

THE FUTURE OF US-UK TRADE

WHAT CASE FOR A BILATERAL TRADE AGREEMENT?

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UK TRADE POLICY OBSERVATORY

KEY POINTS

- There is public support for a US-UK trade agreement, but this sits alongside worries about existing trade agreements, particularly over NAFTA in the US, and is contingent on the kind of regulatory framework pursued.
- Seeking an agreement allows both countries to present themselves outwardly as pursuing a sovereign policy in their own best interests as well as constructive members of a liberal world trading order.
- Any meaningful agreement (economically as opposed to politically) will need to deal with the barriers to trade in services, and the regulatory barriers within specific manufacturing sectors. Given the different approaches to regulation, this may be challenging.
- Among the most important of challenges in negotiating a US-UK trade agreement will be managing the trade implications of standards and technical regulations. The UK's post-Brexit regulatory regime risks being pulled in different directions by the EU and the US. A solution will depend on the UK's capacity to navigate the demands of both of its trading partners.
- The UK will have to settle its position in the multilateral trading system before meaningful and substantive negotiations with the US can commence.

INTRODUCTION

Both the Trump administration and the May government have stated their keenness to conclude a US-UK bilateral trade agreement, and to do so with speed.¹ While it remains—for the moment at least—aspirational, a dialogue between the two countries has begun and support continues to be expressed by political elites on both sides of the Atlantic.²

There are good reasons to ask questions about the likely support for, as well as the value and content of, a prospective US-UK trade agreement. In both the US and UK, trade agreements with partner countries have suffered from varying degrees of public buy-in and their value has been called into question. We need only think of the split in public opinion about membership of the EU in the UK, or of the North American Free Trade Agreement (NAFTA) in the US, for contemporary examples.

The public reaction to the Transatlantic Trade and Investment Partnership (TTIP) negotiations between the EU and US—of which the UK would have been part—provides a further example.³

Our purposes are threefold. First, we explore the extent to which a trade agreement between the US and the UK would have popular support at a time when debate about trade on both sides of the Atlantic is contested. Second, we consider what the benefits of such an agreement might be by considering the aggregate economic case. Finally, we probe where problems and tensions may lie, focusing primarily on the regulatory aspects of a transatlantic commercial tie-up. In the final section, we offer some concluding reflections.

PUBLIC SUPPORT FOR A US-UK TRADE AGREEMENT

One issue where there appears to be a measure of convergence in opinion among UK and US citizens—and where we might find evidence of support for a bilateral transatlantic endeavour—is on the desirability of a stronger UK-US relationship. When polling organisation YouGov surveyed UK citizens in 2017 about which country they considered to be the most desirable partner in a bilateral trade agreement, the US was their first choice.⁴ Similarly, when US citizens were asked in which country they had the most confidence to deal with the world's problems, the UK was ranked number one.⁵

However, recent polling of US opinions on free trade and trade agreements—conducted by the polling organizations Gallup and Pew—suggests that public support may be somewhat contingent. While a February 2018 survey found that 70 per cent of respondents viewed trade as an opportunity—with just 25 per cent seeing it as a threat⁶—when asked about their views on trade agreements rather than “foreign trade” more generically public support was found to be significantly less strong. For instance, a September 2017 Pew survey found that just 52 per cent of respondents saw trade agreements as “good” for the US compared with 40 per cent who viewed them unfavourably. Pew also found that 44 per cent of respondents said that trade agreements had helped their own financial situation whereas 38 per cent responded that they had hurt.

Public support for trade in the UK is significantly higher than in the US. More than 88 per cent of respondents in a recent survey believed that “free trade” between the UK and EU should be maintained.⁷ Moreover, US citizens are significantly more likely than UK citizens to say that growing trade is “very bad” or “somewhat bad,” as well as to believe that trade has a negative impact on wages and employment.⁸

One possible explanation for the difference in attitudes in the US and the UK is the type of trade flows that occur in both countries. The majority of the UK's most significant trading partners are European with the corresponding trade flows between advanced industrial countries generally believed to be characterised by small income-distribution effects. In contrast, a significant proportion of US trade is with middle-income countries (including with Mexico, a NAFTA partner), the type of trade flows that are usually associated with creating both large gains and significant losses.

