WORLD TRADE RULES AND THE POLICY OPTIONS FOR BRITISH AGRICULTURE POST-BREXIT

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UK TRADE POLICY OBSERVATORY

INTRODUCTION

EU policies have directly influenced UK food supplies and prices, the profitability of farm businesses, and the rural environment and land use, in at least four ways. First, through the Common Agricultural Policy (CAP), considerable transfers of taxpayer funds have supported the farm sector and paid for the delivery of environmental services. Second, very high import taxes (known as tariffs or duties) on many agricultural commodities and processed foods and drinks, coupled with preferential access to the EU market from many developing countries, have helped determine the UK's agri-food trade flows and food prices. Third, many of the regulatory conditions relating to agricultural production, and food and drink processing, are currently based on EU provisions. Finally, the horticultural sector and dairying, and food processing and catering, are often heavily dependent on migrant labour.

These are issues that were discussed and debated before the referendum, largely from an agricultural perspective (for example in Buckwell, 2016, Swinbank, 2014, and YAS, 2016), but to a large extent, it remains uncertain how they will be addressed post-Brexit. Other policy themes that impact on agriculture and the rural environment could be added to the list: for example support for biofuel, and renewable energy targets; the challenge of climate change and agriculture's role in reducing emissions of greenhouse and other obnoxious gasses; support for research.

The UK's exit from the EU means that policies can be redesigned to better suit British preferences and circumstances; and understandably various lobby groups are keen to influence that outcome.

KEY POINTS

- The EU has influenced UK food supplies and prices, the profitability of farm businesses, the rural environment and land use, in a number of ways, for example through agricultural subsidies and a highly protective trade regime. UK agriculture is probably larger and less efficient than had it been less subsidized.
- Brexit is an opportunity to redesign policies to better suit the UK. Post Brexit, taxpayer support to the farm sector is likely to be reduced, and to become more focused on environmental goals. But WTO rules on financial support to agriculture would have to be respected.
- Maintaining a 'soft' border with Ireland could be difficult if trade barriers are erected between the UK and the EU.
- New trade deals with third countries could be incompatible with any future UK-EU trade regime: and may expose UK farmers to tariff and quota-free access from highly competitive overseas suppliers.
- Food prices will be influenced by: the post-Brexit exchange rate; extra transaction costs involved in trading outside the Customs Union and Single Market; and the UK's new food trade regime. Liberal, free-trade, policies could result in lower food prices in the UK, whilst a protectionist policy could see them increase.

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However the UK does not start with a blank sheet of paper, as various political, financial, and international constraints will apply.

This Briefing Paper explores the issues encompassed by two of the four policy foci outlined above: i) existing and continuing support for farm businesses and the rural environment, and ii) the UK's future agri-food trade relations. Both are constrained by the rules of the World Trade Organization (WTO).

TAXPAYER SUPPORT FOR AGRICULTURE

Under the CAP farmers can claim "direct payments" based on the area of farmland at their disposal. Until 2015 this was known as the Single Payment Scheme, but the 2013 recalibration of the CAP reformulated the arrangements (see chapters in Swinnen, 2015). Currently these payments are fully funded by the EU budget (i.e. by taxpayers across the EU). In 2015 this paid £2.2 billion to UK agriculture as detailed in the penultimate row of Table 1.

Second, under the so-called 2nd Pillar of the CAP, farmers can be paid to implement environmental schemes (in England, in 2015 for example, the Environmental Stewardship Scheme). These are co-funded by the EU and the Member State concerned, and in 2015 paid out £605 million to UK agriculture. The bottom row of Table 1 shows the UK Agriculture Departments' preferred measure of farm income — TIFF, Total Income from Farming— in 2015. The 2015 outcome is substantially lower than that recorded in earlier years (about £5.3 billion in both 2013 and 2014 for example), but nonetheless the relative magnitude of the CAP payments to TIFF is evident. In the middle of the Table these CAP payments have been deducted from TIFF to give what has here been labelled *"Farming Income"*. In 2015 this results in a negative number for Wales and Northern Ireland. If these CAP payments were to be withdrawn the farm sector would over time undoubtedly shrink, but as a result of restructuring the overall impact on Farming Income would not be quite as dire as this static comparison of numbers seems to imply. Restructuring could be facilitated by a phased removal of support, possibly with those residual payments fully decoupled from farming, as advocated by Tangermann (2016).

