Balance of Competences Review: Trade and Investment

Evidence submitted to the UK Department for Business, Innovation and Skills

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The Competitive Enterprise Institute (CEI) is a leading free-market advocacy group based in Washington, DC. Since its founding in 1984, CEI has worked on promoting global free trade and has consistently advocated a free-market approach to trade and investment that would see freer movement of goods and peoples across borders, to mutual benefit. Iain Murray is a British citizen who is Vice President at CEI and heads the Center for Economic Freedom, which includes trade and other international issues in its portfolio. Fran Smith, adjunct fellow at CEI, and a member of the U.S. Trade Representative's Trade and Environment Policy Advisory Committee, also contributed to this submission. This evidence is submitted in order to argue that Britain and the USA would be better off if Britain were to handle its own trade negotiations with the USA, rather than allowing trade to remain an EU competence.

The evidence has two main components – a brief analysis of the potential barriers to UK-US Trade in the negotiations over the Transatlantic Trade and Investment Partnership (TTIP) currently under discussion, and an overview of potentially feasible multilateral trade partnerships involving the UK and US in an era when the UK regains trade competence.

1. Potential Barriers to UK-US Trade in the TTIP Negotiations

We have already seen that a least one area of promise for increased UK-US trade and investment – a greater integration of the English-language film industry – has already suffered a protectionist blow in the TTIP negotiations, almost before they started. The French government successfully lobbied for *l'exception culturelle* in the negotiations, protecting culturally-important industries from competitive pressures. There is a fuller treatment of this presented in the recent opinion piece by CEI's Iain Murray and Alex McHugh attached at Annex A. At a time when British actors are in very high demand in Hollywood, it would seem that a trade agreement that allowed increased British involvement in US filmmaking would be extremely beneficial to the UK acting profession, but this has been taken off the table already. That is the sort of barrier that is being placed between increased US-UK trade in the TTIP negotiations. There are several other areas of concern

Remaining Tariff Barriers: The US remains the UK's largest non-EU trading partner in terms of both exports and imports, and existing US-EU tariffs remain a burden on both economies. In terms of exports, it has been estimated[1] that getting rid of tariffs on merchandise trade between the EU and the US would increase EU exports to the U.S. by up to $69 billion, while U.S. exports to the EU could increase by up to $53 billion. There would be substantial gains in both economies – GDP in the EU could rise from $58 billion to $85 billion, while US GDP could increase from $59 billion to $82 billion.

On a simple per capita basis, with a population of 62 million out of the EU's 503 million citizens, many of these benefits would accrue to the UK – in the form of at least $3 billion in increased GDP. However, given the UK's historic trading links with the US, it is reasonable to believe that the UK would gain disproportionately from a relaxation in tariffs between the UK and EU as a whole.

In a free-trade lesson the UK could learn from, in November 2011 Canada announced that, to help spur the economy, it was eliminating tariffs on imports used by Canadian manufacturers.[2] Tariffs would be cut on about 70 items, the latest in government moves to get rid of all tariffs by 2015. Already Canada has abolished tariffs on more than 1800 items — relief that is expected to add about US $423 million annually to its economy.

However, in a signal that eliminating all tariffs is not in the cards in the TTIP negotiations, the report of the High Level Working Group twice mentioned that "the most sensitive" products on both sides would continue to be treated differently from other goods and services:

> The HLWG recommends that the goal of the agreement should be to eliminate all duties on bilateral trade, with a substantial elimination of tariffs upon entry into force, and a phasing out of all but the most sensitive tariffs in a short time frame. In the course of negotiations, both sides should consider options for the treatment of the most sensitive products.[3]

This should be worrying for British industry. As suggested above, the UK stands to gain disproportionately from any relaxation in tariff barriers with the US. Freeing the UK from the burden of tariff barriers advocated by its European neighbours would significantly increase the benefits of free trade with the US.

Important too for the UK should be the recognition that tariffs on imports are in reality added taxes on the foreign goods and services that consumers and businesses purchase. Trade agreements should consider the consumer impact. Consumers benefit from imports that reduce prices, increase choices, and provide new technological advances. Eliminating tariffs can provide major "tax cuts" that can help

[1] Fredrik Erixon, and Matthias Bauer, "A Transatlantic Zero Agreement: Estimating the Gains from Transatlantic Free Trade in Goods," European Centre for International Political Economy, ECIPE Occasional Paper, April, 2010.
[2] *Digital Journal*, November 28, 2011. http://digitaljournal.com/article/315162.
[3] Final Report High Level Working Group on Jobs and Growth, February 11, 2013. http://trade.ec.europa.eu/doclib/docs/2013/february/tradoc_150519.pdf

stimulate the economy. Again, the UK is more likely to benefit if it were free to negotiate with the US in a bilateral or non-EU multilateral (see part 2) framework.

