

International Trade Committee

Oral evidence: UK trade options beyond 2019, HC 817-i

Tuesday 29 November 2016

Ordered by the House of Commons to be published on 29 November 2016.

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Members present: Mr Angus Brendan MacNeil (Chair); Liam Byrne; James Cleverly; Marcus Fysh; Mr Ranil Jayawardena; Chris Leslie; Shabana Mahmood; Toby Perkins; Sir Desmond Swayne.

Questions 1-105

Witnesses

I: John Alty, Director General, Trade Policy Group, Department for International Trade, Oliver Griffiths, Director, Capability, Trade Policy Group, Department for International Trade, Paul McComb, Programme Director—Transition, Department for International Trade, and James Norton, HR and Organisational Development Director, Department for International Trade.

II: Professor Patrick Minford, Professor of Applied Economics, Cardiff University/Co-chair of Economists for Brexit, Martin Howe QC, Economists for Brexit/Lawyers for Britain, Dr Swati Dhingra, Centre for Economic Performance, London School of Economics, and Professor Jim Rollo, UK Trade Policy Observatory, University of Sussex.

Examination of Witnesses

John Alty, Oliver Griffiths, Paul McComb and James Norton gave evidence

Q1 Chair: Thank you for coming this morning, panel. Can I ask the panel, from my left, to introduce themselves and their positions for the record, please?

James Norton: James Norton. I am the HR and Organisational Development Director for the Department for International Trade.

Paul McComb: I am Paul McComb. I am the Director of Transition for the Department for International Trade.

John Alty: John Alty. I am the Director General of the Trade Policy Group in the Department for International Trade.

Oliver Griffiths: I am Oliver Griffiths. I am the Director of Capability in the Trade Policy Group reporting to John.

Q2 Chair: Thank you very much. As this is the first official meeting between the Committee and representatives of the Department, Mr McComb, could I ask you just a daft laddie question, in a way: what is the purpose of your Department?

Paul McComb: The Department has three objectives. The first is to promote and support UK businesses in exports and investment in order to grow the economy. Secondly, it is to maximise wealth creation through supporting foreign direct investment into the UK and outward direct investment overseas. Thirdly, delivering the best trading framework for the UK after the referendum.

Q3 Chair: With the Department being new, do you know yet all that is going to be asked of you or all that is being asked of you?

Paul McComb: I think it is fair to say that a lot of what the Department has done and what I have just described there is work that has already been in train with the former UK Trade and Investment organisation, with UK Export Finance. Clearly there are new requirements that have been placed on the Department to develop a trade policy framework, which John and Oliver will be able to give more detail on, to develop our trade agreements going forward. Also I think it is fair to say that on the outward direct investment, it is an area where Government have provided some support but we are also reviewing our approach to that.

Q4 Chair: Thank you. DIT Minister Mark Garnier recently told the House that the DIT aggregates UKTI, UKEF and trade policy units from the Business, Energy and International Strategy Department as well as some new "hires". Can you explain what those constituent parts do and how they are being brought together now?

Paul McComb: Would you like me to go into a reasonable amount of detail on this? I am happy to do so.



Chair: I think a sketchy amount of detail would suffice.

Paul McComb: If I could start with the former UKTI, essentially the UKTI organisation supports trade promotion. What that boils down to in a practical sense is supporting the delivery, first of all, of very high value export campaigns overseas. UKTI has a programme of just under 200 campaigns that are run over the next five years and they span 25 sectors in the UK and 108 markets overseas. That is to support British businesses in securing typically deals that are in the hundreds of millions territory, so big stuff.

On the inward investment side, again UKTI focuses on about 250 major projects, this time spanning about 21 sectors into the UK, sizeable investments where with the assistance of Government we think we can get a better deal for the UK.

The third aspect of the former UKTI and their responsibility is trying to get more businesses exporting. Traditionally the way that has been managed has been through teams out in the UK regions, international trade advisers working with local Chambers of Commerce, that kind of thing, but over the last six months there has been huge investment into providing a new digital service that launched as a public beta. The intention there, first of all, is it is a bit of a right move style system, whereby you are trying to connect opportunities abroad with businesses in the UK. It is much more sophisticated in the sense that it is trying to recognise new exporters through to companies who have already been exporting for some time. That is beta. It will be developed further but that is our big investment there, to try to get more UK companies into the exporting side.

That is the trade promotion piece and the work of former UKTI. The change I should just signal there is UKTI was a non-ministerial Department. It is now part of the Department for International Trade. It does not have the separate accounting arrangements and it is accountable to the Secretary of State.

If I move to UK Export Finance, it is a separate legal entity. It has a credit limit, if I could describe it that way, or a risk limit of £50 billion, which basically will provide insurance or finance in order to support some of these big, high-value campaigns that I described before. Export Finance plays a very key role in some of these, shall we say, slightly riskier major projects overseas.¹ To give you a sense of scale, in 2015-16 UK Export Finance supported about 280 companies and underwrote about £2 billion-worth of export finance. As has been made clear in the autumn statement, the risk appetite for that organisation has been increased, but their goal is to say no major viable deal should fail for lack of finance. It will remain a separate legal entity and there is good reason for that. They

¹ The Department for International Trade subsequently clarified that "UKEF helps companies of all sizes and in all sectors win, fulfil and get paid for export contracts. In 2015/16 77% of exporters benefiting from its support in the UK were SMEs".



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are underwriting significant sums of money. They are subject to regulatory oversight. They have separate governance arrangements, so the decision on where the Government should underwrite or not is a professionally taken and highly regulated decision, rather than a request from Ministers in that regard.

The final piece of the organisation is the Trade Policy Group on which, if you would indulge me, Chair, I will pass on to the man who is leading it.

John Alty: Thank you, Paul, and good morning. The Trade Policy Group, as Paul explained and I think you mentioned, Chair, was part of the Department for Business, Energy and Industrial Strategy prior to the creation of this Department. It was a directorate covering both policy on trade, so influencing trade policy as a member of the EU, and also our export licensing activities for controlled exports. Both of those features or activities have come into the Department. We are now preparing for the future where the UK has left the EU and so we continue to play an active role within the EU trade policy but we are also building our capability in various ways so that we are able to operate as a UK trade policy group when that is needed.

Chair: I am sure there are no turf wars at all between the various Departments as regarding the Trade Policy Group.

Q5 **Mr Jayawardena:** I do apologise, Chairman and witnesses, I am in and out this morning because I am also meant to be just down the corridor, so you may have covered this. Have you looked at the Export Control Organisation yet, while I was outside the room?

John Alty: Not yet.

Mr Jayawardena: Perfect. Could you explain for the Committee and for the public record what the role of the Export Control Organisation is and how it fits into the Department?

John Alty: Yes, certainly. The Export Control Organisation is a joint unit, so it has a majority of staff in the Department for International Trade but it also has members from the Ministry of Defence—

Q6 **Mr Jayawardena:** Sorry, just to clarify, so the Export Control Organisation is—

John Alty: Is now called the Export Control Joint Unit.

Mr Jayawardena: Right, and so that crosses a number of Departments?

John Alty: It is based in the Department for International Trade but it is a joint unit in that it contains staff from different Departments, and its overall aim is to promote global security while facilitating responsible exports. It carries out licensing activities, exports including military goods, dual use items, items controlled for human rights reasons and items subject to UN or European Union trade sanctions. That function is not a new function. It existed in the Department for Business, Energy and



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Industrial Strategy before but it has been brought over to the Department for International Trade.

- Q7 **Chris Leslie:** Mr Alty, can I ask you about our trade in services? It is a bigger part of our economic interests in the UK. You will know that there are a lot of worries about the two-year Article 50 period in terms of Britain leaving the EU and whether a transitional period might be required in order to go beyond that end of March 2019 period. To what extent are you and your Department involved in thinking through the implications for the trade in services?

John Alty: Perhaps just to first of all explain the respective responsibilities of our Department and the Department for Exiting the European Union. DExEU, if I can call it that for short, is responsible for the exit negotiations with the EU and also the future relationship with the EU. We are responsible for the trade relationship with the rest of the world. Our main focus on services, which I completely agree are a very important part of both our capability and our economy in the UK but also our exports, would be for agreements to facilitate services, exports, outside the EU. We are working closely with DExEU to input and understand the analysis that they are doing, but we are not leading on arrangements for negotiations with the EU or how long that will take or whether or not there will be transition periods and things like that.

- Q8 **Chris Leslie:** You will have seen I think it was Julia Dockerill's handwritten, scribbled note, photographed while leaving Downing Street yesterday?

John Alty: I cannot say I have read it in detail.

Chris Leslie: Well, it is the closest we have had to any suggestions of a plan so far. It said on it that Britain wanted possibly a Canada-plus model but maybe a bit more in services, and obviously that is quite interesting because we have gone through the recent Canadian trade deal negotiations. Is your Department involved in overseeing some of those service trade issues in relation to where Britain might have an input into the Canadian arrangement?

John Alty: Yes. On the Canada-EU trade agreement we would lead on representing the UK's interests on that agreement, absolutely.

- Q9 **Chris Leslie:** By the way, do you have a date when Parliament is going to have a say on that CETA arrangement?

John Alty: The plan I believe is that there will be a debate before the end of the year on that agreement.

- Q10 **Chris Leslie:** Ms Dockerill's note said, "Transitional. Loath to do it. Whitehall will hold on to it. We need to bring an end to the expectation on it." She is in no way representing the Government's view as against transitional arrangements?



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John Alty: I think No. 10 has already issued their statements on that document and I am not sure I can usefully add to them.

Chair: I was not too sure, reading that, who was loath to do it. Was it the UK or the EU that mean an end to it?

Q11 **Toby Perkins:** Questions for Mr Alty and Mr McComb. What do you know about how the Department's role and functions will evolve with the various stages of the triggering of Article 50, the initial negotiations, formal Brexit, transitional arrangements and full Brexit?

John Alty: Thank you. I will pick that up, if I may. At the moment we are on the trade policy side, which is I think primarily affected by the events that you are talking about, very much in a planning and policy development stage. We have the UK's position in the World Trade Organisation, of which we are already a member, but it will be important that we have our own position once the UK has left the EU. We have agreements that the EU has with countries like Canada, as we just mentioned, and there are other countries who are interested in talking to us about future trading arrangements. It is very much at a planning and exploratory stage at this point. We have an obligation as members of the EU not to run our own independent trade policy and I think that the development from there will really depend on decisions that the Government take overall about the UK's future relationships with the EU, which have not yet been taken.

We obviously feed in to the preparations for the Article 50 negotiations in so far as they may affect trade, but the direction of travel will become clearer as the Government take these decisions about how they want to negotiate with the EU.

Q12 **Toby Perkins:** Are you saying that the negotiations that you will be doing with other nations around the world outside of the EU—and obviously you are not responsible, you have said, for those trade negotiations within the EU—will largely be informed by the result of the negotiations that the Government do with the EU as a body itself?

John Alty: Yes, but I think that there is a certain amount that we can do in parallel, as I mentioned, exploratory discussions, understanding what is the most effective way, for instance, to continue trading arrangements with those countries once the UK has left. I think that other countries are interested in understanding that, as are our businesses. That is an important task for us, so that when these decisions are taken and when the UK does leave there can be the minimum disruption in those arrangements. Similarly, as I mentioned, in relation to the World Trade Organisation.

Q13 **Toby Perkins:** I do think that is significant because, accepting what you have just said there, if the attitude of the Department is that the relationships with the countries outside of the EU to an extent will have to wait until we understand what our relationship is within the EU, that does seem slightly different to what some people's expectations were about us



having all these different trade deals with India and other things. Do you think that was maybe unrealistic? Is it realistic to say that the rest of the world will look to see what our relationship is with the EU before wanting to know about how it has separate deals with us?

