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Regulatory Policy Committee

EU-Singapore Free Trade Agreement (FTA)

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

The EU-Singapore FTA (EUSFTA) intends to eliminate existing tariffs and reduce non-tariff barriers (NTBs) that businesses face in the trade of goods and services. The Department expects EUSFTA to reduce the costs to UK firms of importing to and exporting from Singapore. It also expects EUSFTA to increase the welfare of UK households by increasing consumer choice and lowering the price of goods and services. The agreement sets out provisions for intellectual property, sustainable development, sanitary and phytosanitary standards and opportunities for UK businesses to bid for public procurement contracts in Singapore.

The agreement has already been negotiated by the EU and Singapore. The UK and other EU Member States must vote on whether to authorise signature and conclusion of the agreement. The preferred policy option is for the UK to vote in favour of the agreement. If the UK does not support a council decision on signature and conclusion of the agreement it is possible that the council will use qualified majority voting. Under qualified majority voting, if a qualified majority of Member States favoured proceeding to signature then the EUSFTA would still come into force and the impacts would likely be similar to those outlined in the preferred option. The UK Government aims to make it possible for the UK to continue trading with Singapore on terms equivalent to the EUSFTA after the UK's exit from the EU.

Impacts of proposal

The assessment estimates the impacts of EUSFTA by using a 2013 European Commission (EC) study entitled 'The economic impact of the EU-Singapore Free Trade Agreement'. This study applies a computable general equilibrium (CGE) model that shows the impact of the trade agreement across the EU economy. Models of this type simulate the response of macroeconomic variables such as income, production and prices to changes in trade policy taking cross-market spillovers into account. The EC quantifies the direct economic effects of EUSFTA by simulating a bilateral removal of all tariffs on goods and a symmetric reduction of non-tariff barriers on trade in services, modelled as a 3% tariff equivalent reduction in costs.

EUFTA is expected to increase UK GDP by £95 million per year in the long-run compared to a baseline in which the agreement is not in force. The majority of the gains come from the removal of *regulatory* non-tariff barriers in services. The time path used by the Department for the realisation of GDP gains ranges from 68% (£65 million per year) in year one to 97% (£92 million per year) in year seven. The full gains in UK GDP (£95 million per year) are realised in year eight and each year after.

The EC's study estimates the increase in EU GDP as €550 million in 2025 (£450 million in 2017 prices) compared to the baseline. The increase in UK GDP is then calculated by using the UK share (21.3%) of total EU-Singapore trade in 2007. The UK's share (21.3%) is of total trade between the EU and Singapore in 2007.

Benefits to UK Businesses

EUSFTA, by reducing tariff and non-tariff barriers, is expected to benefit UK businesses by increasing the competitiveness of UK goods and services in Singapore and reducing the cost of intermediate products purchased from Singapore. The assessment estimates that UK businesses could save up to £34 million per year from the elimination of tariffs but does not attempt to estimate the proportion passed on to consumers in the form of lower prices. The impact of a reduction in tariffs is included in the Commission's CGE model, and is to this extent reflected in the NPV calculations discussed above.

UK businesses currently trading with Singapore will experience a direct benefit from a reduction in regulatory barriers in Singapore's service market. This reduction directly reduces costs and increases market access for approximately 5900 UK service firms. This impact, modelled as a 3% tariff equivalent reduction in costs, was monetised and is included implicitly within the estimated gains in GDP.

Some non-tariff barriers to trade in goods will also be reduced e.g. for electronics, pharmaceuticals and motor vehicles and parts. The benefits for UK businesses of a reduction in non-tariff measures on goods is not monetised.

EUSFTA will also increase access to Singaporean markets for UK firms that do not currently trade with Singapore in a number of business sectors. The assessment lists the mechanisms through which market access will be improved, including:

- relaxation of licensing requirements for UK financial institutions operating in Singapore;
- giving UK insurance firms the right to offer services online;
- relaxing restrictions on UK legal services operating in Singapore;
- allowing UK healthcare services to operate residential, palliative and specialised care for the elderly in Singapore;
- enabling UK education institutions to explore partnerships with Singaporean pre-school operators; and
- increased access for UK firms to bid on Singapore government procurement contracts (this change would nearly double government procurement opportunities compared to current arrangements under World Trade Organisation (WTO) rules.

The benefits of these forms of greater market access were not included in the EC's CGE model.