Non-Tariff Trade Barriers: Even as tariff barriers to trade have been reduced, non-tariff trade barriers have increased. These barriers can take many forms, from restrictions on food products based on non-scientific assertions or even cultural practices to costly regulatory regimes. The World Trade Organisation, for instance, has recognised that sanitary and phytosanitary measures that go well beyond what is needed for health and safety can constitute unwarranted barriers to trade[4]. The EU has proven more willing to introduce such barriers than other countries, and it is certainly plausible that the UK, absent EU trade competence, would be less likely to indulge in such trade barriers than the EU as a whole. Such protectionism is expensive. According to French economist Patrick Messerlin, protectionism costs the EU 6-7% of its GDP annually.[5]

Of considerable worry to UK farmers should be the looming problem of agriculture in the TTIP negotiations, based around likely EU protectionism in this matter. Senate Finance Committee Chairman Max Baucus (D-Mont.) and Ranking Member Orrin Hatch (R-Utah), in a February 2013 press release and a letter to U.S. Trade Representative Ron Kirk, praised the concept of a trade agreement with the EU but pointed to several EU restrictions on agricultural imports that are not based on sound scientific findings. The Senators urged that those "unwarranted agricultural barriers" be resolved:

> Broad bipartisan Congressional support for expanding trade with the EU depends, in large part, on lowering trade barriers for American agricultural products. This means increased agricultural market access and firm commitments to base sanitary and phytosanitary measures on sound science. The EU has historically imposed sanitary and phytosanitary measures that act as significant barriers to U.S.-EU trade, including the EU's restrictions on genetically engineered crops, a ban on the use of hormones in cattle, restrictions on pathogen reduction treatments in poultry, pork and beef, unscientific restrictions on the use of safe feed additives such as ractopamine in beef and pork, and other barriers to trade affecting a significant portion of U.S. agricultural exports. While we recognize the positive steps the EU has recently taken with respect to imports of beef washed with lactic acid and with respect to swine, there is still much work to be done. We urge you to resolve these and other unwarranted agricultural barriers as part of the FTA negotiations on both an individual and a systemic basis.[6]

In the agricultural areas relating to the US and the EU, both parties should rethink their domestic support programs, especially in these times of budget deficits and the need to cut public expenditures. However, the EU is committed in one form or another to the Common Agricultural Policy (CAP), which was designed to help support the French system of agriculture. HMG should also consider the feasibility

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[4] World Trade Organisation, "Introduction to the SPS Agreement". http://www.wto.org/english/tratop_e/sps_e/sps_agreement_cbt_e/c1s2p1_e.htm

[5] Guy de Jonquieres, "Protectionism is Costing EU 6% of GDP", *Financial Times*, November 10, 1999.

[6] "Baucus, Hatch Outline Priorities for Potential U.S.-EU Trade Agreement", Press Release, Senate Committee on Finance, February 12, 2013. http://www.finance.senate.gov/newsroom/chairman/release/?id=17b2fd73-067d-4a4a-a50f-a00265efbf67

of extracting itself from the CAP in the review of competences. By doing so, it would make it much easier to reach agreement with the US on agricultural issues in any free-trade arrangements the two countries were to make.

Regulatory Burdens: Excessive regulation also constitutes a non-tariff barrier to trade. Both the US and the EU are examples of the modern regulatory super-state, with costs from regulation in the US alone reaching $1.9 trillion annually, according to research by Wayne Crews of CEI[7], close to 13 percent of GDP. Estimates of the cost of EU regulation to the UK vary from 6 to 25 percent of GDP[8], and in the opinion of CEI experts it is much more likely to be at the higher end of that range. If the UK were to regain competences from the EU and thereby reduce the amount of EU-originated regulation, it would make the UK more competitive in the global market, thereby creating positive incentives from regulatory competition.

This would be particularly attractive in the context of UK-US trade, especially in financial services. In its IPO, Facebook specifically singled out the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act of 2010 as "risk factors" that will impose substantial costs to the company and its shareholders and divert resources from the firm's core mission of innovation. Indeed, the former Mayor of London, Ken Livingstone, is known to have used the existence of Sarbanes-Oxley as a major incentive for investment in the City of London:

> "I asked him [Livingstone] what was London's most important economy development strategy," Ms. Wylde said. "He said Sarbanes-Oxley and went on to explain that Tony Blair, unlike our federal government, fully understands that a friendly regulatory environment is critical, especially to attracting mid-size and emerging companies that are just listing on exchanges."[9]

A UK that has freed itself of burdensome EU regulation would therefore be in an enviable position with respect to US-UK trade, and would attract a great deal of inward investment from the US, given its shared language, culture, and legal traditions. In turn, this would likely have a beneficial effect on the US, providing an incentive to reduce its regulations. Both countries would ultimately benefit. However, in a world where the EU almost seems to try to one-up the US when it comes to increasing the burden of regulation, this is unlikely to happen. The most likely precipitant for breaking this cycle is a major reclamation of competences by the UK from the EU.

