



Interim Report #7
18 November 2020

INTRODUCTION

On November 18th, the LSE Economic Diplomacy Commission conducted its seventh and final round of evidence sessions. The discussion reviewed the full scope of the UK's place in the global economy and the work of the Commission thus far, discussing the necessary direction of the UK's economic diplomacy at home, with foreign partners, and in international institutions. This Interim Report begins with the witnesses' overarching analysis of the strategic context in which the UK is now operating – the challenges, opportunities, and broader trends of the international system. It then offers strategic guidance for domestic, bilateral, and institutional policymaking.

The witnesses and participants brought a wide range of high-level political, professional, and academic experience. They were provided a set of questions in advance of the session and were invited to follow up afterwards with further thoughts. The evidence session was conducted under the Chatham House rule and no one opinion in this Report should be taken as the view of any witness, participant, or Commissioner. Given the dynamic nature of some of the issues discussed, the Commission may choose to re-engage with them at a later date. This Interim Report should not be taken as the final considerations of the Commission.

STRATEGIC CONTEXT

COVID-19 has accelerated the fraying of the international system and narrowed the UK's operating space within it. The UK's ability not only to play a leading role in global economic governance but also to tend to its own interests face acute challenges. Adapting to the changing external environment remains pivotal to the Commission's recommendations for an economic diplomacy framework for the UK.

To start, the enduring US-China trade war threatens a bifurcation of the international political and economic system. While certain opportunities for the UK arise from this dispute, as outlined below, the costs of such fragmentation prove substantial. Chief among these costs relates to divergent technology and regulatory regimes. However, it should be noted that such problems do not emanate from the US-China relationship alone. Disputes surrounding data privacy, dual-use technologies, 'digital taxation', and 'Big Tech' regulation will be recurring features of the UK's relationship with the international community in the absence of effective global rules in many of these areas.

Furthermore, fragmented regulatory regimes threaten an era of "precautionism," in the words of one witness, as distinct from "protectionism." Although the challenge of protectionism endures—from the US-China trade war through to the populist pushback against free trade and globalisation—such dislocations in the global economy are known entities, and the international community possesses the institutional means and knowledge to deal with them, even if such rules and norms are currently out of vogue. Precautionism, however, entails a more nebulous challenge to the international system. The growing post-COVID-19 prominence of health, safety, and security standards along with other non-tariff barriers will create serious disruptions to global trade. Coordinating sovereign nations and international institutions in order to respond to these challenges, witnesses argued, will require a conceptual shift in how the UK approaches engagement with the international community—the UK will have to think and act "in terms of networks rather than hierarchies," championing consensus-building, middle-power diplomacy that will allow for continuity and progress in the international system.

Despite these challenges, the near-term domestic and international environments do offer some optimism and lend certain advantages to the UK's economic diplomacy. Primarily, this will come with the rollout of mass vaccination, which should allow for the gradual resumption of in-person activity, reversing job losses in struggling sectors and releasing pent-up consumer demand in the real economy. In addition, witnesses expressed a measure of optimism about the conclusion of the Brexit process. Although there is still substantial uncertainty around the 31 December expiration of the transitional arrangement, witnesses considered the continuation of negotiations to be promising and to provide some business confidence and clarity that have been lacking these past four years. If a deal is reached but not ratified in the coming days, there is a possibility for the "[provisional application](#)" of it, which would stave off the consequences of a no-deal departure on 31 December.

Lastly, as the UK will chair both the UN Climate Change Conference (COP26) and the G-7 Summit in 2021, significant opportunities exist in the coming months with respect to global agenda setting and coordinating international policymaking.

RECOMMENDATIONS

1. **Tending to the domestic environment** - Witnesses stressed that successful economic diplomacy begins at home. Witnesses argued that tending to domestic discontent and providing the necessary adjustment assistance for affected citizens are crucial components of any nation's foreign economic agenda. Given the enduring questions of Scottish and Irish nationalism that have been exacerbated by the Brexit process, the extraordinary role of popular sentiment in shaping the UK's relationship with the EU, and the central challenge of the UK's "left behind" communities, creating a domestic political and economic environment that is conducive to a strong and stable foreign economic agenda must not be overlooked. To this end, witnesses advised the following:
 - **Embedded Advisory Boards** – One lesson from the 2016 EU referendum is the necessity of developing broad-based and enduring support for the UK's foreign economic policies. To do this, it is important to engage diverse segments of the UK's private sector and civil society not only in the communication of the UK's economic diplomacy but also in the formulation of it. Echoing the recommendation from [Interim Report 2](#), witnesses encouraged embedding public advisory boards for this purpose throughout the UK government, as has been done with the Strategic Trade Advisory Group in the Department for International Trade.
 - **Adjustment Assistance** – Although the UK is now affording significantly more attention to the task of "levelling up" of "left behind" communities, globalisation and digitalisation will continue to create structural unemployment concerns across the UK. Witnesses echoed the prior Interim Reports' proposals for more ambitious [Trade Adjustment Assistance](#) schemes as well as more forward-looking [upskilling programmes](#).
 - **Regulatory Clarity** – The importance of high-level, geopolitical and economic positioning should not crowd out the necessity of ground-level coordination. Witnesses said that one of the most substantial problems they hear when dealing with foreign investors and corporations is the absence of the UK's regulatory clarity—an issue which discourages economic engagement writ large with the UK. Although much of

this is understandably caught up in the EU-UK negotiations, witnesses argued that this has been a recurring challenge with the UK and that provisional, forward-looking guidance on the range of possible, post-Brexit regulatory standards should not have to wait until the final conclusion of EU-UK negotiations.

