The UK-Australia Free Trade Agreement (FTA)

Lead department	Department for International Trade
Summary of proposal	The UK and Australia have negotiated an FTA, which aims to enhance the UK and Australia's trade and investment relationship by removing tariffs as well as removing and reducing regulatory barriers in several sectors.
Submission type	Impact assessment (IA) – 22 October 2021
Implementation date	TBC
Policy stage	Final IA
RPC reference	RPC-DIT-5109(2)
Opinion type	Formal
Date of issue	16 December 2021

At the time of our review, sections of the agreement were still under negotiation and therefore, both the IA on which we commented, and our comments may not reflect the final agreed FTA.

The RPC's role in assessing the IA of an FTA is to consider the validity of the analysis underpinning the assessment and its presentation in the IA. The RPC's opinion does not consider the merits of the FTA or the negotiation process.

The RPC's fitness for purpose rating is based on the understanding that the Government should aim for the highest standards of evidence and should seek to present an objective analysis of that evidence to inform Parliament and the public of the impacts of the FTA.

RPC opinion

Rating[1]	RPC opinion
Fit for purpose	The IA is well-researched and provides a good assessment of the potential long run impacts of the negotiated UK-Australia FTA, utilising widely accepted standard global trade modelling and datasets to estimate the impacts.
	On initial review, the RPC raised concerns about the presentation of the results in the IA, which the RPC found disproportionately emphasised the beneficial impacts with very limited discussion of the risks and disadvantageous impacts of the FTA.
	The RPC now considers the IA to be fit for purpose, presenting a clearer, more-balanced assessment of the FTA's impacts and greater recognition of the uncertainties involved, after the Department's response to our initial review.

[1] Where the Department requests the RPC to review the impact assessment for an international free trade agreement (FTA), the RPC may issue a "fit for purpose" or "not fit for purpose" rating on the quality and robustness of the analysis and evidence presented in the FTA impact assessment. The RPC's rating in this opinion is based on a checklist developed in conjunction with and agreed by the Department for International Trade (DIT), the Better Regulation Executive (BRE) and the RPC.

This rating is different from the ratings which the RPC issues on Regulatory Impact Assessments (RIAs) prepared by government departments in accordance with Better Regulation Framework which relate to domestic policy changes. In its opinions on RIAs, the RPC rates the RIAs as "fit for purpose" or "not fit for purpose" based on the quality of the department's (i) analysis and estimate of the equivalent annual net direct cost to business (EANDCB) and (ii) its small and micro business assessment (SaMBA).
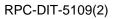
RPC summary

Category	Quality[*]	RPC comments
Rationale and options	Not applicable	Not applicable
Trade modelling and analysis	**Good**	The IA utilises standard global trade modelling, with the inputs, structural assumptions and limitations presented transparently. Some adjustments have been made to the dataset to update it for changes to tariff levels and trade policy changes. Following our initial review, the IA highlights that the baseline data does not account for several recent trends that could influence the impact of the FTA, as this goes beyond the scope of the model. Nevertheless, the IA would still be improved by including a discussion of current and future structural adjustments and changing trade patterns faced by the global and UK economies, on the reliability of impact projections.
Uncertainty, risks, and assumptions	**Satisfactory**	The IA qualitatively describes the different sources of uncertainty and risks. The sensitivity analysis utilises standard statistical practice to generate 90 per cent confidence intervals around some of the central estimates. However, the analysis does not take into account uncertainties about the global context, the behaviour of key parties in response to the FTA and consequently their respective implications for the implementation and outcomes of the FTA. The IA could be improved by including further scenario and sensitivity analysis to test these uncertainties and risks.
FTA impacts	**Satisfactory**	The IA provides a detailed assessment of the FTA's potential trade impacts on macroeconomic indicators, and breakdowns by sector, region and affected groups. Following our initial review, the impact projections are appropriately and consistently contextualised, and the IA makes clear that the central estimates illustrate approximate orders of magnitude and directions of change. The IA presents a more-balanced assessment of the FTA's impact, highlighting the limitations and interpretation of the model results. The IA also now includes alternative modelling approaches to

