

European issues

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European Union, Brexit, USA: The strategic dimension of the new trade issues

Brexit is the source of a great deal of uncertainty as far as the exit agreement is concerned. The British government has announced that it will trigger the procedure provided for by article 50 TEU on 29th March, but the commercial aspect of the negotiations is still subject to several strategic factors. Moreover, Theresa May's visit to the Trump administration at the end of January confirmed London's wish to position itself in a dynamic that is moving towards closer cooperation with the USA via a free-trade agreement that it would like to see implemented in the spring 2019, the planned date of the UK's exit from the European Union. At the same time the new Trump administration's attacks on some of the economic fundamentals of the European Union, particularly the single currency and its accusations of especially German mercantilism, raise a number of questions regarding the future development of trade relations between Europe and the USA. What are, therefore, the issues at stake and the challenges posed by this strategic reshuffle?[1] How should Europe respond?

TRADE ISSUES RAISED BY BREXIT

Although it is still difficult to forecast precisely the details of the negotiations between the United Kingdom and the EU, the position, which will be adopted by the British government is one of a total exit of the single market. London will not try either to achieve a relationship remotely similar to that of Norway or Switzerland since it is adamant in its rejection of the principle of free movement of people. The strategy initiated by the British Prime Minister will therefore comprise a dual negotiation: that of the "logistic" details of the exit specific to the activation of article 50, and at the same time, a negotiation that seeks a complete redefinition of the framework for EU-UK trade. The present mechanisms set out in the Lisbon Treaty only provide however for the first part of the discussions. Michel Barnier, the negotiator in chief of the Brexit for the European Commission recalled at the beginning of December that it would be legally impossible to negotiate "a new trade partnership" with the UK before the divorce had been completely finalised. The issues are complex and notably include compensation ranging from 40 to 60 billion € for the payment

of British financial commitments in the Union's budget until the end of 2020.

The negotiation period over article 50 will be technically shorter than the planned two years since the agreement that will be found (probably around September-October 2018) will then have to be subject to ratification over a six month period, thus not allowing enough time for the consecutive negotiations on a new trade agreement by 2019 before the next European elections. There remains also a fundamental difference: negotiations over article 50 must be approved by qualified majority. A new trade agreement is, however, not limited in time and must be approved unanimously by the EU's Member States[2]. The British parliament admitted in a recent report that negotiations over a new trade partnership with the EU would last much longer than Theresa May has said, and at minimum between five and ten years[3].

This double period of uncertainty, from the point of view of timing and content, has led the British government to consider the principle of "no agreement rather than the conclusion of a bad deal" at the end of 2018. This scenario would

1. The author would like to thank Patrick Messerlin, Stephen Haseler, John Stevens and Stephen Jen for their numerous discussions and contributions on this issue.
2. The most recent EU-Canada free trade agreement (CETA) required the successive ratification of 38 national and regional parliaments before it became effective.
3. According to the UKTPO's (UK Trade Policy Observatory), *Written Evidence to the House of Commons' International Trade Committee, 2017.*

European Union, Brexit, USA: The strategic dimension of the new trade issues

mean that in 2019 trade transactions between the EU and the UK would be governed by default by the non-discrimination principle and the rules of the WTO: British exports would then be subject to the EU's customs tariffs (2.7% on average in 2014 except for some sectors with higher tariffs, notably the car industry, agriculture and textiles) [4]. For the automotive industry alone it might mean a tariff of 10% on cars and 4.5% on average on components – in all up to £4.5 billion in tariff costs for the British car industry – with major consequences on manufacturing costs and on the competitiveness of the products sold[5]. In the dairy sector and products of animal origin, these tariffs might reach 15% to 30%. It is also believed that British farmers' revenues might fall by an average 17,000 € per year.

At least two strategic options might substantively be considered: the negotiation of a free-trade agreement or a customs union between the UK and the EU (i.e. a common external tariff). Strategic divergences are clear: a free-trade agreement would leave the UK able to negotiate other similar bilateral agreements with other partners (starting with the USA), a measure that would not be valid as part of a customs union[6]. For the European Union, customs union would mean that it would retain privileged access to the British market by maintaining the tariffs used with other third countries at their present rates. This option, which seems inconceivable for the UK, would however be the most profitable one from the European point of view. There also remains the difficult question of trade in services, particularly in financial services, which might have to be addressed separately[7] rather than included in negotiations for a free-trade agreement if this option is retained.

From a strategic point of view, the commercial balance is much less favourable for the UK than for the Single Market with a high level of asymmetry. In 2015, British exports to the EU totalled nearly 45% of all of its exports, or 13% of the British economy, whilst the UK's share only represents on average 7% of the EU's total exports or around

3% to 4% of European economies when taken as a whole[8]. In the financial sector alone, the revenues of the City of London's financial sales to the EU amount to nearly 45 billion € whilst the City generates £200 billion in activities overall and some 60 billion in tax revenues. Many financial businesses based in London anticipate that exiting the EU could well translate into a necessary improvement of compliance in their activities with the continent as well as a restriction of transactions in the European single currency.

