



Department for
International Trade

An information pack for the Consultation relating to a bilateral Free Trade Agreement between the United Kingdom and the United States



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Introduction



The Department for International Trade (DIT) is an international economic department responsible for securing UK and global prosperity by promoting and financing international trade and investment, and championing free trade. It is working to establish deeper trade and investment relationships with countries beyond the European Union.

As set out in the Government's White Paper "The Future Relationship Between the United Kingdom and the European Union", the UK's proposal for its future economic partnership with the EU would enable the UK to pursue an ambitious bilateral trade agenda. Negotiating and implementing Free Trade Agreements (FTAs) with countries beyond the European Union is a key part of this.

Free Trade Agreements enable trade and investment, secure access for UK exporters to the markets of today and the future, give consumers access to a greater range of products at lower prices, and make the UK more innovative, competitive and prosperous.

Trade agreements aim to reduce trade barriers between countries. Barriers can be taxes charged on goods as they cross borders (tariffs), or different rules and regulations that can add to trade costs (non-tariff measures). Trade and investment barriers make it more difficult and costly to trade or invest overseas. Reducing these barriers can help the flow of goods, services and money for investment between countries, and help businesses to access markets they previously weren't able to. Consumers can benefit from access to a greater variety of products at lower prices.

Trade agreements also have wider benefits. These can include:

- boosting economic growth in the UK by encouraging more competition, investment and innovation;
- contributing to global prosperity, by boosting economic growth in countries that the UK does business with through international supply chains;
- increased global prosperity supporting social cohesion within and between countries, and in turn political stability, which is one of the building blocks of our collective security;
- benefits for developing countries – trade can be a vital tool in boosting developing countries' economic growth and reducing poverty, while also providing UK consumers and businesses with goods at competitive prices;
- an instrument of foreign policy – some countries use trade policy (including trade agreements) to advance standards and values.

DIT is committed to using high-quality evidence to inform its trade policy. It is conducting a consultation to seek views from stakeholders on the economic, social and environmental impacts of an FTA with the United States of America (US).

The aims of this pack are to:

- *provide stakeholders with background evidence to support the consultation,*
- *clarify some of the terminology relating to FTAs, and*
- *provide information to respondents wishing to submit evidence setting out their views on the priority areas and expected impacts of an FTA with the US.*

The pack provides a brief overview of the economic impacts of FTAs and the primary mechanisms through which they can affect businesses, consumers and workers.

Definition of a Free Trade Agreement

A Free Trade Agreement (FTA) is an international agreement which removes or reduces tariff and non-tariff barriers to trade and investment between partner countries.

Trade and investment barriers can make it more difficult and costly to trade or invest overseas. By removing or reducing them, FTAs can make it easier for businesses to export, import and invest. They can also benefit consumers by providing a more diverse and affordable range of imported products.

FTAs may be multilateral, plurilateral, regional or bilateral:

- multilateral agreements are agreed by all members of the World Trade Organization (WTO);
- plurilateral or regional agreements are agreed by subsets of WTO members;
- bilateral agreements primarily relate to the liberalisation and regulation of trade and investment between the two signatories to the agreement.

FTAs differ from customs unions. Parties to an FTA maintain independence to set their own tariffs on imports from non-parties. By contrast, all signatories of a customs union commit to apply the same external tariff to non-signatories.

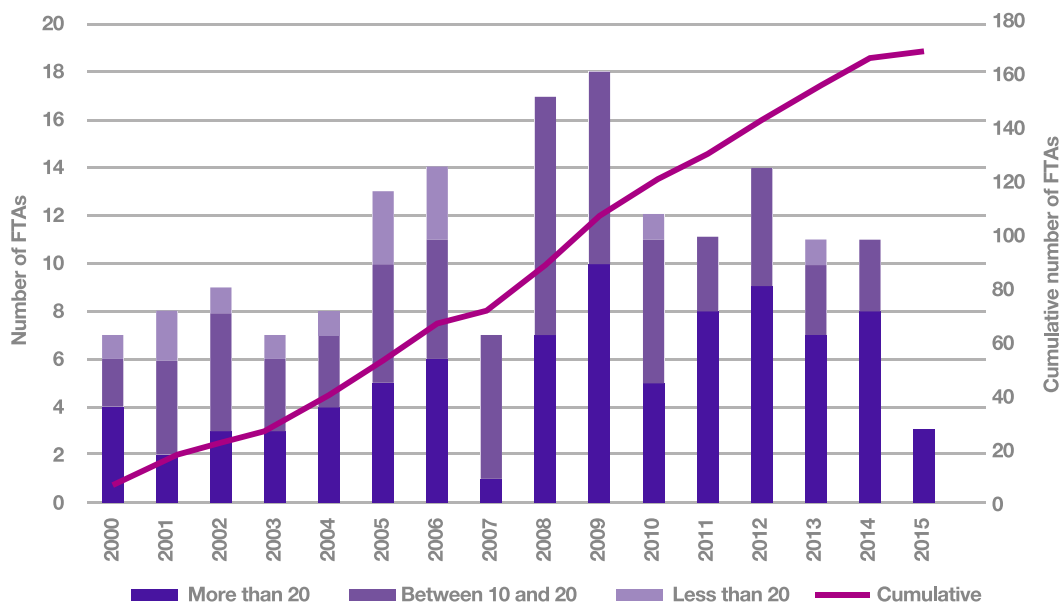
FTAs do not prevent governments from regulating in the public interest – for example, to protect consumers, the environment, animal welfare and health and safety. Equally, trade agreements do not require governments to privatise any service or prevent governments from expanding the range of services they supply to the public. For example, the UK Government has been clear about its commitment to protecting public services, particularly including the NHS. No future free trade agreement would affect the fact that it would remain up to the UK and devolved governments to decide how to run our publicly funded health services.

Scope of a Free Trade Agreement

The number of free trade agreements (FTAs) around the world has grown substantially in recent decades (Chart 1).

FTAs can vary in their scope and level of ambition. Less complex agreements focus more on trade in goods and the elimination of tariffs. Over time the scope and depth of FTAs has generally grown, including provisions addressing trade in services and investment. FTAs increasingly address domestic policies inhibiting trade and investment, known as “behind the border” barriers.

Chart 1: Number of bilateral trade agreements, by the number of provisions covered (2000-2015)



Source: DIT Analysis of the World Bank’s Content of Deep Trade Agreements Database. Coloured bars refer to the number of provisions in the FTA. The maximum number of provisions is 52.

Types of provisions included in Free Trade Agreements

The provisions included in free trade agreements (FTAs) vary across agreements. The World Bank has created a database that summarises the content of all FTAs that were in force and notified to the World Trade Organisation (WTO) as of 2015.¹ It covers 279 FTAs. For each agreement, the commitments are classified in one of 52 categories (outlined in Table 1 below) and distinguished according to whether or not they are legally enforceable.

Some areas of policy cooperation are more commonly included in FTAs than others. The World Bank classifies 18 of the 52 areas of policy cooperation as “core” provisions. These are provisions which the World Bank identify as most meaningful from an economic point of view and have appeared most frequently in FTAs. “Non-core” provisions – which sometimes go beyond areas directly associated with trade and investment – have appeared less frequently in FTAs. As with all provisions, their inclusion typically depends upon the specific objectives of an agreement and the preferences of the partners involved.

Table 1: Areas of policy cooperation in past Free Trade Agreements and Economic Partnership Agreements

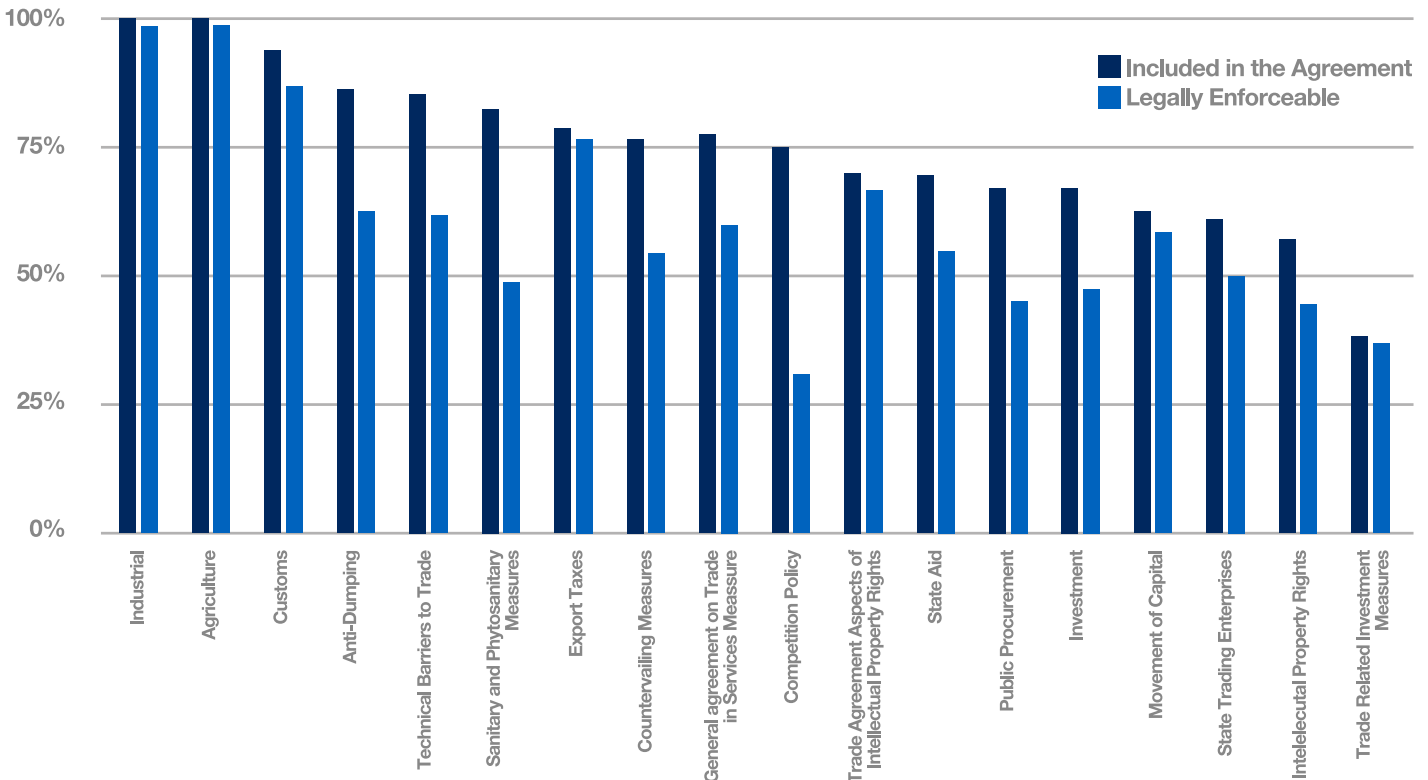
<p>“Core” provisions (as defined by World Bank)</p>	<ul style="list-style-type: none"> · Tariffs on industrial goods · Tariffs on agricultural goods · Customs administration · General Agreement on Trade in Services (GATS) · Export taxes · Sanitary and Phytosanitary (SPS) · State Trading Enterprises 	<ul style="list-style-type: none"> · Technical Barriers to Trade (TBT) · Trade Related Aspects of Intellectual Property Rights (TRIPS) · Countervailing measures · Anti-dumping · State Aid/Subsidies · Public Procurement 	<ul style="list-style-type: none"> · Trade Related Investment Measures (TRIMS) · Intellectual Property Rights (IPR) · Competition Policy · Investment · Movement of capital
<p>“Non-core” provisions</p>	<ul style="list-style-type: none"> · Anti-corruption · Environmental laws · Labour market regulation · Consumer protection · Data protection · Agriculture · Political dialogue · SMEs · Social Matters · Visa & Asylum · Approximation of legislation · Audiovisual · Civil protection 	<ul style="list-style-type: none"> · Innovation policies · Cultural cooperation · Economic policy dialogue · Public administration · Statistics · Education and training · Energy · Financial assistance · Health · Human Rights · Illegal immigration · Regional cooperation · Taxation 	<ul style="list-style-type: none"> · Illicit drugs · Industrial cooperation · Information society · Mining · Money laundering · Nuclear safety · Research and technology · Terrorism

Source: World Bank “Content of Deep Trade Agreements Database”²

A further description of these provisions is provided at the end of this document.