From the EC analysis, reductions in tariffs and NTBs are estimated to increase net exports from the UK to Singapore by £296 million in the long run. The sector that is expected to gain the most from the agreement is commercial services, which includes finance, insurance, business, real estate and construction. EUSFTA is expected to increase net imports to the UK from Singapore by £607 million in the long run. The increase in GDP estimated follows a clear time path with the full gains realised in year eight onwards, however, the assessment does not mention when the gains in imports and exports are expected to be realised. The EC's study also does not provide a sectoral breakdown for imports from Singapore.

The agreement is also expected to increase UK business productivity by increasing competition and stimulating comparative advantage and efficiency increases.

Costs to UK Businesses

The assessment states that there will be a one-off cost from reading and understanding the agreement. In 2016, 10,120 VAT registered businesses exported to Singapore and 3,457 VAT registered businesses imported from Singapore. The assessment uses 13,591 as an upper bound for the number of businesses exporting or importing from Singapore. It is recognised however, that this figure double counts firms that both export to and import from Singapore. The assessment assumes that 40% of firms will read the agreement themselves while 60% will employ the services of a specialist agent. Using average reading times, assumptions about the personnel involved in familiarisation and published ONS labour market statistics on wage rates, the assessment estimates that the one-off cost to UK businesses of reading and understanding the agreement will lie between £2.68 million and £2.83 million. This cost to business will be incurred during the first three years following ratification.

Businesses will also be required to produce a certificate to trade under EUSFTA preferences, which confirms that export contents meet 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. The assessment also mentions – but does not monetise - other possible one-off costs such as IT set-up and custom declarations.

EUSFTA is expected to increase competition through greater trade liberalisation. The Department notes that this may cause a decline in production for UK firms that are less competitive. Although the overall impact of EUSFTA is expected to be positive the Department concedes that the impact may be negative in some sectors. The Department also state that increased competition from Singaporean firms could lead to less efficient UK firms exiting the market.

Wider Impacts

Consumer welfare is expected to increase in the long run through: lower prices of imported final goods and services; lower prices for final goods and services produced with imported inputs; and (potentially) wider choice among goods and services. UK businesses will benefit from the ability to import intermediate goods and services at lower cost; this may increase of decrease profits, but should increase producer surplus. The assessment also claims that in the long run there could be an increase in real wages, if greater competition leads to productivity gains. These welfare impacts are not directly monetised in the assessment but are to some extent implicitly included in the estimated GDP gains.

Part of the justification for not seeking greater quantification is that some of the impacts are ambiguous; the assessment acknowledges that trade liberalisation as achieved with EUSFTA could reduce choice and/or increase prices for UK consumers. For example, multinational firms with large economies of scale may drive higher cost domestic firms out of the market. The remaining firms could exploit their market power to raise prices or even collude.

The agreement is also expected to affect the UK Exchequer by potentially reducing tariff revenues from imports from Singapore, estimated at £34 million per year. This may partially be offset by increased tax revenues from increased domestic economic activity and profit. The Department argues that both lost Government tariff revenues and increased Government tax revenues are transfers among the Exchequer, consumers and businesses.

SaMBA

The Department estimates that 1,810 small and micro UK businesses import from Singapore and 6,457 small and micro UK businesses export to Singapore. Small and micro businesses account for 52% of the total number of UK firms importing from Singapore and 63% of the firms exporting to Singapore. However, these businesses account for only 14% of total trade value with Singapore. These firms will wish to export to Singapore under EUSFTA preferences if the reductions in tariff and other barriers outweigh the cost of complying with rules of origin requirements and declarations, taking into account trade volumes. Businesses can still trade under existing Most-Favoured Nation terms if the cost of complying with the agreement outweighs the increase in business revenue from greater exports under EUSFTA preferences.

The Department concedes that smaller firms may not have the capacity or capability to understand and comply with rules of origin requirements, which could lead to disproportionate burdens. However, it states that many small and micro businesses will benefit from the proposals through increased revenue from greater market access, lower prices on intermediate goods and services and a mutual recognition of certain standards leading to a less burdensome and easier to understand regulatory environment.

Quality of submission

Issues addressed following RPC's initial review

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

The Department was asked to demonstrate the impact of developments in other trade agreements, particularly the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) and Transatlantic Trade and Investment Partnership (TTIP), on the UK-Singapore trade baseline. The assessment now provides a clear explanation of why the impact of these trade deals on UK-Singapore trade is likely to be small.

