THE IDEAL U.S.-U.K. FREE TRADE AGREEMENT

A Free Trader's Perspective

EDITED by DANIEL IKENSON, SIMON LESTER, AND DANIEL HANNAN

Executive Summary

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Edited by Daniel Ikenson (Cato Institute),
Simon Lester (Cato Institute), and
Daniel Hannan (Initiative for Free Trade)

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Primary authors
Daniel Ikenson and Simon Lester

Contributing authors
Shanker Singham (Institute of Economic Affairs), Barnabas Reynolds (Shearman & Sterling), Dan Griswold (Mercatus Center), Derek Scissors (American Enterprise Institute), Ted Bromund (Heritage Foundation), Tom Clougherty (Centre for Policy Studies), Sheila Lawlor (Politeia), Matt Kilcoyne (Adam Smith Institute), Diana Furchtgott-Roth (Manhattan Institute), and Iain Murray (Competitive Enterprise Institute)

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Cato Institute
1000 Massachusetts Avenue, N.W.
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Preamble

This paper endeavors to describe the principles that should be reflected—as well as the substantive issues, elements, and provisions that should be included—in what free traders would consider the ideal free trade agreement between the United States and the United Kingdom. Immediately, conflict exists.

Real free traders may consider the notion of an ideal free trade agreement oxymoronic. After all, real free traders are most concerned about eliminating domestic barriers to trade, whereas trade agreement negotiators consider those same barriers to be assets. Free traders seek the removal of domestic barriers, regardless of whether other governments promise to do the same; we understand that the primary benefits of trade are the imports we obtain, not the exports we give up. The benefits of trade are measured by the value of imports that can be purchased for a given unit of exports—the more, the better. The benefits of unimpeded access to the wares produced and services provided by people in other countries include greater variety, lower prices, more competition, better quality, and the innovation that competition inspires.

Free trade is a condition characterized by the absence of trade barriers. Establishing the most important conditions for free trade—the elimination of domestic barriers—requires no formal agreements between or among governments. It is misguided to believe that the economic freedom of people living in one sovereign nation should depend on the consent of a foreign government. But the benefits that accrue to producers, workers, consumers, and taxpayers when their own government eliminates or reduces its own trade barriers—regardless of whether a foreign government agrees to do the same for its citizens—are ample and well-documented.

The stories behind the compelling 20th-century economic turnarounds in places such as Hong Kong and Singapore, Australia and New Zealand, Chile and Mexico, and China and India have in common the commitments of those governments to deep and broad unilateral

reforms. Those examples and others notwithstanding, trade liberalization throughout history—and especially over the past 85 years—has followed a model best described as "mercantilist reciprocity." Although economists tend to appreciate that trade enables us to specialize, and that by specializing we can produce and thus consume more, trade policy is less informed by economics than it is shaped by matters of political economy.

The primary architecture that enabled the world to achieve massive reductions in tariffs and other trade barriers since the end of World War II was built around this idea: because of the political costs to exposing one's industries to foreign competition, negotiators agreeing to that outcome would have to receive compensation in the form of better foreign market access for their exporters to balance the domestic scorecard. Although it is incongruous—even intellectually dishonest—to conduct trade negotiations premised on the idea that one's barriers are assets to spend sparingly and only if exchanged for export market access, the fact is that between 1947 and 1994 average global tariffs fell from 40 percent to 4 percent. At the risk of spinning Adam Smith in his grave, mercantilist reciprocity has delivered a healthy dose of freer trade.

Historically, free trade agreements have not been about "free trade" per se. These deals are better characterized as managed trade agreements because they tend to simultaneously liberalize, divert, and stymie trade and investment flows. Whereas some parts of these agreements clearly reduce barriers, other provisions work to insulate incumbents and the status quo from dynamic, competitive forces.

In 2016, the Cato Institute published a chapter-by-chapter assessment of the Trans-Pacific Partnership (TPP) agreement from a free trader's perspective. Most of the chapters were deemed to be at least moderately trade liberalizing, but some were found to be protectionist. In the end, the authors found that—despite its shortcomings—the agreement was "net liberalizing," and they were able to lend their endorsement to the pact, concluding that free traders who could refrain from making the perfect the enemy of the good should be able to support the TPP.

It is with that critique in mind—by grading each TPP chapter for what it achieved and what it would have had to achieve in order to receive a perfect free trade score—that we approach the current endeavor. But instead of evaluating something that has already been created, identifying its virtues and flaws and rendering judgment, here we are starting with

a tabula rasa with the goal of drafting the ideal free trade agreement from the free trader's perspective.

This paper is intended to serve several related purposes. First, it is to persuade policymakers and the public in both the United States and the United Kingdom that it is in their respective national interests to enter into a comprehensive bilateral trade and investment agreement. Specifically, the goal is to establish that the type of agreement that will have the greatest positive effect on the economies of both countries is one that removes border barriers and behind-the-border barriers to trade across all sectors of both economies without exception.

Second, this paper is intended to provide the intellectual foundation for what limited-government, free-market supporters would consider the ideal free trade agreement (FTA). Third, and ultimately, the objective is to produce the text—the specific language, terms, and provisions—of an FTA that would be more "liberalizing" than any other FTA in the world, and that would be attractive and open to other countries to join.

In the sections that follow, we will (a) describe the various kinds of FTAs in force today, (b) explain why certain provisions must be included and why others must be avoided in a U.S.-U.K. FTA, (c) offer a summary of the kinds of reforms that an ideal FTA would entail, and, finally, (d) include a rough approximation of the actual language of this ideal FTA.

Why a U.S.-U.K. Free Trade Agreement?

At the outset, it should be made clear that free trade and FTAs are not the same thing. Free trade is about the freedom of people to transact as they wish, when they wish, with whom they wish, and without politicians and bureaucrats as gatekeepers. Free trade is about removing impediments that benefit some at the expense of others so that each of us individually has the fullest battery of choices to decide how best to use our own resources.

FTAs are really more about managed trade, which often includes labyrinthine rules intended to distribute particular benefits to specific interests. In some respects, FTAs give free trade a bad name. However, despite their flaws, FTAs have helped reduce domestic impediments to trade, expand our economic freedoms, and lock in positive reforms. Over the years, FTAs have delivered freer trade.

