



Interim Report #4

3 July 2020

INTRODUCTION

On June 19th, the LSE Economic Diplomacy Commission conducted its fourth round of evidence sessions concerning COVID-19 and its consequences for the UK. The discussion broadly covered the shock to the international system and the UK's changing place within it. More specifically, the witnesses weighed in on the pandemic's implications for the governance of global public goods as well as the UK's prospects including for trade and investment. This Interim Report begins, as the prior ones have, with reflections on "Global Britain" and how COVID-19 may affect the realisation of the post-Brexit project.

The witnesses, who brought a wide range of academic, political, and professional expertise, were provided a set of questions in advance and were invited to follow up afterwards with further thoughts. Given the degree to which COVID-19, the global response, and the domestic response are still evolving, the opinions expressed here should not be taken as the final considerations of the witnesses, the Commissioners, or the Commission. As such, the Commission may wish to re-engage with these issues towards the end of the year.

GLOBAL BRITAIN & COVID-19

While much uncertainty continues to surround the pandemic and cloud its political and economic implications, what has become clear is that COVID-19 is accelerating many familiar trends and challenges in international affairs. Chief among them, as prior Interim Reports have noted, is the balkanisation of the international system and the retreat of globalisation as it has come to be understood over the past 30 years or so. The twin crises in the global political and economic orders will be discussed more specifically in the subsequent sections, but it is important to note in broad strokes why these constitute so great a threat to the idea of Global Britain.

As one witness framed the issue, "We are too big to ignore, but too small to do things our own way."

What appears to be a frustrating geopolitical predicament, however, may offer an opportunity to strengthen international institutions, rules and norms. By providing a diplomatic forum and pressure valve for states' disputes, institutions promote an international system that is less defined by its material impulses (revolving around hard power and economic might) than it is by certain normative practices (such as democratic governance and liberalised trade). Such a world order places greater value on the UK's strengths—diplomacy, values, a globally connected services-based economy, and more. The UK, with pre-eminent roles in the institutions that govern such a world order such as its permanent seat on the UN Security Council, is better served by a principles-based world order.

The crisis today is that we are drifting away from the former and advancing precariously towards the latter. In this world—in which the WTO is circumvented, the WHO under challenge, the UN Security Council increasingly sidelined, and other norms and rules are regularly contravened—the ambition to establish a Global Britain that rests atop a peaceful and liberal international system is challenging.

This crisis is made all the more pressing in light of COVID-19. The pandemic has exposed the international system not only to health and economic shocks, as discussed below, but also to policy shocks. The world's hurried and uncoordinated response to COVID-19, which produced widespread worries of supply chain disruptions and food and medicine shortages, set in motion a wave of measures that included everything from travel bans to restrictions on the export of Personal Protective Equipment (PPE) to escalatory reprisals for both. As the policy shock endures, witnesses worried that it will be increasingly unclear how or when the world may agree to an exit strategy from these disruptive measures. They also noted that it will invite a concomitant economic shock that may deeply damage institutions such as the WTO. This will come about not only through the exacerbation of the US-China trade war but also, as one witness observed, through the rise in non-tariff trade distortions such as subsidies, which will likely grow more prominent as states seek to rebuild and compete for market share in key industries such as commercial aviation.

CHAMPION MULTILATERALISM

Given the absence of governance around global public goods, the UK has a natural opportunity to champion multilateralism.

For instance, there was optimism about the potential for the UK to lead on the issue of global climate action. With the UK set to host COP26 a natural role has emerged for the UK to set a global climate agenda and lead the multilateral effort to promote its execution. Similarly, there is a viable path, outlined below, for the UK to lead on the important work of re-liberalising the trade of medical supplies that has been put at risk by COVID-19.

The recent decision to fold the Department for International Development back into the Foreign & Commonwealth Office raised some concern. Although the decision is not inherently counterproductive, witnesses noted that it does pose considerable risks to the continued strength and capability of the UK's aid work—which goes hand-in-hand with its work to support a norms-, rules-, and institutions-based order that may safeguard global public goods such as healthcare and development.