- Singapore only imposes tariffs on 6 of the 9,558 Harmonised Standards product categories at present; this will fall to zero once EUSFTA comes into force. Given this, the Department claims that CPTPP will only marginally erode the relative degree of tariff preference accorded to the UK.
- The Department notes that Singapore already trades under some form of FTA with 7 of the 10 members of CPTPP and that 96% of Singapore's total trade in goods with CPTPP members already occurs under an FTA. For this reason, the likelihood of trade diversion away from the UK is small. The Department further considers the 3 CPTPP members with whom Singapore does not trade under an FTA: Mexico, Canada and Chile. It notes that the UK does not compete with Chile in the goods imported to Singapore and that the four Singaporean imports in which the UK competes with Canada and Mexico account for only 1.2% of Singapore's total imports.
- The assessment claims that negotiations are unlikely to weaken the position of the UK as a service provider to Singapore. The Department states that Canada is the only high-income country in CPTPP with which Singapore does not currently trade under an FTA. Taking into account the fact that Canada only accounts for 0.4% of Singapore's service imports, and the UK's strong competitive advantage in financial and insurance services it is unlikely that Singapore would substitute UK services for Canadian services under CPTPP.
- Although arguing that the effect of alternative trade partnerships and agreements will be small, the Department does concede the possibility of some level of trade diversion depending on the outcome of the agreements.

The Department was asked to justify why the 3% tariff equivalent reduction in costs found when analysing the Doha Development Agenda applies specifically to the EUSFTA or alternatively to conduct sensitivity analyses. The assessment has, through communications with the authors of the EC study, justified the use of this estimate in the analysis of the EUSFTA.

- The authors of the EC study argue that using a 3% tariff equivalent reduction in costs is applicable to the EUSFTA based on the best available expert judgement.
- The assessment also notes that the 3% tariff equivalent reduction in costs falls within the range estimated in the Department's assessment of the EU-Japan Economic Partnership Agreement (EPA) (0.9% to 19.2%) and the EU-

Canada Comprehensive and Economic Trade Agreement (CETA) (0.1% to 5.7%).
- The 3% tariff equivalent reduction in costs was originally used in a study by Yvan and Lionel (2011) entitled 'Economic Impact of Potential Outcome of the Doha Development Agenda (DDA) II', which argued that DDA would have limited impact on trade in services and that 3% was a conservative estimate. The RPC has seen correspondence with the authors of the EC's study who similarly consider 3% to be a lower bound estimate of the impact of EUSFTA.

Although the RPC believes the Departments justification for using a 3% tariff equivalent reduction in costs is sufficient, the assessment would have benefitted from the Department conducting sensitivity analysis. It is not clear that a 3% tariff equivalent reduction in costs accurately captures the UK specific impacts but the RPC believes that the approach taken by the department is, in this case, proportionate.

It was unclear whether the estimates of gains in GDP given in the EC study should be interpreted as net annual gains reached in year 8 (as the Department assumed) or total absolute gains realised over the 15-year period. The Department was asked to explain why the method they had used to calculate the total net present value was an accurate interpretation of the EC's estimates or to update the assessment to reflect the gains as absolute. The Department has explained that the use of the term 'absolute' (in both the Commission study and this assessment) refers to GDP as being measured in volume terms as opposed to relative terms. It has presented correspondence with the study's authors confirming this. It also states that the calculation of total net present value presented within the IA is consistent with the normal presentation of estimates attained through CGE modelling.

The EU Commission's study uses a 2007 baseline when estimating the gains in GDP resulting from EUSFTA. As the level of trade between the EU and Singapore has increased since then, and the UK's share of this trade has decreased, the Department was asked to explain implications for the estimates. The assessment now clarifies that a 2017 baseline in the European Commission's study would likely have led to larger estimated gains in EU GDP. However, the falling UK share of total EU-Singapore trade means that using a 2017 baseline would likely yield similar estimates. The Department used the UK's share of total EU-Singapore trade from 2007 to maintain consistency with the European Commission's 2013 assessment of the economic impacts of the FTA, which used 2007 as its baseline year. The RPC believes that the approach is proportionate in this case but in the future would expect the Department to provide clear justification for why the change in UK share of total EU-third country trade since the chosen baseline would not significantly impact the estimates and why sectoral differences are not taken into account. In this case, such changes relating to trade between the UK and Singapore include: the increased balance of trade in goods; the declining service trade balance since 2008; and the continued growth in the overall balance of bilateral trade.

The Department was asked to provide a discussion of ways in which trade liberalisation could lead to less choice for consumers. The assessment now notes that small domestic firms may, through increased competition, exit the domestic market leading to less choice for consumers and possibly increased prices.

It was suggested that the Department provide a discussion of how UK businesses could benefit from trade liberalisation through greater choice, higher quality and/or lower prices for intermediate goods and services. The assessment now includes this in its analysis of direct benefits to business.

