European & International Analysts Group

Trade and investment policy: Options for UK policy in 2024

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The purpose of trade and investment policy

Within a market economy, trade is a function of need and competitiveness: need, because all nations need certain goods and services that they cannot supply competitively themselves; and competitiveness, where trade reflects an existing competitive advantage.

Openness to trade and investment is a useful indicator both of a nation's ability to supply its own needs as economically as possible, and of the efficiency of its production, because firms that trade tend to be more efficient to compete internationally, and to grow faster. In turn, this supports jobs, growth, and prosperity. Trade and investment policy needs to be linked to delivery of these goals.

Trade requires open global markets. These in turn depend on governments' actions and also on firms able to invest and build their competitiveness. Governments' actions, for good or ill, can be critical (in the financial crisis of 2008-09 the G20 governments were mindful of the disastrous mistakes of the 1930s, when countries closed their markets). Open global markets have benefited not only advanced countries but also developing and emerging economies. The cost-savings enabled by digital trading have led many smaller businesses to enter new markets.

Imports allow for greater specialisation of production and help ensure that more competitive firms actively respond to market conditions while weaker businesses either rise to market challenges or cease trading. So trade openness is important for both exports and imports. Both depend on investment which is linked to trade growth.

International trade increasingly embraces services as well as goods. Historically, trade in goods preceded trade in services, and the global trade system is still skewed towards catering for goods. Since 1945 trade liberalisation has advanced much more rapidly for goods than services. Tariffs and quota restrictions affecting goods can be dismantled rapidly while liberalisation of services requires agreed approaches to regulatory standards, relevant professional qualifications, and often on cross-border movement of workers; all of which are politically sensitive issues.

Today wider issues are being raised about trade in a lower trust global economy. Trade policy has become more politicised, facing challenges over the extent to which it can be used to promote values or proactively influence trade partners' policies and practices in fields such as human rights, labour conditions, or gender equality. How far should trade only be encouraged between countries that have shared values? Can trade be made more eco-friendly? Does there need to be regulation of digital trade? How can overseas investments best be protected? What process ensures that trade and investment policies remain consistent with national defence and security priorities? And, given that current international institutions active in trade and investment policy were created soon after World War II, can they be fair to developing countries emerging much later, in today's changed circumstances?

Against this background this paper considers how far the UK can influence the international trade environment, and which specific policies best support UK based firms to increase their global competitiveness.

The current global trade environment

The following key features are worth highlighting:

- There are continuing dynamic changes in world trading patterns. Dominant in 1945, the US later faced competition from Japan and the EU. The rise of China, with its specific brand of state capitalism and use of state-owned enterprises (SOEs), means that there are now three global trading blocs – China, the EU, and the US – with separate approaches. And new geopolitical questions – the Covid pandemic and Russia's war on Ukraine – have led to realignments bearing down on former supply chains. **Digitisation of trade** is a further dynamic change.
- Against this unstable background, the outlook for the global trading system remains challenged by the **weakness of the World Trade Organisation**. There is little prospect of a new global round of trade negotiations following the abandonment of the Doha Trade and Development Round started over twenty years ago. The WTO dispute resolution process is increasingly contested by large actors including the United States.
- **Discriminatory protection** of national production is rising globally. Measures used include tariffs, import restrictions, discriminatory government procurement, restrictions on inward investment, bans of goods considered sensitive for security reasons, and controls on capital movements from third countries. Domestic producers in the US and elsewhere are receiving large subsidies which distort investment and trade.
- **Reversing these trends** would require a strong lead from the US, China, and the EU, as the major global trade blocs. Current political tensions, including within the US, make that unlikely. Increased management of trade and investment between major blocs for strategic/defence reasons, and to support national or regional protectionist policies, looks set to continue. Any trade and investment policy therefore requires navigating in an evolving environment, balancing any perceived attractions of "going it alone" with the need to court like-minded allies.
- **Migration controls** are increasingly critical to trade, particularly in the service sector. Limiting the movement of skilled workers and researchers inhibits cross-border investment, does not encourage mutual recognition of qualifications, and raises costs for transnational businesses. Developing countries seek more freedom of movement for workers – particularly in the digital and IT sectors – while advanced countries request better access for business personnel and professionals in developing and emerging economies.

In addition the coming decade will see a growing impact of **climate change** issues including carbon border adjustments, increased cross-border regulation of digital trade, and political pressure for more control of global supply chains and attempts to widen the taxation of trade and investment flows.

Implications for United Kingdom policy

Although well behind the three major trading blocs, the UK remains a significant trading country. Brexit has produced a decline in the UK's overall trade with the EU, which however remains the UK's most important market for both exports and imports. There has been some increase in UK trade with the US, reflecting higher US growth rates. But the EU is at least twice as important a market for the UK compared with the US.