16/12/2021

		capture disadvantageous impacts on affected sectors. However, there is only a partial discussion of the costs and other impacts associated with enforcement, monitoring, and public sector post-implementation activities related to the FTA.
Wider impacts	**Good**	The IA extensively analyses the FTA's wider and distributional impacts, including impacts on competition, innovation, IP rights, digital, trade and gender equality as well as the environmental impacts. The IA considers the labour impacts for protected groups by assessing long run changes in sectoral employment. Further analyses of the impacts on small and medium sized enterprises (SME) should be considered.
Monitoring and evaluation	**Good**	The Department has committed to publish a monitoring report for the FTA every two years and a comprehensive evaluation within five years of its entry into force. However, given the long run impacts are estimated at 10-15 years from implementation, the Department should consider repeating the five-year evaluation or conduct a final evaluation once the full effects of the FTA have been realised.

[*] **Explanation of quality assessment**

- **Good -** Addresses the issue well. The analysis is sufficiently robust and addresses the issue properly. The analysis is based on good to high-quality, proportionate evidence and uses appropriate assumptions. It could be improved only in minor areas (if at all) and provides good support for decision-making on these aspects of the assessment.

- **Satisfactory** - Addresses the issue adequately. The analysis is considered satisfactory. The analysis is based on adequate, proportionate evidence and uses appropriate assumptions. Some improvements could be made, but it provides sufficient support for decision-making on these aspects of the assessment.

- **Weak** - Weak analysis of the issue. The analysis is not sufficiently robust to address the issue. Improvements are required in one or a number of areas. It provides inadequate support for decision-making on these aspects of the assessment.

- **Very weak -** Very weak analysis of the issue. The analysis is poor and has significant flaws. Significant improvements are required in one or a number of areas. It provides inadequate support decision-making on these aspects of the assessment.

16/12/2021

Response to initial review

As originally submitted, the IA was not fit for purpose as the results in the IA were presented in a way that disproportionately emphasised the beneficial impacts with very limited discussion of the risks, disadvantageous impacts, and potential mitigations. In addition, the IA did not adequately describe a range of significant risks and uncertainties associated with the impacts and did not contextualise the estimates sufficiently. The IA suggested a greater degree of certainty and accuracy to the projections than was supported by the underlying evidence and modelling.

The Department has addressed the presentation concerns raised by the RPC and the IA now presents a more balanced view of the FTA impacts as well as outlining the degree of uncertainty and the risks around the analytical results.

Summary of proposal and projected impacts

At present, UK firms trade under World Trade Organization (WTO) terms on most favoured nation (MFN) tariffs with Australia. The Government launched negotiations with Australia in June 2020. The FTA is the UK's first new trade deal negotiated since leaving the EU and aims to enhance the UK and Australia's trade and investment relationship by removing and reducing tariffs and non-tariff barriers in several sectors, and enhanced mobility opportunities. It is viewed as a stepping-stone to wider opportunities within the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) and strategically, greater involvement in the Indo-Pacific region. The UK is also negotiating to join the CPTPP, a free trade area of 11 Indo-Pacific nations, including Australia, covering £8.4 trillion in gross domestic product (GDP).

The IA includes central modelling estimates of the long-run consequences of the FTA, expressed as percentage changes relative to the 2014 baseline. The conversion to pound (£) values provides a basis for contextualising of the results in 2019 prices. The estimates are indicative of the direction and broad orders of magnitude of impacts relative to the baseline. These are:

- UK GDP is expected to increase by £2.3 billion. When applied to projections of UK GDP in 2035, this is equivalent to a 0.08 per cent increase over the baseline.
- UK trade with Australia could increase to £10.4 billion. When applied to projections of UK trade in 2035, this is equivalent to a 53 per cent increase over the baseline.
- UK exports to Australia could increase by £6.2 billion and UK imports from Australia could increase by £4.2 billion, when compared to projected levels of trade in 2035.
- Overall, total UK exports and imports are expected to increase £3.1 billion and £3.0 billion, respectively, when compared to projected levels of trade in 2035.
- UK real wages are estimated to increase by £900 million in the long run or 0.1 per cent compared to 2019.
- The overall structure of the economy remains broadly unchanged, with a marginal reallocation away from agriculture, forestry, and fishing and semi-processes foods in favour of manufacturing sectors, manufacture of motor vehicles and manufacture of machinery and equipment.

