



Interim Report #2

May 2020

INTRODUCTION

In April, the LSE Economic Diplomacy Commission conducted its second round of evidence sessions centred on options for the UK's economic future and diplomacy. The discussions covered the rapidly changing global economic landscape, optimal approaches for the UK's post-Brexit economic relationships and services trade, as well as the future of digital trade and governance. The witnesses, who hailed from multiple countries and spanned the policy and academic spectrum, were provided a set of questions ahead of the sessions and were invited to follow up afterwards with further thoughts.

With the severity of the COVID-19 pandemic now beginning to emerge, much attention was devoted to how the UK may best shape and navigate the post-pandemic world. However, given the vast uncertainties which still pervade the crisis, the opinions expressed should not be taken as the final judgments of the witnesses, the commissioners, or the Commission. As the disruptions from and policy responses to the pandemic continue to come about, the Commission may wish to re-engage with some of the witnesses towards the end of the year.

This Interim Report begins with the witnesses' reflections on the challenges and opportunities facing globalisation and global governance. It then relays the witnesses' proposals for how the UK ought to move forward with its post-Brexit 'Global Britain' ambitions, namely with respect to services trade and regulation, offering both a theoretical and practical outline for economic diplomacy in today's world. It concludes with a more specific overview of the UK's role in the digital space.

DE-GLOBALISATION OR RETHINKING GLOBALISATION

While it is too early to determine the future consequences of COVID-19, **a clear consensus is beginning to emerge that the pandemic has not only had a massive impact on the global economy – according to a recent UN report, it has wreaked havoc on the global economy unleashing the worst economic downturn since the Great Depression – it has also served to accelerate pre-existing trends away from global cooperation. From fresh confrontations within the European Union regarding the mutualisation of debt, to new challenges facing the World Health Organization regarding the U.S.-China relationship, to pronounced disruptions in the international distribution of medical data and equipment, the pandemic appears to have advanced the breakdown in global governance, which has been much-discussed in recent years. Now, as the virus has spread and accusations have mounted, other distressing fissures have deepened.**

The most prominent example, witnesses worried, is the widening political and economic divergence between the U.S. and China—and the balkanisation of global commerce and society that it portends. The challenge this poses was made clear this month as a contingent of U.S. senators moved to [block](#) the deployment of 48 fighter jets to the UK due to Huawei's role in the UK's 5G infrastructure. As the U.S. draws more red lines around cooperation with China (having previously implied it would exclude the UK from the [Five Eyes](#)), there is concern that states, including the UK, will struggle to operate **freely with and between** both powers. This threatens to create not only regulatory and market access burdens—though these, too, are costly—but also disruptions to the forms of globalisation and global governance that have emerged in the past fifty years. Such disruptions may

in turn produce expensive inefficiencies and indeed the spectre of hostilities.

However, the current crisis might open up the possibility of developing a new model of globalisation with fewer of the downside features associated with the hyper-globalized form it was to take following the end of the Cold War. As one witness put it:

“The hyper-globalisation era was built on a set of expectations, I think, that have been unfulfilled because they were unfulfillable. They created a lot of fragility, a lot of asymmetry, and essentially we had a period of the last 30 years or so where international economic integration happened at the expense of domestic **integration**.”

Although the politics of COVID-19 and the pandemic’s economic fallout will aggravate dislocations in the global economy in the short term, the attention they bring to the problems of the current globalisation regime may prove to be productive in the long-term, **some** witnesses argued. One natural area for international cooperation after the pandemic has passed is global health governance—an issue which historically has not been a core concern of globalisation but whose importance has been unmistakably brought to light. Another is climate change, as the current borderless crisis, its shock to global energy markets, and its steep decline in global emissions have [led](#) to environmental improvements in the past few months. Now governments are seeking to hold onto those gains.

An additional area of heightened concern, the most prominent feature of the pandemic’s economic fallout, relates to labour protections. According to a recent [report](#) of the International Labour Organization, coronavirus-induced restrictions have led to a global reduction in working hours equivalent to 305 million full-time jobs. An additional 1.6 billion workers in the informal economy are said to be “significantly impacted by lockdown measures,” with a projected 60% decline in their earnings. The pandemic has thus put a spotlight on the precariousness of the world’s workers, it was noted in the discussions, leading witnesses to consider how to improve labour protections during this period of a changing global economic landscape.