Even though liberalization is beneficial if undertaken without regard to others' reforms, the economic benefits can be much greater if liberalization is mutual. Agreements that remove more tariffs, abolish more market-distorting subsidies, dismantle discriminatory regulations that serve to protect incumbent firms at the expense of society, and, in the process, lock in more countries to those commitments can be more liberalizing than a single country committing to reform unilaterally. Formal commitments between and among governments can prevent protectionist backsliding in a way that unilateral reforms do not. Accordingly, trade agreements can and have played a constructive role in the process of trade liberalization.

But reciprocity-based negotiations are not costless. First, reciprocal negotiations reinforce the notion that import barriers are assets to be dispensed with only in exchange for better market access abroad. The idea that reforms to eliminate barriers already under consideration might be viewed as desirable by current or prospective negotiating partners can change the perception of those barriers from burdensome liability to negotiating chit. That misconception can retard the liberalization process, even in countries that may already have been inclined toward reform.

Second, a country's reform efforts could be stunted through negotiations with countries that are less ambitious about liberalization. Instead of 100 percent unilateral reduction in tariffs by one ambitious government, the result might be a 25 percent reduction—the negotiating partner's red line—for both.

Third, although agreements might help consolidate and buffer domestic reforms from subsequent political pressures to backslide, negotiations could cause countries to recoil from reforms they might otherwise undertake. The same can be said about the concept of a "single undertaking," which is trade parlance for the typical framework under which trade deals are negotiated. It means that nothing is agreed until everything is agreed. It means that an industrial market access agreement is conditioned upon agreement on trade remedies that is conditioned upon agreement on intellectual property, and so on. It means that areas that have agreement to move forward and liberalize today cannot be liberalized until the slowest, most politically fraught items on the agenda are agreed. It means lost time and opportunity cost.

The argument supporting a single undertaking is predicated on the idea that by suspending agreement until the end, greater scope exists for negotiating tradeoffs to facilitate a more balanced final outcome. History suggests, however, that this approach leads to interminable negotiations, lost time, and significant opportunity costs (see, for example, the Doha Round).

Many good reasons exist to negotiate and conclude a bilateral trade agreement between the United States and the United Kingdom. One of the best reasons is that it affords two of the world's largest economies—both deeply committed to the institutions of free-market capitalism and the rule of law—the opportunity to break new ground and pioneer the rules of a genuinely liberalizing 21st-century trade agreement.

Former U.S. president Barack Obama used to warn that if the United States didn't ratify the TPP, the Chinese would become the primary architects of the rules of trade. Although that is a bit hyperbolic, there should be no doubt of the existence of an ongoing competition among governments to create trade rules that become the standards for future agreements. Oftentimes, those rules advantage particular commercial interests in particular countries. At present, dozens of FTAs are in various stages of negotiation around the world. In many respects, each is a laboratory for experimenting with creative solutions to some of the more vexing forms of protectionism, while some are creating precedents for heavy-handed governance protocols.

The rules that endure and serve as the global standard should be simple, fair, transparent, and efficacious. In other words, they should reflect the primacy and efficiency of free markets and free trade.

What Kind of Free Trade Agreement?

It is one thing to support and advocate the merits of a bilateral U.S.-U.K. free trade agreement, but what exactly should a meritorious agreement include? Ideally, the language would be short, sweet, and unequivocal: "There shall be free trade among the Parties." Regrettably, in a world of increasing levels of services trade and nontariff barriers, that free trade mantra does not suffice to address the complex challenges of many modern forms of protectionism.

The whole point of trade is to expand the size of the market to enable greater and more refined levels of specialization, and economies of scale. Reducing tariffs and other border barriers to enable goods and services to cross frontiers is one way—the traditional, textbook way—to expand the size of the market. Remarkably, these kinds of barriers are still formidable in some manufacturing and agricultural sectors of rich countries. However, integration and market expansion will remain hindered if the laws and regulations governing commerce differ between or among the countries that reduced their border barriers.

Some degree of harmonization of product standards, equivalence of regulations, similarity of intellectual property regimes, and coherence among other domestic frameworks that govern or affect commerce is also necessary to expand the "effective size" of the market, provided that this "harmonization" is around pro-competitive and not anti-competitive standards and rules. The latter form of harmonization would be profoundly wealth destructive even as costs of differences would be reduced. It is this latter form of market expansion that has made the pursuit of modern trade agreements so contentious and their terms so controversial.

Not long ago, most products were produced in a single country and selling those products in foreign markets involved exporting from one location to an unaffiliated importer abroad. The kinds of trade barriers that concerned foreign producers, exporters, and importers were border barriers, such as tariffs and slow customs clearance procedures, which could increase the costs of their transactions. Minimizing discrimination against imports mostly required addressing protectionism at the border only.

Revolutions in communications and transportation—along with continuous reductions in tariffs throughout the second half of the 20th century—spurred a proliferation of cross-border investment and the emergence of transnational production and value chains. These developments changed the complexion of international competition. With products and services being created and delivered in multiple countries and with companies setting up operations abroad and competing directly with incumbent domestic firms, the scope for discrimination expanded. Or to be more accurate, discrimination in legal and regulatory environments became more noticeable. No longer was protectionism perceived as just a problem of border barriers. It now lurked in national regulations, performance requirements, buy-local provisions, investment benchmarks, regulatory standards, intellectual property laws, and other domestic laws, regulations, and rules.

Accordingly, modern trade agreements have expanded coverage in efforts to prevent, mitigate, and discipline these more hidden forms of discrimination. But in so doing, the terms of trade agreements have occasionally encroached into areas of domestic policymaking space, generating resistance amid concerns that bundling commitments in international trade agreements might serve to circumvent domestic regulatory and legal processes.

The ideal free trade agreement from a free trader's perspective is one that forecloses governments' access to discriminatory protectionism and obligates the parties to refrain from backsliding. It accomplishes maximum market barrier reduction and enables maximum

market integration, while simultaneously preserving national sovereignty to legislate and regulate in ways that do not discriminate against imported goods, services, and capital.