The Prime Minister's announcement that the Government will introduce a 'Great Repeal Bill' to remove the European Communities Act from the statute book, and to transcribe the existing body of EU law into British law, together with her assurance that any subsequent 'changes in the law will have to be subject to full scrutiny and proper Parliamentary debate', potentially extends the CAP policy mechanisms beyond Brexit (May, 2016).

Earlier, in August 2016, the Chief Secretary to the Treasury had reassured 'the agricultural sector that it will receive the same level of funding that it would have received under Pillar 1 of CAP *[i.e. the direct payments discussed above]* until end of the *[EU's]* Multiannual Financial Framework in 2020 …' He went on to write: 'The government will work closely with

Table 1: UK Farm Income, and CAP Payments, 2015: £ million

	England	Wales	Scotland	Northern Ireland	UK
Gross Output at Basic Prices	17,675	1,495	2,937	1,745	23,852
Gross Value Added at Basic Prices	6,628	385	1,132	351	8,495
Farming Income	*927*	*-58*	*223*	*-104*	*988*
Less Favoured Area & Environmental Scheme payments	410	43	101	51	605
Single Payment Scheme	1,402	190	348	236	2,176
"Total Income from Farming"*	2,739	175	672	183	3,769

Adapted from Tables 3.2 and 10.3 of Agriculture in the United Kingdom 2015.
Provisional data.
* 'Total Income from Farming (TIFF) represents business profits and remuneration for work done by owners and other unpaidworkers.'

stakeholders to ensure that funding in the period immediately after exit is used to help the agricultural sector transition effectively to a new domestic policy framework. These funds will be allocated using the principles of CAP Pillar 1, and we will of course consider the opportunities post exit for making any short-term improvements to the way the system operates once we cease to be bound by EU rules' (Gauke, 2016).

The letter also gave an assurance 'that all multi-year projects administered by government *[e.g. environmental projects under CAP's Pillar 2, as discussed above]* with signed contracts or funding agreements in place, and projects to be signed in the ordinary course of business before the Autumn Statement, will be fully funded, even when these projects continue beyond the UK's departure from the EU.' As the Autumn Statement has now been delivered, farmers would probably be unwise to enter into new multi-annual environmental projects.

What will happen to these schemes after 2020?

Successive British governments have been critical of the EU's blanket approach to supporting farm incomes through Pillar 1, although the devolved administrations are rather more wedded to the idea (Swinbank, 2015b). It is difficult to justify the policy in social welfare terms. A farm household's income (or lack of) is not a factor determining entitlement, or the size of the payment: this depends on the area of farmland in-hand. Thus the bigger the area farmed, the larger the payment; and —because of the link with land— the expectation that the landowner, rather than the tenant farmer, will be the main beneficiary of the policy's largess (although the larger part of UK farmland is owner-occupied).

Furthermore, to the extent the policy inflates land prices it will hinder the expansion of existing farms and deter new entrants. Less-efficient producers will be cushioned in their loss-making operations, absolved for a time from the need for change. In short, we might expect UK agriculture to be larger and less efficient than it might otherwise be in a less subsidised environment.

Nor would an appeal to agriculture's multifunctional role in protecting an environmentally diverse and attractive countryside necessarily justify these payments. Cross compliance, and more recently 'greening', do make payments conditional on some effort by the farm business to protect the environment, but payments are usually well in excess of the cost of compliance, and —as flat rate payments— are not calibrated to site-specific conditions.