John Alty: No, I do not think that they will wait for that before starting those discussions. Indeed, they are not waiting, so I think the task for us is to prepare things as well as possible so that, as I said, we can continue and achieve continuity of trading arrangements as the UK leaves the EU. That is the work we are embarked on at the moment. It is early stages. We will see how straightforwardly and how quickly those can be achieved.

- Q14 **Marcus Fysh:** Mr Alty, what are you doing to identify what the optimal trade policy for the UK would be with its global outlook, which you can then feed into the negotiations with the EU? It seems to me to be slightly the wrong way round to be thinking that the EU negotiations should then inform what we can or cannot do internationally. Surely we should be looking at what is the best arrangement for the UK globally and how does that inform what we require or do not require of a constructive relationship with our EU friends?

John Alty: We certainly are looking at arrangements with many countries outside the EU and obviously we have some important markets outside the EU, so I think that the two things need to be looked at together. Our trade with the rest of the EU is very significant and, as you imply, we need to look at the whole picture and see what the overall interest for the UK is.

- Q15 **Shabana Mahmood:** Mr Alty and Mr McComb, I am just trying to understand the relationship of the Department with the rest of Government. We have had a bit of discussion about what this Department will be responsible for and what DExEU will be responsible for. There is a lot of grey in between. Could you expand a bit more on the specific division of labour between this Department and DExEU, but also the Cabinet Office and any other Department that has a significant Brexit-related role?

John Alty: I think that the principles are clear that, as I said, DExEU is responsible for the exit and future relationship with the EU and we are looking at the rest of the world. As we were talking earlier, clearly there are interactions there that we work together on, but you are right that this is not just a two-horse race. We need to work across the whole of Government because when we look at trade agreements, and picking up what was said earlier, they cover all sectors of the economy, or most of them: financial services, agriculture, intellectual property. We have established committees and groups to make sure that we bring all those Departments together and that as we develop our policy on trade it brings in and is done in conjunction with those Departments that are responsible for the particular sectors concerned.



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Paul McComb: Very early on in the creation of the Department one of the things we did was work through what is the scope of the Department and we talked briefly about what was inherited and what was new. There are a lot of pre-existing relationships in place, for example on prosperity and economic diplomacy. The former UKTI worked very closely with the Foreign Office. Out at post you will find that the Government operators, One HMG Abroad, some of the trade directors will provide leadership to economic diplomacy, prosperity and to trade promotion. That gives them a very clear view of how efforts on, for example, sorting out banking sectors in countries, getting payments flowing, insurance, those kinds of things, lay the ground for what will be very important trade deals going in there as well. We continue, as the Department for International Trade, to sit on all of the decision-making bodies on prosperity. At post we are completely signed up to One Her Majesty's Government Abroad and co-operate fully there as well.

Two things that we have done and are doing more on is working with the Department for International Development and in part looking at how British companies can support some of the ambitions on that side, not getting into tied aid or those sorts of issues but focusing on how the two Departments can support each other there.

Finally, some of you may recall that the export strategy that was published back in January of this year talked about a much more co-ordinated approach between the sector teams that are sitting within UK Trade and Investment and respective Departments in Whitehall. For example, we are balancing the regulatory role of some Departments with those Departments thinking about the competitiveness of British businesses abroad. The Great British Food Unit is a really good example of that; the Defence and Security Organisation has been going for years and has also been balancing those kinds of questions. All of that continues.

Q16 **James Cleverly:** Mr McComb, other Government Departments that have been closely interwoven with the EU—I am thinking particularly the Department for Business, Energy and Industrial Strategy, MoD, Defra, DFID, for example—cannot wait. They cannot just wait until this Department has concluded all of its work, so what arrangements do you have in place for liaison and co-ordination and, perhaps most importantly, deconfliction between yourselves and those other Departments?

Paul McComb: Are you referring to the extent to which those Departments are bound by EU requirements or regulations?

James Cleverly: I am assuming that those Departments will be doing policy planning, they will be putting things in place. What we need to ensure is that when Article 50 has run its course and everyone pulls their respective rabbits out of their respective hats that we are not tripping each other up and are not at cross-purposes. What arrangements are in place to make sure that does not happen?



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John Alty: I will pick that up if I may. Just building on what I was saying earlier, we have a trade policy cross-departmental group that includes pretty well all the relevant Departments who have an interest in trade policy. As I was saying a bit earlier on, we are using that group as a clearing house to make sure that when we are looking at trade issues we have taken account of other Departments, whether it is DFID or Treasury or whoever. That is a pretty regular and normal process that we would expect to go through, a cross-departmental exercise like this. I think it is working well and I am pretty confident at the moment that we will not have silos developing or people going off and not knowing what is going on. That is our objective and we have a good buy-in from other Departments to operating like that.

Q17 **James Cleverly:** In that grouping, if the work of another Government Department was pulling in a direction that was unhelpful to the work that your Department is conducting, who has the veto on that? Who is able to rein them in, and what method is there to rein them in?

John Alty: I think ultimately it is like any other issue. If you have a difference of view between Departments then you try to resolve that at a working level if you can. If you can't then it goes up the chain. Ultimately there will be Cabinet committees and so forth, collective responsibility. In relation to EU and trade there is a committee chaired by the Prime Minister, so ultimately that would happen, but our aim is to minimise the number of issues that need to be handled in that way.

Q18 **Chair:** Just a general question before I move to Chris Leslie, is it the view that DExEU, as it is being called, the Department for Exiting the European Union, will continue once Brexit has been completed?

John Alty: You should ask the Secretary of State for that Department but my understanding is that they very much see themselves as a Department with a job to do and then they will finish that job and they will not be a continuing forever Department.

Q19 **Chair:** Presumably then you will take over the role as regards the EU at that point?

John Alty: I think in so far as there are trade relations with the rest of the EU we would expect that to happen, but obviously this is some time in the future so we will see how things develop.

Chair: It would be in two years next March.

Q20 **Chris Leslie:** I am keen to bring in others. Mr Griffiths, what does Director of Capability mean?

Oliver Griffiths: That is a good question. I point to four things. First, just to contextualise, this is within trade policy rather than within the broader Department. It is getting in the right people; making sure they have the right skills; that we have them working in the right structures; and we have the right systems there to support. This is against the background of a very significant ramp-up in personnel.



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- Q21 **Chris Leslie:** It is similar to the human resource side of things as well?
- James Norton:** I cover across the whole Department and work closely with Oliver on the trade side to make sure we are recruiting the right people.
- Q22 **Chris Leslie:** That is good to know, because I was just trying to get a sense of the budget for the Department. What is the top-line figure? How much do you have to spend revenue-wise annually?
- Paul McComb:** We have a few negotiations to settle, and I can describe those to you but we would expect it to be just over £400 million for the whole of the Department for International Trade.
- Q23 **Chris Leslie:** What is the current combined unit pre-referendum of the various components?
- Paul McComb:** Broadly speaking, if you were to imagine life before creation, our baseline was around £344 million.
- Q24 **Chris Leslie:** £344 million, so it has gone up by about £56 million, something like that?
- Paul McComb:** Yes, and I am using the 2016-17 figures to give you a baseline. There was additional funding of around £79 million announced at the autumn statement for the trade policy piece.
- Chris Leslie:** Sorry, would that be on top of the £400 million?
- Paul McComb:** No, that is across the spending review period. The other things we are working through but will have finalised, I hope, very shortly, if you can imagine we had the former Department of Energy and Climate Change, Department for Business, Innovation and Skills, Department for Education and ourselves effectively affected by the machinery of Government changes that took place. We are working through things like corporate services, paying for IT, paying for estates, those kinds of things, which will find their way into the baseline of this Department also.
- Q25 **Chris Leslie:** Broadly speaking, am I right in thinking that you are about £350 million, we had the referendum, you are expanding to around the £400 million mark, so I should mentally ascribe £50 million or £60 million extra for the additional activities of the Department that would not necessarily have been there pre-referendum?
- Paul McComb:** Some of the budget that increases the annual figure is the GREAT funding, the funding of the GREAT campaign. If you are trying to say what is being spent additionally on trade policy, £79 million across the spending review period is the current figure, and I think a statement has been made that as things develop we do not have to wait for a fiscal event to say if that is the right figure.
- Q26 **Chris Leslie:** How are you splitting that between what you might call promotion, dialogue with UK business and negotiation costs? I want to



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know how much it costs to negotiate a free trade agreement, but maybe that is asking you how long a piece of string is. Broadly speaking, what resource, pounds, shillings and pence, as it were, are you putting into the hard end of negotiation practice within the Department?

John Alty: Just taking the Trade Policy Group, we had about £15 million in our budget prior to the autumn statement on an annual basis. The autumn statement gave us an extra £7 million this year and rising over time to about £21 million extra by the end of the spending period, so that would create about £36 million or so.

Q27 **Shabana Mahmood:** I am trying to understand and following on, on resources, whether you are competing with other Departments, particularly DExEU, on Brexit-related policy issues. You are doing the rest of the world, and they are doing the European Union, but they are doing the trade deal within the European Union. That obviously has trade negotiators there. Are you in a bit of a fight with them as to how many you need and what the resource allocation between the two of you must be seeing as you cover basically everything that is not the EU?

John Alty: I do not think we are in a fight with them. Both Departments separately have had discussions with the Treasury about the resources that they think they need. I think that we will be talking and we are talking to them about how we support them in those negotiations and that will depend on decisions to be taken about how the negotiations are run. As I said, we certainly work with them and we do expect that we will support them but that they will have responsibility for leading those negotiations.

Q28 **Chair:** I have a question for Mr Norton. How many staff do you have and how many staff do you need? I am thinking of the growth of the Department and how that is going.

James Norton: In total we are looking at about 2,700 employees. That includes our international network that we share with the Foreign Office, which is just short of 1,300. Do you want me to break that down?

Q29 **Chair:** To follow on from Chris Leslie's question of the like-for-like, beforehand it was £344 million versus £400 million. What is the staff? Is it a similar story there?

James Norton: The principal growth in the Department has been on the policy side, so Oliver may want to come in in a minute, but essentially we have gone from about 140 people, including the Export Control Unit. We are currently at about 240 and we have plans to grow by the end of the year to 350.

Q30 **Chair:** Could a scurrilous tabloid journalist say this is a growth of Westminster bureaucracy in the absence of European bureaucracy, perhaps?

James Norton: I wouldn't comment. We are just getting the resources into the Department to support its being established.



Q31 Chair: I am confident you do not put your mind into the mindset of a scurrilous tabloid journalist. What sort of specialists do you have? Do you need a lot of trade specialists, a lot of negotiating specialists? What sort of view do you have for the future? We were told in certain press reports that the UK only had about 12 international trade negotiators. I think the Faroe Islands might have somewhat more than 12, but I am just wondering where the Department stands now.

Oliver Griffiths: As John said at the beginning, we started from a core that was strong on trade policy, so we had about 45 people in June who were focused on trade policy, albeit within the context of that being a support position for the European Commission in the EU. That is the core that we are building from. We are about 100 up from that. To your question of how specialist does this need to be, I think it is important to think of this in two ways. One is that trade policy is much more than trade negotiation, and so we need to think about things like the trade remedy regime that we have to deal with import surges in the future. We need to think about what is going to be our independent position in the WTO, which obviously is going to be a multilateral negotiation rather than a bilateral negotiation. We then also have what our relationship is going to be with third countries.

