

UK trade deals: a tale of two cities

Blog post by Partner Stephen Adams, 06 February 2017

The British Prime Minister has just returned from an important visit to a large UK trading partner with a controversial and often provocative leader. There was talk of a possible future bilateral trade deal between the two, and agreement to start preliminary discussions to this effect. This was a cause of mild irritation in Brussels, where the UK's right to trigger such bilateral engagement is contested, and its tendency to break European ranks seen as a political problem. Yes, Theresa May has just been in Ankara.

Following directly in the wake of the much higher-profile visit to Washington, the UK Prime Minister's visit to Turkey was easy to miss. But the decision to go to Ankara and the explicit focus on a possible trade deal are important, especially given the UK position codified in the White Paper on Exiting the EU published last week.

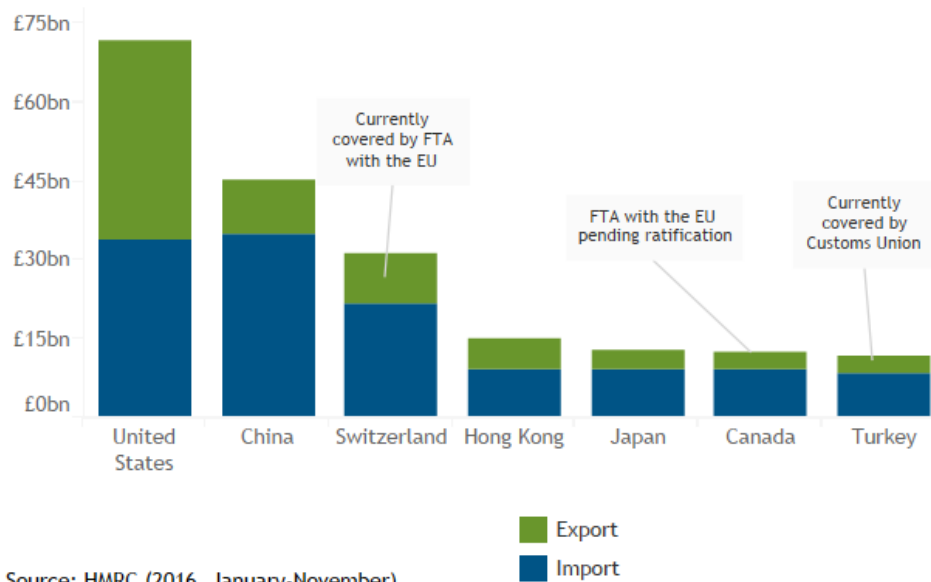
In the media and elsewhere the trip was bracketed as just another in what is likely to be a long series of overseas visits 'confirming' international support for post-Brexit Britain as a commercial and strategic partner. But this is to miss something very important about the UK-Turkey trading relationship, which puts it in a very different category from the future relationship under discussion in Washington.

The essence of that difference is this: unlike the US, the UK already has a preferential trade deal with Turkey. It is in a customs union with it, via the EU. Goods traded under this arrangement, which include all industrial products, are traded tariff-free. Last week's UK White Paper confirmed the UK's intent to exit that arrangement, a decision which potentially exposes UK trade with Turkey to tariffs in both directions at the point of Brexit. Imports to Turkey because Ankara imposes the EU's external tariff schedule on goods entering its market. Imports to the UK, because the UK has signalled that it intends to impose the EU's tariffs as its own at the point of exit, and this would include Turkish trade.

Turkey's status in the EU Customs Union adds a dimension of complexity to fixing this problem. Turkey cannot cut its tariffs on UK exports of its own volition, only as part of a UK deal with the EU: this is what being in a Custom's Union with the EU means. However, whatever deal the UK might strike with the EU will not cover UK imports from Turkey. The UK and Ankara must strike their own agreement to cover flows in that direction. How such an agreement needs to be sequenced with an EU-UK agreement, and how openly it can be discussed while the UK remains in the EU is contested and will ultimately need discussion in Brussels, Ankara and London.

How much of a problem is this? The UK runs a large trade deficit with Turkey in goods - importing about £8.3 billion in goods in the first 11 months of 2016 and exporting just over two-fifths of that, most of this manufactures. Turkey is the UK's seventh largest non-EU source of manufactured imports (see chart). Much of this import trade is UK manufacturers and retailers using Turkish facilities as part of their wider supply chains. A lot of UK high street fashion retailers have exposures to Turkey, as do many UK carmakers and advanced manufacturers. Many of these goods bear tariffs in the EU and UK schedule, and some, like cars and vans, carry high ones.

Main UK trade partners outside of the EU for manufactured goods



Source: HMRC (2016, January-November)

This puts Turkey in an entirely different category to the US as a trade policy problem for the UK. The decision to set up a UK-Turkey working group on the issue is a good sign that the problem is understood, but political attention in general is arguably still too focused on the medium rather than the short term. Total trade with Turkey may be dwarfed by US-UK volumes (see chart), but the prospect of the re-imposition of tariffs on UK-Turkey trade is material, while the prospective gains from a UK-US deal remain at this point hypothetical. For the UK (and Turkey), trade with Turkey needs to be seen not as the sunny uplands of a future UK autonomous trade policy, but as a sub-problem of the wider challenge of extracting itself in an orderly way from the EU single market.