A natural place to start is the International Labour Organization. Going forward, it will be important to advocate for the creation of formal enforcement mechanisms of ILO standards. Given that the ILO is currently one of few major international institutions that lack effective enforcement authority, it has thus had little ability to significantly shape global rules and norms. Any institutional revamping that strengthens the rule- and norm-making authority of the ILO should also be buttressed by greater provisions for labour protections in bilateral and multilateral trade deals. One [set](#) of policy changes, advocated by the International Trade Union Confederation, encourages trade deals to provide policy space for governments in the developing world to defend and promote infant industries. This can be done through the implementation of binding commitments to ILO standards, the creation of labour impact and compliance assessments, the formulation of enforcement mechanisms (such as financial penalties), as well as the acceptance of tariffs and non-tariff measures to protect early-stage firms. An additional solution to strengthen labour protections takes inspiration from the Investor-State Dispute Settlement (ISDS) system: much the same way that ISDS provisions can be used to defend the interests of multinational corporations, a similar legal recourse ought to be available for labour to bring its own disputes without relying on its government. More fundamentally, the broad absence of labour protections—in institutional, multilateral, and bilateral arrangements—and the global discontent which it has created [suggest](#) that trade unions and civil society groups ought to offered

official involvement in the formulation and negotiation of future trade agreements.

TOWARDS GLOBAL BRITAIN?

In the discussion of the difficulties and possibilities that accompany the changing global political and economic landscape, the witnesses assessed what might be the optimal role of the UK. Witnesses noted that the absence of leadership in the areas above dovetail with the ambitions of ‘Global Britain’, as the UK’s soft power standing and normative interests can be well served by a greater commitment to the causes of public health, climate change, and labour protections. The International Labour Organization and World Trade Organization are particularly ripe for a greater UK role, according to witnesses with experience in those institutions. Beyond the particular problems exposed by the pandemic, there was also discussion of how the UK ought to take the lead on the “unfinished work” of global governance—namely, clamping down on tax base erosion and profit shifting, which cost the world [\\$600 billion](#) in lost corporate tax revenue per year, the IMF estimates.

However, witnesses also stressed that building a ‘Global Britain’, reshaping the world’s rules and norms, starts at home. “The UK’s capacity to be influential and have credibility and relevance on economic and trade issues and foreign policy really does depend on the strength of the economy in the UK.” This is not only a matter of ensuring the UK’s attractiveness to foreign partners going forward, it is also about shoring up the discontent regarding globalisation that undid its prior regional- and global-governance agenda in the 2016 EU referendum. In order to legitimise at home any globalisation campaign abroad, one witness advised:

“[It] means putting the domestic economic strategy first and foremost... creating an inclusive society, producing good jobs, having the kinds of economic strategy that achieves that, and seeing the global economy as we used to see it until the Bretton Woods system: as a vehicle for a more prosperous domestic economy, rather than seeing the domestic economy as a means for achieving global competitiveness or having more globalization.”

Building ‘Global Britain’ involves the UK’s material and commercial priorities—not just its soft power and normative interests. To that end, the following five agenda items emerged from the session which aim to further the UK’s economic diplomacy:

1. **A Global Trade Hub for Services:** Despite accounting for [80%](#) of the UK’s total economic output, the UK’s services have long underperformed as an export relative to goods, according to the [Department for International Trade](#). While there are basic regulatory and structural reasons why services would be less tradable than goods, it is also true that much can be done to help bridge the gap. For this reason, the UK ought to take a leadership role on the [Trade in Services Agreement \(TiSA\)](#) to help liberalise the global market for services in much the same way it has been liberalised for goods. Given the U.S.’ temporary aversion to trade leadership and liberalisation, as well as China’s relatively closed and underdeveloped services sector, the UK is a logical candidate to lead the [TiSA campaign](#) and advocate its adoption in the next multilateral round of trade liberalisation.
2. **Compatibility & Mutual Recognition:** As the UK reshapes its relationship with the EU, its largest trading partner, there is much to be learned from other third-country European

arrangements. One such lesson comes from Switzerland, which established the policy of *Europa Verträglichkeitsprüfung* (“European Compatibility Test”) in 1988, mandating that the government demonstrate whether all new measures are compatible with EU law. Should there be divergence, the government is also instructed to outline the merits of the decision to diverge. In effect, learning lessons from other non-EU countries would provide clearer thinking for the UK, as it has for Switzerland, in making its decisions about balancing foreign market access and domestic policy priorities. Moreover, it will be helpful in encouraging harmonisation with certain EU rules and attaining mutual recognition agreements with the EU in order to provide the UK market access to the EU.

