Title: Impact assessment of the EU-Central America Association Agreement Trade Pillar (covering Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama) **IA No:** - N/A **Lead department or agency:** FCO **Other departments or agencies:** BIS	**Impact Assessment (IA)** **Date:** 07/05/2015 **Stage:** Development/Options **Source of intervention:** EU **Type of measure:** Other **Contact for enquiries:** Hugh Billane **02070082686**
Summary: Intervention and Options	**RPC Opinion:** Awaiting Scrutiny

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
£998m	£1,110m	NQ	No	NA

What is the problem under consideration? Why is government intervention necessary?

In 2007 the EU opened negotiations with Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua with a view to organising an EU-Central America Association Agreement (AA). In 2012 the European Parliament gave consent that the trade pillar could be applied ahead of the political and cooperation pillars, which may take more time to finalise. The trade pillar consists of a Free Trade Agreement between the two regions, which looks to reduce current tariff and non-tariff trade barriers that distort the market price and results in less consumer choice. The EU have been negotiating the FTA in accordance with WTO, which the UK must now decide to ratify, or not to ratify.

What are the policy objectives and the intended effects?

The objective of the FTA is to reduce current tariff and non-tariff barriers between EU and the six Central American countries markets ie liberalise trade. The intended effect is to increase free and efficient trade, opening up export opportunities for EU exporting businesses, create greater competition and consequently lower prices, incentivise innovation, increase investment in R&D and result in a greater variety of goods and services for EU consumers. The agreement also intends to lock in binding agreements on sustainable development, intellectual property rights, sanitary, photo-sanitary and human rights.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The content of the FTA has already been negotiated and is therefore not subject to change. The options open to the UK are:

- Option 0: the UK does not ratify the EU-CA FTA.
- Option 1: the UK does ratify the EU-CA FTA.

Option 1 is the preferred option. The UK have supported the negotiations of the FTA, which is consistent with the UK's objectives in trade policy (free, fair and open markets) and with wider relevant HMG policy goals. It is expected to have benefits that filter to UK industry and UK consumers. In addition, the EU Parliament gave its consent to the trade pillar in December 2013. If the UK did not ratify the FTA, it would be at risk of an infraction on proceedings.

Will the policy be reviewed? It will not be reviewed. **If applicable, set review date:** Month/Year

Does implementation go beyond minimum EU requirements?			No		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/Q	**Non-traded:** N/Q	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY: ____________ Date: Shamik Dhar 07/05/2015

Summary: Analysis & Evidence

Policy Option 1

Description: UK ratifies the EU-Central America Free Trade Agreement

FULL ECONOMIC ASSESSMENT

Price Base Year 2015	PV Base Year 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 714	**High:** 1,093	**Best Estimate:** 998

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	N/Q		10	**86**
High	N/Q		14	**121**
Best Estimate	N/Q		13	**112**

Description and scale of key monetised costs by 'main affected groups'

-Lost tariff revenue to UK Government from imports from Central America.

Other key non-monetised costs by 'main affected groups'

-Adjustment costs for UK businesses, customs, enforcers and officials. These are expected to be minimal, as UK imports from Central America are not a large proportion of the UK's total imports (0.01% on average). There will be a one-off cost to firms, enforcers, customs and officials from reading the agreement.
-Inceased competition for UK businesses from Central American businesses. Estimated to be minimal competition between Central American and UK firms, who specialise in different goods.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/Q		92	**793**
High	N/Q		138	**1,189**
Best Estimate	N/Q		126	**1,086**

Description and scale of key monetised benefits by 'main affected groups'

-Increased UK exports to Central America. Agricultural exports are estimated to increase as the agricultural tariffs halve under the FTA, and manufacturing exports will also likely increase as manufacturing tariffs are reduced to zero.
-Tariff savings for UK exporters to Central America.

Other key non-monetised benefits by 'main affected groups'

-Positive impact on UK GDP.
-Greater consumer choice for UK customers.
-Greater investment flows between the UK and Central America.
These are estimated to be negligible given the UK's trade with Central America makes up approximately 0.01% of its total trade each year.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5%

This analysis assesses UK costs and benefits as a share of the EU costs and benefits estimated by the European Commission. Assumption that UK feels 13.7% of EU costs and benefits based on the proportion that UK trade is of total EU trade. Sensitivity analysis also assess costs and benefits if it were 10% and 15%. Assumption in the calculations that tariffs are liberalised from year 1. In reality they will be liberalised mainly in year 1 and then increasingly over the first 10 years.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: N/Q	**Benefits:** 129	**Net:** 1,290	No	NA

EVIDENCE BASE

I. Introduction

1. In 2007 the European Commission, acting on behalf of the European Union and its member states, opened negotiations with Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua with a view to organising an EU-Central America Association Agreement (AA). Panama joined negotiations in 2010 and the Agreement was initiated in 2011. In 2012 the AA was signed by EU Member States and by the governments of Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama.
2. The EU-Central America AA covers three areas: political dialogue, trade and cooperation. The main political aims will be to bring about closer relations between the EU and Central America (CA). It will encourage improvements in human rights, democracy and good governance and lead to higher labour standards in CA, and the continued regional integration in CA will lead to greater coordination on common issues such as security, climate change, migration and disaster relief. The AA will also encourage greater trade and investment by addressing obstacles to trade in goods and services such as tariffs, anti-competitive practices, increase transparency and move towards international standards. And the cooperation pillar will aim to implement common rules to level the playing field between the two regions. These will involve adhering to international standards for intellectual, industrial and commercial property rights, the banning of anti-competitive practices and effective dispute settlement systems.
3. The European Parliament gave its consent in December 2012 that the trade pillar of the AA could be applied first, ahead of the political and cooperation pillars, which may take several years to complete negotiations on. Ratifying the trade pillar now means benefits from greater trade can be accrued whilst the other pillars are finalised and ratified.

II. Rationale for action from the UK

4. In order for the trade pillar of the AA to come into effect, all EU Member States and the individual Central American countries involved, must ratify this pillar of the AA in their own right.
5. The AA is a regulation of the European Parliament and of the Council, and the EU Parliament gave its consent to the agreement on 11 December 2012.
6. The UK Government is committed to implementing this trade pillar of the agreement between the EU and the six Central American countries, which is designed to open markets to business, services and investment in accordance with World Trade Organisation (WTO) law. The agreement is consistent with the UK's objectives in trade policy (free, fair and open markets) and with relevant wider policy HMG goals. And the trade pillar of the AA, which includes a FTA, is expected to generate extensive benefits to both UK industry and the UK consumer. The UK Government supports this agreement, which is well balanced and ambitious with substantial gains for all parties on market access and rules. Given the EU Parliament gave its consent to the trade pillar in December 2012, if the UK did not ratify it, it would be at risk of an infraction on proceedings. All considered, the UK supports the ratification of the trade pillar of the AA.
7. This Impact Assessment assesses the costs and benefits of the trade pillar of the AA to the UK, in preparation for the UK's ratification.

III. Economic Overview

Economic background of the Central American countries involved in the AA (Panama, El Salvador, Nicaragua, Guatemala, Honduras and Costa Rica)

8. Central America (CA) is a small market. It has a population of nearly 43 million (0.6% of the global population) and accounts for about 0.25% of global GDP.

9. Aside from the global economic downturn in 2009, CA countries have achieved steady economic growth over the past decade. Although, rates of growth vary significantly. In 2013, Panama grew by 8.4%, Nicaragua by 4.6%, Guatemala by 3.7%, Costa Rica by 3.5%, Honduras by 2.6% and El Salvador by 1.7%[1]. In 2013, this meant an average growth rate across the countries of 4% - higher than the regional average across Latin America and the Caribbean that year of 2.7%, and above the global average of 3.3%. Looking forward, the IMF projects positive growth for all in 2019, ranging from 5.8% in Panama to 2% in Nicaragua[2].

