The Commonwealth: A Panacea for the UK's Post-Brexit Trade Ills?

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Overview

The central tenet of this paper is that geography has become a dominant factor in determining trade flows. In particular, those positing a reorientation of UK trade towards the Commonwealth fail to consider the importance of modern Global Value Chains (GVCs) in determining both the loci of production and the size and nature of trade flows. British accession to the EEC in 1973 did not cause a discernible break in export trends already visible, suggesting that GVCs were already instrumental in shaping Britain's trading relations.

As a complement to the existing literature on prospects for post-Brexit trade, we consider in-depth case-studies to ascertain the extent to which a reorientation of UK trade flows towards the Commonwealth might be feasible. In each case, substantial barriers towards a substantive improvement in export conditions remain. As such, this paper seeks to deepen our practical understanding of barriers to trade and explain why, ultimately, geography trumps history in determining British trade flows and will continue to do so, irrespective of the UK's future relationship with the EU.

Background

On 23rd June 2016, the British electorate voted to leave the European Union. Since this point, there has been intense debate within the UK over what the UK's future trading relationships, both with the EU and third parties, will look like. Whilst the possible economic impact has been a core concern, much of the public discourse has been shaped by the UK's particular history at the centre of a vast trading empire. As such, two very distinct conceptualisations of national identity have emerged in this discussion. These two competing world-views see Britain alternatively as fundamentally "European" or as desiring an "escape to the open seas".

The latter often places great emphasis on the UK's links with its former colonies. The potential for greater trade with the Commonwealth is a clear part of the government's agenda for post-Brexit Britain in spite of widespread scepticism within the civil service establishment (Blitz, 2017). Prior to joining the European Economic Community (EEC) in 1973, the UK was a central pillar of the Commonwealth Preference Area and many proponents of Brexit view joining the EEC as a historic betrayal (Better Off Out, 2016). These debates are not new: Britain's initial decision to remain outside the nascent European Steel and Coal Community in 1955 was made on the basis that British trade with the Commonwealth was much more important (Gowland & Turner, 1999).

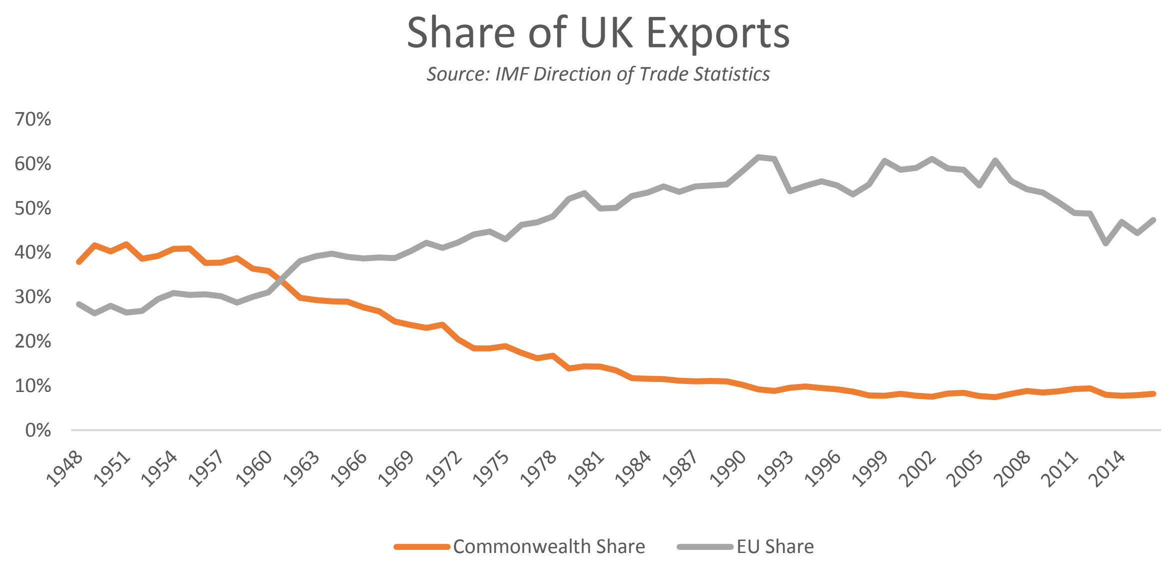
History

In the early post-war period, the UK was at the epicentre of the Sterling Area, allowing dollars to be pooled across members of the Commonwealth: critically important to those members afflicted by dollar shortages in the early Bretton Woods era. It may also have had a role in slowing the decline in intra-Commonwealth trade (and particularly trade between Commonwealth members and the UK). These trading arrangements had their roots in the traumatic experiences of the 1930s. The Imperial Preference agreement came into being in 1932 – initially for a period of 5 years. In the UK, this was given life by the Import Duties Act, which introduced a general tariff of 10% on most imports (subsequently increased for many of them).

