new trade relationship that the UK has said it wants to conclude with EU27 can be agreed within that two-year window. Consequently there is talk of 'transitional arrangements'; but these too would take time to negotiate. The simplest outcome would be for the UK to remain, *temporarily*, within the EU Customs Union (which I assume would be acceptable within the WTO), and the Single Market, pending negotiation of a new trading relationship; but such an outcome would be deeply unpopular with the Brexiteers and may well be unacceptable to the Government.

Thus it seems to me that there is a real possibility that in March 2019 the UK will leave the EU without any new trade deal in place (neither permanent, nor temporary): i.e. a 'hard' Brexit.

The Government has said that it wants to secure 'the freest and most frictionless trade possible in goods and services between the UK and the EU'; and that it 'will pursue ... a new strategic partnership with the EU, including an ambitious and comprehensive Free Trade Agreement and a new customs

agreement' (HM Government, 2017: 35). This sounds to me to be saying that the UK wants to be *almost* in the Customs Union and Single Market, whilst technically remaining outside! If such arrangements extend to trade in agricultural commodities and food and drink products (which could greatly eliminate the need to erect border controls in the island of Ireland, as discussed below), this could result in the UK applying, in effect, the CAP's agricultural tariffs post-Brexit, and severely limit its ability to negotiate free trade area (FTA) agreements with competitive agricultural producers such as Australia and Brazil.

At the other extreme the Government has said that 'no deal for the UK is better than a bad deal for the UK' (HM Government, 2017: 65): i.e. a 'hard' Brexit. Under these circumstances border controls would almost certainly have to apply between the Republic of Ireland and the UK (in particular on the land border with Northern Ireland), but the UK would be free to unilaterally reduce its tariffs on agricultural goods (i.e. pursue 'free trade', as advocated by some economists, although this seems unlikely to me) or negotiate a series of FTAs with WTO Members around the world.

The UK's WTO Membership: Rights and Obligations

I do not think there is any doubt that the UK is a founder Member of the WTO, and that it will remain a Member after Brexit. Thus it will be bound by all the WTO's provisions, including for example the *Agreement on Agriculture* and the *Agreement on the Application of Sanitary and Phytosanitary Measures*. The WTO's most-favoured-nation (MFN) provisions ensure that the UK could not treat the EU (or an EU Member State, for example Ireland) more favourably than any other WTO Member (and vice versa), *unless* within the context of a UK-EU27 customs union or FTA. Moreover, the WTO's rules on customs unions and FTAs would appear to preclude a sectorial agreement between the UK and other WTO Members (covering just agricultural goods for example, or motor cars) because this would not cover substantially all the trade between the parties. Many FTAs, however, have only partial coverage, and typically exclude some agricultural products.

Quite what the UK's Schedule of Commitments will look like is a more open question. On tariffs I would like to think that other WTO Members would simply accept that the UK could inherit the EU's bound tariffs: after-all, the UK authorities would have been applying them the day before Brexit. Unless the UK remained within a customs union with EU27, however, products imported into the UK would no longer have free circulation within EU27 (although they could transit the UK under customs control) potentially leading some WTO Members to complain that their rights had somehow been nullified or impaired.

Many of the EU's bound MFN tariffs are *specific duties*, as illustrated in Table 1. It is difficult to believe that the UK's Brexiteers would wish to see the UK's tariffs fixed in the despised euro, but how these amounts might be converted into pounds sterling is unclear, and could result in some dissent in the WTO.

The UK would be free to *reduce* its tariffs, provided it applied them on a MFN basis; but it could not unilaterally *increase* these bound rates. It could continue to apply a Generalised System of Preferences (GSP) on a MFN basis, replicating the EU's scheme for example, and its own version of the EU's *Everything but Arms* scheme for the least-developed countries (LDCs).