Chart 2 shows the proportion of FTAs which include each of the “core” provisions.

Chart 2 – Percentage of bilateral FTAs that included specific “core provisions” (agreements that entered into force between 2000 – 2015)



Source: DIT analysis of the World Bank’s “Content of Deep Agreements Database”. Analysis covered 198 agreements since 2000

Economic objectives of free trade agreements

Free trade agreements (FTAs) are expected to enhance economic growth and prosperity by:

- increasing import and export flows;
- increasing investment flows (both outward and inward);
- enhancing productivity through a more efficient allocation of resources and greater openness to international competition.

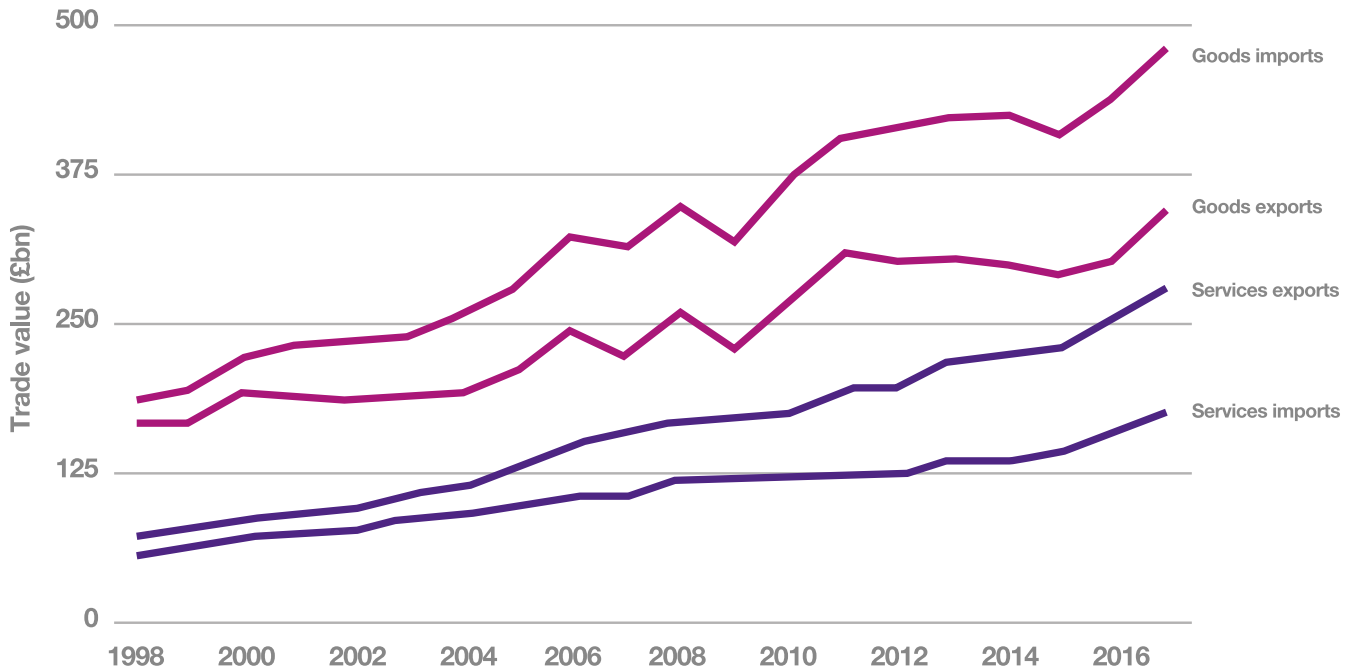
Free trade agreements and bilateral trade in goods and services.

The UK is a highly open economy with trade (imports and exports together) equal in value to 62% of GDP.³

62%
of the UK’s GDP
is comprised by
trade

3. ONS UK Trade (March 2018), ONS GDP releases

Chart 3 – UK trade in goods and services with the world (1998-2017)



Source: ONS UK Trade (March 2018), current prices.

Free trade agreements and trade in goods

Trade in goods represented 64% of all UK trade and 55% of UK exports in 2017⁴.

International trade in goods is subject to a wide range of tariff and non-tariff measures. These can significantly increase the costs and difficulties associated with international trade. Higher costs reduce the profitability of international trade, raise prices and reduce consumer choice globally.

Tariffs can be implemented in a range of ways, including ad valorem tariffs, non-ad valorem tariffs, tariff rate quotas and countervailing measures.⁵ These can be levied with the objective of protecting domestic producers, raising revenues, or both.

Non-tariff measures (NTMs) are policy measures that may have an effect on trade by changing what can be traded, and at what price. For example, goods may need to comply with technical regulations. There can also be a need to meet requirements intended to protect humans, animals, and plants from diseases, pests, or contaminants. NTMs may occur at the border or 'behind the border'. Behind the border refers to any NTMs that are applied inside an individual country but do not get checked at the border and therefore do not stop a product entering - for example labelling requirements.

NTMs can serve legitimate public policy objectives, and they do not all reduce trade. For example, the enforcement of high product standards may increase consumer demand for some goods. However, in other cases, non-tariff measures can act as barriers, raising trade costs and reducing trade.



4. ONS UK Trade (March 2018), current prices.

5. Ad valorem tariffs are based upon a percentage of the value of a good, while non-ad valorem tariffs are based on the weight or the ingredients within a good. Tariff rate quotas allow a specific quantity of goods to enter at a reduced or tariff-free rate before higher duties are charged. Countervailing measures are duties levied on goods from countries which may have unfair state subsidies.

FTAs can liberalise trade in goods by:

Addressing border barriers

- **Lowering costs:** Reducing tariffs between countries can increase opportunities for businesses that export and import, and improve choice for consumers. Tariff liberalisation may be immediate or phased over several years.
- **Providing greater certainty:** Countries sometimes apply lower tariffs than those they have committed to in their WTO schedules. FTAs can remove or reduce the gap between the maximum tariffs countries have committed to and the tariffs they apply in practice. This means that exporters and importers do not face the risk of tariffs suddenly being raised.
- **Providing greater ease:** FTAs can streamline customs procedures within partner countries to facilitate the entry of goods, reduce administrative costs and reduce delays. These measures reduce the costs of trade and allow production to take place across borders.

Addressing 'behind-the-border' barriers to goods trade

- Removing or reducing non-tariff barriers to trade, and improving policy cooperation on non-tariff measures, can reduce the cost of trading products internationally. This can both increase the number of exporters and also increase the value of trade undertaken by existing exporters and importers.

Evidence suggests that FTAs can lead to large, sustained increases in trade in goods between partner countries. A review of many studies of the impacts of FTAs found that that they can boost total bilateral trade between partners by around 32%, although estimates from the literature vary widely.⁶ A recent study by HM Treasury, based on different data sources and methodology, estimated that FTA membership is associated with a 17% increase in total trade, on average.⁷ These studies indicate that deeper agreements tend to generate larger increases in trade. Evidence also suggests that trade flows continue to increase for up to 10 years after an agreement enters into force, meaning that the impacts of FTAs takes time to be fully felt.⁸

Not all of the increases in bilateral trade between partners of an FTA represent additional trade at a global level. Some of the increases will have been diverted from trade with other countries that are not in the agreement.

6. Head & Mayer (2013)

7. HMT (2016) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/517415/treasury_analysis_economic_impact_of_eu_membership_web.pdf

8. See for example: Egger et al. (2015); Baier & Bergstrand (2007)

From an economic perspective, free trade agreements provisions can reduce the fixed and variable costs associated with trading internationally, leading to an increase in both the number of exporting businesses and the value of exports from existing exporters.

Preferential tariffs and Rules of Origin (RoO)

Free Trade Agreements (FTAs) liberalise tariffs on a preferential basis between parties. Unlike in a customs union, members of an FTA can decide the tariffs which they apply to imports from any other country, and the FTA provides an opportunity for members to agree to offer each other preferential rates of tariffs below these generally applied levels. In order to ensure that only members of an FTA can benefit from these preferential tariff arrangements, the parties to the FTA need to agree a set of rules of origin to determine which goods imported from a partner country can qualify for preferential tariff treatment under the agreement. Rules of origin are necessary to prevent goods from other countries taking advantage of preferential tariff rates. However, implementing, administering and complying with rules of origin can generate costs.

There are two broad categories to determine whether goods have been substantially produced or transformed within the FTA countries and hence qualify as originating under an FTA:

1. Wholly originating: the good must have been entirely created or produced in the partner country.
2. Sufficient working or processing - this can take either one, or a combination of one or two or more of the following three forms:

a. Regional value content requirement: the final cost of a good must contain a certain percentage of value originating in a partner country;

b. Change in tariff classification: the production process must be sufficient to alter the HS Code classification of imported materials used in the production of the good, either by changing the HS2, HS4 or HS6 code;

c. Specific process rule: a good must undergo a set production process, for example a defined chemical reaction as set out in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership.

The FTA sets out which of these rules each product must meet.

Free trade agreements and trade in services

Services are increasingly important for the UK economy, accounting for 79% of UK GDP in 2016.⁹ Service sectors are also very important for UK trade. The UK consistently exports more services than it imports and ran a surplus in services trade of £112bn in 2017.¹⁰ In gross terms, services exports accounted for around 45% of total UK exports in 2017. However, when measured on a value-added basis, around two-thirds of the value of UK exports originate from services sectors.¹¹ This means that services provide an important source of inputs which are used to make UK exports.

As defined under the WTO's General Agreement on Trade in Services (GATS), trade in services is categorised in four ways (modes). A company in one country can sell services across a border to consumers in another (Mode 1), a consumer can buy services while abroad (Mode 2); a company can establish a commercial presence abroad to provide services (Mode 3) and services suppliers can travel abroad to provide a service (Mode 4).

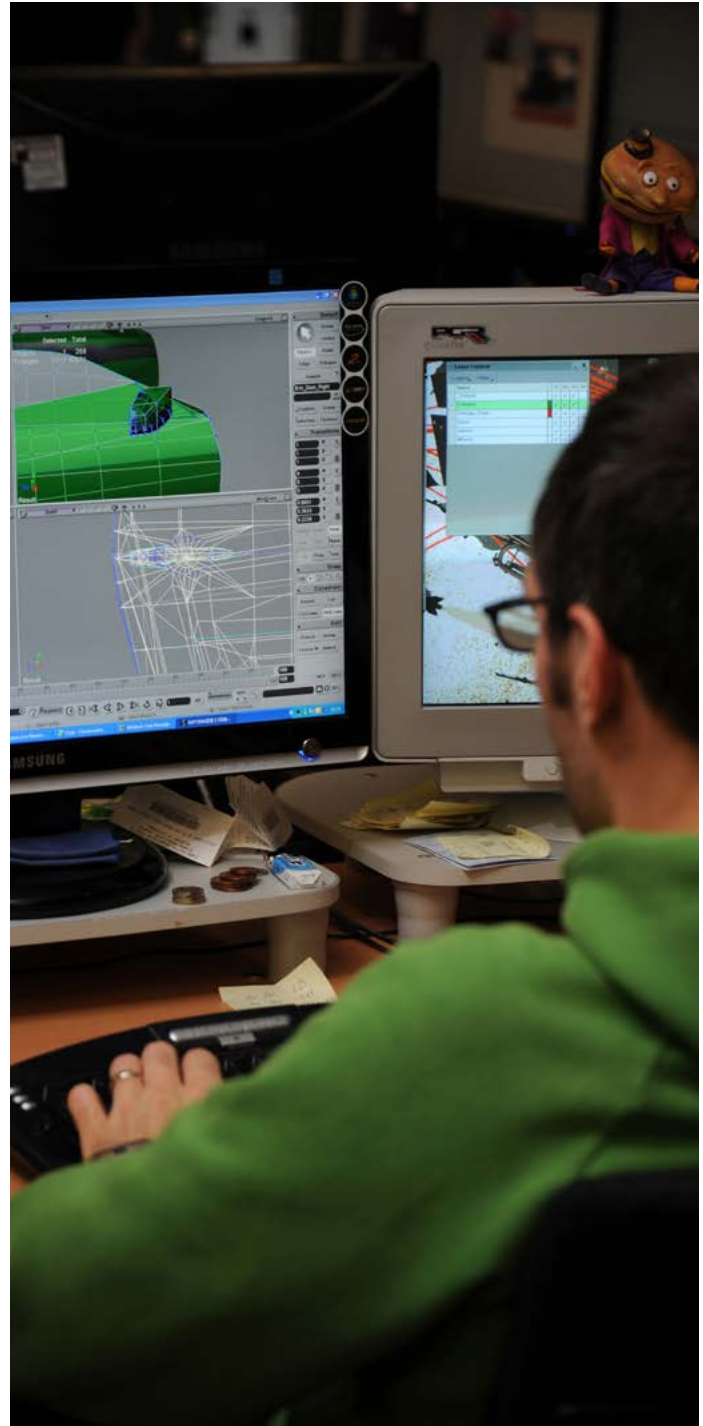
Services trade is not subject to tariffs. However, each mode of service supply can be subject to a range of 'behind-the-border' measures. These may restrict the access of foreign service suppliers to the market or discriminate against foreign suppliers in favour of domestic suppliers.

