

TRADE POLICY TRENDS

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BREXIT: IMPLICATIONS FOR CANADA-UK TRADE

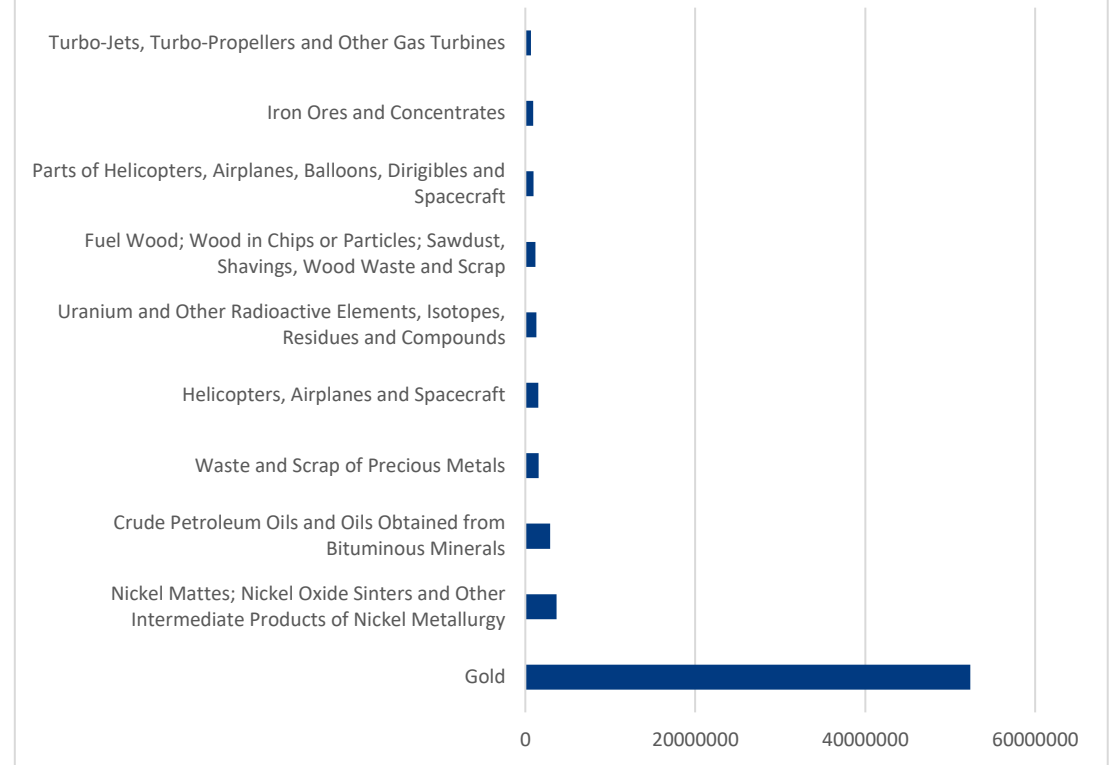
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After a referendum on June 23rd, 2016, the United Kingdom (UK) decided to leave the European Union (EU). Since then, the UK has attempted to negotiate and implement an exit deal with the EU. The UK's parliament rejected three deals and the EU has agreed to extend the withdrawal deadline to October 31st, 2019. Boris Johnson, who became the Prime Minister of the UK on July 23rd, has stated that he will lead the UK out of the EU "with or without a deal." A "no deal" Brexit will terminate the UK's agreements with 3rd parties that are currently governed by the EU. This scenario could influence Canada's economic ties with the UK, which are significant.

The UK is Canada's fifth largest trading partner (and its largest trading partner in the EU), with two-way merchandise trade in 2018 amounting to \$25.51 billion. The UK is the third largest destination for Canadian goods exports and in 2017 ranked second behind the US in Canada's list of top destinations for services exports. Finally, the UK is Canada's second largest source of Foreign Direct Investment (FDI) and second largest foreign destination for Canadian investors.

Due to Brexit, the future of this economic relationship is uncertain. Canadian exporters may face higher trade restrictions, as the UK would cease to be a part of the Canada-EU Comprehensive Economic and Trade Agreement (CETA). The UK could also become a less appealing destination for Canadian investment largely because the UK will lose preferential market access to the EU.

Top 10 Canadian Exports to the UK, 2014-2018 (Thousands of CAD)



The UK accounts for almost 3% of Canadian merchandise exports. Figure 1 displays Canada's 10 most valuable exports (in terms of product groups) to the UK over the last 5 years. Exports of gold are sizably larger than Canada's other top exports to the country. Most Canadian gold exports originate in Ontario, making that province by far the largest provincial exporter to the UK. In addition to gold, Canada's most significant goods exports to the UK in recent years have been nickel products and crude petroleum oils. Newfoundland and Labrador is the largest exporter of crude petroleum while Ontario is the sole Canadian province exporting nickel products.

If the UK leaves the EU without a deal, Canadian exporters will face a tariff schedule released by the UK government offered to World Trade Organization (WTO) members on a Most-Favored-Nation (MFN) basis. In the event of a deal, the UK will likely be able to remain part of CETA for up to two years. In either case, it is very likely that Canada and the UK will want to negotiate a bilateral agreement in order to maintain preferential market access.

CETA ensures that most tariffs on Canada's top exports are, or will become, zero. According to the Canadian Trade Commissioner Services (TCS), the no-deal Brexit tariff schedule would do away with import duties on 95% of the UK's tariffs. Some products will face higher tariffs. However, these products (such as autos) are not among Canada's top exports to the country. Rather, tariffs will remain 0% on Canada's most valuable exports to the UK regardless of Brexit's outcome. For example, Canada's most valuable export to the UK – gold – will not face tariffs in any Brexit scenario. A no-deal Brexit also threatens to eliminate the liberalization of trade in services accomplished by CETA. This is cause for concern, as the UK is second largest national destination of Canadian services exports, accounting for over \$6 billion in exports in 2017.

Overall goods trade with the EU has increased since CETA came into force (a 7.7% increase in two-way trade). However, Canada-UK two-way merchandise trade declined 3.5% one year after the implementation of CETA. In addition, Canadian trade in services with the EU increased almost 7% after the agreement went into effect. A no-deal Brexit could result in decreased trade flows (in both goods and services) between both countries.

Regardless of how Brexit plays out, it is important that both countries complete a FTA to avoid disruptions to trade flows. Both countries have already committed to making this a reality. Most recently, PM Justin Trudeau confirmed his commitment to “increase trade” between the two countries after PM Johnson became the new leader of the UK.

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