Around 80% of Empire products were to be admitted duty free, and the remainder were subject to duties (although these were typically lower than similar products from other nations – often being equal to their pre-1931 level). In exchange, Australia granted preferences – i.e. reduced tariffs – to British goods, as did South Africa, New Zealand and India, although in each case the details varied (Glickman, 1947).

Post-1947, this morphed into the Commonwealth Preference Area. In the immediate post-war period, the importance of the Commonwealth to British exports reached its zenith, accounting for a 42% share of all British merchandise exports. This share was broadly maintained until the mid-late 1950s, at which point it began to decline precipitously. This decline continued at a relatively steady pace through Britain's entry into the EEC in 1973 until the mid-1980s. Today the Commonwealth accounts for around 8% of British exports.

The share of the EU (defined as the present 27 other members) in British merchandise exports has been more-or-less a mirror image of that of the Commonwealth, increasing steadily from just over a quarter of British trade in the immediate post-war period to around 60% at the beginning of the 1990s. This remained around the same level until the mid-2000s and has since fallen to 47% in 2016. The fall in the EU share of services exports may have been somewhat less pronounced, being around 40% in 2003 and remaining near this level in 2015.



There is no evidence of a "shock" to British trade with either the EU or Commonwealth at the point of British accession to the EU. It appears unlikely, therefore that it was the EEC that reduced trade to the Commonwealth. Indeed, in absolute terms, British trade with former colonies has increased. The major difference is that Commonwealth nations are now free to trade with other partners. As Head et al. (2013) show, trade with former colonies has tended to fall substantially for all colonial pairs: this is not a peculiarly British phenomenon. As such, it is difficult to envision a resurgence in old trading relationships – and case studies will shed some light onto why this may be the case.

Perspectives on Modelling Trade

Perspectives on the potential consequences of Brexit for Britain's trading relationships can be broadly classed as falling on twin spectra: one political and the other methodological. One's position on the political economy of Brexit appears intimately linked to the methodology used to evaluate it. A broad categorisation of opinion on the political economy of Britain's possible post-Brexit trading relationships might run as follows. On one end of the spectrum lie groups such as Economists for Free Trade, who broadly favour what has come to be categorised as a "hard Brexit" (Minford, 2017). Similar views are espoused by the Legatum Institute (2017), with a slightly different emphasis, arguing for a "zero for zero" tariff deal, combined with strong emphasis on arrangements that facilitate customs clearance.

Moving along this spectrum of political economy, one encounters a plethora of private sector or political think tanks with divergent views on post-Brexit trade. Open Europe, for example, considers that whilst Brexit is likely to be a net drag on UK trade, there are actions that could be taken to mitigate this (Chapman, 2017). As such, the long-run outcome of Brexit upon trade will be, according to this perspective, critically dependent upon those agreements (including non-FTAs like bilateral investment treaties) the UK is able to obtain. Others have argued that many within the policy community (particularly the UK Treasury) may have overestimated the impact of Brexit upon trade (Gudgin et al., 2017).

There is a cluster of academic and professional economic opinion that holds rather more negative views on the probable impact of Brexit upon British trade. In general, this posits that Brexit, in and of itself, will have a deleterious impact upon trade and that through this mechanism will also lead to a fall in both economic output and welfare for UK citizens. Nevertheless, although there is consensus over the direction of any post-Brexit change in GDP, there is a wide variety of estimates as to the possible size of this effect. The Treasury (2016), NIESR (Ebell & Warren, 2016) and Centre for Economic Performance (Dhingra et al., 2016) find a range of negative estimates for the impact of different trading scenarios on GDP and trade. It is probable that this cluster of opinion is what Michael Gove disparagingly referred to in his statement "people in this country have had enough of experts" (Mance, 2016). In general, policymakers, academics and others in this group seek a "soft Brexit" that cleaves as close to EU membership as is possible.

In parallel with (and linked to) the political economy of Brexit, there also exists a methodological spectrum on which each of these broad groups can be placed. Economists for Free Trade take a highly theoretical view, basing their estimates of potential long-run consequences of Brexit on a CGE trade model (Minford, 1997) and producing short-run forecasts via the Liverpool Model (a rational-expectations DSGE model (Minford et al., 1984).

Critical to the working of such models, however, are the assumptions underlying them and the micro-foundations implied by these models have been widely criticised. Of particular concern is that products are fully homogeneous, leading to all trade taking place with the lowest cost supplier. In reality, particularly for manufactured goods and services, quality is an important differentiator. Additionally, the increased dominance of GVCs in trade implies a role for factors such as time to market and flexibility that may explain why non-price factors are so important (not to mention the continued role of distance in trade). Many of the empirical estimates generated by the model appear quite extreme (notably that a 10% tariff leads to a near-doubling of the size of the manufacturing sector and a 30% fall in services output).