Over the past two decades, the United States has developed and refined its approach to bilateral and regional trade agreements. Although no formal "Model FTA" exists, as does a formal bilateral investment treaty, U.S. FTAs contain a standard package of provisions that has remained fairly consistent over time. The precise contours of these standard features shift with changes in the balance of political power in and between Congress and the White House, have shifted during the Trump presidency, and will very likely shift again with the new Congress in January 2019. But by and large, the core elements have remained fairly consistent. Congressional objectives articulated in the current "trade promotion authority" language provide the most comprehensive view of the standard features expected in a U.S. free trade agreement.

The United Kingdom, on the other hand, has no recent independent experience of its own negotiating FTAs, having relinquished autonomy over trade policy to the European Union (EU) more than four decades ago. As the United Kingdom prepares to repatriate its trade policy decisionmaking in 2019, the government has many issues to consider, including whether it wishes to pursue free trade agreements and, if so, with whom, how quickly, how deeply, and how exclusively.

Trade agreements come in all shapes and sizes. In broad terms, the substantive provisions of most FTAs tend to fall into one of two categories: liberalization or governance. Provisions in the liberalization basket are typically obligations assumed by the parties to reduce and constrain their own protectionism. Explicit tariff reductions, facilitation of customs clearance procedures, and commitments to open services markets to foreign participants are among the kinds of obligations assumed in trade agreements that fall into the category of liberalization.

Governance provisions—while included in trade agreements ostensibly to constrain protectionism—often establish the conditions under which governments can engage in actions that protect domestic industry. Governance provisions often require the establishment of rules, regulations, and regulators, who are susceptible to the arguments of actors with economic interests in the outcomes of their regulatory decisionmaking. Although governance provisions affect trade, they do not necessarily lower trade barriers—and sometimes may even raise them.

Commencement of U.S.-U.K. FTA negotiations would present a fine opportunity to lay the groundwork for an ideal, model, 21st-century agreement that maximizes economic benefits and is open to other countries to join. Keeping in mind the distinction between liberalization and governance can help guide the process of creating the ideal FTA. In short, the liberalization should be maximized and the governance minimized.

Core Elements of the Ideal Free Trade Agreement

The core provisions common to all trade agreements—and essential to the ideal U.S.-U.K. FTA—concern market access for goods, services, and investment. The ideal FTA provides for the elimination of tariffs as quickly as possible on as many goods as possible and to the lowest levels possible. It should limit the use of so-called trade remedy or trade defense measures. It should open all government procurement markets to goods and services providers from the other party. It should open all sectors of the economy to investment from businesses and individuals in the other party. It should open all services markets without exception to competition from providers of the other party. It should ensure that the rules that determine whether products and services are originating (meaning that they come from one or more of the agreement's parties) are not so restrictive that they limit the scope for supply chain innovations. Those rules should reflect the fact that globalization has made it difficult—and sometimes arbitrary—to define a product's origin. Because of cross-border investment and global supply chains, the DNA of products and services is very difficult to trace nowadays, and that is good. Finally, the ideal agreement should simplify, streamline, and make transparent all administrative procedures governing customs clearance for goods and the admission of all qualifying persons for the purpose of conducting business services.

In addition to those free-market requirements, the ideal FTA must also include rules governing e-commerce. Digital trade—data flows that are essential components in the provision of goods and services in the 21st century—must remain untaxed and protected from misuse and abuse. Rules that prohibit governments from imposing localization requirements or any particular data architectures that reduce the efficacy of digital services should be included, and obligations should be imposed on entities to ensure data privacy, consistent with the requirement that data flow as smoothly as possible.

When border barriers come down, the potentially protectionist aspects of regulation and regulatory regimes become more evident. Certainly, when businesses have to comply with

two sets of regulations to sell in two different markets, it limits their capacity to realize economies of scale and reduces their capacity to pass on cost savings in the form of lower prices or reinvestment.

If those regulations are comparable when it comes to achieving the same social outcomes—consumer safety, product reliability, worker safety, environmental friendliness—there may be scope to require businesses to comply with only one set. A regulatory cooperation mechanism to promote mutual recognition would be a useful innovation, as a means to reducing business costs (provided no deep cultural aversion or science-based reason exists for considering one regulation better than the other and worth the greater cost). It would not have to be fully functioning as part of the FTA upon signing, but including basic elements that can be developed later would be useful. However, for financial and certain other services, sophisticated arrangements for mutual recognition and the reliance on the other party's rules and enforcement would operate from day one.

As to regulatory barriers, keep in mind that the World Trade Organization (WTO) already has extensive and effective disciplines in place. Protectionist tax and regulatory measures already violate core provisions of the General Agreement on Tariffs and Trade (GATT), as well as several other WTO agreements.

Finally, the rules of the ideal FTA must be enforceable. What's the point of a trade agreement if its terms are just suggestions? To make sure governments keep their promises, trade agreements should have a binding and enforceable dispute settlement mechanism, to ensure that the agreement is followed. That mechanism would not be a true court, with the power to order governments to comply. Rather, the standard mechanism used in most trade agreements—with recourse to a third-party adjudicator for a ruling and then self-enforcement through authorized suspension of the trade agreement obligations—is sufficient.

Some other common FTA provisions are—to some extent—superfluous, because the WTO already has rules in these areas that work well enough. In the Tokyo Round, the GATT negotiators developed rules for product standards and regulations, and then in the Uruguay Round they added new rules on food safety regulations. The resulting Agreement on Technical Barriers to Trade and the Agreement on the Application of Sanitary and Phytosanitary Measures have seen extensive litigation in recent years, yielding a substantial body of jurisprudence to rely on to understand their boundaries and role.

Those disputes make clear that the impact of these provisions has been limited in cases where there are political or cultural sensitivities. But the many cases in which responding parties have complied with rulings against them demonstrate the value of these agreements. There is the possibility of improving some of these rules, and perhaps more importantly subjecting them to a more effective dispute settlement mechanism than exists at the multilateral level. In addition, given difficulties in the WTO and the potential for members to exit, ensuring that WTO disciplines are legally enforceable and that the provisions of the agreement can stand alone—whatever the future of the WTO—has some independent value.