Other comments

The Department has provided a detailed economic background to the FTA, and clearly explains the problem under consideration and rationale for the intervention. The assessment takes a proportionate approach to addressing the RPC's concerns and has striven to provide a balanced analysis of the impacts. The Department has also contacted the authors of the EC study for clarification of issues including the use of a 3% tariff equivalent reduction in costs and interpretation of the study's estimates.

The assessment should provide a more balanced analysis on the effects of competition resulting from trade liberalisation. For example, the Department states that UK firms will benefit from being able to bid for Singapore public procurement contracts but does not mention the increased competition for UK public procurement contracts resulting from EUSFTA. The Department outlines the impacts of greater market access between the UK and Singapore but does not mention the impacts on the UK of greater market access between the EU and Singapore. The assessment should provide a discussion of how EUSFTA could lead to Singapore competing with the UK for EU business. In the RPC's initial review notice, the Departments was asked to consider possible costs to the UK of greater market access such as skilled labour migration and/or greater competition for EU public procurement contracts. The Department did not include a discussion of these costs. The assessment would have benefited from providing a more balanced perspective on the costs and benefits of greater market access.

The assessment acknowledges that UK businesses may become less price competitive and experience a fall in domestic production. The Department should provide analysis of which sectors would be most affected by increased competition. It would have also been beneficial had the Department acknowledged possible increases in UK unemployment (especially for certain skills) as a result of increased competition faced by UK firms. The Department expects imports from Singapore to increase by £607 million in the long-run. Given the size of the potential increase in imports the assessment would have benefitted from a more detailed analysis of how this could impact UK firms. Further justification of the expected net positive impact of the agreement on small and micro businesses would also have improved the assessment, as would consideration of the impact on small and micro businesses at a sectoral level.

The Department argues that the FTA has a positive impact on UK GDP despite the fact that increases in UK imports (£607 million in the long run) are expected to be greater than increases in UK exports (£296 million in the long run). It does not provide a clear explanation of its reasons for believing this to be the case within the IA, but has provided relevant evidence in subsequent correspondence. It should add this evidence as soon as possible, and in any case before publication of any IA in support of subsequent implementing regulations.

The assessment also claims that in the long run there could be an increase in real wages through an increase in UK productivity. However, in a competitive market, it is likely that the gains of increases in productivity would be captured by consumers instead of workers. Furthermore, taking account of possible falls in UK employment through increased competition with Singapore it is unclear how EUSFTA will impact UK real wages.

The Department’s discussion of wider impacts should have considered the environmental consequences of EUSFTA. The agreement is predicted to increase economic activity by making it easier for the UK to trade with Singapore. Increased production in both the UK and Singapore and increased shipping could have adverse effects on air and water quality.

The assessment claims a benefit from the UK and Singapore aligning themselves to the same international standards, but this will depend on the standards and the nature of the alignment. There is likely to be a saving compared to a scenario where firms produce products to two different sets of standards, but more aligned UK-Singapore standards may diverge from those in place in other countries, which could offset efficiency gains. In addition, savings from the predictability of the regulatory environment may be offset by 'least-common-denominator' standards that impose costs on countries whose standards are changed from what was considered an optimal position. Finally, this alignment may reduce the variety of specific standards reflecting different national, market and technological circumstances.

The assessment would have benefitted from a clearer discussion of these points.

The Department has chosen not to present an equivalent annual net direct cost to business, as the agreement is outside the scope of the Business Impact Target, but it has discussed the impacts of the agreement on businesses in some detail. The RPC considers the analysis of impacts on businesses included in the impact assessment to be fit for purpose.

The Department assumes that the UK will continue to trade with Singapore on equivalent terms following the UK's withdrawal from the European Union. It is not clear, however, that a deal reached between the UK and Singapore, after the UK's exit from the EU, would mirror the terms set out in EUSFTA. The assessment could have been improved had the Department discussed how the negotiation of a UK-Singapore free trade agreement could influence the estimated costs and benefits of EUSFTA.

Following the UK's exit from the EU, and therefore from EUSFTA, the RPC expects the Department to submit a further impact assessment appraising any final trade agreement negotiated between the UK and Singapore. The RPC also recommends that the Department conduct an (interim or *ex post*) evaluation of this trade agreement to assess the actual impacts of the agreement on the UK. The RPC suggests that The Department should also set out a plan to evaluate and monitor the effects of the EUSFTA to better prepare the UK for any future trade agreement between the UK and Singapore.

Departmental assessment

Classification	Not a regulatory provision
Societal net present value	£1,024 million

RPC assessment

Classification	Not a regulatory provision – following legal advice from the Better Regulation Executive
Small and micro business assessment	Sufficient
RPC rating of initial submission	Not fit for purpose

Regulatory Policy Committee