Moving along the methodological spectrum, one finds a variety of CGE models with different underlying assumptions. (Swati Dhingra et al., 2016), for example, argue in favour of a model that incorporates imperfect substitution (although not, interestingly, imperfect competition). This approach is typically criticised on the grounds that imputing elasticities as "fundamental parameters" into a model on the basis of past estimates fails the Lucas critique. More crucially, the epistemological foundations of both sets of general equilibrium models are deeply questionable, failing to capture the complexity of modern global value chains and their organic development over time.

The approach adopted by HM Treasury (2016) and others is to make assumptions about the impact of EU membership based on an econometric estimate of the average impact of EU membership on trade of all members. The Treasury then input the resulting impact into a CGE model in order to estimate the impact on GDP and other variables. As Gudgin et al. (2017) point out, the residual for UK trade with the EU is consistently negative, suggesting that the effects of membership on trade may be smaller for the UK than other members of the EU.

This approach is justified if and only if the econometric equation is well specified. The first (and most obvious) source of error in the Treasury equation is the use of OLS as an estimation technique. In the absence of extremely restrictive assumptions placed upon the error term, log-log (constant elasticity) models of the form used in the gravity literature produce biased and inconsistent estimates when estimated by OLS (J. M. C. Santos Silva & Tenreyro, 2006). Moreover, the nature of trade flows (with variance related to GDP) means that these assumptions are almost certainly violated in practice.

This paper seeks to outline another perspective approach when considering Britain's future trading relationships: namely consideration of in-depth case-studies. Doing so enables us to consider plausible changes in the trading relationship between the UK and its Commonwealth partners. Australia, India and Nigeria were chosen as case studies both because of their overall importance – representing the majority of the Commonwealth population and its largest markets – as well as representative examples of different levels of economic development in the Commonwealth.

India

As the most populous country in the Commonwealth and one of the largest economies in the world, India is a natural target for enhanced trade and economic links post-Brexit. It is argued that the UK should seek to decouple from a "moribund" European economy and engage more with the dynamic and rapidly growing economies of Asia. The example of India suggests that this vision may be more challenging to execute than has been envisioned.

India ranks 130th on the World Bank's "Ease of doing business" rankings (2016), similar to Nicaragua, Tajikistan and Cambodia. Whilst India ranks relatively highly for its protection of minority investors, getting electricity and ease of gaining credit, it presents particular problems for companies that need to deal with construction permits, pay taxes or enforce contracts. India also ranks 143rd out of 190 countries for trading across borders.

There is enormous scope for tariff reduction were a free trade agreement (FTA) between the UK and India to be signed. Scotch accounts for some 22% of all British exports of food & beverages (HMRC, 2017b) and as India is by some measures the world's largest whisky market, the potential stakes for the food & drink industry are significant. Nevertheless, given that food & drink combined accounted for only 6% of British goods exports in 2016 (and in the region of 3.4% of total British exports), this impact ought not to be overstated. At present it is subject to applied duty of 150%, which is likely to be an area of contention during any negotiations (Ryan, 2017).

Major difficulties in establishing an FTA exist. Firstly, tariffs are often used for domestic political purposes: in April 2008. For example, India substantially reduced import duties for a number of agricultural products in an effort to reduce inflation. Tariffs on many of these were subsequently raised again. There are powerful entrenched domestic political interests that would be disadvantaged by any reduction in tariffs and it may be difficult to negotiate a settlement, particularly given that any FTA would have to cover “substantially all” of the trade between the UK and India (GATT, 1947).

Current Regime

India is a comparatively closed market relative to European standards and there are numerous challenges to doing business and exporting. Import duties and additional taxes are “likely to be a minimum of 35%” for many exporters (DIT, 2016b). India’s system of tariffs and fees is both complex and relatively opaque. In general, it consists of customs duty, an “additional” or “countervailing” duty, a “special additional duty” and an education assessment. Additional duty is applicable to all imports except alcoholic beverages.

The special additional duty is a 4% ad valorum surcharge applied to all imports, except those explicitly exempted via an official customs notification. Finally, the education assessment is a further 3% surcharge on the post-duty price, and is applicable to most imports (once again, except those officially exempted). Further to this, there is a landing fee of 1% included in the valuation of all imported products except those exempted through special notification (USTR, 2013).

In addition to its complexity, the Indian tariff system is characterised by uncertainty, ad hoc alterations and changes by administrative fiat. The granting of official exemptions is exceptionally opaque, leading to high risks of corruption and uncertain costs. There is also a large disparity between India’s bound tariff rates (averaging 48.5%) and those currently applied (averaging 13.4%). As a result of this, India is able to change tariffs with minimal notice, leaving exporters uncertain as to the tariff rates their goods will face. 25% of all non-agricultural goods are not covered by WTO binding (U.S. Department of Commerce, 2017).