As with non-tariff measures affecting trade in goods, regulatory barriers affecting services can achieve legitimate public policy objectives. However, in some cases, they have an unwanted effect of impeding trade in services and it is desirable to remove them.

The Organisation for Economic Co-operation and Development (OECD) produces a Services Trade Restrictiveness Index, which measures the restrictions faced by foreign service suppliers in various sectors in over forty countries.¹² The policies include:

- Restrictions on foreign companies entering the market
- Restrictions to the movement of people
- Barriers to competition
- Lack of regulatory transparency
- Other discriminatory measures

It has become increasingly common to include services provisions within bilateral FTAs. According to the Design of Trade Agreements (DESTA) database, the number of bilateral agreements in force which included meaningful provisions relating to services trade rose from just 12 in 2000 to around 88 agreements by 2016.¹³



9. ONS UK gross domestic product (output approach) low-level aggregates

10. ONS UK trade: goods and services publication tables

11. OECD Trade in Value Added dataset.

12. <http://www.oecd.org/tad/services-trade/services-trade-restrictiveness-index.htm>

13. The Design of Trade Agreements database (DESTA) assesses the content of over 600 trade agreements from 1948 to 2016. <https://www.designoftradeagreements.org> (Dür et al., 2014)

Members of the WTO's General Agreement on Trade in Services (GATS) provide lists of commitments relating to maintaining the openness of their services sectors. In general, FTAs can provide opportunities to agree 'GATS-plus' provisions, such as:

- guaranteeing existing levels of market access;
- negotiating new market access in sectors of particular interest;
- promising that the current FTA partner will be offered at least as good access as any future FTA partner (an extension of the "most favoured nation" principle);
- improving transparency of domestic regulation such as standards, licensing and recognition of qualifications;

Economic evidence suggests that deep trade agreements increase services trade if they include provisions on specific sectors and tackle pervasive behind-the-border barriers, such as regulatory alignment and national treatment rights.¹⁴ Services and goods trade are interlinked, so that an open services sector is an important contributor to maintaining internationally competitive goods sectors.

From an economic perspective, FTAs liberalise trade in services via 3 channels:

- **Lowering barriers and levelling the playing field**
- **Providing greater certainty**
- **Reducing costs**

- Lowering barriers and levelling the playing field: Liberalising services trade by lowering barriers allows for greater market access for foreign services suppliers.

- Providing greater certainty: 'Locking-in' currently applied levels of market access ensures greater certainty for businesses and encourages new exporters to incur the fixed, sunk costs required to export their services.

- Reducing costs: Regulatory alignment and transparency can reduce the 'compliance costs' associated with meeting regulatory requirements of a trading partner's regime to enable trade in services.

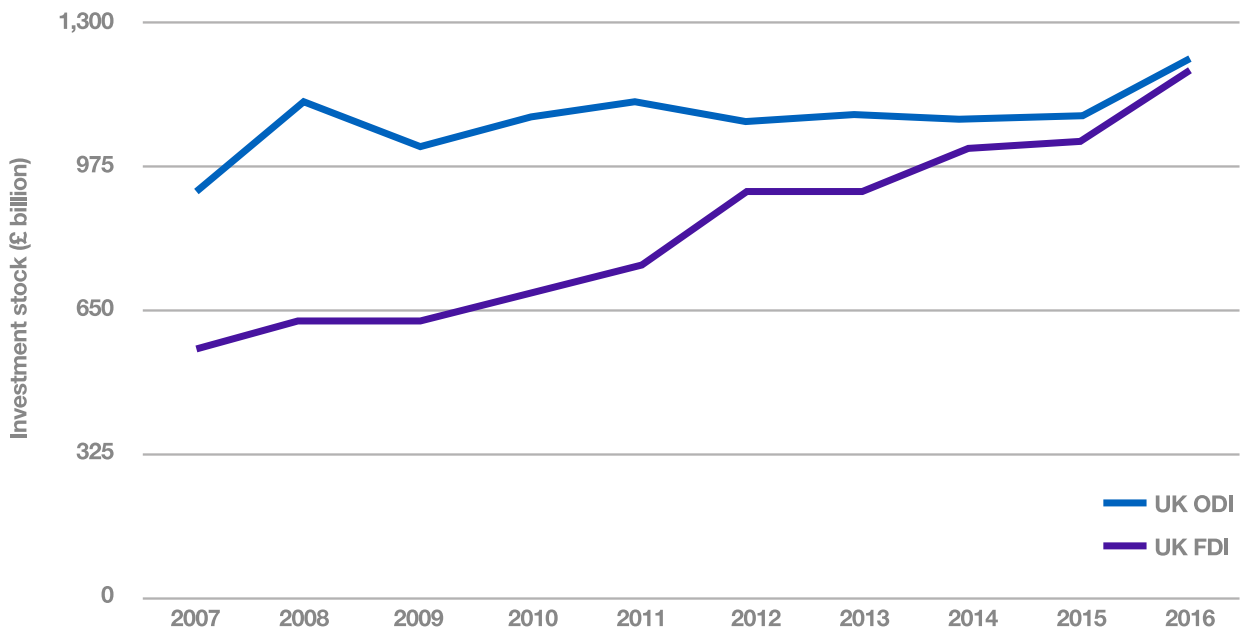


14. See for example: Guillin (2013); Lamprecht and Miroudot (2018)

Free trade agreements and investment

The UK is both a major destination and source of overseas direct investment. The value of the total stock of (inward) Foreign Direct Investment (FDI) in the UK has been rising noticeably over recent years, from under £600 billion in 2007 to around £1.2 trillion in 2016. The value of the UK's stock of outward direct investment (ODI) has been more stable over the last decade, and was also around £1.2 trillion in 2016.

Chart 4: Stock of Foreign Direct Investment to and from the UK (2007 – 2016)



Source: ONS "Foreign Direct Investment involving UK companies", inward and outward tables

Investment between countries generates many economic benefits. It leads to a more competitive business environment, which in turn creates jobs, increases innovation and generates economic spill-overs to the rest of the economy.¹⁵ There is also evidence of links between trade and investment.

Despite the benefits, global investment can be unnecessarily restricted by host government measures. Modern free trade agreements (FTAs) therefore increasingly include provisions relating to investment, including investment by establishing a commercial presence abroad. FTAs can seek to create a level playing field between domestic and foreign investors by prohibiting discrimination, market access barriers, and measures that could unduly distort investment flows. FTAs can also seek to increase certainty for investors by providing them with protections against arbitrary or manifestly unfair treatment. Addressing risk and uncertainty is particularly important for

companies that may incur significant "sunk" costs¹⁶ when they invest. The right of governments to regulate in the public interest is recognised in investment chapters in FTAs.

There is evidence that FTAs can increase certain forms of investment.¹⁷ This depends on the specific provisions within the agreement and the economies involved.¹⁸

15. See for example: technology transfers from investment in R&D-intensive countries (Van Pottelsberghe and Luchtenberg, 2001), positive impact on economic growth (Szkorupova, 2014), increase on employment, productivity and competitiveness (HMG, 2014), R&D (Lin and Yeh, 2005)

16. A sunk cost is a cost that once a business pays can no longer be recovered by any means.

17. See for example: Lejarraga and Bruhn, 2017, Velde and Bezemer, 2006, Bütthe and Milner, 2014, Kim, Lee and Tay, 2017, Kohl, Brakman and Garretsen, 2016, and Berger et al., 2013.

18. For example vertical foreign direct investment: Osnago et al., 2015

Free trade agreements and productivity

“Productivity” is defined as the amount of output that an individual, firm, sector or economy can produce from a given level of inputs. Productivity growth is the single largest determinant of living standards and one of the principal determinants of long-run economic growth.

Theory suggests that openness to trade and investment may be an important driver of productivity growth. Trade liberalisation can result in a more efficient allocation of resources in the economy. It can shift the pattern of production in each country towards products and services in which the country has a comparative advantage. In doing so the price of goods and services across the economy can fall, benefiting consumers.

Greater opportunities to sell overseas should reward the most productive firms, allowing them to expand and attract investment, while competition encourages less productive firms to innovate and adapt. Competition can also provide companies with the incentive to invest in the skills of their workers, adopt better management practice and innovate in their use of capital, raising the productivity of firms and the workforce.

Empirical evidence seems to support this. The OECD estimates that a 10 per cent increase in openness to trade is associated with a 4 per cent increase in income per head.¹⁹

Impacts: How different groups might be affected by a Free Trade Agreement

FTAs are expected to boost overall trade, investment and productivity. They can have different impacts on groups within society, such as businesses, consumers or workers.



Potential impacts of an FTA for businesses

Free trade agreements (FTAs) can generate a range of opportunities and challenges for businesses. Providing greater market access for existing exporters, increasing the number of companies that export, and providing access to more imported inputs are important benefits of trade liberalisation.

- FTAs can help businesses by expanding the size of the market into which they export. As well as increasing turnover, this can allow businesses to benefit from economies of scale, lowering their operating costs and raising profitability. This can help them attract investment and expand further.

- By reducing barriers on imports, FTAs can reduce costs and expand the choice of imported inputs for businesses. This can help to raise the competitiveness of businesses.

- Where they include investment provisions, FTAs can help to foster a favourable investment environment and provide a level playing field. This can help businesses to invest overseas more easily and attract investment from partners abroad.

- Where FTAs reduce the fixed costs of exporting, they are likely to provide particular benefits for small and medium-sized enterprises. This can raise the number of smaller firms which find it profitable to export, helping to spur innovation and increase productivity.

- The evidence shows that increased competition from trade promotes business innovation and growth. Some sectors may expand, creating more jobs and prosperity but some sectors or companies, which fail to adjust to such competition, can be adversely affected.

19. OECD. Sources of Economic Growth in OECD Countries (Feb 2003).

Administrative benefits and costs for businesses

According to the World Bank database on the content of FTAs, over 90% per cent of the 279 agreements in the database include customs provisions.²⁰ Where these provisions address bottlenecks and streamline customs procedures, they can reduce the administrative or procedural costs faced by businesses when exporting and importing.

As with any economic policy, it can take time and effort for businesses to familiarise themselves with the changes. Businesses will incur some costs as they learn how to take advantage of the new commercial opportunities. FTAs can also generate additional administrative or compliance costs associated with meeting the requirements of rules of origin. Agreements can be designed in a simple and transparent manner to minimise the familiarisation costs and administrative burden caused by rules of origin.

Potential impacts of an FTA for consumers

At the heart of trade liberalisation is the expected benefit for consumers. Free trade agreements (FTAs) can directly benefit consumers in two ways:

- 1) **Increases in product quality, variety and consumer choice.** Lowering trade costs between countries raises the probability that businesses will find it profitable to trade. This increases the number of firms that trade, and the variety of products traded.
- 2) **Welfare gains from lower prices for existing products.** Reducing barriers on consumer goods and the regulatory barriers affecting cross-border trade in services can generate lower prices for consumers.

In addition, FTAs often benefit consumers indirectly through an impact on domestically produced goods. They can stimulate competition, resulting in lower prices for consumers. Domestic firms also benefit from improved choice, quality and lower prices of their intermediate inputs, which may be passed on to consumers in the form of lower prices.