US public perceptions of NAFTA, compared to their overall opinion of trade more generally, support this view. An October 2017 Gallup poll found just 46 per cent of respondents had favourable views of NAFTA, with 48 per cent registering negative opinions.⁹

Perhaps because of Trump's rhetorical stance on NAFTA, there are strong partisan divisions over NAFTA in contrast to the lack of divisions regarding trade overall. In 2017, just 22 per cent of Republicans viewed NAFTA favourably compared to 67 per cent of Democrats and 53 per cent of independents. NAFTA was not a partisan issue in 2004, but by 2017 it had become strongly so. That said, Gallup did find support for NAFTA among young adults, with 73 per cent of those aged between 18 and 29 saying that they thought it was good for the US.¹⁰

What we can extract from the polling data is that general support for trade exists but it sits alongside worries about existing trade agreements, particularly over NAFTA. However, given the mutually favourable views of the UK and US public, it is reasonable to suppose that a sufficient measure of support would exist for a new transatlantic commercial agreement—at the outset at least.

WHAT IS THE ECONOMIC CASE FOR A US-UK TRADE AGREEMENT?

Working on the assumption that there would be sufficient public as well as political support on both sides of the Atlantic for a US-UK trade agreement, what are the likely economic impacts? While seeking to present themselves as pursuing a sovereign policy in their own best interests, the UK and the US governments will probably also wish to present themselves as constructive members of a liberal world trading order. A US-UK free trade agreement offers the opportunity to satisfy both of these potentially contradictory objectives. In this context, primary areas for progress include alignment of regulatory regimes (an issue to which we return below), services and investment liberalisation, and investor-state dispute settlement.

That said, there is a real risk that a meaningful agreement will be hard to achieve. How much of any of this may or may not be possible will come down to each country's offensive and defensive strategic interests and how this plays out in terms of their respective domestic constituents. In turn, and in good part, this will be determined by what is traded and what the barriers to that trade are. Here several issues emerge.

Figures 1 and 2 set out the shares of imports and exports of goods out of total goods in each country's total goods trade to enable us to consider the respective importance of mutual trade. Not surprisingly the US is much more important for the UK than vice-versa. For example, the US accounts for around 15 per cent of UK exports, while the UK accounts for just over 3 per cent of US exports. This asymmetry in relative importance may well be reflected in future negotiations.

When we look at trade in services, we see that the relative importance of the US for the UK is even higher. The US accounts for nearly 19 per cent of the UK's total imports of services and nearly 22 per cent of the UK's total exports of services. With regard to investment, for each country, the other is a relatively important destination and source of financial inflows. Over the period January 2014 to March 2018, 13 per cent of UK foreign direct investment (FDI) was destined for the US; and 9 per cent of US FDI was destined for the UK. Over the same period, the US accounted for 10.6 per cent of total FDI in the UK, and UK accounted for 7.9 per cent of FDI in the US.

If we consider the relative importance of goods and services we find that 55 per cent of UK imports from the US are goods imports and 45 per cent are services imports; whereas 47 per cent of UK exports to the US are goods exports and 53 per cent are services exports. From this it should be clear that in any agreement both services trade and goods trade are important; and in the long run it is likely that services will be much more important than goods. This is for two reasons: the preceding data do not take into account Mode 3 service flows, that is foreign direct investment; and the preceding are gross figures and do not take into account the services that are embodied in the production of goods which are then exported. For both the UK and the US, the OECD TiVA database indicates that the share of services embodied in the exports of goods is close to 50 per cent.