The UK is a net contributor to the EU budget, even allowing for a substantial rebate (Matthews, 2016: 14). Thus, with a repatriation of the UK's budget contribution following Brexit, there would appear to be ample scope to fund continuing support for British agriculture into the foreseeable future (although of course the changing fortunes of the British economy, and the electorate's expectations, could derail that prognosis). But in the referendum campaign, Vote Leave (2015: 30) gave the distinct impression that this money would not be available for farm support.

All this suggests that the Treasury will be keen to reduce the level of taxpayer support to the farm sector once the current guarantees of continued funding expire in 2020. However, the highly influential farm lobby will doubtless seek to retain a generous budget, and will probably be backed in this by the devolved administrations which are more dependent upon the rural economy than is the UK as a whole, and whose farmers tend to rely more on CAP subsidies than their English counterparts (see Table 1). Agricultural support is a devolved policy arena, but funding would be dependent upon Treasury support; and so a clash between London on the one hand, and Edinburgh, Cardiff and Belfast, can be expected.

Whilst downward pressure on Pillar 1 payments might well prevail, there is considerable lobbying to retain the same pot of money but switch it to other on-farm uses. The Tenant Farmers Association (2016: 3) has advocated retention of 'the current UK budget of approximately £3 billion allocated to agricultural support through the CAP but spent … according to new priorities.' They would ditch the current system of direct income payments, but retain a revised agri-environment programme; and introduce various new schemes. Similarly, in its post-Brexit consultation paper, the National Farmers' Union (2016: 15) pointed out that: 'Eliminating direct support does not necessarily imply ending all policies which benefit farmers and growers. If the same total budget could be preserved, there would be considerable sums available for, to take one example, encouraging investment and improving competitiveness.'

The environment lobby has, understandably, suggested shifting the funding focus from the farm to the rural environment. Thus the National Trust —one of the larger recipients of CAP support, reflecting its huge estate— has called on the government 'to put the recovery and future resilience of the natural

Box 1: The UK's WTO Commitments?

For the purpose of this Briefing Paper it is assumed that the UK —a founder member of the WTO— will continue as a WTO Member post-Brexit (as in UK Trade Policy Observatory, 2016), and be bound by the full repertoire of the WTO's multilateral agreements, including for example the *Agreement on the Application of Sanitary and Phytosanitary Measures*. A more open question relates to the UK's Schedule of Commitments. Again, for the purpose of this Briefing Paper, it is assumed that the UK will simply inherit (or in some way share) the existing EU28 schedule. If that is not the case, establishing a new Schedule could prove time consuming and messy. But a precedent, of sorts, exists.

When the former Czech and Slovak Federal Republic (Czechoslovakia) became two independent republics on 1 January 1993, and each became GATT Contracting Parties, they both assumed the MFN (most-favoured-nation) tariff bindings of the former Czechoslovakia. The situation was unusual, and the US delegate recorded a number of reservations including his observation that 'that the new States were not contemplating important reorientations to their basic trade and economic policies which would nullify or impair trade opportunities enjoyed by other contracting parties in their markets' (GATT, 1993: 4). It is then perhaps important to recall that the Czech Republic and the Slovak Republic established a custom union between themselves, considerably reducing the possibility that the new arrangements would 'nullify or impair trade opportunities.'

Administratively there would be no difficulty in the UK and the EU27, post-Brexit, *both* applying the MFN tariffs currently imposed by the EU28. Whether other WTO Members would consider this new arrangement nullified or impaired the trade opportunities they had previously enjoyed might be a more problematic issue.

