

## Introduction

1. We both work in academia and have previously worked in the policy making sphere (for example, Department for International Development and The World Bank). Our recent academic research focuses on trade policy and we have collectively published eleven articles discussing a range of issues concerning UK trade negotiations (see the bibliography for more details). Our modelling approach is to use counterfactual analysis within a structural gravity framework. The following evidence cuts across our body of work in order to respond to a number of the questions in the terms of reference.

### FTAs: general principles

2. Free trade agreements (FTAs) are a very important component of the policy toolbox, which may generate additional trade as well as realigning the structure and direction of existing trade flows. While the Department for International Trade (DIT) has set out its negotiating priorities for each potential agreement, in our view there is still further work to be done in terms of agreeing a broader policy framework. In other words, the DIT needs to have the right objectives in respect of each FTA negotiation but also a broader set of principles that cut across agreements. The absence of this framework tends to create extensive discussion at the International Trade Committee. Furthermore the DIT needs to provide fuller guidance on their website so that various stakeholders (for example devolved nations, local government, businesses, consumers and civil society groups) can understand legal texts and provide informed feedback<sup>1</sup>.
3. Increasingly, FTAs go beyond simple tariff reductions, encompassing elimination and harmonization of non-tariff measures, services liberalization, government procurement. Moreover, they are also framed within a discussion of common values<sup>2</sup>. These more complex agreements require extensive cross-Whitehall communication. There is also the matter of ensuring that trade partners deliver on the more ambitious commitments (for example, applying the labour commitments in an FTA). In response to these type of difficulties, in Feb 2018, the EU set-out a 15-step action plan to support the sustainable development aspects of the EU's FTAs. It is likely that

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<sup>1</sup>For example, the European Commission publishes guidance on how to read a trade agreement: <https://trade.ec.europa.eu/access-to-markets/en/content/how-read-trade-agreement>

<sup>2</sup>For example, Rt Hon. Liz Truss MP (Secretary of State for International Trade, Department for International Trade) responded to Q182 from the International Trade Committee Oral evidence: UK trade negotiations, HC 127 on Wednesday 7 July 2021 by saying: "But our trade policy does have to reflect our values. It has to be a values-based policy. The important principle for me is that the trade that we are undertaking is not undermining our way of life or our beliefs in the UK, whether it is our beliefs in achieving net zero, whether it is our belief in high animal welfare standards, or whether it is our belief in having strong labour laws."

the UK will face similar challenges and, therefore, a strategy needs to be developed and agreed in this area.

4. The benefits of FTAs depend on their depth, differences between countries in terms of industrial structure and comparative advantage, economic size of negotiating partners, level of development, and trade costs size and structure. Trade negotiations are a costly and lengthy process, which involves trade-offs. To generate net benefits, FTAs are usually formed with 'natural' trading partners, who either already have substantial trade flows prior to the negotiations or who have a trade potential, expected to materialized as a result of the negotiations. Members of the International Trade Committee have questioned the benefits from potential FTAs and cited evidence provided by the DIT. This has led to a debate about whether the modelling is backward looking and therefore not able to account for additional potential gains (Rt Hon. Liz Truss MP (Secretary of State for International Trade, Department for International Trade) responding to questions from the International Trade Committee; Oral evidence: UK trade negotiations, HC 127 on Wednesday 7 July 2021). In our opinion there is scope for rethinking the approach to impact assessing potential agreements. Furthermore, these assessments should offer evidence to support signing (or not) the proposed agreement.
5. FTAs should not be looked at in isolation from each other, but within a broader picture. In this regard, each new agreement should be assessed against a backdrop of Brexit and other existing or negotiated agreements. According to Jackson and Shepotylo (2018), the UK's real GDP will drop by 2.63% if there is a shallow FTA in place with the EU (akin to Canada's). If the UK manages to also conclude a FTA with the US, the effect of leaving the EU will be -2%. And an agreement with the largest Commonwealth countries will make it -1.93% worse off than staying in the EU.

## **FTAs with developed countries**

6. Applying these basic principles to the UK FTA strategy, leads to the following conclusions. Negotiating a traditional, shallow trade agreement with the US or other developed countries does not bring any sizable advantages due to historically low levels of ad valorem tariffs, the reduction of which is the main objective of a shallow FTA. One area, where tariff liberalization between developed countries is still limited, is agriculture and food products. A more advantageous strategy would involve removing non-tariff barriers (NTBs) in goods, harmonizing remaining non-tariff barriers, and extending the negotiations to trade in services, digital trade and technology, and investment agreements. While conducting bilateral negotiations, the repercussions of bilateral trade liberalization on existing agreements should be assessed as current commitments impose constraints on future trade liberalization

and involve trade-offs. In this regard, multilateral trade negotiations may be considered as a more efficient instrument of the trade policy negotiations.

## **UK-US trade negotiations**

7. The ability to strike new trade deals was a key promise of the Brexit campaign. Trade between the UK and US reached an all time high of more than US\$140 billion in 2019 and has been growing steadily for the past two years prior to the COVID-19 crisis.
8. UK exporters already have strong access to the US market; the US is the most important export nation for UK goods exports. On the other hand, there are more opportunities for better access to the UK market for US products. US negotiators are particularly keen for the agricultural and food sectors to be opened up.
9. From a UK perspective, there does not seem to be that much to gain from a trade deal in economic terms; the UK government's own modelling estimates predict increases of 0.07-0.16% of GDP in the long run depending on whether the deal would lead to partial or full trade liberalisation. For the US, a deal would only start to look more economically beneficial if the UK is willing to open up the food or healthcare markets.

## **FTAs with developing and emerging economies**

10. Trade negotiations towards shallow FTAs with developing countries may generate more benefits as developing country tariffs are generally higher. At the same time, there is less room for negotiation on the UK side, since UK tariffs are already low, so in exchange for tariff concessions from developing countries, the UK needs to offer better market access, removal of NTBs or concessions in non-trade related areas, such as liberalization of the movement of people.
11. The UK may also leverage relatively high bargaining power, as it can offer better access to a large market for goods and services, and advanced technologies. It has been found that developing countries may benefit from importing intermediate and capital goods from more developed countries.

## **UK and China**

12. Chinese policies in the area of international trade and investment are unified by the overarching Belt and Road Initiative (BRI). Its main goal is to realise improvements in Chinese connectivity to global markets by means of investment in infrastructure as well as the creation of new transport links. It also aims to streamline trade

procedures, which will reduce non-tariff barriers (NTBs) and transportation costs along six corridors. For the UK this initiative is potentially important since BRI routes end in Europe.

13. Jackson and Shepotylo (2021) find that a reduction in transport costs between China and the EU would lead to considerable welfare gains for both parties. For example, a 10% reduction in transport costs would increase the welfare of a representative consumer in China by 1.57% and in the EU by 0.49% (based on the full general equilibrium model). On the other hand, signing a deep FTA between China and the EU would increase welfare by 2.52 and 1.25% respectively. Further, a joint policy of reducing transport costs (via the BRI) and signing a (deep) FTA would increase welfare by 4.26 and 1.79%; this is larger than the sum of the gains from the two separate policies.
14. The BRI is a good example of where new trade deals are taking different forms. Another example of an arrangement that is not an FTA in the traditional sense is the China-US Phase One Agreement. The UK needs to consider whether they are confining their negotiations to traditional trade deals, which are reported to the World Trade Organisation.

## Bibliography

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