Figure 1 - UK goods imports and exports from the US as a share of total UK goods imports and exports

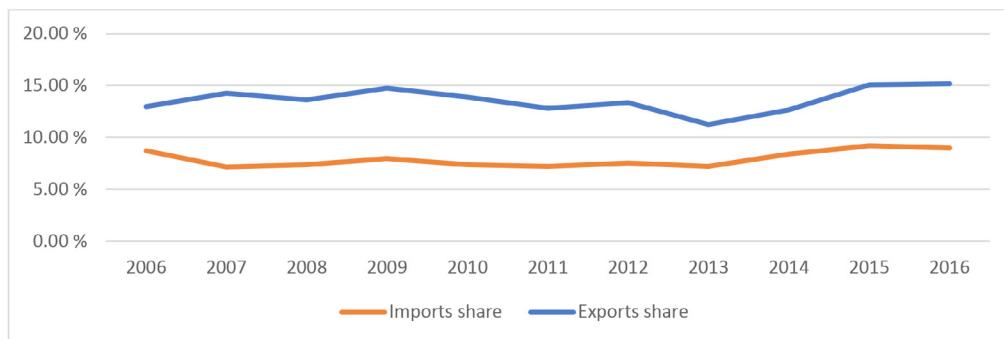
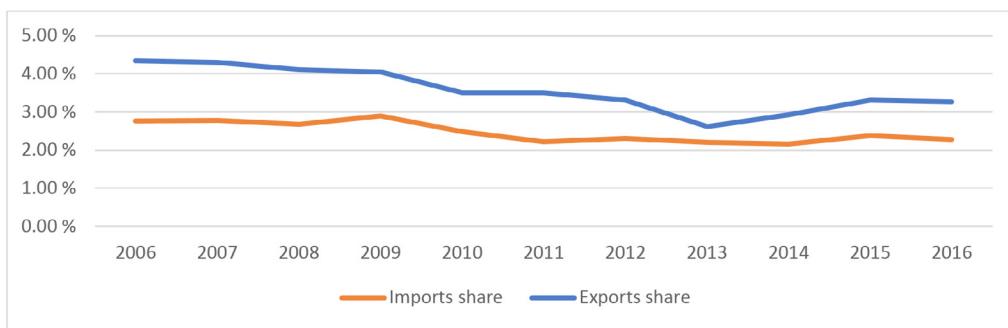


Figure 2 - US goods imports and exports from the UK as a share of total US goods imports and exports



Turning to the composition of the trade in goods between the US and the UK three factors emerge. First, a high proportion (around 60 per cent for both the UK and US) of what is traded between the US and the UK are intermediate goods. This varies considerably across industries. For example, close to 80 per cent of rubber and plastics exported by both the US and the UK are intermediate goods, while the figure for motor vehicles is closer to 40 per cent. This suggests that rather than simply shipping final goods, US and UK firms are quite closely integrated into each other's supply chains.

Second, there is a fair amount of overlap in what is traded. If we take the top 100 products imported by the UK from the US, and by the US from the UK (out of a possible total of over 5,000 products), there are 53 products which overlap. Third, approximately 70 per cent of the goods traded between the US and the UK are in high-tech or medium high-tech sectors (based on the OECD STAN classification).

Table 1 provides information on the key sectors traded bilaterally, based on UK goods import and exports. Consistent with the above, other than the category of pearls and precious metals, we see the concentration of trade in machinery, aircraft, electrical machinery, and pharmaceuticals.

It is worth also noting that 50 per cent of UK exports to the US already face zero tariffs; and a further 41 per cent face tariffs of less than 5 per cent. Similar figures apply to US exports to the EU and, by extension, to the UK.

With regard to services trade and investment flows, the data indicate that business services, financial services, and travel dominate bilateral services trade for both the UK and the US. According to UK figures, these account for close to 70 per cent of UK trade with the US; and for the US, the figure is close to 60 per cent. Regulations and barriers in these sectors are therefore likely to be an important focus in future negotiations.

Table 1 - key sectors traded bilaterally

HS Code	Product Name	UK Imports (\$bn)	Imports Share	UK Exports (\$bn)	Exports Share
84	Reactors, boilers, machinery...	15.4	26.8%	10.9	17.0%
88	Aircraft, spacecraft	8.8	15.4%	3.3	5.2%
71	pearls, precious metals, jewellery	5.0	8.8%	1.9	3.0%
85	Electrical machinery & equipment	4.0	7.0%	3.2	5.0%
90	Optical, photographic, medical	3.3	5.8%	3.6	5.6%
30	Pharmaceutical prods	2.5	4.3%	9.3	14.3%
27	Mineral fuels	2.2	3.8%	3.8	5.9%
97	Works of art	1.7	2.9%	4.6	7.2%
39	Plastics	1.3	2.2%	0.9	1.4%
44	Wood and articles of wood	0.9	1.6%	0.0	0.0%
Total		45.0	78.6%	41	64.5%

SO, DO THE DATA SUGGEST AN AGREEMENT IS WORTH PURSUING?