10. The countries of CA have varying levels of economic development. Whilst all are classed by the World Bank as 'developing countries', there are wide disparities in size and wealth: Guatemala is the largest economy in the region with a GDP of $50.2 billion, followed by Costa Rica ($45.1 billion), Panama ($36.3 billion), El Salvador ($23.9 billion), Honduras ($18.5 billion) and Nicaragua ($10.5 billion). In terms of wealth, Panama is amongst the richest countries in Latin America, with GDP per capita of $11,040. In comparison, Nicaragua is the second poorest in the Western Hemisphere after Haiti, with $1,851 per capita[3]. Poverty levels range from 22.4% in Costa Rica to 64.5% in Honduras[4].

11. Most CA economies have been characterised by large agricultural sectors with some light manufacturing. Traditionally they were reliant on exports of coffee and sugar and, more recently, of fruit, vegetables and fish. Light manufacturing such as of plastics and textiles has also developed, often serving the US market. There is now a trend towards providing services, particularly back office services such as call centres. However, there is also considerable diversity. For example, Panama is now largely a service economy (roughly 80% of output) with a large financial centre, logistics and distribution services that cater to the wider Latin America region. Costa Rica meanwhile has developed more advanced manufacturing, including microchips as a result of large-scale investment by Intel.

12. Regional integration of these CA countries is relatively strong, and is growing, which the UK is already involved in. The six CA countries included in this AA are members of the Central American Integration System (SICA), alongside Belize and the Dominican Republic. SICA is a regional body whose aim is greater political integration and is considered one of the most integrated regions of the world, progressing towards a customs union and with elaborated potential integration mechanisms[5]. SICA is advised by the Secretariat for Central American Economic Integration (SIECA) on economic issues, and aims to foster greater economic integration across the region. The UK is an observer member of SICA, alongside many other EU Member States, the US, Japan and Australia and others. This privileged relationship enables the UK to work more closely with SICA and to take part in certain meetings of the organisation.

13. The history of the relationship between the EU and CA extends beyond trade. The EU has supported regional integration in CA for many years - for example, the San Jose Dialogue, launched in 1984 to seek solutions to the armed conflicts, by means of negotiations. And the EU is a leading donor of official development aid to the region.

14. CA's main trading partners are the US (following the 2005 Central America-US FTA), the region itself (the Central American Common Market) and the EU. As a result, its exports go mainly to the US (32%), Central America (26%) and the EU (9%). And its imports come mainly from the US, China, and other parts of Latin America, but this varies across countries. Table 1 lists the main export and import destinations for each of the CA countries involved in the AA. It shows that all of the CA countries have relatively large values of exports and imports in relation to their GDP, and rely heavily on international trade.

[1] International Monetary Fund World Economic Outlook October 2014 Update http://www.imf.org/external/pubs/ft/weo/2014/02/pdf/text.pdf

[2] International Monetary Fund estimates for 2019 as of October 2014

[3] World Bank Database 2013 data http://data.worldbank.org/indicator/NY.GDP.PCAP.CD

[4] World Bank Database 2014 data http://data.worldbank.org/indicator/SI.POV.NAHC/countries/CR?display=default

[5] European Commission http://ec.europa.eu/trade/policy/countries-and-regions/regions/central-america/

Table 1: Exports and Imports for Central American economies included in the AA

Country	Exports as a % of GDP[6]	Main export destinations[7]	Main exports[8]	Imports as a % of GDP[9]	Main import origins[10]	Main imports[11]
Costa Rica	35% ($13.4bn)	US (39%), Netherlands (11%), Mexico (9%), China (5%), Malaysia (3%)	Integrated circuits (44%) Office machine parts (11%) Medical instruments (6%) and tropical fruits (5%)	39% ($15bn)	US (51%), China (8%), Mexico (6%), Japan (3%), Panama (3%)	Refined petroleum (12%), Integrated circuits (10%), printed circuit boards (4%), Cars (3%) and packaged medicaments (2%)
Panama	80% ($27bn)	Ecuador (30%), South Korea (10%), Guatemala (10%), Costa Rica (10%), and US (5%)	Refined petroleum (17%), Passenger and Cargo Ships (15%), Packaged medicaments (7%), Bananas (4%) and Special Purpose Ships (4%)	75% ($28.9bn)	China (35%), South Korea (11%), Singapore (10%), Colombia (8%), US (7%)	Refined petroleum (14%), crude petroleum (10%), passenger and cargo ships (7%), sulfonamides (6%) and packaged medicaments (3%)
El Salvador	26% ($6.4bn)	US (46%), Guatemala (13%), Honduras (13%), Nicaragua (6%), Costa Rica (4%)	Knit t-shirts (14%), coffee (6%), knit socks & hosiery (5%), electrical capacitors (4%) and raw sugar (4%)	46% ($11.1bn)	US (36%), Guatemala (10%), Mexico (7%), China (6%), Honduras (4%)	Refined petroleum (12%), crude petroleum (4%), light rubberised knitted fabric (4%), packaged medicaments (3%) and planes, helicopters and/or spacecraft (3%)
Honduras	48% ($6.4bn)	US (56%), Germany (6%), El Salvador (5%), Guatemala (4%), Mexico (3%)	Coffee (15%), knit t-shirts (10%), knit sweaters (9%), insulated wires (7%) and petroleum gas (3%)	70% ($10.1bn)	US (44%), China (8%), Guatemala (7%), El Salvador (7%), Mexico (6%)	Refined petroleum (18%), non-retail pure cotton yarn (6%), non-retail synthetic staple fibers yarn (3%), packaged medicaments (3%) and delivery trucks (2%)
Nicaragua	41% ($5bn)	US (37%), Venezuela (12%), Canada (10%), El Salvador (7%), Costa	Coffee (14%), gold (12%), frozen bovine meat (10%), raw sugar (6%) and knit	52% ($7.3bn)	US (17%), Venezuela (12%), China (9%), Mexico (8%), Curacao (8%)	Refined petroleum (14%), crude petroleum (6%), packaged medicaments (4%), light rubberised knitted fabric (2%) and

6 World Bank Indicators, 2013 data (goods and services) http://data.worldbank.org/indicator/NE.EXP.GNFS.ZS
7 Observatory of Economic Complexity http://atlas.media.mit.edu/profile/country/gtm/
8 Observatory of Economic Complexity http://atlas.media.mit.edu/profile/country/gtm/
9 World Bank Indicators, 2013 data (goods and services) http://data.worldbank.org/indicator/NE.EXP.GNFS.ZS
10 Observatory of Economic Complexity http://atlas.media.mit.edu/profile/country/gtm/
11 Observatory of Economic Complexity http://atlas.media.mit.edu/profile/country/gtm/

		Rica (4%)	sweaters (4%)			delivery trucks (2%)
Guatemala	24% ($12.7bn)	US (44%), El Salvador (9%), Honduras (7%), Mexico (6%), Costa Rica (4%)	Coffee (10%), raw sugar (9%), bananas (7%), gold (5%) and precious metal ore (5%)	35% ($19.1bn)	US (37%), Mexico (11%), China (8%), El Salvador (4%), Colombia (4%)	Refined petroleum (17%), cars (3%), packaged medicaments (2%), delivery trucks (2%) and broadcasting equipment (2%)

Current EU-Central America trade

15. Bilateral trade between the EU and CA is relatively small in absolute size. Although, the exports and imports complement each other in terms of the sectors that make up their economies: EU economies rely more heavily on manufacturing (18%) than agriculture (5%), whereas CA relies more on agriculture than manufacturing. In terms of services, the picture varies. Services contribute to around 75% of production for the EU, Costa Rica and Nicaragua, compared with 53% in Honduras and El Salvador, and 83% for Panama, which depends heavily on services provided around the Panama Canal. Overall, the EU's trade with CA makes up a very small proportion of total EU trade (the GDP for the CA countries amounts to less than 1% of the EU GNP). In comparison, for CA, the EU is its third largest trading partner.

16. *Total bilateral trade* between the EU and CA in 2012[12]:
    - totalled €14.9bn (£11bn), an increase from €9.9bn (£7.29bn) in 2007,
    - the EU has consistently maintained a trade surplus with CA.

