

UK preferential international trade after 23 June 2016

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Abstract

The preferential international trade agreements are currently processed by the EU to enhanced trade with Lesser Developed countries. The EU negotiates these agreements over many years and have a Generalised System of Preference (GSP) committee in place, which oversees the current GSP process.

Now the situation is changing as the UK has voted to come out of the EU on the 23 June 2016. So how is this going to affect the UK importers? UK Importers are concerned if trade agreements and preference agreements can be renegotiated and how long will it take for this process to be completed. The impact could be a large rise in cost of manufacture and retail goods which may have to be passed onto the end consumer. Research has been undertaken reviewing interviewing 9 leading UK importers, UK government white papers and the UK House of Lords papers to establish the possibilities the UK are currently considering in relation to how it is going to negotiate its trade policy with the EU in relation to after it leave the EU, in particular Non-EU trade.

Introduction

Since the Brexit vote on 23 June 2016 the UK has been negotiating how to leave the EU and with forty six years of being a member of the EU the UK has incorporated the EU law and trade policies, which have to be separated from the EU when it leaves in March 2019. This is only two of the many EU policies which have to be reformed. This paper considers the continuing role of GSP and if the UK will utilize the preference after it leaves the EU.

Since 1971, the European Union has encouraged trade with developing countries, (Brenton and Machin, 2002). The main mechanism used to facilitate trade is to lower importation tariffs at the point of entry into the EU. The discount system is called the Generalised System of Preferences (GSP). Its application makes goods supplied by lesser developed countries (LDCs), cheaper and hence more attractive to EU importers. GSP was first implemented by the EU in 1971. It is a nonreciprocal trade programme. It is reviewed and renewed every ten years, (McQueen, 2007) The EU has the ability of withdrawing preferences when the recipient's exports have increased, (Ózden and Reinhardt, 2005).

With the globalisation of trade there is more opportunity for EU importers to expand their supply chain across the globe. The availability of the GSP scheme should in principle enhance this trade further. A number of manufacturers have factories overseas and import completed components to the EU for further processing or for the retail market. Brenton (2003), found that the greater fragmentations of the supply chain has made it more difficult to comply with 'rules of origin'. This constrains LDCs manufactured from engaging in the global production networks.

Due to the globalisation of trade the UK currently is part of the global supply chain with a number of multinational companies trading with the UK and importing/exporting goods to Non EU countries. The EU GSP currently allows Lesser Developed Countries (LDC) to import to the UK with a reduction of tariff, normally to zero. However, there is a concern that if the preference is not continued after the UK leaves the EU and the UK has to start from scratch with its GSP negotiations, this could take between 3 to 4 years, that these goods will have to revert to the World Trade

Organisation (WTO) tariff. This could see goods, in particular retail clothing having a rise in cost from zero to 12% of value after March 2019 when it leaves the EU.

Due to the fact that Brexit is current, the paper has been written to highlight the many issues that could affect GSP and how GSP could become instrumental within the UK trade policy as a temporary trade agreement while the free trade agreements are negotiated.

The structure of the paper takes the form of a literature review, considering the issues academics have raised with regard to the current EU preference, then there is a discussion section highlighting the opportunities the UK government could incorporate if they undertake GSP. The research for the discussion relates to 9 semi-structured interviews with leading UK importers. The current situation in relation to the UK government and Europe with regards to Non-EU trade is considered leading to an overall conclusion.

Literature Review

There are aspects of the Generalised System of Preference that have provided difficulty to the importers to utilize the preference. The country of origin rule, graduation and general administration form some of the main issues concerning the application of the GSP. The literature review considers the academic research undertaken within these areas, highlighting the main problems that importers/exporters have when applying GSP. At the time of writing the UK is still a part of the EU and the issues highlighted are within the EU GSP which still applies to the UK.

2.1 Country of Origin

For a number of years proving the country of origin has been an issue for both the importers and the LDC exporters. It has been suggested that the rules of origin had actually suppress trade rather than increase it. In particular in relation to the fractionalization of production which is not only occurring between the EU and the LCDs (Cadot, et al. 2006), but the LCDs are also now fractionalizing manufacture. As one LCD is coming out of GSP, manufacturers in the LCD will actively develop manufacture in another LCD which will continue with GSP and offer this to the EU importer, in order to maintain low cost. Therefore it is more difficult to follow the origin of goods included in the process of this type of supply chain. There is a cost to the LDC as they have to install compliance. However, the EU importer has to prove to the EU authorities that the all the goods supplied have complied with the rules of origin (RoO). Under the 2017 EU GSP reforms the responsibility is clearly on the EU importer to insure that contractual agreements between them and the LDC supplier to have clear contractual agreements between the importer and exporter. It is the importer that will be penalized for non-compliance. If there is an issue with non-compliance, import duties will be levied against the EU importer, retrospectively for three years after the initial importation. Also the importer will face additional penalties for any false origin claims. Therefore if the importer has any doubt of origin they should not claim the preference. This defeats the overall objective of the GSP and the EU importer may as well import from another developed country and pay the import duty as normal, as the risk of non-compliance becomes too high. Naumann, (2012). This is not a new issue, as Benton and Machin (2002) suggested the Country of Origin status was an issue, as the importers had to ensure that all rules are fulfilled when importing preference goods under GSP.