India maintains a “negative list” of goods subject to additional non-tariff barriers. These include items that require an import license (notably livestock & a number of chemicals). Other goods can only be imported by the government or certain monopoly providers (some pharmaceuticals fall into this category) and are typically subject to approval by the government in both timing and quantity. Once again, this system is largely opaque. India requires import license for all remanufactured goods at the present time. This is often burdensome for businesses with delays in processing licenses and quantity limitations on certain parts being particular problems (USTR, 2013). Even the largest companies at times fall foul of licensing restrictions, with Apple being refused permission to import used iPhones into the Indian market (Worstall, 2016).

India has the second highest number of barriers to trade of all countries surveyed by the Trade and Investment Barriers Report (EU Commission, 2017). Moreover, India has put the second highest number of new barriers in place over the past year (behind Russia), suggesting that trade distorting measures continue to be an active policy tool for the Indian government and bureaucracy. Tellingly, the admission that FTA negotiations with India have come to an impasse is explained by “a mismatch of the level of ambitions” (EU Commission, 2017).

India is, furthermore, a patchwork of 36 state and union territories with considerable autonomy as regards a wide variety of important matters (including transport, transfer of non-agricultural land, contracts, bankruptcy, economic planning, labour welfare, stamp duties and many others). Although

English is widely used in officialdom, the official language also varies by state. States additionally vary enormously in size from Sikkim with a population of less than 1 million to Uttar Pradesh with a population of around 200 million. Exporters will want to concentrate their focus on a certain number of selected markets.

In its own advice for exporters, the British government notes that "[c]orruption is well entrenched in India and pervades many aspects of daily life" (DIT, 2017). This poses a significant barrier to trade with judicial and police corruption posing a particular problem. "Politicians, bureaucrats and law enforcement officials often wield significant discretionary power and notable abuses have been brought to light" (DIT, 2017). India's infrastructure is extremely poor, most notably with regard to transportation.

The US government notes that "India remains one of the world's most challenging major economies with respect to protection and enforcement of IP". In common with problems pertaining to bribery and corruption, lax (or non-existent) enforcement is a problem even when the overarching legal framework is in place. Further issues surround the interpretation and application of patent law. India has no statutory protection of trade secrets. Some action is now beginning to be taken at a state level, although the scope and extent of this remains unclear at the present time.

Restrictions on automotive imports present an excellent indication of both the challenging nature of exporting to India and the entrenched rent-seeking domestic interests that make change unlikely. India's present MFN applied rate for motor cars is 60% and is currently an unbound industry. India further operates a number of duty exemption regimes for imports. These are opaque in nature and eligibility is typically subject to a number of conditions (often including an obligation to export from India).

India's automotive lobby, the Society of Indian Automotive Manufacturers, is vociferously opposed to reducing tariffs on motor cars, commercial vehicles and many component parts. In 2015, it commented on the prospect of a free trade agreement with the EU, stating, "FTAs with competing countries do not benefit Indian automobile industry", arguing that "it is against the concept of 'Make in India' for local value addition and local employment" Economics Times (2015). As of today, cars, buses, trucks, bikes and engines are all on the list of items that SIAM seeks to exclude from FTAs (SIAM, 2017).

India additionally maintains substantial non-tariff barriers on the import of motor vehicles. In particular, they can only be imported direct from the country of manufacture (thus preventing the storage or warehousing of cars en-route) and can only be imported through 3 ports, namely Chennai, Calcutta and Nhava Sheva in Mumbai. The restrictions on importing used vehicles are yet more stringent. All vehicles must comply with the Indian Motor Vehicles Act of 1988.

Australia

Australia is one of the most advanced economies in the Commonwealth and is a large, sophisticated market for British goods. Its institutional set-up bears striking resemblances to that of the UK and there is an extremely large British diaspora living there. Historic trading links are strong. As a result, there are high hopes and expectations that a post-Brexit trade deal can be struck relatively quickly with Australia (and possibly New Zealand as well).

In many regards, Australia and the UK have relatively complementary trade flows. Whilst the former is a large commodity exporter, the latter specialises in producing high-value industrial and service goods. Australia scores highly on a variety of economic rankings and is widely considered to be an "easy" place to do business. It ranks alongside the more developed markets in the EU in this respect, scoring between Latvia and Germany in the World Bank's "ease of doing business" rankings (2016). Australia is likely to expect concessions around rules on migration during trade negotiations, as well as opening up Britain's agriculture sector. These may be sticking points during negotiations if the UK seeks to achieve the government's target of limiting net immigration to 100,000 people. There are likely to be significant entrenched domestic interests in the UK opposing a reduction in agricultural subsidies or tariffs, particularly in rural constituencies.