17. EU *imports* from CA in 2012[13]:
    - totalled €9,566bn (£7.05bn) (an increase of 14% on 2011);
    - made up 0.5% of the EU's total imports that year;
    - came mainly from Costa Rica (54%), Honduras (22%) and Guatemala (12%);
    - were made up of machinery and transport equipment (59%), food & live animals (30%), miscellaneous manufactured articles (3%), crude materials (inedible) except fuels (2%), animal and vegetable oils, fats and waxes (2%) and beverages & tobacco (0.9%).

18. EU *exports* to CA in 2012[14]:
    - totaled €5,355bn (£3.95bn) (an increase of 23% on 2011);
    - made up 0.3% of the EU's total exports;
    - went mainly to Costa Rica (36%), Guatemala (28%) and El Salvador (15%);
    - were made up of machinery and transport equipment (48%) and chemicals & related products (22%), manufactured goods (10%), miscellaneous manufactured articles (9%) and food & live animals (4%), beverages and tobacco (2.9%).

Current EU-Central America barriers to trade

19. The barriers to trade between the EU and the six CA countries exist in the form of both tariffs and deeper non-tariff barriers.

20. <u>*Tariff barriers to trade:*</u> All countries involved in this AA are members of the WTO and are therefore subject to their principles on tariffs. Under the WTO's principle of Most Favoured

[12] European Commission, 2012 data http://ec.europa.eu/trade/policy/countries-and-regions/regions/central-america/ Pound sterling values calculated using an exchange rate of €1: £0.74 on 25 March 2015. Note – this is one of the most recent reliable sources of published data on EU trade with CA economies.

[13] European Commission, 2012 data http://ec.europa.eu/trade/policy/countries-and-regions/regions/central-america/

[14] European Commission, 2012 data http://ec.europa.eu/trade/policy/countries-and-regions/regions/central-america/

Nations (MFN) tariffs[15], a country should not discriminate between its trading partners, so any favoured treatment to one trading partner should be applied to all its trading partners. CA applies MFN tariffs to trade with the EU. In terms of tariffs from the EU on CA goods, an exception to the MFN principle applies because the CA countries are classed as 'developing countries'. The EU's Generalised Scheme of Tariff Preferences grants trade benefits to 15 developing countries it trades with, which includes these CA countries. As a result, they currently experience even lower tariffs than under the EU's MFN tariffs, to reflect the differing trade, development and financial needs. The GSP scheme is also expanded to the GSP+ scheme for those countries that commit to embracing core universal values on human, labour rights, environment and governance, which includes these CA countries. The tariffs from the EU on CA goods are therefore heavily reduced already – and are practically nonexistent for manufactured goods. Current tariffs are outlined in tables 2 and 3.

21. The EU's GSP scheme has been in place since 1971 and is part of the EU's common commercial policy, in accordance with the general provisions governing the EU's external action. In light of the EU-Central America FTA under the trade pillar of the EU-Central America AA, Honduras, Nicaragua, Panama, Costa Rica, El Salvador and Guatemala will be removed from the GSP scheme.

Table 2: Current tariffs on EU exports to Central America

Product	Current MFN tariff (trade weighted in %)	Current trade value (millions €)
Agriculture & food products	11.28	314
Minerals and energy	5.13	300
Manufacturing	3.77	2,527
Total or combined average	4.65	3,141

Source: CEPR EU-Central America Study, using Eurostat, WITS and GTAP data

Table 3: Current tariffs on EU imports from Central America

Product	MFN tariff (trade weighted in %)	Applied tariff under the GSP+ scheme	Current trade value (millions €)
Agriculture & food products	12.52	9.07	3,035
Minerals and energy	0.26	0.00	45
Manufacturing	0.68	0.00	2,155
Total or combined average	7.54	5.26	5,235

Source: CEPR EU-Central America Study, using Eurostat, WITS and GTAP data

Table 4: Current tariffs on EU's top 10 goods exports to Central America[16]

Product	MFN Tariff	Value of exports (millions of euros)
Medicaments consisting of mixed/unmixed products for therapeutic/prophylactic uses	2.0	179
Light petroleum oils & preparations	4.2	169
Medicaments containing hormones	0.1	125
Perfumes & toilet waters	7.7	93
Whiskies	15.3	69
Vehicles principally designed for the transport of persons	11.8	55
Articles of jewellery & parts there of precious metals	10.0	51
Vehicles principally designed for the transport of persons	12.6	41
Petroleum oils & oils obtained from bituminous minerals	4.1	40
Bending, folding, straightening/flattening machines	0.0	40

Source: CEPR EU-Central America Study, using Eurostat, WITS and GTAP data

[15] World Trade Organisation, https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm

[16] European Commission, 2012 data http://ec.europa.eu/trade/policy/countries-and-regions/regions/central-america/

22. *Non-tariff trade barriers:* Differences exist in product standards and conformity assessments related to food safety, customs, and administrative procedures, amongst others. These restrict free trade, which distorts the market price, resulting in lower competition and less choice for consumers.

Current UK–Central American trade

23. Table 5 lists the UK's exports and imports between 2008 and 2013 with the whole of 'other Central American countries', giving absolute values of trade and their percentage of the UK total trade. Published ONS data on UK trade gives data for the UK's trade with the category 'other Central American Countries', which gives a general indication of the UK's trade with Central America (in the knowledge that figures for Belize and the Dominican Republic are also included). No country level breakdown is available from the ONS so this is the next best alternative.

24. It is estimated that UK-Central American bilateral trade is relatively small. UK exports to 'other Central American Countries' has consistently represented around 0.01-0.02% of the UK's total exports since 2008. And UK imports from this group have consistently represented around 0.01% of the UK's total imports over the same period. If Belize and the Dominican Republic are excluded to increase the accuracy of the estimate for the countries involved in this AA, then these figures are only likely to go down even further. Consequently UK-Central American bilateral trade is estimated to be relatively small, although still represents a few £billions of UK exports.

Table 5: UK trade with 'other Central American countries'

Component	2008	2009	2010	2011	2012	2013
UK exports to CA of goods and services	£6.717bn	£6.557bn	£6.789bn	£6.548bn	£7.169bn	£6.150bn
(% of total UK exports)	(0.02%)	(0.02%)	(0.01%)	(0.01%)	(0.01%)	(0.01%)
UK imports from CA of goods and services	£4.070bn	£4.104bn	£3.405bn	£2.983bn	£2.934bn	£3.194bn
(% of total UK imports)	(0.01%)	(0.01%)	(0.01%)	(0.01%)	(0.01%)	(0.01%)

Source: UK Office for National Statistics Pink Book October 2014

IV. Objective of the EU-Central America FTA

25. The key objectives of the trade pillar are as follows, with the summary of all chapters included in the trade pillar outlined in Annex 1:

(a) the reduction or the elimination of tariff and non tariff barriers to trade;

(b) agreed provisions regarding customs and trade facilitation, standards, technical regulations and conformity assessment procedures as well as sanitary and phytosanitary measures;

(c) the liberalisation of trade in services, in conformity with Article V of the General Agreement of Trade and Services (GATS);

(d) the promotion of economic regional integration in the area of customs procedures, technical regulations and sanitary and phytosanitary measures to facilitate the circulation of goods between and within the Parties;

(e) the development of a climate conducive to increased investment flows, the improvement of the conditions of establishment between the Parties on the basis of the principle of non-discrimination and the facilitation of trade and investment among the Parties through current payments and capital movements related to direct investment;

(f) the effective, reciprocal and gradual opening of government procurement markets of the Parties;

(g) the adequate and effective protection of intellectual property rights, in accordance with international obligations in force between the Parties, so as to ensure the balance between the rights of the right-holders and public interest, taking into consideration the differences between the Parties and the promotion of technology transfer between the regions;

(h) the promotion of free and undistorted competition in the economic and trade relations between the Parties;

(i) the establishment of an effective, fair and predictable dispute settlement mechanism; and

(j) the promotion of international trade and investment between the Parties in a way that contributes to the objective of sustainable development through joint collaborative work.

26. Notably there are two specific key objectives that have been negotiated by the EU:

27. **EU key export industry concerns:** The FTA will address specific concerns relating to a number of EU key export industries. For example, the FTA will provide new disciplines in textile labelling and marking that will limit the amount of information that can be required on a permanent label. Consequently it will prevent overly burdensome and unnecessary labels that are not relevant to consumers.