Some other common free trade agreement provisions simply don't belong in free trade agreements. Their inclusion is based on successful lobbying from particular interest groups, whether businesses or nongovernmental organizations.

The most prominent example from the business side is overly protective intellectual property rules. Economists generally agree on the merits of free trade, but widespread disagreement exists on a number of aspects of intellectual property protection as carried out in trade agreements, such as the length of copyright terms. And even more controversially, the EU has pushed for so-called geographical indication protections, which many view as simple protectionism for its farmers.

Trade agreements now have established rules in these and other areas of intellectual property, but it is not even clear that those rules are always economically beneficial. It is important that intellectual property rules protect what is actually intellectual property and do not go beyond that or create rights where none actually exist.

On the other side of the political spectrum, nongovernmental organizations have used trade agreements as a vehicle to argue for provisions on labor rights protections and environmental protections. That situation has expanded the scope of trade agreements far beyond traditional trade and commercial issues, raising concerns from many on the right. The scope and reach of labor laws and environmental protections are a controversial domestic policy issue, and the use of international agreements to create a one-size-fits-all solution in these areas is problematic.

Furthermore, the United States and the United Kingdom have open, transparent, and free market–oriented economies. But if a U.S.-U.K. FTA is to be open to other countries, it is useful to set it up in a way that deals with issues that may arise down the road.

Other countries' economies are less open and have more state intervention; therefore, it is worth having the United States and the United Kingdom work out rules in this FTA that could apply to others who join later. Examples in this regard are transparency, the behavior of state-owned enterprises, and government regulations that are anti-competitive (anti-competitive market distortions). The United States and the United Kingdom should be able to agree to very high standards in these areas, standards that other parties might not reach. And then through the open accession clause, parties that wanted to reap the benefits of this agreement would have to accept these disciplines.

The United States and the United Kingdom are generally very transparent with their legislation and regulation. But in many other countries, it can be hard to know even what laws and regulations apply and how they will be implemented. Guidelines for making these domestic processes more transparent are therefore useful.

And some countries still rely on state-owned enterprises for a significant part of their economic activity. Defining these entities, and requiring them to act in a nondiscriminatory and commercial manner, can push them toward more market-oriented practices. The TPP was a first step in this direction, and a U.S.-U.K. FTA should push further.

Summing up, the ideal FTA is one that removes all barriers to trade in goods and services, opens up all sectors of the economy to investment, and, ultimately, goes as far as possible to remove all administrative impediments to integration of the economies of the parties without encroaching on the sovereignty of governments to pass laws and regulate in the public interest in ways that do not discriminate against foreign goods, services, and companies.

In practical terms, that means that the ideal agreement will result in the following:

- Zero tariffs on all goods (agricultural commodities, primary industry resources, and manufacturing industry goods);

- Zero discriminatory nontariff barriers, which means no discrimination by either party in the content or exercise of the laws, regulations, or practices affecting the provision of services of either party, including no restrictions on the entry of businesspeople in the conduct of the provision of business services;

- Zero restrictions on competition for government procurement;

- Zero restrictions on foreign direct investment in the economy;

- Zero restrictions on cross-border data flow;

- Elimination to the fullest extent possible of impediments to expeditious customs clearance procedures for both imports and exports;

- Preclusion of the adoption of antidumping or safeguard measures between or among parties; and

- Strict prohibitions against the use of nontariff barriers, such as performance requirements, restrictions based on scientifically unsubstantiated public health and safety concerns, and restrictions based on national security concerns that fail to meet certain minimum standards.

What this means substantively is that, without the need to articulate exceptions and carve-outs, which are so common in other agreements, the U.S.-U.K. FTA can be shorter and simpler, and its provisions can be covered in fewer chapters. We see a need for 18 substantive chapters in the ideal U.S.-U.K. FTA (compared with 17 in the Australia-Singapore agreement, 24 in both the U.S.-Korea and U.S.-Chile agreements, and 30 in both the TPP and the EU-Canada Comprehensive and Economic Trade Agreement).

Summary of the Chapters and Provisions of the Ideal FTA

Chapter 1. Initial Provisions and National Treatment

Chapter 1 establishes the structure of the agreement, determines how it relates to the obligations of the parties under other trade agreements, and provides general and technical definitions. The United States and United Kingdom (and, presumably, any potential future members) already have obligations to each other as World Trade Organization (WTO) members. The provisions in this chapter acknowledge that the U.S.-U.K. free trade agreement (FTA) is sensitive to those obligations and does not intend to create any new obligations that would be inconsistent with those agreements. Parties have recourse to consultations with other parties if they believe inconsistencies exist.

The WTO enshrines the principles of "most-favored nation" (all trade liberalization by a member country should apply on a nondiscriminatory basis to all other members) and "national treatment" (foreign entities and their products and services should be accorded the same treatment under law as domestic entities and their products and services are accorded). However, that institution has long recognized that some members might wish to pursue deeper and broader liberalization outside the WTO. As long as certain core conditions are met—especially that the liberalization between or among the countries party to the agreement applies to substantially all of their trade and that the agreement does not raise barriers to external trade—these preferential (bilateral or regional) agreements are permitted.

This chapter establishes that the parties will extend national treatment to the goods and services of the other party under the laws and regulations of all levels of government. This fundamental principle is reflected in all trade agreements. It also establishes that the parties agree to refrain from using their respective antidumping laws against entities exporting from

the other parties and to exempt the other parties from any remedies that might be imposed pursuant to domestic safeguards cases.

Chapter 2. Market Access for Goods

This chapter establishes the basic rules for trade in goods between the parties. The parties commit to eliminating tariffs and tariff-rate quotas (TRQs)—upon entry into force of the agreement—on imports of all goods from all other parties that meet the origination requirements. Limited exceptions from the requirement of no tariffs and no TRQs upon entry into force will be granted by way of publication of party-specific annexes. Each party will list products (by Harmonized Tariff Schedule code) that will continue to be assessed with tariffs subject to the following limitations: (a) the aggregate import value of the listed products cannot exceed 10 percent of the total value of imports from the parties in calendar year 2018 and (b) tariffs will go to zero for all products on the list within 10 years of entry into force.