Consumers can also be affected by specific provisions within FTAs. Applying the World Bank's classification, the most relevant provisions are likely to relate to competition policy, consumer protections, sanitary and phytosanitary standards, technical barriers to trade and e-commerce. Consumers may regard the impact of specific provisions to be positive or negative depending on their individual perspectives and priorities.

As set out in the White Paper "Preparing for our future UK trade policy", the UK Government is committed to maintaining high standards of consumer protection for its citizens.

Economic evidence suggests that FTAs signed by developed nations such as the EU and US have indeed reduced consumer prices for their consumers and have increased the average quality of imported products.²¹



20. Hoffman et al. (2017)

21. See for example: USITC (2016), Cernat et al. (2018) and Breinlich et al. (2016)

Potential impacts of an FTA for workers

Just as free trade agreements (FTAs) present opportunities and challenges for businesses, they also generate opportunities and challenges for the workers of those businesses. They can also affect the dynamism of the labour market more widely.

Workers can benefit from FTAs through a variety of channels:

- Where FTAs boost productivity within firms and sectors, and across the economy more widely, this is likely to generate increases in the employment opportunities and real wages of workers.
- Where FTAs lower consumer prices, this is likely to benefit workers in the form of higher real wages, meaning that they can purchase more even at the same wage.

Economic evidence shows that, on average, trade has benefited workers through increasing employment levels over the longer-term²² and FTAs have had a positive impact on average real wages.²³

Trade liberalisation can affect the structure of the economy over time. Workers may move between jobs and sectors, as changes in the pattern of trade leads to some sectors expanding and some sectors declining. Evidence shows that the UK has one of the most dynamic and flexible labour markets in the world, which helps to facilitate adjustment and reduce transitional costs for workers.²⁴

Modern, dynamic economies are continually reshaping in line with global developments which drive a continual process of worker and job transition in the labour market. It is possible that lower barriers and greater import competition resulting from an FTA could accelerate this ongoing process.



Potential wider social impacts of a free trade agreement

As described above, free trade agreements (FTAs) can affect employment prospects, wages and wider working conditions in specific sectors or for specific professions or skill levels.

The characteristics of workers can sometimes differ across sectors, professions and skill levels. It is therefore possible that these changes could affect various social groups differently and influence the distribution of income.

The regional location of workers in different sectors and professions may also vary. This means that different areas or regions within a country may be affected differently by an FTA.

The impacts on different groups and regions will depend upon the details of each agreement. The Government will assess the potential impacts on different groups in more detailed studies before and after negotiations take place with partner countries.

Potential impacts of a free trade agreement on the environment

The economic changes resulting from FTAs have the potential to affect some aspects of the environment including, for example, greenhouse gas emissions, air pollution, water quality and land use.

The indirect impacts on the environment may occur as enhanced trade induces the economy to grow (a 'scale' effect affecting pollution for example) and as economic activity shifts between sectors with different levels of emissions (a 'composition' effect). FTAs can also positively impact the environment as increased trade leads to the transfer of new, potentially more environmentally friendly, technologies and production methods (a 'technique' effect).

The impact of FTAs on the environment will depend upon the design of an agreement and the economies of the countries involved. As set out in the 2017 White Paper "Preparing for our future UK trade policy", the UK Government is committed to maintaining high standards of environmental protection in trade agreements. The Government will assess the potential environmental impacts in more detailed studies before and after negotiations take place with partner countries.

22. See for example: ILO (2016).

23. See for example: Caliendo and Parro (2015) and Trefler (2006).

24. For example, the UK is rated as having the 5th most efficient labour market in the world in the World Economic Forum's Global Competitiveness Report, 2016-17, behind only Switzerland, Singapore, Hong Kong and the United States.

Trade and investment relationship between the United Kingdom and the United States

A Free Trade Agreement between the UK and the United States (US) would represent an important opportunity to deepen our bilateral trade and investment relationship. This information note provides an overview of the existing relationship between the two countries. The US and UK are the first and fifth largest economies in the world.²⁵ Total trade in goods and services between the US and the UK reached over £180bn in 2017.²⁶

The UK and the US have a long history of cooperation in international trade and investment forums. On trade, the two countries were among the original signatories to the General Agreement on Tariffs and Trade (GATT – the precursor to the WTO), having committed in the 1941 Atlantic Charter “to further the enjoyment by all states, great or small, victor or vanquished, of access, on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity.” For the last 70 years, the UK and US have worked alongside other GATT/WTO members to liberalise trade and strengthen the multilateral trading system through successive Rounds of trade talks.²⁷

On investment, the UK and US have worked with other members of the Organisation for Economic Cooperation and Development (OECD), agreeing – for example – common commitments on removing unnecessary barriers to the movement of capital and services.



Facts and figures for bilateral trade and investment flows

Economies of the United Kingdom and the United States

The UK and US economies are similar in structure, although US gross domestic product (GDP) is around seven times larger than the UK's. The services sector accounts for 79% of economic output in both. Both economies are highly engaged

in global trade. Trade (imports plus exports) is equivalent to a higher proportion of UK GDP, at 59% compared to 27% for the US, as the US is a bigger economy and able to supply a higher proportion of domestic demand internally.

Figure 1 – Headline Economic Indicators for the US and the UK

Economic Indicator (2016 unless specified)	US	UK
GDP (PPP ²⁸ , 2011 prices)	\$17.3 trillion	\$2.58 trillion
GDP per capita (PPP 2011 prices)	\$53,399	\$39,309
Trade (% GDP)	27%	59% ²⁹
Population	323.4 million	65.6 million
Services, value added (% GDP)	78.9% [2015]	79.2%
Agriculture, value added (% GDP)	1.1% [2015]	0.6%
Industry, value added (% GDP)	20.0% [2015]	20.2%

Source: World Bank Development Indicators, sector value added data retrieved as of May 2018

25. Based on 2017 GDP in US\$ at current prices, World Bank Development Indicators

26. Office for National Statistics, UK Trade (March 2018)

27. Atlantic Charter text: https://www.nato.int/cps/en/natohq/official_texts_16912.htm

28. A purchasing power parity (PPP) adjustment has been applied to GDP figures. This adjustment accounts for differences in prices between two countries, such that the same GDP (on a PPP basis) would allow consumers to buy the same basket of goods in both countries

29. Note that this figure is taken from the World Bank Development Indicators dataset and therefore does not exactly match the ONS figure of 62% quoted above

Trade flows

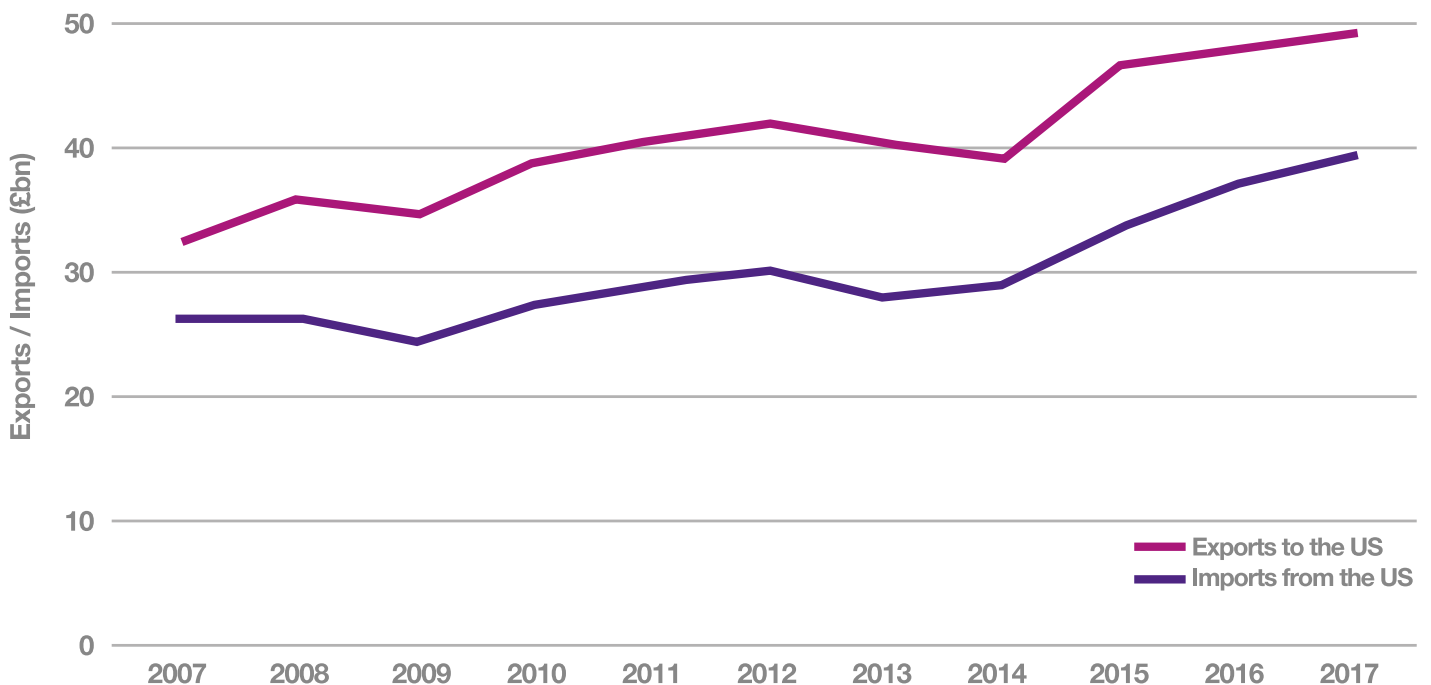
The following statistics show trade flows between the UK and US:³⁰

- in 2016 the US was the UK's largest single bilateral trading partner, accounting for 15% of total UK trade.
- the US was also the UK's largest single export market, accounting for 18% of all UK exports. The US was the UK's second largest single source of imports.
- total trade in goods and services (exports plus imports) between the UK and the US reached £181.2bn in 2017, an 8.0% increase from 2016.
- of all UK exports to the US in 2017, 45% was made up of goods and 55% in services. This compares to UK exports to the EU being 61% goods and 39% services.
- in 2017, 53% of the UK's imports from the US were goods compared to 47% services.

Trade in goods

The UK exports a higher quantity of goods to the US than it imports from it, leading to a trade surplus in goods. This trade surplus has remained fairly constant over the past ten years, as growth in the UK's goods exports to the US has kept pace with growth in goods imports from the US.

Figure 2 – UK goods exports and imports to and from the US (2007-2017)



Source: Office for National Statistics, UK Trade (March 2018), values in current prices