The position of the London's financial market has been indeed so far intrinsically linked to its importance in the sale, purchase and management of euro-denominated assets (more than 50% and up to 90% depending on the activity). Some banks, including HSBC and Goldman Sachs, have already planned to move part of their staff with a view to relocate at least 1,000 employees from the HSBC investment bank to Paris; Goldman Sachs plans to move around the same number of people to Frankfurt, whilst overall some 230,000 jobs in the City could be lost[9]. International financial companies with European headquarters in London are trying to anticipate the fact that they may no longer have access to the "European passport" which allows them to use the British licence to trade within the EU. It will be, indeed, important for the European Union to limit its opening to non-EU Member States' financial services (including a post-Brexit UK). This will represent a key issue in the upcoming negotiation. In particular, necessary regulatory developments should be implemented so that activities linked to euro-denominated transactions be located only in the Eurozone, thereby excluding clearing houses based in the UK.

All of these factors will no doubt significantly influence the course of the negotiations with, above all, the crucial issue of the free movement of people and that of European citizens currently residing in the UK. The future of bilateral trade relations will also be governed at least by two other important issues: first, the political difficulties

4. Tariffs under the principle of the most favoured nation (MFN).

5. Report by the House of Commons' International Trade Committee, UK trade option beyond 2019, "No deal" - Trading under WTO rules alone, 7th March 2017.

6. Morgens Peter Carl, How to (BR)EXIT : a Guide for decision-makers, Friends of Europe, March 2017. Other British observers seem to privilege a third option: that of a free-trade agreement restricted to certain industrial sectors, which would be extremely difficult to achieve since it would require to find sectoral agreements able to satisfy the relative interests of the 27 EU Member States and those of the UK.

7. Ibid, p. 13.

8. EU-UK Trade Statistics, House of Commons, N°7851, 6th January 2017.

9. According to Xavier Rolet, Director of the London Stock Exchange, Financial Times, 10th January 2017.

which the UK may have to face in exiting the EU, since the possibility of a new Scottish referendum on independence which could take place at the end of 2018 or the beginning of 2019 seems increasingly likely, thereby questioning the very continuation the United Kingdom as a political entity. Second, the development of Euro-American relations and Europe's ability to respond to it with a united voice.

THE NEW AMERICAN POLICY AND THE CHALLENGES OF A RETURN TO PROTECTIONISM

Whilst the vote on Brexit was largely influenced by the return of political populism in the UK, the election of Donald Trump in the USA and his new administration add the threat of a return to protectionism with a mercantilist vision of international trade and unpredictable policies over the continuity of on-going trade agreements. The American withdrawal from the Trans-Pacific Partnership signed in 2016 as well as the suspension of negotiations regarding the Transatlantic Trade and Investment Partnership with the EU, are all raising concerns over future trade actions, especially since President Trump also mentioned a possible withdrawal of the USA from the WTO.

This change in emphasis towards championing "America First" is however nothing new. In 1992, for example, the billionaire and businessman Ross Perot, who opposed the implementation of the North American Free-Trade Agreement (NAFTA), ran as an independent candidate in the presidential election winning almost 19% of the vote. Twenty-five years later, President Trump is not saying anything different when he challenges the very existence of NAFTA^[10] with a view to either renegotiate the accord or leave it at once if no new agreement can be found.

The American approach which is, it seems, likely to prevail in the short run will be that of a foreign policy based upon the conclusion of strategic

bilateral deals between nations or blocs and not one based upon maintaining an American "empire" with universalist goals^[11]. This would mean that the USA become a power like any others, and that its allies be seen as independent players with whom the Americans will conclude agreements – deals, which might only be temporary arrangements depending on US national interests. This strategy will also extend to trade with existing agreements being challenged to assert the primacy of bilateral alliances over multilateral or regional accords.

Such a policy does not, however, come without serious risks for the American economy. The trade regime envisaged by President Trump includes the introduction of a border tax on imports and a tax waiver on profits for export companies, which should hit import businesses and major industrial groups. Moreover, the repatriation of funds from major American multinational companies, constrained by the planned fiscal reform, could lead to a significant appreciation in the dollar in the short-term, negatively impacting the competitiveness of American products. Favouring dedicated import sectors will also inevitably harm other parts of the economy by disadvantaging many companies. It will, for example, be difficult to rapidly recreate a full American car industry within the country, whilst simultaneously raising customs duties on foreign imports: according to the American Automotive Research Centre introducing a 35% tax on Mexican imports would lead to the destruction of 30,000 jobs in the USA (40% of the components of imported cars from that country are produced in the USA). The efficiency of President Trump's announced protectionist measures to revive the American economy could also be increasingly challenged politically from within with a relatively short window of action given the mid-mandate elections of 2018.