2. Feasible Multilateral Trade Formulations with UK Trade Competence

Given the size of the UK economy, a bilateral free-trade deal between the UK and US is not out of the question (many smaller economies have just such a deal). However, there might be concern in the UK that such a deal would be dominated by the US side. Accordingly, it is worth constructing scenarios whereby the UK and the US might both be members of a multilateral trade agreement. This submission

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[7] Wayne Crews, "Ten Thousand Commandments 2013," CEI, May 21 2013

[8] Professor Patrick Minford CBE, "Setting Business Free: Into the Global Economy", The Hampden Trust and The Freedom Association, July 2013.

[9] Jill Gardiner, "If London Were a Stock, Its Price Would Be Soaring: New York & London: Tale of Two Cities", *New York Sun*, September 8 2006

postulates two such agreements – a North Atlantic Free Trade Area (NAFTA2) and a Global Free Trade Association (GFTA).

North Atlantic Free Trade Area: In 2000, a US Senate report commissioned by then-US Senator Phil Gramm (R-Texas) concluded that UK entry into the North American Free Trade Agreement (NAFTA) would be beneficial to the UK. According to the *Daily Telegraph*, "The report concluded that if Britain joined NAFTA while remaining in the EU its exports to the US would increase by £1.9 billion per year, while exports to the EU would decrease by £680 million."[10] Reaction in the US to the report was generally favourable, while it was dismissed as "barmy" by then-UK Foreign Secretary Robin Cook.

It is now feasible to consider a NAFTA2, however. There is a possibility that the Icelandic government might adopt the Canadian Dollar as a national currency, given the close relationship in industries and business cycles between the two countries. It would not be too great a step then for NAFTA to expand to include Iceland. Once that has happened, the continental identity of the current NAFTA would no longer apply, and a precedent would have been set for the inclusion of other North Atlantic countries with similar business cycles. The UK is one such country. It should therefore be plausible to imagine a NAFTA2 with membership including the US, Canada, Mexico, Iceland, the UK, Ireland (perhaps in a currency union with the UK), Greenland, and Norway. Such a free trade area would incorporate 30 percent of world GDP[11] and be a major step towards the breaking down of trade barriers worldwide. In addition, former Canadian Prime Minister Brian Mulroney has also floated the possibility of Australia and New Zealand joining NAFTA, which would further expand the agreement's reach.

Global Free Trade Association: Another potential idea is for the world's freest economies to come together to form a mutually-beneficial free trade association. Eligibility for membership in a GFTA would be determined by reaching an appropriate score in an index of economic freedom, akin to those compiled each year by the Heritage Foundation in America or the Fraser Institute in Canada. These economies are by their nature committed to free enterprise and free exchange of goods and services.

The inventor of the GFTA idea, Dr. John Hulsman, described it as follows in 2004:

> The GFTA will be founded on a genuine shared commitment to increasing trade between its member states and at a global level. It will serve as a practical advertisement for the enduring global benefits of free trade as the advantages of such an association become apparent; an example all the more precious in the wake of the Seattle WTO debacle. It would presently encompass New Zealand, Hong Kong, Ireland, Chile, Singapore, Denmark, Luxembourg, Estonia, Australia, Finland, Iceland, the UK and the US. The GFTA will be a voluntary and inclusive grouping, whose expanded membership should be based solely on a policy commitment by its member states to a genuinely liberal global trading order. The plan embraces a commitment to a state's sovereignty. Its economic policies (and the choices they represent) will determine whether or not it qualifies for the grouping. This commitment will be characterized by a state's meeting certain numerical targets (such as those used in the methodology employed in The

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[10] Toby Harnden, "Nafta partnership would help Britain, says American study", *Daily Telegraph*, August 29 2000
[11] Total GDP of listed countries is c.$21.19 Trillion, out of a Gross World Product of c.$71.8 Trillion