28. **Trade remedies:** Trade remedies are trade policy tools to counter imports which are causing damage to a domestic industry, such as anti-dumping action. In this FTA, measures are included in the trade remedies, providing protection for EU and Central American businesses. These measures include:

- provisions which reaffirm commitments to WTO principles and promote development of harmonised regulations and standards;
- sanitary and phytosanitary standards which go beyond WTO requirements;
- a ban on anti-competitive practices such as cartels and abuse of dominance;
- agreement that CA will move towards international standards in customs legislation and promote development of regional customs regulations;

Evidence of the benefits of free trade

29. Countries engage in trade because it is mutually beneficial and can lead to numerous benefits. Consumer choice can increase the variety and quality of goods and services. Lower prices can be achieved through increased competition and efficiency, higher productivity and higher real wages. And living standards for the countries can be improved.

30. But barriers to trade can occur through a number of channels - often referred to as ‘trade protection’ or ‘protectionism’. Trade protection occurs when governments deliberately or otherwise, restrict trade flows, which attempt to guard their domestic industries from the increased competition that comes with international trade or foreign investment. The most common forms of protection include tariffs, subsidies and quantitative restrictions, but can include more obscure forms such as complex regulations (health and safety, packaging and labelling and product regulations) and customs procedures.

31. Most economists would argue that trade protection may provide some nations/sectors with short term gains but in the long run it is considered harmful. Actions of one trading partner, taken to protect their own industry, may have adverse effect on others, and there is the possibility of retaliation from trading partners. Protectionism negatively affects consumers and firms that use imports as production inputs and in the long-run will undermine a country’s competitiveness, however the exact magnitude of this is difficult to quantify.

32. Numerous studies have investigated the effects of trade liberalisation on growth, showing increased openness can lead to increased income per capita. For example, an OECD[17] study found that a 10% increase in trade openness could lead to a 4% increase in per capita income in OECD countries. The Centre for Economic Performance in 2009 estimated that the proposals that were being discussed as part of the Doha Development Agenda, in which applied protection would be cut by 26%, would deliver an additional $167 billion to global GDP.

[17] Bassanini, A. and S. Scarpetta (2001), “The Driving Forces of Economic Growth: Panel Data Evidence for the OECD Countries”, OECD Economic Studies, No. 33, OECD, Paris.

33. A number of studies have estimated the cost of protectionism, showing that increased protectionism can reduce growth rates. The 2001 study by Messerlin[18] estimated that if all major economies increased their applied tariff rates (the tariff rates that are currently being applied to other nations) to their bound rates (the tariff rates that a country can levy without breaking WTO law) then the world economy would shrink by 0.5%. Similarly, if countries maintained the Smott-Hawley tariff regime of 1930 (the US act of 1930 that raised US tariffs on over 20,000 imported goods to record levels) and reciprocal tariff regimes were introduced by US trading partners then the world GDP was estimated to have been approximately 7.4% lower in 2003[19].

Box 1. How Free Trade Agreements work alongside the World Trade Organisation

The WTO was formed in 1995 and is based on the General Agreement for Tariffs and Trade (GATT) which was initiated by 23 countries in 1947. The WTO now has 161 members (as of March 2015) and its main aim is to provide a system of rules and procedures to ensure the orderly and transparent conduct of international trade and trade policies. It also provides a forum for trade negotiations.

A key principle of the WTO is non-discrimination which is encapsulated in the Most-Favoured Nation treatment (MFN) which states that members should accord similar treatment for all other members. For example if the EU were to lower tariffs on goods coming from India then it would need to offer the same reduction to all other members.

Free Trade Agreements (FTAs) are allowed as an exception to the MFN principle under Article VI of WTO law if they cover 'significantly all trade', which in practice means the FTA covers around 90% or more of the value of trade between countries/regions.

FTAs can be bilateral or between a large number of countries, usually regionally. Larger trading blocs include the European Union (EU), the North American Free Trade Area (NAFTA) and the Association of South East Asian Nations (ASEAN).

FTA's can complement the WTOs multilateral trade agreements. FTAs between a small number of countries are generally considered to be easier to negotiate than multilateral agreements between 160 countries. Consequently they may achieve results quicker and could potentially achieve deeper integration between the economies concerned.

V. Policy objective and intended effects of the trade pillar of the AA

34. The objective of the trade pillar of the EU-Central America AA is to achieve a 'deep' FTA that successfully eliminates tariff and non-tariff trade barriers.

35. The intended effect is for all countries involved to benefit from the FTA in boosted trade and investment, and a range of other reassurances such as harmonised regulations and standards that could increase legal certainty and lower compliance costs for EU and UK businesses.

36. The EU-Central America AA was concluded in May 2010 and initialled by the chief negotiators from each side in March 2011. The European Parliament gave its consent that the trade pillar progress in December 2012. Once all Member States ratify the agreement, the council will adopt the decision concluding the agreement and there will be full entry into force of the FTA.

37. The EU-Central America AA is a priority for the Central American governments and the EU, and ratification would have positive benefits for the UK in a wide range of areas, with positive trade, political, environmental and social impacts.

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18 Messerlin, P. (2001), "Measuring the costs of protection in. Europe", European commercial policy in the. 2000s

19 Bradford, P. "The Payoff to America from. Global Integration", Peterson Institute for International Economics

VI. Options

38. The terms and conditions of the FTA have already been negotiated and cannot now be altered, so only two options are now open to the UK – not to ratify, or to ratify.

Option 0: Do nothing - do not ratify the trade pillar of the EU-Central America AA

39. Option 0 is for the UK not to ratify the trade pillar of the EU-Central America AA.

Option 1: Ratify the trade pillar of the EU-Central America AA

40. Option 1 is for the UK to ratify the trade pillar of the EU-Central America AA.

41. The agreement has been negotiated by and given consent by the European Parliament and the European Council, and is scheduled to become part of EU law. The UK has supported the negotiations of the FTA so far because it is expected to generate benefits to both the UK industry and the UK consumer.

42. Option 1 is the government's preferred option. The FTA aims to increase the available export opportunities of EU businesses, create greater competition and thus lower prices, increase innovation and investment in R&D and increase the variety of goods and services to the benefit of consumers. These benefits will filter through to UK industry and UK consumers.

VII. Costs and benefits of option 0

43. In 2012 the European Commission (EC) modelled the estimated costs and benefits of an EU-CA FTA. The analysis in this impact assessment relies heavily on figures calculated in this modelling, estimating UK benefits based on their calculated EU benefits. When figures have been taken from their work, the EC are referenced in this paper as a footnote. In their modelling the EC used a Computable General Equilibrium (CGE) model to calculate the estimated costs and benefits to the EU.

44. The UK, as a member state of the EU, bears a degree of the EU costs and benefits via its EU membership and the resulting change in actions of the EU. In 2013, the UK made up 13.3% of the EU's goods exports and 14% of the EU's good imports – an average of 13.7% of EU trade in goods. We can therefore approximate the UK's costs and benefits by taking 13.7% of the EU's costs and benefits. There is some degree of error in this method, but it provides an indicative estimate of the scale of impacts. Given the uncertainty, sensitivity analysis is also done to show the UK costs and benefits if this proportion were to be 10% or 15%.

45. It is assumed for simplicity in the following calculations that the EU-Mercosur FTA, the US-Central America and Colombia FTA and the EU-Peru & Colombia FTA remain unsigned.

Costs of option 0

46. *Opportunity costs.* Under option 0, the benefits of option 1 would be foregone (also known as the opportunity costs).

47. *Risking infraction of proceedings with the EU*. Choosing this option and not ratifying the FTA, the UK would be voting against what the EU Parliament have already given their assent to and have agreed will become law. It consequently puts the UK at risk of an infraction of proceedings. There would likely be some legal proceedings associated with this, and consequently a degree of legal costs. The scale of legal costs is unknown. They are not estimated here because doing so would require making a number of assumptions of unknown various scenarios until the issue is resolved between the EU and the UK.

48. *Risk to UK reputation.* The UK has supported all negotiations of the FTA so far. Not ratifying the FTA would mean backtracking on the UK's previous – and current – position of support for the FTA and the wider AA. The risk of reputational loss to the UK would be significant.

