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An effective UK trade policy and a customs union are compatible

by Sam Lowe

If the UK enters into a customs union with the European Union it will be able to operate an effective trade policy, but the political focus would need to shift away from headline-grabbing, comprehensive free trade agreements.

The chances are rising that the UK will be in a customs union with the EU after the transition period ends, either temporarily or permanently. The withdrawal agreement does not, as many of its critics argue, lock Britain into a permanent customs union. The EU and the UK have agreed that before the backstop can come into force, and even afterwards, they will seek other solutions to prevent a hard border on the island of Ireland and a customs border down the Irish Sea. But even if it is possible to tackle the border issue with new technological fixes, it is unlikely that they will be ready by December 2020. In that case, the UK will probably seek to extend the transition period, but even that will be unlikely to buy enough time to avoid triggering the backstop. And any new Tory leader would face a Parliament without a majority for customs union withdrawal, especially if it entailed a customs border between Great Britain and Northern Ireland.

A customs union would certainly constrain an independent UK trade policy. However, what the constraints are, and what they are not, is little understood in the Brexit debate. Unless supplemented by other provisions, a customs union is simply an agreement in which participating countries commit to lower or remove tariffs on goods traded between them, and levy tariffs at the same level on goods entering their territory from elsewhere. If the UK were to enter into a customs union with the EU it would be bound to apply the EU's external tariff to all goods imported from the rest of the world. This places obvious constraints on the UK's ability to strike new trade agreements: the UK would not be able to offer tariff reductions on imports as part of an agreement.

It is important to note that even if it is in a customs union with the EU, the UK will not be subject to the EU's common commercial policy – its joint trade policy. This means that the European Commission will no longer negotiate trade agreements on the UK's behalf, and the UK will no longer be covered by the EU's existing free trade agreements, which will need to be replaced. Additionally, were the EU to enter into a new trade agreement with, for example, China, the UK would need to negotiate its own agreement in parallel. Otherwise, there would be an asymmetric relationship, in which Chinese exports to the UK benefited from a lower tariff rate (because the UK would have to apply the EU's tariff) but UK exporters would not receive reciprocal treatment from China.

Many in the UK fear that this will lead to the UK facing similar problems to Turkey, whereby some countries that have entered into free trade agreements with the EU have refused to negotiate parallel FTAs with Turkey. In reality these fears, while real, are overstated. The UK is not comparable to Turkey – it is a larger, more developed and better regulated economy, and access to its market is more prized. Moreover, for some time the Commission has been sitting on proposals for modernising and improving the arrangement with Turkey with regard to third country agreements. Ideas that have been floated include a firmer EU line with FTA partners, obliging them to negotiate in parallel with customs union members. The UK-EU agreement could involve more concrete consultation mechanisms; perhaps even allowing the UK to observe but not vote in relevant EU trade policy committee meetings. The EU and the UK could seek to implement their trade agreements at the same time, to avoid asymmetries.

In a minimal customs union that covered only tariffs and quotas, the UK would be able to determine its external trade policy entirely free of EU influence in other areas. Being in such a customs union would place no constraints on the UK's ability to negotiate in the areas of services, intellectual property, public procurement, data and regulatory barriers to trade in goods. (It would be more sensible for the UK to unilaterally align with EU rules in many of these areas, but given the EU's desire not to split the four freedoms of the single market, the UK may not be able to persuade the EU to recognise British rules as equivalent to its own). The UK would have its own voice in some negotiations, for example the Trade in Services Agreement currently being negotiated by 23 members of the World Trade Organisation.

Comprehensive free trade agreements would be tricky, given the UK's inability to make tariff concessions. But this need not prevent the UK from operating an effective trade policy. As a high-income, services economy, an obvious priority would be easing the movement of people, technology and ideas. This would involve making it easier for people to provide services both inside and outside the UK by handing out more visas or removing regulatory barriers to services imports, either unilaterally or on the basis of reciprocity. Easing limits on movement would also mean rowing back on legislation that constrains one of the UK's more successful export industries: its universities. Foreign graduates could be given more time to find a job before they must leave the country. The government could prioritise research co-operation agreements, such as that between the EU and Israel.

"The bigger impediment to the UK's trade ambitions is not a customs union with the EU, but the Home Office."

Such a trade strategy might also involve government investment in frontier industries – for example, tidal energy production – in order to develop a unique base of expertise that could be sold across the world. Improving Britons' poor educational attainment in mathematics and science – core subjects needed for many exporting sectors – should be a priority, as should improving transport, telecommunications and energy infrastructure, especially in post-industrial towns and cities. That would make it easier for workers to travel to jobs in high productivity, exporting companies, ease the distribution of those companies' products and reduce their production costs.