What we can surmise, then, is that with respect to trade in goods there is likely to be a high degree of overlap in each country's strategic interests. On the one hand, that commonality might make agreement easier; on the other hand, it could lead to competitive concerns within each country. Those interests are likely to have a fairly narrow sectoral focus; and there is likely to be a strong focus on the higher technology sector. With regard to the latter, it is worth noting that these are typically sectors in which supply chains are more complex, where services inputs may be more significant, and where regulatory issues with regard to goods and services, as well as technical standards and conformity assessment in goods, are more likely to be important.

Beyond this, the low level of existing Most Favoured Nation (MFN) tariffs between the two countries means that in any future deal in goods between the US and the UK tariffs are unlikely to be an important issue. The key issues will be regulatory and related to non-tariff measures. Any meaningful agreement (economically as opposed to politically) will need to deal with the barriers to trade in services, and the regulatory barriers within specific manufacturing sectors. Given the two

countries' differing approaches to regulation, this may be challenging. There is a clear danger that the UK, in its desire to show success in pursuing an independent trade policy, will agree to a relatively shallow—or a relatively disadvantageous—agreement, and one that does not deal satisfactorily with the issues that really matter in terms of US-UK economic relations. It is to these issues that we now turn.

THE REGULATORY ELEMENTS OF A US-UK AGREEMENT: "A TTIP FOR TWO"?

Among the most important of challenges in negotiating a US-UK trade agreement—and one which will test the resilience of public opinion in the UK—will be getting to grips with the trade implications of standards and technical regulations. The issue here is that the UK's post-Brexit regulatory regime will be pulled in different directions by the EU and the US. Any solution will depend on the UK's capacity to navigate the demands of both of its major trading partners as well as to allay public anxieties.

Measures concerning regulatory politics have the potential to impact trade significantly. Two World Trade

Organization (WTO) agreements are important in this regard: the first on sanitary and phytosanitary standards (SPS); and the second on technical barriers to trade (TBT). In both cases, the agreements seek to prevent domestic regulations from being used as disguised restrictions on trade, with SPS covering health and safety standards, and TBT covering labels, licenses, and certification. The language of SPS and TBT show how different these measures are from tariffs and more traditional barriers to trade. Terms like “based on science” and “legitimate public policy” take centre stage, expanding the scope of trade to include domestic rule-making. An agreement between the US and UK will have to go deeper than WTO rules, offering “plus provisions” which bear not just on the substance of regulations, but the domestic politics of legislating them. Since the EU and the US have very different regulatory regimes, unless an artful solution can be found, the UK will probably have to choose between the two. This is a significant obstacle for UK-US regulatory integration. In order to avoid the need for border inspections between the Republic of Ireland and Northern Ireland, the UK seems likely to have to adopt—or at least align very substantially with—EU standards for goods.

Regulations typically become trade issues when a government manages “risk” in a way that discriminates in favour of domestic versus foreign producers or lacks an empirical referent in science. Banning a pesticide used by farmers abroad, but not a similar pesticide used by farmers at home is a case in point. Moreover, it is not just the substance of the regulations that matters, but the process by which these regulations are legislated. This is where trade issues may prove problematic, particularly for the UK, as they can have an impact upon perceptions of sovereign decision-making and on public sensitivities about food hygiene standards and health.