> Heritage Foundation and The Wall Street Journals' 2001 Index of Economic Freedom) regarding a country's openness, relating to its trade policy, capital flows and investment, property rights and low level of regulation (for details of the plan, see appendix.)
>
> Members will thus select themselves based on their genuine commitment to a liberal trading order. It is hoped that membership will quickly grow, as a further 19 countries are within sight of the numerical target for accession (including Bahrain, Canada, El Salvador, the Czech Republic, Italy, Spain, Poland, Hungary, Switzerland, Thailand, and the UAE.) Given my firm belief in the economic superiority of the Anglo–American economic model, such an organization will have a disproportionate number of English-speaking members, certainly in the short- and medium-term. However, the numerical target methodology allows for self-selection, giving the whole project an inclusivity it would otherwise lack, while advancing our common desire to strengthen the ties that bind the English-speaking world together. The Global Free Trade Association's internal initiatives will include: freer movement of capital within the new grouping; establishing common accounting standards; setting uniform numerically-driven very low rates of subsidy, as well as diminishing overt and hidden tariffs.[12]

Initial enthusiasm for the idea from a number of smaller countries was dashed on the rock of the EU's sole competence in trade. If the UK regained trade competence, the idea would once again become viable.

In either of these institutional arrangements, the UK would have the advantage of not being the junior partner, and would carry weight according to the success or otherwise of its economy. In both cases it would have every incentive to remain friendly to free enterprise and to economic freedom. Sadly, such incentives do not exist as long as the UK remains dependent on Brussels for trade negotiations.

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[12] John Hulsman PhD, "The Global Free Trade Association: Preserving and Expanding the Special Relationship in the Twenty-first Century", Bruges Group, September 8 2004.

Annex A

A culture of freedom: the first casualty of the U.S.-EU trade deal

By Iain Murray and Alex McHugh 07/18/2013 In The Daily Caller

The proposed trade agreement between the United States and the European Union, the Transatlantic Trade and Investment Partnership (TTIP), is projected to create 100,000 jobs and $90 billion in economic growth. Unfortunately, as U.S. and EU representatives meet for the first round of negotiations this week, an old threat to those gains has reemerged, one that shows why this agreement is not being advertised as a “free” trade deal.

EU negotiators have come to the table with directives in hand that include a blatantly protectionist “cultural exception” for the audiovisual industries, especially film. American negotiators should push back against EU-sponsored exemptions like this by calling for trade liberalization without exceptions. Just as importantly, they should refrain from engaging in a tit-for-tat dispute, trying to get similar exemptions for U.S. industries.

On May 14, the French Culture Ministry issued a letter supporting the protection of audiovisual industries throughout Europe, which mentions a pro-exception petition by filmmakers that has gathered 5,000 signatures. Given this, the assertion from European Commissioner for Trade Karel de Gucht that the industry could always be brought back onto the table is questionable. French cinema will probably keep its protections.

Will it delay the treaty moving forward on time? Probably not, as policymakers are anxious to push this through as quickly as possible on the assumption that it will drag our economies upward. But this will open the door to other exceptions to the treaty that will blunt the gains from trade and create new layers of bureaucracy. It’s not worth it to put this together in record time if granting exceptions to all comers is the price of speed.

This isn’t the first time the “culture” sector was taken off the table in a trade deal. From discussions surrounding the General Agreement on Tariffs and Trade to regional treaties like the North American Free Trade Agreement, Mercosur, and some of the EU’s founding documents, audiovisual goods have been widely protected against foreign competition. Emotional, fact-free appeals to “cultural heritage” seem to trump sound economics every time.

To make matters worse, EU policies on culture allow member states to pay lip service to free trade while protecting markets back home. This sets a bad precedent and should be of concern for the final TTIP text. Here’s why.

EU media policies work at cross purposes, seeking to simultaneously promote “cultural diversity” while striving to create a single European market. Under existing EU agreements, member states may enact subsidies, broadcast quotas, investment caps, or a combination of these. French producers, for example, are protected by quotas and have access to $525 million in annual subsidies from Paris.

If the EU model dominates the upcoming TTIP talks, we could be looking at an expensive international subsidy program meant to offset internal subsidies.

Protectionist EU policies like these could weigh down the TTIP negotiations if they are not reformed. It's easy to see why the word "free" was scratched from the Transatlantic Trade and Investment Partnership's title. This kind of trade policy is anything but.

It is also worth remembering how broadly "culture" can be drawn. For example, part of the argument for the EU's disastrous Common Agricultural Policy is based on the idea of the cultural importance of French farming traditions. *On leur donne la main, ils prennent le bras.*

How the final deal addresses this and similar issues will determine how wide, or how limited, the benefits of the eventual treaty will be on both sides of the Atlantic. A Swiss-cheese deal full of exemptions by October is a much smaller achievement than a robust free trade agreement a year — or years — later.

Otherwise, European film actors may have some new competition after all — from the anti-protectionist play-acting that comes with policies like this.

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