None of the above requires the UK to set tariffs, but would create opportunities in sectors and industries consistent with the UK's comparative advantage. However, it does require a retreat from the obsession with FTAs, and a more holistic approach to trade policy. And it requires Britain's politicians to think differently about trade policy, seeing it less as a political tool to generate favourable headlines, and more as an extension of a broader economic strategy. UK policy-makers would also have to change the politics of immigration to achieve such a vision for 'Global Britain', because the UK cannot both aspire to be a services powerhouse and crack down on immigration. The bigger impediment to the UK's trade ambitions is not a customs union with the EU, but the Home Office.

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Forthcoming publication by Sam Lowe "Brexit and services: How deep can the UK-EU relationship go?', December 2018.

China and Europe: Buying hearts and minds?

by Ian Bond

For a country whose GDP per capita is $16,800 (in purchasing power terms), China has deep pockets. Estimates of how much its 'Belt and Road Initiative' (BRI) to improve connections between East Asia and Europe might eventually cost vary between $1 trillion and $8 trillion (most of which will be in the form of long-term loans to pay for Chinese-built projects). By contrast, the EU's GDP per capita is $41,000, but its proposed budget for all its external actions globally from 2021-2027 is only €123 billion – small change in Chinese terms.

When China first launched 'One Belt, One Road' (as it was initially known) in 2013 its focus seemed to be on the land routes from China to Europe via Central Asia. The EU thought Chinese funding would develop an area badly in need of better transport infrastructure, complementing a more modest European programme known as TRACECA (Transport Corridor Europe Caucasus Asia), which has spent more than €180 million since it began in 1993.

At the same time, the European Commission was concerned that good governance, sustainability and competitive tendering were a lower priority for China than for the EU. In 2015, China and the EU created the 'Connectivity Platform between the EU and China', the aim of which was to promote "an open and transparent environment and a level playing field for investment" in Asia-Europe transport connections. Commission officials are reasonably satisfied with co-operation so far on specific projects.

Since then, however, the EU's concerns about China's wider ambitions have grown. Much BRI investment has been in port facilities and other critical national infrastructure, particularly along the 'Maritime Silk Road'. China is increasingly using its soft power (or 'sharp power', as Christopher Walker and Jessica Ludwig of the US National Endowment for Democracy term it) for more political ends, including through its Confucius Institutes, teaching Chinese language and culture, of which there are more than 130 in the EU. A Hong Kong-based professor, Willy Lam, has described the institutes as bases for infiltrating host universities. Germany, once keen to attract Chinese investment, now worries that it may entail China acquiring (and German industry losing) valuable intellectual property.

Financially, BRI projects have been a mixed blessing. Some of the earliest recipients of Chinese loans to support infrastructure projects, including Sri Lanka, now have unsustainable debt levels, prompting a backlash against BRI. A study by the

Center for Global Development (a US think-tank) in March 2018 identified eight countries that had received Chinese loans for projects, including EU candidate country Montenegro, as particularly vulnerable to debt distress.

Moreover, Europe has had to reappraise China's role in global security. China's assertive attitude to friends of the EU like Japan and to South-East Asian countries (with which China disputes ownership of the South China Sea) has been a worry for some years. China's military co-operation with Russia has grown, and spread to the European theatre. In 2017, China sent ships to take part in joint naval exercises with Russia in the Baltic Sea.

Europe has begun to hedge against China's growing power. Before the latest Asia-Europe Meeting (ASEM – a summit of 51 Asian and European leaders, which took place in Brussels in October), the Council of the EU endorsed a joint communication from the Commission and the European External Action Service on the elements of an EU strategy for connecting Europe and Asia. The EU's aim is to work with like-minded countries in Asia, including Japan and India, not exclusively with China, and to strengthen the links between the EU and (for instance) members of ASEAN in a way which is rules-based and sustainable. But to compete with China, Europe will need to invest more time and money in Asia.

The EU is working towards adopting a foreign investment screening regulation, aimed at China among other countries. While leaving it to national governments to decide whether to accept foreign investment in sensitive sectors, the regulation would give other member-states and the Commission the opportunity to comment, and oblige the state concerned to take these views into account. There would be no enforcement mechanism, but even so some states, including Italy, are resisting the regulation. Italy hopes to emulate other EU member-states, including the Czech Republic, Greece, Hungary and Malta, that have memorandums of understanding with China on participation in BRI.