Current regime

Australia imposes some of the world's lowest tariffs. A large proportion of all Australian trade is not subject to any tariff at all. Indeed, the maximum Most Favoured Nation (MFN) tariff levied by Australia is 5%. Australia does impose "Import Processing Charges" although these are typically modest and, according to the Australian government, are designed to recover border costs rather than penalise imports. Nevertheless, due to how they are structured they can constitute an additional barrier to import consignments of modest value (approximately between AU$1000 & AU$3000).

Australia's trade policies have been labelled "highly transparent" by the WTO (2015) and non-tariff barriers in the country are generally regarded as modest in most industries. In trade terms, Australia specialises in the extraction and export of commodities in addition to having a substantial agricultural sector. Like the UK, services make up a large proportion of the total Australian economy and it is here that non-tariff barriers are most clear.

Nevertheless, in most respects, these non-tariff barriers do not take the form of regulatory barriers deliberately designed to disadvantage international competitors. Rather, regulations and standards are typically designed to achieve some domestic policy objective (e.g. ensuring public safety or environmental protection). In practice, this means that British companies seeking to export to Australia need to comply with two sets of standards (British and Australian), often in order to achieve the same ultimate objectives in terms of public welfare.

Australia is presently undertaking negotiations to accede to the WTO Agreement on Government Procurement. Once it has done so, it will be legally obliged to offer other members' suppliers conditions "no less favourable" than that it offers to domestic suppliers. The UK is already a signatory to this agreement through its membership of the EU. Australia's protection of intellectual property (IP) rights is strong. The relative familiarity of the Australian legal framework suggests that there are limited barriers in this areas to UK companies seeking to trade there.

In terms of the service sector, there are specific areas where Australia engages in restrictive practices. This is particularly the case with regard to television broadcasting where there are minimum annual sub-quotas for Australian content. Codes of practice for commercial radio broadcasting similarly stipulate minimum proportions of their output that must be performed by Australian artists. Both of these may act as impediments to British service exports, although it is unclear what the Australian government's negotiating position is likely to be.

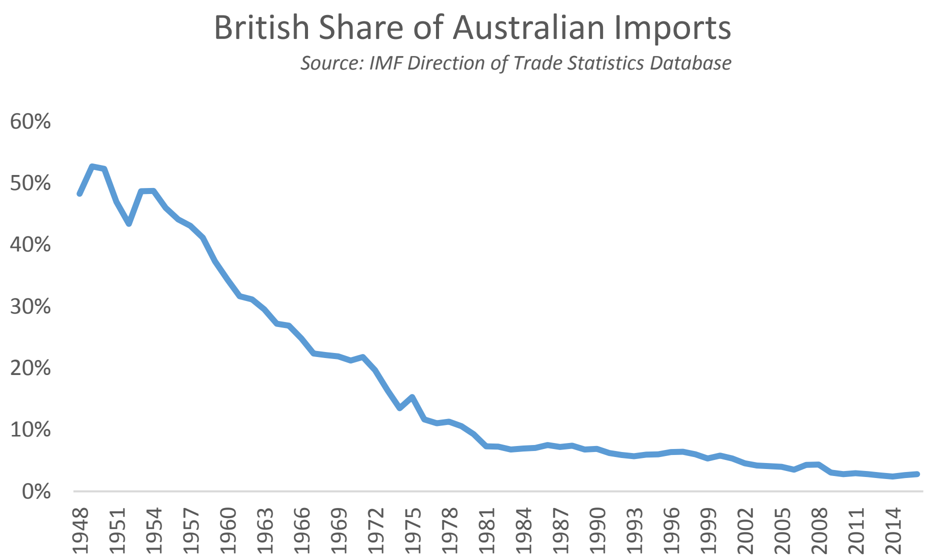
Whilst the National Broadband Network has facilitated neutral access to Australia's broadband infrastructure, the presence of physical infrastructure located in Australia inevitably limits telecommunications service exports. This market remains less open to competition than most, as exhibited by the Telstra Foreign Ownership Regulations (limiting foreign ownership of Australia's national telecommunications provider).

A variety of issues (most notably around standards and certification) can be tackled in order to lower non-tariff barriers further. The British government should seek to ensure that rules regarding proof of origin are as liberal as possible as part of any trade agreement and needs to work with potential exporters to ensure that they understand what needs to be done to comply with them.

As part of negotiations for any free trade agreement, the Australian government is likely to ask for a relaxation of visa requirements. This is likely to be reciprocal, although it is unclear whether this will undermine the UK government's net migration target. Excluding students from this target is likely to be a relatively easy way of creating some breathing space and will have the additional advantage of enhancing British service exports.