Trade in goods by sector

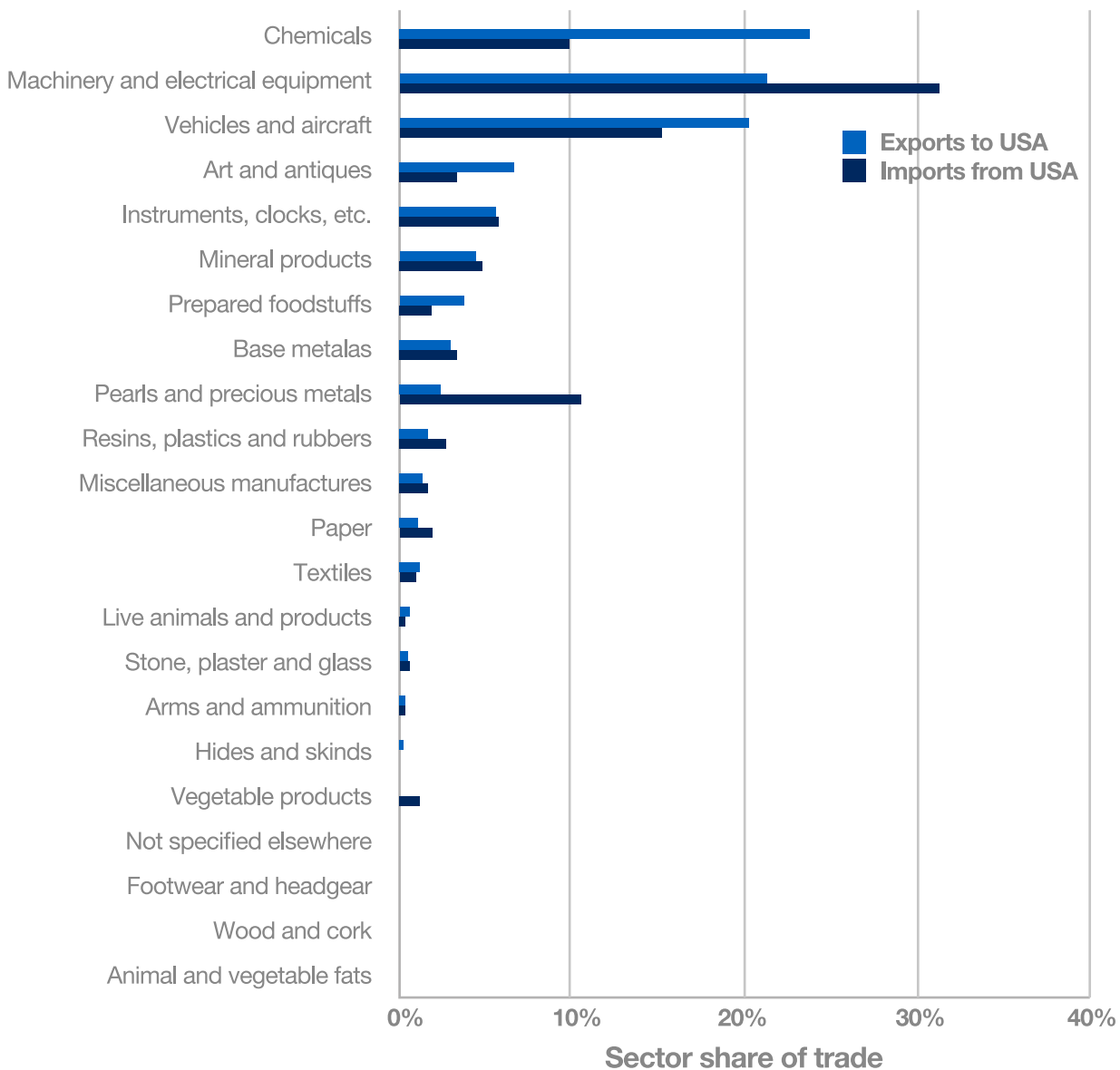
As shown in Figure 3, the UK and the US export fairly similar goods to one another, reflecting similar economic strengths. The three goods sectors in which the UK exports the most to the US are:

- chemicals
- machinery/electrical equipment
- vehicles.

The three goods sectors in which the US exports the most to the UK are:

- machinery/electronic equipment
- vehicles
- pearls/precious metals.

Figure 3 – Bilateral services trade between the UK and the US, broken down by sector (average 2015-17)

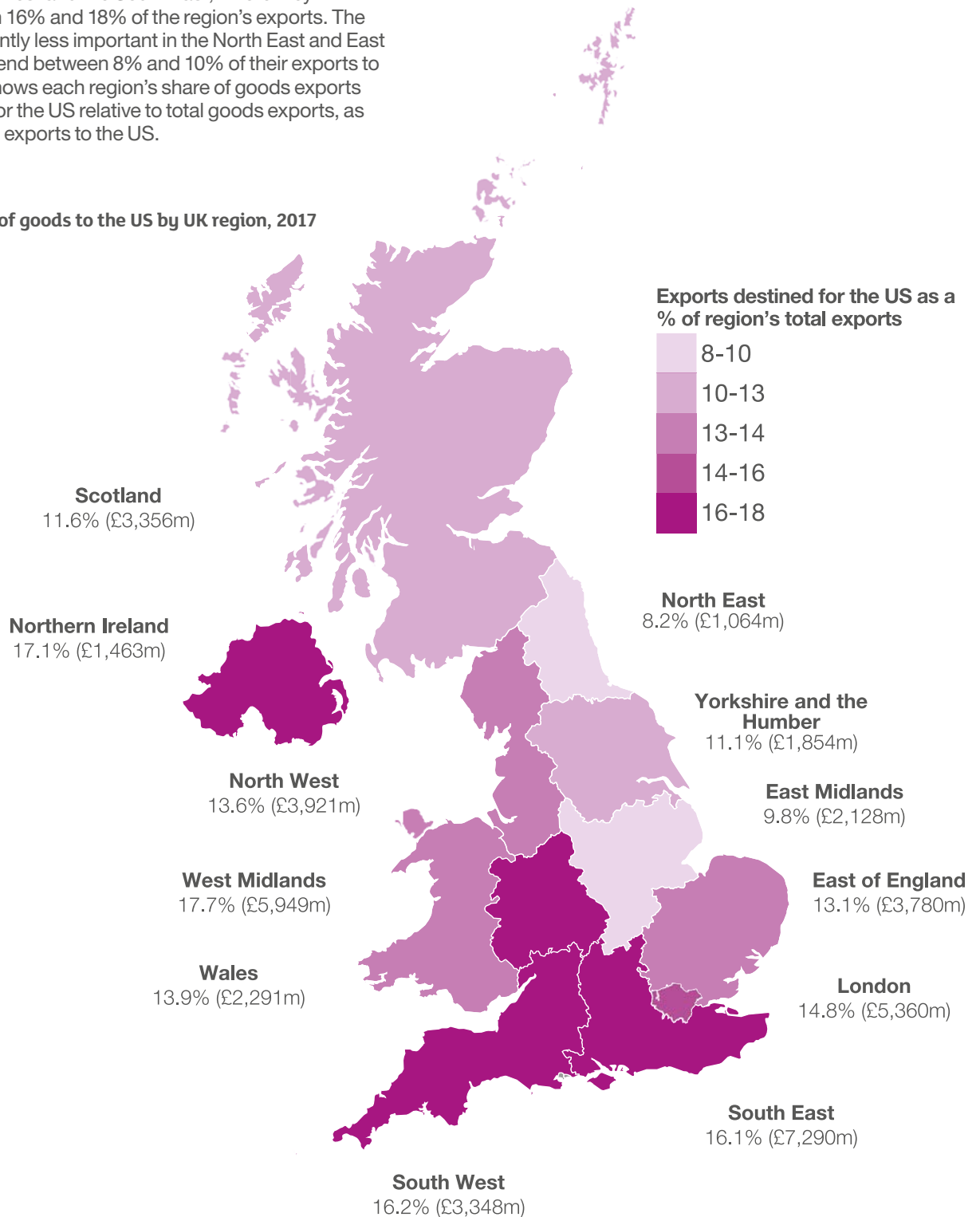


Source: HMRC trade statistics by commodity code. Sectors classified according to Harmonised System Sections. Data uses an average from 2014 to 2016.

Trade in goods by region

The US is an important export destination for all regions of the UK. Currently, the regions sending the highest proportion of their goods exports to the US are the West Midlands, Northern Ireland, the South West and the South East, where they comprise between 16% and 18% of the region's exports. The US market is currently less important in the North East and East Midlands, which send between 8% and 10% of their exports to the US. Figure 4 shows each region's share of goods exports that are destined for the US relative to total goods exports, as well as total goods exports to the US.

Figure 4 – Exports of goods to the US by UK region, 2017

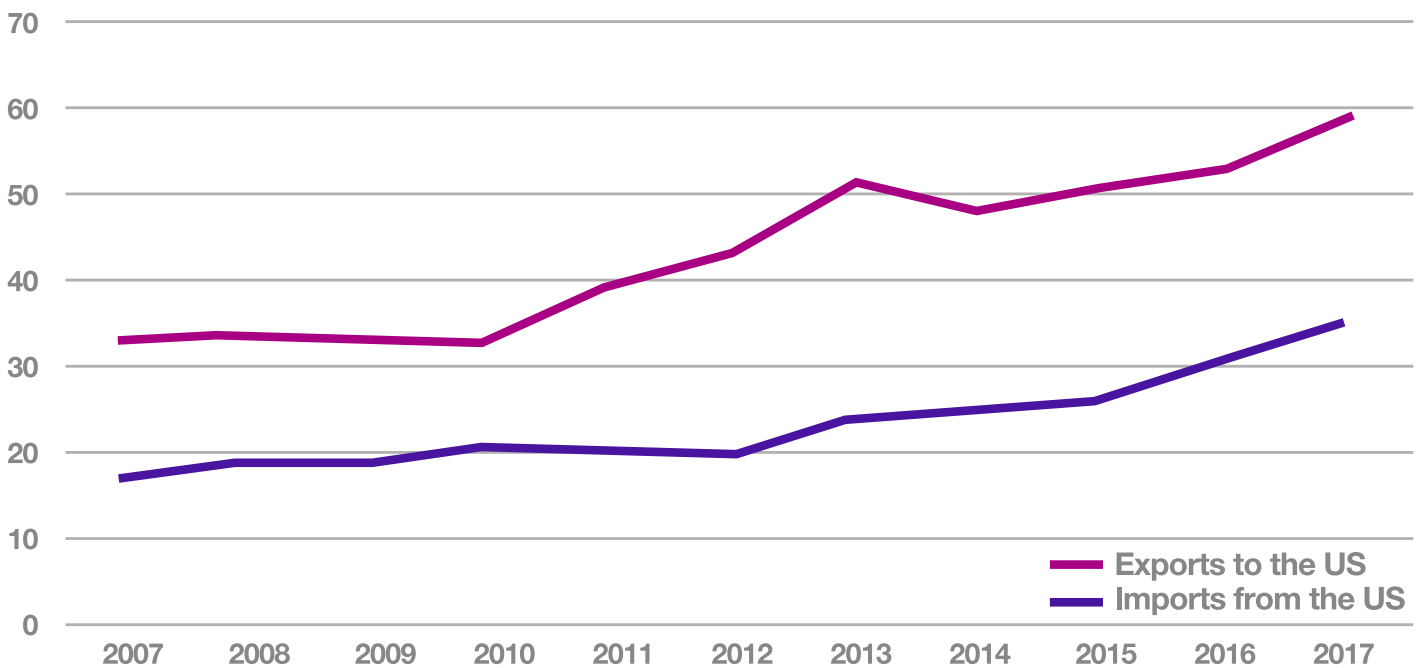


Trade in services

In 2017, more than half of UK exports to the US were services. The UK's total services trade with the US – imports plus exports – has almost doubled in the last decade from £49 billion in 2007 to £94 billion in 2017, as shown in Figure 5.³¹

The main types of services traded between the UK and the US are similar. The UK's main exports to the US are categorised by the Office of National Statistics as "other business services", finance and transport. "Other business services" includes legal and accounting services. The UK's main imports from the US were in "other business services", travel and finance.

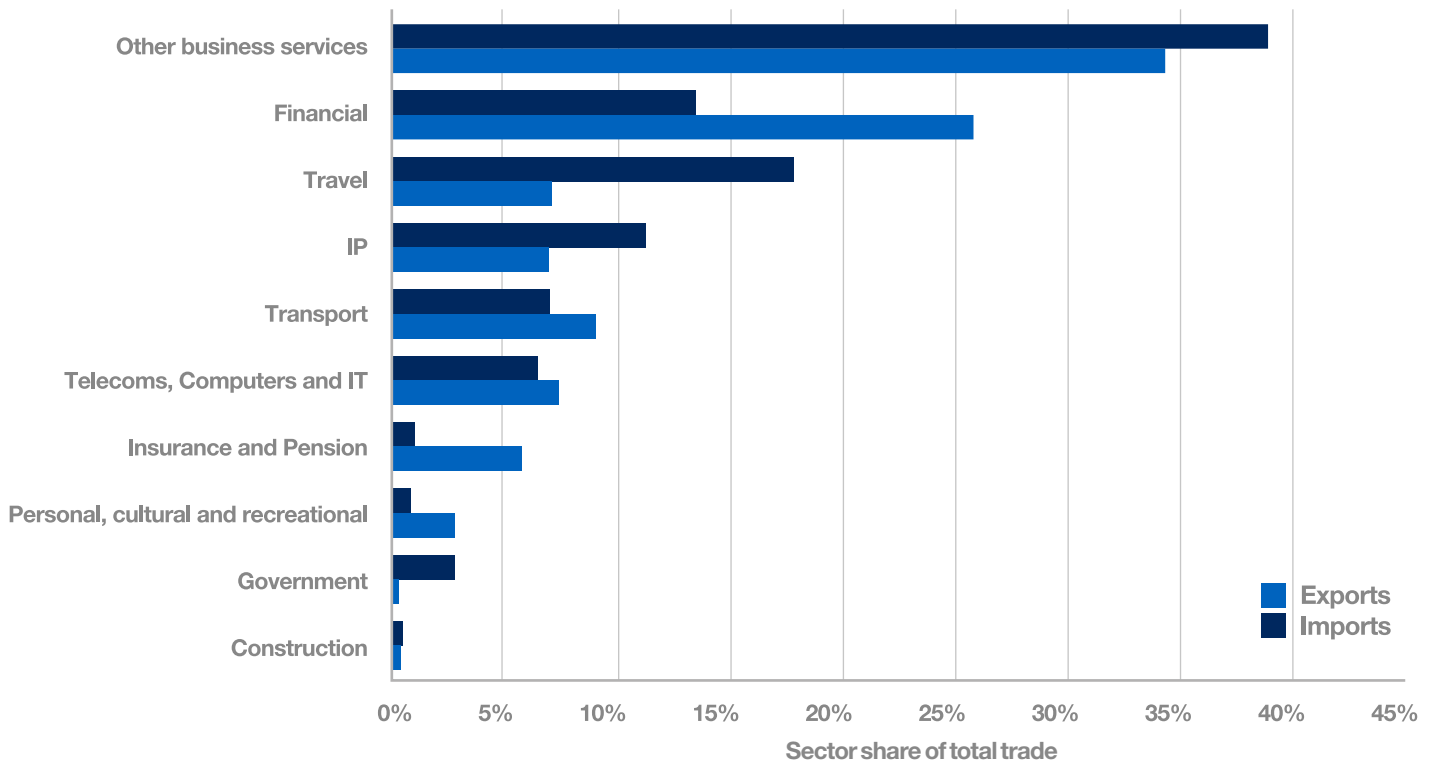
Figure 5 – UK services exports to the US and services imports from the US (2007-2017)