What would appear to be a more difficult issue to resolve is the division of other elements of the EU's current schedule between the UK and EU27. For example the extent to which the EU can provide trade-distorting support to agricultural producers is limited; and the EU is currently obliged to offer import opportunities at a reduced tariff on a range of agricultural products (so-called Tariff Rate Quotas: TQRs). How will these 'entitlements' and 'obligations' be shared between the EU27 and the UK, if at all; and what role, if any, will the wider WTO membership play? These complex questions go far beyond the remit of the present Briefing Paper (and the expertise of its author!) but form the backdrop to the discussion in the main text.

environment at the heart of any funding system that replaces CAP.' [1]

Helm (2016: 13) is particularly critical of Pillar 2 support. He suggests that 'payments under Pillar Two are designed to protect land from the pollution and destruction that would otherwise take place', and goes on to comment: 'In any other industry, such damage would be subject to regulatory restraints and pollution taxes.' Thus he would not only phase out Pillar 1 support, but change the focus of Pillar 2 as well: 'Pillar Two is not … the panacea for improving the natural environment that a number of NGOs suggest. It is not obvious that the payments should go direct to farmers' (pp. 14-5).

But there will be WTO constraints

The scope and generosity of the UK's support for agriculture will be constrained by WTO rules (see Box 1). In particular, the *Agreement on Agriculture (AoA)*, in conjunction with other WTO provisions, has rules relating to 'domestic support measures in favour of agricultural producers'.

The AoA identifies three categories of 'domestic support measures in favour of agricultural producers' for developed economies such as the UK (see Daugbjerg & Swinbank, 2009: 59-62). First, those that are deemed to have 'no, or at most minimal, trade distorting effects or effects on production', and meet a number of policy-specific criteria: the so-called Green Box. For these policies no expenditure limits apply. Second, 'direct payments under production-limiting programmes', such as area payments or 'livestock payments … made on a fixed number of

1 The future of our countryside: https://www.nationaltrust.org.uk/news/the-future-of-our-countryside, 4 August 2016, accessed 21 October 2016.

Table 2: EU Declarations of Amber, Blue and Green Box Support, 2012-13

	Totals, €m	
Amber Box	5,899.1	
de minimis payments	1,780.6	*of which:* *- product specific: €986.1* *- non-product specific: €794.5m*
Blue Box	2,754.2	
Green Box	71,140.0	*of which:* *- decoupled income payments: €34,493.5m*

Source: WTO (2015)

head': the Blue Box. Currently no expenditure limits apply, but in the Doha Round of trade negotiations proposals to apply limits looked as if they would be accepted had the round been successfully concluded. All other support, by default, falls within the Amber Box, which is subject to limits. There are, however, two *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. Barring the exception set out below, any Amber Box support that exceeded these *de minimis* provisions would violate that country's WTO obligations.

A number of WTO Members had applied Amber Box support in excess of these limits prior to the Uruguay Round, and they were allowed to continue doing so, albeit at a reduced level. The EU was one such entity, and its current Amber Box limit *(its Final Bound Aggregate Measurement of Support (AMS))* stands at €72.4 billion:[2] well in excess of its annual declarations of Amber Box support, as illustrated in Table 2.

A succession of CAP reforms, and some creative accounting, has switched the bulk of what was once Amber Box Support into the Green Box (Swinbank, 2015a). In 2012-13, the latest data available, decoupled income support payments amounted to €39.5 billion. Whether these payments really met the WTO's strict Green Box criteria is immaterial. Taken together, the EU's Amber Box declaration, *de minimis* trade-distorting support not counted in its Amber Box, Blue Box support, and the €39.5 billion of decoupled income support, add-up to just less than €50 billion: well short of the EU's €72.4 billion AMS 'entitlement'.

2 This number is a self-declaration on the part of the EU, following enlargements in the 2000s, which has not yet been formally accepted by the WTO's membership (see Brink, 2016).