Given the already largely open nature of the Australian economy, the scope for further improvement in terms of tariff reduction is extremely modest. There are improvements that can be wrought in terms of reducing regulatory overlap, easing rules around proof of origin and ensuring that certification and adherence to standards is as easy as possible. Nevertheless, trade barriers are already low and continue to fall.

Since 1999, Australia has consistently absorbed around 1.3% of British goods exports (ONS, 2016) ranging from a low of 1% in 2006 to a high of 1.6% in 2012. Until recently, the picture in the service sector looked somewhat rosier with Australia growing from around 2.2% of exports in 2007 to almost 3% in 2012. More recently, however, the share has fallen back. Australia accounts for a slightly more important proportion of the West Midlands' goods exports – around 2.2% - and this has grown from 1.3% a decade ago (HMRC, 2017a). In either case, however, trade would need to increase notably in order to offset any reduction of British trade with the European Union.



As can be seen, the UK share of Australian merchandise imports rapidly fell from around 50% in the mid-1950s to below 10% in the early 1980s. This decline has continued at a much more modest pace since then. In light of the rapid growth of Australian trade with East Asia, it would be unrealistic to expect this share to increase dramatically. Given the reliance of Australia upon East Asian GVCs, both as a source of imports and as a destination of commodities exports, it is almost impossible to see how the UK can displace these – Japan and Thailand, for example, being the largest exporters of cars to Australia.

The Australian Trade Minister during 2016, Mr. Steven Ciobo, made clear the extent to which the UK has become a minor trading partner in a talk to the European Parliament, where he described the historical links between the UK and Australia as “in many respects a relationship of yesteryear”. He added that negotiating a free trade deal with Britain would be “at a minimum … two and half years away”, and said talks with the EU were significantly more advanced. Evident then is that Australia, at the time of writing, is prioritising a trade deal with the EU. (Stone, 2016). Assuming that negotiations between the UK and Australia begin in a few years, noting that it took Canada seven years to thrash out a deal with the EU, then it could well be the late 2020s before any trade deal between Australia and the UK would be operative.

Nigeria

Nigeria has the largest economy in Africa with a rapidly growing population of some 190 million, in addition to being a major oil producer and exporter. Nigeria is already the 7th most populous country in the world and is projected to overtake the United States of America as the world’s third most populous country during the 21st century. Nigeria is a major commodities exporter and is a significant potential market, leading it to be considered a target to grow post-Brexit trade within the Commonwealth. The country has the world’s 10th and 9th largest oil and natural gas reserves respectively. Nigeria is the number-one recipient of FDI in Africa (DIT, 2016a), although the country is extremely poor relative to European standards and has problems in infrastructure, power supply and mass unemployment.

Several factors facilitate trade between the UK and Nigeria – not least the use of English. Additionally, the UK is home to a substantial Nigerian diaspora and ongoing educational links (most notably at the higher education level where Nigerians are the third largest group of overseas students in the UK) continue to strengthen ties between the Nigerian elite and upper middle classes and the UK. In addition, flights are regular and time differences modest (certainly relative to the American and East Asian markets). 134,000 Nigerians visited the UK in 2014.

One result of this is that British luxury brands are comparatively well-known in Nigeria, which together with the oil industry may help explain why a number of major British firms already have extensive relations with (and operations in) Nigeria. The country also runs a number of investment incentives and infrastructure is being developed by the Nigerian authorities in partnership with a number of western firms. UK exports account for a greater share of Nigerian imports of merchandise goods - 4.4% in 2016 - than they do for EU merchandise goods imports - 3.8% in 2016 (IMF, 2017). There are not sufficient data on Nigerian service imports to be able to make any comparison with confidence, although it’s worth noting that some 8.8% of all EU services imports came from the UK, according to the OECD (2017).

Whilst these figures suggest comparatively successful penetration of the Nigerian market, it should be noted that the comparatively small volume of total imports into Nigeria mean that the overall market is modest. Sub-Saharan Africa (excluding South Africa) as a whole accounted for just 1.6% of UK exports of goods & services in 2015 (ONS, 2016). Data from HMRC suggest that Nigeria accounted for a mere 0.3% of UK goods exports in 2016. For many UK regions, Nigeria is an even less significant export destination: just 0.1% of the West Midlands’ exports are destined for the country.

Nigeria is heavily dependent on the oil and gas sector, both as a source of government revenue and foreign exchange. The fall in oil prices since 2014 has therefore led to a fall in exports and economic growth (particularly when combined with recent unplanned shutdowns and reductions in production as a result of militancy in the Niger delta). IMF data indicate that the Nigerian economy shrank by 1.6% in 2016 and is expected to grow by just 0.8% this year before staging a modest recovery. Imports have fallen by around 30% since their peak. In the absence of a rebound in oil prices or an end to violence in the Niger delta (which has had a major impact on oil production), the economic situation means that Nigeria is likely to prove a challenging market over the next few years. Also noteworthy is that the present situation means that payment (particularly in foreign currency) can be slow.