Benefits of option 0

49. *Adjustment costs of option 0 would be avoided.* Option 0 would mean no short term adjustment costs that ratifying – and then implementing – the FTA would mean.

VIII. Costs and benefits of option 1

50. In 2012 the European Commission (EC) modelled the estimated costs and benefits of an EU-CA FTA. The analysis in this impact assessment relies heavily on figures calculated in this modelling, estimating UK benefits based on their calculated EU benefits. When figures have been taken from their work, the EC are referenced in this paper as a footnote. In their modelling the EC used a Computable General Equilibrium (CGE) model to calculate the estimated costs and benefits to the EU.
51. The UK, as a member state of the EU, bears a degree of the EU costs and benefits via its EU membership and the resulting change in actions of the EU. In 2013, the UK made up 13.3% of the EU's goods exports and 14% of the EU's good imports – an average of 13.7% of EU trade in goods. We can therefore approximate the UK's costs and benefits by taking 13.7% of the EU's costs and benefits. There is some degree of error in this method, but it provides an indicative estimate of the scale of impacts. Given the uncertainty, sensitivity analysis is also done to show the UK costs and benefits if this proportion were to be 10% or 15%.
52. It is assumed for simplicity in the following calculations that the EU-Mercosur FTA, the US-Central America and Colombia FTA and the EU-Peru & Colombia FTA remain unsigned.

Costs of option 1

53. *Adjustment costs for UK businesses, enforcers and officials.* There will be one-off minimal costs to firms, enforcers, customs and government officials from reading and understanding the text of this agreement. The cost will be their time. There will be some financial costs in changing prices on final product prices where tariffs change, but these are expected to be minimal and are therefore not quantified here.
54. *Lost tariff revenue for UK Government.* The EU will receive less in tariff revenue from EU imports from CA under option 1. The EU tariff revenue from CA imports is already relatively small given that tariffs on imports from CA are already very low under the EU's GSP+ scheme, and because the EU imports from CA make up only 0.5% of total EU imports.
55. Table 6 estimates the tariff revenue lost to the EU from CA imports under the FTA, comparing the current tariffs with the tariffs under the FTA. It estimates that the EU will lose approximately €133m (£96m) each year through agricultural products alone (tariffs on manufacturing imports and on minerals & energy imports are already 0%). However, this calculation assumes that the *value* of imports from CA under the FTA will be the same as current levels, whereas in reality imports may increase under the FTA. As the volume of imports increases, the tariff revenue will increase. This would likely be a small affect, but would nonetheless be expected to help minimise the tariff revenue loss.

Table 6: Tariff revenue for the EU on EU imports from Central America

Product	MFN tariff on CA imports	Applied tariff under GSP+ scheme on CA imports	FTA tariff on CA imports	Trade Value (millions of euros)	Current tariff revenue (millions of euros)	Tariff revenue under FTA (millions of euros)	Loss of tariff revenue under FTA (millions of euros)
Agriculture & food products	12.52	9.07	4.69	3,035	275	142	133
Minerals and energy	0.26	0.00	0.00	45	0	0	0
Manufacturing	0.68	0.00	0.00	2,155	0	0	0
Total or average	7.54	5.26	2.72	5,235	275	142	**133**

56. The UK share of these costs is estimated by taking 13.7% of the EU costs, as discussed in paragraph 51. With an estimated cost to the EU of £96m each year, the estimated cost to the UK is therefore £13m each year in our central estimates. (A range is tested in the sensitivity analysis.)

57. *Increased competition for UK business from imports from CA*. Trade liberalisation and greater trade facilitation between the EU and CA is likely to increase imports from CA imports to the EU. EU, and consequently UK businesses, will therefore face increased competition. For UK businesses that do not remain competitive, this could result in less demand for their goods as consumers might substitute their goods with imports from CA. This could result in job losses and possibly being driven out of business. However, UK imports from CA represent 0.01% of UK total imports (see Table 5) and so these costs are expected to be minor for the UK. For this reason, an estimate for these costs is not quantified here.

58. *Total monetised costs.* The monetised cost of option 1 is the lost tariff revenues to the UK Government, estimated at £13m each year. Table 7 outlines the profile of total costs over 10 years. If discounted at the Green-Book recommended risk-free rate of 3.5%, this results in a Present Value of costs to HMG of £112m over the 10 year period.

Table 7: Profile of total estimated costs under option 1

Year	0	1	2	3	4	5	6	7	8	9	Total
Costs to UK											
Lost tariff revenue to UK Government (£m)	13	13	13	13	13	13	13	13	13	13	130
Total cost to UK (£m, 2013 prices)	13	13	13	13	13	13	13	13	13	13	130
Total cost to UK (£m, Present Value Prices)	13	13	12	12	11	11	11	10	10	10	112

Benefits of option 1

59. *Increased UK exports*. Tariff reduction/elimination will affect 70% of trade between the regions, with the remaining 30% protected because of the importance of EU exports of fruit and vegetables. Of the 70% of trade that will be liberalised, some tariffs will be eliminated immediately on implementation of the FTA and others will see staggered liberalisation over 10 years (and 17 years for a very small number of sensitive goods).

On completion of the staggered implementation, the weighted overall tariff for EU exports to CA will fall from 4.65 to 0.56 (Table 6).

Table 8: Current tariffs on EU exports to Central America

Product	Current tariff	Proposed new tariff under FTA
Agriculture & food products	11.28	5.58
Minerals and energy	5.13	0.00
Manufacturing	3.77	0.00
Total or combined average	4.65	0.56

Source: CEPR EU-Central America Study, using Eurostat, WITS and GTAP data

60. In *agricultural exports,* the FTA will halve tariffs on EU agricultural exports to CA from 11.28% to 5.58%[20]. The European Commission estimates that EU exports of agricultural products to the six countries are expected to rise by around 40% as a consequence[21]. Quotas will remain on EU exports of sensitive goods such as milk powder and cheese, whose duty-free quotas will be maintained initially, with yearly increasing quota ceilings. Tariffs will remain on EU exports of bananas. Table 3 shows that the value of current EU exports of agricultural goods to CA totals €314m. A 40% increase on this would be worth an additional €126m each year. The UK's share of this would be 13.7% of €126m, which equals €17m (£13m) benefit each year. However, this benefit to the UK may be overstated because the UK is not as agricultural as other parts of the EU and so the assumed share of 13.7% of EU agricultural trade may be too high. However, the difference is estimated to be of marginal absolute value and so is not accounted for here.

61. In *manufacturing exports*, EU companies exporting machinery and transport equipment should be particular beneficiaries of the FTA with tariffs in Central America being reduced from 3.77 to zero. The European Commission estimate that the EU's exports of manufacturing goods will increase by 41%[22]. Table 4 shows that EU exports of manufacturing currently totals €2,527m. A 41% increase would be worth an additional €1,036m each year. The estimated UK share would be 13.7%, worth €142m (£103m) each year.

62. *Tariff savings for UK exporters to CA.* EU companies will face much lower tariffs on their exports to CA. Table 9 outlines the change in tariffs. The average level of tariffs on EU exports to CA will fall from 4.65% to 0.56% under the FTA. It calculates the current tariff costs compared to those under the FTA, showing that tariff costs to EU exporters will reduce from €146m to €18m, a saving of €128m each year. The UK share is estimated as 13.7% of this, totalling €18m (£13m) each year.