Moreover, witnesses noted, much of the building of a more favourable international system that enshrines global public goods must start at home. Higher education is a prime area where the UK's leadership can both help foster a more cohesive international community and provide significant benefits to the UK's economy and clout. It is also an area that has been and will continue to be greatly harmed by COVID-19, with its consequences for foreign student enrolment, in-person teaching, budget cuts, and more.

As of 2017, the last year with available data, UNESCO recorded some [5.3 million](#) outbound international students in the world. With [458,490](#) of them studying in the UK, the UK hosts 8.6% of the world's foreign students, who in turn account for 19.6% of the UK's total student population. With nearly one-in-five students in the UK likely to be affected by some form of travel ban or residency uncertainty, and with [120,000](#) Chinese students in the UK sure to face difficult decisions about enrolling or returning in the fall, UK universities—an immense source of the UK's soft power—will indeed suffer in the months ahead.

Finding ways to recover the UK's educational standing and soft power will be vital in the years ahead. To do so, witnesses argued, the UK ought to become more generous and competitive with recruiting and retaining foreign students. The government's decision to re-instate the two-year work visa allowance in September was a welcome step. Similar measures to open up the UK's educational opportunities and attract foreign talent should remain at the centre of the Global Britain agenda.

However, the balkanisation or, at times, the bipolarisation of the international system will of course have consequences that cannot be solved by soft power strategies and domestic reforms alone. A great challenge for the UK's foreign agenda in the years to come, witnesses agreed, will be the deterioration of the US-China relationship and the far-reaching political, economic, and technological toll it will carry. Exacerbating this problem is the widespread disagreement at home about how best to proceed. While some witnesses expressed their concern with the rise of China's more aggressive and interventionist foreign policies, other witnesses argued that it would be a "strategic mistake" to adopt a hard line against China—calling instead for Ostpolitik and the further development of UK-China relations.

It may prove to be difficult to find common ground between these two positions and, as witnesses noted in prior sessions, Washington will likely resist and indeed penalise the UK's effort to work towards the middle. Nevertheless, the worst of the deterioration in US-China relations may well be mitigated through the re-establishment of strong international institutions which can both serve as dispute resolution mechanisms and allow parties to express their displeasure in less material and more diplomatic ways. It is advised that the UK approach issues that concern US-China relations multilaterally, which will both help to reinforce international institutions as dispute resolution mechanisms and both cushion and contain the impact of one or the other party's displeasure.

Recommendations:

- Champion global action on climate change as host at COP26 and through the new UN forum of which the UK is joint leader
- Support global public goods such as health - for instance, build a coalition of countries to agree to maintain the pandemic-driven relaxation of import restrictions (details below)
- Reiterate the UK's commitment to higher education openness to foreign students, some of whom end up staying and are tech and other entrepreneurs as seen in the UK
- Maintain the UK's leadership role in development by ensuring that aid is focused on poverty reduction and is not an arm of export promotion or national security with the merger of DFID into the FCO

FREE TRADE AGREEMENTS (FTAs) AND MORE

The world is suffering a series of COVID-19-induced supply, demand, and policy shocks. This is clearest in the United Nations Conference on Trade & Development's (UNCTAD) [foreign direct investment](#) projections for 2020, which hold that FDI flows are set to drop by 40% in 2020, tumbling below \$1 trillion for the first time in 2005. UNCTAD further projects a 5-10% decrease in FDI in 2021, before cautiously projecting the beginning of a recovery in 2022. The WTO projects [world trade](#) could contract by one-third in a worse drop than the global financial crisis of a decade ago.

The international toll of these shocks will be immense. The World Bank's baseline scenario envisions [71 million](#) people falling into extreme poverty this year. The International Labour Organization estimates that COVID-19 restrictions have led to a global reduction in working hours equivalent to [305 million](#) full-time jobs.

The crisis for the UK is compounded, witnesses noted, when considering Covid's disproportionate impact on the services sector, in which [85%](#) of the UK's employees work. The UK also exports those services, and is the second largest exporter after only the United States in this sector. As countries are likely to maintain and perhaps entrench their "Mode 4" restrictions on the movement of people, trade in services will be dampened, adding ever more stress to the UK and global economy.