But the situation could be rather more critical for a post-Brexit UK. It is not yet known whether the EU27 and the UK will share the existing EU28 AMS Binding of €72.4 billion (and if so, how the shares would be divided, or how a decision would be reached), or whether the EU would retain the entire entitlement leaving a zero share for the UK. If the latter, the UK would have to rely on the AoA's *de minimis* provisions. But Table 1 shows that, in 2015, direct income support in the UK was equivalent to 9.1% of Gross Agricultural Output. Had this been post-Brexit UK, with a zero AMS Binding, other WTO Members might have been tempted to challenge the UK's invocation of the Green Box to house its direct income support payments. Given that these are annual payments, claimed on the area farmed that year, it might be difficult to satisfy the condition that: 'The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period' (Paragraph 6(d) of Annex 2 of the AoA). If it was found that this condition was not met, the payments could be deemed to offer non-product-specific Amber Box support in excess of the *de minimis* provisions.

Public support for 'income insurance and income safety-net programmes' would have to adhere to the provisions of paragraph 7 of the AoA if these schemes were to count as Green, rather than Amber Box support. Similarly, a post-Brexit UK would have to ensure that its environmental payments to farmers met the Green Box criteria: 'a clearly-defined government environmental or conservation programme … dependent on the fulfilment of specific conditions under the government programme'; and 'payment … limited to the extra costs or loss of income involved in complying with the government programme' (Paragraph 12, Annex 2, AoA). Failing that, these payments would be Amber Box measures; and again the *de minimis* provisions could be critical.

Table 3: The EU's MFN tariffs on selected products and their support prices under the CAP

	MFN tariff per tonne	**CAP support price per tonne**
Beef carcass, fresh or chilled	12.8% *plus* €1,768	€2,224
Butter	€1,896	€2,463.9
White sugar	€419	€404.4

A further complication to bear in mind is that the UK Government would be responsible for providing the WTO with an aggregate listing of all UK support on an annual basis. How the UK will ensure that support across all its devolved parts fits within its WTO commitments is no doubt one of the issues to be negotiated between London and the Devolved Administrations in the months to come.

TRADE POLICY AND AGRICULTURE

Whilst taxpayer funded support programmes have an important role to play in shaping the fortunes of the UK's farm economy, rural land use and the environment, trade policy is also critical. While the UK remains within the EU, agri-food imports from other Member States (and some important shipments, such as sugar, from developing countries) can enter the UK duty-free, although of course EU prices are often well in excess of world prices because EU agriculture is very heavily protected in many sectors (sugar, dairy products, beef, lamb, for example). In the main, imports of competing products from other origins face prohibitively high tariffs (see the examples in Table 3). There are of course some exceptions: there is a duty-free tariff rate quota (TRQ) for carcasses of lamb from New Zealand for example, which would otherwise face a full MFN tariff of 12.8% plus €1,713 per tonne. The EU currently administers 128 TRQs on agri-food imports (WTO, 2016). In 2014 some 6% of the EU's agri-food imports, by value, benefitted from these TRQ commitments in the WTO (European Commission, 2015: 6).

New Zealand's TRQ for lamb might be thought to be one that the EU27, New Zealand, and the UK would be happy to see transferred to the UK. But the commercial interests involved might not be quite that simple. The UK currently produces about as much lamb as it consumes, with its imports from New Zealand offset by exports of UK-sourced lamb to France and other EU countries. But if the UK's exports of lamb now faced the EU's full MFN tariff, would the UK be quite so keen to accept onto its market New Zealand produce? Reaching an equitable solution to the complex web of TRQs and other preferential arrangements, and reconciling differing commercial interests over sugar, could be even more challenging.

The range of potential trade policy scenarios for the UK's future trade in agri-food products with the EU is large. Elsewhere I identified a number of different tariff regimes (Swinbank, 2016), ranging from no change in tariff barriers (by either remaining in the present Customs Union, if that were possible, or by negotiating a new UK-EU27 customs union), to a *free trade* scenario involving the *complete* elimination of all tariffs as advocated by some economists (see also Gasiorek, Holmes & Rollo, 2016). Some of these scenarios could be combined with remaining in the Single Market, as illustrated in Table 4. As the terminology can be confusing, and not all interlocutors adhere to the same definitions, the Annex on p.8 sets out some of the terminology used in this Briefing Paper.