When we are thinking about the negotiation itself, would it be helpful for me just to sketch out what a negotiation team looks like in this area? A free trade agreement typically is about 20 to 30 chapters. Each individual chapter will cover a particular area, for example on agriculture trade or services. For example, on agriculture trade or services, you will tend to have an individual who is leading at that chapter level and that will be a specialist who understands that policy area very well. Occasionally you might have one person who covers one or two chapters. You will then have a level of deputies who provide the co-ordination and oversight of the text that is being produced and a chief negotiator who sits at the top. It is a pyramid structure and you can imagine a free trade agreement team to be 50 to 100 people, depending on how big the negotiation is.

Q32 Chair: For each trade agreement?

Oliver Griffiths: For each trade agreement. As I said, you might have individuals who double-hat, so that they might be covering, say, investment across a number of different free trade agreements, but that will be the team that you will have on the trade agreements. We have a number of people who are well experienced in trade, and if we look at the individual chapter heads we are identifying those people. We then have an important decision to make that effectively is: do we buy or do we build on that piece? Our strong preference will always be to build, and our focus of recruitment to date has been almost exclusively from Whitehall, but that puts a huge weight on the upskilling and training piece and we have a trade faculty that has been set up by the Foreign Office that is going to be playing a huge role on that. It is not just going to be a question of the trade faculty. It needs to be something cultural for us that we are looking to upskill ourselves the whole time.



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Q33 **Chair:** You are training new trade negotiators?

Oliver Griffiths: Correct. Across the piece.

Q34 **Chair:** You could reach a level where you will then have an unskilled or an inexperienced team, or perhaps skilled but inexperienced?

Oliver Griffiths: I think it is helpful to deconstruct what you need to be a trade negotiator. There is a danger that we turn this into a slightly mythical creature, the trade negotiator. There are essentially two things. One is that within your whole team you really understand the policy area, and the other is that you have the experience and the skills to carry out a negotiation in a very complex, multi-stakeholder environment. We have done a lot of the latter in the civil service in the past but I think it would be a mistake to just look at the civil service. As we move into that open and detailed negotiation phase that John was talking about in the future, we would certainly be looking to have that as posts that are open to the best and brightest both in the public and private sectors.

Q35 **Chair:** We have a team of experts that is growing within the Department. What is your best bet on the trade, which is the inquiry we are carrying out, on the trading situation that the UK will be facing in 2019, post-March 2019 when we have left the EU? How will we, the UK, be trading with the rest of the world and on what basis?

John Alty: That slightly goes to what I was saying earlier, that clearly that depends on decisions that are taken about our relationship with the EU and, therefore, the extent of our trading relations and the nature of our trading relations.

Q36 **Chair:** What is the feeling within the Department? Is it going to be EEA? Is it going to be EFTA? Is it going to be the World Trade Organisation? Are you going to have a special deal? Where do you think you are going to be?

John Alty: I am not going to speculate on that. The Government will no doubt announce their objectives in due course, but at the moment, as I said, we are planning for certain things that we are pretty confident that we will need to do. That is to establish ourselves in the World Trade Organisation. We are looking at the agreements that the EU already has with certain countries, which provides some sort of benchmark for our trading relations, and then we are starting to talk with other countries. We continue, as I said, to try to push the trade agenda within the EU because we think that will not only be good for the EU but it will help us.

For instance, we talked about services earlier. There is an agreement under negotiation called the trade in services agreement, which involves about 20 or so countries, major service exporters. That will be a very important agreement for the UK to be part of.



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We are in this preparatory phase. We have to analyse the options, but there are certain things that we can be pretty confident we need to do and we are getting on with those.

Q37 **Chair:** Given you will be needing 60 to 100 people presumably over a period of years to negotiate a deal, how many deals do you think you can get negotiated before March 2019?

John Alty: The first point, just to be clear, is that when we talk about the people involved in these negotiations they will not just come from the Department for International Trade. They will come from, as Oliver was saying, the sector specialists across Government. I think that it is difficult to be very precise about that, because we are in an unusual or unique situation but—

Q38 **Chair:** Roughly what kinds of deals, just to give us a feel?

John Alty: I think that other countries have typically said that actively negotiating four or five agreements at the same time is about the most that one can do but, as I said, we are in a different situation. When we talk about the agreements that the EU already has with different countries we are not starting a negotiation from scratch there, so it is difficult to translate that into exact numbers for the UK.

Q39 **Liam Byrne:** I want to pursue this for a moment because it is such an important line of inquiry. I want to get to the bottom of what your Secretary of State has told you about what success looks like. Are you able to say, for example, that the £1 trillion export figure that was set as the Chancellor's target is still the target by 2020?

John Alty: I believe that target is still there. Paul?

Paul McComb: It is still the target, which I think was described to the former BIS Committee as a stretch target.

Q40 **Liam Byrne:** That is the target we should judge the Department by? I just want to clarify. I do not quite understand this, because the OBR said last week that by 2019 net trade is going to stop contributing to growth and will start dragging growth. Do you agree with those OBR targets, or disagree?

Paul McComb: The OBR draw its own conclusions. The only thing I can really point to here is, first of all, what we know in terms of the value of exports is around £525 billion. The campaigns I was describing before, the high export value campaigns, were very much targeted on providing additional export value in addition to whatever the ONS figures were reporting. The OBR have not made any provision for that, because they are not landed—they do not typically do that in many areas of what we do. The Department is still focused on driving high export value. The target is a stretch target and all I can say is that the line is on the way up, not on the way down, but the OBR have their view.

Q41 **James Cleverly:** Mr Alty, is there a plan for Brexit?



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John Alty: I am not sure if I am the best person to answer that question. As I have said, our Department—

Q42 **James Cleverly:** Let me ask perhaps an easier question. Have you seen the plan for Brexit? Is it a nice bound folder or something like that?

John Alty: All I can say is what I was saying earlier, which is that we are working closely with the Brexit Department. Ministers have made various statements about decisions not having been made on some of the key issues yet and we are in a planning, analysis and option-testing phase.

Q43 **James Cleverly:** I take it from that that the condensed answer is that, no, you have not yet seen the big plan for Brexit. What plans have you put in place? What planning are you doing for receipt of the grand plan?

John Alty: As I said, there are certain things that we can definitely get on with. We can get on with our position in the World Trade Organisation. We can get on with looking at how we avoid disruption in relation to third country deals with the EU trade deals and we can start to prepare for wider trade agreements. At the same time, we are contributing to the analysis of the options and we need to understand the implications of different options for our trade policy development, but that is the stage that activity is currently at.

Q44 **James Cleverly:** Over the next few years—as I am sure we will get to know each other very well across this space—there will be certain points where you can say, “We have done this much and here is a decision point, a Brexit decision, a Brexit policy goes in here and here are the branch lines that come off that decision point once we get to it.” Is that the kind of thing we can expect to see in the short term until we get certainty over the detail side of it?

John Alty: As the Government takes decisions, and as those decisions are made public in whatever way is decided, then obviously we will be able to be more precise about the implications of those in trade terms.

Paul McComb: I was given the role of helping support the ministerial team set up the Department from the constituent part, so this may be a rather boring thing to throw on the table but—

Chair: Keep it short.

Paul McComb: Short and boring, but the basics are around: creating a Department, settling a budget, having the teams in the right location so that they can function effectively, creating a departmental board, getting non-executive directors, appointing a HR director, a finance director, a communications director, people to have a functioning Department. All of that has been going on so that, when these decisions are made, this is not going to be a Department that is looking around but can organise and run itself.

Q45 **Sir Desmond Swayne:** We have already partially covered this, Mr Chairman, but the Secretary of State in his letter to us has said that the



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pace will be fast and we may well be negotiating several agreements simultaneously. The key question is: to what extent are you capable of dealing with the Brexit elements of that? How many negotiations can we reasonably expect to have the capacity to deal with simultaneously? Specifically thinking of negotiators, how many specialist negotiators do we have and how many do we need?

John Alty: I will say a little bit more and Oliver might want to add to that. In terms of pace and how many can we do, as I said at the moment we are very much in exploratory mode. I have seen various PQ answers about the countries that Ministers have visited from this Department, and I am sure people will keep asking those questions, so we will keep giving that information. In many cases, but not in all, those visits involve discussions with the country involved, which are at this stage exploratory—about if they are, for instance, a country that has an agreement with the EU, what their interest is in making sure that there is continuity there. If they do not have an agreement with the EU, what are the sorts of issues that are important to them and us? That is the phase that we are in at the moment. We are operating on a reasonably wide canvas, I would say, in the number of countries that are interested in talking to us and vice versa. At some point we will get into more intensive discussions. As I say, we have to bear in mind our duties as a member of the EU but we will probably get into more intensive discussions.

I explained what other countries had said about the numbers of active negotiations. Many of these negotiations if they take time obviously will go through periods of higher and lower activity. I think the EU has about 20 or so negotiations that are live or open but will not be working on them all at the same time.

In terms of numbers of negotiators, as Oliver was saying, there isn't a single negotiator for an agreement; there is a pyramid, and you would have people who are responsible for particular chapters and then people who are co-ordinating that activity. At the moment we are not in negotiations, just to be clear, and we will be developing those negotiators at different levels over the coming period, through the training and involvement of experienced people coming to help us with that and potentially, also, through recruitment as we were saying. I don't know if there is anything you want to add, Oliver.

Oliver Griffiths: The only thing I would add on this is that we have spent the period since July in some very detailed dialogues with other foreign Governments, so that we learn as quickly as we can specifically what do we need for the negotiators and what can we learn from them. At the moment we have a secondee, who is a senior negotiator with the New Zealand Ministry of Foreign Affairs, who is sitting with us and working through these questions as well. It is a commitment that we are working very hard on that resourcing piece and developing a very sophisticated picture of what we will need.

Sir Desmond Swayne: Finally, I presume that we can assume that all



those involved will have studied the seminal text on this, namely, "The Art of the Deal". Don't answer that.

Chair: I think that that book is the preserve of an EU nation, isn't it?

- Q46 **Marcus Fysh:** What are you doing to elicit different views from the different sectors of the economy about which particular trading models suit them best and what is optimum for the UK and how their stakeholders fight the effect?

John Alty: A very important point. We have already been involved in many discussions with different parts of the economy, different sectors, to understand that. Obviously many of them are also focused on the EU relationship as well, and the Minister for Trade Policy, Lord Price, has been holding sector round tables. We receive written information and so forth. Building on what was happening before, given that this function comes out of the Business Department and historically has had good engagement with business sectors, as we get into negotiation itself or prenegotiations then we will have to think about the best way to structure that consultation. It needs to be more structured. There are different models for doing that, but we are very clear that we will need to understand the implications for different parts of the economy.

- Q47 **Marcus Fysh:** To come back to what Mr Cleverly was asking about earlier on the interplay between different Departments, one of the potential concerns that I would have is that there may be an element to which different trading options might be shut down by particular decisions that might get made before they got to a political level, in terms of choices that might be able to be made in negotiations. How are you going to try to avoid that and try to keep as many beneficial trading options on the table for as long as possible, and potentially to have that political input?

John Alty: I would be pretty confident that that will not happen. As I say, we do have good ministerial oversight within the Department. Lord Price is very active in overseeing what we are doing, and obviously the Secretary of State above him. Different countries have evolved systems to make sure that where there are differences of view, for instance, or particular sectoral interests, then those can be escalated and ultimately collective ministerial decisions taken. I don't see any reason why we should not be able to operate effectively to do that.

- Q48 **Marcus Fysh:** Finally, a question about the general philosophy behind negotiating free trade agreements. There are some who say that free trade agreements are effectively an establishment of a type of regulation and that can be in a tension with free trade imperatives. To what extent are you getting input and giving input to the Government on that general philosophy of what trade negotiation is about and what our objectives should be?