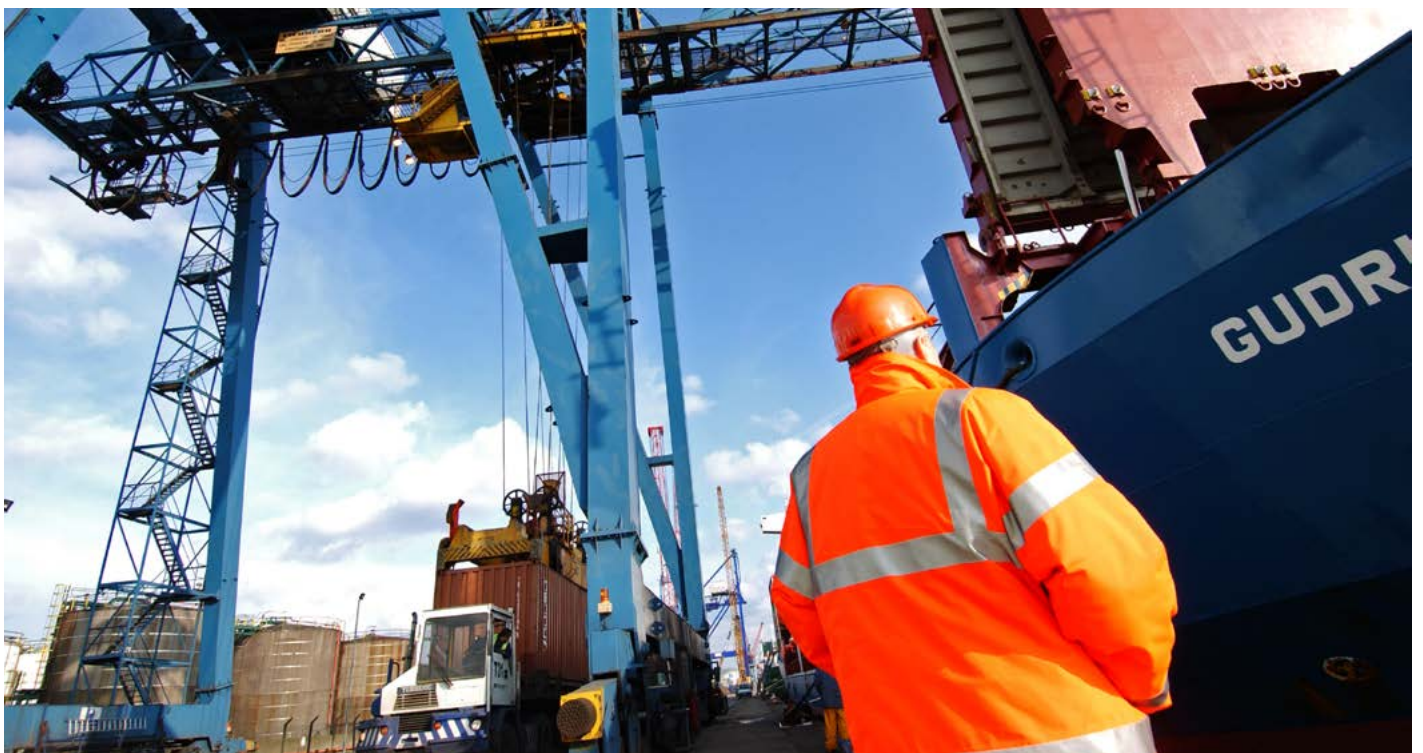
Source: Office for National Statistics, Economic Accounts, March 2018

31. Asymmetries exist in trade in UK-US services trade data where both countries report a trade surplus with each other. According to the ONS, in 2016 the UK reported a trade in services surplus with the US of £22.5 billion, while the US reported a trade in services surplus of £10.4 billion with the UK. See <https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/articles/asymmetriesintradetadivingdeeperintoukbilateraltradedata/2018-01-29> and <https://www.bea.gov/scb/2018/02-february/0218-asymmetries-in-bilateral-trade-statistics.htm> for an explanation.

Figure 6 – Bilateral services trade between the UK and US, broken down by sector (average 2014-16)



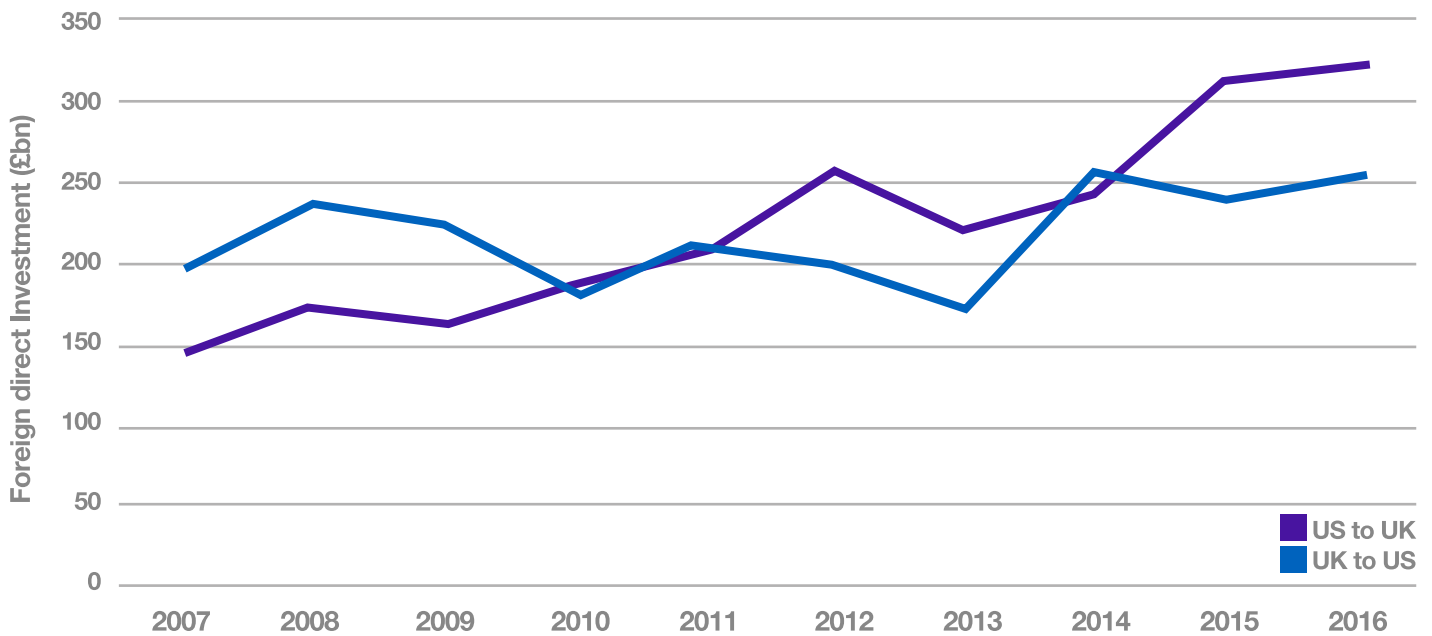
Source: Office for National Statistics: User Requested Data, 2017 – Trade in Services data.



Investment stock

The US was the top destination for UK Foreign Direct Investment (FDI) in 2016 (accounting for 20% of total UK outward FDI stock) and the top investor in the UK in 2016 (accounting for 26% of total UK inward FDI stock).³² Both the stock of US investment in the UK and UK investment in the US have gradually increased over the past decade.

Figure 7 – Stock of US FDI in the UK and UK FDI in the US (2007-2016)



Source: Office for National Statistics, Foreign Direct Investment Involving UK Companies, 2016. FDI data refers to stocks.

32. Office for National Statistics, Foreign Direct Investment Involving UK Companies, 2016. Inward and Outward investment.

Evidence relating to trade and investment barriers

A trade agreement can help remove trade barriers between countries. The main barriers to trade are:

- tariffs on goods
- non-tariff barriers affecting goods and services
- investment barriers

International evidence relating to barriers affecting trade in goods

Tariffs

Tariffs are customs duties on goods imported into a country. The simple average tariff on goods imported into the UK is 5.7% and for the US 3.5%.³³

On a trade-weighted basis - accounting for the specific value of bilateral UK-US trade in different sectors - the average tariff is around the same in both directions at 1.6%.



Figure 8 – Tariffs applied by the US and the UK (ad-valorem equivalent)³⁴

	US	UK
Simple average tariff	3.5%	5.7%
Trade weighted average (based on UK-US bilateral trade)	1.6%	1.6%
% of goods with no duty (HS 6-digit goods categories)	39.2%	26.0%
% of goods with tariffs above 15% (HS 6-digit good categories)	2.5%	5.7%

Source: World Bank Integrated Trade Solution, DIT calculations. Data for 2016.

Applied tariffs vary across different types of goods. Across the 21 goods categories³⁵, the UK's average tariffs- currently determined by the EU tariff schedule - vary from 0% on paper goods to around 20% on prepared foods, while US tariffs from 0% on paper goods to around 9% on textiles. Peak UK/EU tariffs - the highest level of tariff on specific goods within each HS sections - are 200% on vegetable products, compared to 101% on instruments or clocks in the US.