Domestic Support: The agricultural sector is unique in that it has its own WTO agreement. The *Agreement on Agriculture* has specific rules governing 'domestic support measures in favour of agricultural producers'. The UK, after Brexit, could declare some of its farm policies to be 'green box' measures, not subject to any expenditure limits, claiming that they have 'no, or at most minimal, trade distorting effects or effects on production' and meet a number of policy-specific criteria (other WTO Members could challenge this self-declaration in the Committee on Agriculture, or through the WTO's Dispute Settlement procedure). Other measures might be declared as 'direct payments under production limiting programmes' (the so-called 'blue box'), again not subject to expenditure limits under current WTO rules. All other support (the 'amber box') is subject to WTO limits.

The current *Agreement of Agriculture* has fairly generous *de minimis* provisions: product-specific support that does not exceed 5% of the value of that product's output that year is disregarded, as is non-product-specific support which does not exceed 5% of the country's total agricultural production. In addition, and reflecting their support for agriculture in the 1980s, a number of WTO Members, including the EU, are entitled to apply a higher level of amber box support (its *Final Bound Aggregate Measurement of Support* (AMS)). What is unclear is whether any of the EU's current amber box entitlement would be shared with the UK on Brexit. In Swinbank (2017) I outline some circumstances in which these rules could constrain the design of farm policy in a post-Brexit UK. No doubt the Australian Government, and other WTO Members, will monitor developments carefully.

Tariff-Rate-Quotas (TRQs): A TRQ allows a fixed quantity of product to enter a WTO Member's customs territory paying a much lower tariff (often 0%) than the MFN rate. The EU administers 128 different TRQs for products covered by the *Agreement on Agriculture*, many of which are open to all WTO Members (*Erga omnes*), although some are country specific (WTO, 2016). Some were written into the EU's Schedule of Commitments in the Uruguay Round, whilst others have subsequently been added following successive EU enlargements and other negotiations with WTO partners.¹ Australia can of course avail itself of the EU's *Erga omnes* TRQs, but it has access to relatively few country specific TRQs into the EU. These relate to a small quantity of raw cane sugar for refining, high quality beef, buffalo meat, a small quantity of sheepmeat, cheese for processing, and cheddar cheese.

Whether the TRQs that the current EU is obliged to offer will be retained by EU27 after Brexit, or shared with the UK in some (unspecified) manner, is yet

¹ TRQs may also be deployed *within* FTAs. Thus within the recently agreed Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada, the EU's MFN tariffs on beef and pigmeat are only reduced for specified TRQ quantities. Similarly, the Australia-USA FTA limits by TRQs preferential access to the US market for a number of Australian farm products. Moreover, a WTO Member can unilaterally open (and subsequently close) a new *Erga omnes* TRQ, over and above those it is obliged to offer because of its WTO commitments.

to be determined, as is the method of determining the allocation and the role to be played by WTO Members. One can imagine that farmers in EU27 would be quite keen to off-load the obligation onto the post-Brexit UK. Commercial interests in the supplying countries will no doubt be monitoring developments carefully. If, for example, they currently supply the UK using the EU's TRQs they might want the future obligation to be devolved onto the UK, particularly if they suspect the UK is going to follow a protectionist policy. However, if their perception is that the UK will unilaterally reduce its tariffs post-Brexit, or enter into a FTA with their home country, offering tariff free access, their preference would probably be for the TRQ obligation to remain with EU27.

There are significant trade flows between EU27 and the UK. If the UK and EU27 fail to agree a FTA, then traders eager to maintain their current trade flows will presumably seek to take advantage of the *Erga omnes* TRQs that each party makes available to the generality of WTO Members. This would increase competition with other WTO suppliers, and arguably upset the balance of trade advantages that other WTO Members had enjoyed in the EU27 and UK markets. This change in circumstance might conceivably lead them to argue that a 'benefit accruing ... directly or indirectly ... is being nullified or impaired', citing GATT Article XXIII.