John Alty: I would answer that at two levels. First, as the Prime Minister has said, and our own Secretary of State, we see the UK as being a



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champion for free trade, so we will be approaching these agreements from a liberalising point of view. As you say, we will want to try to ensure that agreements open markets, not close them down. Secondly, we need to develop the detailed policies that will ensure that that happens. We need to understand the way in which trade agreements work, as you said, and the work that Oliver referred to talking to other Governments will help us do that. We are taking our cue from the political steer that we have been given.

Q49 Liam Byrne: Just to close off Sir Desmond's line of questioning, are you basically happy that you have the organisation and the resources that will deliver the deals that yield this £1 trillion export figure in 2020?

John Alty: That is a combination of what Paul was saying about the work of what is now the International Trade and Investment Group, plus the policy work that we are doing. Yes, I think that we feel we are resourced to carry out the jobs that we have been asked to do. On the trade policy side we are in the planning stage. It will be clearer when decisions are taken by Ministers how widely and in exactly what way they want us to engage, and if we need more resources then we have been in discussion with the Treasury about provision of that resource.

Liam Byrne: We are obviously concerned, as a Committee, that you have the resources to do the job, to hit the target. You are telling us this morning that you are?

John Alty: I am saying that we are satisfied with the resources that we have at the moment.

Q50 Toby Perkins: Mr Alty, you described previously the way in which your Department would support the Department for Exiting the European Union on their work of negotiating. Their work will be going across and getting pressures from a number of different Departments, pressures on immigration, a broader relationship from the Foreign Office and, of course, how we trade internationally. We anticipated that there would be a lot of turf wars within your Department, but it seems if they are taking place they have possibly already been lost. If I dare say, the Department seems a bit subordinate to those Departments. I am anxious about the extent to which this Department sees its role to be fighting for getting the best trade deal, making sure that the importance of getting a trade deal is paramount in comparison to issues of immigration or pressures that other people might be bringing. Can you give us a sense there is a real fire in the belly of the Department to fight for trade deals ahead of all else?

John Alty: I would certainly say that we are playing a very active role in those cross-Government discussions. It is not just our Department—if you are talking about that in relation to the EU—but the Business Department and many other Departments that have an interest in the trading relationship with the EU, so I don't feel that we are at all marginalised or unable to play a role there.



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Q51 **Chris Leslie:** The point is it can feel quite marginalised because you are not just a reserve Department. You are a hypothetical Department if we are still in the customs union. You are not allowed to do trade agreements if we are in the customs union. Do I have that right?

John Alty: The customs union covers goods. We talked about services earlier on. We have also talked about the important work to promote exports, to promote inward investment. There is a huge range of activity the Department needs to be carrying out.

Q52 **Chris Leslie:** You can get on with free trade agreements on services now?

John Alty: As I said, we are a part of the EU. We are part of the common commercial policy. I was just talking about customs union.

Q53 **Chris Leslie:** Yes, but if the customs union is the inhibition to you getting on with striking new trade agreements around the world, and that just restricts you to goods, what is stopping you from getting on with things for services now?

John Alty: We are part of the EU's common commercial policy, which covers goods and services.

Q54 **Chris Leslie:** So it may be that you are a hypothetical Department, that eventually, at the end of this process—

John Alty: We will see what the decisions that are taken imply.

Q55 **Chris Leslie:** Okay. I was hoping that at some point Parliament might get its teeth into some proper free trade agreements that the Government and Ministers and yourselves have negotiated ready for ratification. If in that hypothetical scenario Parliament does get to see some of those things—I see that when the Secretary of State wrote to us he finished his letter with the point about fast-moving deals, we don't know what is coming—we will use to the best effect existing mechanisms that have allowed Parliament to scrutinise international treaties in the past. Could you explain what you anticipate those would be? I mentioned the CETA deal. Earlier you said there could be a debate before the end of the year. Are we expecting that these are the sorts of free trade deals that will go through specific statutory processes? What do you anticipate those are? What was the Secretary of State referring to there?

John Alty: He said a number of things about parliamentary scrutiny. He talked about having a full and transparent debate and finding ways that you can combine the reality of negotiations with scrutiny by Parliament. We don't have a model to pull out of a hat. I am sure that Parliament itself will have views on that, but it was a commitment from the Secretary of State that we understand the importance of oversight and scrutiny of trade agreements and we would fully expect there to be arrangements for that before they come forward.

Q56 **Chair:** Thank you. A final question, panel. Article 50 will be triggered by



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31 March 2017. We should then be out of the European Union by March 2019, two years later—this is the understanding. Can you tell me how many trade negotiations you think you will have negotiated by March 2019 and who will they be negotiated with?

John Alty: I don't think I can give you the full detail that you have asked. We have talked about—

Q57 **Chair:** The number then—how many?

John Alty: I explained earlier that we are looking at the existing agreements that the EU has with a number of countries, about 30, some of them developing countries.

Chair: I think 38, yes.

John Alty: Those will be the priorities to test out the appetite of countries to do what I was saying earlier, which was to see continuity there. There will be other countries where the EU does not have agreements, and we need to use the coming months to test out within the confines of EU law the appetite of some of those countries for—

Q58 **Chair:** Which is your big priority then?

John Alty: At the moment we are looking at a wide range of countries.

Chair: Do you have a priority?

John Alty: We do not have a single priority, no.

Chair: Panel, thank you very much for your time this morning. I appreciate it very much for sharing your insights and your feelings on the development of your Department. As a Committee, we wish you luck. As James Cleverly said, I am sure we will meet in the future. Hopefully, we can be helpful as well as critical in equal measure, and of course I mean positively critical there. Thank you very much.

Examination of Witnesses

Professor Patrick Minford, Martin Howe, Dr Swati Dhingra and Professor Jim Rollo gave evidence.

Q59 **Chair:** Can I ask you to introduce yourselves and your organisations for the record, starting on my left?

Professor Rollo: My name is Professor Jim Rollo. I am Professor Emeritus at the University of Sussex and for the purposes of this I am Deputy Director of the UK Trade Policy Observatory, which has been set up at Sussex to draw on our trade policy experience and capability there.

Chair: Thank you. Presumably, it was your colleague I saw on "Question Time" on Thursday night along with Chris Leslie.



Chris Leslie: It was Mariana Mazzucato.

Dr Dhingra: I am Swati Dhingra at the London School of Economics and the Centre for Economic Performance. I am Assistant Professor there and my main specialisation is in international economics.

Martin Howe: My name is Martin Howe. I am a practising barrister and my main field of specialisation is European Union law, particularly relating to the free movement of goods and services and intellectual property. I am also Chairman of an organisation called Lawyers for Britain.

Professor Minford: I am Patrick Minford. I am Professor of Applied Economics at Cardiff University and Co-chair of Economists for Brexit. I think we circulated some pamphlets that represent our viewpoint. We are now actively engaged in promoting free trade and own UK regulation and control of immigration by the UK as the optimal policies for achieving the Brexit that was voted for in the referendum.

Q60 **Chair:** Thank you for your pamphlet "The Economy after Brexit", much appreciated. Can I ask Mr Howe and Professor Rollo to explain to us, as they see it, the WTO's most-favoured-nation rule and how it will affect the UK after Brexit? I will go to Martin Howe first.

Martin Howe: In its simplest application, the most-favoured-nation rule means that, for example, if you have a policy under which you impose tariffs—let's take that as an example—effectively you have to make them uniform to all comers, or if you reduce for one country you have to, under the most-favoured-nation rule, reduce for everyone. The permissible exceptions to that are if you become a member of a customs union or if you become a member of a free trade area. In either of those cases you are allowed to continue to charge external tariffs at your standard level but, as between yourself and the other members of your customs union, your free trade area, of course you have zero tariffs.

Professor Rollo: I totally agree with what Mr Howe has just said on that. In terms of where we go when we joined the EU there is a question of who we apply that MFN tariff to and, most notably, do we apply it to the EU?

Q61 **Chair:** What would be the significance of applying the most-favoured-nation status to the EU?

Professor Rollo: It would immediately put up barriers to our exports and we would put up barriers to their exports, because at the moment we charge no tariffs and there is the whole complicating issue of applying the single market as well. But in the first place MFN tariffs applied to the EU could be significant in a number of cases. Two cases in particular come to mind. One is vehicles where there is a 10% tariff currently. The other is the whole area of agriculture where there are some extraordinarily high MFN tariffs, some of them with two elements to them, 12% or 13% per ad valorem tariff but also a fixed sum tariff of the order of €1,700 or



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€1,800. You can imagine that per time. You can imagine that is a very significant barrier to trade.

Q62 **Chair:** You have a puzzled look on your face, Mr Howe, so therefore I shall give you a right of reply there.

Martin Howe: Sorry, yes, so I want to add one point to that. As regards the European Union's external tariffs, of course they are pretty well fixed. They have a system, the common customs tariff. If we were to exit and then did not have a free trade agreement with them they would be required to impose their standard external tariffs on exports from us to them. We would not be required to impose tariffs of the same level. We would choose the level of our tariffs. They could be zero, as Professor Minford and his group advocate, or they could be lower level in terms of imports from the European Union, because—

Q63 **Chair:** Which would help EU exporters, presumably?

Martin Howe: Well, it helps consumers in this country with lower costs.

Chair: And EU exporters?

Martin Howe: And EU exporters, yes.

Q64 **Sir Desmond Swayne:** But they would be the same tariffs that we would have to pass across the board?

Martin Howe: That we would have to pass across the board, indeed. You are not allowed to have x% of country A and y% of country B.

Q65 **Marcus Fysh:** Is it not the case that under Article 24, I think it is, of the General Agreement on Tariffs and Trade, a country can enter into a preferential trade agreement where there is a difference of tariff applied for a period of time, and that is normally interpreted as up to 10 years? Could that not potentially be used as some sort of a transitional concept?

Martin Howe: It does recognise having transitional arrangements, yes. Let's assume for the sake of argument that we leave the customs union. Carrying on from what was said in the previous session, there really isn't any point in having an international trade department if we stay inside the customs union, but we would want to negotiate a free trade area agreement with the European Union. You could have, compatibly with GATT, an interim agreement bridging the two for a temporary period, yes.

Professor Rollo: I think that is absolutely right but if you read Article 24 it is so clear that that transition period is for—say, take the Swiss-China agreement, the Chinese got 10 years to approximate to the final terms of the agreement. You agree the terms of the overall agreement, the target that you are aiming for, and then one party, maybe both, have transition periods on all or some of that to take them there. My problem at the moment with the transition period story is that if we have a transition period it would be because we would appear, on day one of Brexit, with



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no negotiation having gone on on what the EU-UK arrangement would be. As things stand, anything that has come out of the EU is saying, "No, we can't touch that until you are no longer members." That means we will not have agreed on the final objective, so what we will be doing is using the transition period to do that negotiation.

There is a second problem on that, it seems to me. If that is not just purely grandfathered from now, meaning that we just apply the current policy, the one we have today, for that transition period, we start another negotiation about what is included and what is excluded from the transition period. It seems to me there are a series of difficulties there that need quite a lot of managing, and as much of it as possible we can get managed before we join the part of Article 50, ideally in negotiations, the better.

Q66 **Chair:** Thank you. I think we will be fleshing more of that out as the session goes on. I just want to establish a couple of principles here, because there is a risk or a probability that the UK could be trading in WTO with the EU and with everybody else. Could you explain to us what the WTO's schedules of concessions and the commitments mean?

Martin Howe: There are a number of different kinds of schedules of concessions of commitments under the WTO agreements. If I take as a starting point the schedules of concessions on tariffs, those are extremely long and extremely boring documents. I think in the case of the European Union's schedule of concessions it is an Excel file of 700 kilobytes.