Some US demands might be hard for the UK to meet. Washington’s preference for “science-based” SPS measures, for example, will test the UK’s ability to come through on WTO plus provisions. The EU’s “precautionary principle” stands out in this regard. Whereas Brussels has given member states latitude to regulate where science is lacking, the US balks at these temporary measures if they are not continuously revised in keeping with state-of-the-art data. This is clear in the design of the Trans-Pacific Partnership (TPP), where the US pushed for regulations to be based on “the best reasonably obtainable information including relevant scientific, technical, economic or other information.” For some, this might not sound significantly different from WTO case law on SPS Article 5.7. The key is that it complicates European-style “hazard-based” approaches where science is not certain. This, in turn, will compel the UK to keep its “risk assessments” current, and potentially give rise to conclusions that are at odds with Brussels.

The way these regulations are legislated may also be a source of tension. In the TPP, the US pushed

for provisions that would give its exporters a seat at the regulatory table of other members. The WTO’s TBT Agreement Article 8.7, for example, requires that members allow “persons of the other Parties to participate” in each other’s deliberations. Some countries currently allow for this where a foreign producer has a local presence, but the US “ask” is more akin to national treatment in domestic regulatory politics.

Another challenge is the means by which conformity with these regulations is tested. The EU regime is embedded in the national regulatory processes of member states, which designate approved accreditation bodies that are formally recognised by the EU. Historically, sector-by-sector Mutual Recognition Agreements (MRAs) on conformity assessment have been signed across the EU. Some of these MRAs span the Atlantic as well. But the US is not fond of this piecemeal approach, and Europe has its doubts as well. If the UK were to maintain close regulatory alignment with the EU, in terms of both standards and enforcement measures, this would likely restrict its ability to allow US conformity assessment bodies to certify that US products met UK regulatory specifications. Since the US is keen to curtail that demands for “redundant testing” abroad, a “TTIP for two”—as a US-UK agreement might be characterised—will have to grapple with the scope of national treatment on conformity assessment.

One option might be to identify carve-outs that would enable the UK to maintain alignment with the EU in some sectors, and the US in others. That said, the EU is pushing for more substantive harmonisation across the board and has also resisted sectoral approaches to regulatory alignment with the UK.¹¹ Moreover, the US also prefers “horizontal commitments.” But as a short-run strategy aimed at appeasing the EU and US, some kind of hybrid model will buy time for the UK.

In the long run, a “TTIP for two” would serve as a bridging mechanism for a fuller transatlantic trading relationship, one that comes to terms with the EU-Canada Comprehensive Economic and Trade Agreement (CETA) and (possibly) a revised NAFTA. In fact, litigation at the WTO is increasingly forcing these issues, highlighting the many challenges of legislating national standards in a global economy.

The multilateral view

The regulatory conundrum does not end there, however. Trade agreements are intended to create trading conditions between signatories that are better than their existing MFN commitments. Hence, it is highly unlikely that any major trading country—including the US—would wish to conclude agreements with the UK until the latter has largely settled its position in the WTO. Moreover, there is an inevitable spill-over between two countries’ relations in the WTO and their attempts to negotiate a bilateral deal.

Although the UK government's intention is to replicate the EU's schedules in the WTO,¹¹ even this will generate complications. For example, the proposed division of the EU's Uruguay Round Tariff Rate Quotas for around 100 agricultural products between the UK and the remaining EU27 attracted immediate and sharp opposition from trading partners.¹² There is also, however, another (little discussed) potential flashpoint.

As noted above, it is likely that the UK, in order to avoid a hard border in Northern Ireland, will voluntarily adopt, *inter alia*, the entire range of EU TBT and SPS measures. These are far from uncontroversial and are issues that partners have discussed—and sometimes tired of discussing—with the EU. However, when the UK voluntarily adopts them as part of its own new policy, they could suddenly be re-opened.

One measure of this possibility is the so-called Specific Trade Concerns (STCs) that trade partners have raised about EU practices in the WTO's TBT and SPS Committees. Between 2000 and 2017, 105 TBT concerns were raised, of which the US initiated or associated itself with 42 (STCs can have more than one sponsor). Similarly, 80 SPS concerns were raised, 32 by the US. The bulk of the concerns of both types referred to food and food-related products and issues of public health.