There is an element of a trade barrier being instigated when using the RoO, and the under-utilisation of the preference will restrict exports from the LDCs, Brenton, (2003). Brenton and Machin (2002) and Candau, Fontagne and Jean (2004) have evidenced that the Country of Origin Rules used by the EU in many cases have resulted in importers just paying the fully import duty rather than the GSP reduced tariff.

2.2 Graduation Issues

As an LDC economy improves the GSP is removed as it can provide an advantage on global trade. The GSP can be reduced over a period of time, in stages, to allow the LDC to adjust to their

new standing in the global economy. This is known as graduation. Hoekman and Ozden, (2006). The graduation from a GSP scheme ensures that the GSP is successful in its function and provides a support to the developing economies and the EU views graduation as an important element of this. Townsend, (2008).

However, Ozden and Reinhardt (2005) considered that as GSP is not within the GATT legal system, the preferences are not protected and can be changed or cancelled at any time. The EU GSP committee can alter the GSP allocation. The GATT membership approved GSP with an 'enabling clause'. Therefore the GSP is not held within the usual legal constraints and Countries are able to provide and adjust their schemes 'as they seem fit'. Hudec, (1987); Jackson, (1997). Currently the EU GSP scheme protects the EU producer by allowing the preference to be suspended or graduated. This has been an issue with the United Nations and at the United Nations Conference on Trade and Development (UNCTAD), it was highlighted and argued that the type of graduation protects producers in the importing countries. Irish,(2007).

2.3 Knowledge and Administration of GSP

The importers have to be compliant with the various rules and regulations when applying GSP. Country of origin is the main complex regulation, however, the importer has to ensure that the GSP certificate is original and not a fake. The GSP forms A must meet the following requirements:-

size

weight of paper

layout

background - which must consist of a green (shade not specified) guilloche pattern.

A number of countries are known to have issues with the GSP form A for example:- Argentina, India, Sri Lanka and Uganda. H M Revenue and Customs (2005),

Also they have to ensure that the supplier is compliant with the Country of Origin rule, which can be very difficult to ascertain. UK H M revenue and Customs will check for this compliance and if the importer is unable to produce the correct administration they are fined. Therefore companies will complete everything to the best of their knowledge, however, they may not be aware of some of the documentation and therefore find themselves liable to the H M Revenue and Customs fines. When it was H M Customs and Excise training was provided to non-compliant companies, allowing for lack of knowledge. However, now that H M Revenue and Customs are in place, the fines are allocated, even when companies have to their knowledge covered the required administration. H M Revenue and Customs state that all paperwork for imports should be kept for 3 years. If Country of Origin cannot be proved then full duty will become payable. H M Revenue & Customs (2013). Brenton and Machin (2002) highlighted that the burden of administrative costs on companies proving origin is an issue, as there is the cost in relation to proving the origin and to maintain the administrative systems to ensure consistency.

Discussion

Currently there are many issues in relation to why importers are not utilizing the EU Generalised System of Preference. However, the vote on 23 June 2016 to leave the EU does now allow an opportunity for the UK to update the preference and could increase the utilization from the smaller and medium size UK companies.

Opportunities

Currently the country of origin rules are very complicated and 67 percent of the interviewees stated that UK importers can be overwhelmed with the administration as well as the cost of keeping up with the knowledge base to be able to comply with all the regulations. Rather than help to educate companies, HM Revenue and Customs are wanting to charge the full duty, up to three years retrospectively. There could be an opportunity here for H M Revenue and Customs to be able to engage more with the smaller/medium size companies to enable them to benefit from the reduction

in import tariffs. This will provide more income for these companies, which in turn, allows for companies to develop their business and increase their profitability, thus being able to pay more corporation tax as well as increase their employees. As small/medium sized companies add the majority of economic benefit to the UK this would also help to regenerate the UK economy. Therefore if the country of origin rules are more accessible for all importers not just the large companies who are able to afford the compliance the UK economy would benefit.