UK trade policy will need to have a particular focus on services:

- **Services exceed goods as a share of UK exports**. Until 2021 services lagged goods, but in that year services accounted for £344.8 billion of UK exports, while goods stood at £331.2 billion. In 2022 the shares roughly reversed (goods £425.4 billion, services £412.3 billion). Over 2023 however UK goods exports fell by 7.7 per cent compared with 2022, while UK services exports rose by 13.2 per cent. Services accounted for 54.3 per cent of total UK exports of £859.2 billion in the year 2023.[1] This percentage may be even greater if account is taken of services provided through commercial presence in third countries, the profits of which are not shown in UK trade statistics.
- The UK economy has a **large and globally competitive services sector**, particularly in high value-added services. Seeking greater services access to third countries requires a different approach from trade in goods. Services differ from goods in significant ways: they are often supplied and consumed simultaneously; they cannot be stored for subsequent distribution; services are often "embedded" in goods (*e.g.* service contracts, training, upkeep/repair, IT support or other embedded services); they are not subject to import duties but are heavily affected by behind-the-border regulatory disciplines, sometimes politically difficult to change; and, at the retail level, they often require commercial presence through establishment overseas.
- **Moves to increase trade in services** raise difficult issues around:
  - **Movement of skilled workers** – a particular issue for India, in digital tech sector.
  - **Enforcement of standards** – labour, consumer protection, mutual recognition of professional qualifications.
  - **Rights to establish** a services business in third countries.
  - **Resistance to liberalising cross-border supply** among trade partners.
  - **Restrictive data rules**, particularly on data movement and data localisation.
- It is therefore **hard to achieve legally robust agreements on services**. Only the European Union single market has provided for legally robust cross-border service provision in sectors such as financial services; even there, despite the

[1] See HM Government, *'Official Statistics: UK trade in numbers'*, 22 February 2024

EU's advances (in which the UK played a major part), progress has been slow and much remains to be done. The EU remains the largest single export market for UK services. Globally, wherever legally robust market access for services remains difficult, UK trade policy will need to rely on regulatory cooperation, within the framework of "living agreements" with trade partners to provide another means of slow but effective liberalisation of trade in services.

Geographical priorities will also remain important:

- Given the **EU's importance as the UK's primary trading partner** good bilateral relations with the EU remain critically important to improve trade and investment flows. The political sensitivities in this relationship are well known. But a successful UK trade policy must include close cooperation with the EU for market access on both goods and services. Here the arguments over sovereignty and alignment (whether dynamic or not) come into play, particularly as regards UK and EU sanitary and phyto-sanitary (SPS) policies, and how far the UK should go in in aligning with the EU. It is not an issue that can be dodged: it has already arisen the case of UK agri-food imports from the EU, for which the UK introduced new customs procedures from 31 January 2024. These have brought with them some accompanying cost and supply chain problems. It has been suggested that these could be greatly eased (particularly in relation to border complications with Northern Ireland) if the UK were ready to move to recognition of EU SPS rules. Beyond recognition, it would be open the UK to move to alignment with EU rules, which could include "dynamic alignment" *i.e.* a UK-EU agreement that future UK SPS standards would remain aligned to those of the EU, including any future changes made by the EU, and thereby recognised as equivalent.
- **Other bilateral trade agreements** are likely to be either of marginal benefit to UK consumers with an offsetting cost to less competitive UK agricultural producers (Australia, Canada, or New Zealand); or require major concessions on free movement of workers (India); or mutual recognition of standards (China). Agriculture was a key factor in the recent "pausing" of the UK-Canada FTA negotiations, after the Canadian side made demands on agriculture and agricultural standards that the UK had long made clear it could not meet. The Canadian case is also an instance of SPS standards intersecting with strongly held popular opinion, the role of the precautionary principle, and other regulatory difficulties in which trade policy can become entangled.
- **UK accession to the CPTPP** currently offers little if any services liberalisation or an effective enforcement mechanism. But over time the UK, as a CPTPP member, will be able to help shape developments if this potentially important trading bloc deepens the market among its members in the future.
- The other major area for UK focus must be the **United States**. Problems here include regulation at state level affecting a range of services; the number of regulatory bodies with differing requirements and legal standards; the sensitivity of differing agricultural phytosanitary standards; the political symbolism of tariffs and the increasingly protectionist approach of both major US political parties. This requires continued focus at both federal and state

levels. Despite consistent efforts, the wider transatlantic political environment means that significant progress is likely to remain out of reach in the near term.