Given the UK government's expressed intention not to reduce standards in these sensitive areas after Brexit, it will not easily be able to distance itself from these issues.¹³

Of course, some of these STCs have been resolved and some may not apply to products imported by the UK or to UK practices. However, it is clear that many of them will do so. They will have to be explained and justified at the WTO when they are raised. Moreover, a few issues have proceeded beyond STCs to actual trade disputes—for example, hormone-treated beef—which will be even more complex to deal with.

Two questions arise. First, will the UK government have the capacity to deal with all these complaints? Second, a traditional way of dealing with complex trade frictions in the past is to roll them up into a subsequent trade agreement at which solutions—or at least acquiescence—are negotiated in return for other concessions. The US is not shy about pressing its trading interests and so, in negotiating a UK-US agreement, the UK is likely to start with a substantial list of grievances registered in the multilateral system that it has to settle before it can get on to negotiating its offensive interests.

CONCLUSION

What we see, then, is that while political and popular support may exist for negotiating a trade agreement between the US and UK, and there are reasons to suggest that gains could accrue to both sides, the major sticking points are likely to be regulatory. In turn, these sticking points are likely to have a significant bearing on the extent to which British public support endures, particularly if the UK government pushes forward with an approach that jars with public perceptions of sovereign decision-making or sensitivities around food standards and health but which are consistent with US approaches.

In negotiating with major trading partners after Brexit, the UK is likely to be a price taker—that is, its negotiating position will be relatively weak compared with bigger economies like the US and weakened because it will need to negotiate new agreements to ensure that UK goods and services find export markets as well as to appease leave-voters in the UK referendum. This means that the UK will probably have to accept binding obligations on regulations and standards that tie its hands in setting domestic regulations on matters as diverse as animal hygiene and weights and measures. And given that the UK's primary objective is negotiating a trade deal with the remaining EU27 that covers the transition from a deep association with its biggest trading partner, the price that it takes will initially have to be acceptable to the European Commission.

Yet, in doing so the UK's capacity to negotiate a deal with the US that is anything more than an expression of mutual interest is likely to be limited, for the medium term at least. Thus, it may be prudent for the UK to resist the pressure to choose between regulatory regimes—particularly if public opinion turns—and prioritise reaching an agreement with its European trading partners first. The UK can then start work on a trade arrangement with the US that starts in those areas where agreement is likely and where difficult-to-swallow regulatory frameworks do not exist, such as in some services sectors. Whatever the UK decides, as with much else in its departure from the EU, artful diplomacy will be required to resolve its trading future. For the US, the picture is likely to be slightly different. While the benefits of a bilateral agreement with the UK may be limited, in an era when so many of its established trade relationships are being put to the test, it may be prudent—politically at least—to signal a concomitant ability to negotiate new agreements that are perceived to be more beneficial.

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- 10 Pew found similar partisan and age-group divisions over NAFTA. In terms of partisanship, 35 per cent of Republicans thought NAFTA was good compared to 73 per cent of Democrats. Indeed since 2015, Republicans have expressed much less favourable views of trade than have democrats. In 2017, just 36 per cent of Republicans (compared to 67 per cent of democrats) say trade agreements are good for the US; and just 35 per cent of Republicans say trade agreements have helped their own financial situation compared to 54 per cent of Democrats. Examining responses by age group, Pew found 69 per cent of young adults aged between 18 and 29 approved of NAFTA. In the Pew data, the partisan division over trade agreements is consistent with partisan divisions over trade.
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FURTHER INFORMATION

The authors are members of faculty at the universities of Georgetown and Sussex. This briefing paper is the first output of a collaborative venture exploring the future of US-UK trade. We are grateful for the on-going commitment and of our respective institutions to this project.

The UK Trade Policy Observatory (UKTPO), a partnership between the University of Sussex and Chatham House, is an independent expert group that:

- 1) initiates, comments on and analyses trade policy proposals for the UK; and
- 2) trains British policy makers, negotiators and other interested parties through tailored training packages.

The UKTPO is committed to engaging with a wide variety of stakeholders to ensure that the UK's international trading environment is reconstructed in a manner that benefits all in Britain and is fair to Britain, the EU and the world. The Observatory offers a wide range of expertise and services to help support government departments, international organisations and businesses to strategise and develop new trade policies in the post-Brexit era.

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