Chair: Spare us the detail then.

Martin Howe: It contains a very large number arranged by world customs organisation classifications of types of goods, and it contains upper limits on the tariffs that the EU can charge.

Having said that, keeping the paperwork up to date is not necessarily that important because at the World Trade Organisation there are separate national schedules still sitting there on behalf of Finland and Austria, who joined in the 1990s, and on behalf of Poland and the other group of states who joined in 2004, and, as far as I can see, no one has bothered to update those and integrate them into a single EU schedule. When we leave, for paperwork's sake, we ought to convert that effectively into a UK schedule, but that is essentially an administrative paperwork thing.

Q67 **Chair:** That is transposing the EU schedules to UK schedules?

Martin Howe: Yes. Indeed, I think the Secretary of State announced in his speech to the World Trade Organisation that the intention was to take the EU schedule and, effectively, just adopt it on behalf of the UK, in other words, having the same set of upper bounds on tariffs. It does not follow that we would have to charge that level of tariffs, but it would set the upper bound.



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Q68 **Chair:** Professor Rollo, do you want to add to that?

Professor Rollo: I broadly agree with that. The things I am sort of worried about are not the ad valorem tariffs, because a 10% tariff is a 10%. You don't have to share it in any way. There are some tariff quotas in there that do contain quantitative numbers and those have to be shared. Also—

Q69 **Chair:** Do they have to be shared? What I have understood from other conversations I have had is that the EU has agricultural tariff quotas that they might not have to share. Is this a matter of law or negotiation?

Professor Rollo: I guess that is part of the negotiation. We might be quite pleased to have no tariff quotas, but not if it left us in the position where we could only charge the out of quota tariff, which is extraordinarily high, rather than the within quota tariff, which is merely very high in this context, so I think there is a potential problem there.

There is another problem, which is over dividing up bits of public expenditure on agriculture, because there are limits or caps on how much you can spend on different types of agricultural support. To some degree those will have to be divided between us because we will need a cap, and the rest of the WTO will not leave us alone and that is a broader point. We are not the only people there and it is not a given that we can walk in and put a bit of paper down and no one will raise a word about them. One of the reasons that there are still things not done and under notifications and rectifications to schedules, is there is dispute between members of the WTO and the EU about what should go into those rectifications. That is at a standstill at the moment but it is still there.

Q70 **Marcus Fysh:** To follow on from that, my understanding is that these third parties are potentially important to the negotiations between the UK and the EU on some of these matters. For example, the New Zealanders are very concerned to see that their quota on lamb is freely transferable between either being able to be put into the UK or entirely into the EU. They would want to reopen the whole arrangement that they have with the EU. Does that put any pressure on the EU in terms of its negotiating stance in these matters?

Professor Rollo: It might, but to take the lamb quota issue at this point, as I understand it we currently have a more or less self-sufficient production of lamb in this country. We import lamb under these TRQs from third countries—New Zealand mainly but others—and we export just about as much as we import of high quality British lamb to the rest of the EU. You can see immediately there is a whole series of potential trade policy issues that could arise out of that. British farmers might not be terribly interested in extending the TRQ system, if they can't, after Brexit, export fully to the EU. Then we get surplus on the UK market that will drive prices down, so I can imagine quite a lot of what economists call political economy in that.

Q71 **Chris Leslie:** I want to ask you about trade and services, because you



will know that something like 78% of the British economy is service-based, not necessarily goods. Obviously the ratio of what is exported is slightly different from that, but what is your understanding of how services could be sold, for instance, within the existing 27 other countries in the EU if we left the single market, I mean particularly with financial services?

Professor Minford: This is all about passporting and so forth. This is a very detailed area where we are producing a lot more work and we will send it on to you in written evidence. The point to remember about British services is that they have always been very liberally administered and regulated nationally. Essentially what the EU has done, in its passporting and other service interventions, has been to liberalise other countries' service regimes that have been quite intrusive and regulative, and effectively acted as trade barriers on services.

When we talk about the EU's activity in the services area, we need to be clear that it is about reducing other national regulative barriers against service entry and essentially has no effect on the liberal nature of the UK service area, which has always been very liberal, if you look at all the OECD indicators.

Q72 **Chris Leslie:** You would accept, though, that if as things stand the single market rules, passporting, if we are not able to access those economies on the basis of the arrangements that they currently have, and perhaps with those outside the EU, it will not just be a question of a 10% or 20% tariff on those service exports; it will be that many of those services are illegal to trade at all? They will not be allowed to be traded within that EU27. Would you accept that?

Professor Minford: There is a lot of discussion of the quantities involved here. It is a quantitative issue, and that is where we are going to send you a paper. We think there has been a lot of exaggeration in this area. You have to remember the passporting equivalence; equivalence is something that succeeds in passporting.

There is a very interesting paper by Barney Reynolds in *Politeia*, to which we would like to draw to your attention, which goes into a great deal of detail. The basic point is: we would hope that the EU would be non-protectionist in this area in its own interest because protectionism, in our view, is self-harm. There are two big issues here. One is that, as a result of Brexit, we calculate the City will do extremely well because it is one of our areas of comparative advantage, so resources will naturally flow into it. The other point is that any EU protectionism will not really affect the City; it will affect the EU. The City will simply do a little bit less business with the EU and more business with the rest of the world, but the EU will damage itself by imposing costs on its consumers in accessing the UK financial centres and other service areas.

Q73 **Chris Leslie:** But it would be incredibly disruptive to that 10% of our GDP that is generated in financial services—let's stick to financial services



for now—if, all of a sudden, those companies that currently do business in the EU27 are no longer able to under the WTO framework.

Professor Minford: If you read Barney Reynolds's analysis and the sorts of things we will send you in due course, you will find this is a highly exaggerated area of damage because, first of all, the amount of trade that we do with the EU has been vastly exaggerated, and I would say the Oliver Wyman report in our opinion. Secondly, there is a question of the likelihood of the EU embarking on something that would be very damaging to them. Thirdly, there is a question of how far our firms, over a period of time, would simply divert trade to other areas. For all these reasons, the disruption is massively exaggerated. Obviously, any kind of intervention in trading arrangements creates potential disruption in the short run. Any supply-side reform or change in arrangements creates short-term changes and, of course, damages particular vested interests. But the national interest is in the long-run change in the economic structure—the very long run particularly, because that goes on forever. That is why we have always stressed that you must look at long-run effects rather than be mesmerised by these short-term complaints, usually from vested interests.

Q74 **Chris Leslie:** This is completely a dream-like state, surely, with this hoping for things, you can send us something eventually. We have to deal with Article 50 in a matter of weeks, potentially, Professor Minford. You are suggesting that we should just keep our fingers crossed and ditch up to 10% of our GDP in financial services trade that currently goes on with those EU27 countries, on the basis of what you hope might be the case in the longer run. You would not advise that—

Professor Minford: If you had listened to what I said, you would realise what you have just said is a complete misrepresentation of what I said. I don't want to waste the time of the Committee telling you again what I just said and why what you are saying is totally misleading, but I am happy to do it afterwards if you like because I don't want to waste a lot of people's time here.

Chris Leslie: I have not heard any facts.

Q75 **Liam Byrne:** How long is the short run?

Professor Minford: For the short run, typically we look at about five years. We have examined the short-run impacts of Brexit and we find that they are generally positive, not as positive as in the long run, and the long run is more like 10 to 15 years. That is the sort of timescale we need to be looking at because this is a major change of regime. That is why in our work we have looked at the long-run effects of a major change in regime on the whole structure of the economy and we are not confining ourselves to short-run demand effects and so on. We have looked at those in our macroeconomic projections and, on the whole, what you find with these supply-side changes is that they do have beneficial effects in the short run, but much smaller of course. They take time to come in.



Q76 **Liam Byrne:** A bit of shock therapy in the short run for a longer-term gain?

Professor Minford: There is no shock therapy. What there is is reallocation of resources, which benefits some sectors and, of course, there are sectors that contract. The overall effect is expansion. That is why all this talk from the OBR and other kinds of forecasting organisations, about the shock of Brexit being entirely negative, are completely wrong because there are a lot of sectors that are positively affected by Brexit. The whole point of it in these macro models, as you know—the idea is true of all these models these days—is rational expectations. People see these things coming down the line and they react now, but not just to the negative effects in the sectors that are contracting but to the positive effects in the sectors that are expanding.

You look at these sorts of things. What you find with these supply-side reforms is that they take time to come through but they are generally positive because they are expanding the national income through obeying comparative advantage. We heard from all this discussion we have just had how protectionist the EU is and we calculate that that is about 20% on the food and agriculture and also on manufactures—the sorts of things that Martin and Jim were saying about these huge quota arrangements and tariffs and non-tariff barriers and so forth. When you get away from that, of course, you create a supply-side bonus to the economy.

Q77 **Sir Desmond Swayne:** This is what I suppose Madsen Pirie would call the “If you are so clever why aren’t you rich?” question. Patrick, why have so few and so insignificant countries gone for the unilateral free trade model? And what can Singapore teach us anyway?

Professor Minford: Well, it isn’t just Singapore that has gone for the unilateral free trade model. New Zealand, of course, which you were talking about earlier with the Department, is advising the Department, I think—a good choice. Then you have got China—no insignificant economy, that—that has pursued a massive reduction in its own protectionism in order to prosecute its entry into the world economy. It has been enormously successful. Those are a few examples and there are others, but I think those three would be interesting ones to focus on.

Q78 **Sir Desmond Swayne:** Why haven’t the rest cottoned on to the advantages that you advocate? What is stopping them?

Professor Minford: As a matter of fact, if you look at the trends in world tariffs, they have all come down massively in the last 30 years. I think that is due to supply chains putting pressure on Governments to get into the supply chain by cutting their tariffs. Although there have been no big Doha rounds and so forth—they have all stalled on all sorts of issues—if you look at the progress of world trade in terms of protectionism it has come down a lot. It has been countries surrendering their tariffs, initially on imports but then it gradually catches on, so I think there is quite a lot of this going on.



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The basic answer to your question is an intellectual one. I think people find it hard to get their minds around unilateral free trade because they don't understand that tariffs are self-damage. They think it is good for your industry to have tariffs, because you are protecting your guys and then you do trade deals that gets protection down and penetrates other markets in return for you giving them rewards in yours. This sort of thinking dies hard.

Chair: Other members of the panel are looking to come in. Professor Rollo?

Professor Rollo: Just to take up some of the empirics there. To be fair to the rest of the world, China's liberalisation was essentially the price that was charged for entering the WTO. That is when the liberalisation took place and the Chinese have been extremely reluctant to liberalise beyond that outside bilateral preferential agreements, which by and large are rather weak agreements: they don't put much pressure on China at all. So I think there is an issue there.

That said, there is a lot of unilateral going on around the world. India has done that in the last few years, but the important point to remember there is they have left their bound MFN tariffs in place. They have not reneged on those and they have the possibility of going back up to them at any time, and India has done that on occasions. All of that points to some difficulties in saying this is full-hearted, long-term, unilateral liberalisation of necessity.

Out there is something called trade defence instruments. India, for example, is one of the most frequent users of anti-dumping. The Chinese are in the same sort of position. They are accelerating up the curve of frequency of use, and there the numbers are not small. Anti-dumping duties can be 50%, so we are not talking about the 5 or 10 you usually see in manufacturers' maximums. You are talking some really quite big numbers. That is sometimes called contingent protection: in other words, you just focus on the areas, but while that is still in place—and I was interested that the Department for International Trade did not mention that it was setting up a trade defence instruments unit. That will be a major element in trade policy.