All in all, there will be a range of drivers of future UK trade policy. Some of these will need to be based on a coherent and settled domestic view of how some social, commercial, and environmental priorities are to be achieved in the future, and the role of trade and investment policy in achieving them, bearing in mind that the rules-based international system for trade lacks some of its past vigour and reputation. Implementing any trade policy will involve an exchange of concessions, involving a balance of enhanced market access, on the one hand, and impacts (*e.g.* on UK domestic producers), on the other, requiring careful prior assessment, including a clear-eyed view of the UK's real strength and influence. It is also likely to require prior domestic agreement on how far to accept equivalence or compliance with other countries' legal systems – sometimes involving a degree of legal alignment with a trade partner. Such concessions involve exercising sovereignty, not sacrificing it – an aspect that needs to be clearly understood and accepted in the domestic policy context, so that sensible policy choices can be made when dealing with trade partners.

Next Steps

The UK needs to have a coherently formulated trade and investment policy that is recognised as being an integral part of a wider commercial and industrial strategy focussed on competitiveness and productivity. This wider policy must also shape its trade priorities to cater for providing the most substantive improvements for UK firms and key sectors pursuing investment, whether inward or outward.

The policy needs to be applicable across all markets, while also being sensitive to the UK's current trade circumstances and likely future developments. For instance, the scale of current trade flows in goods and services to the EU and US requires a focus on these two markets which extends into regulatory and tax issues rather than simply tariff reductions or broad confirmation of both sides' GATT and GATS commitments.

The UK's wider trade policy will need to include a careful assessment of Free Trade Agreements (FTAs). Although labelled as "free", such agreements usually involve special rules (*e.g.* rules of origin) carrying their own compliance costs. The benefits accruing specifically to the UK from bilateral preferential trade agreements are likely to be modest and short-term, since any concessions given to the UK will be expected by other major trading countries under the most favoured nation (MFN) principle. Over time this leads to "preference erosion". This makes bilateral deals less attractive unless there is some distinctive and lasting benefit that can be secured. Prioritisation of worthwhile trade deals, and the components within them, is therefore critical.

In terms of trade policy priorities that have most direct impact on UK growth and employment we would identify the following areas:

1. **More structured trading relations with the EU**, as the UK's nearest and most important market. This should include agreement on common regulatory standards wherever possible, less restrictive controls on movement of workers particularly in the service sector, and facilitation of trade by smaller companies including digital trade.

2. There is also scope for **close joint working with partners on multilateral issues** in the WTO and other fora, and specifically on carbon border adjustments to avoid divergent carbon trading systems. **The EU** is one obvious partner with which to work.
3. A more consistent government focus on **supporting smaller firms** to export, particularly into the European market, to help compensate for the costs of new barriers since Brexit.
4. **Making trade and investment part of a wider UK industrial strategy**, to focus on facilitating trade in digital services, encouraging a globally consistent approach to data management, intellectual property, taxation, and consumer protection; including specific assistance to tech firms seeking to develop the UK as a global hub. This should include a transparent approach to state aids and rigorous competition policies.
5. **Keeping a balance between bilateralism and multilateralism**. The UK should not focus on bilateral trade agreements at the expense of action to strengthen multilateral and plurilateral trade arrangements. In particular it should work with partners including the EU and Japan to rebuild the credibility of WTO rules and disciplines.

Overall, trade and investment policy is an essential component of UK government strategy now that UK trade policy is nationally determined, even if it is not a panacea for solving the wider challenges of improving UK competitiveness.

Whatever the choice of departmental lead for trade and investment policy the key requirement is to ensure effective coordination across all relevant government policy. This must include the Home Office's migration responsibilities, and engagement with sectoral regulators in charge of setting standards for market access.

There is also a need for transparent communication of both wider trade and investment strategy and individual negotiations with Parliament, stakeholders, and the public. This is important for democratic oversight and accountability at a time when trade and investment policy is more highly politicised. It is also needed to ensure that sensitive issues such as investment protection agreements are fully discussed and their relationship with other policies is understood. Together with this, a coherent – possibly mandatory – system for consultation on UK trade and investment policy still needs further development. Trade and investment policy decisions, with their many implications across society, are too important to be decided behind closed doors.

John Cooke is a member of the European & International Analysts Group and was a member of the UK Permanent Representation to the European Communities, 1969–1973 and 1976–77; Under-Secretary, International Trade Policy Division, Department of Trade and Industry, 1992–96; and Chairman, OECD Trade Committee, 1996–97

Sir Martin Donnelly is a member of the European & International Analysts Group and was Director, Foreign & Commonwealth Office, 2004–08; Permanent Secretary, Department for Business, Innovation & Skills, 2010–16; and Permanent Secretary, Department for International Trade, 2016–17

February 2024

European & International Analysts Group

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contact@eiag.org.uk

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