Regulatory Policy Committee

Comprehensive Economic and Trade Agreement (CETA) between the European Union and Canada

Department for International Trade

RPC rating: **fit for purpose**

The IA is now fit for purpose as a result of the Department's response to the RPC's initial review. As first submitted, the IA was not fit for purpose.

Description of proposal

CETA has been provisionally implemented in the UK since 21 September 2017. Its intended effects are to eliminate most tariffs and reduce non-tariff barriers (for example, product standards and customs procedures) for businesses trading and investing between the EU and Canada. As a result, the Department expects that CETA will enable UK firms to export and import at a lower cost and give UK businesses more opportunities to bid for public procurement contracts in Canada. It also expects that CETA will increase the welfare of UK households by lowering the price of goods and services and by increasing consumer choice.

The provisional agreement brought the majority of the agreement into operation. All EU Member States must ratify the agreement for the all aspects of the measure to be implemented. The UK Government proposes to ratify CETA in order to maintain and fully realise the benefits of the agreement.

Impacts of proposal

The assessment estimates impacts using a study commissioned by DIT and conducted by Ciuriak Consulting. The study applies a Computable General Equilibrium (CGE) model that shows the impact of the trade agreement across the UK economy. Evidence from a paper produced by the European Commission on the economic impact of CETA on the EU is also used to assess qualitatively and quantitatively a range of measures included in CETA.

Direct Benefits to UK Businesses

CETA will reduce regulatory barriers to trade in services, resulting in a direct benefit to UK businesses. The assessment also claims this would benefit consumers through lower prices and greater choice in the long run. A combined measure of the OECD's Services Trade Restrictiveness Index, the GATS Trade Restrictiveness Index and analysis of the Ciuriak (2018) paper is used to estimate reductions in service regulation barriers.

Indirect Benefits to UK Businesses

CETA is expected to increase UK GDP by between £485 million and £730 million per year in the long run. The increase in GDP is associated with:

- net increases in exports from the UK to Canada by £530-680 million per year;
- net increases in imports to the UK from Canada by £1.1 billion per year;
- net increases in UK production of goods and services by £900 million per year;
- savings to UK exporters of £64-90 million per year from reduced tariffs; and
- increases in opportunities for UK firms to compete for Canadian Government procurement projects worth £65-80 million per year (estimated by the European Commission).

CETA is also expected to result in efficiency savings from reductions in non-tariff barriers (for example, the mutual recognition of conformity assessment bodies) and eventually to increase UK business productivity by increasing competition.

Direct Costs to UK Businesses

The assessment states that there will be a one-off cost from reading and understanding the agreement. Approximately 11,300 UK businesses export to Canada and 8,400 UK businesses import from Canada, according to the Inter-Departmental Business Register overseas trade statistics.

The assessment also details two on-going business costs resulting from CETA: custom declarations; and rules of origin certification. It is stated that firms already trading with Canada would not incur additional custom declarations costs. Estimates of the number of firms that will begin trading with Canada due to the introduction of CETA are not available. However, a qualitative assessment using information from a 2015 HMRC survey shows that 68% of businesses undertook custom declarations obligations in-house, while 19% of businesses used specialists that charged approximately £41 per declaration. This allows a rough calibration of the cost impacts of increased numbers of exporters (assuming that the survey population is representative of new exporters to Canada following full CETA implementation).

Businesses are required to produce a certificate to trade under CETA preferences that confirms that the export content meets rules of origin requirements. Businesses can submit these forms to HMRC to process for free or submit them to the British Chambers of Commerce for processing for a fee of £46.80.

Indirect Costs to UK Businesses

UK domestic production is expected to increase by up to £1 billion per year. However, some sectors could experience a decline of approximately £130 million per year due to reallocation across sectors and realisation of comparative advantage. These adverse impacts are likely to be concentrated in sectors in which the UK imports more from Canada.

CETA is expected to increase the ability of Canadian businesses to bid for UK public contracts and *vice versa*. This increased competition may lead to better value for money for UK public procurement, however, this may be partially offset by some UK businesses losing out on public contracts to Canadian competitors.

Wider Impacts

Consumer welfare is estimated to increase between £330-400 million per year due to: UK businesses passing along lower import prices to consumers; and increased real wages resulting from higher UK productivity. UK consumers are also expected to benefit from a greater choice of goods and services from Canada.

CETA is also expected to have impacts on the UK Exchequer. These include a potential reduction in revenue from lower tariffs on imports from Canada, estimated at £90 million per year, partially offset by increased domestic economic activity, which would in turn increase revenue for the UK Exchequer. There are also expected to be one-off costs to customs and government bodies from reading the text of the agreement.