3. **Institutional Leadership & Labour Protections:** As previously discussed, the crisis of the coronavirus has demonstrated a need for strengthening the norm making and enforcement authority of the International Labour Organisation (ILO). Moreover, there is a clear need for a reorientation of the agenda of the World Trade Organisation (WTO) to centre the rules-based globalisation system more on jobs and labour protection. The UK should consider taking a leading role in both supra-national bodies to further these aims.
4. **Soft Collaboration:** While there is a natural emphasis on multilateral arrangements, trade deals, and legislation, there is also an important role for less formal, non-binding forms of economic diplomacy. Indeed to achieve the former, it is necessary to devote attention to the latter: the “soft collaboration” of regulatory cooperation and institutionalised “dialogues”. These may be inserted in trade deals or pursued separately, before and independent of official negotiations. Flanking trade agreements with softer, forward-looking forms of collaboration will be important to deepen the UK’s economic diplomacy and expand the scope of existing relations, which is of particular importance for the new demands of digital services governance, as discussed in the next section.
5. **Stakeholder Diplomacy:** It is also important to note, as witnesses did, that strong foreign relations and robust domestic policy will depend on the proactive engagement of the UK’s private sector. Stakeholder diplomacy, the role of businesses in identifying opportunities for opening or improving economic and regulatory relations, will be a tremendous asset for the UK against the uncertainties of the post-Brexit, post-pandemic world. In this respect, the onus is on the private sector to work towards industry-government cohesion at home and strengthen relations with foreign partners—in the private and public sectors—abroad. One example mentioned by witnesses is to embed the Strategic Trade Advisory Group, recently set up by DIT, into policymaking. It includes broad stakeholders such as business, trade unions, and consumer groups.

DATA & DIGITAL

The evidence session also covered the more specific matters of higher education, digital services trade and governance. If nothing else the pandemic has highlighted how dependent UK universities have become on a steady stream of overseas students – mainly from Asia and China – who may well not be returning in large numbers at least in the short term. The pandemic has also provided a clear reminder of the growing significance of the technology sector in light of its current outperformance of all other industries, its fundamental importance for remote learning and working,

as well as the questions it has raised regarding contact tracing and data privacy. However, even before the pandemic, there was already little denying the technology sector's growing centrality in the UK economy. In the decade to 2015, the volume of data flows passing through the UK increased [28 times](#), making the United Kingdom the largest data centre market in Europe. In the first three years after the EU referendum, while the UK's economy grew by just 5.5%, the technology sector saw growth of [17.6%](#). From 2017 to 2019, employment in the UK's technology sector expanded by 40%, totalling [2.9 million](#) jobs last year. In the same year, venture capital funding in UK firms increased by [44%](#), outstripping the growth rates of both the United States and China. Just as well, following a [13%](#) raise, the UK's software engineers benefited from the biggest pay bump out of all the world's tech hubs.

However, alongside the many opportunities for the UK's technology sector, there are many challenges. In a recent survey of the Confederation of British Industry (CBI), upwards of 90% of CBI members said their biggest concern regarding the UK's departure from the EU is the fate of data flows and data protection. There is good reason for their concern: in leaving the EU, the UK has resigned its seat on the European Data Protection Board. Given that [75%](#) of the UK's cross-border data flows pass to the EU, the UK will need to find novel ways to retain its rule-shaping abilities and influence from the outside. The failure to do so risks severing the free flow of data between companies operating in the UK and companies operating in the EU, thus introducing costly and daunting regulatory burdens. At the same time, the non-EU world remains a vital and at-times overlooked market for the UK's digital exports, accounting for 50% of the digital goods exports and 66% of digital services exports.

New strategies will be required to improve, expand, and protect the UK's digital services trade and standing—both in Europe and around the world. Three policy priorities stand out:

1. **Adequacy Agreement:** As the UK becomes a 'third country' regarding its data relationship with the EU, the government will need to continue to push for an adequacy agreement between the UK and the EU. The ratification of an adequacy agreement would amount to the EU Commission's acknowledgement that the UK's data protection standards and digital governance are equivalent to those of the EU. The effort to achieve this began in earnest in [March 2020](#); however, given a standard ratification timeline of 18 months, more work is required to lobby for and expedite the process.
2. **Digital Chapter:** In recent years, the UK has successfully worked to rollover the trade deals with non-EU states and blocs that it had struck as an EU member—achieving a post-Brexit adaptation for [20](#) of them by May 2020. At the same, the UK has begun to explore or formally embark on new trade deals with [16](#) states and blocs. Negotiations of other forms of trade deal continuity, such as the proposed Mutual Recognition Agreements with [Japan](#), are also in progress. However, the significance of data and digital services must not be overlooked in these efforts. To commit the necessary attention and resources to these issues, the UK ought to establish a policy of inserting dedicated digital chapters in all of its rolled-over and new trade agreements. The intention of these will be both to safeguard cross-border data flows and promote joint understandings and practices of data governance.
3. **Osaka Track:** The UK will also benefit from leading the efforts of the international community

to modernise global governance with respect to data flows, intellectual property, cyber-security, and the rapidly expanding e-commerce space. Increased involvement in the WTO's progress on these issues can come in the form of championing the "[Osaka Track](#)," an initiative formally launched in 2019 which seeks to build a new, global, and liberalised regulatory framework for emerging technologies and digital relations.

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