It will not just be the importers that could benefit as it would allow more trade to take place with LDC and therefore be able to be more in compliant with the WTO mission statement. "reduce poverty through trade". The policy makers need to consider carefully how to apply these rules. Do they just want the current system to apply and in turn have many importers not using the system due to its complex application? Or will they take measures to allow smaller and medium businesses to be able to develop trade with LDC.

Currently companies have little influence over the graduation process being applied and as to which commodity lines are being cut from preference back to full import tariff. GSP policy currently is applied in Brussels and the UK importers feel remote from this process. The UK policy makers do have an opportunity to engage the UK importers more directly with the graduation process and allow them to be consulted within the withdrawal process. So will there be an opportunity for company consultation and also for more smaller/medium sized companies to be involved? If importers did not feel so removed from this process they may be encouraged to utilize the preference more. Stevens & Kennan (2016), suggested that the by the UK having a wholly new GSP scheme allowing the continuation of trade after Brexit, it would allow the opportunity of developing a more friendly UK trade policy. The House of Lords (2017), further acknowledged while a new GSP would take time to implement, it would take less time than other trade agreements as there is will be no external negotiations, as countries can decide if they want to accept the GSP scheme and its framework. This places the GSP entirely under the UK's control. The UK therefore is able to consider the above opportunities within the GSP framework. The House of Lords (2017).

Current Situation

29 March 2017, Article 50 is triggered.

29 March 2019, UK leaves the EU.

There is uncertainty at the moment as the UK has to still declare to the EU the sort of relationship the UK wants with the EU after it leaves.

Michel Barnier European Chief Negotiator, BBC, (2018) gave a speech on 9 January 2018 highlighting the current situation.

With regards to trade the UK has declared it wants impence to be able to negotiate its own international agreements and therefore it wishes to leave the EU customs union. It is possible that this will trigger the EU to form trade barriers with the UK and goods exported to the EU will require documentation to be checked, as well as, tariffs being applied when crossing the EU borders. BBC (2018).

A transition period has been requested by the UK and the commission of 27 countries have preliminary agree to a 21 month period from the UK withdrawal to 31 December 2020.

UK government is currently considering its options with how it approaches its trade agreement with the EU.

The UK had GSP as part of its trade policy in 1971 and did not become an EU member until 1973. Therefore the UK already has had GSP as part of its trade law and this could be utilized as a temporary preference while the main trade agreements are negotiated.

Penalties could be reduced for UK business while encouragement for trading more effectively could be introduced. After all an increase in trade = increase in profits = increase in tax revenue.

This would be very effective with regards to making the preference more accessible for smaller/medium size business. Also it will increase exports for LDCs.

However, there is the issue that the exporters will only export to the EU as this has more benefit due to more countries being accessible. So if there is too much difference then this would be an issue and therefore needs to be considered. Options to try and remain comparable with the EU system will make the UK easier to trade with but will not necessarily allow improvements to be made, or to make it more UK defined, but it will have to be still accessible for the LDC as well as, the importers. House of Lords (2017) suggested that if a transitional period is agreed, the UK government could negotiate access to the EU's preferential trade agreements with third countries.

100% of the interviewees stated that UK importers business is finding it difficult to plan ahead and implement business strategy moving forward. In July 2017 the Institute of Directors voiced concern that businesses are considering contingency plans in relation to setting subsidiaries within other EU countries and are postponing any large UK investment projects due to the uncertainty of Brexit, with an estimation of 11 percent acting already according to a recent survey carried out by the Institute. Wallace (2017). This theme has continued throughout 2017, in November 2017 the following was reported. Due to the uncertainty the Confederation of British Industry, has predicted that 60% of its members are already putting contingency plans in place if the uncertainty continues until March 2019. The Confederation also stated that 10% of firms are already moving parts of their business to other countries to protect their supply chains. This will help to mitigate the prospect of the UK being subject to tariffs or border controls. Inman, (2017). However, this is not just within the business community but also there are similar views within the financial sector, as UBS surveyed senior figures in 1,200 major corporations across the Eurozone, this has resulted in just under half will relocate British staff out of the UK into the Eurozone. Martin, (2017).

Current Business Issues

There are a number of issues that UK Businesses have concerns with regard to Brexit and how the UK overseas trade moves forward. The interviewees regarding this matter, had the following concerns:-

Number of trade agreements will be negotiated and who with?

EU Custom's law and its effects for EU and non-EU trade.

Knowledge of the transitional years, nature of negotiations that are going to take place.

UK business survival within the transitional years

Implementation of Article 50

Article 50 has been activated and the UK will leave the EU on 29 March 2019. This allows a 2 years transitional period before the UK comes fully out of the EU. Currently there is a lot of negotiation being done at ministerial level to try and agree the progression of policy and therefore to enable the best possible solution for the EU.

