The Economic Impact of Tariff Eliminations in a U.S.-U.K. Free Trade Agreement

The USITC report that measures the effects of all US trade agreements signed over the last 35 years shows that they have produced a small but positive influence when measured in several economic parameters including trade, output, income, wages, and employment. The distributional advantages of trade agreements are more likely to benefit non-minorities, men, and professionals who have graduated from college.

Generally, the US faces higher tariffs on its exports to the UK than UK's exports to the USA markets. So, the relative tariff reduction by the US may have a relatively small effect on prices in the US than the relative tariff reduction by the UK on the UK prices.

Also, the UK accounts for about 3% of US imports whereas the US accounts for around 9.3% of UK imports, raising the likelihood that the UK will experience a higher price decline than the US. These findings in turn imply that the UK may benefit from trade more than the US due to price reductions.

The results of the baseline scenario for the UK-US FTA which considers complete tariff elimination between the two countries show that member countries will be slightly but favorably impacted by the switch to zero tariffs in both countries. The UK gains $330 million in GDP and this is three times more than that of the US ($98 million).

The output of food manufacturing, mining, apparel/textile, healthcare, and oil industries, etc. increases in the USA. Import growth is positive in all sectors including the manufacturing sectors-wood/rubber, chemical, and apparel/textile, and export growth is the highest in apparel/textile, food/beverage, and wood/rubber.

Analysing the sectoral results of the UK with zero tariffs between the US and UK shows that sectors like food/beverage manufacturing, healthcare, computer/electrical manufacturing, and oil manufacturing experience an increase. Akin to the US results, import growth of the UK is also positive in most of the sectors though it is the highest in wood/rubber, chemical, and food/beverages. Exports growth is more pronounced in apparel/textile, wood/rubber, and oil manufacturing sectors.

Secondly, when we incorporate worker displacement, which is considering the reallocation of labour resources from the adversely impacted industries into the model, UK experiences a small yet positive impact whereas the US experiences a negative effect. In terms of GDP, the United Kingdom is expected to gain $202 million while the US loses $142 million. The estimated job loss is a very small fraction, and this comes from the displacement of workers in the sectors that shrink in response to the shock. In the US, this loss is high enough to produce an adverse impact on its GDP. In the UK, though job losses happen on a similar scale to the US, the impact of positive prices compensates for the adverse impact of job loss of a few workers.

In both scenarios, UK gains more than the US because of the larger gains from manufacturing value added and lower wages in the UK. Also, worker displacement is an important attribute in trade policies and manufacturing is a significant driver of changes in trade. Nevertheless both the economies gain from the trade agreement, while their magnitude varies based on various factors as mentioned above.

Reference:

Ferry, J., Gopalakrishnan, B.N. & Mayoral, A. The impact of a U.S.–U.K. free trade agreement on workers: a CGE model with worker displacement. Bus Econ 57, 121–138 (2022). https://doi.org/10.1057/s11369-022-00268-1