This chapter also (a) prohibits export restrictions and "performance requirements" as conditions of reducing import tariffs and (b) establishes rules on import and export licensing to ensure that such programs operate transparently and in a nondiscriminatory manner and that they do not constitute some form of disguised protectionism.

Additionally, this chapter limits any administrative fees and formalities (e.g., customs fees) associated with importation or exportation to the approximate cost of the services rendered and commits the parties to publishing promptly any changes to the rules, regulations, and procedures governing the importation or exportation of goods.

Chapter 3. Rules of Origin and Origin Procedures

Chapter 3 establishes the rules for customs authorities to determine whether an imported good "originates" within the free trade area, qualifying it for the preferential treatment afforded under the agreement. Generally, a product is considered originating if it was wholly made within the region (in the countries party to the agreement), or if it was significantly transformed within the region from imported materials and components, or if the relative value of originating materials and manufacturing performed in the region constitutes a large enough percentage of the product's value.

Conceptually, rules of origin are necessary in preferential trade agreements because, by definition, without such rules there would be no way to distinguish qualifying from nonqualifying goods. Rules that permit greater use of nonoriginating inputs or apply broader definitions of what constitutes product transformation tend to be more trade liberalizing than more proscriptive rules, which impose greater restrictions on qualification for the agreement's preferential tariff rates.

In today's global economy, strict rules of origin impede the operations of more diversified supply chains and can act to limit competition to the benefit of incumbent producers. They increase the likelihood and cost of trade diversion, which occurs when less efficient producers are chosen simply for the tariff advantages they receive.

Moreover, complicated rules of origin tend to generate higher compliance and verification costs, which erode the benefits of preferential duties causing importers to simply forgo their claims to preferences. So while parties to a preferential agreement might want to make sure that their entities are benefiting the most from the deal's provisions, if the origin rules are too restrictive, fewer will choose to incur the costs of complying with the qualification procedures and forgo preferential access altogether, negating the benefits that the deal was intended to deliver.

The most recent trade agreement to which the United States was a party—the Trans-Pacific Partnership (TPP)—included rules of origin that were generally more liberal than previous U.S. trade agreements. Whereas the average content origination threshold in earlier U.S. agreements was roughly 35 percent, the threshold in the TPP was about 30 percent. Origination requirements vary across products or sectors and some, such as chemicals, apparel, and automobiles, are subject to much higher thresholds, but they were about 5 percentage points lower across the board in the TPP than in other U.S. FTAs.

The TPP's rules of origin content requirements for automobiles are between 35 percent and 45 percent, which is significantly more liberal than those of the North American Free Trade Agreement (NAFTA), which are about 62.5 percent. The Trump administration seems to be reversing course on this trend and is seeking much more restrictive rules in the NAFTA renegotiation.

For the ideal U.S.-U.K. FTA, we are requiring a minimum local content value threshold of 25 percent and requiring the product in question to be produced or substantially transformed

(in accordance with the World Customs Organization's definition of "substantial transformation") in order to obtain originating status.

Chapter 4. Customs Administration and Trade Facilitation

Studies conducted by economists at the World Bank and elsewhere have found that border delays constitute significant barriers to trade. The purpose of having rules in this area is to ensure that customs procedures facilitate—and do not inhibit—trade by maximizing predictability, consistency, and transparency to the rules governing the clearance of goods at the border. The provisions are intended to reduce transaction costs by reducing administrative barriers to trade. Moreover, opaqueness of customs processing and clearance procedures creates greater scope for corruption, which also raises the costs and reduces the benefits of trade.

Recognizing that time in transit is a trade barrier, this chapter mandates maximum time limits for shipment processing at borders. Customs authorities are required to release all express shipments within 6 hours of document submission and to release all shipments within 48 hours of arrival. Modern communications and tracking technology make it possible to expedite the process of moving goods across borders and make it easier to detect customs evasion and corruption.

The chapter includes language requiring customs authorities to respond expeditiously to requests for information, including the issuance of advance product classification rulings requested by importers. It requires that governments publish, and make available to importers and exporters, customs laws and procedures, and that automated systems be available to traders to facilitate classification, valuation, and customs clearance procedures.

Among the liberalizing provisions of this chapter is one that prohibits customs duties on express shipments valued at or below $999.

Chapter 5. Cross-Border Trade in Services

In the 23 years since the WTO's General Agreement on Trade in Services (GATS) took effect, very little enforceable services liberalization has been achieved globally. The GATS schedule

follows a "positive list" approach, which means that only the sectors selected and listed by the parties are required to liberalize. For most parties, only a few services industries were on the list.

Subsequently, attempts to secure stronger commitments in the Doha Round failed, and efforts to push those commitments forward as part of the WTO Trade in Services Agreement have floundered.

By adopting a so-called negative list approach to liberalization, the U.S.-U.K. FTA would commit the parties to much greater openness to competition in their services industries than was accomplished under GATS. The negative list approach means that the parties commit to full liberalization of every service sector that has not been carved out as a "nonconforming measure," which is essentially an exception to the general rule. The U.S.-U.K. FTA permits limited nonconforming measures, which means—for example—that U.S. maritime services and commercial airline services industries, which have languished in inefficiency for decades behind protectionist walls, likely would be opened to competition.

The U.S.-U.K. FTA forbids any "local presence" requirements, conditions that require service suppliers of another party to have an office or store or any form of presence to qualify as a cross-border supplier of services. It also requires each party to ensure that all measures of general application affecting trade in services are administered in a reasonable, objective, and impartial manner.

A specific instance of cross-border trade in services can be found with respect to financial services in Annex I, as this is a novel and groundbreaking area. It is anticipated that other similar schedules, for other professional services such as law and accounting, would be created in due course on a similar basis.

Chapter 6. Regulatory Coherence

The divergence of regulations and regulatory practices between countries, while expected and understandable, can also serve to increase costs and frustrate market integration. Sometimes, those divergences mask protectionism. Clearly, when businesses must comport with two sets of regulations to sell in two different markets, it limits their capacity to realize economies of scale and reduces the scope for passing on cost savings in the form of lower prices or new investment.