- On services, the largest contributions in absolute terms come from wholesale and retail services (+£341 million), public services (+£264 million), and business services (+£212 million).
- On goods, the largest contributions come from the UK's advanced manufacturers, with expansions in the manufacture of machinery (+£231 million) and motor vehicles (+£202 million). The largest contractions come from primary agriculture (-£94 million) and semi-processed foods (-£225 million).
- Regionally, the greatest proportional gains are expected in the West Midlands and the North East of England, equivalent to £195 million and £65 million each year, respectively. Wales, Scotland and Northern Ireland combined could see an increase in gross value added (GVA) of around £200 million.

Trade modelling and analysis

The RPC considers the trade modelling and analysis to be of good quality and the inputs, structural assumptions and limitations are discussed transparently.

Data and evidence

The IA is based on the standard Global Trade Analysis Project (GTAP) model and latest available GTAP 10A dataset, which draws on a global comparative trade dataset from 2014. Some adjustments have been made to the baseline data, to reflect changes to tariffs and trade policy since 2014, including UK's departure from the EU and updates to the UK and Australia tariff schedules. The analysis within the IA utilises official data sources to estimate projected impacts. To quantify impacts, the monetary figures provided in the IA are constructed by applying the long run changes to the relevant 2019 figures. This appears reasonable and acceptable in view of the complexities of trade system dynamics. The IA would be improved by including a discussion of current and future structural adjustments and changing trade patterns faced by the global and UK economies, on the reliability of impact projections.

Baseline

The IA assesses the FTA's impacts against a baseline where the UK and Australia do not have an FTA with each other, and trade based on MFN status. The IA acknowledges that both the UK and Australia's trading relationships have changed since the baseline, and that this influences the validity of the estimated impacts of the FTA included in the IA. The IA highlights the assumptions used in the baseline to represent the trade relationship between the UK and EU based on zero tariffs and average non-tariff measures (NTM) costs. The baseline also considers trade agreements that the UK and Australia have with other countries and excludes those that are not completed. The RPC agrees that this is an appropriate baseline.

Modelling

The impacts of the FTA are forecast using a Computable General Equilibrium (CGE) model, using standard global trade models and datasets. Improvements and changes to the Department's model techniques and (Armington) specification have allowed for modelling at a more disaggregated sector level (61 sectors) and ensures greater responsiveness of trade flows to reductions in trade costs. The model specifications, structural assumptions

and modelling inputs relating to tariff and NTMs are clearly defined and presented in the IA and technical annexes. The estimated long run impacts are typically assumed to occur over a period of around 10-15 years after implementation (to 2035) and the estimated changes are assumed to be additional to any long-term economic changes. The IA highlights the limitations of comparative static modelling and acknowledges; although CGE modelling is a standard approach to quantify the impacts of FTAs, it is an inherently uncertain exercise and does not capture the full range of dynamic impacts of the FTA. The RPC commends the Department for discussing the limitations and uncertainties, which following our initial review features more prominently in the presentation of the FTA impacts.

Analysis

The IA presents a broad assessment of the potential long run impacts of the FTA. The final IA updates the analysis undertaken in the scoping assessment, applying an updated modelling approach, and adjusting the inputs to better approximate the negotiated outcome. The RPC commends the Department for a well-researched assessment and coverage of the FTA's wider impacts.

Uncertainty, risks, and assumptions

The RPC acknowledges the improvements made to the IA's discussion of uncertainty and risks associated with the impacts of the FTA, which is rated as satisfactory.