Dr Dhingra: I am going to make a point about where these numbers come from, about how protectionism is essentially constraining the UK because the European Union is very protectionist. Professor Minford's numbers rely essentially on comparing goods prices across different OECD countries, and it turns out that the UK, Netherlands, Belgium and Germany, if you look at the average there, tend to have much higher prices for comparable goods compared to the rest of the OECD countries. What Professor Minford's work does is attribute that to protectionism. What I am going to argue is that, in fact, that is not correct. In most of the trade literature in the past 30 years this has been the big development, that we understand that, even when we see comparable goods—so you could be looking at a washing machine that is very similar,



whether you buy it from China or from the US—what we agree, though, is that there are quality differences that we aren't able to measure just by the data that we currently collect. These are essentially reflected in the prices of goods being different across—if you buy the washing machine from China, potentially cheaper; if you buy it from the United States, potentially more expensive. That difference in prices cannot be attributed just to protectionism. It has to be attributed, at least partially, to differences in quality, which are good for the consumers, potentially, if they are willing to pay for it.

On the financial services point that you raise, there is a similar kind of argument, which is that even though that is not manufacturing goods, that is something which is services-related. What the City UK said to one of the parliamentary Committees where it gave evidence was that it did not feel that the EU regulations were a binding constraint on its own ability to conduct business, and that is the reason that it manages to be one of the biggest exporters to the European Union of financial services, not just the UK.

What we do know, though, is that it is very difficult to quantify the actual numbers in terms of how much would be the loss if there is a Brexit, because we need to then be able to understand how much business would want to move to the European Union. That number is generally very difficult to quantify. There is a lot of uncertainty about how you would forecast that sort of number. We can just give a qualitative analysis and say that, yes, we would see some reduction because some of those transactions might get routed to the European Union if we lose passporting rights, and we would also lose the ability to essentially appeal to the European Court of Justice, which has been done successfully in the past.

Professor Minford: Could I come in just to tidy up? On the question of trade policy that Jim Rollo made about India and so on, obviously I do accept that there are a lot of vested interests pressing for protection. One of the key points we have made in this Brexit debate is that the anti-Brexit camp has been full of vested interests and the consumer is the main gainer from Brexit. That is the first point. In India and China there are a lot of vested interests pressing for protection and we accept that, and so I totally accept what Jim has said. Nevertheless, there is a national interest in getting rid of this stuff because it damages you and, therefore, it is the national interest, the consumer interests against the vested interests.

Coming to what Swati just said about our estimates of the non-tariff barriers, essentially this has been a longstanding discussion between us. The price indices we use, which are aggregated across broad sectors, are based on very authoritative consumer price indices from the UN, national statistical agencies and so on. They have all been screened for quality. All these consumer prices are quality-adjusted. There is a big effort going into statistical agencies in cleaning up the quality of consumer price



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indices, and so we have used them, it is perfectly true, to calculate the overall barriers that drive up prices inside the EU.

There is quite a lot of evidence that prices inside the EU are higher. I notice that our estimate of non-tariff barriers, which is about 17% for manufacturing, is more or less identical to the one the LSE have in the appendix to their Brexit book of 2008, where they have a figure of 14.7 based on work done on the EU versus US non-tariff barriers, which is where there is quite a lot of empirical evidence. I don't think there is any great difference between us on the assessment of non-tariff barriers. It is pretty clear from all the fuss made about the EU that non-tariff barriers set up by the EU are pretty important.

The last point I would make is about this business of financial services. I rather agree with what Swati said, that the numbers here are pretty soft and there may or may not be some trade diversion protectionism by the EU. This is all I think to be played for in terms of how equivalence plays out and how passporting plays out, probably to be replaced by equivalence, but who knows exactly? The key point is that if there is a bit of protectionism by the EU it will be self-damaging. The UK is the biggest financial centre in the world. It will simply replace any business that the EU withdraws by switching to other markets, as it always has done in the past. It is the No. 1 financial centre in the world, and you can look at Barney Reynolds's analysis of this. He is very firm on this as a major City lawyer.

Q79 Sir Desmond Swayne: To nail the difference between yourself and Dr Dhingra, your model suggests a unilateral embracement of free trade, a fall in prices of 10%, as against a common external tariff at the moment of 3%. Explain the difference to those of us who are numerically challenged.

Liam Byrne: The exchange rate effects too. It is important because what the OBR is forecasting, of course, is inflation going up in part driven by—

Professor Minford: No, the exchange rate is something to do with macroeconomic short to medium-term events. It should really be kept on one side because these trade models are dealing with a world in which you can think of it as, essentially, fixed exchange rates and long-term worlds of real movements of relative prices and of trade.

To answer your point, Mr Swayne, the calculation we do is that currently the degree of protection that the EU exerts on agriculture and manufactures through its tariff barriers, through the common agricultural variable levies and subsidies and through the customs union, non-tariff barriers and its tariff, are about 20% on both sectors currently. We project over the next 10, 15 years that that would gradually come down, as it has done elsewhere, to about 10.

Q80 Chair: Just for the purpose of the 10, I think the question was about the 10% and the 3% and the discrepancy between those two. Can you



explain it?

Professor Minford: I am explaining it; I was just explaining it.

Chair: I am time-conscious.

Professor Minford: I am explaining it. There has been a tendency for protection levied by the EU, and indeed by the US, to be coming down over time, over the last 20 years. We project that over the next decade or so that protection of 20% today would have come down to, say, around 10% or 15% or so. Obviously, we have no idea exactly but it would come down so that is what we put into our calculations, 20% now coming down to 10% in 10 to 15 years' time. In the long term it is 10%, but currently it is around 20%. I hope that answers your question. When we plug that into our models, when we get the long-run effect, we assume 10%, for the very long-run effect in 10 to 15 years' time. That is a declining price.

Dr Dhingra: To very quickly explain why there is a big difference in the numbers, our numbers would say the unilateral liberalisation would save about 0.3% of GDP if we were to do a unilateral liberalisation as opposed to going to a WTO default. The reason our numbers are so different is because Professor Minford's model would assume that the exporters in the UK and everywhere else in the world go to some fictional world market where the lowest-cost supplier essentially wins. There is no difference in quality; there is no difference in taste; nothing. That is what creates these big movements in their models, while our models will not give that big movement because we know from 50 years of working with trade data that goods are not perfectly substitutable; perfect competition just does not exist. In that sense, our numbers look very different.

The second point I want to make is about the idea that essentially EU regulations are increasing protectionism and that it is embedded in this non-tariff barrier. Most of the same OECD, UN sorts of respectable sources that Professor Minford is talking about also claim that essentially the UK is among the top three countries if you look at product market regulations, labour market regulations—up there in terms with the US, Canada, the Netherlands. In that sense there just are not those kinds of big gains in terms of being able to get regulations out of the way.

Martin Howe: I don't want to enter into a debate between economists on these figures—

Chair: Always a dangerous pastime.

Martin Howe: Indeed, but I think I can cast some light on the subject of non-tariff barriers because I regularly deal with these in the course of my practice. One particular example I think helps explain it. A number of years ago there was a case in which Tesco bought up large quantities of Levi jeans in the North American market because they were sold cheaper there than Levi sold them in this country. They were genuine Levi jeans bearing Levi trademarks. They imported them into this country. Levi did



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not like it because it undercut their local prices for jeans and they brought a trademark infringement action. The European Court held that Levi were entitled to enforce their trademarks, not because these were not genuine goods but because they had been imported into the European Union and the trademark proprietor, under European Union laws interpreted by the court, is given a monopoly right to introduce goods bearing its trademark into the EU.

I deal with this regularly in my practice, across all sorts of ranges of goods. Although I cannot talk economic statistics, I know from my clients that there are very significant price differences inside and outside the EU market for all sorts of branded goods, from clothes to perfumes to electronic goods and so on. The price differences are sufficient to pay my fees either to suppress the trade or to encourage the trade.

- Q81 **Chair:** On that point, before we move on—I am thinking Sir Desmond Swayne might want to come back—if Levi were to be operating in the North American market and somebody, let's say Walmart or Tesco Canada, whatever, were to buy Levi 501s in the Far East and import them, would Levi then have the power in the North American market, in the United States market, to do similarly? The question is, therefore: is this an EU rule or is this an issue of the legal protection that companies find themselves having because they have perhaps lobbied quite successfully with legislators in particular locations across the world to have that protection?

Martin Howe: It varies from country to country. I cannot tell you what the US law rule is, what their law would allow as regards parallel imports, but in Singapore—

- Q82 **Chair:** Would that change post Brexit?

Martin Howe: Yes, it would, or could. It is our choice, basically. It is our choice. Singapore was mentioned. Singapore is interesting because Singapore copied out the UK's Trade Marks Act, but when they came to the section in our Trade Marks Act that reflects this restriction on goods from outside the EEA, Singapore replaced that with so-called global exhaustion—in other words, goods put on the market under the trade mark in any part of the world.

- Q83 **Chair:** Post Brexit we would have to copy Singapore in the UK legislation?

Martin Howe: Yes. It would be illogical, post Brexit, to keep it the same as it is.

- Q84 **Liam Byrne:** Professor Minford, you seem to think that a tariff-free world is a good thing, and I would agree with that, but if that is our pursuit, is it not the case that the EU is potentially a positive force for good, not least because of all the free trade agreements that it is negotiating internationally?



Professor Minford: Let me first of all clear up this issue about the size of the protectionist barriers. I am grateful to LSE for having tried to compute what the effects of unilateral free trade would be in their model but they have done it in a weird way. All they have included is the elimination of our tariffs if we were to leave the EU and have the EU tariff that, as has been pointed out, averages about 3%, 3.5%, depending on how you weight it. However, the whole fuss about the EU is about non-tariff barriers and the way in which they raise prices in this country. Martin Howe has explained how it works. Our estimate of these non-tariff barriers based on these price differentials, which are not out of line with a lot of other price differential studies, suggests that prices here in the EU are much higher than elsewhere. I first came across this when I was on the Monopolies and Mergers Commission on cars in the early 1990s, when we discovered that the price differential was much higher then—about one third—and we let the British car traders off with a free no-monopoly judgment because we realised that it was all done by the EU.

The point is the non-tariff barriers that we get, which are about 17%, as I pointed out earlier, are more or less spot on what the LSE has for non-tariff barriers based on the literature of the computation of these between the EU and the US, which of course is the one we can see most clearly. When you factor in those non-tariff barriers of 15% on top of the tariff, and you allow for the variable levies of the CAP, which is another 2% on the calculation, you multiply that 0.3% that the LSE got by 7 and you make it 2%, which more than wipes out the loss they compute for Brexit on their model.

The interesting thing, although I am pretty critical of their model in lots of ways, is that if you do put the assumptions about Brexit free-trade policy into their model you come up with a net plus. It is small—everything in their model is quite small, which is a refreshing change after the Treasury's dramatics with the same sort of approach—but nevertheless it is a positive when you allow for these things. That is the point I would like to make.

You wanted to ask about something else so you had better repeat it.

Q85 **Liam Byrne:** Non-tariff barriers could, for example, presumably include environmental regulation, but my real question is this: is the EU not a force for driving down global tariff barriers because of the FTAs it is negotiating?

Professor Minford: As has been pointed out by many people, we will probably be in a much better position to do FTAs than the EU is because we have much less baggage. Trying to do an FTA with Canada, when you have 27 countries, including Wallonia, to deal with is a big problem. One of the things that is perfectly clear from the gentleman who was sitting here before is that they are on a better wicket when it comes to doing FTAs with the rest of the world than the EU is, which has had terrible trouble doing them because of the huge number of vested interests that they have to square off. I think that once we are out we will do free trade



arrangements with probably the 30 that they started off with quite easily, because we do not have any reason on either side to want to redo it, and, of course, with all these other countries that these people talked about.