Many regulations across countries are intended to achieve the same kinds of objectives, such as consumer safety, worker safety, or environmental friendliness. Sometimes, the differences in requirements—a minimum length of a washing machine's electrical cord of one meter versus three feet, for example—generate no discernible differences in outcomes (the incidence of fires or electrocution) but drive up business costs nonetheless. Under these circumstances (and many other examples exist), it may be possible to permit businesses to comply with only one of the two standards.

This chapter establishes a regulatory cooperation mechanism to find the scope for, and develop the rules of, a mechanism to promote mutual recognition of effectively equivalent regulations. This innovation will put the U.S.-U.K. FTA at the forefront of pioneering techniques to facilitate market integration behind the border.

The parties will make commitments to apply agreed coordination and to review obligations when proposing new regulatory measures and to implement "core good regulatory practices." These commitments will be important to ensure that each party is moving toward progressively more competitive regulation that is least trade restrictive and least damaging to competition consistent with clearly articulated legitimate regulatory goals. As a result, bad practices cannot be hidden in supposedly reasonable regulatory goals. Good regulatory practices also ensure that disguised methods of protection are resisted.

Also included are provisions governing the promulgation of regulations, in order to address the problem of regulations that were developed opaquely, without sufficient input from stakeholders, without a sound rationale, or for the benefit of a particular industry, company, or stakeholder. The rules encourage the publication of impact assessments of proposed regulations and cost–benefit analyses to determine whether the regulations performed effectively and as expected.

The chapter requires the parties to promulgate regulation that has the least trade restrictive and anti-competitive impact while being consistent with legitimate regulatory goals. It also enables a party to request information from another party on any upcoming regulatory initiatives. It includes an ability to provide consultation comments on new regulatory measures, a regular retrospective review of regulations, and an ability for interested persons to petition for review of a party's regulations. The parties are also required to maintain publicly accessible electronic databases of national regulations to ease the compliance burden for cross-border businesses.

Chapter 7. Movement of Labor

The free movement of people will be an important feature of an ideal U.S.-U.K. free trade agreement. It will open opportunity for workers in both nations to raise their productivity and their standards of living. It will allow for more competition and division of labor in the provision of tradeable services, primarily through the Mode 4 provision of services through the movement of natural persons.

The aim of the agreement will be to allow the free movement of labor between the two nations. That can be accomplished through the text of the agreement and the resulting modification of each nation's immigration laws. Existing models include the free movement of labor within the EU, the New Zealand–Australia Closer Economic Relations Agreement of 1983, and the E-3 visa created in conjunction with the 2005 U.S.-Australia Free Trade Agreement.

To further facilitate the benefits of the free movement of people, the agreement should contain language to establish the mutual recognition of professional credentials. Here, the agreement can follow the precedent of the Trans-Tasman Mutual Recognition Act 1997 that allows anyone who is registered to practice an occupation in one country to practice in the other.

Chapter 8. Investment

International trade and investment go hand in hand, as most trade is conducted between affiliates of the same multinational enterprises. In fact, about 88 percent of the revenue generated from U.S.-U.K. commerce comes from affiliates' sales. This process often involves parent companies in the United States (United Kingdom) exporting components or finished products to affiliates in the United Kingdom (United States), which then process or package and sell down the supply chain or to end users abroad.

This chapter provides basic guarantees and protections for investors and investments, including "national treatment," "most favored nation treatment," and rights to compensation for government expropriation of an investment.

Like the investment chapters in several other trade agreements, this one obligates the parties not to interfere with capital flows related to covered investments, including transfers of profits, dividends, interest payments, and royalties, subject to exceptions that ensure that governments have the flexibility to engage in prudential measures to manage potentially volatile capital flows.

It prohibits the use of "performance requirements," including local content requirements, minimum export requirements, technology transfer, and localization requirements as conditions of investment. It guarantees that investors have the ability to appoint senior managers without regard to nationality and ensures that any restrictions of the appointment of board members based on nationality do not adversely affect an investor's control of its investment.

The chapter requires the parties to take a "negative list" approach to identifying which sectors are open to investment, meaning that the rules of the chapter apply to all sectors and activities that are not explicitly identified as exemptions.

The chapter does not include "investor–state dispute settlement."

Chapter 9. E-Commerce

The free flow of information is essential to free trade in electronic commerce, as well as to the industries for which data are crucial components of the product manufactured or the service provided. The provisions on electronic commerce concern measures that affect trade by electronic means and are intended to (a) ensure the free flow of data, (b) prevent forced localization of data servers and technologies, (c) promote the security of the internet, and (d) protect the privacy of individuals and businesses as they use and create content.

The language is intended to prohibit the parties from (a) imposing customs duties on electronic transmissions, (b) requiring foreign companies to provide software source code as a condition of doing business, (c) restricting the cross-border transfer of information by electronic means, and (d) requiring use of local computing facilities as a condition of doing business in the territory.

Chapter 10. Government Procurement

With limited scope for nonconforming measures, Chapter 10 commits the parties to accept bids for all public procurement projects from producers and service providers of the other party, and to consider those bids on a nondiscriminatory basis. The chapter harmonizes the procedures associated with announcing public procurement projects and considering the offered proposals and provides rules to ensure transparency in the decisionmaking process. The chapter requires the United States to waive its Buy America provisions, which represent significant and persistent obstacles to the estimated $1.7 trillion U.S. government procurement market (federal, state, and local).

Chapter 11. Intellectual Property

Both the United States and the United Kingdom have high standards of intellectual property protection. The United States has traditionally pushed for stronger protection for intellectual property in trade agreements. The United Kingdom is likely to do the same. Between these two jurisdictions, the only necessary language may be a requirement to enforce domestic laws.

With regard to countries that are potential accession candidates to the agreement, the concerns about inadequate intellectual property protection are likely to vary and may change over time. That could make it difficult to negotiate such rules as part of a U.S.-U.K. FTA, since right now it is hard to address issues that may exist or become apparent later. As a result, the best approach to intellectual property protection in this FTA may be to limit it to a requirement to enforce domestic laws and to address it in the accession process on a country-by-country basis as others join.

Chapter 12. Sanitary and Phytosanitary Measures

It is critical that measures to protect animal, human, or plant health are based on sound science and that the parties do not adopt measures that are disguised barriers to trade and competition. The purpose of this chapter is to afford appropriate protections and to impose disciplines on the parties to ensure that measures in this area are not corrupted toward impeding trade.

