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Glass half full at leaving the EU? Look at the gains of truly free trade

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If we play our cards right, the UK can benefit CREDIT: REUTERS/TOBY MELVILLE

At the centre of disputes about how the UK will fare outside the EU lies concern about trade. Remainers argue that, unless we manage to secure a deal, our exports will have to face the EU's common external tariff (CET) and presumably we will impose the equivalent on the EU's exports to us, thereby reducing trade in both directions.

From this all sorts of bad things follow – a loss of the usual efficiency gains from trade, reduced economies of scale in production, and lower investment, by both overseas firms and British ones.

It all sounds pretty dreadful. But things don't have to turn out like this, and if we play our cards right, they won't. It is widely believed that the EU is a free trade area. It is not. It is a customs union. There are no tariffs on trade between members and the EU seeks to minimise non-tariff barriers between members (although the service sector is nothing like a true single market).

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But it hampers trade between members and non-members, by the imposition of the CET, certain non-tariff restrictions on imports from non-members, and through the Common Agricultural Policy (CAP).

In their pre-referendum assessments of the impact of Brexit on the UK economy, the Treasury and other mainstream forecasters assumed that not only would the EU impose the CET on us but we would reciprocate, while continuing to impose tariffs and non-tariff barriers on imports from the rest of the world (ROW) and remaining in the CAP. This would be just about the worst possible outcome.

But suppose that, even though the EU imposed tariffs on our imports, we did not reciprocate, left the CAP and dropped the CET (and other restrictions) on imports from the ROW. Things would then look very different.

Of the UK’s total goods exports, about 47pc is accounted for by exports to the EU and about 53pc by exports to the ROW. (For exports of services, the figures are 39pc and 61pc.) If, post-Brexit, the EU decided to subject imports from the UK to the CET then that would mean tariffs on UK manufactured exports of about 4pc on average, with 10pc on exports of cars.

The total sum that would be raised for the EU by these tariffs is about £4bn per annum, paid either by European consumers, if the tariff were fully reflected in higher prices, or if not, by our exporters. Either way, this sum is pretty small beer. It amounts to about half of the UK’s net budget saving from leaving the EU.

The key thing to appreciate is that if we withdrew from the CAP and dropped the CET on imports from the ROW then this would be a move in the direction of free trade giving a large saving to UK consumers and other users of foreign imports.

Prices would fall, offsetting the increase from the earlier fall of sterling. Admittedly, this would put increased competitive pressure on domestic producers and would tend to result in increased imports. But offsetting that is the likelihood that EU exporters to the UK would cut their prices in order to compete with imports from the ROW.

If the UK price of wine from South Africa, Australia, Chile et al fell significantly then the UK price of French wine would have to fall or France would suffer a big loss of business CREDIT: IGOR KLIMOV / ALAMY

Take wine as an example. If the UK price of wine from South Africa, Australia, Chile et al fell significantly then the UK price of French wine would have to fall or France would suffer a big loss of business. Some industries (including agriculture) might need support but, helped by the now much lower pound, most manufacturing sectors would cope very well, with some benefiting strongly from lower import prices.

Bamboozled by the post-war consensus in favour of multilateral trade deals, and emasculated by the transfer of competencies to the EU, politicians and government officials, as well as many businesspeople, still don't fully appreciate the attractions of free trade. The balance of trade is viewed as a sort of profit and loss account. Exports are good and imports are bad. But this is nonsense. In reality, the gains from trade derive not from exports but from the exchange of exports for imports. In this exchange imports are just as important as exports.

According to all the great economists, the ultimate aim of economic activity is consumption. Investment and production are means to this end. But there is another tradition in popular thinking and economic policy-making that values production for its own sake. It is called mercantilism. This is the philosophy that underlies the economic policies of Germany, which seems content to run huge current account surpluses without end. Our leaders must not succumb to it.

By all means let us try to gain preferential access to European markets if we can. But if we don't succeed, this is no reason for us to restrict or penalise imports. We should be aiming for completely free trade – with everybody. Moreover, to embrace free trade ourselves, we don't need to engage in endless negotiations taking umpteen years. If they don't play ball we should simply do our own thing.

This won't be readily accepted by our business lobby groups, many of whom will argue for tit–for–tat and for continued protection against the ROW. This is because much of the advantage of free trade will accrue to consumers, who do not have a say in their deliberations. It is up to ministers and officials to take full account of the interests of 65 million consumers who, if they understood what was at stake, would be clamouring for free trade.

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