The assessment references The European Commission Sustainability IA (2011), which highlights possible environmental impacts of CETA. For example, the agreement could lead to increased agricultural production, which could in turn lead to a greater use of chemical inputs. However, negative impacts could be mitigated due to lower emissions and chemical inputs if production increases in crops are achieved using more sustainable practices. The study also argues that the environmental impact associated with energy and extractive industries is likely to be limited, and the growth of trade could lead to a replacement of land transport by maritime transport, which has a lower environmental impact.

SaMBA

The assessment estimates that 60-70% of UK businesses that trade with Canada are small and micro businesses. These firms will have the incentive to export to Canada if the reduction in tariff and other barriers outweighs the cost of complying with rules of origin requirements and declarations. To reduce disproportionate burdens affecting smaller businesses, only shipments over the value of €6,000 will require a Rules of Origin certificate. Small businesses would still be expected to comply with rules of origin requirements, however it is likely that this cost will be mitigated because businesses can still trade under existing Most-Favoured Nation terms if the regulatory cost of complying with CETA outweigh the increase in business revenue from greater exports under the CETA preferences.

The assessment states that some less-competitive small UK businesses may be adversely affected by greater competition, but expects the net impact to be positive on the grounds of lower import costs as a result of the mutual recognition of conformity assessment bodies will outweigh lost sales.

Quality of submission

Issues addressed following RPC's initial review

The Department has adequately addressed all of the red-rated points and the majority of 'areas for improvement' that were suggested by the RPC. The red-rated points are discussed in more detail below.

The Department was asked to demonstrate that the costs to business from removing provisional elements of CETA, if the UK did not ratify the agreement, were likely to be small. The assessment now provides a clear justification both of why it has not been able to estimate the size of these losses in detail and of why they are expected to be small, explaining that:

- it is too soon to gather evidence on the current provisional application due to time lags in trade data;
- they do not know to what degree the UK and Canada have implemented non-tariff measures; and
- losses are estimated to be small due to the expected time lag in investing in activities such as relabelling or retooling, meaning that there are as yet few sunk costs.

The assessment would benefit from providing details of how empirical evidence is planned to be gathered following the ratification of CETA.

Other comments

The Department has provided a detailed economic background to the agreement, which includes descriptions and quantitative assessments of: the current levels of trade between the UK and Canada, broken down by sector and product; tariffs that currently exist between the EU28 and Canada by sector; the strategic background to CETA; and a clear rationale for intervention.

The assessment quantifies the various impacts of CETA where possible using the Ciuriak (2018) model and European Commission paper. Some impacts have not been monetised individually, for example, efficiency savings from a reduction in non-tariff measures and increases in UK business productivity by increasing competition. However, the assessment explains that these impacts have been included in the final NPV figure as they are captured in the impact of CETA on UK GDP. The Department has chosen not to present an EANDCB figure, as the measure is outside the scope of the Business Impact Target, but has discussed the impacts of the measure on businesses in some detail.

The Department has been unable to provide a clear breakdown of the different figures that were combined to calculate the total NPV, due to the complex nature of CGE modelling. However, a description of how CETA is expected to affect particular aspects of the UK economy has been helpfully provided, covering e.g. increases in exports from the UK to Canada, increases in imports from Canada to the UK, increases in UK production of goods and services, UK business savings from reduced tariffs, and increases in opportunities for UK firms to compete for Canadian Government procurement projects. These quantified elements could be used to monitor the impacts of CETA.

The Department has also considered a range of wider impacts and clearly explained how they expect any negative impacts of CETA to be mitigated, or why the impacts are likely to be small. Wider impacts considered include the environment, UK consumers, and the UK Exchequer. The assessment would have benefitted from providing evidence comparing the relative merits of different shipping modes when considering the environmental impact of CETA.

Consideration is also given to the impact of CETA on small and micro businesses; the agreement exempts businesses from completing Rules of Origin certificates on shipments worth up to €6,000. The assessment acknowledges that smaller businesses may be adversely affected by greater competition and provides an explanation of why the net impact of CETA on small and micro businesses is likely to be positive. The assessment would have benefitted from further evidence in support of this net positive impact.

It would have been beneficial for the assessment to provide more clarity as to the nature and impacts of CETA's regulatory coordination and reduction provisions. The assessment could also have provided more of a discussion of the impacts associated with increased trade flows involving existing traders.

Following the UK's exit from the EU, and therefore from CETA, the RPC expects the Department to submit a further impact assessment appraising the final trade agreement that is negotiated between the UK and Canada.

Departmental assessment

Classification	Not a regulatory provision
Societal net present value	£7,800 million

RPC assessment

Classification	Not a regulatory provision
Small and micro business assessment	Sufficient

Anthony Browne, Chairman