The World Bank's "Ease of Doing Business" ranking places Nigeria at 169th (out of 190 countries), between Iraq and the Syrian Arab Republic (2016). Comparative strengths include protection of minority investors and ease of gaining credit. Major areas of weakness include trading across borders, access to electricity, paying taxes and registering property (all 180th or worse out of 190 countries).

Border compliance is a particular challenge, taking an average of 284 hours and costing over US$1000. Comparative figures for the OECD are 9 hours and US$115 (World Bank, 2016) whilst those for sub-Saharan Africa as a whole are 144 hours and US$676, suggesting that Nigeria lags not only the UK's present major trading partners but also its own peers in developing Africa. Border compliance for the UK's largest markets in the EU is essentially zero-cost (in terms of both time and money) due to the regulations surrounding the Single Market and EU Customs Union.

Current regime

Nigeria is a member of the Economic Community of West African States (ECOWAS). Members of ECOWAS have adopted a common external tariff (CET) with five bands: zero tariffs on "essential social commodities", 5% on raw materials, capital goods and certain commodities, 10% on intermediate products, 20% on consumer goods and 35% on goods for economic development. ECOWAS also permits a number of further "trade defence" measures (either in common or at the discretion of member states).

One wide-ranging measure is the so-called "safeguard measure". This permits the imposition of additional import duties or quantity restrictions either for ECOWAS as a whole or on behalf of a member state for a period of up to 10 years in order to protect specific industries. ECOWAS additionally may impose more conventional anti-dumping measures or countervailing duties (in order to stop "dumping" or cancel out export subsidies offered by trading partners).

ECOWAS also allows certain "supplementary protection measures" to be enforced. Import adjustment taxes may be used until 2020 in cases where member states initially had higher tariffs than the agreed common external tariff. In addition, a "supplementary protection tax" may be added to imports when the volume of a particular product being imported exceeds certain thresholds (or the price is below a certain threshold – linked to the average price over the past 3 years). Supplementary protection taxes can be imposed on up to 3% of product types (and the maximum additional tariff is 70%).

Interestingly, in light of the UK's decision to leave the European Union, economic integration between ECOWAS members has increased (albeit slowly) in recent years. ECOWAS has moved in a direction very akin to the European Economic Area, and has the stated intention of developing a Common Market. The Protocol on Free Movement of People ostensibly gives the right to freedom of movement (albeit imperfectly implemented), whilst the ECOWAS Trade Liberalisation Scheme (ETLS) effectively functions as a Free Trade Agreement (FTA). The CET may also help facilitate the free movement of goods. There has been speculation that ECOWAS may seek to introduce a single currency. Whilst implementation of all of these initiatives has been extremely slow and patchy at best, the move towards regional integration will likely make conclusion of trade agreements or other measures to enhance British exports to Nigeria more difficult. The European Union has an economic partnership agreement with ECOWAS, covering trade in goods and economic development.

In addition to import tariffs, Nigeria has a relatively extensive and arbitrary list of imports that are completely banned. These include beef, pork, frozen poultry, mayonnaise, cakes, spaghetti, paracetamol, aspirin and a wide range of other everyday goods. The Nigerian central bank also does not provide foreign exchange for a variety of imports (thus making import of these items more difficult and costly). Examples of things in this category include cold rolled or galvanised steel sheets, wire rods, steel drums, steel pipes, glass, textiles, cosmetics, soap, plastics and some financial products (Eurobonds, foreign currency shares and bonds).

In common with many less developed markets, corruption in Nigeria is a major inhibitor of trade. Corruption is widespread throughout Nigerian institutions and is particularly pervasive in relation to oil and commodities. Political interference with judicial decision-making is problematic. Bribery is a significant problem in the customs procedure (including at port). Whilst many consider the present Nigerian president, Muhammedu Bahuri, to have been elected partly on the basis of a promised anti-corruption drive, practical progress in more than a handful of areas has yet to match the rhetoric on this issue.

Political stability and the security situation in Nigeria are further challenges facing British exporters (and even more so for foreign investors). This impacts demand directly – political instability and a deteriorating security situation tend to have a negative impact on import demand – and indirectly. The latter effect operates primarily by making it more difficult and complex to move goods around the country and increasing the risk of loss of inventory and sales (e.g. by wanton destruction, hijacking etc.) as well as making business visits to the country much more difficult. Whilst larger exporters may be able and willing to bear this risk (or at least insure against it), it may prove prohibitive for some smaller exporters. Additionally, political instability and poor security tend to be inimical to long-term economic growth, lessening Nigeria's future attractiveness as a market for British goods.