One of the many known unknowns is the length of time it will take to negotiate new trade deals with the EU27 and with the many WTO Members with which the EU has FTAs. Unless the UK and EU27 agree on some form of customs union —which seems to be highly unlikely, and which would preclude the UK determining its own trade policy— then the default position would appear to be that, on Brexit, the UK would perforce trade at arms-length over MFN tariffs. Unless, that is, transitional arrangements could be agreed with the EU27 and the wider WTO membership. For example Gasiorek, Holmes & Rollo (2016 9) have suggested a 'grandfathering of existing trade arrangements to … say 5 years after Brexit'.

Table 4: Schematic View of the Possible Treatment of Agri-food Products in Future UK-EU Trade

		EU Single Market	
		Out	In
WTO	**Customs Union**	"Turkey"*	
	Free Trade Area		"Norway"*
	MFN Tariffs	The default option	

* Although, of course, agri-food trade is not formally included in either the EU-Turkey Customs Union or the EU-Norway FTA!

Some FTA deals that the UK might eventually strike with Third Countries could expose UK agriculture to tariff and quota-free access from highly competitive overseas suppliers: sugar from Australia or Brazil (Mercosur) for example (although, as with CETA, some "sensitive" sectors could be left out of the FTA or subject to restrictive TRQs). Consequently it will be the combination of changes to the domestic support arrangements *and* the trade regime that will determine the impact on British agriculture. The more liberal the trade regime —exposing UK farmers to external competition— the greater the lobbying for a continuation of financial support is likely to prove.

Both the Irish and British governments have said that they want to avoid the creation of a 'hard' border dividing the island of Ireland; but this outcome is particularly difficult to achieve for agriculture. If a FTA between the EU27 and the UK is agreed that does include agriculture, then tariff barriers between the two parties on that politically sensitive border would be avoided, even though border controls to apply rules of origin —and regulatory provisions should the UK not retain free access to the Single Market— would probably remain.

A UK-EU27 FTA that did include agriculture, however, would probably preclude the UK unilaterally embarking on ambitious FTAs with competitive agricultural suppliers such as Australia and Brazil. Despite rules of origin, how eager would the EU be to accept free access onto its markets of 'British' agri-food supplies, if the UK could then provision itself duty-free from its other FTA partners? A similar outcome would arise if the UK unilaterally adopted free trade or reduced its MFN tariffs on key products to zero; and why would the EU conclude a FTA with the UK if it could in any event gain duty-free access to a free-trade UK?

If the EU27 and the UK fail to conclude a FTA that includes agriculture, then both the EU27 and the UK would, by virtue of the WTO's most-favoured-nation clause, have to apply their MFN tariffs against each other. Considerable disruptions to existing trade flows would ensue. Again, the Irish border springs to mind. Ireland is a major exporter of livestock products to the UK; highly integrated supply chains link manufacturing activities north and south of the border; and shoppers are readily attracted by price differences between border towns. Whilst modern computer and tracking systems could minimise the need for border checks on manufactured goods, would that suffice for livestock, agricultural commodities, and food? Smuggling of livestock in particular was a feature of this border during the Troubles in the past.

FOOD PRICES AND AVAILABILITY

Suggestions that the security of the UK's food supplies will be compromised, as a result of Brexit are, in my view, unduly alarmist. Whilst a whole host of economic, climatic, and other influences will impact on future world food supplies and prices, three Brexit-related factors for the UK are identified in this Briefing Paper.

First there is the exchange rate. The decline in the value of sterling following the referendum, widely regarded as referendum-induced, will feed through into the price of traded goods, including food. Second, withdrawal from the Customs Union and the Single Market will increase the cost of trade with the UK's erstwhile EU partners, because of the extra customs formalities and border delays involved. In a pre-referendum study for the National Farmers' Union, van Berkum et al. (2016: 17) assumed these additional trade facilitation costs would amount to between 5 and 8%. Third there is the new galaxy of tariffs that will impact on the consumer cost of traded goods.