It becomes more important to support greater trade liberalisation. Witnesses urged the Commission to consider Free Trade Agreements (FTAs) as only one part of how to achieve openness. For instance, strengthening the domestic economy's competitiveness as well as unilateral liberalisation are as important. They also recommended ways to avoid entrenching the protectionist measures associated with the pandemic.

It is not just tariffs; another problem is the use of subsidies. One witness noted that 66% of UK exports compete with subsidised rivals. Although the EU and UK suffer mightily from these sorts of trade distortions in the global economy, they are also complicit in the perpetuation of it, as the European Commission has authorised €1.95 trillion euros of subsidies to be used by the EU 27 and the UK. This is an area where the UK can lead discussions to improve the multilateral trade system.

The matter of protectionism also applies to development. As the UK seeks to alleviate the economic consequences of COVID-19 in the developing world, the UK can liberalise its tariff regime post-Brexit with developing countries. One key example, a witness noted, is the case of Ghana, which is able to export its key crop of cocoa without facing tariffs or quotas but is blocked by EU tariffs from refining that cocoa into chocolate. This is an example of unilateral liberalisation which promotes greater openness.

Covid-19 has given a great deal of warranted attention to the issue of supply chain fragility, but witnesses stressed that it should be stressed that the private sector has the right incentives to make them robust. A witness noted that the UK's medical imports, for which China is the majority supplier, total only \$168 million per year. In all, only 16 countries account for more than 1% of UK's Personal Protective Equipment (PPE) needs. Although oversight of critical supply chains remains important, as discussed in the prior Interim Report, this should be evidence based. As one witness put it: "If there isn't a problem, don't fix it." In this area, the UK can strengthen its own supply chains, while not distorting commercial decisions, which strengthens its domestic capacity as a trade and investment

partner. It can also negotiate “trade bargains” with trading partners to ensure no tariffs or restrictions on medical supplies in the event of another pandemic.

A different sort of example is to strengthen trade facilitation by improving customs, for instance, at Dover. Reducing trade frictions at the border can have an important effect on competitiveness of an economy, as witnessed by the WTO efforts to improve trade facilitation in its latest liberalisation round.

So, trade openness can be advanced by free trade agreements which open up markets, but also by strengthening the domestic economy and through unilateral liberalisation. The UK also has an interest in leading efforts to promote multilateral trade liberalisation such as the use of subsidies and opening up services markets.

Recommendations:

- Focus not only on FTAs but on unilateral actions, including strengthening the domestic economy, that promote trade and investment;
- Strengthen domestic capabilities to boost domestic competitiveness that will in turn generate more trade and investment, e.g., trade facilitation, supply chain resilience
- Offer more favourable terms than the EU tariff regime for low income countries particularly around food, and generally aim for a low tariff regime;
- Lead multilateral efforts to eliminate trade-distorting subsidies and promote the global trading system, particularly around services trade including mobility covered under Mode 4.

PARTICIPANTS

Professor Linda Yueh - Chair, LSE Economic Diplomacy Commission

Professor Michael Cox – Head Commissioner, LSE Economic Diplomacy Commission

Professor Simon Evenett – Professor of International Trade and Economic Development, University of St. Gallen

Lord Stephen Green – former UK Minister of State for Trade and Investment

Professor Katharina Hauck – Reader in Health Economics, Deputy-Director of the Abdul Latif Jameel Institute for Disease and Emergency Analytics, School of Public Health, Imperial

College London

Professor Alan Winters – Professor of Economics and Director of the UK Trade Observatory at the University of Sussex, and former Chief Economist at DFID

Professor Swati Dhingra – Commissioner, LSE Economic Diplomacy Commission

Baroness Kishwer Falkner – Commissioner, LSE Economic Diplomacy Commission

Guy Monson – Commissioner, LSE Economic Diplomacy Commission

Lord Nick Macpherson – Commissioner, LSE Economic Diplomacy Commission

Lord Charles Powell – Commissioner, LSE Economic Diplomacy Commission

Susan Scholefield – Commissioner, LSE Economic Diplomacy Commission

Gidon Gautel – Project Manager, LSE Economic Diplomacy Commission

Stephen Paduano – Executive Director, LSE Economic Diplomacy Commission

Inga Runarsdottir – Research Assistant, LSE Economic Diplomacy Commission