Chapter 13. Technical Barriers to Trade

The United Kingdom and the United States agree to ensure that technical barriers to trade do not attenuate the liberalization achieved in the rest of the agreement. The provisions in the chapter build on best practices in the WTO and in the work of the WTO Committee on Technical Barriers to Trade to ensure that product regulations are not developed in a way that is trade restrictive or anti-competitive.

A particular example of this includes labeling regulations for synthetic biology (genetic modification and other gene technologies) products. These provisions will ensure that any labeling requirement is not deployed in ways that are disguised barriers to trade.

This chapter also lays out a framework for advanced mutual recognitions of conformity assessment—a crucial means by which to smooth technical barriers to trade between the parties.

Chapter 14. Competition Policy

The purpose of this chapter is to ensure that the reduction of border barriers is accompanied by reductions in "behind-the-border" barriers. That applies both to private anti-competitive practices, but more important, to anti-competitive regulations and other government restraints (anti-competitive market distortions). Moreover, this chapter includes provisions to discipline the potentially market-distorting practices of state-owned enterprises by focusing on their effect on the market, while being somewhat agnostic about their structure.

Also included are meaningful disciplines on what has become one of the biggest problems in services trade: anti-competitive market distortions behind the border. Providing for disciplines on the parties in this area is important to ensuring freer trade and more competitive markets.

Chapter 15. Defense Trade Cooperation

If either party chooses to define its national defense industrial base in legislation or policy, the other party shall be included in that definition. Each party shall reduce the barriers to the seamless integration of the persons and organizations that compose their national defense industrial base and shall consult regularly with the other party to achieve that end.

To give effect to the U.S.-U.K. Defense Trade Cooperation Treaty (2007), each party shall adapt its system of defense trade controls to allow all defense-related exports to the other party to (a) proceed absent an explicit decision to refuse within a specified and limited time; (b) be licensed at the system level within the approved community as defined by the 2007 treaty; and (c) automatically include the provision that all follow-on parts, components, servicing, and technical plans be obtained directly from commercial suppliers.

Purchases made by one party for the purposes of national defense from the other party shall be deemed to meet all domestic content provisions of the first party. Each party shall—with the agreement of and in cooperation with the other party—seek to expand the provisions to other close and traditional allies. Neither party shall—without the agreement of the other party—enter into research, development, or procurement relationships with third parties that are closed to the other party of this agreement.

Chapter 16. Dispute Settlement

For trade obligations to have a liberalizing effect, they must be binding and enforceable. The enforceability of obligations in any trade agreement is of great importance, because if governments cannot be held accountable to their commitments, the value of those commitments is significantly diminished. Accordingly, the U.S.-U.K. FTA includes robust, broadly applicable, properly functioning dispute settlement provisions.

The language in this chapter establishes that all of the obligations undertaken by the parties in this agreement are subject to dispute settlement. The provisions call for transparent, accessible, and expeditious dispute settlement procedures, which include a process for consultations, dispute panel composition and adjudication, and a secretariat.

Chapter 17. Exceptions

Exceptions for nontrade policies are a standard part of most trade agreements. The specific language can be important, as differences in wording can lead to more or less deference to governments in pursuing these policies.

With regard to policies other than security, we have adapted the language used in GATT Article XX.

As for security, every U.S. trade agreement includes a broad security exception. For some prospective trade agreement, such as a U.S.-Vietnam FTA, such an exception would be appropriate and could enhance prospects for ratification. For a U.S.-U.K. FTA, however, national security concerns are less prevalent, and narrowing the exception may be desirable.

Security was a nagging issue before 2017 and has received greater visibility by the Trump administration's invocation of national security to apply tariffs to steel and aluminum and to investigate auto trade. A danger exists in that national security will become entwined with notions of self-sufficiency, which are antithetical to genuinely open trade. We have added language that narrows the typical security exception.

Chapter 18. Institutional and Final Provisions

The long-term effect of an FTA depends in part on how the parties implement it. The substantive obligations of trade agreements may need to be updated; disputes arise and need to be resolved; and other countries may want to accede. Having the appropriate rules and institutions can help with all of those issues. To that end, this chapter establishes two institutional bodies that can assist in those matters: a joint committee made up of U.S. and U.K. government officials and a small administrative secretariat. It also sets out some basic rules on accession.

Annex I. Financial Services

Annex I sets out the requirements for a specific iteration of cross-border trade in services. It supplements Chapter 5, as described earlier.

Financial services cover a broad swathe of activities, including banking, investment banking, dealing, broking, asset management, derivatives trading, custody, market infrastructure, insurance, and reinsurance. Trade in financial services already constitutes a significant share of U.S.-U.K. commerce, but the parties' commitments to open those markets fully will likely expand trade considerably.

The financial services annex provides for parties to enter into a master agreement under which specific mutual recognitions are established. We envisage mutual recognition under

these arrangements across all financial services areas, which would permit the parties to continue with their divergent approaches to regulation while seeking to collaborate in identifying the necessary outcomes that regulations should achieve. Those outcomes have largely been harmonized between the United States and United Kingdom since the 2007–2008 financial crisis, when the issues pertinent to systemic risk were much discussed and broadly agreed.

Services and products would be regulated solely in the home state under a regime recognized as equivalent, and purchasers in the other country would operate on a caveat emptor basis. Remedies would be solely available in the home state (i.e., originating state). Both states have highly sophisticated regulatory and judicial systems that can provide reliable redress to corporations and citizens of the other country affected adversely by any misselling or misperforming products or services. Customers can evaluate the service or product against the backdrop of the relevant legal and regulatory regime.

Overall recognition principles, conditions for mutual recognition, and consultation are established at the master level in the annex. The annex's schedule is left open for the parties to negotiate and to "fill in," which as mentioned will cover the gamut of financial services. It is expected that the annex's schedule would set out (a) definitions of the types of parties benefiting from the agreed equivalence recognition (we envisage that all will be covered, but, at the very least, wholesale customers), (b) the intended legal effect of the particular equivalence recognition (e.g., that a party's banks are treated under national law as having the same authorized status for a particular financial activity as domestically authorized banks), and (c) any conditions applicable to equivalence recognition (e.g., a requirement for parties benefiting from an agreed equivalence recognition to be listed on a national financial services register or to have membership in an appropriate investor compensation scheme).