Uncertainty and risks

Following our initial review, the IA provides a detailed and qualitative discussion of the degree of uncertainty and risks associated with the estimated projections in the IA. The IA has improved its statistical (Monte Carlo) simulation to capture uncertainty surrounding the key parameters and input assumptions in the model. This is used to generate a 90 per cent confidence interval of 0.06% to 0.10% increase in GDP, when compared to projected levels of GDP in 2035. The IA acknowledges that these results do not account for the dynamics of the FTA nor exogenous factors. The RPC believes this is important as such changes would result in differences in the CGE model outputs and/or actual outcomes. The analysis could be improved further by including scenario analysis to test for uncertainties such as structural shifts in the global context and capturing risks to the FTA's implementation (e.g. such as economic or geopolitical factors or the behaviour of key parties) and discuss the implications for the implementation and outcomes of the FTA.

Assumptions

The modelling and analytical assumptions are clearly set out in the IA and technical annexes. These include long run assumptions about full employment of labour and capital, perfect labour mobility between sectors in the same country, and countries are linked only via trade in goods and services, i.e. that there are no migration or international capital flows. The modelling assumptions appear standard and acceptable for CGE modelling and analysis. The assumption of perfect labour mobility could be improved by subjecting it to sensitivity and scenario analysis, especially for sectors disadvantageously affected by the FTA.

FTA impacts

The RPC recognises the improvements made in the presentation of results in the IA, providing a more balanced presentation of the FTA's impacts, which are rated as satisfactory.

International trade

The IA presents central estimates of the FTA impacts, setting out macroeconomic impacts and breakdowns by sector, region and affected groups. The IA, following our initial review, clearly states that the results provided are central point estimates used to indicate the direction of impacts and broad orders of magnitude.

The IA presents macroeconomic impacts in GDP terms and regional impacts by GVA. Although, both are appropriate measurements for the results, it would be helpful to the reader, if the Department could include an explanatory note of these measurements and make clear the difference between GDP and GVA when presenting the analytical results. The impacts are assessed and presented in the IA by region and sector, separately. The IA could benefit from analysing these impacts together, especially when the IA refers to levelling up because only considering these impacts individually could obscure adverse impacts on regional economies.

Given the importance of the business services and financial services sectors for the UK, the analysis in the IA should consider in more detail the FTA impacts on capital flows, potential risks or threats to investment and the cost of capital.

Tariff/NTMs

The IA states that the FTA secures tariff-free trade for all UK exports to Australia and that 98 per cent of estimated tariff reductions will be available as soon as the agreement enters into force. The IA describes how the FTA will substantially reduce tariffs imposed on imports from Australia to the UK, while retaining safeguards for certain products. The technical annex goes further to set out the method and limitations for assessing impacts and estimating the value of tariff reductions. However, tariff changes are not independent of each other, and the IA should consider the effects and costs of the protections and safeguards being proposed on certain products and analyse the structure, conduct and performance of firms in these sectors.

Trade flows

The IA notes the commitment to international development as a key chapter in the FTA, and assesses the possible trade diversion from developing countries, which rely on preferential access to the UK market for their exports. The IA provides a quantitative assessment of the scale of current trade with African, Caribbean and Pacific countries and concludes that these impacts are not substantial as the extent to which trade diversion occurs, notably in the sugar industry, depends on several external factors. The impacts could be further analysed by applying sensitivity analysis and introducing additional analysis on the displacement effect on trade with other countries.

Economy and productivity

The FTA is estimated to increase UK GDP by £2.3 billion a year, equivalent to 0.08% when applied to the Office for Budget Responsibility's projection of GDP in 2035 (around 10-15 years from the implementation of the FTA). The IA assesses 20 out of the 23 aggregated sectors will experience higher growth as they take advantage of the FTA provisions. The overall structure of the economy remains broadly unchanged, with a marginal reallocation away from agriculture, forestry, and fishing and semi-processes foods in favour of manufacturing sectors – manufacture of motor vehicles and manufacture of machinery and equipment. The RPC is pleased to see the sector breakdowns clearly presented in the main IA document.