100% of the interviewees express the argument that this has a negative impact on some UK businesses as they are unable to plan ahead due to the unknown situation. Many UK businesses trade with countries that currently have trade agreements in place and therefore, these agreements could be at risk when the UK breaks away from the EU. However, the UK government are currently negotiating hard to try and allow the UK to continue to have access to the EU trade agreements, by transferring the trade agreements from the EU and installing them in the UK law, which is the most simplistic approach. However, at the moment this is in the air as there are many complicated aspects which have to be considered before this can really be solution. Currently UK businesses in a state of flux at the moment and unable to complete their business planning for the next 5 years but, are just running on a year by year basis until this is firmly resolved.

Number of Trade Agreements

56% of the interviewees raised this has an issue because the EU over a number of years have negotiated and re-negotiated many trade agreements. These agreements take many years to negotiate and are done so by a very experience team within the EU. As the UK has not had to negotiate on its own since joining the EU in 1973, the UK will have to negotiate a large number of trade agreements if the EU decides not to allow the UK to incorporate the EU trade agreements and then develop them into UK law over time.

There is the issue of Countries not wanting to trade with the UK now that article 50 has been put in place as they will see that the EU will hold a larger export market and therefore will be negotiating with the EU first. The EU has directed the UK that they are not able to start negotiating to entering to free trade agreements with Non-EU countries until after March 2019. BBC, (2018).

EU Custom's law

56% of the importers interviewed have invested a lot of time and training in becoming compliant with the EU customs law which is still going through is transitional phase and should be finalised by 2020. This has taken a number of years for the EU to get to this level of harmonisation and has been a rolling program incorporated by many UK businesses. No customs law has been amended in the UK since the UK joined the Customs union in 1993. The House of Lords (2017), recommended to the UK Government to negotiate the continuation of the Authorised Economic Operator system will lower the cost of UK businesses with regards to customs checks. Along with this recommendation the House of Lords suggested that the UK will have difficulty in continuing access to the EU's free trade agreements, unless the UK negotiates with the EU for their current free trade agreements to be transferred into UK trade law when it leaves.

Survival within the transitional years

Risk

Businesses feel there is a real risk that Custom laws, trade agreements and GSP that are in place within the EU will be lost along with trade uncertainty. Therefore the big issue is that the 2 years grace after Article 50 is too short and it could be 5 to 10 years before business can trade with certainty again. 78% of the interviewees stated that the 2 years were too short. However, some businesses are currently booming due to the weak pound and therefore exports have increase. So there are winners and losers in this situation.

Businesses hoped that when the Article 50 of the Lisbon Treaty 50 was evoked then at least it will start to become clear as to how trade agreements and preferential trade agreements will be introduced. However, since it was triggered on 29 March 2017 the uncertainty still exists. Will there continue to be preferential trade? If there is not then retail value of goods to the end consumer will rise considerably as import tariffs are introduced. Also the impact of increased expenditure on manufactured goods due to the rise in import costs on parts.

The UK has however, got an opportunity to increase trade with Non-EU markets, currently the EU has free trade agreements negotiation with US, Japan, India, China, Australia and New Zealand, but as yet they are complete legal ratification. The UK could negotiate for its own terms rather than having to consider 27 other countries and become a significant country within the global market. House of Lords (2017).

Conclusion

This paper was written to highlight the current issues in relation to GSP with respect to the future UK trade after it leaves the EU. There is academic literature available which raises the issues that currently the EU GSP scheme has developed over the last forty six years. The UK is in a very unusual situation by leaving the EU and it can consider developing its own GSP and therefore there is a good opportunity for it to improve the scheme and thus enabling LDCs to continue or even increase trade to the UK.

The UK is in a unique position as by leaving the EU it can negotiate its own trade agreements and become an independent global economy. However, it is going to take time for the UK to establish itself after leaving the EU. Currently there is a great deal of uncertainty with regards to the UK's future relationship with the EU. Also the UK has to disentwine itself from EU legislation which is complicated and time consuming. The two years the UK has to negotiate its exit is proving to be difficult and a transition period has been agreed to 31 December 2020, however, even this will be a time constraint.

Limitations and notes for further research

The main limitation for this research is due to the UK currently within the transition of leaving the EU and the level of uncertainty, does provide a limitation on how the preferential trade will be treated within this process. However, because it is a unique situation it is important to document at various points in the process, the issues that UK businesses are currently having. This will provide evidence for further research when evaluating the UK preferential trade after the UK has left the EU and how UK business has incorporated leaving the EU.

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