The EU's problem is that China is already leveraging its economic importance to get European countries and businesses to lobby for its interests. Hungary is the biggest recipient of Chinese investment in Central Europe, and China plans to build a high-speed rail link between Budapest and Belgrade. The Chinese firm COSCO operates the Greek port of Piraeus, in which it invested when the Greek financial crisis was at its worst. Big member-states like France and Germany have their own bilateral dialogues with China, outside any EU framework.

The Commission has been concerned for some time that the '16 + 1' process (which brings together China and 16 Central and Eastern European states), though ostensibly about trade and people-to-people links, is undermining EU cohesion. China was able to use EU member-states such as Hungary and Greece to block an EU statement in 2016 supporting the Permanent Court of Arbitration's ruling against China's territorial claims in the South China Sea, and an EU statement in 2017 at the UN criticising China's human rights record. Following a UN report that a million members of the Muslim Uighur minority are detained in re-education camps in the Xinjiang region, the EU ambassador in Beijing in Beijing is one of 15 signatories to a November 2018 letter to the Chinese authorities expressing concern, but in a sign of disunity most EU member-states' ambassadors have not signed.

"China is leveraging its economic importance to get EU countries and businesses to lobby for its interests."

The EU should not go overboard in recalibrating its approach to China. There are many issues on which the EU and China still need to work together, particularly in the era of Donald Trump. Despite many EU-China trade disputes, Trump's hostility to the World Trade Organisation (WTO) has driven them together: both recognise their need for a functioning WTO, able to make, monitor and enforce rules. Both also understand that they have a major role to play in shifting the world to a low-carbon economy, regardless of Trump's rejection of the science of climate change. And they are on the same side (along with Russia) in wanting to preserve the Iran nuclear deal, from which Trump has withdrawn the US.

But the EU cannot afford to tolerate a situation in which its unity in dealing with China is undermined by Beijing's financial leverage in individual member-states. The Commission and Parliament are right to push for screening of future investments; but that will not mitigate China's current influence. There must be more transparency about the value and the quality of Chinese investments in the EU. Member-states should discuss frankly how the EU can pursue a balanced policy of co-operation with China where possible, and criticism where necessary. And there must be more willingness to challenge European leaders who seem more interested in taking Chinese cash than defending European values.

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What is Europe doing to fight disinformation?

by Camino Mortera-Martinez

Focusing on the most blatant disinformation and helping target audiences understand the difference between real and fake news is the best way to fight disinformation.

Using misleading information or even outright lies for electoral or geopolitical gains is not new. But the internet has made it possible to spread fake news instantaneously to thousands if not millions of users. This has the potential to alter the outcome of democratic processes: easily shareable social media content may do more to shape some people's political opinions than mainstream media reports. But the line between suppressing freedom of speech and shutting down disinformation campaigns is thin. To fight back, the EU needs not only to punish those spreading fake news but also to help citizens distinguish between what is true and what is not.

One good way to identify a disinformation campaign is to look at who is sharing it. Researchers look at behavioural patterns to single out accounts which are fake or do not seem to be manned by humans. A high concentration of those accounts sharing similar content is an early indicator that something is not quite right. For example, groups affiliated with the Russian government, like the so-called Internet Research Agency, allegedly used fake social media personas ('trolls') and automated accounts ('bots') to influence the outcome of the 2016 US presidential election. Similarly, Twitter users with abnormally high levels of activity (and hence, presumably fake), helped controversial far-right leader Jair Bolsonaro win Brazil's presidential elections in October.

Europe is not immune to disinformation. The committee on foreign relations of the US senate thinks that Russian bots contributed to the Brexit vote and to civil unrest in Catalonia. But, for now, European countries do not want to deal with these problems through legislation. Both EU governments and the European Commission think that moving targets like online disinformation campaigns are better left to those with the right tools to stop them.

The in-house expertise of social media and internet companies is crucial. The European Commission has asked internet companies to come up with a voluntary code of practice on online disinformation. The code, which the EU unveiled in September, requires participating social media companies and other platforms to be more transparent with their algorithms and advertising campaigns, to flag fake news and close down accounts which may promote them. The code would allow users to decide what sort of social media content they want to see; improve algorithms so results from well-respected sources appear first in search results; allow fact-checkers and research organisations to access data; and deprive questionable users of advertising revenues.

There is no mechanism for enforcing the code and it is too early to know whether it is working. But the Commission has said it will consider passing binding laws if it finds that the code is not useful. The Commission will also establish a network of independent fact-checkers in preparation for the 2019 European Parliament elections.

To counter Russian propaganda, in 2015 the EU set up the East StratCom task force in the European External Action Service. The task force has a dedicated Twitter account and works with journalists, think tanks and NGOs to spot and debunk Russian disinformation. It publishes a weekly 'myth-busting' newsletter and runs a database of documented cases of Kremlin disinformation. It also works to present an accurate picture of the EU in the Union's eastern neighbourhood – a favoured target of Russia's disinformation machine.