However electoral support may evolve, this American shift in economic doctrine generally constitutes a real threat to Europe and to the interests of the Eurozone. Although the American introduction of new dissuasive customs duties

¹⁰. See Stephen Haseler, *Trump's new world order: Brexit and Europe in a world turned upside down*, Global Policy Institute and Blenheim Strategy, 2nd March 2017.

¹¹. *Ibid.* page 11.

European Union, Brexit, USA: The strategic dimension of the new trade issues

should only apply initially to Mexico, it cannot be ruled out that it may afterwards be extended to the countries, which export the most to the USA, above all China (with possible custom tariffs of up to 45%). Some believe that restrictive measures on prices at sector level might rather be considered by the American administration in its relationship to Europe, and above all to Germany^[12], rather than increased customs duties. But all forecasts on this issue are still very uncertain and, indeed, unlikely, since the USA would lose much from implementing such a trade policy. Euro-American exchanges amount for nearly one third of global trade with a relatively balanced interdependence. The United States accounts for 17.6% of European trade and 21% of European exports, whilst the EU totals 18.7% of American trade and nearly 19% of its exports.

Recent political announcements made by close supporters of President Trump, particularly those of Stephen Bannon and Ted Malloch – who is seen by some as the possible next American ambassador to the European Union – do, nevertheless, suggest a desire to divide Europe in terms of trade coherence and to question the very continuation of the single common currency. In answer to such rhetoric about “shorting the euro” and to American support for Brexit as a model for other member states to follow, it will be imperative for Europe to respond pragmatically and firmly so that it can maintain its unity, protect its strategic interests, stick to its political and commercial ideas and take advantage of the opportunities opened up by the new situation in America.

CONSOLIDATING TRADE WITH CHINA AND ASIA: AN OPPORTUNITY FOR EUROPE

It is still too early to gauge the details of retaliatory counter-measures (if any) that might be adopted by the USA against China. The introduction of tariffs as high as 45% seem however highly dangerous for American interests, even though it cannot be ruled out given the political unpredictability of the Trump administration. China still holds a

significant share of American Treasury bonds, which in theory places it in a position of strength for future negotiations, but the country is also weakened by a flight of capital outside of the country and, at the same time, its will to maintain the renminbi at a relatively stable rate.^[13] Some, therefore, believe that the position put forward by President Trump could in fact help the USA gain better access to the Chinese market as an alternative to fighting a trade war given the level of economic interdependence between the two countries.

However, nothing is certain, particularly in the mid-term. Firstly, because China is seeking to find new trade openings for its products so as to limit its exposure to the American market. The American withdrawal from the Trans-Pacific Partnership (TPP) should thus re-launch negotiations over the development of a Regional Comprehensive Economic Partnership in Asia led by China, aiming to include, amongst others, all the Asian signatory countries of the TPP. This trade area would represent over 25% of the world’s GDP with GDP forecasts placing China at nearly 50% of the economic weight of this new Asian entity by 2050. Secondly, because China’s policy might, in response to potential damage from American protectionism towards Chinese exports and investments in the country, adopt a new trade policy favouring Europe rather than the USA to secure the economic growth necessary to consolidate the development of its internal domestic market.

In this scenario, the first question for Europe will be to gain better access to the Chinese market and greater reciprocity in trade to address the growing bilateral structural imbalance. The European Union is, indeed, increasingly dependent on trade with China, which accounts for 20% of the total of its imports, with a European trade deficit of 180 billion € in 2015. A “strong, clear, unified Europe”^[14] would therefore be a necessary pre-condition to seize the opportunity of closer strategic cooperation with China, to counterbalance American threats

^{12.} The USA became the first destination of German exports in 2015, thereby overtaking France.

^{13.} Japan regained its place as the USA’s primary creditor at the end of last year following China’s sales of American debts to support its currency.

^{14.} Elements for a new EU strategy on China, Communication from the EEAS, 22nd June 2016.

and Brexit. Europe would also benefit in this context by accelerating the last stages of on-going negotiations for a free-trade agreement with Japan, as well as the launch of similar negotiations with Australia and New Zealand to strengthen its economic presence in Asia.

In short, this strategic reshuffle provides an opportunity to strengthen the European project, with which political leaders must urgently reconnect. The next elections in France and in Germany in May and September are indeed of vital importance to respond to the siren call of populism and protectionism, with a political vision able to

bring sense to and more hope in an independent Europe able to master its own continental fate. In the Brexit negotiations with the UK and in future discussions with the USA, it will be vital to defend the integrity of the European Single Market and strengthen the Eurozone by providing it with true economic and political governance to fully protect its geostrategic interests.

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