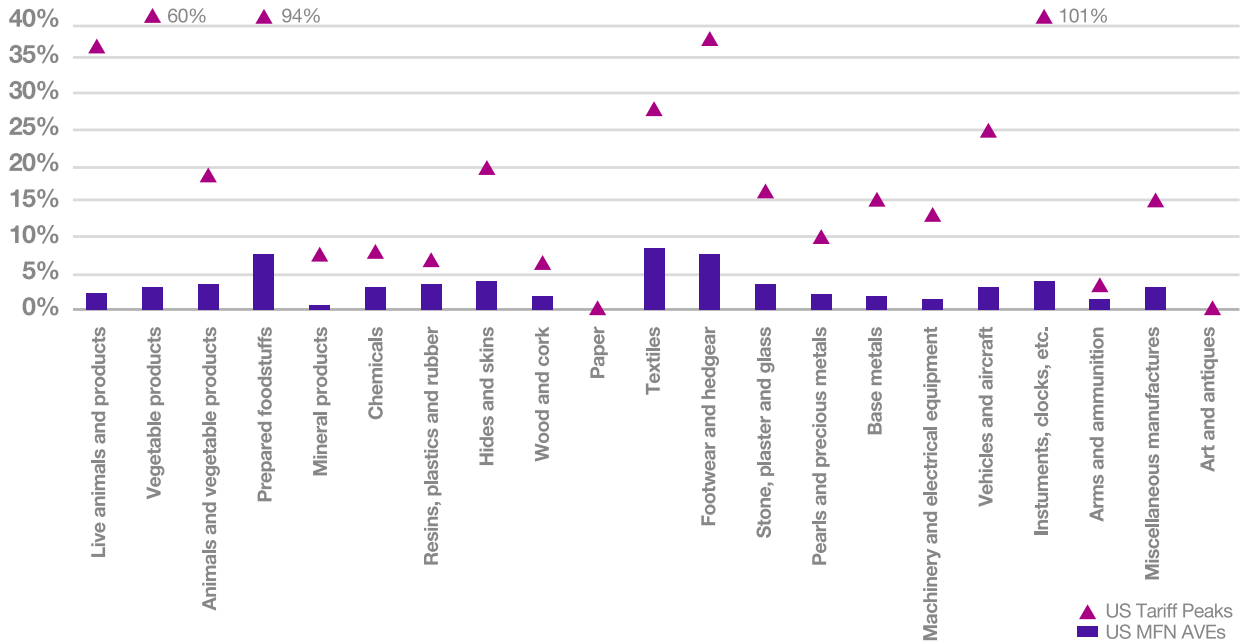
33. Tariff average calculated using simple average of applied tariffs in 2016. Ad-valorem equivalents calculated for specific taxes. Note: Specific taxes are taxes applied per unit of good sold rather than as a proportion of overall value. 'Ad valorem equivalents' convert these specific taxes (e.g. £5 per kilo) into the tariff rate that would be payable if items taxed according to its value. Source: WITS database; EU tariff schedule used for the UK

34. ariff average calculated using simple average of applied tariffs in 2016. Ad-valorem equivalents calculated for specific taxes. Note: Specific taxes are taxes applied per unit of good sold rather than as a proportion of overall value. 'Ad valorem equivalents' convert these specific taxes (e.g. £5 per kilo) into the tariff rate that would be payable if items taxed according to its value. Source: WITS database; EU tariff schedule used for the UK

35. Defined by the Harmonised System classification of goods by section

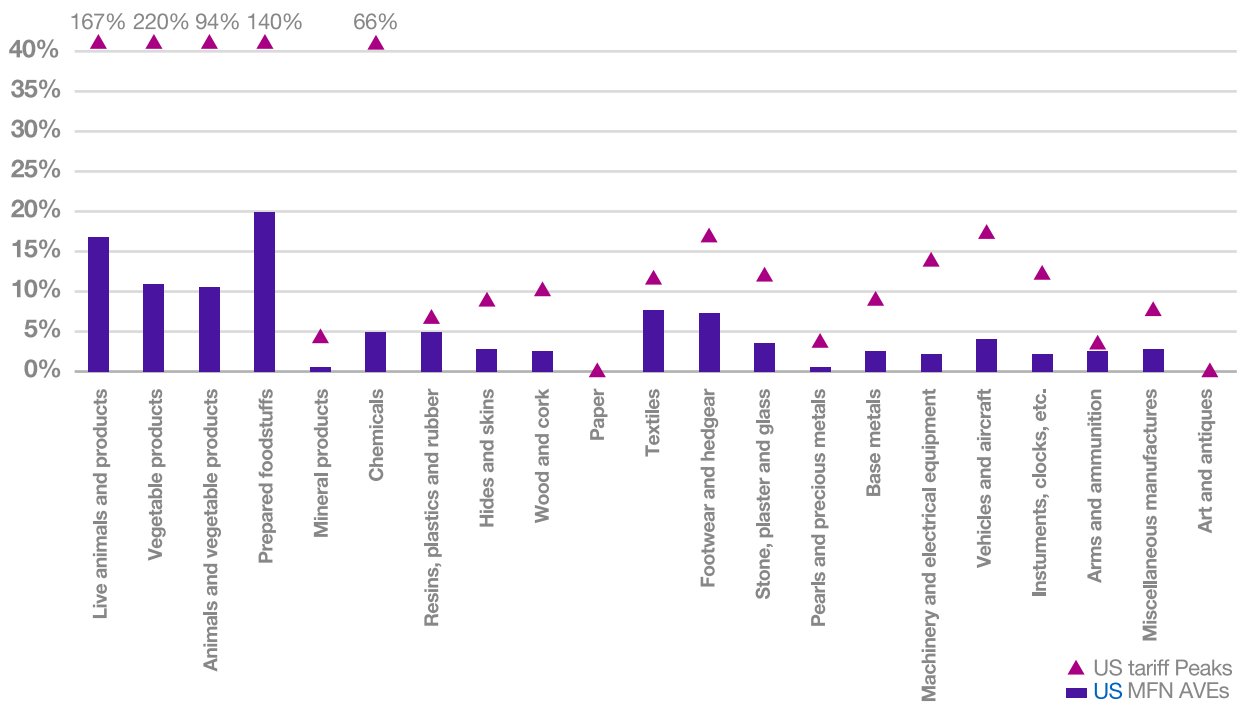
36. 'Ad valorem equivalents' convert these specific taxes (e.g. £5 per kilo) into the tariff rate that would be payable if items taxed according to its value. Source: WITS database; EU tariff schedule used for the UK

Figure 9 – US Tariff Composition (% ad-valorem equivalent³⁷)



Source: World Bank Integrated Trade Solution, DIT calculations. Data for 2016.

Figure 10 - EU Tariff Composition (% ad-valorem equivalent)



Source: World Bank Integrated Trade Solution, DIT calculations. Data for 2016.

37. 'Ad valorem equivalents' convert these specific taxes (e.g. £5 per kilo) into the tariff rate that would be payable if items taxed according to its value. Source: WITS database; EU tariff schedule used for the UK

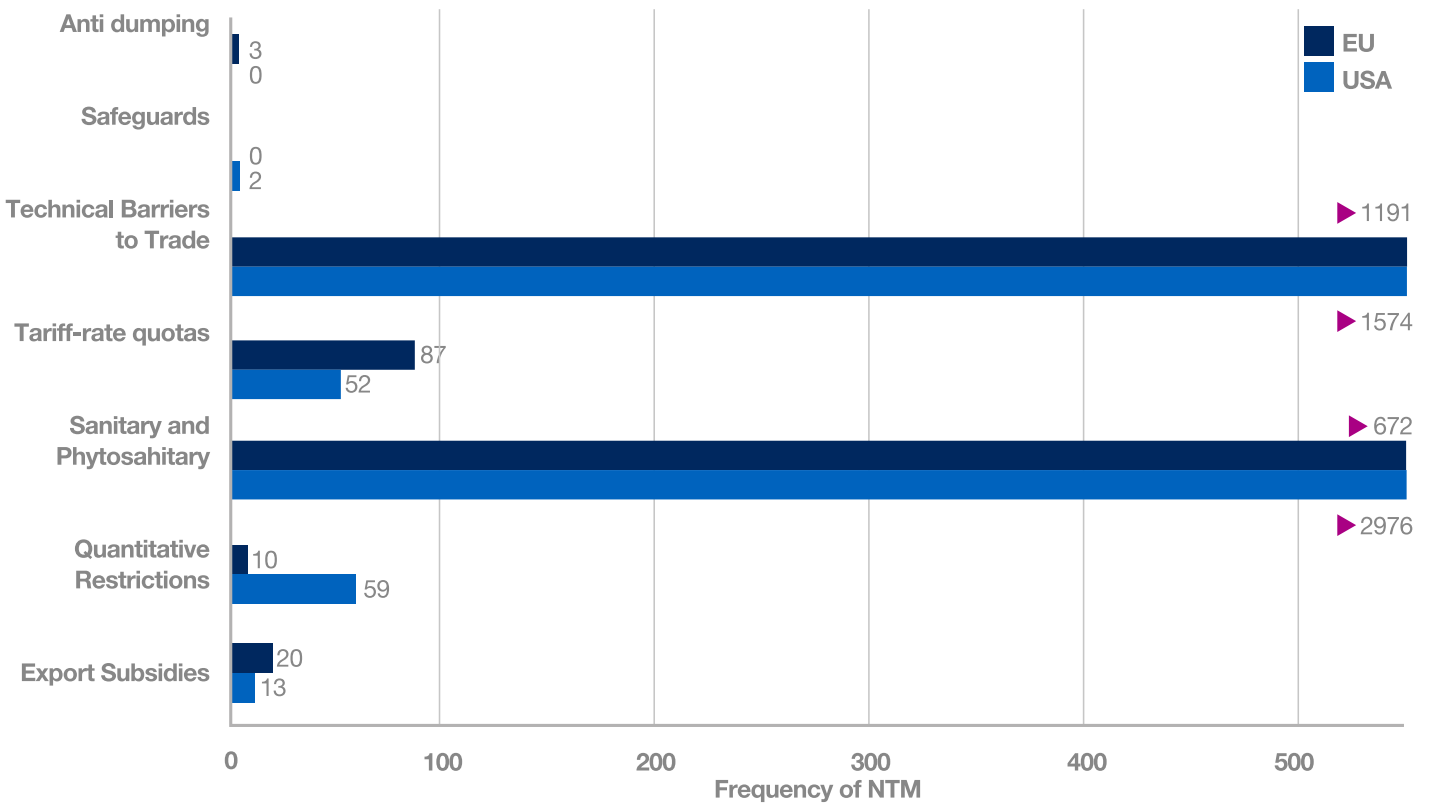
Non-tariff measures affecting trade in goods

A non-tariff measure is defined as being any policy measure other than customs tariffs that can potentially affect the quantity or price of international trade.

Data from the WTO’s Integrated Trade Intelligence Portal (I-TIP) shows that the greatest number of non-tariff measures in the US fall under the category of sanitary and phytosanitary measures. This is a category which covers any standards which a country applies to ensure food safety, animal health or plant health standards. According to this data the US also has a high number of technical barriers to trade, which include regulations, standards and procedures required to ensure that domestic legislative requirements are met.

In comparison to the EU, the US has a greater number of sanitary and phytosanitary measures, technical barriers to trade and quantitative restrictions. Quantitative restrictions are limits on the quantity or value of goods that can be imported or exported during a specific period. However, the EU has a greater number of export subsidies and tariff-rate quotas (two-tiered tariffs operating beneath and above a quota threshold) than does the US.

