

Going it alone on trade is like bringing a chocolate spoon to a knife fight



*What does the Bombardier dispute tell us about the likely impact of Brexit? First of all, state aid is a fact of life in civil aviation, writes **Chris Kendall**. Without it, companies would not be able to compete effectively in the global market. Free market Leavers believe Britain can prosper without it because our example will encourage others to remove their subsidies. Yet it is rarely in their interests to do so. Lexiteers, meanwhile, want to use state aid to protect British jobs and industries. But being inside the EU gives us a degree of protection from retaliatory attacks – and the EU in any case allows considerable scope for helping domestic industry.*

The 219% tariff slapped on sales of Bombardier aircraft in the United States came as a shock in Britain, where the threat to the Canadian aircraft maker puts a number of UK jobs at risk. Many have been quick to warn the dispute bodes ill for the UK as it leaves the EU. They are right. The Leave camp's various promises of a global Britain thriving on unshackled free trade, or a workers' Britain intervening to support resurgent heavy industry, are illusory, naive and downright misleading.

During the post-war period, Britain learned the hard way that size matters in international trade, and that even our best friends can fight dirty. The British lead in aerospace was lost to the United States when the latter took advantage of the De Havilland Comet's poor safety record to regulate subsequent, safer models out of its lucrative domestic market. Boeing and McDonnell-Douglas moved in to occupy that space, and went on to conquer the global market. Europeans, recognising the need to group together if they were to be able to take on the Americans in the aerospace sector, formed the Airbus consortium at the beginning of the 1970s. Within 20 years the global market for large civil aircraft effectively became a duopoly, with Airbus and Boeing duking it out for dominance. British Aerospace now manufactures wings for Airbus aircraft in the UK.



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It costs a lot of money to make an aeroplane. Lead times are long, it takes years before a design moves from the drawing board to the skies, and it is even longer before a new plane model starts earning money from sales. Commercial money markets don't function at that scale, and state intervention is usual. In the EU, we use Launch Aid: huge injections of finance to get a design into production, which are then recouped from royalties on sales. The level of subsidy cannot be determined until the final plane is sold and the last royalty cheque arrives. For the more elderly models in the Airbus fleet, state investment has turned a profit and the subsidy level is zero. For the more recent models, we wait and see.

Free market libertarians are horrified at this arrangement – and indeed the US called foul, taking the EU to court (first in GATT, then in the WTO) over what it claimed were illegal, market-distorting subsidies. But American aircraft manufacturers have also relied upon massive injections of taxpayer money to develop and sell their products. Boeing has benefited from a range of state aids, including generous tax breaks and indirect subsidies. The EU countersued the US in the GATT and then WTO for providing its large civil aircraft manufacturers with indirect subsidies through defence contracts. Billions are channelled to private companies by the US Department of Defense to allow them to develop new military products, technology and techniques, which are then also deployed in civilian products. The WTO has ruled in support of both the US and the EU in their respective cases against Airbus and Boeing.

Like it or not, state intervention is a fact of life in the civil aviation industry and in many other sectors. State aids are a lifeline for companies, but they are also a weak point that competitors can exploit in the courts. In the cut-throat world of international trade, the WTO is the battleground where the big players fight for dominance and survival. Slapping a regulatory barrier or punitive tariff on a competitor's product can deliver a death blow, as De Havilland found out in the 1950s and as Bombardier may find out now.

This is where size matters. In the WTO, the US and EU dominate. Both defend their industries ferociously and do not shy away from litigation or deploying Trade Defence Instruments (TDIs). TDIs include anti-dumping measures (ADs) and countervailing duties (CVDs) by which tariffs are imposed on the imports of a competitor found to be breaching WTO rules. Other sectors can also be targeted in retaliation. Being part of a huge, rich market lends considerable heft. In a trade conflict scenario where we found it necessary to retaliate against the US, what would the impact be if the UK alone were to increase tariffs on, say, oranges from Florida? Compare that with the impact if the entire EU were to increase tariffs on oranges from Florida.

Leavers on the left and the right are enticed by a seductive whiff of liberty. They want to take back control. The liberal Leavers on the right envisage a buccaneering, freely trading Anglosphere where nimble entrepreneurs have no need for state subsidies and can sell their products to each other without fear of trade barriers or regulatory red tape. Meanwhile proponents of a left-wing "Lexit" want to be able to revive Britain's struggling heavy industries, shoring up protection for British workers, free of the constraints of Brussels' state aid rules and without the pressure on wages brought by free movement. Both are in a state of profound denial.

The free trade nirvana of liberal Leavers doesn't exist. State intervention in the world of business is a fact of life, and wishing it away won't work. Contrary to the caricature pushed by 'liberal' Leave, State Aids are not the exclusive preserve of a protectionist European Union. Others can and do use them; and they use trade policy in a profoundly political way to challenge others when they use them. The Bombardier case reminds us that the United States and others in the Anglosphere also see it this way. Some liberal Leavers advocate unilaterally abandoning the weapons of trade warfare and throwing ourselves on the mercy of the goddess Free Market. Unilateral trade disarmament will set an example which others will follow, they argue.

Forgive me if I am sceptical. Unlike nuclear weapons, trade weapons are often used in real world situations, effectively, and I see no reason why disarmament by one player would lead to disarmament by others. I've described it as bringing a chocolate spoon to a knife fight. In the real world, the UK will have to rely on all the instruments it so bemoans in Brussels: regulatory convergence, mutual recognition, and – yes – tariffs and TDIs. But instead of being a key part of the most influential global player, setting the rules, the UK will be outside, taking them.

Things don't look any better for the Lexiteers. We know that their plans to use state instruments to support industry and workers will be targeted by competitors through the WTO. Contrary to what they say and seem to believe, most of the instruments they want to use can already be deployed inside the EU. And within the EU, we enjoy collective defence against attacks in the WTO. Outside the EU, not only do we lose the EU's extra's defensive heft, we also find it potentially turned against us. If outside the EU the British state intervenes to support its industries in contravention of WTO rules, it can't expect the EU to stand by while its industries are put at a competitive disadvantage. Picture a scenario in which the UK loses a case in Geneva over state support to its steel industry and suddenly finds its exports of innovative jam to the entire European Union subject to increased tariffs.

A South Korean trade official once said that there are only two real players in Geneva: the US and the EU. As an EU Member State, the UK has a seat at the top table. And, as the saying goes, if you're not at the table, you're on the menu.

This post represents the views of the author and not those of the Brexit blog, nor the LSE.

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