Table 9: Tariff changes to EU exports to Central America[23]

Product	MFN tariff (trade weighted in %)	FTA tariff	Trade Value (millions of euros)	Previous tariff costs	New tariff costs
Agriculture & food products	11.28	5.58	314	35	18
Minerals and energy	5.13	0.00	300	15	0
Manufacturing	3.77	0.00	2,527	96	0
Total or combined average	4.65	0.56	3,141	146	18

63. For *agricultural tariff revenue,* the FTA will halve tariffs on EU exports from 11.28% (weighted average of all agricultural tariffs) to 5.58%[24]. The European Commission estimate that EU exports of agricultural products to CA will rise by around 40% as a consequence[25]. Quotas will remain on EU exports of sensitive goods such as milk powder and cheese, whose duty-free quotas will be maintained initially, with yearly increasing quota ceilings. Tariffs will remain on EU exports of bananas. Agriculture only accounts for approximately 6% of the EU's and around 1% of the UK's value added share. Therefore, although the MFN tariff of 12.52% on Agricultural and Food products is reduced to a new tariff of 4.69%, the FTA benefits to the EU's and UK's primary sector are expected to be small. EU and UK trade in agriculture products will be largely unchanged, with the main exception being vegetables, fruit and nuts imports increasing by 0.4% and exports decreasing by 1.2%. In fact, EU's agricultural output is expected to decline slightly by 0.04%[26] as a result of the increased competition in agricultural products.

64. For *manufacturing tariff revenue*, EU companies exporting machinery and transport equipment should be particular beneficiaries with tariffs falling to zero. Table 10 shows that most EU exports to

[20] European Commission, 2012 data http://ec.europa.eu/trade/policy/countries-and-regions/regions/central-america/

[21] European Commission, 2012 data http://ec.europa.eu/trade/policy/countries-and-regions/regions/central-america/

[22] European Commission, 2012 data http://ec.europa.eu/trade/policy/countries-and-regions/regions/central-america/

[23] European Commission, 2012 data http://ec.europa.eu/trade/policy/countries-and-regions/regions/central-america/

[24] European Commission, 2012 data http://ec.europa.eu/trade/policy/countries-and-regions/regions/central-america/

[25] European Commission, 2012 data http://ec.europa.eu/trade/policy/countries-and-regions/regions/central-america/

[26] This expected fall in EU's agricultural output is likely to be concentrated in vegetables and fruits (0.38% decrease) and other agricultural sectors (0.21% decrease).

CA are manufacturing goods, so this will likely lead to an improvement in European competitiveness in CA markets. The European Commission estimate that the EU's exports of manufacturing goods will increase by 41%. The impact on the overall EU and UK industrial sectors will be relatively modest. Manufacturing accounts for approximately 19% of the EU's output. EU trade with Colombia and Peru is largely concentrated in manufacturing sectors, with €4,056 million worth of trade (2007 prices). The proposed removal of these tariffs (from 5.39%) will lead to a major improvement in European competitiveness in the Colombian and Peruvian markets for these products. Furthermore, even with the current MFN tariff for cars set as high as 35%, it is still the second most important EU export to Colombia. With the FTA tariff for this sector set to zero, the relative competitiveness of European cars will improve significantly. Overall, as a result of the changes in the trade policy, output of manufactured goods in the EU are expected to increase slightly by 0.04%, mainly through the increase in production of Textiles (0.16% increase) and Motor Vehicles (0.07% increase).

65. For *services tariff revenue,* the output impact on services for the EU and the UK will be limited. Services account for three-quarters of the overall EU production and as a result of the Trade Agreement, the services sector as an aggregate is estimated to grow by 0.02%, mainly driven by activities in maritime, air transport, insurance and recreational sub-sectors. The underlying assumption for this growth is that the demand for services generally increases due to a combination of increased intermediate demand and services liberalisation. The EU and the UK service exports are expected to remain largely unchanged, however, insurance (0.2%), business services (0.1%) and recreation activities (0.4%) are forecast to increase compared to the do nothing scenario.

66. Table 10 estimates that the top 10 EU exporters to CA would save approximately €47m (£33m) each year. Assuming a UK share of 13.7%, the UK would save €5m (£3m).This figure is not included in the wider costs and benefits of the FTA to the UK, as they will be included in the above estimate to all UK exporters. This is solely for illustrative purposes.

Table 10: Top 10 EU exports to Central America[27]

Product	HS6 number	Current tariff	FTA tariff	Current value of exports (millions euros)	Current EU tariff revenue from Central America (millions euros)	Estimated tariff revenue to EU under FTA (millions euros)	Change in tariff revenue (millions euros)
Medicaments consisting of mixed/unmixed products for therapeutic/prophylactic uses	300490	2.0	0.0	179	3.58	0.0	-3.58
Light petroleum oils & preparations	271011	4.2	0.0	169	7.10	0.0	-7.10
Medicaments containing hormones	300439	0.1	0.0	125	0.13	0.0	-0.13
Perfumes & toilet waters	330300	7.7	0.0	93	7.16	0.0	-7.16
Whiskies	220830	15.3	12.3	69	10.56	8.5	-2.07
Vehicles principally designed for the transport of persons (i)	870323	11.8	0.0	55	6.49	0.0	-6.49
Articles of jewellery & parts there of precious metals	711319	10.0	0.0	51	5.10	0.0	-5.10
Vehicles principally designed for the transport of persons (ii)	870324	12.6	0.0	41	5.17	0.0	-5.17
Petroleum oils & oils obtained from bituminous minerals	271019	4.1	0.0	40	1.64	0.0	-1.64
Bending, folding, straightening/flattening machines	846229	0.0	0.0	40	0.00	0.0	0.00
TOTAL	-	-	-	862	46.92	8.5	-38.43

67. *Positive impact on UK and CA GDP*. Paragraph 32 outlines previous analysis that suggests an increase in openness in trade can result in increased economic growth. The level of trade CA for the EU is relatively small so the impact on EU GDP is likely to be negligible, but if anything, likely to be positive. For the CA the impact would likely be larger given that the EU is CA's third largest trading partner. Any increase in economic growth in CA will positively affect the EU (indirectly) particularly when the wider EU-CA AA is implemented, which will create greater trade and investment flows between the regions. This impact has not been quantified in this analysis.

68. *Greater consumer choice for UK consumers.* As barriers to trade reduce and bilateral trade and competition increases, EU and UK consumers will be able to access cheaper products more easily from CA. This is likely to be a minimal benefit given that only 0.1% of the UK's imports come from CA but will be a positive one nonetheless. This impact has not been quantified in this analysis.

69. *Greater investment flows between the UK and CA.* The agreement includes binding measures on the transparency of tax and non-tax incentives in the extraction and service industries, which will help encourage Foreign Direct Investment (FDI) in the CA markets. Such FDI changes were not included in the European Commission's modelling of costs and benefits – but it is significant as some services (e.g. retail branch banking) can only be delivered via FDI. The Centre for the

[27] European Commission, 2012 data http://ec.europa.eu/trade/policy/countries-and-regions/regions/central-america/

Analysis of Regional Integration at Sussex (CARIS) in 2009 estimated that the impact of previous FTAs can lead to significant increases in FDI flows. This study found that “North” : “South” FTAs led to an increase in bilateral FDI flows of around 30%, with potentially even higher gains in the flows from “North” to “South” countries. However, it should be noted, that this study was based on a small number FTAs and without further evidence, it would be difficult to estimate the impact from this agreement on outward FDI from the UK to the CA countries and vice versa. The FCO and BIS plan to monitor investment flow changes closely. Given the uncertainty, these impacts have not been quantified in this analysis.

70. *Social impacts.* According to the IA, this policy change will have no impact on the wages of skilled and unskilled workers in the EU. The Agreement is expected to contribute to poverty and inequality reduction in CA, albeit the impacts are generally small. The EC’s modelling suggests that wages would increase in all CA countries for both skilled and unskilled labour. This corresponds to previous modelling of the FTA by the EC that estimated that unskilled and skilled wages increased in Costa Rica, Nicaragua and Guatemala respectively; but fell in Panama by 0.5% for unskilled and 0.8% for skilled. Their modelling also found that poverty is reduced, though only by a small margin, whilst inequality would remain the same.[28] Given the uncertainty, these impacts have not been quantified in this analysis.

71. *Environmental impacts:* The objective of sustainable development is embedded in all sections of the FTA. Energy accounts for approximately 2.9% of the EU’s output. The estimated effect of the FTA on the EU’s Energy output is expected to be negligible. This impact has not been quantified in this analysis.

72. *Total monetised benefits*. The monetised benefits of option 2 include the quantifiable benefits outlined in this section: increased UK agricultural exports to CA, increased UK manufacturing exports to CA, and tariff savings to UK exporters to CA.