But the UK does have trade policy choices, with two pole outcomes. If it adopts a free trade commercial policy, consumer prices (for sugar, beef, dairy products, etc.) would be lower than they might otherwise be. If, however, it adopts a protectionist policy, taking full advantage of the MFN tariffs inherited from its EU membership, and applies them to imports from EU27, food prices could increase. Irish beef, and Danish bacon, for example, would face hefty tariffs and consequently be more expensive when on sale in the UK. The Food and Drink Federation points out that 70% of the UK's imports of food and non-alcoholic drink in 2015 (and 72% of its exports) were from the EU.[3] Thus the reorientation of trade flows to take advantage of changed trading circumstances, could be substantial.

CONCLUSION:

Devising new domestic and trade policies for UK agriculture, food and the rural environment, will not be straightforward or easily compartmentalised. It is highly unlikely that agricultural issues will determine the UK's future trade policy, as easy access for sugar, beef or butter to the UK's market for example could well be some of the key demands of potential FTA partners. FTAs, in turn, will be difficult to negotiate until likely trade partners have some clarity over what is at stake: what are the UK's MFN tariffs, for example, and what is the nature of the new UK-EU27 relationship? A unilateral reduction in tariff barriers, to lower food prices and increase competitive pressures, would probably be unwise (although appealing to a number of economists) as it is those high tariffs that strengthen the UK's negotiating capital.

These trade policy decisions will feed through and interact with domestic policy concerns. What implications do these alternative trade scenarios have for UK agriculture and the rural environment, and what domestic policies might then be requested to counteract any adverse impacts? After all, the individual farm income, and site-specific agri-environmental impact, of freer trade in sugar is likely to be rather different from that in beef. A large number of farms could be put under considerable financial pressures, with an uncertain impact on farming practices and the environment. The environmental lobby might be quite content to see a reduced area of sugar beet *(but what would the health lobby feel about lower sugar prices?),* but express considerable concerns if trade policies reduced the viability of upland farms. Farmers might reluctantly accept a drastic cut in direct income support (or greater emphasis on enhanced environmental outcomes) if tariff protection remained, but would probably protest vigorously if both tax-payer funded support and tariff protection were removed in a double-whammy. And Conservative MPs with rural constituencies could well support their cause.

The policy debate has scarcely begun!

3 https://www.fdf.org.uk/eu-referendum-food-drink-statistics.aspx (accessed 25 November 2016).

ANNEX: CUSTOMS UNIONS, FREE TRADE AREAS, RULES OF ORIGIN, AND THE SINGLE MARKET

Both the terms *Customs Union* and *Free Trade Area* (FTA) have specific meanings in the WTO, as regulated by GATT Article XXIV (Similar provisions apply with the General Agreement on Trade in Services: GATS). A customs union involves the abolition of tariff barriers and 'other restrictive regulations' on 'substantially all the trade' between its constituent members. Quite what is meant by the word 'substantially' has never been entirely resolved. The Turkey-EU Customs Union excludes agriculture for example; but it is difficult to believe that WTO Members would now agree that a new agreement was WTO-compatible if it excluded a major sector of the economy such as agriculture. Similarly all of the members of the customs union apply 'substantially the same duties' on trade with Third Countries. The EU is itself a customs union, with *complete* product coverage, and a *common external tariff*, meaning that goods once imported into the EU are in free circulation and can be transferred to other EU states without further payment of customs duties.

A *Free Trade Area* (FTA) is rather different. This involves the elimination of tariffs and other restrictive regulations of commerce on 'substantially all the trade' in products *originating* within the FTA. Many FTAs have only partial coverage of agricultural, food and drink products. Thus the European Commission (2014: 3-4) has reported that the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada will eliminate tariffs and quotas on 91.7% of agri-food tariff lines on EU products entering Canada, and on 93.8% of EU tariff lines faced by Canada. TRQs will apply on imports of beef and pigmeat into the EU, and on some dairy products into Canada, whilst some poultry products will be excluded from the FTA altogether.