Terrorism is a major threat throughout much of the country, particularly focussed on the poorer north. Boko Haram, Ansaru and Islamic State in West Africa are all substantial threats, both to business and visiting British nationals (FCO, 2017). In addition to terrorist threats in the north of the country, there is militant conflict in the Niger delta in the far south. The groups operating in the Niger delta have a variety of different political aims, although there is a notable ethnic dimension. In part, this appears to have been fuelled by resource competition (most obviously over the uses of the area's oil wealth). Again, there is a degree of ethnic (and regional) conflict around possession and use of oil and the area is highly militarised with many groups actively challenging the Nigerian military. Recent violence has reduced Nigeria's oil production to a 20 year low, causing additional strain on government revenues and hampering exports, both of which had already been reduced by a falling oil price. The area has strong secessionist tendencies.

As in the Indian case, the automotive sector provides an instructive example of the barriers faced by importers. In 2013, Nigeria announced that it was going to introduce an "Automotive Industry Development Plan" (USTR, 2015). This imposes a punitive 35% additional tariff on top of the 35% tariff already levied by ECOWAS. This tariff varies depending on precisely what components are to be imported and whether the company in question also manufactures in Nigeria. Thus, for example, companies who assemble cars in Nigeria are permitted to import 2 vehicles with a tariff of "only" 35% for every 1 vehicle they assemble in the country.

Tariffs on "completely knocked down" parts for local assembly are free of additional import tariffs, whilst "partially knocked down" kits are taxed at 10% or 5% depending on whether they are painted or unpainted, respectively. Machinery and equipment for tyre production and vehicle assembly are free of VAT, giving domestic producers an additional price advantage over foreign competitors. Domestic vehicle assembly and tyre firms also qualify for so-called "pioneer status", exempting them from income tax for a five-year period.

Importation of vehicles over land borders is prohibited in Nigeria, constituting a non-trivial non-tariff barrier for the sector. Given the strength of protectionist sentiment in Nigeria, it seems improbable that these barriers will be eased in the near future. Additionally, given the scope for rent-seeking and corruption that such restrictions upon external trade give rise to, such measures may prove increasingly difficult to unwind.

Conclusion

The UK's embeddedness in the EU for over forty years has transformed its relationship with Commonwealth countries and has shaped – and been shaped by – the EU's relationship with them. In this sense, somewhat ironically, the fostering of these relationships by the EU with Commonwealth countries can be seen as having resulted in an extension of *European*, rather than *British*, influence per se (Adler-Nissen et al., 2017; our emphasis), suggesting that if a post-Brexit Britain aspires to displace the EU in this regard, then it will find it difficult to do so.

More likely, therefore, is that any post-Brexit trade agreements that the UK seeks to pursue with individual Commonwealth countries will simply mirror, or "grandfather", current EU agreements. At the official level, the Commonwealth as a formal body, took a "pragmatic, non-committal stance" (ibid. 585) during the Brexit referendum, only serving to underline the reality of the new economic landscape between it and the EU. Ultimately, therefore, geography will trump history in determining Britain's future trading patterns and relationships upon exiting the EU. It is our proposition that this will continue to be the case, even if the rupture with the EU is to be in the form of a "hard Brexit".

Whilst there is scope to agree FTAs with other developed Commonwealth markets, their limited size (Australia, Canada, New Zealand and Singapore combined are roughly the equivalent of France) and geographic distance make them unlikely candidates to "replace" the EU as a trading partner. Furthermore, in no case can these nations replace the UK's integration in European GVCs as either source or destination. The rise of "just-in-time" manufacturing and lean production methods have meant that flexibility, time-to-market and reliability of supply are often more crucial than price (in contrast to the assumptions embedded in many general equilibrium trade models).

Proximity to one's supply chain means that companies can be responsive to demand: waiting for components to ship from Australia is not feasible. Similarly, an engineer can make a return-trip to a supplier in Germany in one day: doing the same for Australia requires at least 3 (time differences and jet-lag notwithstanding). Furthermore, all countries considered have made it clear to the UK Government that any rights secured for EU citizens coming to the UK post-Brexit, should also apply to citizens of their own countries. As the examples of Nigeria and India show, striking trade deals with large developing markets is likely to be extremely challenging due to domestic political issues.

In conclusion, our case studies shed some light on why the "laws of gravity" appear to hold and are likely to do so in future, irrespective of the UK's decision to leave the EU. British manufacturers are deeply embedded into European supply chains and the barriers to market penetration identified in this paper only serves to reinforce this. The long-term structural changes accompanying the emergence of proximity-based value chains were already contributing to changes in the composition of UK trade prior to EU entry and geographical proximity will continue to be the overwhelmingly important determinant of production (Baldwin, 2012) and the UK's position in a global economy.

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