Table 11: Profile of estimated benefits under option 1

Year	0	1	2	3	4	5	6	7	8	9	Total
Benefits to UK											
Increased UK agricultural exports to CA (£m)	13	13	13	13	13	13	13	13	13	13	130
Increased UK manufacturing exports to CA (£m)	103	103	103	103	103	103	103	103	103	103	1,030
Tariff savings to UK exporters to CA (£m)	13	13	13	13	13	13	13	13	13	13	130
Total benefit to UK (£m, 2013 prices)	129	129	129	129	129	129	129	129	129	129	1,290
Total benefits to UK (£m, Present Value Prices)	129	125	120	116	112	109	105	101	98	95	1,110

IX. Net impact of option 1 for the UK

73. Table 12 compares the total monetised costs of option 1 against the total monetised benefits across 10 years, to give the net benefit. The total cost across the first 10 years is estimated to be £112m (in present prices), whilst the total benefit over the first 10 years is estimated to be £1,102m (in present prices). The net impact for the UK is therefore estimated to be positive over 10 years at an estimated £862m.

Table 12: Estimated net impact of option 1 for the UK

Year	0	1	2	3	4	5	6	7	8	9	Total
Costs to UK											
Lost tariff revenue to UK Government (£m)	13	13	13	13	13	13	13	13	13	13	130
Total cost to UK (£m, 2013 prices)	13	13	13	13	13	13	13	13	13	13	130
Total cost to UK (£m, Present Value Prices)	13	13	12	12	11	11	11	10	10	10	112
Benefits to UK											
Increased UK agricultural exports to CA (£m)	13	13	13	13	13	13	13	13	13	13	130
Increased UK manufacturing exports to CA (£m)	103	103	103	103	103	103	103	103	103	103	1,030
Tariff savings to UK exporters to CA (£m)	13	13	13	13	13	13	13	13	13	13	130
Total benefit to UK (£m, 2013 prices)	129	129	129	129	129	129	129	129	129	129	1,290
Total benefits to UK (£m, Present Value Prices)	129	125	120	116	112	109	105	101	98	95	1,110
Net Present Value (£m)	116	112	108	105	101	98	94	91	88	85	998

[28] European Commission http://ec.europa.eu/trade/policy/countries-and-regions/regions/central-america/

X. Rationale and evidence that justify the level of analysis used in the IA

74. The European Commission's impact assessment of the EU-CA FTA provides a basis for the calculation of EU costs and benefits of the FTA, which this IA uses to calculate the estimated costs and benefits for the UK. However, there are a number of limitations of their modelling of EU costs and benefits. Firstly, their results depend on the assumptions, such as estimating trade elasticities in certain markets. The results also depend on the data inputted in the model and the assumption that future outcomes depend on past behaviour, which is not always the case. It is difficult and subjective to model dynamic changes. For instance, this trade agreement is likely to result in increased competition between firms, which could result in higher innovation. And in future, other FTAs are likely to be signed in the region, such as a possible EU-Mercosur FTA.

75. The EC's calculations did not explicitly undertake sensitivity analysis for the impacts of the EU-Central America Association Agreement. However it did include scenario analysis using three scenarios depending on other FTAs signed in the region. The following section provides sensitivity analysis to show an estimated range of the possible costs and benefits to the UK from the FTA, to help account for the uncertainties in the estimates that exist because of a range of assumptions made in the calculations.

XI. Sensitivity Analysis

76. The costs and benefits calculated above are reliant on the assumption made in paragraphs 44 and 51 that the UK will experience 13.7% of the costs and benefits of the EU. This proportion is based on the estimate that the UK comprises 13.7% of EU trade when looking at UNCTAD trade data. However there is a degree of uncertainty in this assumption, as the UK will experience varying costs and benefits depending on a range of parameters such as sector, year and trade by all other EU members. Here we use a range of the proportion of 10 and 15% of costs and benefits that the UK experiences of the EU costs and benefits to allow for uncertainty.

77. Costs of option 2:

- *Lost tariff revenue for the UK*. Lost tariff revenue for the EU is estimated at £96m each year. If the UK experienced 13.7% of EU costs this would total £13m each year, if 10% this would total £10m, and if 15% it would total £14m.

78. Benefits of option 2:

- *Increased UK agricultural exports to CA.* Increased EU agricultural exports to CA is estimated to be £91m each year. If the UK experienced 13.7% of the EU benefit it would total £13m per year, if 10% then it would total £9m per year and if 15% it would total £14m per year.
- *Increased UK manufacturing exports to CA.* Increased EU manufacturing exports to CA are estimated to be worth £751m each year. If the UK experienced 13.7% of the EU benefit then it would total £103m per year, if 10% then it would total £75m per year and if 15% then it would total £113m per year.
- *Tariff savings to UK exporters to CA.* Tariff savings to EU exporters to CA are estimated to be worth £93m each year. If the UK were to experience 13.7% of the EU benefit it would be worth £13m per year, if 10% then it would be worth £9m per year and if 15% then it would be worth £14m per year.

79. Table 13 provides the profile of costs and benefits to the UK if the UK experienced 10% of the EU's costs and benefits. This estimates a total benefit (in present value) of £801m over 10 years and a total cost (in present value) of £86m over 10 years, giving an estimated net benefit of £714m to the UK over 10 years.

Table 13: UK costs and benefits of EU-Central America FTA, assuming UK costs and benefits are 10% of the EU's

Year	0	1	2	3	4	5	6	7	8	9	Total
Costs to UK											
Lost tariff revenue to UK Government (£m)	10	10	10	10	10	10	10	10	10	10	100
Total cost to UK (£m, 2013 prices)	10	10	10	10	10	10	10	10	10	10	100
Total cost to UK (£m, Present Value Prices)	10	10	9	9	9	8	8	8	8	7	86
Benefits to UK											
Increased UK agricultural exports to CA (£m)	9	9	9	9	9	9	9	9	9	9	90
Increased UK manufacturing exports to CA (£m)	75	75	75	75	75	75	75	75	75	75	750
Tariff savings to UK exporters to CA (£m)	9	9	9	9	9	9	9	9	9	9	90
Total benefit to UK (£m, 2013 prices)	93	93	93	93	93	93	93	93	93	93	930
Total benefits to UK (£m, Present Value Prices)	93	90	87	84	81	78	76	73	71	68	801
Net Present Value (£m)	83	80	77	75	72	70	68	65	63	61	714

80. Table 14 provides the profile of costs and benefits to the UK of the UK experienced 15% of the EU's costs and benefits. This estimates a total benefit (in present value) of £1,214m over 10 years, and a total cost (in present value) of £121m over 10 years, suggesting an estimated net benefit of £1,093m to the UK over 10 years.

Table 14: UK costs and benefits of EU-Central America FTA, assuming UK costs and benefits are 15% of the EU's

Year	0	1	2	3	4	5	6	7	8	9	Total
Costs to UK											
Lost tariff revenue to UK Government (£m)	14	14	14	14	14	14	14	14	14	14	140
Total cost to UK (£m, 2013 prices)	14	14	14	14	14	14	14	14	14	14	140
Total cost to UK (£m, Present Value Prices)	14	14	13	13	12	12	11	11	11	10	121
Benefits to UK											
Increased UK agricultural exports to CA (£m)	14	14	14	14	14	14	14	14	14	14	140
Increased UK manufacturing exports to CA (£m)	113	113	113	113	113	113	113	113	113	113	1,130
Tariff savings to UK exporters to CA (£m)	14	14	14	14	14	14	14	14	14	14	140
Total benefit to UK (£m, 2013 prices)	141	141	141	141	141	141	141	141	141	141	1,410
Total benefits to UK (£m, Present Value Prices)	141	136	132	127	123	119	115	111	107	103	1,214
Net Present Value (£m)	127	123	119	115	111	107	103	100	96	93	1,093

81. This sensitivity analysis shows that if the UK experienced between 10-15% of the EU's costs and benefits, the EU-Central America Association (Trade Pillar) is net beneficial to the UK.