Figure 11 – Non-tariff measures (NTMs) in the EU and the US, by frequency

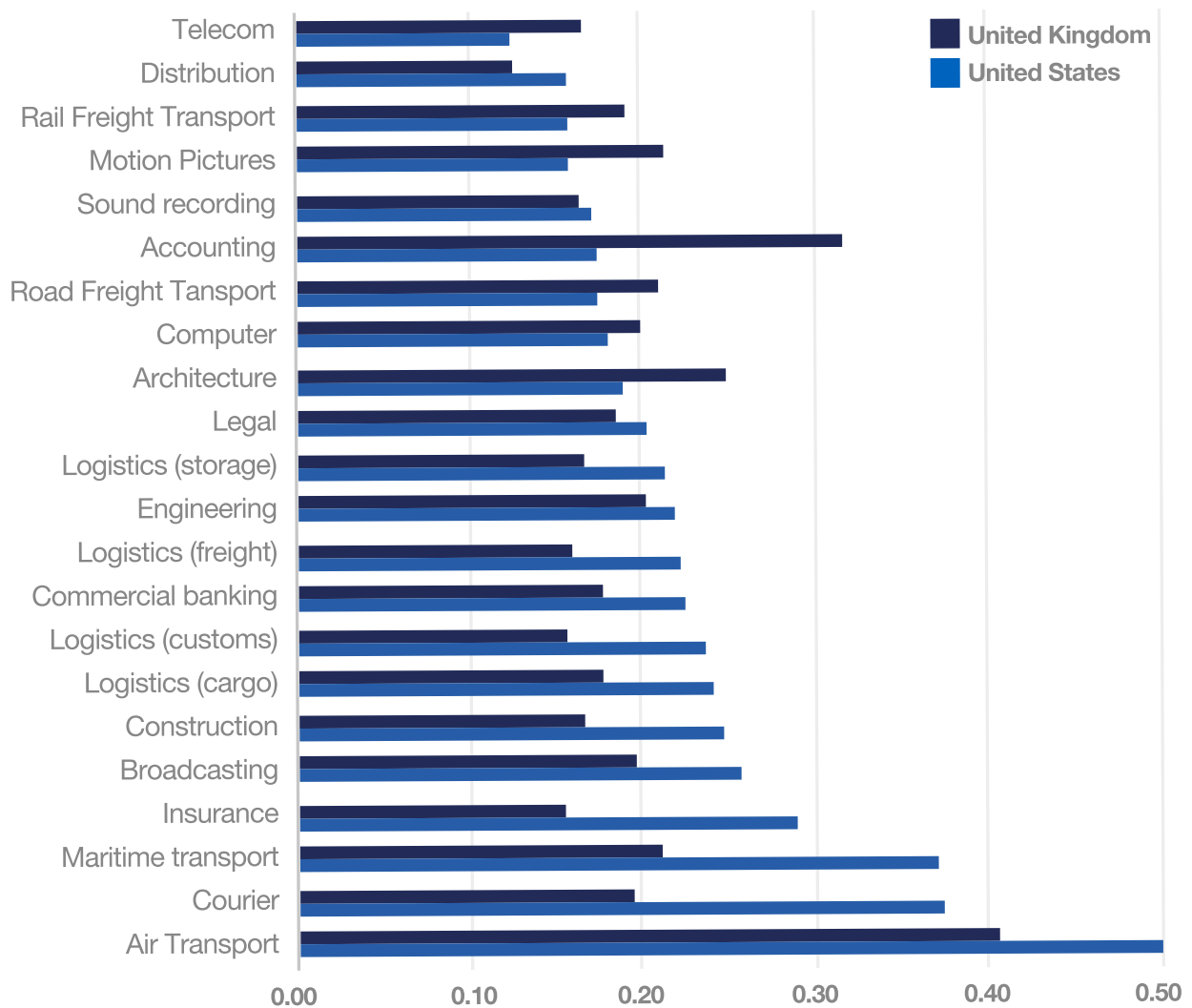


Source: WTO, Integrated Trade Intelligence Portal (I-TIP). NTMs either initiated or in force at 30/06/2018.

International evidence relating to barriers affecting trade in services

The OECD’s Services Trade Restrictiveness Index (STRI) provides an assessment of trade in services barriers across 22 sectors. A higher STRI value indicates higher regulatory requirements that are needed for exporters to provide services in that country. The sectors with the highest STRI values in the US are in air transport, courier services and maritime transport. For the UK, these are in air transport, accounting and architecture.

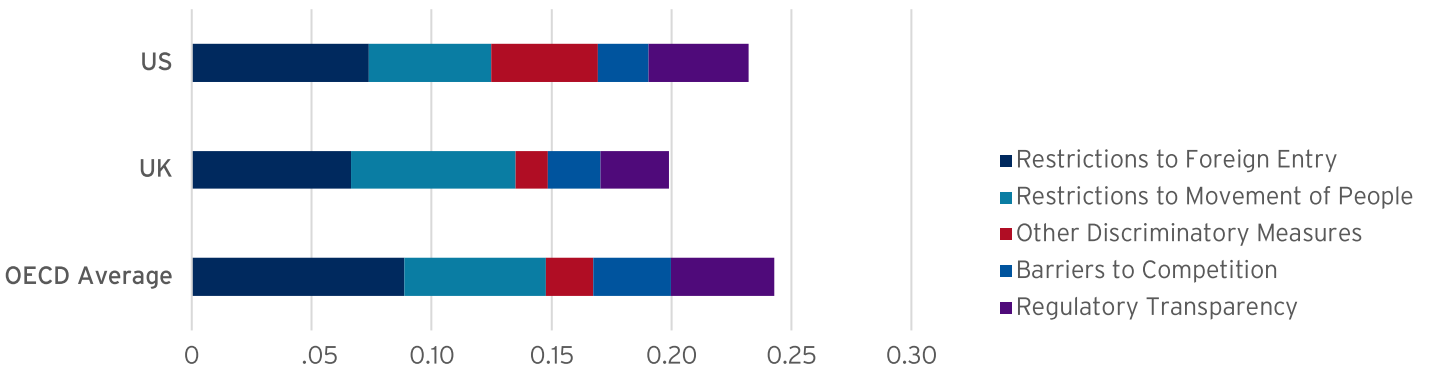
Figure 12 – UK and US Services Trade Restrictiveness Index (STRI) Comparison



Source: OECD Services Trade Restrictiveness Index (STRI). 2017 data.

Overall, the US has a higher services trade restrictiveness than the UK, but is below the OECD average.

Figure 13 – US Services Trade Restrictiveness Index, by type of restriction



Source: OECD STRI. 2017 Data.

Restrictions on Foreign Direct Investment

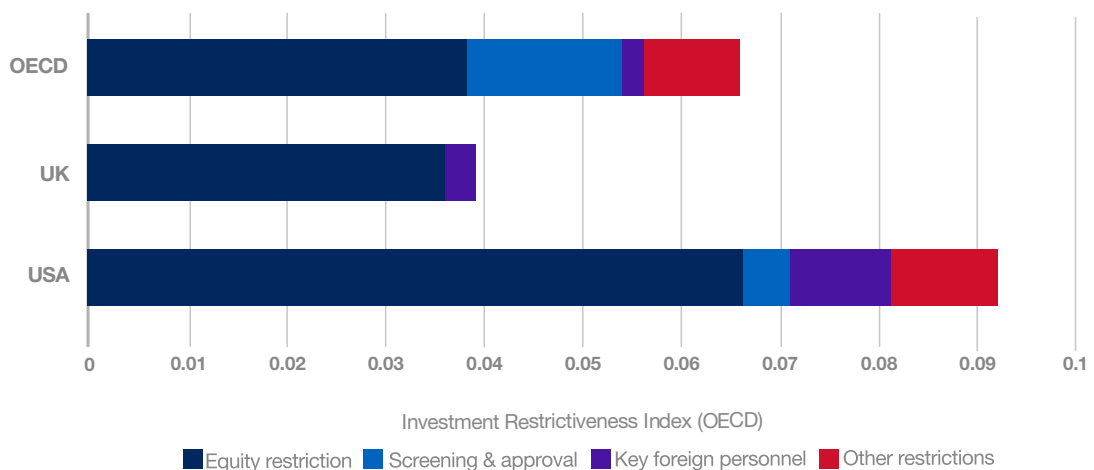
Investment provisions within a trade agreement can help create a level playing field for domestic and foreign investors by limiting discriminatory rules and increasing market access. They also seek to increase certainty, and in turn lower costs associated with foreign investment projects, thus reducing risks for business.

The OECD’s FDI Restrictiveness Index assesses the restrictiveness of a country’s foreign direct investment (FDI) rules by looking at four main types of barriers to FDI:

- foreign equity restrictions;
- discriminatory screening or approval mechanisms;
- restrictions on key foreign personnel and
- operational restrictions.

The index shows the US is more restrictive to FDI than the OECD on average. The majority of US FDI barriers fall under the category of ‘equity restrictions’ - that is, restrictions on the proportion of a business that can be owned by individuals who are not US citizens.

Figure 14 – US investment restrictiveness, by type of restriction



Source: OECD FDI Restrictiveness Index. 2017 data.

Conclusion from analysis

The international evidence shows that free trade agreements (FTAs) have the potential to deliver substantial economic benefits to an economy, including increased trade, investment and productivity. Transparent, well-designed FTAs have the potential to benefit businesses, consumers and workers alike.

The evidence suggests that the US is an important trade and investment partner and that deepening the trade and investment relationship through an FTA could generate benefits to the UK and US economies.

The international evidence also suggests that FTAs generate a range of opportunities and challenges. This consultation will inform an evidence-based approach to decision-making and inform future assessments of the impacts of an FTA with the US.

The UK Government has committed to publishing scoping assessments before entering into negotiations with partner countries, and to publishing an impact assessment later in the process, at an appropriate time.



Description of provisions in the Content of Deep Trade Agreements Database

WTO-plus areas	
FTA Industrial	Tariff liberalization on industrial goods; elimination of non-tariff measures
FTA Agriculture	Tariff liberalization on agriculture goods; elimination of non-tariff measures
Customs	Provision of information; publication on the Internet of new laws and regulations; training
Export Taxes	Elimination of export taxes
SPS	Affirmation of rights and obligations under the WTO Agreement on SPS; harmonization of SPS measures
TBT	Affirmation of rights and obligations under WTO Agreement on TBT; provision of information; harmonization of regulations; mutual recognition agreements
STE	Establishment or maintenance of an independent competition authority; non-discrimination regarding production and marketing condition; provision of information; affirmation of Art XVII GATT provision
AD	Retention of Antidumping rights and obligations under the WTO Agreement (Art. VI GATT).
CVM	Retention of Countervailing measures rights and obligations under the WTO Agreement (Art VI GATT)
State Aid	Assessment of anticompetitive behaviour; annual reporting on the value and distribution of state aid given; provision of information
Public Procurement	Progressive liberalisation; national treatment and/or non-discrimination principle; publication of laws and regulations on the Internet; specification of public procurement regime
TRIMs	Provisions concerning requirements for local content and export performance of FDI
GATS	Liberalisation of trade in services
TRIPs	Harmonisation of standards; enforcement; national treatment, most-favoured nation treatment
Anti-Corruption	Regulations concerning criminal offence measures in matters affecting international trade and investment
Competition Policy	Maintenance of measures to proscribe anticompetitive business conduct; harmonisation of competition laws; establishment or maintenance of an independent competition authority
Environmental Laws	Development of environmental standards; enforcement of national environmental laws; establishment of sanctions for violation of environmental laws; publications of laws and regulation
IPR	Accession to international treaties not referenced in the TRIPs Agreement
Investment	Information exchange; Development of legal frameworks; Harmonisation and simplification of procedures; National treatment; establishment of mechanism for the settlement of disputes
Labour Market Regulation	Regulation of the national labour market; affirmation of International Labour Organization (ILO) commitments; enforcement
Movement of Capital	Liberalisation of capital movement; prohibition of new restrictions
Consumer Protection	Harmonisation of consumer protection laws; exchange of information and experts; training
Data Protection	Exchange of information and experts; joint projects

WTO-X areas

Agriculture	Technical assistance to conduct modernisation projects; exchange of information
Approximation of Legislation	Application of EC legislation in national legislation
Audio Visual	Promotion of the industry; encouragement of co-production
Civil Protection	Implementation of harmonised rules
Innovation Policies	Participation in framework programmes; promotion of technology transfers
Cultural Cooperation	Promotion of joint initiatives and local culture
Economic Policy Dialogue	Exchange of ideas and opinions; joint studies
Education and Training	Measures to improve the general level of education
Energy	Exchange of information; technology transfer; joint studies
Financial Assistance	Set of rules guiding the granting and administration of financial assistance
Health	Monitoring of diseases; development of health information systems; exchange of information
Human Rights	Respect for human rights
Illegal Immigration	Conclusion of re-admission agreements; prevention and control of illegal immigration
Illicit Drugs	Treatment and rehabilitation of drug addicts; joint projects on prevention of consumption; reduction of drug supply; information exchange
Industrial Cooperation	Assistance in conducting modernisation projects; facilitation and access to credit to finance
Information Society	Exchange of information; dissemination of new technologies; training
Mining	Exchange of information and experience; development of joint initiatives
Money Laundering	Harmonisation of standards; technical and administrative assistance
Nuclear Safety	Development of laws and regulations; supervision of the transportation of radioactive materials
Political Dialogue	Convergence of the parties' positions on international issues
Public Administration	Technical assistance; exchange of information; joint projects; Training
Regional Cooperation	Promotion of regional cooperation; technical assistance programmes
Research and Technology	Joint research projects; exchange of researchers; development of public-private partnership
SME	Technical assistance; facilitation of the access to finance
Social Matters	Coordination of social security systems; non-discrimination regarding working conditions
Statistics	Harmonisation and/or development of statistical methods; training
Taxation	Assistance in conducting fiscal system reforms
Terrorism	Exchange of information and experience; joint research and studies
Visa and Asylum	Exchange of information; drafting legislation; training

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The UK's Department for International Trade (DIT) has overall responsibility for promoting UK trade across the world and attracting foreign investment to our economy. We are a specialised government body with responsibility for negotiating international trade policy, supporting business, as well as delivering an outward-looking trade diplomacy strategy.

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