Dr Dhingra: A quick clarification on the non-tariff barriers. It is not just the average that matters; it is also the sectoral make-up of these non-tariff barriers that matters because if it is something that is important to many different processes, if that has a heavy non-tariff barrier, that is going to have much more influence than anything else. We do not choose just manufacturing. Our analysis is much more disaggregated to try to take into account those things.

The second point is that non-tariff barriers are not just about that I can eliminate them unilaterally. Typically, this is about coming together with your trade partner and deciding on rules and regulations that are common across borders, things like product standards. In that sense, we cannot do it unilaterally either. We need the trade partner to agree with us or we move to a lower-level standard. Say if we were to do a deal with China and we just go to Chinese product standards, that would be fine but it would come at the expense potentially of other sources of environmental as well as social regulations that are being compromised.

Chair: Thank you very much. You have opened up a rather interesting scene there.

Q86 **Mr Jayawardena:** Dr Dhingra, you and your LSE colleagues have argued that the process that Professor Minford has arrived at with his 10% figure was “deeply flawed” both “empirically and conceptually”.

Dr Dhingra: Yes.

Mr Jayawardena: Very powerful statements. Can you explain why you believe that is the case?

Dr Dhingra: What we know from 50 years of trade data, and what has often—by Paul Krugman—been called social physics, is that the law of gravity holds on trade data, which is to say most countries, whether we look at any time period, any set of countries, tend to trade much more with their closer trade partners, bigger, rich, close-by countries. By close by, this is both geographically as well as culturally. That is something that Professor Minford’s model would not predict and that is the one really sound piece of empirical evidence that we know from years and years of trade data, even going back to Chinese imperial trade. If you cannot replicate that basic trade fact, then the model is just deeply flawed in the sense that it is not giving you the basic fact that we know is true empirically. We can only say that at least our model will respect that, will not do that kind of violence to the data. When we run the same kinds of simulations, we get very different answers.

Q87 **Mr Jayawardena:** If there was ever a country, though, that was right for conducting the sorts of international trade that Professor Minford talks about, surely it would be the United Kingdom, with a very liberalised



economy, soft power across the world—I could keep going on and on but I shan't, in the interests of time.

Dr Dhingra: In terms of whether we would be the ones who would be able to get better trade deals from other countries, potentially we would not have to go with all the rest of the EU partners, so that would be a plus, definitely. However, whenever countries in the past have negotiated alone with big trade partners, they have not been able to get a good deal unless they have either given up a lot in the bargaining process or they have managed to somehow exercise some other kind of economic power, which is what we see even in the US-Canada free trade agreement, that the Canadians do not have quite as good a deal as the US does.

Q88 **Mr Jayawardena:** You mentioned that potentially there could be reduced quality standards if we were to do what Professor Minford says, but isn't that what the consumer already does in discerning between different brands, dare I say—washing machines was your example—or, indeed, in the supermarket? Someone going to Aldi or Lidl perhaps does not expect the same products as those going to Booths or Waitrose.

Dr Dhingra: Exactly. That is what we are saying.

Mr Jayawardena: What is wrong with that?

Dr Dhingra: There is nothing wrong with that and that is the part that we have modelled, which is saying that you do not perfectly substitute across different products. Some consumers select into one kind of product, others into others. In Professor Minford's world you always go to the lowest-cost supplier of that product and that is what we think is deeply flawed.

To follow up with another example, one could call the toy safety directives of the European Union protectionist but the other view would be that, no, we want those directives because they are good for consumer welfare. There is always some risk of cross-contamination, which is why most countries are coming together trying to have multilateral directives rather than just doing it unilaterally.

Mr Jayawardena: It is interesting that you say multilateral because, of course, that is countries doing it themselves with others and not being dictated to. It is possible to do that from outside the European Union and continue to have those standards that consumers might want but equally consumer choice ought to be driven through to provide people with that possible welfare gain. Professor Minford, perhaps you could explain a little bit more about how you believe the economy could benefit through that welfare gain.

Professor Minford: Yes, indeed. I don't know where this idea that the LSE people have had, that we are looking at depressing standards in our comparisons, came from. The comparisons we made to establish these non-tariff-barrier price differences are all with OECD countries and the main comparator country that was the cheapest supplier was the US in



almost all these cases—not exactly a country that hasn't got good standards. The runner-up was South Korea, which I think is a pretty advanced standard enjoying country. So it is nothing to do with standards. The fact is, the EU is a highly—viscerally—protectionist organisation. It is fundamentally corporatist and is dominated by large corporations. This is the problem. The vested interest element is huge here and that is what we see in the price differentials and indeed is what we see in the non-tariff-barrier calculations of the LSE's own. So I just do not know where this is coming from.

Turning to the gravity model and how we see the world compared with the gravity model, it is a very ingenious model where you get an awful lot out of very little. There is something called the gravity equation, which has a trade elasticity in it. That assumes that every country has a niche market with very little competition against it, a high degree of imperfection of competition, measured by this elasticity, which is in this trade equation that says that trade depends on how close you are to another country, how big your GDP is relative to it, and how many barriers you have. In our approach we think the World Trade Organisation, the world trade, is very competitive. You only have to think about free entry into the world market and the fate of companies like BlackBerry and Nokia or IBM laptops, to realise they are very competitive. That is our principle—competition and the way in which removing these barriers will change the structure of our economy and benefit our consumers.

Mr Jayawardena: Professor Minford, in an article for *The Sun* before the referendum you said that under a policy of unilateral free trade, "We would mostly eliminate manufacturing but this shouldn't scare us". I am sure you are not suggesting that those great businesses that are expanding even in the light of Brexit—Jaguar Land Rover, Boeing and so on—would be closing down; I am sure you are not saying that. Why should we not be scared? Is it because of what I say, is it because of other reasons, or something in between?

Professor Minford: It is because manufacturing is going up the value chain and the companies referred to are high tech companies that embody skilled labour-intensive activities, very similar to service activities, which are highly skilled labour-intensive.

Q89 **Chair:** Which manufacturing industries would we eliminate?

Professor Minford: The point I was making there, which I made in the surrounding text that backed up this statement, was that manufacturing would be subjected to competition. The metal-bashing element, the pure making element, would reduce substantially and those industries doing that would go up the value-added chain and become more and more high tech and raise productivity—as has happened, of course, relentlessly, in the last 40 years in this economy, bringing down the share of manufacturing employment from 35% to 8% today.



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Q90 **Chair:** Which occupations in manufacturing would go?

Professor Minford: The unskilled labour-intensive aspects would decline and the skilled labour-intensive aspects would increase.

Q91 **Marcus Fysh:** We have a wonderful manufacturer, Westland, in my constituency and I would like to see that survive, absolutely.

Professor Minford: I am sure it will.

Q92 **Marcus Fysh:** To come back to the gravity model, because I think it is really important to understand, one of the things that I learnt in my career in financial services was that sometimes what goes into these models is massively important in what comes out of them.

In terms of the correlation that you are effectively talking about between the trade data and the proximity in one way or another of a country, these are historical correlations that you are looking at. Within your model, what are the periods of time where the majority of the impacts of using that correlation are from? My concern with it is that we have seen a period over the last 20 years, say, of some major regional trade blocs being set up. The EU is one; NAFTA is another. In my supposition, that might create a correlation in itself, which if you then use to take forward in a slightly different environment is not necessarily valid. To what extent do you think there is room for further work to be done on trying to model future correlations based on different circumstances?

Dr Dhingra: Let me start by saying that the gravity model, for those who do not follow it, would say that there is a trade elasticity that essentially predicts that if I change my trade values, let's say 1%, what is going to be the change in trade flows between the two trade partners? Professor Minford's world would assume that that elasticity is infinite. In our case, it is not going to be infinite; it is going to be something that we get from the data. You are completely right in asking this question: are these just correlations or is it saying something about causality? That has always been a challenge for most of this literature. What I can argue is that you can control for many things like cultural proximity, like the formation of an RTA, and so on, which is motivated by time-invariant factors, by factors that are specific to your relationship with me, and so on and so forth. All of that has been controlled for.

People have looked at very many different time periods. The work that the Treasury has done had a time period from 1948 to the 2000s. What our time period looks like, in my own work that I have done, is something from, say, 1995 onwards, which is the new regional trade bloc that the EU has been doing. In that sense, whenever people have looked at this—and that is the reason why we think that this is such an important empirical fact—this is true across different time periods, across different subsets of countries; it is a very robust relationship. It is the most robust relationship that we know within the literature. In that sense, if the model does not do justice to that, we are really talking about something that is not managing to explain trade volumes.



Q93 James Cleverly: I completely understand what you are saying and all these models have to be based on historical data, but we are seeing a very fast change from historically what would have been the trade in physically heavy primary products. We are now, particularly for the UK, seeing a massive distortion in that we rely so very heavily on services, which are increasingly digital and which increasingly point themselves towards fast growth, potentially developing economies where we can see the maximum return on risk. Those, by their nature, tend to be further away than our historical trade partners. Even if the gravity model has been historically accurate, do we not run the risk of saying that because it has always been, therefore it will always be?

Dr Dhingra: Sure. You are completely right again in thinking about that. We have always worked with data that is manufacturing-heavy, not really services-heavy. More recently people have looked at foreign direct investment and how that reacts. Foreign direct investment also tends to follow a gravity-style framework. If we look at just services trade, it is a similar kind of answer. People have also looked at eBay transactions and find that the gravity model works even though you can control very easily there for trade cost because we observe how much people are paying for transactions.

I want to clarify one point. We are only parameterising the model with historical data because that is the only data we have but the predictions are much more forward-looking and they can be changed to think in terms such as, "What if China were to grow faster than the European Union?" and so on. Many of those things do not have much bite simply because we are still talking about China, which is starting from a very low level in terms of our trade relationship with it, while the EU is already at 45%, so even if it grows slowly we would see bigger effects there.

Q94 James Cleverly: Has there been an equivalent of the gravity model with non-physical transactions?

Dr Dhingra: Yes. The eBay transactions.

James Cleverly: With eBay you still have ultimately a physical, delivered product. What about things like digital music, digital imagery, text, e-books, things like this, where there is no physical transfer of product?

Dr Dhingra: The UK is the only one that has some level of high quality services trade data and my colleagues have a paper that also looks at services data, which is everything from R&D activities to financial services.

Professor Rollo: I want to make some rather more mundane points on this in the context of services data. The UK TPO has just published a working paper on services trade. It points out very clearly something that we do not always grasp when we have these debates, which is that the numbers we have on services are not very high quality in the first place and only cover the cross-border flows. They do not cover the services trade that follows from what is called mode 3, which is investment in the



target country; so you set up, let's say, a bank subsidiary or an insurance company subsidiary, there. That has not been measured.

The other thing that has not been measured, and it is important in two elements of services trade, one is when the consumer moves—this is close, of course, to any academic's heart because this is students coming to be educated here, so we lose that; we do not have the granularity on that to say clearly how that might move in new circumstances. The other one is what is called movement of natural persons, which we like to think of as very high-skilled lawyers or whatever going to tell the rest of the world how to do things properly, but also India and other countries like that are very interested in moving low-skilled workers around construction, say, and perhaps also issues like seasonal movement of labour for agriculture and so on. Those are not really being picked up. When we look at the services numbers, we are already underestimating the impact of cross-border activity in this. We really need to look at the subsidiary sales, which the Americans measure but we don't, and issues like that.