As a relatively new initiative (and because attitudes towards Russia differ across the EU), the East StratCom task force is still under-funded and too dependent on the goodwill and financial contributions of member-states. The EU is trying to change this: last year it endowed the task force with its own (tiny) budget of €1.1 million a year; and set up two additional units: the Western Balkans StratCom task force, to promote the EU and fight Russian propaganda in the region; and the South StratCom task force, whose main purpose is to counter Islamic State terrorist organisation narratives in the Middle East and North Africa.

All this work, while encouraging, is not enough: money is still tight and some member-states feel that the EU should expand the powers of its propaganda-fighting teams. In response, the Commission has promised to come up with plans to strengthen the three task forces before the next European Parliament elections.

Individual member-states, like the Czech Republic, Estonia and Lithuania, have also devised their own disinformation strategies. These include countering campaigns via a dedicated Twitter account; supporting civilian volunteers fighting Russian troll factories; and working with social media companies to counter fake news. France and Germany have also passed laws allowing courts and regulators to take down fake accounts.

Neither the EU nor its member-states will be able to deal with the phenomenon of disinformation through laws or algorithms alone. Governments everywhere need to pay more attention to the people exposed to fake news, and not just its originators.

If there is one thing that the EU should have learned from the disinformation campaigns over the last few years, it is that preventing them needs a dual-track approach: education for target audiences to ensure that they are better able to distinguish real from fake news; and a firm line with the originators of propaganda. This is the best way to ensure that no European citizen can be easily deceived.

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CER in the press

The Telegraph
14th November
As John Springford at the **CER** has written, the choice is very clear: remain in an all-UK customs union, or leave and accept the need for a customs border in the Irish Sea that leaves Northern Ireland in a different relationship to the EU.

Bloomberg
13th November
"It's likely we will see populists use the EU as a scapegoat for all the misgivings they have about politics domestically, just as we saw in the UK's EU referendum," says Agata Gostyńska-Jakubowska of the **CER**.

National Public Radio
5th November 2018
"If the Republicans do well, then across Europe, people will be thinking Trump is not just a passing phase," says Ian Bond of the **CER**. "

The Telegraph
2nd November
"Even now, she [Merkel] still has the moral authority on the EU stage to knock heads together," says Charles Grant of the **CER**. "Just look around the table of EU leaders, they are political pygmies, apart from Emmanuel Macron, who is weak at home and Mark Rutte, who only represents a middle-sized country. She's still head and shoulders above all other leaders."

The New York Times
1st November 2018
"The euro crisis started getting better the moment Europe decided to go against what Merkel said the policies should be," said Christian Odendahl of the **CER**.

BBC News
11th September 2018
Sam Lowe of the **CER** said: "If, as it appears, the UK is close to accepting the presence of an Northern Ireland-specific backstop, albeit one they wish to supplement with a whole-UK customs union, then this is good news for the withdrawal negotiations."

The Financial Times
26th October 2018
Emmanuel Macron's blockbuster EU vision speech is one year old and almost none of his big ideas have come into fruition. Leonard Schuette from the **CER** reviews the French president's "mediocre record" thus far.

Recent events

Mário Centeno

20 November
CER/Kreab breakfast on 'Have we completed euro area reform?', Brussels
With Mário Centeno

16-17 November
Conference on 'The politics of slow growth in Europe', Ditchley Park
Speakers included: Agnès Bénassy-Quéré, Laurence Boone, Jean Pisani-Ferry, Paul Tucker and Jeromin Zettelmeyer

Agnès Bénassy-Quéré

Marco Buti

23 October
CER/Kreab breakfast on 'Should the eurozone be less intergovernmental?', Brussels
With Marco Buti

22 October
Launch of 'Growing together: The Angelopoulos project on the future of the European economy', Berlin
Speakers included: Stephanie Flanders, Marcel Fratzscher, José Leandro and Isabelle Mateos y Lago

Stephanie Flanders

Antonio Vicente

16 October
Conference on 'Innovation: Is Europe falling behind?', Brussels
Speakers included: Jemima Kelly, Reza Korshidi, Alexander Mahnke, Pierre Meulien, Martin Siegert, Paweł Świeboda and Antonio Vicente

12-14 October
CER/EDAM 14th Bodrum Roundtable, Bodrum
Speakers included: Faruk Kaymakçı, Yuri Kim, James Kolbe, Charles Kupchan and Marietje Schaake

Marietje Schaake

For further information please visit

www.cer.eu