Agri-food sectors

The primary, agriculture and semi-processed food sectors are expected to be disadvantageously affected by the FTA. The IA sets out the safeguards to protect sensitive sectors, noting the threat of competition given Australia's strong comparative advantage. The safeguards include staging tariff reductions and using transitional Tariff Rate Quotas (TRQs), over several years. The analysis suggests a marginal decrease to the share of UK GVA of 0.01 percentage points for the agri-food industry in the long run, although the IA acknowledges that these results do not take into account the impacts of the staging of tariff reductions.

On initial review, the RPC commented on the lack of analysis on disadvantaged sectors and lack of discussion on possible short run effects. The IA now includes an alternative approach using partial equilibrium (PE) modelling to analyse the impacts on the beef and sheep meat sectors. Although the findings are not directly comparable to the CGE results and subject to different model limitations, the IA includes the PE results that forecast reductions in gross output for beef and sheep meat of around 5 and 3 per cent, respectively. This provides a much better sense of disruption in the sector but would benefit from clarifying whether the impact is based on total trade value or volume, and whether these estimates consider the reliance of the UK's import propensity in these markets. The protections for the sector seem primarily to involve tariffs and quotas and this may not be enough to protect the UK agri-food industry. Also, the timing of protections and the impact of the TRQs on output and sector damage is unclear. The IA could have been improved by including qualitative case study or stakeholder insight to better understand the effects on businesses.

Food standards and animal welfare

The FTA includes a non-regression clause on animal welfare which ensures that the UK and Australia continue to uphold high standards with respect to food standards and animal welfare and prevents Australia from lowering its standards in order to encourage trade. The focus on bilateral standards for UK-Australia trade does not consider the effects these measures could have on the world playing field for UK agricultural products. The IA should consider how current standards will be upheld or enforced and the requirements for labelling. The analysis would benefit from discussing these issues or make use of sensitivity analysis to analyse the impact of standards on price and demand.

Businesses

The IA presents data suggesting around 5,600 UK businesses imported goods from Australia, while around 15,400 UK businesses exported goods to Australia in 2019. It also provides a qualitative discussion on the prospects of enhanced mobility for businesses and early career professionals, suggesting this should facilitate cross-border trade with greater ease.

The IA explores the voluntary costs for businesses choosing to utilise the FTA provisions and estimates potential one-off familiarisation costs to businesses from reading and understanding the FTA to be £11.8 million, ranging from £11.4 million to £12.2 million. This reflects the number of current UK businesses that trade with Australia and the use of agents for tax affairs for 60 per cent of businesses, reflecting a 2015 HMRC report. The IA uses tariff equivalent trade costs to estimate potential on-going administrative costs to businesses. The IA's central estimate of these costs are £69.1 million per annum, within a range of £46.4 million to £91.7 million. The IA should clarify whether voluntary and civil society organisations are included as part of the business analysis and highlight where impacts are likely to differ in nature or scale from those experienced by businesses.

Consumers

The IA applies economic theory to consider how the FTA provisions will benefit UK consumers through increased consumer choice (due to an increased list of tariff free consumer goods), better quality products, and lower prices for imported goods. The IA notes that the extent to which businesses or consumers in the UK will benefit from reduction in tariffs will depend on the rate at which lower costs are "passed through" from importing businesses to consumers. It also highlights specific commitments to tackling digital barriers to trade with respect to consumer protection and safeguards for businesses and individuals, for example, entering into legally binding contracts electronically. These arguments appear to be well grounded by evidence and theory.

Public sector

Whilst noting the implementation of the FTA may require legislative changes, the IA does not consider the enforcement or implementation costs and other impacts on the public sector. The IA should include a section to identify and analyse these impacts.

Wider impacts

The RPC considers the coverage and analysis of wider impacts of the FTA to be of good quality.