Professor Minford: Can I make a brief reply to this? The thing is that Swati Dhingra is absolutely right: the gravity equations are the data. They basically are descriptive equations and we have known for years that these gravity equations are around. We have always loved them because they are very good ways of predicting what trade will be next year. They are related to GDP and various other factors, like country dummies and so forth. So, these are the data. It is not surprising they fit the data because what these gravity models have done is taken the data and then assumed that it is generated by a model in which every country has got its own niche market, where there is minimal competition and everything depends on the size of your border and how far away you are from other people. Of course, this is completely wrong in the case of the UK because we have always had a very far-flung set of relationships.

I think your question, Mr Cleverly, was absolutely correct. These are associations in the data we find. The question is: what do they mean? What is driving them? Is it this elasticity that you find in these gravity equations, which is a blanket kind of fact that you find in the data but has nothing to do with fundamental substitutability? You have to go to what is driving it and that is about causality, which is what Mr Cleverly's question is about.

Q95 **Chair:** However, for a rule of thumb you are saying the gravity models are right and are reasonably good indicators. Did I pick that up in the beginning?

Professor Minford: They are just data, you see; they are just data. If you look at trade data and relate it to GDP and a bunch of factors, you get the gravity equation, which is a very good predictor but it is not telling you what is driving that stuff. Behind all that stuff is policy, supply shocks, demand shocks, comparative advantage; all sorts of deep things. All these things are driving this data. When you come to test models like



gravity or my model, you have to look at movements in data over periods of time and simulated correlations versus actual things in the data.

Q96 **Chair:** Just for ease of understanding, is it fair to say, for a rule of thumb, that the gravity model is a broad brush and the things you mention are the fine brush within that broad brush? Is that fair?

Professor Minford: Not exactly. You see, the gravity equation is a description of data, which we have known about for years and it is a very good description of data but it does not tell you where that is coming from. What the gravity modellers have done—and there is a great industry in this, of which LSE is a distinguished example—is very cleverly derived from this a world in which everybody had a niche market and then you can generate a sort of elasticity. They use that elasticity to then make simulations about what would happen with the world. The problem is that the way they have approached it assumes very little substitutability—that is the fundamental problem—whereas the way I have approached it assumes a very high degree of competition in the world market, driven by factors that cause comparative advantage.

Dr Dhingra: I will be brief.

Chair: LSE, thank you. I will appreciate your brevity because I am losing members here.

Dr Dhingra: We do a model just the way Professor Minford would do a model. His model is a subset in many degrees of our model. Ours generates the gravity equation. It is not saying that that is the fundamental relationship we are going to start with and then make predictions based on that. The predictions are based on changing actual fundamental policies but the model also generates the gravity equation so it does not do violence to the data. It says, yes, there is a description of the data; we are going to respect that and we are going build policies based on facts that are reflected in that data.

Q97 **Chair:** If I could turn to Professor Minford; a brief answer, please. Your model predicts a big increase in wage inequality under your Britain Alone policy. Why is that and do you think that is a good or a bad thing?

Professor Minford: What it is predicting is as comparative advantage favours skilled labour-intensive industries, this will tend to drive up the price of skilled labour relative to unskilled labour. It is simply what is in the national interest. To allow comparative advantage to work out, that is what our model says would happen. What we argue is that we have plenty of policies in the British economy for dealing redistributively with inequality and that would be the way we would go about it. What we would say is let the economics work but redistribute, as we do. Obviously we would expect the stock of unskilled labour to be generally diminishing over time relative to the stock of skilled labour, with our policies of education and so forth. Our preferred approach is education, education, education, as the Prime Minister once said.



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Q98 **Chair:** Would you call for increased welfare spending?

Professor Minford: We have a very redistributive welfare system, which we do not argue with. It consists of all sorts of benefits, which are in-work benefits—

Q99 **Chair:** It has changed markedly in the last few years. When you say you do not argue with it, are you happy with the welfare we have now in 2016, the welfare in 2011, the welfare in 2006, the welfare in 2001?

Professor Minford: This is not something that is particularly relevant in the Brexit debate. The point is that we say the sort of welfare system it has is a democratic decision of this country, but it has been traditionally very interventionist.

Q100 **Chair:** You are predicting a rise in inequality. I am now trying to see if you are comfortable with that and if you are not comfortable with that, because you have mentioned education, you have mentioned certain policies—then I brought up welfare and you said you are happy with the welfare. I am trying to work out at which point are you happiest with the welfare? Are you happy with the evolving welfare, the changing welfare, or was there a point in time where you thought the welfare was better than it is now?

Professor Minford: I have always supported the welfare system of this country. It was put in place very largely under the Thatcher Government, boosted up substantially to give in-work benefits to get people into work and off unemployment benefits. I think that is a very important element. I think it has dealt very well with the globalisation shock, the deindustrialisation of Britain before the globalisation of the 1980s. I think our welfare system, our system of targeted—now called tax credits—has done very well.

Q101 **Chair:** Moving a bit further maybe from inequality and from industrial inequality is agriculture. I should perhaps state an interest here. I am a crofter in the Outer Hebrides and I keep some sheep; not too many, as you can see I have to have a day job as a result of it. What do you think Brexit might mean for agriculture in the UK, not just for farmers but for crofters as well?

Professor Rollo: That is quite a big question because the options are quite wide. At the moment we spend, give, about £3 billion directly to agriculture in the UK and in addition to that, we give significant protection at the frontier. In the new post Brexit world our policy certainly will be still governed to a very considerable extent by the agricultural agreement agreed under the Uruguay Round by the EU on our behalf at that point but none the less we will still, as members of the WTO, be subject to that.

There are two broad camps about what to do in the future, as I understand it. There is a farming lobby that is quite strongly of the mind that the direct payments that are currently put into agriculture should be



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shifted to being, in effect, indirect aid to production. Dieter Helm at Oxford in particular has argued quite strongly that this money should be taken away from farmers and given to public authorities to buy from farmers particular public goods, especially local and focused environmental goods rather than, as now, getting flat-rate payments. It is an interesting question of how that debate might play out.

On the other side of that debate, the £3 billion of course is a burden on the Exchequer and post 2020 it looks to me at least that there must be some chance of some fiscal contraction to take account of the burgeoning debt. That might put quite a lot of pressure on the Treasury to try to find some money from agriculture, which might leave it feeling happy about having quite high protection at the frontier because that would put the burden of support of agriculture on to that leg of the policy.

How that will play out, at this point I don't know. I have to say the debate on agriculture is the debate that doesn't seem to me to be taking place at the moment.

Q102 **Chair:** Does anybody else want to contribute to the agriculture point?

Professor Minford: I will happily say something. It seems to me absolutely a no-brainer that we leave this common agricultural policy, which is vastly expensive to our consumers and vastly generous to EU farmers. Then the question is, having left it, how do we help crofters and other such impoverished farmers? I am totally on your side. I am not a crofter but I would like to help you and it seems to me it is basically peanuts. We can give transfer compensation to needy farmers at vastly less cost than through the common agricultural policy, which spreads it around and is hugely expensive to consumers. I am not an expert on farming but we have said repeatedly that there should be some inquiry into how we can get back into a domestically organised regime for helping farmers in a constructive way, benefiting the environment and helping needy farmers.

Q103 **Chair:** In short, in your view, post 2020, should the UK Government, devolved Governments as well, be supporting farmers to the same level as it is currently supporting them?

Professor Minford: No, I don't think so. There is enormous generosity to extremely efficient and rich farmers in this country. The irony is that most of them do not want to stay in the EU because it is such a bureaucratic nightmare. They would be very happy to be free to run their farms in the most efficient way and be free of the intervention from the EU, is the story I am hearing from many farmers. As far as the benefits to the national interest are concerned, it is perfectly cut and dried.

Q104 **James Cleverly:** We touched upon your views, Professor Minford, about unilateral reduction in tariffs. Other economists who are pro-Brexit—I think particularly of Andrew Lilico—are much more in favour of a series of bilateral trade deals. If I have misquoted you, I apologise, but I have a



quote here that suggests that you say these are “harmless but pointless”. Is that a fair description? If so, how do you come to that conclusion?

Professor Minford: In the competitive world of our model that I described earlier, essentially the bit that harms you is the tariffs you put on because it raises prices to your consumers and reallocates your production to less efficient industries. In that world, the tariffs that other countries put on essentially lead to what we call trade diversion—you sell less to them but you sell more to others—and the people to whom your demand is diverted, that supply that demand in these protected markets, then sell less to the other markets. There is a kind of reallocation of supply, in your case away from the protected market, with no effect on world prices because total demand for this product is unaffected in the world market. You just get trade diversion, essentially, with no effect on your total supply. That is the basis.

In the short run, as we discussed earlier, there is some disruption so there are some short-term costs, even though there are no long-term costs, and you might want to try to reduce those, if you can, through trade agreements. Trade agreements are one way of doing it; reducing short-term disruption, essentially. I am not really against trade agreements. The point is that they may be a route to getting to the same objective. If you have lots of trade agreements, you get to the same objective of unilaterally low tariffs. That is what brings you the big dividend. The other does not bring you much gain, except in the short run.

Professor Rollo: My reading is not quite the same. Economists traditionally, at least since the early 1950s, have talked about preferential agreements in terms of trade creation and trade diversion, trade creation being where you cut a tariff with a partner who is already one of the most efficient in the world. We do a deal with Australia; we get efficient sugar production from that—they come in over no barrier, perhaps—and that is a gain to us from that side. Again, and Patrick is absolutely right, economists think mainly about imports in this context, They think the point of trade is to import because that is where the difference is coming from. That is where the variety is coming from—stuff you do not produce. However, there is a possibility that what you do is bring a high-cost producer into the preferential arrangement and that raises basically the foreign exchange cost that you pay for that good compared with the pre-agreement number. That is essentially what we did when we joined the common agricultural policy in 1973. We gave that advantage to, let’s call it, the French agricultural lobby. We also gave it to people who were already trading with us, like the Irish, the Dutch and the Danes, but I will put that on one side. Part of what Patrick has been railing about for the last hour or so, about the horrors of protectionism from the EU, is the agricultural bit of it. I find it hard to quite get that on the same ground as his assertions that such agreements really do not matter very much, because clearly it does seem to me that the common



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agricultural policy was not particularly good for the British economy, taken by itself.

Chair: I will let you come in on that point.

Professor Minford: Can I explain on this point that when you join the EU you are joining a customs union, which is very different from having a country change a tariff against you. That is the point. Joining a customs union, as I have argued—as he says, I have railed for the last hour about it—is very damaging to us because it effectively means you suffer from the protection of the customs union and you divert resources to inefficient producers in the customs union.

Professor Rollo: I am sorry, I am not sure that is quite right in this context. What the customs union does is it gets away from something nasty called rules of origin, which you need in a free trade area, and those can be worth quite a lot in protection terms. I don't think it is quite straightforward to say it was just because it was a customs union. It was because the policy went way beyond just tariffs that was the key part about it because it was an agricultural support policy that had been unified, not just some external tariffs.

Dr Dhingra: Empirically speaking, when people have looked at them there is very limited evidence for trade diversion across different trade agreements. Most of the time most trade agreements that are done are much more trade-creating and that is something that we see even in the European Union. If you look at how membership in the European Union affected trade volumes, there is a 62% increase compared to a group of countries that have signed any kind of other trade agreement. In that sense, calling it trade diversion is misrepresenting the facts.

Q105 **Chair:** A 62% increase by membership—

Dr Dhingra: By both of you becoming a member of the European Union.

Chair: Ranil, do you want to move any further on this?

Mr Jayawardena: No, thank you.

Chair: Panel, thank you very much for your time this morning, and now early this afternoon. It certainly was lively and certainly a lot of food for thought, which we will process as a Committee over the coming hours, days, weeks, possibly even months, hopefully not too much longer. Can I thank you for your input to our investigations and wish you well for the future? Thank you.