The parties to a FTA still determine their own trade barriers against Third Countries. Consequently *rules of origin* (which can often be extremely complex) have to be negotiated to determine what constitutes an originating product *(what minimum level of processing is required?).* Moreover border controls are still needed at the FTA's internal borders to differentiate between originating products (entitled to duty-free access) and non-originating products (on which duty is payable). If this did not happen, *trade deflection* would be an issue, as traders tried to import their goods into the FTA via the country with the lowest external tariff. The problem becomes more acute when commodities (such as bulk sugar) are involved, where product substitution could readily occur. Thus if the EU maintained its very high tariffs on sugar and negotiated an FTA with the UK that did include sugar, but left the UK to freely import sugar from the world market, the outcome might be that the UK would source all its supplies for domestic consumption from world markets, while exporting all its domestic production (produced from sugar-beet grown on British farms) to the EU.

It is not just tariffs that can restrict trade. Divergent regulatory provisions (e.g. covering food safety, animal and plant health) can do so too. Although the WTO has attempted to provide a framework within which such provisions can apply (the *Agreement on the Application of Sanitary and Phytosanitary Measures* for example) many FTAs now include agreements that go beyond the WTO rules. The European Commission has talked about Deep and Comprehensive Free Trade Area (DCFTA) agreements. However its ambition has on occasion proved deeper and more comprehensive than can be readily delivered. Thus the proposed Transatlantic Trade and Investment Partnership (TTIP) between the US and the EU has had difficulty with a number of regulatory issues, including US reluctance to accept the EU's policy on Geographical Indications (GIs) of origin on many food and drink products, and EU concerns about the chlorine washing of poultry carcasses to reduce pathogens (Josling & Tangermann, 2015: 241-6).

The EU's *Single Market* goes beyond regulatory convergence on selected topics. A key element in achieving the free movement of goods —one of the 'four freedoms' for goods, services, capital and workers— is that the same regulatory regime applies in all the Member States (or the principle of mutual recognition results in products legally produced in one Member State being accepted throughout the Single Market). With a customs union covering all goods, and regulatory harmonisation or equivalence achieved, there is no need to apply border controls within the EU.

Norway, through the *European Economic Area* (EEA), applies EU regulatory provisions enabling it to participate in the Single Market;[41] but paradoxically it is not in the Customs Union as the EEA is built on a series of FTAs (and nor do its FTA provisions apply to agriculture). Consequently, border controls are still necessary to apply rules of origin. Turkey, despite its partial customs union with the EU, is not in the Single Market, and so border controls are needed to ascertain that traded products do fall within the remit of the customs union, and that the EU's regulatory provisions are met.

1 Of the various Directives regulating agricultural production (the Nitrates Directive, the Water Framework Directive, etc.) the National Farmers Union (2016: 32) identified only two —the Habitats and the Birds Directives— that Norway is not obliged to apply for it to participate in the Single Market.

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FURTHER INFORMATION

This document was written by Alan Swinbank, University of Reading, with inputs from other members of the UKTPO. The UK Trade Policy observatory (UKTPO), a partnership between the University of Sussex and Chatham House, is an independent expert group that:

1) initiates, comments on and analyses trade policy proposals for the UK; and

2) trains British policy makers, negotiators and other interested parties through tailored training packages.

The UKTPO is committed to engaging with a wide variety of stakeholders to ensure that the UK's international trading environment is reconstructed in a manner that benefits all in Britain and is fair to Britain, the EU and the world. The Observatory offers a wide range of expertise and services to help support government departments, international organisations and businesses to strategise and develop new trade policies in the post-Brexit era.

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