The UK-EU27 Border

The UK has one land border with EU27, dividing the island of Ireland. This is a highly sensitive border, and both the UK Government and the Government of the Republic of Ireland are keen to ensure that 'hard' border controls are avoided: particularly the physical presence of customs officers or immigration officials. This outcome could be very difficult to achieve given the very high tariffs that apply to many CAP products. The UK is a major market for Ireland's livestock industry; and many food and drink manufacturing and retail businesses operate highly integrated operations either side of the border. In 2016, for example, 26%

of the pigs slaughtered in Northern Ireland's bacon plants were imports (presumably from the Republic of Ireland).²

If the UK and EU27 successfully conclude 'an ambitious and comprehensive Free Trade Agreement and a new customs agreement' (HM Government, 2017: 35), with the UK's MFN tariffs kept more-or-less in line with those applied by EU27, then a 'hard' border could be avoided. In effect, the CAP's border protection would be kept in all but name. Rules of origin might still be problematic —would EU farmers, for example, be content to allow sugar produced from imported raw cane sugars by the UK's cane sugar refiner free access to the Irish market (bearing in mind that Ireland is not a sugar producer)?

But an ambitious and comprehensive FTA with EU27, embracing agriculture, might only be negotiable if the UK agreed to limit its ambitions for its FTAs with other countries around the world. If the UK was free to negotiate FTAs with competitive agricultural suppliers, allowing free access for Australian raw cane sugar for example, would that not *displace* British farm produce into the EU27 market whilst the Brits provisioned themselves with imports?

If there is no UK-EU27 FTA —a 'hard' Brexit— then both the UK and EU27 would have to apply their MFN tariffs against each others' exports, with border controls on the Irish border. Recall: Irish beef could not be treated more favourably than beef from other origins, such as Australia.

FTAs with Australia and Others

The EU has a number of FTAs around the world, many of which include agriculture to a greater or lesser extent. Many recent FTAs are so-called 'mixed agreements' in that they not only cover trade (an exclusive EU competence) but other matters over which Member States retain control. Thus these agreements have been signed and ratified by the Member States as well as the EU. To what extent the UK would remain bound by these mixed agreements post-Brexit is an

² Excel data sheet available at <https://www.daera-ni.gov.uk/publications/slaughtering-pigs-2003> (accessed 16 February 2017).

open question. Many experts suggest that —as with traditional FTAs for which the EU had exercised its exclusive competence— the UK would no longer be party to such agreements following Brexit, but in the UK there is some expectation that the trade provisions could be rolled forward into a post-Brexit world (for discussion, see Miller, 2017). Thus, it is argued, if the South Korean Government agreed, preferential access for British farm, food, and drink products into South Korea could perhaps be maintained, mirroring the current arrangements in the EU-South Korea 'mixed agreement' FTA.

FTAs with high cost agricultural producers such as South Korea and Japan offer export opportunities for the UK's food and drink products and agricultural commodities. FTAs with more competitive suppliers of the temperate farm products produced in the UK, such as Australia and New Zealand, and South America, are more problematic. They could offer the UK's quality food and drink manufacturers improved access into overseas markets: Pitney Bowles reports for example that Australia's import duty on chocolate, and on cream biscuits, is 5%, plus an import processing charge of AU\$50.³ However UK farmers would be alarmed at the prospect of cheaper beef, lamb, dairy products and sugar penetrating the British market. And, as explained above, liberal access for these products from the Antipodes and South America is hardly compatible with maintaining an open border between the UK and the Republic of Ireland.

Following the election of Donald Trump as US President, and despite his repudiation of the Trans-Pacific Partnership (TPP) and his criticisms of the North American Free Trade Agreement (NAFTA), there is some enthusiasm in the UK for negotiating quickly a FTA with the US. But that too could present challenges for UK policy makers. The US might well demand access for poultry-meat washed with chlorine as a pathogen control, beef produced from cattle treated with beef hormones, and genetically modified organisms. If a post-Brexit UK persists in applying measures restricting these imports, the US might well

³ <https://www.dutycalculator.com/dc/185274180/home-garden/groceries/biscuits-without-chocolate/import-duty-rate-for-importing-cream-biscuits-from-singapore-to-australia-is-5/> (accessed 17 February 2017).

challenge the UK's stance through Dispute Settlement proceedings in the WTO.
Where would Australia's sympathies lie in such circumstances?

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