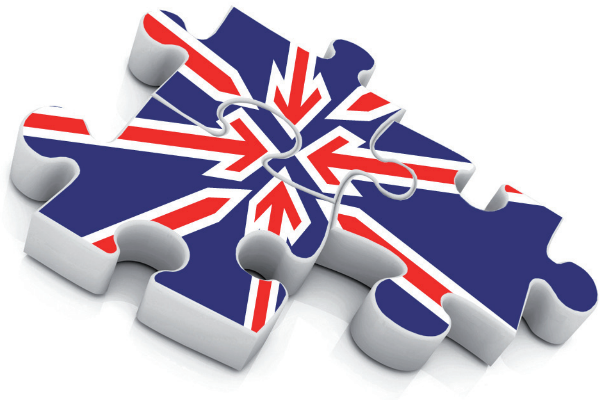

A GLOBAL TRADE HUB FOR SERVICES

THE UK AFTER BREXIT

LINDA YUEH

STRATEGIC UPDATE

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To become a global trade hub means positioning the UK in the midst of overlapping free trade agreements (FTAs) that is a characteristic of world trade.

I've written in my previous LSE IDEAS Strategic Update ***Realising the aims of 'Global Britain'*** about how countries such as Mexico and now also Canada benefit from duty-free sales of goods to the EU, while US companies must pay a tariff. It's because Canada and Mexico have free trade agreements with the European Union while the United States does not. That puts them in a privileged position since they are also in a free trade area with the US, NAFTA. Another example is Switzerland, which has a FTA with China as well as one with the EU, which places it in an advantageous place.

It suggests that the UK can similarly position itself as a global hub for trade. Given its long history of internationalism and London's position as an international financial centre, Britain is well situated to become a global trade hub with its attendant economic advantages.

To achieve this aim will require taking a number of strategic decisions.

The first of which is to aim for a Brexit outcome that enables the UK to be a bridge between the EU and other major economies – simply, Britain must be able to do its own trade deals.

The second is to seek to open up the services sector of major economies which do not have FTAs with each other, e.g. the EU and US or the EU and China or US and China, so that there is an advantage to trading via the UK. The strategic aim would be to target the opening up of the services sector, rather than comprehensive FTAs which are challenging and take a long time to negotiate.

It implies for Brexit that the agreement with the EU will need to be bespoke. This is particularly challenging as the EU has stated repeatedly that it will not allow 'cherry picking' and is therefore not open to a unique agreement for Britain. But for the UK to become a global trade hub, it will require a Brexit deal that doesn't fit into any of the existing models.

To prevent a hard border with Ireland, the British government has agreed that unless it presents an alternative plan, the UK will remain in a Customs Union and abide by EU standards. Staying in a Customs Union implies that the UK will not be able to do its own trade deals, because it would have the same external-facing tariff as the EU. Following EU standards, e.g. for products, would be necessary because differing standards would require border checks or pre-verification procedures.

A combination of a Customs Union and common standards would effectively preserve the open border that is a result of the historic Good Friday Agreement. It is also valued by manufacturing businesses, whose supply chains will be hit with higher costs if Britain leaves the Customs Union. Given the UK's proximity to the EU, and the presence of numerous established supply chains, this must be considered. But, the UK must make clear that any such customs agreement, which apply tariffs to goods, only apply to manufacturing.

This fallback arrangement ties the hands of the UK in two crucial ways. The first is not being able to negotiate its own trade agreements. The current EU-Turkey Customs Union does not allow Turkey to negotiate its own trade agreements. But, it's worth stressing again that the Turkey-EU Customs Union only applies to goods and not services. Still, Turkey was unsuccessful in arguing that it should be able to conduct its own trade negotiation in the area of services with America; the EU insisted that Turkey would instead be part of TTIP (Transatlantic Trade & Investment Partnership), the US-EU FTA that was being negotiated by the Obama administration.

The second implication is the UK becomes a 'rule-taker' in some respects, since Britain will not be part of how EU standards are set but would need to mimic them. This might work for UK manufacturing, but it would not be agreeable to all of the firms in the UK services sector. Notably, financial services firms would be opposed, according to the City's EU representative. This is another reason why the separation of manufacturing from services should be made clear in any new customs arrangement to stress that services are not covered.

But the challenge in terms of separating manufacturing from services is considerable, since a number of industries sell services as well as physical products. An OECD-WTO study found that over half of the total value-added embodied in the manufactured exports of major economies come from the services sector. As a result, a World Bank study concludes that liberalising services trade would facilitate more goods trade.

Although goods and services are clearly interlinked, they are not equally open to global trading. This is because they are treated differently by the international trading system. Although the GATS (General Agreement on Trade in Services) under the World Trade Organisation (WTO) covers trade in services, trade in services remains far less open than trade in goods. The 2013 launch of the Trade in Services Agreement (TiSA) by the EU, US, and other economies together representing 70% of global trade in services was intended to open up the global market for services. The countries involved stressed the benefits of services trade, which would help advanced economies sell what they mostly produce - services and not goods. For example, the economy of the EU is 70% services, but services make up just 25% of its exports. Even if services are partly non-tradable (e.g. consumed locally such as restaurant services), these nations believed that there was scope to increase their sale of services abroad.

Indeed, in our digital age, technology enables greater transmission of services and not just goods via e-commerce across national borders. This group of countries had hoped that if TiSA became widely adopted, then it could eventually constitute the next round of multilateral liberalisation under the WTO. This initiative has stalled with the change in US administration, but it underscores how it is possible to negotiate a services free trade agreement.

It also points to how the UK can become a global trade hub without pursuing time-consuming comprehensive FTAs. Targeting the opening up of the services sector in major economies would be a bilateral version of what TiSA was trying to achieve. It's a narrower goal, though it would still be challenging because services trade is particularly tied up with regulations and non-tariff measures including standards. Opening up service sectors would require difficult negotiations between countries with different legal and regulatory systems. But, TiSA shows that many advanced economies believed it was worth pursuing. For Britain, focusing on services plays to its strengths as a mostly services-based economy, while using less negotiating resources than a full FTA.

Even without services trade being as liberalised as manufacturing, Britain is the world's second largest exporter of services (after only the US) and runs a trade surplus in exporting services. Focusing on becoming a global trade hub for services is consistent with the UK's longstanding position as an international financial centre as well as a hub for other services such as education, professional services, and the creative industries.

Therefore, Britain is well placed to position itself a global trade hub for services, which is one of the fastest growing areas of world trade and reflects the nature of commerce in the 21st century. It's one possible future for post-Brexit Britain.

THE AUTHOR

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THE UK AFTER BREXIT

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Can Britain become a hub for global trade in services, with overlapping free trade agreements? In this Strategic Update, Linda Yueh outlines the approach to the Brexit negotiations needed to achieve this outcome.

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