It would also be possible for other types of equivalence recognitions to be agreed in the chapter's schedule that do not directly relate to cross-border market access or licensing and authorization requirements—but that ease compliance burdens for financial institutions operating on a cross-border basis. For example, it might be possible to agree that financial institutions carrying out cross-border business—which might otherwise be subject to both parties' regulatory regimes for mitigating the risks of over-the-counter derivatives—would need to comply only with the regime of one jurisdiction. We envisage that such additional recognitions will be negotiated swiftly and maximally.

Overall, the financial services annex requires the same kinds of commitments to nondiscrimination and liberalization that are required in the cross-border trade in services chapter and in other parts of the agreement. These are reflected in the recognition principles.

Financial services have typically been a sensitive area in trade negotiations, in part because of fears that the rules established would interfere with issues of prudential and systemic risk regulation. However, the proposal here caters to such concerns by ensuring agreement on the necessary regulatory outcomes that each party's system must achieve.

We think both systems already achieve those outcomes and are pretty much certain to continue doing so, given the sophistication of the regulators in each jurisdiction, and the sophisticated legislative oversight that protects taxpayers from the consequences of systemic risk. However, the financial services annex states that equivalence recognitions may be suspended for a sector by a party if another party's financial services regime in that sector is no longer materially equivalent. Tests for material equivalence are proposed, using an outcomes-based approach that would benchmark against relevant international standards, reducing the ability for one party to refuse or suspend mutual recognition in one sector because of any regulatory idiosyncrasies.

Annex II. Professional Services

Annex II addresses barriers to trade that take the form of restrictions on the provision of professional services, such as occupational licensing and professional registration. It is intended to encourage the parties to permit employment of persons who have met the qualifications for licensing or registration in other jurisdictions without having to requalify.

Postscript

Contingency Provisions: Ideal Meets Political Reality

It is important to recall that the "ideal" agreement may not be the most politically acceptable agreement to the polities of the United States and United Kingdom. For example, although provisions guaranteeing protections of labor rights and the environment have no place in an agreement committed to simple, straightforward, free market–based rules (even more so when the parties aren't regarded as significant transgressors in these areas), they have become standard features in free trade agreements. To even consider supporting these agreements, some political parties demand that they include—at a minimum—provisions ensuring certain standards of labor conditions or environmental practices.

In the United States, as a condition for agreeing to grant the president the authority to negotiate trade agreements with foreign governments and bring them back for expedited (fast-track) legislative consideration (no amendments, no extended debate, just an up-or-down vote), Congress requires an agreement to meet a variety of negotiating objectives. Ignoring Congress's demand that the trade remedies laws "not be weakened" by proposing a trade agreement that prohibits the use of those laws might not be the best approach politically. Many of the congressional objectives in the trade promotion authority law make for bad economics. Some reflect political compromises; others, plain ignorance.

Moreover, one of the characteristics of the ideal free trade agreement (FTA) is that it is a "living agreement." If the United States and United Kingdom are to obtain "first-mover advantages" by authoring the rules of the model 21st-century agreement, they will want its potential benefits to be perceived as significant enough to attract new member countries—including developing countries—to join. For that to happen, the terms of the agreement cannot be so stringent as to preclude the majority of countries from meeting the requirements. That would seem to counsel in favor of including terms that have more to do with pure

liberalization than governance. But by the same token, the prospect of extending membership to countries that have—or are perceived to have—weaker commitments to labor rights, environmental protections, competition rules, or intellectual property standards will undoubtedly prompt louder calls in the United States and the United Kingdom for strict provisions in these areas.

With that in mind, what might a realistic U.S.-U.K. FTA look like? First of all, full and fast trade liberalization should be the goal, with exceptions limited to the most sensitive products. Tariffs on all U.S.-U.K. trade should be zero or close to it soon after the agreement enters into force.

On services, there are opportunities for innovations, but also some sensitivities. Both sides have strong financial services sectors, which could thrive when subjected to greater competition. It is proposed that mutual recognition exist across all financial sectors (including banking, investment banking, dealing, broking, fund management, custody, derivatives dealing, clearing, financial infrastructure, and, where possible insurance and reinsurance) from day one. Given the experiences after the 2007–2008 financial crisis, we believe the two regimes are generally already synchronized and seek to achieve the same outcomes.

As for other services areas, health services are an area where both sides would benefit from openness to foreign competition, although we recognize any changes to existing regulations will be extremely controversial. Perhaps, then, for other areas the initial focus should be on other fields such as education or legal services, where negotiators can test the waters and see what is possible. That said, we would envisage a swift, time-tabled implementation of recognition across all areas within 5 years.

On government procurement, support for Buy America provisions is strong in the United States. But such policies are clearly bad for those adopting them. The United Kingdom should push as hard as possible for the United States to allow U.K. goods and services providers to have access to U.S. procurement markets, and open its procurement to U.S. companies, as well.

As for governance, some basic rules on intellectual property, labor, and the environment are inevitable. But there is no need to push the boundaries here, with provisions that go beyond existing U.S. FTAs. On the other hand, the United States and the United Kingdom may want

to develop advanced rules on e-commerce. Other possible areas where governance rules may be helpful are with state-owned enterprises and transparency/anti-corruption rules.

Even constrained by political realities, the United States and United Kingdom—traditionally two of the world's leading supporters of free trade—may be able to craft a free trade agreement that reshapes the model by pushing it in the direction of more trade liberalization and less governance, and that is appealing enough to others that they want to join.

The U.S.-U.K. FTA should be a living agreement—one that is open to new members who are willing and able to comply with its terms. Accession provisions are common in trade agreements, and the U.S.-U.K. FTA should accommodate other countries that wish to join, as long as they are willing to take on significant, liberalizing commitments. The greater the number of countries operating under the same set of rules, the greater the potential gains, the lower global transaction costs, and the lower the likelihood of trade diversion.

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