XII. Cost to UK business

82. UK firms of all sizes are open to be impacted by the EU-Central – micro, small, medium and large. They might be exposed to increased competition from imports from Central America. However, this is estimated to be negligible for two reasons. Firstly, the very small level of trade between the UK and Central America, which is approximately 0.01% of the UK's total trade. Secondly because UK and Central American firms tend to specialise in different areas. For example, the Central American countries tend to specialise in agriculture, whilst the UK tends to specialise in services.

83. UK businesses are expected to benefit from greater UK exports to CA, which has been outlined in the estimates above. The increase in UK exports could result in benefits between £74m and £111m depending on the level of UK costs and benefits compared to the EU's.

XIII. Specific impact tests

Statutory Equalities Duties Impact Test

84. The impact of this agreement on protected groups should be positive, as consumers and businesses overall should benefit from this agreement. The actual impacts will be monitored and reviewed during the implementation phase.

Competition Impact Test

85. Competition is a core part of the FTA. The chapter on competition recognises the importance of free and undistorted competition to trade relations, and ensures that competition laws in the EU and Central American countries will be applied so as to prevent the benefits of trade liberalisation being eliminated by anti-competitive business conduct or transactions.

86. Competition in the EU and the Central American countries is likely to increase as a result of this agreement as the FTA will remove barriers that currently prevent firms from each side accessing the other's market, hence the total number of firms will increase. This will result in benefits including increased innovation, greater efficiency, lower price and more choices for consumers and businesses within the respective economies. However as already mentioned in the analysis section, not all firms or sectors will benefit from this agreement. Even in sectors where the UK is competitive, weaker firms may suffer from stronger competition from the Central American countries; but the overall impact will be beneficial.

Small Firm Impact Test

87. Small and medium firms are not exempt from this agreement or any of the specific chapters within the agreement. SMEs are less likely than larger firms to have the capacity and capabilities to deal with and understand the different standards and regulatory barriers in the Central American market. Because of this Agreement, firms will benefits from removing some of the trade barriers in the Central American markets that prevent these firms from exporting. In addition, firms that use imports from the Central American markets are likely to benefit, as the cost of existing Central American imports are likely to reduce. Some uncompetitive firms may be adversely affected from competition from Central American firms, however the net impact on SMEs is expected to be positive.

Human Rights Impact Test

88. The agreement includes a robust essential elements clause that comprises both human rights and weapons of mass destruction. These aspects can be invoked by either party as grounds for their unilateral and immediate suspension of trade preferences. In addition, as outlined earlier, trade agreements are important for economic growth and prosperity, which should help improve human rights in the Central American countries.

Annex 1. Summary of chapters within the EU-CA FTA

Tariff Elimination

89. The Trade Agreement, over the course of its implementation, will halve tariffs (to 5.58%) for UK exporters of agricultural and fisheries products to the six Central American countries. There will also be savings from agricultural products lines that will be liberalised over a 17 year period. It is estimated, that an additional €22 million will be saved annually on exports of agricultural and processed agricultural products, bringing the total benefit for the EU export sector at the end of the transition period to more than €270 million a year. Sectors of importance to the UK that will benefit include automotive and car parts (€33m annually for the EU in duties), chemicals and pharmaceuticals (€16m annually for the EU in duties).

Trade in Goods

90. All parties have agreed to enhance communications and cooperation in the area of technical regulations (e.g. on health and safety, consumer safety policy on electrical and gas appliances), standards and conformity assessment. In practise, this means that other parties will have the opportunity to comment on technical regulations and there is an obligation to make comments received and final regulations available on a public website.

91. The Trade Agreement will also address specific concerns related to a number of EU key export industries. In textiles for example, the Agreement provides for new disciplines in labelling and marking that will limit the amount of information that can be required on a permanent label and thereby prevent overly burdensome and unnecessary labels that are not of strict relevance to consumers.

Trade Defence

92. The UK considers that the safeguard measures agreed in the trade defence chapter will provide effective protection to EU and Central America's industry without undermining the benefits that an ambitious agreement will bring to business.

Trade Remedies and Technical Barriers to Trade

93. The commitments in the Agreement regarding Technical Barriers to Trade (TBT) reaffirms the parties' commitments to the principles of the World Trade Organisation (WTO) TBT Agreement.

Trade in Services Establishment and E-Commerce

94. Key UK and EU objectives in trade in services and establishment, have been included in the Agreement, and in some sectors the commitments offered by the Central American countries can be considered ambitious compared to provisions in other FTAs.

Migration - Mode 4

95. The Agreement contains provisions on the temporary movement of natural persons for business purposes (often known as "Mode 4" trade in services). These Mode 4 commitments are an integral part of our wider approach on other commitments in services and investment liberalisation.

96. The UK is already bound by commitments to admit services professionals employed by companies in Central America in the context of the supply of a service to a UK client by virtue of its existing commitments under the General Agreement in Trade in Services.

97. The Mode 4 provisions of the EU-Central America Association Agreement extend these existing commitments in respect of the sectoral coverage of the arrangements for contractual service suppliers and in respect of provision for short-term visitors for business purposes. It is unlikely that these additional commitments would give rise to a significant increase in the number of arrivals from these countries as the Mode 4 categories are tightly defined, with a clear focus on highly skilled, highly qualified services professionals.

Government Procurement

98. The Government Procurement chapter is highly ambitious, and the access to procurement markets agreed goes beyond the coverage the EU or the six Central American countries gives in other FTAs.

99. The Central American countries have committed to full access to the procurement of local municipalities, in addition to central procurement above a certain level. This will allow UK businesses tendering opportunities and as such the possibility to win significant economic projects in both countries.

100. The service and establishment commitments included within this chapter will also allow UK firms to establish themselves in many different sectors, including the manufacturing, service and mining industries, which could provide significant commercial benefits to UK businesses.

Intellectual Property Rights

101. The protection and enforcement of intellectual property rights is crucial to UK competitiveness at home and abroad. The agreement contains clear commitments on intellectual, industrial and commercial property rights for EU producers and the agreement will provide protection for geographical indications in the Central American markets. On enforcement, EU right holders on copyrights and trademarks will have the necessary tools to defend these rights (such as civil, administrative and border measures), which go beyond the ones that are already covered by multilateral agreements.

Competition

102. Once the Agreement comes into force, all EU operators will benefit from an open, fair and reliable competition environment in which the Parties are required to ban through their national and regional legislation the most harmful anticompetitive practices including restrictive agreements, cartels and abuse of dominance. Mergers which significantly impede competition are also prohibited and independent competition authorities will be required to enforce the above rules in a transparent, timely and non-discriminatory manner, respecting the principles of procedural fairness and rights of defence.

Transparency

103. All parties will have the responsibility to provide regular reports to the other party in the agreement on central government subsidies. The reports will include the legal basis, amount or budget and where possible, the recipient of the subsidy granted by the government or any of its Public Bodies.

Trade and Sustainable Development

104. When this agreement comes into force, all EU tariffs on industrial, manufacturing and energy goods will be removed, which will generate noteworthy opportunities for businesses from the Central American countries. In addition, there will be significant tariff savings for Central American agriculture exporters. These tariff savings in all sectors of the economy will make Central American exports cheaper, which will increase the demand for them resulting in higher growth and employment in the Central American countries.

105. The agreement will promote and preserve existing labour and environmental protection standards on all sides. The Agreement includes firm commitments on the Central American side to effectively implement core labour standards, as contained in the ILO Fundamental Conventions, and eight key environmental international conventions. It furthermore includes commitments to refrain from waiving or derogating from protection standards to encourage trade or investment.

106. The agreement also includes a framework that can be used to address trade, social or environmental issues.

Dispute Settlement

107. The dispute settlement system for this Agreement will be transparent, with open hearings. No party will have the right to retaliate until non-compliance is verified.

Interest of Devolved Administrators

108. The UK's trade policy is a reserved matter under the UK's devolution settlements, the devolved administrations have been consulted throughout the negotiations.

Impact on UK Law

109. The FTA will be ratified by the UK following designation as a European Union Treaty in an Order in Council made under the European Communities Act 1972.

Gibraltar

110. The agreement will not apply to Gibraltar as it is excluded from the Common Commercial Policy.

European Economic Area

111. The agreement is likely to be adopted by the European Economic Area which applies EU internal market legislation.