Competition and innovation

The IA applies economic theory and provides a qualitative assessment of the competition and innovation impacts. The IA notes that UK businesses may experience greater competition as a result of Australian imports. The IA considers the possible reallocation of resources within sectors and points to evidence to suggest that competition may spur innovation and growth, acknowledging some businesses (and the employment they generate) may expand, but some businesses may be adversely affected by the increased competition.

16/12/2021

The IA gives prominence to procurement commitments, which offer UK businesses more access to government procurement contracts in Australia, worth an estimated £10 billion. The IA also highlights ambitious IP rights that may encourage creativity and innovation but does not quantify these impacts.

Environment

The IA considers the FTA's environmental impacts and describes its implications for the UK environment, including greenhouse gas (GHG) emissions (CO_2 and non-CO_2), energy usage, trade-related transport emissions and wider environmental impacts on areas such as air quality, biodiversity and water use/quality. Whilst outlining the limitations of the analysis, the IA provides an indicative assessment that overall GHG emissions for the UK will be largely unchanged due to an offset between the scale and composition effects on economic activity. However, the IA could state the sectors for which the increases in GHG emissions are most likely or prominent. The IA anticipates some increase in transport-related emissions of 0.1 to 0.3 $MtCO_2e$ each year between 2020 and 2035.

In addition, the IA provides some analysis on Australian production emissions, which it expects to increase by 0.01% or 0.9 $MtCO_2e$ when compared to 2014 levels. Whilst the IA notes this increase occurs as a result of a net shift to more emission-intensive sectors or the composition effect, the IA should clarify whether or not this increase is simply a transfer of emissions from the UK to Australia.

Distributional/equality impacts

The IA considers a range of distributional impacts, by sector, region and affected groups. The sensitivity analysis also tests the role of local spending multipliers, which indicate a possible loss in GVA in Northern Ireland, given the concentration of the semi-processed food sector in the region. The IA would benefit from clarifying how the semi-processed sector is defined and which standard industrial classification (SIC) codes are covered.

The IA includes a separate section considering trade and gender equality. The IA analyses the labour impacts for protected groups by assessing the long run changes in sectoral employment to understand whom the FTA may disproportionately affect. It highlights an overrepresentation of women and underrepresentation of young people in the sectors where it is anticipated that the FTA will lead to a reduced share in overall employment when compared to national averages. Although the IA sets out several limitations to this analysis, it should extend its analysis of labour impacts to cover regional employment.

Small and medium sized enterprises (SMEs)

The IA considers the impact on SMEs, noting that the FTA's provisions aimed at improving trade facilitation could positively impact their propensity to export. Further, it notes that a large proportion of these firms are located within sectors expected to grow as a result of the FTA whereas the SME population in adversely affected sectors like agriculture, fishing and semi-processed foods represent a small proportion of total SMEs. However, the IA could provide further analysis on the importance of SMEs including relevant market shares within sectors and the consequent impacts, clearly addressing any negative impacts or risks to SMEs.

Monitoring and evaluation

The RPC considers the monitoring an evaluation (M&E) proposal to be of good quality.

The Department has committed to publishing a monitoring report for the FTA every two years that will cover the evolution of trade flows between the countries and those flows attributed to the FTA, the utilisation of the FTA and the work of committees established under the FTA.

The Department has also committed to conducting a comprehensive evaluation within five years of its entry into force. The evaluation report will synthesise findings from monitoring, evaluation, and stakeholder engagement activities to assess the realised impacts of the FTA, with further in-depth analysis in selected sectors, and answer the Department's core evaluation research questions. The IA highlights a mixed methods analytical approach using quantitative and qualitative research methods and techniques to evaluate the proposal.

The RPC welcomes the Department's M&E commitment and considers it critical to understanding the FTA's true long-term effects, including any unintended consequences, filling in any gaps in the evidence with respect to the uncertainties noted in the IA, and to shaping the design of future trade policies and agreements. However, as the IA has estimated the long run impacts by comparing outcomes with and without the FTA after 10-15 years, the Department should repeat the five-year evaluation review or ensure an evaluation is conducted once the full effects of the FTA have been realised.

Regulatory Policy Committee

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16/12/2021