2. **Europe** - Second only to establishing a domestic environment conducive to the UK's economic diplomacy agenda, witnesses agreed that the UK's relationships in Europe must be the top priority in the coming years. The UK must work to preserve areas of common interest and cooperation with the EU across the board, and witnesses advised that the UK place special emphasis on cultivating links with the EFTA and EU nations unlikely to join the Euro.
3. **USMCA+1** –The pursuit of a U.S.-UK free trade agreement now faces acute difficulties. In addition to being a low-priority issue for the incoming administration, President-elect Biden's strong support for the Good Friday Agreement and the UK Prime Minister's less strong relationship with the Democratic Party will complicate future negotiations. Should Republicans retain control of the Senate and if the President's Trade Promotion Authority (TPA) expires in July 2021, a U.S.-UK FTA will struggle to advance in Washington. In order to alleviate these tensions and accelerate this process, the UK must find alternate avenues for constructive engagement with the Biden administration, particularly related to global economic governance reform and global climate policies. At the same time, the UK must work to position a U.S.-UK FTA not as a Trump administration leftover, but rather as an opportunity for progress on concluding trade agreements that incorporate labour standards and environmental protections on which the two countries are not far apart. The experience of the Trans-Pacific Partnership should be instructive: it is crucial to earn the support of the Democratic Party's left flank on issues of trade, labour, and environmental policies. However, as a procedural matter, it is also necessary to find an innovative argument for why a split Congress should come together to extend the President-elect's "fast track" trade authorities (TPA). Witnesses encouraged the UK to re-approach a U.S.-UK FTA as an opportunity to build on the U.S.-Mexico-Canada Agreement (USMCA), the NAFTA revision which entered force in July 2020. Given the USMCA's broad bipartisan support in the House and Senate, there is reason to believe that Republicans and Democrats may look favourably upon a TPA extension for a USMCA+1 deal with the UK, thus freeing President-elect Biden to pursue a trade deal with fewer political and procedural obstacles.
4. **China** – While extraordinary difficulties exist within and beneath the surface of the relationship with China, witnesses noted that the West's long-running "responsible stakeholder" strategy — the idea of encouraging China's participation and leadership in the international system — remains the best approach. This will face difficulties, as indeed it has in decades past. However, the UK's response to the situation in [Hong Kong](#) and its coordinated statements on [Xinjiang](#) are positive indicators of how the government can maintain a nuanced relationship with Beijing, holding a firm line against its human rights abuses without attempting to escalate to more serious, destabilising action. As outlined below, there are more such policies the government should consider in the way of coordinated and countervailing responses to China. Nevertheless, a "responsible stakeholder" approach would see the UK continue to encourage Beijing to buy into the liberal institutions and norms of the post-war system, a difficult task but one which has achieved observable progress over the past four decades as China has sought greater leadership roles within the existing system. This may create tensions in the UK's foreign and foreign economic policies, as efforts to make China a more willing participant in,

for example, the IMF may necessitate efforts to check China's influence in the institution. However, it is important to understand that the push-and-pull of working with China without conceding to China is not a self-contradictory strategy but rather a two-tiered approach, with both the engagement of China and the counterbalancing of its presence being pursued at once. Witnesses noted the lesson to be learned from China's construction of the Asian Infrastructure Investment Bank (AIIB), the multilateral development bank China was compelled to create after the U.S. and Japan refused to accept a greater Chinese role in the Asian Development Bank (ADB). In addition, it is worth noting the UK's foresight in joining the AIIB, defying the U.S.' opposition, as the bank's global and Western partners have helped socialise the AIIB in the norms and practices of established multilateral development banks — providing a helpful, pre-emptive counterweight to excessive Chinese influence.

In this vein, there was much discussion about the opportunities that exist for the UK to manage as a "middle power" and create operating space between the US and China. Indeed, as one witness argued, "There is an opportunity for the UK to leverage its position of *not being* the United States." Further witnesses noted that if an independent policy can create bridges with Beijing and provide necessary additional perspectives for US lawmakers, such independence can be constructive for the United States and would be appreciated in Washington. Nevertheless, it is important to approach such a 'non-aligned' or 'middle-way' policy lightly, particularly in the coming months as establishing a strong working relationship with the Biden administration will take precedence.

5. **D-10/T-12** – There was continued discussion about the proposal to create a formal or informal collection of like-minded democracies to work together on various political, economic, and technological challenges, particularly as they relate to China. Some witnesses were reluctant to formalise such an organisation, noting the difficulties in other bodies (e.g., the EU) to establish common policies on China, the inadvisability of tying the UK to nations with more troubled relationships with China (e.g., India), and the broader counter-productivity of membership selection debates. Nevertheless, it remains important for the UK to create a more reliable system for coordinating China-related policies with its partners. As president of the G7, the UK can take a leading role in establishing collective technology initiatives, for instance, that bring together public and private sector actors from "D-10/T-12" countries.
6. **Economic diplomats** – The Foreign, Commonwealth & Development Office, Her Majesty's Treasury, the Department for International Trade, and the Cabinet Office should be encouraged to develop a career path in economic diplomacy. Civil servants already working in this space should be integrated as a more formal cadre of economic diplomats, encompassing different Departments and involving more interchange and more structured secondments, e.g. to the IMF, OECD and WTO.
7. **Foreign aid** - Noting the importance of Official Development Assistance to the UK's presence and prominence around the world, witnesses strongly encouraged the government to return to the 0.7% of GNI commitment as soon as resources allow.

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